WESSEX WATER LTD GROUP
CONSOLIDATED ACCOUNTS

For the year ended
31 December 1999

Registered in England and Wales No. 2366633

AN AZURIX COMPANY

DIRECTORS' REPORT

The directors present their report and the audited accounts for the year ended 31 December 1999.

PRINCIPAL ACTIVITIES AND OPERATIONAL REVIEW

Wessex Water Ltd's principal subsidiary is Wessex Water Services Ltd, a regulated company licenced for the supply of clean water and treatment and disposal of waste water. Wessex Water Services Ltd operates in a region of 10,000 square kilometres in the south west of England.

On 21 July 1999 the company by Special Resolution, confirmed by an Order of the High Court, cancelled its capital redemption reserve of £120.8m, creating additional distributable profits which, together with the distributable profits already available, enabled the company to declare dividends of £200.3m (£198.3m relating to the year ended 31 December 1998 and £2.0m relating to 1999) as originally intended out of distributable profits. These dividends were treated as satisfaction of amounts due to the company by Azurix Europe Ltd.

The group has continued to provide an excellent service and high quality standards for customers. The last year has been important for the group as it prepares for the review of customer charges to be effective from 1 April 2000, and ensured that it had no problem with the millennium date change.

The Director General of Water Services announced on 25 November 1999 a 12% price cut for Wessex Water Services Ltd from 1 April 2000, before adjustment for inflation. The announcement also included level prices for the years commencing 1 April 2001 and 1 April 2002, with price increases of 3.8% and 4.7% for the years commencing 1 April 2003 and 2004 respectively.

PROFIT AND DIVIDEND

Profit for the period after taxation was £114.4m (9 months to 31.12.98 - £88.9m). Dividends of £254.0m were declared during the year and the directors are proposing a final dividend of £37.8m.

DIRECTORS

The directors of the company during the year to 31 December 1999 were:

C F Skellett	Chairman
W N Hood	Resigned 29 October 1999
C J Bishop	
E J Gawith	
N A W Wheatley	Resigned 31 January 2000

T K Harris was appointed a director on 1 February 2000. During the period no director was materially interested in any contract with the company or with any of its subsidiaries. There are no interests in shares of group companies that are disclosable in these accounts.

EMPLOYMENT

The group offers equal opportunities to all applicants for employment. Disabled people are considered for employment, training, career development and promotion on the basis of their aptitude and abilities, in common with all employees.

A high priority is given to employee communications which include team meetings, an employee newspaper, newsletters and conferences.

ENVIRONMENT POLICY

The group protects, conserves and improves the environment and operates in a socially responsible manner. Working practices are continually revised as improved techniques and technologies become available. Wessex Water Services Ltd has an environmental advisory panel and an environmental and sustainability charter. A separate sustainability report is prepared indicating the progress made in this area during the year.

RESEARCH AND DEVELOPMENT

The group carried out research and development in support of existing activities to improve the reliability and effectiveness of water and waste water services.

CHARITABLE DONATIONS

During the year £128,000 was donated to UK charities (9 months to 31.12.98 - £84,000).

SUPPLIER PAYMENT POLICY

The policy in respect of its suppliers is to agree the payment terms for transactions in advance and to make payments in accordance with those terms. At 31 December 1999 trade creditors represented approximately 37 days trade purchases (31.12.98 - 46 days).

YEAR 2000

The group undertook a major project between 1996 and December 1999 to ensure that it had no problems with the year 2000 "Millennium Bug" in respect of computer systems, equipment and telemetry. In total £13.6m was spent on capital projects and £2.6m was charged to the profit and loss account. No such problems have arisen.

AUDITORS

A resolution to reappoint Arthur Andersen as auditors of the company will be proposed at the Annual General Meeting.

N G Wooller

By order of the board
N G Wooller
Company secretary
14 April 2000

DIRECTORS' RESPONSIBILITIES

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

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

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

By order of the board
N G Wooller
Company secretary
14 April 2000

N G Wooller

AUDITORS' REPORT TO THE MEMBERS OF WESSEX WATER LTD

We have audited the accounts on pages 4 to 17, which have been prepared under the historical cost convention and the accounting policies set out on pages 6 and 7.

Respective responsibilities of directors and auditors

As described above, the company's directors are responsible for the preparation of the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guide.

Basis of opinion

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

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

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the group and of the company at 31 December 1999 and of the group's profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen

ARTHUR ANDERSEN
Chartered Accountants and Registered Auditors
1 Surrey Street
London
WC2R 2PS
14 April 2000

GROUP PROFIT AND LOSS ACCOUNT
For the year to 31 December 1999

	NOTE	12 months to 31.12.99 £m	9 months to 31.12.98 £m
Turnover	2	287.9	212.8
Operating profit	2,3	149.2	98.6
Share of operating profit of associated undertaking		-	4.9
Profit on sale of associated undertaking		-	3.8
Profit on ordinary activities before interest and taxation		149.2	107.3
Net interest payable	5	(22.6)	(10.9)
Profit on ordinary activities before taxation		126.6	96.4
Taxation on profit on ordinary activities	6	(12.2)	(7.5)
Profit attributable to shareholders		114.4	88.9
Dividends	7	(291.8)	(5.3)
Transfer (from)/to reserves	18	(177.4)	83.6

The group's turnover and operating profit were generated from continuing activities.

There were no recognised gains and losses in either period other than the profit for each period.

The accompanying notes are an integral part of this profit and loss account.

BALANCE SHEETS
31 December 1999

	NOTE	Group 31.12.99 £m	Group Restated 31.12.98 £m	Company 31.12.99 £m	Company 31.12.98 £m
Tangible assets	8	1,259.8	1,160.5	-	-
Investments	9	0.4	0.4	85.0	83.8
		1,260.2	1,160.9	85.0	83.8
Current assets					
Stock	10	2.2	2.2	-	-
Debtors	11	155.1	264.7	172.5	330.1
Investments	12	0.7	0.7	0.7	0.7
Cash at bank and in hand		3.6	2.2	0.8	30.9
		161.6	269.8	174.0	361.7
Creditors - amounts falling due within one year	13	(190.2)	(401.2)	(43.5)	(21.0)
Net current (liabilities)/assets	28	(28.6)	(131.4)	130.5	340.7
Total assets less current liabilities		1,231.6	1,029.5	215.5	424.5
Creditors - amounts falling due after more than one year	14	(472.2)	(93.9)	-	-
Provisions for liabilities and charges	15	(10.7)	(8.6)	(0.4)	-
Deferred income	16	(22.3)	(22.5)	-	-
Net assets	2	726.4	904.5	215.1	424.5
Capital and reserves					
Called up share capital	17	131.8	131.8	131.8	131.8
Capital redemption reserve	18	-	120.8	-	120.8
Share premium account	18	28.8	29.0	28.8	29.0
Profit and loss account	18	565.8	622.9	54.5	142.9
Equity shareholders' funds	19	726.4	904.5	215.1	424.5

The accompanying notes are an integral part of this balance sheet.

These accounts were approved by the board of directors on 14 April 2000 and signed on its behalf by:

C F Skellett
Chairman

T K Harris
Director

NOTES TO THE ACCOUNTS
For the year to 31 December 1999

1 **Accounting policies**

a. **Basis of preparation**

The accounts have been prepared under the historic cost convention and in accordance with applicable accounting standards in the United Kingdom and, except for the treatment of certain grants and contributions (see note 1g) in accordance with the Companies Act 1985. The group has adopted all applicable accounting standards up to and including FRS14 "Earnings per Share". The adoption of FRS12 "Provisions, Contingent Liabilities and Contingent Assets" has given rise to a prior year adjustment as set out in note 1e below.

b. **Basis of consolidation**

The group accounts include the accounts of the company and its subsidiaries up to 31 December 1999. As permitted by the Companies Act 1985 a profit and loss account for Wessex Water Ltd is not presented. The profit attributable to shareholders of the company in the year was £82.6m (9 months to 31.12.98 - £91.7m).

c. **Associated undertakings**

The accounts incorporate the group's share of the results of associated undertakings, where material. The consolidated profit and loss account incorporates the group's share of profits less losses and the group's share of net assets is included in the consolidated balance sheet.

d. **Turnover**

Turnover for the group represents income receivable in the ordinary course of business, excluding VAT, for services provided to external customers outside of the group.

e. **Tangible fixed assets and depreciation**

Tangible fixed assets comprise infrastructure assets and other assets.

i. Infrastructure assets comprise a network of systems of mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines, sea outfalls and infrastructure investigations and studies. Expenditure on infrastructure assets relating to enhancements of the network is treated as additions which are included at cost after deducting connection charges and grants.

It has been necessary to change the method of accounting for infrastructure maintenance expenditure following the introduction of FRS12, as it is no longer possible to account for the difference between planned and actual expenditure on infrastructure renewals as a provision or prepayment. As a consequence the balance sheet has been restated to take account of necessary changes since 1 April 1989, when renewals accounting was first adopted in the accounts, and any previous provisions or prepayments have been subsumed into fixed assets. Further information is given in note 8. This change of accounting policy has no effect on the profit and loss account other than to reclassify the renewals charge as depreciation.

The depreciation charge for infrastructure assets is the estimated level of average annual expenditure required to maintain the operating capability of the network, based upon the company's independently certified asset management plan. No other depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

ii. Other assets include properties, plant and equipment and are shown at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Buildings and operational structures	15 - 80 years
Plant machinery and vehicles	3 - 30 years
Other assets	4 - 15 years

f. **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 charge being written off to the profit and loss account over the period of the lease in reducing amounts in relation to the outstanding obligations. The assets are depreciated over the shorter of their estimated useful lives and the period of the lease.

All other leases are regarded as operating leases. Rental costs arising under operating leases are written off in the year they are incurred.

g. **Grants and contributions**

Grants and contributions in respect of specific expenditure on non-infrastructure fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets. This is not in accordance with the Companies Act 1985 which requires assets to be stated at their purchase price or production cost, without deduction of grants and contributions which would be accounted for as deferred income. The departure from the requirements of the Act is, in the opinion of the directors, necessary to give a true and fair view. This is because infrastructure assets are not depreciated and accordingly the related grants and contributions would not be recognised through the profit and loss account. The effect on the value of fixed assets is disclosed in note 8.

h. **Investments**

Investments held as fixed assets are stated at cost less any provisions for impairment. Those held as current assets are stated at the lower of cost and net realisable value.

i. **Stock**

Stock and work in progress are stated at the lower of cost and net realisable value. In respect of work in progress, costs include labour, materials and attributable overheads. Long term contract turnover and profit are recognised according to the value of work done. Where amounts received are different from the turnover recognised, they are included in debtors or creditors according to the circumstances of each individual contract.

j. **Foreign currency**

All transactions of UK companies denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the dates of the transactions. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. The results of overseas subsidiaries are translated at average rates of exchange for the year. Differences arising from the translation of retained profits at closing rates are taken to reserves, as are differences on the translation of opening balance sheets and foreign currency funding.

k. **Interest rate instruments**

Interest rate instruments are used to hedge against interest rate movements on the group's external financing. Interest payable or receivable is accounted for on an accruals basis over the life of the hedge.

l. **Research and development**

Research and development expenditure is written off in the period in which it is incurred.

m. **Goodwill**

Goodwill arising on acquisition, being the excess of purchase consideration over the fair value of assets and liabilities acquired, relating to acquisitions on or after 1 April 1998, is held on the balance sheet and amortised over its useful economic life. On acquisitions before 31 March 1998 goodwill was eliminated immediately against reserves.

n. **Taxation**

The charge for taxation is based on the profit for the period adjusted in accordance with tax legislation. Tax deferred or accelerated is accounted for in respect of all material timing differences to the extent that it is probable that a liability or asset will crystallise. Timing differences arise from the inclusion of items of income and expenditure in tax computations in periods different from those in which they are included in the accounts. Provision is made at the rate which is expected to apply when the liability or asset crystallises.

o. **Pensions**

The cost of providing benefits is charged to the profit and loss account on a basis designed to spread the cost over the expected average service lives of employees. Differences between the amounts funded and amounts charged to the profit and loss account are treated either as provisions or prepayments in the balance sheet. The pension schemes are of the defined benefit type, which are externally funded and valued by an independent actuary.

p. **Cash flow**

Under the provisions of FRS1 (Revised) the company has not prepared a cash flow statement because its ultimate parent company Azurix Corp., which is incorporated in Delaware, USA, prepares consolidated accounts which include the accounts of the company and which contain a cash flow statement.

2 Segmental analysis

Substantially all of the turnover, operating profit and net assets derive from activities within the United Kingdom.

	12 months to 31.12.99 £m	9 months to 31.12.98 £m
a. Turnover		
Water supply	90.6	66.2
Waste treatment	197.3	146.6
	287.9	212.8
b. Operating profit		
Water supply	40.0	25.4
Waste treatment	109.2	73.2
	149.2	98.6
c. Net assets		
Water supply	374.6	345.3
Waste treatment	765.5	684.1
Interest bearing operating liabilities	(413.7)	(124.9)
	726.4	904.5

3 Operating profit

a. Operating profit is shown after charging/(crediting) the following items:

	12 months to 31.12.99 £m	9 months to 31.12.98 £m
Manpower costs (note 4)	28.1	18.9
Materials and consumables	16.5	12.1
Other operational costs	46.2	37.1
Exceptional cost of acquisition of the company by Azurix Europe Ltd	-	12.5
Depreciation of fixed assets – as restated	47.7	33.5
Amortisation of grants and contributions	(0.7)	(0.6)
Loss on disposals of fixed assets	0.9	0.7
	138.7	114.2

Exceptional costs associated with the acquisition of the company by Azurix Europe Ltd were expensed by the group. These included advisors' fees and compensation in respect of cancelled share option schemes.

b. Operational costs include:

	12 months to 31.12.99 £m	9 months to 31.12.98 £m
Operating leases for plant and machinery	0.5	0.5
Other operating leases	0.4	0.3
Research and development	0.3	0.2
Directors' remuneration (note 4)	0.7	0.8
Audit fees	0.1	0.1

4 Employment costs

		12 months to 31.12.99 £m	9 months to 31.12.98 £m
a.	Total employment costs of the group:		
	Wages and salaries	37.4	23.7
	Social security costs	2.7	1.8
	Other pension costs	2.2	2.6
		42.3	28.1
b.	Total employment costs are charged as follows:		
	Capital schemes	12.9	8.3
	Infrastructure renewals expenditure	1.3	0.9
	Manpower costs	28.1	18.9
		42.3	28.1

			31.12.99	31.12.98
c.	Monthly average number of employees during the period	- Engineering department	213	185
		- All other staff	1,238	1,225
		- Total	1,451	1,410

		12 months to 31.12.99 £000	9 months to 31.12.98 £000
d.	Total directors' remuneration		
	Fees	-	45
	Salary	643	556
	Bonuses	-	171
	Benefits in kind	47	37
		690	809

5 directors have benefits accruing under defined benefits pension schemes (31.12.98 – 5).

e.	Remuneration of highest paid director		
	Salary	256	149
	Bonus	-	47
	Benefits in kind	11	7
		267	203

The highest paid director had an accrued pension entitlement of £145,823 at 31 December 1999 (31.12.98 - £123,672).

	12 months to 31.12.99 £m	9 months to 31.12.98 £m
5 Net interest payable		
On bank loans	24.6	8.1
On other loans	0.5	0.4
On finance leases	4.5	3.9
Total interest payable	29.6	12.4
Inter company interest receivable	(3.9)	-
Share of interest receivable of associated undertaking	-	(0.3)
Other interest receivable	(3.1)	(1.2)
Total interest receivable	(7.0)	(1.5)
Net interest payable	22.6	10.9

6 **Taxation**

a. Taxation on profit on ordinary activities

UK corporation tax at 30.25% (1998 – 31%)	14.2	19.4
Advance corporation tax utilised relating to prior years	(9.5)	(16.2)
Payment for group relief	7.5	0.4
Share of tax charge of associated undertaking	-	1.7
Capital gains tax on disposal of associated undertaking	-	2.2
	12.2	7.5

The cumulative amount of advance corporation tax written off of £26.4m (1998 - £35.9m) remains available to reduce future liabilities to UK corporation tax.

b. Deferred taxation

No deferred tax has been provided as projections indicate that the potential liability will not crystallise within the foreseeable future. The full potential amount of deferred taxation calculated at 30% on all timing differences is as follows:

Accelerated capital allowances	225.7	215.2
Other timing differences	(4.5)	(4.8)
Advance corporation tax recoverable	(26.4)	(35.9)
	194.8	174.5

Included in accelerated capital allowances are timing differences on infrastructure assets.

7 **Dividends**

Ordinary shares		
Interim dividend 1999	55.7	-
Final dividend 1999	37.8	-
Ordinary dividend reinstated (note 18c)	198.3	-
	291.8	-
Preference shares – non equity		
For the period 1 January 1998 to 9 December 1998	-	5.3
	291.8	5.3

8 Tangible fixed assets

	Freehold land and buildings	Infra-structure assets	Plant machinery and vehicles	Other assets	Payments on account and assets in course of const-ruction	Group Total
	£m	£m	£m	£m	£m	£m
Cost						
At 1 January 1999 (restated)	381.1	600.9	401.0	31.6	92.9	1,507.5
Exchange difference	(0.1)	-	(0.2)	-	-	(0.3)
Additions	4.8	31.9	29.0	4.0	83.4	153.1
Transfers on commissioning	8.2	26.2	16.0	0.5	(50.9)	-
Disposals	(0.7)	-	(6.3)	(1.4)	(0.8)	(9.2)
Grants and contributions	-	(3.7)	-	-	-	(3.7)
At 31 December 1999	393.3	655.3	439.5	34.7	124.6	1,647.4
Depreciation						
At 1 January 1999 (restated)	70.0	106.4	152.9	17.7	-	347.0
Exchange difference	-	-	(0.1)	-	-	(0.1)
Provision for year	6.3	11.2	25.5	4.7	-	47.7
Disposals	(0.3)	-	(5.4)	(1.3)	-	(7.0)
At 31 December 1999	76.0	117.6	172.9	21.1	-	387.6
Net Book Value						
At 31 December 1999	317.3	537.7	266.6	13.6	124.6	1,259.8
At 1 January 1999 (restated)	311.1	494.5	248.1	13.9	92.9	1,160.5

Infrastructure assets comprise a network of systems of mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines, sea outfalls, and infrastructure investigations and studies.

Other assets include furniture and fittings, laboratory and other equipment.

The net book value of assets held under finance leases is £80.4m (31.12.98 - £82.3m).

The depreciation charge for the period on assets held under finance leases is £1.9m (9 months to 31.12.98 - £1.4m).

The net book value of infrastructure assets at 31 December 1999 is stated after the deduction of grants and contributions amounting to £51.0m (31.12.98 - £47.3m) in order to give a true and fair view (see note 1g).

Included in the cost of infrastructure assets is £124.3m (31.12.98 - £ 109.7m) of expenditure on maintaining the network previously charged to the infrastructure renewals provision, and £117.6m (31.12.98 - £106.4m) of depreciation previously included in the profit and loss account as an infrastructure renewals charge (note 1e). This prior year adjustment has not had any impact on the profit of the company in either period.

Included in freehold land and buildings above is an amount of £6.3m (31.12.98 - £6.3m) in respect of land which is not depreciated.

9 **Investments**

	Group	Company	Company	Company
	Associated undertakings	Subsidiary companies	Associated undertakings	Total
	£m	£m	£m	£m
Cost				
At 1 January 1999	0.4	96.5	0.4	96.9
Additions	-	1.2	-	1.2
Disposals	-	-	-	-
At 31 December 1999	0.4	97.7	0.4	98.1
Amounts written off				
At 1 January 1999	-	13.1	-	13.1
Provision made	-	-	-	-
At 31 December 1999	-	13.1	-	13.1
Carrying value at 31 December 1999	0.4	84.6	0.4	85.0
Carrying value at 1 January 1999	0.4	83.4	0.4	83.8

The principal subsidiary companies and associated undertakings are listed in note 26.

10 **Stock**

	Group	
	31.12.99	31.12.98
	£m	£m
Stock	0.4	0.4
Work in progress	1.8	1.8
	2.2	2.2

11 **Debtors**

	Group		Company	
	31.12.99	31.12.98	31.12.99	31.12.98
Amounts falling due within one year	£m	£m	£m	£m
Trade debtors	30.9	38.3	-	-
Amounts owed by subsidiary companies	-	-	81.2	131.8
Amounts owed by immediate parent company (note 18c)	91.0	198.3	90.0	198.3
Other debtors	5.6	5.7	-	-
Prepayments and accrued income	27.6	22.4	1.3	-
	155.1	264.7	172.5	330.1

An infrastructure renewals prepayment of £3.3m at 31 December 1998 has been included in fixed assets (see note 8). A loan of £90.0m was made to Azurix Europe Ltd. The loan is a floating rate sterling loan repayable in October 2002 with interest based on LIBOR plus 0.5%.

12 **Investments**

The market value of listed investments at 31 December 1999 was £2.0m (31.12.98 - £2.7m).

13 **Creditors - amounts falling due within one year**

Bank overdraft repayable on demand	0.9	0.6	-	-
Loans repayable	13.2	258.2	4.8	15.0
Obligations under finance leases	15.1	13.0	-	-
Trade creditors	2.8	9.6	-	-
Dividends	37.8	-	37.8	-
Other creditors	1.8	0.6	-	-
Corporation tax	22.5	27.2	0.8	5.1
Other taxation and social security	0.8	0.7	-	-
Accruals and deferred income	95.3	91.3	0.1	0.9
	190.2	401.2	43.5	21.0

14 Creditors - amounts falling due after more than one year

		Group 31.12.99 £m	Group 31.12.98 £m
Loans repayable	- within 1-2 years	33.3	3.3
	- within 2-5 years	1.6	34.9
	- after 5 years	100.0	-
		134.9	38.2
Obligations under finance leases	- within 1-2 years	17.6	15.2
	- within 2-5 years	20.3	37.9
		37.9	53.1
Bond	- after 5 years	296.7	-
Other		2.7	2.6
		472.2	93.9

15 Provisions for liabilities and charges

	Group			
	at 1 January 1999 £m	Provided £m	Utilised £m	at 31 December 1999 £m
Pensions	5.7	0.8	(0.1)	6.4
Office relocation	2.9	0.3	(1.5)	1.7
Restructuring costs – severances	-	3.2	(0.6)	2.6
	8.6	4.3	(2.2)	10.7

The company had a provision for restructuring costs of £0.4m at 31 December 1999 (31.12.98 – nil).

The adoption of FRS12 "Provisions, Contingent Liabilities and Contingent Assets" did not give rise to any restatement of provisions.

16 Deferred income

Grants and contributions	Group 31.12.99 £m	Group 31.12.98 £m
At 1 January (1 April)	22.5	22.9
Received in the period	0.5	0.2
Less amortisation	(0.7)	(0.6)
At 31 December	22.3	22.5

17 Called up share capital

	Group and Company 31.12.99 £m	Group and Company 31.12.98 £m
Authorised		
346,666,670 ordinary shares of 60p each	208.0	208.0
Allotted and fully paid		
219,585,986 ordinary shares of 60p each	131.8	131.8

18 Reserves

	Capital redemption reserve £m	Share premium account £m	Profit & loss account £m
Group			
At 1 January 1999	120.8	29.0	622.9
Issue costs	-	(0.2)	-
Cancellation of capital redemption reserve	(120.8)	-	120.8
Foreign exchange adjustment	-	-	(0.5)
Retained loss for the year	-	-	(177.4)
At 31 December 1999	-	28.8	565.8
Company			
At 1 January 1999	120.8	29.0	142.9
Issue costs	-	(0.2)	-
Cancellation of capital redemption reserve	(120.8)	-	120.8
Retained loss for the year	-	-	(209.2)
At 31 December 1999	-	28.8	54.5

a. As permitted by Section 230 of the Companies Act 1985, a profit and loss account of the parent company is not presented. The profit attributable to the company is £82.6m (31.12.98 - £91.7m) after dividends from subsidiary companies of £69.5m (31.12.98 - £54.9m).

b. The group's profit and loss account reserve is stated net of cumulative goodwill eliminated on acquisition in prior years of £14.5m (31.12.98 - £14.5m).

c. On the redemption of the preference shares on 9 September 1998 no capital redemption reserve was established by the company (as required by Section 170 Companies Act 1985) and the profit and loss reserve was not reduced by a corresponding amount (£90.3m, being the nominal value of the preference shares then redeemed). Dividends of £125.0m and £73.3m were subsequently declared and such amounts were paid to the immediate parent company in December 1998. As a result of the redemption of the preference shares, these amounts exceeded the profits then available for distribution, although this was not recognised at the time by the company due to the appropriate reserve transfers having not been made. The company obtained counsel's advice to the effect that the aggregate amount of such dividends was held by the immediate parent company on constructive trust for the company and was therefore treated as an amount receivable from the immediate parent company in the financial statements at 31 December 1998 (note 11).

On 21 July 1999 the company by Special Resolution, confirmed by Order of the High Court, cancelled its capital redemption reserve of £120.8m, creating additional attributable reserves which enabled the company to declare dividends of £200.3m (£198.3m were re-declared relating to 1998) out of distributable profits. The release of debt held on constructive trust by the immediate parent company was treated as satisfaction for these dividends.

19 Reconciliation of movements in shareholders' funds

	Group 31.12.99 £m	Group 31.12.98 £m	Company 31.12.99 £m	Company 31.12.98 £m
Profit attributable to shareholders	114.4	88.9	82.6	91.7
Dividends	(291.8)	(5.3)	(291.8)	(5.3)
	(177.4)	83.6	(209.2)	86.4
Share capital issued	-	4.2	-	4.2
Preference shares redeemed	-	(154.5)	-	(154.5)
Share premium	(0.2)	3.3	(0.2)	3.3
Scrip dividend	-	19.7	-	19.7
Goodwill written back	-	134.5	-	-
Foreign exchange adjustment	(0.5)	0.3	-	-
Net (reduction)/addition to shareholders' funds	(178.1)	91.1	(209.4)	(40.9)
Opening shareholders' funds	904.5	813.4	424.5	465.4
Closing shareholders' funds	726.4	904.5	215.1	424.5

20 Financial instruments

Short term debtors and creditors have been excluded from the financial instruments disclosure other than £29.2m of short term borrowings.

The group has financed its activities through a combination of short term borrowings, long term loans and leases and a bond issued by a subsidiary company Wessex Water Services Finance Plc.

The company uses derivative financial instruments to reduce the exposure to foreign currency fluctuations and to limit the exposure to floating interest rates.

The principal borrowings are both fixed rate and in sterling.

a. Interest rate and currency exposure

	Fixed rate borrowings £m	Floating rate borrowings £m	Total borrowings £m
Sterling	349.7	110.7	460.4
US dollar	30.0	-	30.0
Italian lira	8.1	-	8.1
Swiss franc	-	0.2	0.2
At 31 December 1999	387.8	110.9	498.7

The interest rates and period to maturity of the fixed rate borrowings are as follows:

	Interest rate %	Period years
Sterling	6.06	8.3
US dollar	6.04	1.8
Italian lira	5.16	2.5
Weighted average	6.04	7.6

£10.9m of floating rate borrowings are short term, and £100.0m are long term with interest rates moving in line with LIBOR.

b. Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arms length transaction between willing parties, other than a forced or liquidation sale.

	Book value £m	Fair value £m
Borrowings less than 1 year	29.2	29.2
Floating rate borrowings over 1 year	100.0	100.0
Fixed rate borrowings over 1 year	369.5	304.5
At 31 December 1999	498.7	433.7

The fair value of short term and floating rate borrowings approximate to book value. The fair value of long term fixed rate borrowings has been calculated using market values or discounted cash flow techniques.

c. Interest rate and currency swaps

US dollar borrowings of $51.0m at floating rates have been swapped into sterling borrowings of £30.0m at fixed rates, and through further interest rate swaps have been fixed at 6.04%.

Italian lira borrowings of ITL17,850m at fixed rates have been swapped into sterling borrowings of £8.1m at floating rates and through further interest rate swaps have been fixed at 5.16%.

21 Commitments

a. Operating lease payments under leases on land and buildings due within the next year in respect of leases which expire:

	31.12.99	31.12.98
	£m	£m
Between 2 and 5 years	0.3	0.2
Over 5 years	-	0.2
	0.3	0.4

b. At 31 December 1999 the group had interest rate and currency instrument agreements outstanding with commercial banks with a principal value of £169.9m (31.12.98 - £301.3m).

c. Capital expenditure contracted but not provided at 31 December 1999 was £78.1m (31.12.98 - £78.3m).

22 Contingent liabilities and guarantees

a. Wessex Water Ltd has provided performance guarantees on behalf of SC Technology AG on the tendering for contracts, the maximum liability in respect of which, at 31 December 1999 was £1.6m (31.12.98 - £3.8m).

b. Wessex Water Ltd had given a parent company guarantee in respect of an SC Technology contract that has been completed to commission a sludge treatment plant for Dublin Corporation. The company was notified by the Dublin Corporation that should the plant fail to operate satisfactorily legal proceedings will be commenced under the guarantee.

At this stage the directors are not able to quantify the value of the liability, should it arise.

23 Pensions

The defined benefit schemes operated by the group, which cover the majority of staff, are the Wessex Water Pension Scheme (WWPS) the Wessex Water Mirror Image Pension Scheme (WWMIS) and the Wessex Water Executive Pension Scheme (WWEPS). The assets are held in separate trustee administered funds. The pension cost charged to the profit and loss account has been determined on the advice of independent qualified actuaries and is such as to spread the cost of pensions over the service lives of the members of the schemes.

The pension cost for the year, including amounts set aside for early retirees, was £2.2m (9 months to 31.12.98 - £2.6m).

The latest full actuarial valuations for WWPS, WWMIS and WWEPS were undertaken as at 31 December 1998. The projected unit method was used for the WWPS valuation and the attained age method for the WWMIS and WWEPS valuations. The assumptions which have the most significant effect on the results of a valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment returns would be 6.25% per annum for all schemes, that salary increases would average 3.5% per annum and that present and future pensions would increase at the rate of 2.5% per annum. The market value of the WWPS assets as at 31 December 1998 was £112.4m, for WWMIS £40.6m and for WWEPS £2.7m. The valuation showed that the actuarial value of the assets at 31 December 1998 represented 118%, 124% and 117% of the actuarial value of the accrued benefits for the WWPS, WWMIS and WWEPS respectively.

The WWMIS and the WWEPS have been merged into the WWPS with effect from 1 January 2000. Some benefit improvements were awarded as part of the merger process. The impact of the merger will be reflected in pension costs from 1 January 2000 onwards. The next actuarial valuation will be as at 31 December 2001.

24 **Related party transactions**

There are no related party transactions requiring disclosure in these accounts.

25 **Wessex Water Services Ltd - dividend policy**

The policy adopted by the board of Wessex Water Services Ltd is to declare ordinary dividends of two thirds of the historic profit attributable to shareholders, subject to a current cost ordinary dividend cover of one.

26 **Principal subsidiary companies and associated undertakings**

a. Subsidiary companies

Wessex Water Ltd owns 100% of the issued ordinary share capital of each subsidiary company.

Company	Country of incorporation and operation	Principal activities
Wessex Water Services Ltd	United Kingdom	Water supply and waste water services
Wessex Water Trustee Company Ltd	United Kingdom	Trustee of employee share scheme
Wessex Water BV	Netherlands	Financial services
SC Technology AG	Switzerland	Waste treatment processes
Wessex Water Services Finance Plc *	United Kingdom	Issue of bond
Wessex International Water Services Ltd	United Kingdom	Membrane technology

* 100% owned by Wessex Water Services Ltd

Other subsidiary companies are dormant or not material to the group.

b. Associated undertakings

Wessex Water Ltd owns 50% of the management shares and 53% of the funding shares of Brunel Insurance Company Ltd, an insurance company incorporated and operating in Guernsey.

27 **Ultimate parent company**

The company is 100% owned by Azurix Europe Ltd, a UK company which prepares group accounts including the accounts of the company. The directors consider the ultimate parent company to be Azurix Corp. a Delaware corporation, and the consolidated accounts of this company are available as part of its filing with the Securities and Exchange Commission, which can be accessed through the Commission's office or its website www.sec.gov.

28 ***Going concern***

The current liabilities of the group exceed its current assets. The directors have considered the financial position of the group and have concluded that it will be able to meet its liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least 12 months from the date of approval of these accounts.