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Annual Report and Accounts 2003

Anglian Water Services Limited

Group publications

AWG Plc
Annual Report and Accounts 2003
Sustainable Development Report 2003

Anglian Water Services Limited
⇨ ***Annual Report and Accounts 2003***
Environment Report 2003
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Financial highlights

	2003	2002	Change
Turnover	£726.8m	£724.4m	+0.3%
Operating costs	£458.0m	£447.6m	+2.3%
Operating profit	£268.8m	£276.8m	-2.9%
Profit before tax	£166.9m	£177.4m	-5.9%

Financial restructuring

The restructuring was completed on 30 July 2002 resulting in increased leverage

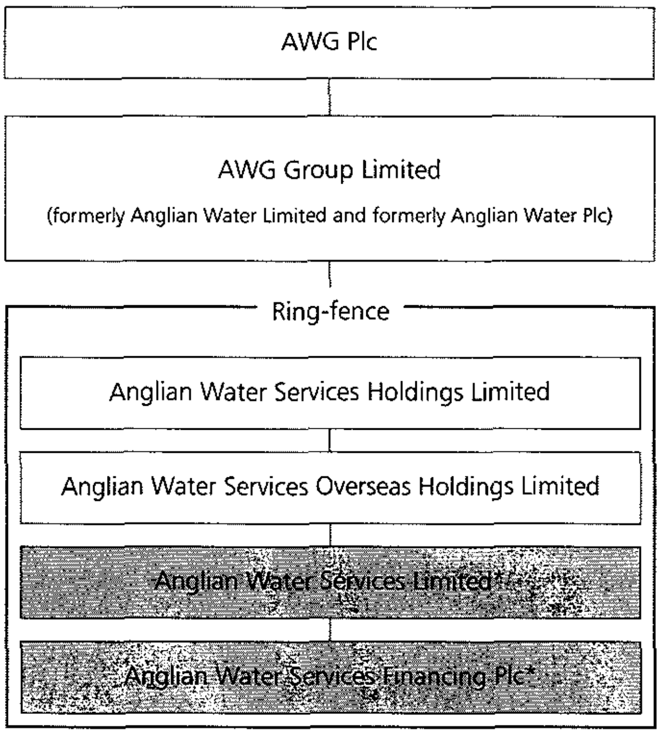
Net Debt at 31 March 2003 £3,289.4 million (31 March 2002: £1,970.9 million)

Net Debt to Regulatory Asset Value ratio at 31 March 2003 82.8%* (31 March 2002: 51.5%)

*Calculated in accordance with the Common Terms Agreement (see Directors' report on page 2)

Legal structure

As part of the financial restructuring the ownership of Anglian Water Services Limited has changed (see Directors' report on page 2) and the new legal structure is presented below:



* The Statutory Accounts in this document have been prepared for this Group

Directors' report

Ring-fencing
Following the financial restructuring of Anglian Water Services Limited (the company) which was concluded on 30 July 2002 the company operates on a ring-fenced basis from the other companies within the AWG Plc group (AWG).

AWS group
The company and Anglian Water Services Financing Plc (AWSF) are collectively known as Anglian Water Services Group (the group). This is the first time that accounts have been produced for the group. The prior year group figures in these accounts relate to the company along with a number of non trading subsidiary companies. AWSF did not trade in the prior year.

The company did own a number of non-trading companies. These entities were sold to AWG Group Limited (formerly Anglian Water Plc) on 29 July 2002 for a nominal consideration (see note 15 on page 18).

Corporate governance
The ring-fencing measures put in place as part of financial restructuring are designed to ensure that the company has the means to conduct its regulated business separately from AWG, and that all dealings between AWG and the company are on an arms length basis.

Each company within the ring-fenced group is required to maintain at least three independent non-executive directors. Further, the board of directors of each ring-fenced group company may comprise directors who are also directors of other AWG companies provided that the executive directors in this category do not constitute a majority of the executive directors. The constitutional documents of each company provide that all conflicts of interest of directors must be disclosed and that no director may vote on any contracts or arrangement between a ring-fenced group company and any other AWG group company if he/she is also a director of the AWG group company.

The processes for identifying, evaluating and managing the significant risks to the company and the company's internal control systems are regularly reviewed by the audit committee which reports its findings for consideration by the board.

The audit committee meets four times a year, comprises non-executive directors of the company and has written terms of reference which deal clearly with its authority and duties. The processes used by the audit committee to carry out its review include:

- the review of plans prepared by internal and external auditors;
- the review of reports arising from the work of the risk management committee on the effectiveness of risk management across the company;
- discussions with management on significant risk areas; and
- the review of significant issues highlighted by the executive directors, internal and external auditors.

Principal activities and business review
The group's principal activities during the year were the provision of drinking water and the treatment of wastewater in a region approximately one-fifth the area of England and Wales. The group provides drinking water to more than 4.1 million customers, and more than 5.4 million customers benefit from our wastewater services.

A review of the group's performance during the year, together with comments on the financial results, is contained on page 4.

Debt refinancing
On 30 July 2002 the financial restructuring of the company was concluded. This involved the transfer of debt previously raised by AWG Group Limited (AWGL) to AWSF and the raising of new debt in the financial markets which increased the overall level of gearing. The additional financing was carried out through AWSF. All borrowings raised by AWSF were on-lent to the company.

At the same time, all new and existing debt was transferred on to a common set of terms and conditions governed by the Common Terms Agreement (CTA) which also sets out the convenant requirements imposed by lenders.

As part of the new debt issuance a Medium Term Note Programme with a value of up to €10 billion has been put in place to provide a mechanism for the group to raise new debt for the medium term.

In addition the company was indirectly sold by AWGL to Anglian Water Services Holdings Limited (AWSH) and the consideration for this was settled by AWSH through a loan of £1,609.1 million from the company to AWSH.

Results and dividends
The profit and loss account on page 6 shows the group's results, dividends and profit for the year.

Research and development
The group has a continuing policy of undertaking market-focused research and development on process plant, biosolids treatment, automatic meter reading and other water and wastewater-related matters.

Regulation
The company's activities are regulated by the Water Industry Act 1991 (which consolidated that part of the Water Act 1989 relating to water supply and sewerage) and the conditions of an Instrument of Appointment (the licence) granted to the company by the Secretary of State for the Environment on 1 September 1989.

With certain exceptions, the regulatory provisions do not apply to business activities which are not connected with the carrying out of the water and sewerage functions.

Under condition F of the licence the company is obliged to provide the Director General of Water Services (DG) with additional accounting information to that contained in the historical cost financial statements. This information is presented in the Regulatory Accounts.

In connection with the restructuring and refinancing, the company has agreed a number of licence modifications with the DG during the year. The principal objectives of these provisions are to:

- strengthen the financial ring-fence around the company;
- tighten the governance arrangements of the company;
- impose new requirements regarding the systems of internal control; and
- impose requirements with respect to outsourcing of services.

Directors and directors' interests
During the year ended 31 March 2003 there was the following change in the directors of the company:

C J Mellor resigned as non-executive chairman on 19 March 2003.

The directors at 31 March 2003 were:

R A Pointer – chief executive
C L Brown – executive director
D S Hipple – executive director
R W Jewson – non-executive director
R Napier – non-executive director
R Witcomb – non-executive director

P C F Hickson was appointed non-executive chairman on 17 April 2003.

Details of the interests in the shares of AWG Plc, and in options over such shares, are shown on page 16.

Charitable and political donations

During the year the group made a payment of £1.0 million (2002 - £1.5 million) to the Anglian Water Trust Fund.

The AWG Community Investment Programme, which is predominantly based on employees' participation in community activities during working hours, saw 355 employees joining up for the Give me five matching hours scheme.

Six management trainees were seconded to community organisations for three month secondments as part of their development programme.

Financially through charitable donations, educational, regeneration and recreation projects the group contributed £0.1 million (2002 - £0.1 million) to other charitable causes.

No political donations were made.

Health and safety

The group is safety conscious and is seeking to achieve high standards for the well-being of its employees, contractors and customers. It encourages ownership of health and safety by all its employees, contractors, visitors and anyone else affected by its activities.

The group has operational procedures for each business area. These procedures take account of good management practice and specific business, statutory and legal requirements. Business heads are charged with the implementation of these procedures within their respective units.

Employees

Employees are kept informed on matters affecting them and are made aware of the general financial and economic factors influencing the group's performance.

The group operates a systematic approach to employee communication through regular briefings, presentations, electronic mailings and the wide circulation of the AWG magazine.

Share option and bonus schemes are in place to encourage participation in AWG's performance.

The group is an equal opportunities employer and applications from disabled persons are fully and fairly considered, having regard to the aptitudes and abilities of the applicant. In the event of disability, every effort is made to ensure that employment continues and appropriate training is given. Career development and promotion of disabled people is, as far as possible, identical to that of other employees.

Policy on the payment of creditors

It is the group's policy to provide suppliers of goods and services with a statement of general conditions of contract. This document is available from the group's supply chain management department. In general, regional purchasing agreements are in place with preferred suppliers and the terms will apply to all transactions. The group abides by the terms of payment. The group's average creditor payment period at 31 March 2003 was 35 days (2002: 37 days).

Auditors

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 17 March 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company will be proposed at the annual general meeting.

By order of the board.

Juana Tinn
Company Secretary
23 May 2003

Registered Office: Henderson House,
Lancaster Way, Huntington,
Cambridgeshire PE29 6XQ
Registered in England and Wales No. 2366656

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and the group and of the profit of the group for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company or group will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 March 2003 and the applicable accounting standards have been followed.

The directors are responsible for ensuring that the annual report and accounts are published and where they are published on the Internet, for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the Internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Performance review

Operating results
Turnover in the current year increased by 0.3 per cent (2002: increase of 4.3 per cent). The impact of the allowable year on year K + Retail Price Index (RPI) increase has largely been offset by negative consumption movements and refinements to the accrual consumption calculation in the current year.

Operating costs, excluding exceptional charges and depreciation, increased from £270.1 million to £282.5 million. The prior year figure included one-off accrual releases of £10.1 million. The upward inflationary pressure and impact of new obligations was largely offset by efficiencies in the current year.

The depreciation charge has increased by 4.2% from £150.6 million to £156.9 million reflecting the group's capital expenditure programme.

Exceptional operating costs of £18.6 million relate to restructuring (£2.9 million: 2002 £4.4 million) and refinancing project costs (£15.7 million: 2002 £22.5 million).

Net interest payable includes £129.6 million receivable from AWSH in relation to an inter company loan (see the Debt refinancing section of the Directors' report on page 2). Excluding exceptional charges and this inter-company loan interest receivable, the interest charge has increased by 80.9 per cent from £102.7 million to £185.8 million as a result of increasing the gearing of the group during the year. The exceptional cost of £49.6 million relates to the one-off cost of the debt refinancing program that resulted in the increased gearing.

Financial needs and resources
At 31 March 2003 the company had net borrowings of £3,289.4 million, an increase of £1,318.5 million over the year. Net borrowings are a mixture of fixed, index linked and variable rate debt of £3,466.3 million and cash and deposits of £176.9 million. The increased net borrowings have been financed by a net increase of £1,663.5 million in loans and associated costs and a net increase of £345.0 million in cash and deposits. Before investing activities, the business generated a net cash inflow of £415.9 million in 2003 (2002: £378.7 million).

The capital investment programme for the year was £263.3 million (2002: £264.4 million). Over the current five year plan period (2000/01 to 2004/05) the group will be investing approximately £1.5 billion on further improvements to drinking water, bathing and river water quality, as well as network improvements to maintain serviceability and meet new demands.

Shareholder's return
Dividends have been declared at 33.6 pence per share. The total cost of the dividend amounts to £288.6 million (2002: no dividend declared). Offsetting this cost AWGL waived £799.2 million of the 2000/01 declared dividend.

Control of treasury
The group financing, including debt, interest costs and foreign exchange, is substantially directed by a treasury team reporting to the group's finance director. Treasury policy continues to be focused on the efficient and effective management of cash and financial resources within the group. The treasury function actively seeks opportunities to:

- ensure that lenders covenants are met;
- secure funds through a balanced approach to financial markets and maturities;
- manage interest rates to minimise financial exposures;
- invest temporary surplus cash to best advantage at minimal financial risk;
- maintain an excellent reputation with providers of finance and rating agencies;
- improve cash management techniques and systems; and
- enhance control of financial resources.

Management of financial risk
Financial risks faced by the group include funding, interest rate, contractual and currency risks. The board of the group regularly reviews these risks and has approved written policies covering treasury strategy and the use of financial instruments to manage risks. The last review was in September 2002 and treasury matters are reported to the board each month.

The group aims to fund its operations primarily through public bond markets, private placements, bank loans and finance leases. Surplus cash is invested in short-term bank deposits and AAA rated money funds.

The group also enters into derivative transactions (principally currency and interest rate swaps) to manage the interest rate and currency risks arising from the treasury policy. Organisation and reporting will be formally reviewed by the board to ensure continued effectiveness and relevance.

Liquidity
The group's objective is to maintain flexibility, diversification and continuity of funding through access to different markets and debt instruments. At the year end the group held cash, deposits and current asset investments of £176.9 million (2002: £0.8 million) and had undrawn facilities of £225.0 million (2002: £nil) funding for day-to-day working capital and capital expenditure. These resources are maintained to ensure liquidity and the continuation of the investment programme. The maturity profile of the group's borrowings is set out in note 19 to the accounts. In addition the group has access to £283 million of 'liquidity facilities', £220 million to finance debt service costs and £63 million to finance operating expenditure and maintenance capital expenditure in the event that the group was in default on its debt obligations.

Borrowing covenants
With the exception of asset-based funding all the group's borrowings are raised by AWSF and guaranteed by the ring-fenced group (see page 1). The group treasury function monitors compliance against all financial obligations and it is the group's policy to manage the consolidated balance sheet so as to ensure operation within covenanted restrictions.

Interest rates
The group's policy as agreed by the board is to achieve an optimum mix of funding at indexed, fixed and floating rates of interest, including the use of interest rate swaps, to manage the group's exposure to interest rate fluctuations. At the year end taking into account interest rate swaps, 28.2 per cent (2002: 16.9 per cent) of the group's borrowings were at rates indexed to inflation, 71.6 per cent (2002: 83.1 per cent) were at fixed rates and 0.2 per cent (2002: nil per cent) were at floating rates.

The group moved to a higher proportion of fixed and index linked interest loans for the remainder of the current regulatory period ending 31 March 2005.

Foreign currency
The group has currency exposures resulting from debt raised in currencies other than sterling and very small purchases in foreign currencies. The group uses a range of instruments to hedge such exposures. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets and profits.

Independent auditors' report

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

Respective responsibilities of directors and auditors

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

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

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

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group at 31 March 2003 and of the profit and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
23 May 2003

PRICEWATERHOUSECOOPERS

Group profit and loss account

for the year ended 31 March

Notes		2003			2002		
		Before exceptional items £m	Exceptional items £m	Total £m	Before exceptional items £m	Exceptional items £m	Total £m
2	Turnover – continuing operations	726.8	–	726.8	724.4	–	724.4
	Operating costs:						
3, 4	Operating costs before depreciation	(282.5)	(18.6)	(301.1)	(270.1)	(26.9)	(297.0)
3	Depreciation net of amortisation of grants and contributions	(156.9)	–	(156.9)	(150.6)	–	(150.6)
3, 4	Total operating costs	(439.4)	(18.6)	(458.0)	(420.7)	(26.9)	(447.6)
5	Operating profit / (loss) – continuing operations	287.4	(18.6)	268.8	303.7	(26.9)	276.8
4	Profit on disposal of businesses	–	3.3	3.3	–	–	–
4	Profit on sale of fixed assets	–	0.6	0.6	–	3.3	3.3
	Profit / (loss) on ordinary activities before interest	287.4	(14.7)	272.7	303.7	(23.6)	280.1
4, 6	Net interest payable	(56.2)	(49.6)	(105.8)	(102.7)	–	(102.7)
	Profit / (loss) on ordinary activities before taxation	231.2	(64.3)	166.9	201.0	(23.6)	177.4
4, 7	Tax on profit on ordinary activities	(75.2)	17.5	(57.7)	21.3	7.3	28.6
	Profit / (loss) on ordinary activities after taxation for the financial year	156.0	(46.8)	109.2	222.3	(16.3)	206.0
8	Dividends						
	- interim / final	(288.6)	–	(288.6)	–	–	–
	– part of 2000/01 final dividend waived by AWG Group Limited	799.2	–	799.2	–	–	–
25	Movement in reserves	666.6	(46.8)	619.8	222.3	(16.3)	206.0

Trading results for 2003 include turnover of £4.4 million and operating profits of £2.2 million arising from the acquisition of part of the business of Geodesys Limited.

As part of the refinancing (see Directors' report on page 2) Anglian Water Services Limited (the company) was indirectly sold to Anglian Water Services Holdings Limited (AWSH) and the consideration of £1,609.1 million was settled by AWSH through a loan of the same amount from the company to AWSH. The resultant profit and loss transactions are shown in notes 6 and 8.

The notes on pages 10 to 26 form part of these financial statements.

No statement of total recognised gains and losses has been presented, as all gains and losses have been included in the profit and loss account.

Group and company balance sheet
at 31 March

Notes		Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
	Fixed assets				
14	Tangible assets	3,696.7	3,607.0	3,696.7	3,607.0
15	Investments	1,609.3	0.2	1,609.3	0.2
		5,306.0	3,607.2	5,306.0	3,607.2
	Current assets				
16	Stocks	4.6	4.1	4.6	4.1
17	Debtors	264.2	558.1	279.2	558.1
	Cash at bank and in hand	176.9	0.8	161.3	0.8
		445.7	563.0	445.1	563.0
	Creditors: amounts falling due within one year				
18,19	Short-term borrowings	(27.4)	(257.0)	(27.4)	(257.0)
18	Other creditors	(449.7)	(1,033.8)	(448.6)	(1,030.5)
		(477.1)	(1,290.8)	(476.0)	(1,287.5)
	Net current liabilities	(31.4)	(727.8)	(30.9)	(724.5)
	Total assets less current liabilities	5,274.6	2,879.4	5,275.1	2,882.7
	Creditors: amounts falling due after more than one year				
19	Loans and other borrowings	(3,438.9)	(1,714.7)	(3,438.9)	(1,714.7)
20	Other creditors	(87.4)	(86.1)	(87.4)	(86.1)
		(3,526.3)	(1,800.8)	(3,526.3)	(1,800.8)
21	Provisions for liabilities and charges	(164.0)	(114.1)	(164.0)	(114.1)
		1,584.3	964.5	1,584.8	967.8
	Capital and reserves				
24, 25	Called up equity share capital	860.0	860.0	860.0	860.0
25	Profit and loss reserve	724.3	104.5	724.8	107.8
25	Total shareholder's funds (all equity)	1,584.3	964.5	1,584.8	967.8

The notes on pages 10 to 26 form part of these financial statements.

Approved by the board on 23 May 2003.

R A Pointer
Chief executive

Group cash flow statement

for the year ended 31 March

Notes		2003 £m	2002 £m
(a)	Net cash inflow from operating activities	415.9	378.7
	Returns on investments and servicing of finance		
	Interest received	95.5	16.7
	Interest paid	(126.6)	(100.0)
	Cash flows treated as finance costs under FRS4	(23.8)	-
	Interest element of finance lease rental payments	(9.7)	(10.4)
	Net cash outflow for returns on investments and servicing of finance	(64.6)	(93.7)
	Taxation		
	Corporation Tax received / (paid)	0.5	(46.4)
	Capital expenditure and financial investment		
	Purchase of tangible fixed assets	(261.7)	(262.0)
	Grants and contributions received	17.0	17.9
	Short-term loan to group company, AWG Group Limited (AWGL)	309.5	(309.5)
	Loan to group company (AWSH)	(1,609.1)	–
	Disposal of tangible fixed assets	1.3	4.8
	Net cash outflow for capital expenditure and financial investment	(1,543.0)	(548.8)
	Acquisitions and disposals		
	Acquisition of trade and certain assets of a group company, Geodesys Limited (net of cash acquired)	1.7	–
	Equity dividends paid	(136.0)	(86.9)
(c)	**Management of liquid resources**		
	Increase in short-term deposits and investments	(88.2)	–
	Net cash outflow before financing	(1,413.7)	(397.1)
	Financing		
	Increase in loans	1,947.3	311.1
(d)	Repayments of amounts borrowed	(255.1)	(82.5)
	Capital element of finance lease rental payments	(21.7)	(19.5)
	Net cash inflow from financing	1,670.5	209.1
(d)	Increase/(decrease) in cash	256.8	(188.0)

The notes on page 9 form part of this cash flow statement.

Notes to the group cash flow statement

(a)	Reconciliation of operating profit to net cash inflow from operating activities	2003 £m	2002 £m
	Operating profit	268.8	276.8
	Depreciation (net of amortisation of deferred grants and contributions)	156.9	150.6
	Sale of businesses	(3.3)	–
	Net movement in prepaid pension contributions	(14.6)	(10.9)
	Net movement on provisions	(1.9)	(5.6)
		405.9	410.9
	Working capital:		
	Increase in stocks	(0.5)	(0.1)
	Decrease/(increase) in debtors	46.9	(26.1)
	Decrease in creditors	(36.4)	(6.0)
		10.0	(32.2)
	Net cash inflow from operating activities	415.9	378.7

The cash flow statement for the year ended 31 March 2003 includes net cash outflows of £39.1 million in respect of current year exceptional charges and £8.1 million in respect of prior year exceptional charges. The prior year comparative includes cash outflows of £17.2 million in respect of prior year exceptional costs.

(b)	Analysis of net debt	1 April 2002 £m	Cash flows £m	Non-cash movements £m	31 March 2003 £m
	Cash	0.8	87.9	–	88.7
	Bank overdraft	(168.9)	168.9	–	–
		(168.1)	256.8	–	88.7
	Deposits and investments	–	88.2	–	88.2
	Debt due within one year	(88.1)	88.1	(27.4)	(27.4)
	Debt due after one year	(1,714.7)	(1,734.8)	10.6	(3,438.9)
		(1,970.9)	(1,301.7)	(16.8)	(3,289.4)

Non-cash movements comprise indexation of loan stock and Retail Price Index (RPI) swaps, transfers between categories of debt, amortisation of debt issue costs and amortisation of 'mark to market' adjustments.

(c) Management of liquid resources is comprised of movements in short-term deposits which have maturity dates of up to one year.

(d)	Movement in net debt	2003 £m	2002 £m
	At beginning of year	(1,970.9)	(1,570.5)
	Increase / (decrease) in cash	256.8	(188.0)
	Increase in short-term deposits and investments	88.2	–
	Increase in loans	(1,947.3)	(311.1)
	Repayment of amounts borrowed	255.1	82.5
	Debt issue costs	23.8	–
	Amortisation of debt issue costs and 'mark to market' adjustments	0.9	–
	Indexation of loan stock and RPI swaps	(17.7)	(3.3)
	Capital element of finance lease rental payments	21.7	19.5
	At end of year	(3,289.4)	(1,970.9)

Notes to the financial statements

1 Accounting policies

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards and in accordance with the Companies Act 1985, except as disclosed in note 1(d) below as relating to grants and contributions.

The following principal accounting policies and estimation techniques have been applied to the financial statements as stated.

(a) **Basis of consolidation**

The group financial statements comprise a consolidation of the financial statements of the company and all its subsidiaries at 31 March. The results of companies acquired or disposed of are consolidated from the effective date of the acquisition or to the effective date of disposal. Intra-group sales and profit are eliminated fully on consolidation.

(b) **Turnover**

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

The measured income accrual is an estimation of the amount of main water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated upon historical billing information. The calculation is sensitive to estimated consumption for domestic customers (a fall of 1 cubic metre in average annual consumption will reduce turnover by approximately £1 million).

(c) **Tangible fixed assets and depreciation**

Tangible fixed assets comprise:

Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of systems. Investment expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition and included at cost after deducting grants and contributions. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on the company's independently certified asset management plan.

Other assets (including properties, overground plant and equipment) are included at cost less accumulated depreciation. Freehold land is not depreciated. Depreciation of other assets is calculated at rates expected to write off cost less the estimated residual value of the relevant assets over their estimated economic lives, which are principally as follows:

Operational structures	
– dams and reservoirs	100 – 300 years
– other operational structures	30 – 80 years
Buildings	30 – 60 years
Fixed plant	15 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

Assets in the course of construction are not depreciated until they are commissioned.

Interest costs are not capitalised into the cost of fixed assets.

(d) **Grants and contributions**

Grants and contributions on capital expenditure, other than those relating to infrastructure assets, are credited to a deferral account within creditors and are released to revenue evenly over the expected useful life of the relevant asset in accordance with the provisions of the Companies Act 1985.

Grants and contributions to capital expenditure on infrastructure assets are deducted from the costs of these assets. This policy is not in accordance with Schedule 4 of the Companies Act 1985, but has been adopted in order to show a true and fair view as, in the opinion of the directors, while a provision is made for depreciation of infrastructure assets, these assets have no determinable finite economic life and hence no basis exists on which to recognise such contributions as deferred income. The financial effect of this departure is disclosed in note 14.

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

(e) **Leased assets**

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor, and the finance costs being written off to the profit and loss account over the primary period of the lease. The assets are depreciated over the shorter of their estimated useful lives and the lease period.

All other leases are regarded as operating leases. Rental costs arising under operating leases are expensed over the term of the lease.

(f) **Own work capitalised**

The Group has a substantial capital investment programme with capital expenditure including internal costs of engineers. These costs are shown in operating costs as own work capitalised and this figure includes direct costs associated with capital investment and applicable overheads but excludes general overheads and administration costs.

(g) **Investments**

Investments held as fixed assets are stated at cost less any provision for impairment.

(h) **Stocks**

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence.

(i) **Pension costs**

The group is a member of AWG Plc Group (AWG), which principally operates defined benefit pension schemes.

Contributions to AWG's defined benefit pension scheme is charged to the profit and loss account so as to spread the regular cost of pensions over the average service lives of employees, in accordance with the advice of an independent qualified actuary. Actuarial surpluses and deficits are amortised, where appropriate, over the average remaining service lives of employees. The cost of the defined contribution scheme is charged to the profit and loss account in the year in respect of which the contributions become payable.

In respect of Financial Reporting Standard (FRS) 17 'Retirement Benefits' the group has adopted the disclosure requirements only and has not adopted the standard. This is permitted by FRS 17.

(j) **Research and development**

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

(k) **Foreign currencies**

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transactions or, if hedged forward, at the rate of exchange under the related forward currency contract.

(l) **Deferred taxation**

Deferred taxation is provided on timing differences, arising from the different treatment for accounts and taxation purposes of events and transactions recognised in the financial statements of the current and previous years. Deferred taxation is calculated at the rates at which it is estimated that taxation will arise. The deferred taxation balances are discounted using the post tax yields to maturity that could be obtained at the balance sheet date on Government bonds with maturity dates similar to those of the deferred taxation assets and liabilities.

Deferred taxation is not provided in respect of timing differences arising from the sale or revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into, and it is unlikely that any gain will be rolled over.

Deferred taxation assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits against which the deferred tax asset can be recoverable in future periods.

Calculation of deferred tax on infrastructure assets:

Infrastructure assets have an effectively unlimited life and a notional depreciation charge, the infrastructure renewal charge (IRC), is applied to the network (see note 1(c)).

For the purposes of estimating the deferred tax liability in relation to infrastructure assets, the useful life over which the underlying differences reverse is estimated by deflating the current cost based IRC to an appropriate deemed historic cost based depreciation charge.

(m) **Bad debts**

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

(n) ***Related party transactions***

The group has taken advantage of the exemption not to disclose transactions with other members of AWG under FRS 8 'Related Party Disclosures' as it is a wholly-owned subsidiary.

(o) **Financial instruments**

The principal derivative instruments utilised by the group are currency and interest rate swaps which are valued at cost. These instruments are used for hedging purposes in line with the group risk management policy and no trading in financial instruments is undertaken. Interest differentials are taken to net interest payable in the profit and loss account, and premiums and fees are amortised at a constant rate over the life of the underlying instrument. The principal amounts under currency swaps are revalued at closing rates of exchange and included in the sterling value of loans.

(p) **Capitalisation of finance costs**

Costs that are incurred directly in connection with the issue of a capital instrument are capitalised and amortised at a constant rate on the carrying amount of debt over the life of the underlying instruments.

2 Segmental analysis

The directors believe that the whole of the group's activities constitute a single class of business.

The group's turnover is wholly generated from within the United Kingdom.

3 Operating costs	Before operating exceptional items £m	Operating exceptional items £m	2003 Total £m	Before operating exceptional items £m	Operating exceptional items £m	2002 Total £m
Operating costs before depreciation:						
Raw materials and consumables	20.9	–	20.9	17.7	–	17.7
Other operating costs	189.9	15.7	205.6	183.2	22.5	205.7
Staff costs (see note 9)	107.0	2.9	109.9	104.2	4.4	108.6
Own work capitalised	(35.3)	–	(35.3)	(35.0)	–	(35.0)
Total operating costs before depreciation	282.5	18.6	301.1	270.1	26.9	297.0
Depreciation of tangible fixed assets	163.5	–	163.5	156.6	–	156.6
Amortisation of deferred grants and contributions	(6.6)	–	(6.6)	(6.0)	–	(6.0)
Depreciation net of amortisation of grants and contributions	156.9	–	156.9	150.6	–	150.6
Total operating costs	439.4	18.6	458.0	420.7	26.9	447.6

The prior year operating costs included a one-off accrual release of £10.1 million.

4 Exceptional items	2003 £m	2002 £m
Operating costs:		
Restructuring costs	2.9	4.4
Refinancing project costs	15.7	22.5
	18.6	26.9
Charged / (credited) after operating profit		
Profit on disposal of businesses (see note 15)	(3.3)	–
Profit on sale of fixed assets	(0.6)	(3.3)
Interest and finance charges	49.6	–
Total exceptional items	64.3	23.6
Taxation credit thereon	(17.5)	(7.3)

The restructuring costs in the current financial year relate wholly to a reorganisation undertaken by the company during the year and comprise principally redundancy costs.

The group completed a major refinancing project on 30 July 2002 (see page 2). The refinancing project costs of £15.7 million principally comprises legal and advisers' fees and banking costs incurred in respect of the ring-fencing and refinancing of the regulated water business.

The profit on sale of fixed assets relates to various sales of surplus land and assets.

The exceptional interest charge of £49.6 million relates to the debt transfer and termination costs from the refinancing project referred to above. This includes a provision of £32.0 million for coupon enhancement and other related costs incurred on the transfer of debt.

5 Operating profit	2003 £m	2002 £m
Operating profit is stated after charging:		
Hire of plant and machinery	2.0	2.1
Other operating lease costs	9.9	11.1
Research and development expenditure	1.9	2.3
Fees paid to auditors:		
– for statutory audit work (group and company)	0.1	0.1
– for regulatory audit work (group and company)	0.1	0.1
– for other work (group and company)	1.2	1.0

The fees paid to auditors for other work principally relates to work undertaken on the refinancing project mentioned in note 4 above.

6	Interest payable (net)	2003 £m	2002 £m
	Bank loans and overdrafts	1.9	1.2
	Other loans including financing expenses	168.0	102.8
	Indexation	17.7	3.3
	Interest and financing charges – exceptional item	49.6	–
	Finance leases	8.7	9.9
	Unwinding of discount on coupon enhancement provision (see note 21)	0.7	–
	Unwinding of discount on unfunded pension obligations (see note 21)	2.4	2.2
		249.0	119.4
	Interest receivable from AWSH	(129.6)	–
	Other interest receivable	(13.6)	(16.7)
	Total interest payable (net)	105.8	102.7

Interest of £23.2 million (2002:£74.6 million) is payable to AWGL, a parent undertaking.

Interest of £7.3 million (2002: £14.9 million) is receivable from AWGL, a parent undertaking.

Interest of £129.6 million (2002: £nil) is receivable from AWSH, a parent undertaking. £82.0 million of the interest received per the cash flow statement (see page 8) relates to this loan.

7	Taxation	2003 £m	2002 £m
(a)	**Analysis of tax charge/(credit) in the year**		
	Current tax		
	UK Corporation Tax at 30 per cent (2002:30 per cent)	38.8	22.3
	Adjustments in respect of previous periods	(1.0)	(35.1)
	Total current tax (see note 7(b))	37.8	(12.8)
	Deferred tax		
	Origination and reversal of timing differences	13.2	35.1
	Impact of discounting on deferred tax liability	(9.1)	(15.0)
	Impact of decrease / (increase) in discount rates	17.7	(17.8)
	Discounted effect of movements in Advance Corporation Tax (ACT)	(7.2)	(23.9)
	Adjustments in respect of previous periods	5.3	5.8
	Total deferred tax	19.9	(15.8)
	Total tax on profit / (loss) on ordinary activities	57.7	(28.6)
	Analysed as:		
	– before exceptional items	75.2	(21.3)
	– exceptional items	(17.5)	(7.3)
	Total tax on profit / (loss) on ordinary activities	57.7	(28.6)

(b) **Factors affecting tax charge/(credit) for the period**

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30 per cent). The differences are explained below:

	2003 £m	2002 £m
Profit on ordinary activities before tax	166.9	177.4
Profit on ordinary activities at the standard UK rate of tax (30 per cent)	50.1	53.2
Effects of:		
Expenses not deductible for tax purposes	1.7	2.4
Accounting for depreciation not eligible for tax purposes	0.2	1.7
Capital allowances for the year in excess of depreciation	(5.6)	(28.4)
Short-term timing differences	(7.6)	(6.6)
Adjustments to tax charge in respect of previous period	(1.0)	(35.1)
Current tax charge/(credit) for the year (see note 7(a))	37.8	(12.8)

Notes to the financial statements continued

7 Taxation (continued)

Based on capital investment plans for the current regulatory period, the group expects to continue to be able to claim tax relief on capital expenditure in excess of depreciation for the remainder of the regulatory period.

The post tax yield to maturity on UK government bonds is used to discount the gross deferred tax liability of the group. Movements in discount rates gave rise to a charge of £17.7 million (2002: credit of £17.8 million) in the year. If all UK gilt rates moved by 0.25% a change in the tax charge of between £10 million to £15 million would occur.

Adjustments in respect of previous periods arise from the agreement of prior year computations.

8 Dividends	2003 £m	2002 £m
Ordinary:		
Interim paid	54.0	–
Interim payable	35.0	–
Dividend paid within the ring-fence group	82.0	–
Dividend payable within the ring-fence group	47.6	–
Final payable	70.0	–
	288.6	–
Part of 2000/01 final dividend waived by AWGL	(799.2)	–
	(510.6)	–

9 Employee information	Before operating exceptional items £m	Operating exceptional items £m	2003 Total £m	Before operating exceptional items £m	Operating exceptional items £m	2002 Total £m
Staff costs:						
Wages and salaries	90.4	1.9	92.3	91.3	2.9	94.2
Social security costs	8.9	–	8.9	8.0	–	8.0
Pension costs (see note 26)	7.7	1.0	8.7	4.9	1.5	6.4
	107.0	2.9	109.9	104.2	4.4	108.6

Pension costs are stated after crediting £2.4 million (2002: £6.4 million) in respect of the amortisation of an actuarial surplus in the main UK pension scheme.

Average number of full-time equivalent persons employed:

	2003	2002
Number employed	3,588	3,705

10 Profit of parent company

The company has not presented its own profit and loss account as permitted by Section 230 of the Companies Act 1985. Profit for the financial year dealt with in the financial statements of the parent company is £106.4 million (2002: £206.0 million).

11 Non-executive directors' fees

The fees for the non-executive directors are set by the board. These fees are £25,000 per annum (pa).

Mr R W Jewson receives an additional fee of £9,000 pa for acting as deputy chairman and £6,000 pa for chairing the audit committee.

Mr R Napier receives an additional £6,000 pa for chairing the sustainable development committee and £3,000 pa for membership of the audit committee.

Mr R Witcomb receives an additional £3,000 pa for membership of the audit committee and £3,000 pa for acting as the company's customer service representative at WaterVoice (a customer liaison watchdog).

The non-executive directors, other than Mr C J Mellor, do not receive benefits or pension contributions from AWG, nor do they participate in any of AWG's incentive schemes.

12 Directors' emoluments

The emoluments of Mr C J Mellor and Mr E M Mannis were paid by AWGL and the following percentages of their total emoluments – C J Mellor nil per cent (2002: 10 per cent) and E M Mannis nil per cent (2002: 10 per cent) – were included within the management charge by AWGL to the group. All the other directors were paid direct by the group.

The emoluments of the directors of the group for their services as directors of the group are set out below (rounded to the nearest thousand pounds).

	Salary £000	Benefits £000	Bonus[c] £000	2003 Total £000	2002 Total £000
C J Mellor (resigned 19 March 2003) [b]	–	–	–	–	34
R A Pointer [a]	210	23	201	434	183
E M Mannis (resigned 26 November 2001) [a]	–	–	–	–	31
C L Brown (appointed 26 November 2001) [a]	139	15	84	238	47
D S Hipple (appointed 26 November 2001) [a]	125	11	88	224	46
R W Jewson (appointed 1 February 2002) [b]	40	1	–	41	10
R Napier (appointed 1 February 2002) [b]	34	–	–	34	5
R Witcomb (appointed 15 March 2002) [b]	31	–	–	31	2
	579	50	373	1,002	358

(a) Executive director

(b) Non-executive director

(c) The maximum annual bonus is 50% of salary, however for 2002/03 it is exceptionally high in respect of the financial restructuring, which resulted in the ring-fencing of the company. The individual bonuses reflect the level of involvement of the individual executive directors. Bonuses were also paid to a number of senior managers and employees who worked on the project. The bonuses were made in recognition of the additional workload that the £3.4bn project demanded.

The amount of pension entitlements earned, the accrued pension liabilities and the changes therein during the year to 31 March 2003 are summarised below in accordance with the Companies Act 1985 and the Listing Rules of the Financial Services Authority (rounded to the nearest thousand pounds). The table shows the full amounts for each of the directors for their services to AWG. The pension liabilities are calculated using the cash equivalent transfer value method, which is the method adopted in the Listing Rules of the Financial Services Authority (rounded to the nearest thousand pounds).

	Accrued pension *2003* £000[1]	Increase in accrued pension *2003* £000	Accrued lump sum *2003* £000[2]	Increase in accrued lump sum *2003* £000	Transfer value at *2003* £000	Transfer value at *2002* £000	Increase in transfer value less directors *contributions* £000[3]	Accrued pension *2002* £000[1]	Accrued lump sum *2002* £000[2]
R A Pointer	109	4	276	(14)	2,109	1,870	239	105	290
C L Brown	36	4	–	–	385	341	40	32	–
D S Hipple	32	4	–	–	315	240	42	28	–

	Additional accrued pension in year *(excluding inflation)* £000	Additional accrued lump sum in the year *(excluding inflation)* £000	Transfer value of the increase in benefits *(excluding inflation)* £000[4][5]
R A Pointer	2	(18)	7
C L Brown	3	–	27
D S Hipple	4	–	31

(1) The accrued pension entitlement shown is that which the director would have been entitled to if he had left service at the end of the period or is entitled to having retired during the period concerned.

(2) The accrued lump sum shown is that which is payable on retirement based on service to the end of the financial year.

(3) The transfer values have been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.

(4) The transfer value of the increase in benefits includes adjustment of pensions to reflect salary increases granted on promotion as well as, where relevant, the value of benefits on improvement award.

(5) Less directors' contributions

Mr C J Mellor's emoluments and pension entitlements in relation to the services rendered in connection with AWG Plc are disclosed in that company's annual report and accounts.

The transfer values disclosed in the two tables above are actuarially determined to provide for pensions liability and not sums paid by AWG or the company to the individuals concerned. They cannot meaningfully be added to their annual remuneration.

Notes to the financial statements continued

13 Directors' interests in shares and contracts

The beneficial interests in shares and options for Mr R A Pointer are the same as, and not additional to, those disclosed in the Annual Report and Accounts of AWG.

Directors have the right to participate in the employee Sharesave Scheme.

Details of directors' options are available in AWG's Register of Directors' Interests, which is open to inspection.

The interests of the directors in the shares of AWG Plc and in options over such shares granted under that company's Executive Share Option Scheme, annual bonus scheme, long-term incentive plan and Sharesave Scheme are set out below.

Throughout this note, all interests in shares as at 31 March 2003 are in relation to AWG Plc ordinary shares of 10p each.

Beneficial and family interests in shares:	31 March 2003 No. of shares	31 March 2002 No. of shares
R A Pointer	17,094	25,724
C L Brown	–	5,615
D S Hipple	–	–
R W Jewson	490	784
R Napier	–	–
R Witcomb	–	–

The figures at 31 March 2003 include ordinary shares held in trust for directors as the share element of the annual bonus scheme, being Mr R A Pointer 1,735.

Each executive director has notified the group that, for the purposes of Section 324 of the Companies Act 1985, he has a contingent interest in the following number of shares, representing the maximum aggregate number of shares to which he would become entitled under AWG's long-term incentive plan: Mr R A Pointer 42,569 (2002: 49,375), Mr C L Brown 15,225 (2002: 21,625) and Mr D S Hipple nil (2002: nil).

Each executive director has notified the company that, for the purposes of Section 324 of the Companies Act 1985, he has a contingent interest in the following number of shares, representing the maximum aggregate number of shares to which he would become entitled under AWG's Executive Share Option Scheme: Mr R A Pointer 243,480 (2002: 126,148), Mr C L Brown nil (2002: nil) and Mr D S Hipple nil (2002: nil). All of these Executive Share Options, apart from the 10,418 granted to Mr R A Pointer prior to 1996, are subject to performance targets details of which are shown in the remuneration report section of the AWG Annual Report and Accounts 2003.

Options to subscribe for ordinary shares, under the Sharesave and Executive Share Option Schemes, granted to, lapsed and exercised by directors during the year, including exercise dates, are summarised below.

	Options outstanding at 1 April 2002	Options granted		Options exercised						Options outstanding at 31 March 2003	
Sharesave Scheme	Number	Number	Option price (£)	Number	Weighted average exercise price (£)	Weighted average market price (£)	Gain on exercise of options (£)	Options lapsed	Option price (£)	Number	Weighted average exercise price (£)
R A Pointer	2,133	1,118	3.38	–	–	–	–	–	–	3,251	4.14
C L Brown	3,159	–	–	–	–	–	–	3,159	–	–	–
D S Hipple	2,261	–	–	–	–	–	–	2,261	–	–	–
Executive Share Option Scheme											
R A Pointer	126,148[1]	117,332[2]	5.38	–	–	–	–	–	–	243,480	5.33
C L Brown	–	–	–	–	–	–	–	–	–	–	–
D S Hipple	–	–	–	–	–	–	–	–	–	–	–

(1) Includes 10,418 options granted to Mr R A Pointer prior to 1996.

(2) Under the Scheme, each participant receives annual options grants, equating to a percentage of base salary, which varies according to seniority up to a maximum of 3x basic salary each year. The exercise of options depends on AWG's earnings per share growth relative to inflation, which the AWG Remuneration committee considers to be the most appropriate way of measuring AWG's underlying financial performance. To date no options have been exercised under the Scheme.

The market price of shares in AWG Plc at 31 March 2003 was £5.26, and the range during the year was £3.15 to £5.39.

No director has an interest in the shares or debentures of the group or any other AWG company other than as shown above.

Options granted under the Sharesave Scheme are exercisable within a period of six months after either the third, fifth or seventh anniversary of the date of the savings contract. Options under the Executive Share Option Scheme are exercisable during a period commencing on the third anniversary and ending on the tenth anniversary of grant. The dates of grant and the option prices are set out below.

13 Directors' interests in shares and contracts (continued)

	No. of ordinary shares	Date of grant	Option price
Sharesave Scheme	107,812	12 December 1996	£4.52
Sharesave Scheme	166,240	10 December 1997	£6.19
Sharesave Scheme	75,149	9 December 1998	£7.12
Sharesave Scheme	681,488	12 January 2000	£4.34
Sharesave Scheme	1,220,079	31 January 2001	£4.68
Sharesave Scheme	1,445,873	6 February 2002	£4.20
Sharesave Scheme	3,353,245	31 January 2003	£3.38
Executive Share Option Scheme	5,590	7 July 1993	£4.74
Executive Share Option Scheme	17,999	15 August 1994	£5.375
Executive Share Option Scheme	5,253	10 June 1996	£5.71
Executive Share Option Scheme	0	7 November 1996	£5.50
Executive Share Option Scheme	1,780,828	21 December 2001	£5.27
Executive Share Option Scheme	1,759,478	9 July 2002	£5.38

No director had during the year, or has, a material interest in any contract of significance to which the group was a party.

	Group and Company				
14 Tangible fixed assets	Land and buildings £m	Infrastructure assets £m	Operational structures £m	Vehicles, plant and equipment £m	Total £m
Cost					
At 1 April 2002	59.6	1,956.5	2,204.1	1,014.1	5,234.3
Additions	0.4	100.4	56.0	106.5	263.3
Disposals	(1.0)	(1.6)	(5.0)	(5.1)	(12.7)
At 31 March 2003	59.0	2,055.3	2,255.1	1,115.5	5,484.9
Grants and contributions					
At 1 April 2002	–	153.2	–	–	153.2
Additions	–	9.4	–	–	9.4
At 31 March 2003	–	162.6	–	–	162.6
Depreciation					
At 1 April 2002	23.6	334.9	631.2	484.4	1,474.1
Charge for the year	3.1	27.0	26.1	107.3	163.5
Disposals	(0.5)	(0.9)	1.6	(12.2)	(12.0)
At 31 March 2003	26.2	361.0	658.9	579.5	1,625.6
Net book amount					
At 31 March 2003	32.8	1,531.7	1,596.2	536.0	3,696.7
At 31 March 2002	36.0	1,468.4	1,572.9	529.7	3,607.0

Tangible fixed assets at 31 March 2003 include £216.3 million of assets in the course of construction (2002: £197.5 million) and also include land of £16.0 million (2002: £15.0 million) which is not subject to depreciation. The group's interests in land and buildings are almost entirely freehold.

The disposals line under both 'cost' and 'depreciation' includes the reclassification of some assets from 'Operational structures' to 'Vehicles, plant and equipment'

The net book value of tangible fixed assets held under finance leases at 31 March 2003 was £151.8 million (2002: £170.3 million). Depreciation charged on assets held under finance leases during the year ended 31 March 2003 amounted to £18.6 million (2002: £19.8 million).

Capital commitments

The group has a substantial long-term investment programme, which includes expenditure to meet regulatory requirements, shortfalls in performance and condition and to provide for new demand and growth. The commitments shown below reflect only the value of orders placed at 31 March 2003.

	2003 £m	2002 £m
Contracted for but not provided in the financial statements	55.6	63.4

Notes to the financial statements continued

15 Fixed asset investments	Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
Shares at cost in participating interests	0.1	0.1	0.1	0.1
Loan to AWSH	1,609.1	–	1,609.1	–
Other loans	0.1	0.1	0.1	0.1
	1,609.3	0.2	1,609.3	0.2

A loan of £1,609.1 million was made by the company to AWSH on 30 July 2002 and is repayable on the later of 30 July 2038 and another date being the next interest payment date following the date which is two years and one day after the final maturity date of the longest dated bond issued from time to time by Anglian Water Services Financing Plc (AWSF). Interest on the loan is calculated at 12% per annum.

The principal subsidiary, which is 100% owned, and is registered, incorporated and operating in the United Kingdom at 31 March 2003 is AWSF whose principal activity is that of a financing company.

The company previously owned a number of non-trading companies, these include Anglian Analytical Services Limited, Anglian Water (Finningley) Limited, Anglian Water (Suffolk) Limited, Anglian Water Engineering Limited, Anglian Water Overseas Limited, Grafham Limited, Grafham Water Limited, Anglian Water Meters Limited, Rutland Water Limited, The Bulk Water Supply Company Limited, Plumbsure Limited, Hour Glass Debt Recovery Service Limited, F Smith & Son (Grimsby) Limited and Whitwell Manor Limited. These entities were sold to AWGL on 29 July 2002 for a nominal consideration. A profit on disposal of these businesses of £3.3 million was recognised being the difference between the nominal consideration and the net liabilities of these companies (Plumbsure Limited £0.9 million and F Smith & Sons (Grimsby) Limited £2.4 million).

16 Stocks	Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
Raw materials and consumables	4.6	4.1	4.6	4.1

The current replacement value of stocks does not materially exceed the historical costs stated above.

17 Debtors	Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
Amounts falling due within one year				
Trade debtors	84.1	81.5	84.1	81.5
Amounts owed by other group undertakings	48.9	341.9	64.1	341.9
Other debtors	12.6	16.7	12.4	16.7
Prepayments and accrued income	79.7	93.7	79.7	93.7
	225.3	533.8	240.3	533.8
Amounts falling due after more than one year				
Prepaid pension contributions	38.9	24.3	38.9	24.3
	264.2	558.1	279.2	558.1

Prepayments and accrued income as at 31 March 2003 includes water and wastewater income not yet billed of £71.7 million (2002: £91.4 million).

18 Creditors: amounts falling due within one year	Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
Current portion of long-term loans (including £nil (2002: £4.6 million) from AWGL)	2.2	75.3	2.2	75.3
Bank overdraft	–	168.9	–	168.9
Obligations under finance leases	25.2	12.8	25.2	12.8
Short-term borrowings	27.4	257.0	27.4	257.0
Trade creditors	86.1	95.9	86.1	95.9
Amounts owed to other group undertakings	1.0	16.5	1.1	13.2
Receipts in advance	64.2	54.1	64.2	54.1
Corporation Tax	47.2	7.7	46.0	7.7
Other taxation and social security	3.1	3.0	3.1	3.0
Deferred grants and contributions	5.6	6.0	5.6	6.0
Accruals and deferred income	89.9	51.4	89.9	51.4
Dividend payable	152.6	799.2	152.6	799.2
Other creditors	*449.7*	*1,033.8*	*448.6*	*1,030.5*

19 Loans, other borrowings and financial instruments

Loans and other borrowings	Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
£100m 12.375% fixed rate 2014 (a), (l)	100.0	100.0	100.0	100.0
£200m 6.875% fixed rate 2023 (a), (l)	200.0	200.0	200.0	200.0
£200m 6.625% fixed rate 2029 (a), (l)	200.0	200.0	200.0	200.0
£150m 8.25% fixed rate 2006 (l)	150.0	–	150.0	–
£150m 'mark to market' adjustment (i), (l)	11.2	–	11.2	–
£250m 5.837% fixed rate 2022 (l)	250.0	–	250.0	–
£246m 6.293% fixed rate 2030 (l)	246.0	–	246.0	–
£275m 7.882% fixed rate 2037 (l)	275.0	–	275.0	–
£100m 5.5% index linked 2008 (a), (f), (l)	149.5	146.8	149.5	146.8
£150m 4.125% index linked 2020 (a), (f), (l)	160.3	157.7	160.3	157.7
£200m 3.07% index linked 2032 (f), (l)	203.8	–	203.8	–
£60m 3.07% index linked 2032 (f), (l)	61.1	–	61.1	–
£75m 3.666% index linked 2024 (f), (l)	76.4	–	76.4	–
£50m LIBOR plus1.2% floating rate 2012 (l)	50.0	–	50.0	–
£180m LIBOR plus1.25% floating rate 2014 (l)	180.0	–	180.0	–
£100m LIBOR plus 2.8% floating rate 2037 (l)	100.0	–	100.0	–
£1.8m LIBOR plus 0.5% floating rate 2002 (from AWGL)	–	1.8	–	1.8
£1m LIBOR plus 1.0% floating rate 2002 (from AWGL)	–	1.0	–	1.0
£0.8m LIBOR plus 1.0% floating rate 2002 (from AWGL)	–	0.8	–	0.8
£1m Base rate plus 1.0% floating rate 2002 (from AWGL)	–	1.0	–	1.0
£60m 7.985% European Investment Bank 2002 (b)	–	60.0	–	60.0
£10m 6.6% European Investment Bank 2003 (b)	–	10.0	–	10.0
£6.3m 11.5% European Investment Bank 2004 (b)	–	6.3	–	6.3
£50m 6.62% European Investment Bank 2005 (b)	–	20.0	–	20.0
£60m 8.2% European Investment Bank 2005 (b)	–	60.0	–	60.0
£8.8m 7.38% European Investment Bank 2007 (b)	–	4.5	–	4.5
£30m 5.28% European Investment Bank 2007 (b)	–	15.0	–	15.0
Finance leases	178.5	200.2	178.5	200.2
Other fixed rate loans	0.2	0.7	0.2	0.7
Retail Price Index (RPI) swap indexation on £150m (j), (l)	2.6	–	2.6	–
RPI swap indexation on £175m (j), (l)	3.2	–	3.2	–
£ loan costs (h)	(19.0)	–	(19.0)	–
€350m 5.375% fixed rate 2009 (a), (d), (l)	229.3	229.3	229.3	229.3
€115m LIBOR plus 2.8% floating rate 2037 (d), (l)	74.0	–	74.0	–
€ loan costs (h)	(1.0)	–	(1.0)	–
US$25m 6.75% private placements 2009 (d), (l)	16.0	–	16.0	–
US$25m 'mark to market' adjustment (i), (l)	0.8	–	0.8	–
US$4m (originally US$10m) 6.71% private placements 2006 (c), (d), (l)	2.2	–	2.2	–
US$4m 'mark to market' adjustment (i), (l)	0.1	–	0.1	–
US$400m LIBOR plus 0.4% 2007 (d), (l)	254.8	–	254.8	–
US$55m (originally US$122m) 6.85% private placements 2006 (a), (c), (d), (l)	35.8	79.3	35.8	79.3
US$40m 6.57% private placements 2005 (d), (l)	28.4	28.4	28.4	28.4
US$35m 6.65% private placements 2006 (d), (l)	24.9	24.9	24.9	24.9
US$100m (originally US$122.75m) 7.01% private placements 2008 (d), (l)	71.0	87.2	71.0	87.2
US$23m 7.13% private placements 2009 (d), (l)	16.3	16.4	16.3	16.4
US$195m (originally US$215m) 7.23% private placements 2011 (d), (l)	138.5	152.6	138.5	152.6
US$ loan costs (h)	(3.6)	(1.1)	(3.6)	(1.1)
Total loans and other borrowings	3,466.3	1,802.8	3,466.3	1,802.8
Less amounts included in creditors falling due within one year	(27.4)	(88.1)	(27.4)	(88.1)
	3,438.9	1,714.7	3,438.9	1,714.7

LIBOR is the 'London Inter Bank Offer Rate'

Notes to the financial statements continued

19 Loans, other borrowings and financial instruments (continued)

(a) As part of the debt refinancing exercise (see page 2) debt was reassigned from AWGL to AWSF.

(b) As part of the debt refinancing exercise (see page 2) the European Investment Bank debt was repaid.

(c) As part of the debt refinancing exercise (see page 2) part of the US$ debt was repaid. This debt was previously internal debt with AWGL on a back-to-back basis with the external instrument in the books of AWGL.

(d) The group has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the US$ and € loans. The adjustment to the US$ loans is £32.8 million (2002: £(3.2) million) and the adjustment to the € loans £(17.2) million (2002: £14.7 million).

(e) The group has entered into swap agreements that convert 99.85% of its floating rate debt into either fixed rate or index linked debt in accordance with the group's hedging policy (see page 4).

(f) The value of the capital and interest elements of the index linked loans are linked to movements in the RPI. The total increase in the capital value of index linked loans during the year of £11.9 million has been taken to the profit and loss account as part of interest payable.

(h) These costs are amortised at a constant rate on the carrying amount of debt over the life of the underlying instruments.

(i) Mark to market adjustments relate to back-to-back debt reassigned from AWGL to AWSF at fair value rather than book value. The difference between the book value and fair value is being amortised at a constant rate on the carrying amount of debt over the remainder of its life.

(j) The group has entered into two index linked interest rate swap agreements. The values of the notional capital on these swaps are linked to movements in the RPI. The increase in the notional capital value is payable at the final maturity date of the swaps. The increase for the current year of £5.8 million has been taken to the profit and loss account as part of interest payable.

(k) The group has entered into two forward starting interest rate swaps commencing in 2007 and maturing in 2010 which have the effect of increasing the level of fixed rate debt for that period to a level consistent with the group's hedging policy.

(l) These loans are 'back-to-back' inter-group loans from AWSF to the company.

Under the company / AWSF loan agreement, AWSF onlends an equal amount to the sterling equivalent of each bond to the company on identical items. Therefore each individual 'back-to-back' inter-group loan has been seperately disclosed. AWSF charges the company an annual management fee in respect of entering into the company / AWSF loan agreement.

(m) The security agreement dated 30 July 2002 between AWSF, AWSL, Anglian Water Services Overseas Holdings Limited (AWSOH) and AWSH and Deutsche Trustee Company Limited (as Agent and Trustee for itself and each of the Finance Parties to the Medium Term Note Programme) creates a fixed and floating charge over the assets of AWSL to the extent permissible under the Water Industry Act 1991. In addition there is a fixed charge over the issued share capital of AWSF, AWSL and AWSOH. At 31 March 2003 this charge applies to £3,466.3 million (2002: £nil) of the group debt shown on page 19.

For the company the current and long-term borrowings can be analysed as follows:

	2003		2002	
	Creditors < 1 year £m	Creditors > 1 year £m	Creditors < 1 year £m	Creditors > 1 year £m
Bank loans and overdrafts	–	–	168.9	–
Amounts owed to group undertakings ('back-to-back' inter-group loans)	3.9	3,307.3	4.6	1,113.1
Debt issue costs	(1.7)	(21.9)	(0.1)	(1.0)
Obligations under finance leases	25.2	153.3	12.8	187.4
Other loans	–	0.2	70.8	415.2
	27.4	3,438.9	257.0	1,714.7

Maturity analysis of financial liabilities	Group and Company 2003 £m	2002 £m
Less than one year	30.9	257.0
Between one and two years	26.7	36.0
Between two and five years	587.9	278.9
After five years	2,850.3	1,399.8
	3,495.8	1,971.7

Included above are amounts due under finance leases of £25.2 million (2002: £12.8 million) payable within one year, £18.6 million (2002: £15.2 million) payable between one and two years, £73.1 million (2002: £62.2 million) payable between two and five years and £61.6 million (2002: £110.0 million) payable after five years. The above maturity profile is determined by reference to the fixed dates on which the liability falls due.

In addition to loans and finance leases the above analysis includes other financial liabilities (including overdrafts, long-term creditors, accruals and provisions) totalling £29.5 million (2002: £168.9 million), of which £3.5 million falls due in less than one year (2002: £168.9 million). This analysis is net of issue costs totalling £23.6 million (2002: £1.1 million).

19 Loans, other borrowings and financial instruments (continued)

Borrowing facilities

	Group 2003 £m	Group 2002 £m
The group has the following unused committed borrowing facilities:		
Expiring within one year	283.0	–
Expiring between one and two years	–	–
Expiring between two and five years	225.0	–
	508.0	–

Financial instruments disclosures

The group's policies on management of financial risk are disclosed in the 'management of financial risk' to 'foreign currency' sections of the performance review on page 4. Those disclosures form part of this note.

Short-term debtors and creditors have been excluded from this note except for the comments on currency exposures to the financial statements.

Currency exposures

The group has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

Fair value of financial assets and financial liabilities	2003 Book value £m	2003 Fair value £m	2002 Book value £m	2002 Fair value £m
The fair value of the group's financial instruments at 31 March was:				
Current asset investments				
Cash at bank and in hand	176.9	176.9	0.8	0.8
Bank overdraft	–	–	(168.9)	(168.9)
Short-term borrowings	(9.6)	(9.6)	(88.2)	(88.9)
Long-term borrowings	(3,435.4)	(3,833.7)	(1,703.2)	(1,791.9)
Currency and interest rate swaps and forward exchange contracts	(21.3)	(33.2)	(11.4)	(4.5)
Net debt	(3,289.4)	(3,699.6)	(1,970.9)	(2,053.4)
Fixed asset investments	1,609.3	2,145.5	0.2	0.2
Provisions excluding deferred tax and pension obligations (see note 21)	(29.5)	(29.5)	–	–
	(1,709.6)	(1,583.6)	(1,970.7)	(2,053.2)

The fair value of loans and other borrowings represents the market value of publicly traded debt instruments or, if in respect of private debt, the cost which the group would incur if it elected to repay these borrowings before their maturity dates, calculated by discounting future cash flows at prevailing rates. In the fair value table above, the book values assigned to derivative instruments are separately analysed from the book values of the underlying loans.

In accordance with the group's accounting policy, long-term borrowings are recorded using the contracted rates implicit in the financial instruments used to hedge the group's exposure to fluctuations in currency and interest rates.

Interest is charged to the profit and loss account based on the contracted interest rates. To determine the fair value of interest rate swaps for inclusion in the above table, a calculation was made of the net gain or loss which would have arisen if these contracts had been terminated on 31 March 2003. The value at that date was determined by market interest rates, which fluctuate over time. The fair value of the group's fixed asset investments is calculated by discounting cash flows at prevailing rates reflecting the relative risks involved. The group has also entered into swap arrangements to hedge overseas investments.

The fair value of the group's provisions and other financial liabilities has been estimated as not materially different from the book value.

Hedges

At 31 March 2003 there are £13.6 million (2002: £22.4 million) of unrecognised gains and £61.8 million (2002: £4.4 million) of unrecognised losses in respect of interest rate swaps. Losses of £6.4 million were recognised in the profit and loss account for the year (2002: £4.8 million). Of the unrecognised gains and losses at 31 March 2003, a net loss of £3.3 million is expected to be included in the profit and loss account for the year ended 31 March 2004 and the balance in future years.

At 31 March 2003 and 31 March 2002, gains and losses on forward exchange contracts taken out as hedges of sales and purchase transactions were not material.

Notes to the financial statements continued

19 Loans, other borrowings and financial instruments (continued)

Currency and interest rate analysis of net financial assets / (liabilities) at 31 March 2003

	Total £m	Index linked £m	Floating rate £m	Fixed rate £m	Financial liabilities on which no interest is paid £m	Fixed Rate Weighted average interest rate %	Fixed Rate Weighted average years to maturity
Sterling	(3,466.3)	(981.9)	(5.2)	(2,490.8)	11.6	6.86	12.1
US Dollar	–	–	–	–	–		
Euro	–	–	–	–	–		
Total borrowings	(3,466.3)	(981.9)	(5.2)	(2,490.8)	11.6		
Sterling	176.9	–	176.9	–	–		
US Dollar	–	–	–	–	–		
Euro	–	–	–	–	–		
Cash, deposits and current asset investments	176.9	–	176.9	–	–		
Net debt	(3,289.4)	(981.9)	171.7	(2,490.8)	11.6		
Fixed asset investments	1,609.3	–	–	1,609.2	0.1		
Provisions	(29.5)	–	–	–	(29.5)		
Net financial liabilities	(1,709.6)	(981.9)	171.7	(881.6)	(17.8)		

Currency and interest rate analysis of net financial assets / (liabilities) at 31 March 2002

	Total £m	Index linked £m	Floating rate £m	Fixed rate £m	Financial liabilities on which no interest is paid £m	Fixed rate Weighted average interest rate %	Fixed rate Weighted average years to maturity
Sterling	(1,971.7)	(304.6)	(169.6)	(1,497.5)	–	7.91	13.7
US Dollar	–	–	–	–	–		
Euro	–	–	–	–	–		
Total borrowings	(1,971.7)	(304.6)	(169.6)	(1,497.5)	–		
Sterling	0.8	–	0.8	–	–		
US Dollar	–	–	–	–			
Euro	–	–	–	–	–		
Cash, deposits and current asset investments	0.8	–	0.8	–	–		
Net debt	(1,970.9)	(304.6)	(168.8)	(1,497.5)	–		
Fixed asset investments	0.2	–	–	0.1	0.1		
Provisions	–	–	–	–	–		
Net financial liabilities	(1,970.7)	(304.6)	(168.8)	(1,497.4)	0.1		

The above tables reflect the net position after swap arrangements, the most significant effect of which is to swap US$877 million (2002: US$558 million) and €465 million (2002: €350 million) into sterling. Fixed rate loans are those for which the interest rate was fixed for more than 12 months at 31 March 2003 and 31 March 2002.

Floating rate cash and investments earn interest based on the London Inter Bank Bid rate (LIBID) for the relevant currency. Floating rate borrowings incur interest based on LIBOR.

20 Other creditors falling due after more than one year	Group 2003 £m	Group 2002 £m	Company 2003 £m	Company 2002 £m
Deferred grants and contributions	87.4	86.1	87.4	86.1

21 Provisions for liabilities and charges	Group and Company			
	Coupon enhancement 2002 refinancing £m	Unfunded pension obligations £m	Deferred tax £m	Total £m
At 1 April 2002	–	25.7	88.4	114.1
Charge for the year	32.0	–	19.9	51.9
Unwinding of discount	0.7	2.4	–	3.1
Utilised in the year	(3.2)	(1.9)	–	(5.1)
At 31 March 2003	29.5	26.2	108.3	164.0

The provision for coupon enhancement relates to coupon enhancement and other related costs incurred on the transfer of debt from AWGL to AWSF. The provision is expected to be utilised over the next 26 years and has been discounted at 6.1 per cent which represents the adjusted credit risk of additional coupon payments following the transfer of debt from AWGL.

The provision for pension obligations relates to the cost of unfunded pension enhancements. These pension payments are expected to be made over several future accounting periods. The provision is determined using actuarial assumptions based on those used for the valuation of the AWG pension scheme and has been discounted at a rate of 9 per cent which reflects AWG's cost of capital.

The deferred tax provision is analysed in note 22. The effect of discounting on deferred tax is shown in note 7.

22 Deferred taxation

The total tax charge or credit will include discounted deferred taxation. Consequently, changes in the medium and long-term interest rates used to discount deferred taxation assets and liabilities will affect the amount of deferred taxation charged or credited in the profit and loss account.

In addition, an ACT asset is offset against deferred tax liabilities; this would be liable to de-recognition if changes in the tax legislation were introduced which restricted the ability of companies to use ACT. In this event, an additional tax charge would arise in the profit and loss account.

	£m
At 1 April 2002	88.4
Deferred tax charged to the profit and loss account	19.9
At 31 March 2003	108.3

	2003 £m	2002 £m
Accelerated capital allowances	727.1	715.4
Short-term timing differences	(10.7)	(16.2)
Surplus ACT asset	(119.9)	(98.8)
Undiscounted provision for deferred tax	596.5	600.4
Discount	(488.2)	(512.0)
Discounted provision for deferred tax	108.3	88.4

23 Commitments under operating leases

At 31 March 2003 the group had commitments to make payments during the next 12 months under non-cancellable operating leases which expire as follows:

	Group and Company			
	2003		2002	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	–	1.1	0.1	–
Between one and five years	–	5.0	–	7.9
After five years	3.2	0.5	3.4	–
	3.2	6.6	3.5	7.9

24 Share capital – equity shares	Group and Company 2003 £m	2002 £m
Authorised		
Ordinary shares of £1 each	860.0	860.0
Allotted, issued and fully paid		
Ordinary shares of £1 each	860.0	860.0

25 Movement in shareholder's funds	Group Share capital £m	Group Profit and loss reserve £m	Group 2003 Total £m	Group 2002 Total £m	Company Share capital £m	Company Profit and loss reserve £m	Company 2003 Total £m	Company 2002 Total £m
At beginning of year	860.0	104.5	964.5	758.5	860.0	107.8	967.8	761.8
Profit for the financial year	–	109.2	109.2	206.0	–	106.4	106.4	206.0
Dividends	–	510.6	510.6	–	–	510.6	510.6	–
At end of year	860.0	724.3	1,584.3	964.5	860.0	724.8	1,584.8	967.8

26 Pension commitments

(a) Pension arrangements for the majority of the group's employees are of the defined benefit type through the AWG Pension Scheme (AWGPS). The scheme's actuaries are Hewitt Bacon and Woodrow.

The administration and investment of the pension fund is maintained separately from the finances of AWG.

The accounting pension costs have been based on the most recent actuarial valuations. Details of the most recent actuarial valuation of the pension scheme attributable to the group are summarised below:

Scheme	
Date of most recent valuation	31 March 2002
Actuarial method	projected unit
Main assumptions:	
Excess of investment returns over:	
– general salary increases	1.9%
– annual increases in pensions	3.8%
Results:	
– market value of assets	£500.4 million
– funding level	110%
Due date of next full actuarial valuation	31 March 2005

The net pension cost for the year ended 31 March 2003 was £7.1 million (2002: £6.4 million). The net pension cost includes a credit of £2.4 million (2002: £6.4 million) in respect of the amortisation of actuarial surpluses. At 31 March 2003 there was a prepayment in respect of pensions of £38.9 million (2002: £24.3 million).

(b) In November 2000 the Accounting Standards board issued FRS 17 'Retirement Benefits'. The group is making use of the transitional arrangements regarding the adoption of FRS 17. These discussions are included below as if FRS 17 had been applied from 1 April 2002.

The valuation used for FRS 17 disclosures has been based on the most recent actuarial valuation for AWGPS which was at 31 March 2002, this has been updated by independent actuaries to take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 March 2003. The group is contributing 17.3% of pensionable pay plus £6.3 million to the AWGPS. The group also operates an unfunded pensioner arrangement (see note 21), which has been valued by independent actuaries under the requirements of FRS 17 as at 31 March 2003.

In addition, the group operates a defined benefit scheme for the employees of the former Hartlepool Water PLC acquired on 1 April 2000 and a defined contribution scheme which commenced on 1 April 2002. The assets and liabilities of these arrangements are not material to the group financial statements and have been excluded from the following disclosures.

The liabilities of the schemes have been valued using the projected unit method and using the following assumptions:

	2003 %pa	2002 %pa
Discount rate	6.5	6.0
Inflation rate	2.6	2.8
Increase to deferred benefits during deferment	2.6	2.8
Increases to inflation related pensions in payment	2.7	2.9
Salary increases	4.6	4.8

26 Pension commitments (continued)

The long-term expected rate of return and the assets in the scheme are:

	2003	2003 AWGPS	2003 Unfunded pensions	2003 Total	2002	2002 Total
	Expected rate of return % pa	Fair value of scheme assets £m	Fair value of scheme assets £m	Fair value of scheme assets £m	Expected rate of return % pa	Fair value of scheme assets £m
Equities	7.6	279.7	–	279.7	8.0	389.1
Corporate Bonds	4.9	22.8	–	22.8	6.0	28.0
Gilts	4.6	65.3	–	65.3	5.0	63.3
Property	6.6	13.0	–	13.0	8.0	15.7
Other	4.0	23.3	–	23.3	4.0	13.7
Total assets		404.1	–	404.1		509.8
Fair value of scheme liabilities		(599.9)	(37.6)	(637.5)		(556.5)
Deficit in the scheme		(195.8)	(37.6)	(233.4)		(46.7)
Related deferred tax asset		58.7	11.3	70.0		11.0
Net pension liability		(137.1)	(26.3)	(163.4)		(35.7)

If the above amounts had been recognised in the financial statements, the group's net assets and the profit and loss reserve at 31 March 2003 would be as follows:

Net assets	2003 £m	2002 £m
Net assets	1,584.3	964.5
Exclude existing net pension liability and prepayment (under SSAP 24)	(9.4)	1.4
	1,574.9	965.9
FRS 17 pension liability	(163.4)	(35.7)
Net assets including FRS 17 pension liability	1,411.5	930.2

Profit and loss reserve	2003 £m	2002 £m
Profit and loss reserve	724.3	104.5
Exclude existing net pension liability and prepayment (under SSAP 24)	(9.4)	1.4
	714.9	105.9
FRS 17 pension liability	(163.4)	(35.7)
Profit and loss reserve including FRS 17 pension liability	551.5	70.2

The group's pension expense for its defined benefit schemes was:

Profit and loss accounts	AWGPS £m	Unfunded Pensions £m	2003 Total £m
Current service cost	15.7	–	15.7
Past service cost	–	–	–
Gain on settlements and curtailments	–	–	–
Charge to operating profit	15.7	–	15.7
Expected return on pension scheme assets	39.0	–	39.0
Interest on pension scheme liabilities	(31.3)		(31.3)
Amount credited to other finance income	7.7	–	7.7
Profit on ordinary activities before taxation	8.0	–	8.0
Statement of total recognised gains and losses			
Actual return on pension scheme assets less expected return	(160.4)	–	(160.4)
Experience gains and losses arising on the scheme liabilities	–	0.9	0.9
Changes in assumptions underlying the present value of the scheme liabilities	(41.2)	(1.8)	(43.0)
Loss recognised	(201.6)	(0.9)	(202.5)

Notes to the financial statements continued

26 Pension commitments (continued)

Movement in scheme deficit (before related deferred tax asset)	AWGPS £m	Unfunded Pensions £m	2003 Total £m
Deficit at 1 April 2002	(10.0)	(36.7)	(46.7)
Current service costs	(15.7)	–	(15.7)
Contributions	23.8	2.1	25.9
Past service costs	–	–	–
Settlements and curtailments	–	–	–
Businesses acquired	–	–	–
Net interest	7.7	(2.1)	5.6
Actuarial loss	(201.6)	(0.9)	(202.5)
Deficit at 31 March 2003	(195.8)	(37.6)	(233.4)

Details of experience gains and losses for 2003	AWGPS £m	Unfunded Pensions £m	2003 Total £m
Difference between expected and actual returns on scheme assets			
Amount	(160.4)	–	(160.4)
Percentage of scheme assets	39.7%	–	39.7%
Experience gains and losses on scheme liabilities			
Amount	–	0.9	0.9
Percentage of present value of scheme liabilities	–	2.4%	0.1%
Amount in Group statement of total recognised gains and losses			
Amount	(201.6)	(0.9)	(202.5)
Percentage of present value of scheme liabilities	33.6%	2.4%	31.8%

27 Contingent liabilities

At 31 March 2003 £119.9 million of ACT has been surrendered to the company by AWGL but remains unutilised. As part of the financial restructuring the company are required to pay AWGL on utilisation of the ACT. A provision has not been recognised in the group accounts as it is uncertain whether the ACT will be utilised (i.e. it is not probable that a transfer of economic benefits will be required to settle the obligation) and it is not possible to make a reliable estimate of the amount of the obligation.

The company, as part of the ring-fenced group, guarantees all the borrowings of AWSF, which at 31 March 2003 amounted to £3,311.2 million.

There are no other material contingent liabilities at 31 March 2003 for which provision has not been made in these financial statements.

28 Ultimate parent company

AWSOH, a company registered in the Cayman Islands, is the immediate parent company of the company.

AWGL, a company registered in England and Wales, is the parent company of the smallest group to consolidate the accounts of the group.

AWG Plc, a company registered in England and Wales, is the parent company of the largest group to consolidate the accounts of the group. The directors consider AWG Plc to be the ultimate parent company.

Copies of the accounts of AWSOH and AWSH can be obtained from the company secretary, Henderson House, Lancaster Way, Huntingdon, Cambridgeshire PE29 6XQ.

Copies of the group accounts of AWGL and AWG Plc can be obtained from the company secretary, Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.

29 Acquisitions

On 1 April 2002 the company acquired part of the business and the following assets and liabilities of Geodesys Ltd:

	Group and Company £m
Fixed assets	0.5
Debtors	0.2
Cash at bank	1.7
Creditors	(2.4)
Net assets acquired (equal to fair value)	–

Trading results for 31 March 2003 include turnover of £4.4 million and operating profit of £2.2 million arising from this acquisition.

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 Anglian Water Services Limited (the company or the appointee) as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines (RAGs) issued by the Office of Water Services (Ofwat).

This additionally requires the directors to:

- confirm that, in their opinion, the company has sufficient financial and management resources for the next 12 months;
- confirm that, in their opinion, the company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the company;
- report to the Director General of Water Services (DG) changes in the company's activities which may be material in relation to the company's ability to finance its regulated activities;
- undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length; and
- keep proper accounting records which comply with Condition F.

These responsibilities are additional to those already set out on page 3.

Notes on regulatory information

1 General

As discussed in the directors' report on page 2, the company's activities are regulated by the conditions of a licence granted to the company by the Secretary of State for the Environment. With certain exceptions, the regulatory provisions do not apply to business activities which are not connected with the carrying out of the water and sewerage functions.

An analysis of the regulatory historical cost profit and loss account and balance sheet between appointed and non-appointed business is set out on pages 29 and 30. A current cost profit and loss account and balance sheet are shown on pages 33 and 34. Other current cost disclosures appear on pages 35 to 42. Additional information required by the licence is shown on pages 31 and 32.

Under the RAGs the treatment of certain turnover and expenditure items differs from that disclosed in the statutory financial statements.

2 Protection of the regulated business

(a) In the opinion of the directors the company 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 its obligations under the appointment).

(b) In the opinion of the directors the company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.

3 Ring-fencing

In the opinion of the directors, the company was in compliance with paragraph 3.1 of Condition K of the licence throughout the year.

Current cost five year performance review

This relates to the five year Profit & Loss Accounts and Balance Sheets on page 42 prepared using current cost accounting principles and should be read in conjunction with the Performance Review on page 4 of this document.

In operating costs there is a year on year increment of £ 8.5 million between 2002 and 2003. Operating costs in the prior year benefited from some atypical credits (see page 4) but continue to have upward pressure from the revenue impact of capital schemes, inflation and costs to meet new obligations.

A commentary on movements between 2003 and 2002 (not discussed on page 4) is discussed below.

a) the working capital adjustment which arises through the indexation of the 2002 balance sheet working capital adjustment (comprising short-term debtors, creditors and cash but excluding debt) by the Retail Price Index (RPI) movement in the current year. This results in a credit to the balance sheet and an offsetting debit to the profit and loss of £8.9 million in the current year.

b) the financing adjustment moved by £63.4 million between 2003 and 2002 due to the indexation of the 2002 balance sheet net assets employed less net operating assets. Net assets employed are lower than net operating assets as net assets include the impact of long-term debt and dividends payable. This results in a debit balance sheet movement and an offsetting credit profit and loss account movement in the current year.

c) the reduction in working capital in the balance sheet of £174.8 million between 2003 and 2002 is due to an increase in accruals of £53 million (principally for interest payable), a reduction in inter company debtors (principally due to the receipt in 2003 of payment for a £309 million debtor balance at 2002) offset by an overall increase in cash balances of £171 million.

Over the five year period a commentary on notable movements is as follows

a) Turnover reduced by £20.3 million from 1999 to 2000, this was as a result of not taking any RPI or K increase in 2000. Revenue again reduced from 2000 to 2001 by £60.4 million as a result of a negative K of 10 being applied as part of the AMP 3 regulatory settlement. From 2001 to 2002 there was a positive K of 1 and an increase in revenue of £20.5 million. The movement between 2002 and 2003 is explained on Page 4.

b) Operating costs (excluding current cost depreciation) over the five year period have continued to be subject to upward pressure. The regulatory price settlement for AMP 3 held operating costs flat in real terms and to date actuals have been broadly in line with the Determination. Current cost depreciation increased over the 5 year period in line with the historic cost depreciation (as adjusted for price inflation).

c) Net Interest moved marginally (£3.4 million) between 1999 and 2000. In 2001 there was an increase of £21.7 million due to some atypical costs for early termination of some loans and very high indexation on RPI linked bonds. In 2002 this returned to a more standard base of £104.8 million. The increase between 2002 and 2003 is described on Page 4.

d) Taxation charges in 1999, 2000 and 2001 were restated to include the impact of deferred tax as per Financial Reporting Standard (FRS) 19.
In 2002 there was a credit due of £29.2 million due to accrual releases following the settlement of prior year tax assessments plus a negative deferred tax charge due to movements in discount rates. The increase between 2002 and 2003 is described on Page 4.

Regulatory historical cost profit and loss account

for the year ended 31 March

	2003			2002		
	Appointed £m	Non appointed £m	Total £m	Appointed £m	Non appointed £m	Total £m
Turnover	719.3	7.4	726.7	717.9	5.4	723.3
Operating costs	(453.4)	(4.7)	(458.1)	(442.6)	(5.0)	(447.6)
Profit on sale of fixed assets	0.6	–	0.6	3.3	–	3.3
Operating profit*	266.5	2.7	269.2	278.6	0.4	279.0
Other income	0.1	–	0.1	1.1	–	1.1
Interest receivable	142.6	–	142.6	16.7	–	16.7
Interest payable	(249.0)	–	(249.0)	(119.4)	–	(119.4)
Profit on ordinary activities before taxation	160.2	2.7	162.9	177.0	0.4	177.4
Taxation						
– Current tax	(35.8)	(0.8)	(36.6)	12.8	–	12.8
– Deferred tax	(19.9)	–	(19.9)	15.8	–	15.8
Profit on ordinary activities after taxation	104.5	1.9	106.4	205.6	0.4	206.0
Dividends	512.9	(2.3)	510.6	–	–	–
Movement in reserves	617.4	(0.4)	617.0	205.6	0.4	206.0

* After exceptional items of £18.0 million (2002: £23.6 million) within the appointed business.

Regulatory historical cost balance sheet
at 31 March

	2003			2002		
	Appointed £m	Non appointed £m	Total £m	Appointed £m	Non appointed £m	Total £m
Fixed assets						
Tangible assets	3,676.4	–	3,676.4	3,602.3	–	3,602.3
Investments	1,609.3	–	1,609.3	0.2	–	0.2
	5,285.7	–	5,285.7	3,602.5	–	3,602.5
Current assets						
Stocks	4.6	–	4.6	4.1	–	4.1
Debtors	299.5	–	299.5	562.8	–	562.8
Cash at bank and in hand	0.6	2.7	3.3	(12.8)	13.6	0.8
Short term investments	158.0	–	158.0	–	–	–
	462.7	2.7	465.4	554.1	13.6	567.7
Creditors: amounts falling due within one year						
Short-term borrowings	(27.4)	–	(27.4)	(257.0)	–	(257.0)
Dividends payable	(150.7)	(1.9)	(152.6)	(786.0)	(13.2)	(799.2)
Other creditors	(295.2)	(0.8)	(296.0)	(231.3)	–	(231.3)
Net current liabilities	(10.6)	–	(10.6)	(720.2)	0.4	(719.8)
Total assets less current liabilities	5,275.1	–	5,275.1	2,882.3	0.4	2,882.7
Creditors: amounts falling due after more than one year						
Loans and other borrowings	(3,438.9)	–	(3,438.9)	(1,714.7)	–	(1,714.7)
Other creditors	(87.4)	–	(87.4)	(86.1)	–	(86.1)
	(3,526.3)	–	(3,526.3)	(1,800.8)	–	(1,800.8)
Provisions for liabilities and charges						
Deferred tax	(108.3)	–	(108.3)	(88.4)	–	(88.4)
Other provisions	(55.7)	–	(55.7)	(25.7)	–	(25.7)
	(164.0)	–	(164.0)	(114.1)	–	(114.1)
	1,584.8	–	1,584.8	967.4	0.4	967.8
Capital and reserves						
Called up equity share capital	860.0	–	860.0	860.0	–	860.8
Profit and loss reserve	724.8	–	724.8	107.4	0.4	107.8
Total shareholder's funds (all equity)	1,584.8	–	1,584.8	967.4	0.4	967.8

Additional information required by the licence

1 Accounting policies

The accounting policies are set out on pages 10 and 11, except that, as noted on page 28, under the RAGs certain turnover and expenditure items are treated differently in the regulatory financial statements. In addition, infrastructure renewals accounting has been retained in the regulatory accounts in accordance with Ofwat's requirements.

2 Information in relation to allocations and apportionments between the appointed and any other business or activity of the appointee or associated company

The non-appointed business relates mainly to service searches, recreation, leisure and the provision of engineering and consultancy services.

A proportion of the operating costs relating to these activities is directly incurred and does not require allocation. Other relevant costs have been allocated according to time spent on these activities.

The North Tees water supply agreements with turnover of £1.3 million and a profit of £0.4 million have been treated as appointed business.

3 Allocation to principal service

(a) Operating costs are incurred directly by specific service and have not required allocation. Indirect costs are allocated on either a causal link basis or according to local managers' assessments. The allocation to principal service of the charge for infrastructure renewals is based on the asset management plan.

(b) Capital costs and hence the related depreciation charges, are incurred directly by specific service and have not required allocation.

4 Information in respect of transactions with any other business or activity of the appointee or any associated company

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in notes (a) to (f) below.

(a) **Borrowings or sums lent**

£309.5 million of private placement debt received by the company in July 2001 was temporarily onlent on identical terms to AWG Group Ltd (AWGL), the former parent company. The £309.5 million was repaid on 30 July 2002.

On 30 July 2002 £1,609.1 million was lent by the company to AWS Holdings Limited (AWSH). No other sums were lent by the appointee to associated companies at 31 March 2003.

Sums borrowed by the appointee from associated companies were:

Lender	Principal amount £m	Repayment date	Interest rate %
Anglian Water Services Financing Plc (AWSF) - fixed rate	100.0	2014	12.375
AWSF - fixed rate	200.0	2023	6.875
AWSF - fixed rate	200.0	2029	6.625
AWSF - fixed rate	150.0	2006	8.25
AWSF - 'mark to market' adjustments (1)	11.2	2006	
AWSF - fixed rate	250.0	2022	5.837
AWSF - fixed rate	246.0	2030	6.293
AWSF - fixed rate	275.0	2037	7.882
AWSF - fixed rate	229.3	2009	5.375
AWSF - fixed rate	74.0	2037	8.195
AWSF - fixed rate	16.0	2009	6.75
AWSF - 'mark to market' adjustments (1)	0.8	2009	
AWSF - fixed rate	2.2	2006	6.71
AWSF - 'mark to market' adjustments (1)	0.1	2006	
AWSF - fixed rate	254.8	2007	5.62875
AWSF - fixed rate	35.8	2006	6.85
AWSF - fixed rate	28.4	2005	6.57
AWSF - fixed rate	24.9	2006	6.65
AWSF - fixed rate	71.0	2008	7.01
AWSF - fixed rate	16.3	2009	7.13
AWSF - fixed rate	138.5	2011	7.23
AWSF - index linked	149.5	2008	5.5
AWSF - index linked (2)	160.3	2020	4.125
AWSF - index linked (2)	203.8	2032	3.07
AWSF - index linked (2)	61.1	2032	3.07
AWSF - index linked (2)	76.4	2024	3.66
AWSF - floating rate (3)	50.0	2012	LIBOR plus 1.2%
AWSF - floating rate (3)	180.0	2014	LIBOR plus 1.25%
AWSF - floating rate (3)	100.0	2037	LIBOR plus 2.8%
AWSF - RPI swap indexation on £150m (3), (4)	2.6	2024	
AWSF - RPI swap indexation on £175m (3), (4)	3.2	2030	

(1) As part of the financial restructuring of the company back to back loans to the company from AWGL were reassigned from AWGL to AWSF. The 'mark to market' adjustments relate to the reassignment of these loans at fair value rather than book value. The difference between the book value and fair value is being amortised at a constant rate on the carrying amount of the debt over the remainder of its life.

(2) The value of the capital and interest elements of the index linked debt are linked to movements in the Retail Price Index (RPI).

(3) The company has entered into swap agreements that convert 98.5% of its floating rate debt into index linked debt in accordance with the company's hedging policy.

(4) The values of the notional capital on these index linked swaps are linked to movements in RPI. The increase in the notional capital value is payable at the final maturity date of the swaps.

Additional information required by the licence continued

(b) **Dividends payable**

A dividend of £273.1 million is paid and payable for the year (2002: no dividend was declared for the year).

In the year AWGL waived its right to £786.0 million of the 2000/01 dividend.

(c) **Guarantees/securities**

The company, as part of the ring-fenced group, guarantees all the borrowings of AWSF, its wholly owned subsidiary, which at 31 March 2003 amounted to £3,311.2 million.

(d) **Supply of services**

Recharges by the appointee to associated companies:

Nature of transaction	Company	Terms of supply	Value £m
IT services	AWG Central Services Limited	Actual costs	0.7
HR services	AWG Central Services Limited	Actual costs	0.2
Other services	AWG Central Services Limited	Actual costs	0.1

Services supplied to the appointee by associated companies:

Nature of transaction	Company	Turnover of associated company £m	Terms of supply	Value £m
Risk management sevice	AWG Central Services Limited	32.8	Negotiated	0.2
Insurance	AWG Central Services Limited	32.8	Negotiated	4.1
Taxation services	AWG Central Services Limited	32.8	Negotiated	0.2
Internal audit services	AWG Central Services Limited	32.8	Negotiated	0.2
Fleet management	Powermarque Limited	29.8	Competitive tendering	8.0
Insurance services	Rutland Insurance Company Limited	6.6	Other market testing	3.4
Rental of office accommodation	Ambury Developments Limited	9.5	Negotiated	1.2
Estate management, etc.	AWG Property Solutions Limited	2.8	Negotiated	1.4
Strumap	MVM Limited	13.4	Other market testing	0.5
Engineering, construction and fabrication	PURAC Limited	44.9	Competitive tendering	10.2
Sewerage maintenance services	Alpheus Environmental Limited	9.1	Competitive tendering	0.3
Facilities management services	AWG Contruction Services Limited	668.4	Other market testing	0.8
Other	n/a		n/a	0.1
				30.6*

* This total includes amounts of £10.2 million which were capitalised by the appointed business.

(e) **Omissions of rights**

No material omissions took place during the year.

(f) **Waivers**

There were no material waivers during the year.

Current cost profit and loss account for appointed business

for the year ended 31 March

Notes		2003 £m	2002 £m
2	Turnover	719.3	717.9
4	Current cost operating costs	(519.0)	(500.1)
3	Operating income	0.3	1.8
		200.6	219.6
1(e).3	Working capital adjustment	(8.9)	1.3
	Current cost operating profit*	191.7	220.9
	Other income	0.1	1.1
	Interest receivable	142.6	16.7
	Interest payable	(249.0)	(119.4)
1(e)	Financing adjustment	63.4	21.9
	Current cost profit before taxation	148.8	141.2
	Current tax	(35.8)	12.8
	Deferred tax	(19.9)	15.8
	Current cost profit attributable to shareholder	93.1	169.8
	Dividends	512.9	–
7	Current cost profit	606.0	169.8

*After exceptional items of £18.3 million (2002: £25.1 million).

The notes on pages 36 to 42 form part of these current cost financial statements.

Current cost balance sheet for appointed business
at 31 March

Notes		2003 £m	2002 £m
	Assets employed		
5	Fixed assets	18,665.9	18,087.6
	Third party contributions since 31 March 1990	(581.6)	(554.0)
		18,084.3	17,533.6
6	Working capital	121.9	287.8
	Net operating assets	18,206.2	17,821.4
	Cash and investments	1,609.3	0.2
	Non-trade debtors	51.3	41.0
	Dividends payable	(150.7)	(786.0)
	Other non-trade creditors due within one year	(27.4)	(257.0)
	Creditors due after one year	(3,438.9)	(1,714.7)
	Provisions for liabilities and charges		
	Deferred tax	(108.3)	(88.4)
	Other provisions	(55.7)	(25.7)
	Net assets employed	16,085.8	14,990.8
	Financed by		
	Called up share capital	860.0	860.0
7	Profit and loss reserve	156.4	(449.6)
8	Current cost reserve	15,069.4	14,580.4
	Total capital and reserves	16,085.8	14,990.8

The notes on pages 36 to 42 form part of these current cost financial statements.

Approved by the board on 23 May 2003.

R A Pointer
Chief executive

Current cost cash flow statement for appointed business
for the year ended 31 March

Notes		2003 £m	2002 £m
9(a)	Net cash inflow from operating activities	415.1	378.3
	Returns on investments and servicing of finance		
	Interest received	94.9	16.7
	Interest paid	(141.8)	(100.0)
	Cash flow treated as finance costs under FRS4	(23.8)	–
	Interest element of finance lease rental payments	(9.7)	(10.4)
	Net cash outflow for returns on investments and servicing of finance	(80.4)	(93.7)
	Taxation		
	Corporation Tax received/(paid)	0.5	(46.4)
	Capital expenditure and financial investment		
	Gross cost of purchase of fixed assets	(219.1)	(220.5)
	Grants and contributions received	17.0	17.9
	Infrastructure renewals expenditure	(42.6)	(41.5)
	Short-term loan to group company, (AWGL)	309.5	(309.5)
	Loan to group company, (AWSH)	(1,609.1)	–
	Disposal of tangible fixed assets	1.3	4.8
	Net cash outflow for capital expenditure and financial investment	(1,543.0)	(548.8)
	Equity dividends paid	(122.4)	(86.9)
	Management of liquid resources		
	Increase in short-term deposits and investments	(88.2)	–
	Net cash outflow before financing	(1,418.4)	(397.5)
	Financing		
	Increase in loans	1,947.3	311.1
	Repayments of amounts borrowed	(255.1)	(82.5)
	Capital element of finance lease payments	(21.7)	(19.5)
	Net cash inflow from financing	1,670.5	209.1
	Increase/(decrease) in cash	252.1	(188.4)

Note 9 on page 41 forms part of this current cost cash flow statement.

Notes to the current cost financial statements

1 Accounting policies

(a) **General**

These financial statements have been prepared in accordance with guidance issued by the Director General of Water Services for modified real terms financial statements suitable for regulation in the water industry.

They measure profitability on the basis of real financial capital maintenance, in the context of assets which are valued at their current cost value to the business, with the exception of assets acquired prior to 31 March 1990.

The accounting policies used are the same as those adopted in the statutory historical cost financial statements, except as set out below:

(b) **Tangible fixed assets**

Assets acquired prior to 31 March 1990 and in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle.

No provision is made for possible funding of future replacement of assets by contributions from third parties and, to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business.

Redundant assets are valued at their recoverable amounts.

Land and buildings

Non-specialised operational properties are valued on the basis of open market value for existing use as part of the periodic asset management plan (AMP) reviews and are expressed in real terms by indexation using the RPI thereafter.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between periodic AMP reviews by adjusting for inflation as measured by changes in the RPI. The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below).

Infrastructure assets

Mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost, determined principally on the basis of data provided by the AMP.

A process of continuing refinement of asset records is expected to produce adjustments to existing values when periodic reviews of the AMP take place. In the intervening years, values are restated to take account of changes in the general level of inflation, as measured by changes in the RPI over the year.

Other fixed assets

All other fixed assets are valued periodically at depreciated replacement costs. Between periodic AMP reviews, values are restated for inflation as measured by changes in the RPI.

Surplus land

Surplus land is valued at recoverable amount, taking into account that part of any proceeds to be passed on to customers under condition B of the licence.

(c) **Modern equivalent asset (MEA) valuation**

A review of the MEA valuation and asset stock is undertaken as part of the last Periodic Review. The revised values arising from this review provide the basis for calculating the MEA in the current cost financial statements.

(d) **Grants and other third party contributions**

Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is after restatement for the change in the RPI for the year. This balance is treated as deferred income.

1 Accounting policies (continued)

(e) **Real financial capital maintenance adjustments**

These adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

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.

Disposal of fixed assets adjustment – the difference between the values of realised assets in these current cost financial statements and in the historical cost financial statements.

The depreciation adjustment is incorporated within operating costs in the profit and loss account. The disposal of fixed assets adjustment is incorporated within operating income in the profit and loss account.

Working capital adjustment – this is calculated by applying the changes in the RPI over the year to the opening total of trade debtors and stock less trade creditors.

Financing adjustment – this is calculated by applying the changes 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 and dividends payable.

2 Turnover for the appointed business	Water service £m	Sewerage service £m	Appointed business 2003 £m	Water service £m	Sewerage service £m	Appointed business 2002 £m
Measured	128.1	191.5	319.6	123.9	188.3	312.2
Unmeasured	118.2	212.9	331.1	115.9	214.1	330.0
Trade effluent	–	25.7	25.7	–	29.1	29.1
Large user revenues	20.1	–	20.1	22.9	–	22.9
Third party services	17.7	1.3	19.0	18.6	1.4	20.0
Other sources	1.7	2.1	3.8	1.1	2.6	3.7
Total turnover	285.8	433.5	719.3	282.4	435.5	717.9

3 Operating income and working capital adjustment for the appointed business	Water service £m	Sewerage service £m	Appointed business 2003 £m	Water service £m	Sewerage service £m	Appointed business 2002 £m
Current cost profit on disposal of fixed assets	0.1	0.2	0.3	0.9	0.9	1.8
Working capital adjustment	(4.4)	(4.5)	(8.9)	0.7	0.6	1.3

Notes to the current cost financial statements continued

4 Analysis of operating costs and fixed asset net book values by service

	Service analysis								Business activities		
	Water service			Sewerage service							
	Resources and treatment £m	Distribution £m	Water service subtotal £m	Sewerage £m	Sewage treatment £m	Sludge treatment & disposal £m	Sewage T&D subtotal £m	Sewerage service subtotal £m	Customer services £m	Scientific services £m	Cost of regulation £m
Direct costs:											
Employment costs	5.9	7.3	13.2	9.3	13.9	5.2	19.1	28.4	10.6	5.0	1.3
Power	5.0	5.3	10.3	1.9	6.4	2.5	8.9	10.8	–	0.1	–
Hired and contracted services	3.9	10.3	14.2	6.2	9.8	16.7	26.5	32.7	8.0	1.5	0.4
Materials and consumables	4.0	1.2	5.2	1.6	4.9	6.5	11.4	13.0	0.3	0.3	–
Service charges	6.8	–	6.8	0.9	4.6	–	4.6	5.5	–	0.6	–
Bulk supply imports	0.9	–	0.9	–	–	–	–	–	–	–	–
Other direct costs	0.3	0.4	0.7	0.2	0.3	0.2	0.5	0.7	4.9	0.2	1.3
Total direct costs	26.8	24.5	51.3	20.1	39.9	31.1	71.0	91.1	23.8	7.7	3.0
General and support expenditure	8.9	6.3	15.2	6.6	11.3	8.4	19.7	26.3	4.3	1.6	1.2
Functional expenditure	35.7	30.8	66.5	26.7	51.2	39.5	90.7	117.4	28.1	9.3	4.2
Total business activities			22.6					19.0			
Rates			19.7					13.0			
Doubtful debts			3.7					4.3			
Exceptional items			9.3					9.3			
Total less third party services			121.8					163.0			
Third party services			11.0					0.7			
Total operating costs			132.8					163.7			
Capital costs:											
Infrastructure renewals expenditure	–	19.1	19.1	23.4	0.1	–	0.1	23.5			
Movement in infrastructure renewal accrual/prepayment	–	(7.0)	(7.0)	(8.6)	–	–	–	(8.6)			
Depreciation† (allocated)	46.0	17.3	63.3	21.5	93.6	8.0	101.6	123.1			
Amortisation of deferred credits			(2.3)					(4.3)			
Business activities depreciation† (non-allocated)			4.7					7.1			
Capital maintenance excluding third party services			77.8					140.8			
Third party services – capital maintenance			3.0					0.9			
Total capital maintenance			80.8					141.7			
Total operating costs[1]			213.6					305.4			
2002 total operating costs			213.9					286.2			
CCA (MEA) values											
Service activities	1,095.9	4,363.7	5,459.6	11,441.2	1,557.5	86.5	1,644.0	13,085.2			
Business activities			16.6					24.9			
Service totals			5,476.2					13,110.1			
Service assets for third parties			66.7					12.9			
Total MEA values			5,542.9					13,123.0			
2002 total MEA values			5,372.1					12,715.5			

† On a current cost basis.

[1] Included within total operating costs are reactive and planned maintenance expenditure on infrastructure assets of £43.1 million. This is split £10.2 million water distribution and £32.9 million sewerage.

		Specialised operational assets £m	Non-specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
5	Fixed assets					
(a)	**Fixed assets by type – water service**					
	Gross replacement cost					
	At 1 April 2002	1,384.1	9.6	4,715.4	266.5	6,375.6
	RPI adjustment	42.9	0.3	146.2	8.3	197.7
	Disposals	(0.2)	(0.4)	–	(5.0)	(5.6)
	Additions	38.2	0.2	32.3	5.1	75.8
	At 31 March 2003	1,465.0	9.7	4,893.9	274.9	6,643.5
	Depreciation					
	At 1 April 2002	832.0	2.8	–	168.7	1,003.5
	RPI adjustment	25.8	0.2	–	5.2	31.2
	Disposals	(0.1)	(0.4)	–	(4.6)	(5.1)
	Charge for the year	47.3	0.2	–	23.5	71.0
	At 31 March 2003	905.0	2.8	–	192.8	1,100.6
	Net book amount at 31 March 2003	560.0	6.9	4,893.9	82.1	5,542.9
	Net book amount at 31 March 2002	552.1	6.8	4,715.4	97.8	5,372.1
(b)	**Fixed assets by type – sewerage service**					
	Gross replacement cost					
	At 1 April 2002	3,387.1	9.9	11,121.5	274.8	14,793.3
	RPI adjustment	105.0	0.4	344.7	8.5	458.6
	Disposals	–	(0.6)	–	(7.1)	(7.7)
	Additions	106.7	0.3	30.3	7.6	144.9
	At 31 March 2003	3,598.8	10.0	11,496.5	283.8	15,389.1
	Depreciation					
	At 1 April 2002	1,867.5	2.8	–	207.5	2,077.8
	RPI adjustment	57.9	0.1	–	6.4	64.4
	Disposals	–	(0.6)	–	(6.6)	(7.2)
	Charge for the year	89.8	0.1	–	41.2	131.1
	At 31 March 2003	2,015.2	2.4	–	248.5	2,266.1
	Net book amount at 31 March 2003	1,583.6	7.6	11,496.5	35.3	13,123.0
	Net book amount at 31 March 2002	1,519.6	7.1	11,121.5	67.3	12,715.5
(c)	**Fixed assets by type – total**					
	Gross replacement cost					
	At 1 April 2002	4,771.2	19.5	15,836.9	541.3	21,168.9
	RPI adjustment	147.9	0.7	490.9	16.8	656.3
	Disposals	(0.2)	(1.0)	–	(12.1)	(13.3)
	Additions	144.9	0.5	62.6	12.7	220.7
	At 31 March 2003	5,063.8	19.7	16,390.4	558.7	22,032.6
	Depreciation					
	At 1 April 2002	2,699.5	5.6	–	376.2	3,081.3
	RPI adjustment	83.7	0.3	–	11.6	95.6
	Disposals	(0.1)	(1.0)	–	(11.2)	(12.3)
	Charge for the year	137.1	0.3	–	64.7	202.1
	At 31 March 2003	2,920.2	5.2	–	441.3	3,366.7
	Net book amount at 31 March 2003	2,143.6	14.5	16,390.4	117.4	18,665.9
	Net book amount at 31 March 2002	2,071.7	13.9	15,836.9	165.1	18,087.6

Notes to the current cost financial statements continued

5 Fixed assets (continued)

(d) In the preparation of its statutory financial statements, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as required by FRS 15 'Tangible Fixed Assets'. However, for the purposes of the regulatory financial statements, Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the tangible fixed assets shown in the statutory financial statements is set out below:

	Infrastructure assets £m
Cost	
At 31 March 2003 per regulatory financial statements	16,390.4
Adjustment to opening balance at 31 March	(14,377.7)
Infrastructure renewals expenditure capitalised in the year	42.6
At 31 March 2003 per statutory financial statements	2,055.3
Grants and contributions	
At 31 March 2003 per regulatory financial statements	–
Adjustment to opening balance at 31 March	(162.6)
At 31 March 2003 per statutory financial statements	(162.6)
Depreciation	
At 31 March 2003 per regulatory financial statements	–
Adjustment to opening balance at 31 March	(334.0)
Depreciation charge for infrastructure renewal expenditure	(27.0)
At 31 March 2003 per statutory financial statements	(361.0)
Net book value	
At 31 March 2003 per regulatory financial statements	16,390.4
Adjustment to opening balance at 31 March	(14,874.3)
Infrastructure renewals expenditure capitalised in the year	42.6
Depreciation charge for infrastructure renewal expenditure	(27.0)
At 31 March 2003 per statutory financial statements	1,531.7
Working capital	
At 31 March 2003 per regulatory financial statements	20.4
Less infrastructure renewals prepayment	(20.4)
At 31 March 2003 per statutory financial statements	–

6 Working capital	2003 £m	2002 £m
Cash	158.6	(12.8)
Stocks	4.6	4.1
Trade debtors	84.1	81.5
Trade creditors	(60.8)	(73.8)
Short-term capital creditors	(25.3)	(22.1)
Infrastructure renewals prepayment	20.4	4.7
Other trade accruals	(154.2)	(105.5)
Corporation Tax	(45.2)	(7.7)
Payroll related taxes and social security contributions	(3.1)	(3.0)
Group trade debtors (net)	63.1	328.7
Prepayments	79.7	93.7
Total working capital	121.9	287.8

7 Current cost profit and loss reserve	2003 £m	2002 £m
At beginning of year	(449.6)	(619.4)
Retained profit for the year for appointed business	606.0	169.8
At end of year	156.4	(449.6)

8 Current cost reserve

	2003 £m	2002 £m
At beginning of year	14,580.4	14,378.9
RPI adjustments:		
Fixed assets	560.7	231.7
Working capital	8.9	(1.3)
Financing	(63.4)	(21.9)
Deferred grants and contributions	(17.2)	(7.0)
At end of year	15,069.4	14,580.4

9(a) Reconciliation of current cost operating profit to net cash inflow from operating activities

	2003 £m	2002 £m
Current cost operating profit*	191.7	220.9
Working capital adjustment	8.9	(1.3)
Increase in stocks	(0.5)	(0.1)
Other income received	0.2	1.1
Current cost depreciation	202.1	187.1
Current cost profit on sale of fixed assets	(0.3)	(1.8)
Decrease/(increase) in debtors and prepaid expenses	31.9	(26.1)
Decrease in creditors and accrued expenses	(22.8)	(6.0)
Provision for infrastructure renewals	27.0	27.0
Net movement in restructuring provision	(1.9)	(5.6)
Amortisation of deferred grants and contributions	(6.6)	(6.0)
Net movement in prepaid pension contributions	(14.6)	(10.9)
Net cash inflow from operating activities	415.1	378.3

*After exceptional items of £18.3 million (2002: £25.1 million).

9(b) Analysis of net debt

	1 April 2002 £m	Cash flows £m	Non-cash movements £m	31 March 2003 £m
Cash	(12.8)	83.2	–	70.4
Bank overdrafts	(168.9)	168.9	–	–
	(181.7)	252.1	–	70.4
Deposits and investments	–	88.2	–	88.2
Finance leases due within one year	(12.8)	12.8	(25.2)	(25.2)
Finance leases due after one year	(187.4)	8.9	25.2	(153.3)
Other debt due within one year	(75.3)	75.3	(2.2)	(2.2)
Other debt due after one year	(1,527.3)	(1,743.7)	(14.6)	(3,285.6)
	(1,984.5)	(1,306.4)	(16.8)	(3,307.7)

Non-cash movements comprise indexation of loan stock and RPI swaps, transfers between categories of debt, amortisation of debt issue costs and amortisation of 'mark to market' adjustments.

10 Regulatory capital value (RCV)

	2003 £m
Opening RCV for the year	3,945.4
Capital expenditure	274.0
Infrastructure renewals expenditure	33.9
Grants and contributions	(15.5)
Depreciation	(131.0)
Infrastructure renewals charge	(22.7)
Outperformace of regulatory assumptions (5 years in arrears)	(51.5)
Closing RCV carried forward	4,032.6
Average regulatory capital value	3,935.8

Notes to the current cost financial statements continued

10 **Regulatory capital value (RCV) (continued)**

RCV figures are extracted from those published by Ofwat on 18 March 2003 in their RD08/03 letter at 2001/02 prices. These have been indexed upwards to 2002/03 prices using an RPI factor of 179.9 / 174.5 (RPI at 31 March 2003 / RPI at 31 March 2002) to give all figures in the table excluding average RCV. The average RCV is derived by indexing the average RCV published on 18 March 2003 by the RPI factor of 177.5 / 173.9 (average RPI for year ended 31 March 2003 / average RPI for the year ended 31 March 2002).

The company intends to log up additional items at the forthcoming periodic review. This will be subject to agreement by Ofwat.

11 **Current cost profit and loss account for appointed business**

	2003 £m	2002 £m	2001 restated £m	2000 restated £m	1999 restated £m
Turnover	719.3	732.8	712.3	772.7	793.0
Current cost operating costs	(519.0)	(510.5)	(497.6)	(509.6)	(511.4)
Operating income	0.3	1.8	(0.6)	(2.2)	3.9
Working capital adjustment	(8.9)	1.3	2.1	1.1	(0.2)
Current cost operating profit*	191.7	225.4	216.2	262.0	285.3
Other income	0.1	1.1	0.6	0.2	0.7
Interest (net)	(106.4)	(104.8)	(124.4)	(102.7)	(99.3)
Financing adjustment	63.4	22.4	35.3	33.8	25.2
Current cost profit before taxation	148.8	144.1	127.7	193.3	211.9
Taxation	(55.7)	29.2	(36.9)	(43.0)	(63.7)
Current cost profit attributable to shareholder	93.1	173.3	90.8	150.3	148.2
Dividends	512.9	0.0	(943.0)	(158.8)	(353.3)
Current cost (loss)/profit	606.0	173.3	(852.2)	(8.5)	(205.1)

* After historical exceptional charge of £18.3 million (2002: exceptional charge of £25.5 million, 2001: exceptional charge of £13.4 million, 2000: exceptional charge of £47.2 million, 1999: exceptional credit of (£35.7) million).

Current cost balance sheet for appointed business	2003 £m	2002 £m	2001 restated £m	2000 restated £m	1999 restated £m
Assets employed					
Fixed assets	18,665.9	18,647.3	18,620.1	18,423.3	17,171.1
Third party contributions since 31 March 1990	(581.6)	(571.1)	(559.0)	(549.5)	(539.2)
Working capital	121.9	296.7	(105.3)	(92.1)	(42.8)
Net operating assets	18,206.2	18,372.9	17,955.8	17,781.7	16,589.1
Cash and investments	1,609.3	0.2	0.2	0.3	0.3
Non-trade debtors	51.3	42.3	32.3	30.1	27.2
Dividends payable	(150.7)	(810.3)	(911.9)	(110.5)	(285.1)
Other non-trade creditors due within one year	(27.4)	(265.0)	(101.2)	(342.9)	(50.6)
Creditors due after one year	(3,438.9)	(1,767.8)	(1,560.3)	(1,232.6)	(1,289.2)
Provisions for liabilities and charges	(164.0)	(117.6)	(141.6)	(126.5)	(112.3)
Net assets employed	16,085.8	15,454.7	15,273.3	15,999.6	14,879.4
Financed by					
Called up share capital	860.0	886.6	898.5	918.7	942.8
Profit and loss reserve	156.4	(463.5)	(647.1)	217.0	231.4
Current cost reserve	15,069.4	15,031.6	15,021.9	14,863.9	13,705.2
Total capital and reserves	16,085.8	15,454.7	15,273.3	15,999.6	14,879.4

The financial information set out above for the four years ended 31 March 2002 is based on the audited current cost financial statements for those years, as adjusted to 2002/03 prices for changes in the RPI. The comparatives for 1999, 2000 and 2001 have been restated in respect of the adoption of FRS19 'Deferred Tax' in 2002.

On 1 April 2000 the company acquired the trade and certain assets and liabilities from Hartlepool Water Plc. The trading results and balance sheet figures for the years ending 31 March 2003, 31 March 2002 and 31 March 2001 reflect this acquisition and are therefore not strictly comparable to previous years.

On 1 April 2002 the company acquired part of the business and certain assets and liabilities of Geodesys Limited. The trading results and balance sheet figures for the year ending 31 March 2003 reflect this acquisition and are therefore not strictly comparable to previous years.

Independent auditors' report

to the Director General of Water Services (the Regulator) and the Directors of Anglian Water Services Limited

We have audited the Regulatory Accounts of Anglian Water Services Limited (referred to as the Company or the appointee) on pages 29 to 42 which comprise:

- the regulatory historical cost accounting statements comprising the historical cost profit and loss account and balance sheet; and
- the regulatory current cost accounting statements comprising the current cost profit and loss account, balance sheet, cash flow statement and the related notes including the statement of accounting policies.

This report is made solely to the Company and the Regulator in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 (the licence). Our audit work has been undertaken so that we might state to the Company and the Regulator those matters we have agreed to state to them in our report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility for our audit work, for our report, or for the opinions we have formed to any other person than those to whom we have agreed in writing to accept responsibility.

Basis of preparation

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. As such, the Regulatory Accounts are separate from the statutory financial statements of the company and have not necessarily been prepared under the basis of Generally Accepted Accounting Principles. Financial information other than that prepared on the basis of Generally Accepted Accounting Principles does not necessarily represent a true and fair view of the financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and Auditors

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon it suitable or appropriate for the Regulator's purposes. Accordingly we make no assessment.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 27.

Our responsibility is to audit the Regulatory Accounts in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, except as stated in the "Basis of audit opinion", below.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 33 to 42 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the performance review, the notes on regulatory information, and the additional information required by the licence.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Independent auditors' report continued

to the Director General of Water Services (the Regulator) and the Directors of Anglian Water Services Limited

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company, which are prepared for a different purpose. We do not and will not, by virtue of this report assume any responsibility, whether in contract, negligence or otherwise, in relation to our audits of the Company's statutory financial statements required by the Companies Act 1985.

The regulatory historical cost accounting statements on pages 29 and 30 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on page 40.

Opinion

In our opinion the Regulatory Accounts for the Company contain the information for the year ended 31 March 2003 to comply with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewage undertaker under the Water Industry Act 1991.

In respect of this information we report that in our opinion:

(a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;

(b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;

c) the regulatory historical cost accounting statements on pages 29 to 30 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;

(d) the regulatory current cost accounting statements on pages 33 to 42 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
23 May 2003

1. The maintenance and integrity of the Company 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

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