

report and accounts

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Directors' Report

Principal Activity and Review of the Year

Glas Cymru is a company limited by guarantee established for the sole purpose of acquiring and owning Dŵr Cymru Cyfyngedig ("Welsh Water"). Its constitution requires that all financial surpluses generated by the business are retained and reinvested for the benefit of Welsh Water and its customers, and that no group company can diversify into unrelated commercial activities.

In April 2001 Welsh Water implemented an outsourced procurement strategy under which around 85% of its annual expenditure is now carried out by specialised service providers selected following a competitive bid process. As a consequence of this strategy, over 1,600 staff transferred from Welsh Water to contracting partners

During 2002/03 Welsh Water commenced work on preparing its strategic business plan and investment requirements and priorities for the period 2005 to 2010. Our strategy for managing the next Price Review is distinctive. In line with our policy of being open and transparent, Welsh Water will publish its draft strategic business plan in full and engage with and try to secure a consensus with stakeholders generally as regards investment priorities and affordability of customer bills.

The operational and financial performance of the group during the year ended 31 March 2003 is described in the Chairman's Review and the Financial Review on pages 3 to 7 and 20 to 23. These, together with the financial statements on pages 43 to 74, confirm that service levels have generally improved and that the financial performance of the business is generally ahead of the projections reported in the Information Memorandum dated 4 May 2001, and on target to deliver forecast financial reserves (Regulatory Capital Value less net debt) of £400 million by 31 March 2005.

Directors

The names and a short biography of each director is set out on pages 24 and 25. All directors were in office throughout the year. No director is or has been party to, or has any interest in, any significant contract with any group company (other than directors' service contracts).

Alison Carnwath, Geraint Talfan Davies and Tony Hobson will retire by rotation and submit themselves for re-appointment at the Annual General Meeting on 4 July 2003, in accordance with Article 46 of the Articles of Association.

Details of the remuneration of individual directors and of the remuneration strategy approved by the Board are included in the Remuneration Report for the year ended 31 March 2003 set out on pages 31 to 35. A resolution will be proposed at the Annual General Meeting to receive and adopt this report.

Members

Glas Cymru has 56 Members. No new Members have been appointed, but two Members have resigned and have not been replaced at this time. The process for the appointment of Members is set out on page 25. The names and brief details of Members can be found on the Glas Cymru's website (www.glascymru.com) or may be requested from the Company Secretary.

Employees

It is the policy of all group companies to treat employees without discrimination and to operate equal opportunity employment practices designed to achieve this. At the financial year end Welsh Water employed 142 people and further information on our approach to managing staff relations is set out on pages 16 and 17. Other than the directors of the Company, Glas Cymru has no employees.

We seek to maintain an awareness among staff of our key corporate objectives and performance, and other material factors affecting the business. During 2002/03 staff received information through a series of seminars chaired by the Managing Director, attended by substantially all staff, and through routine monthly briefings with managers and publication of key messages and publications on our staff Intranet.

Welsh Water's procurement strategy fundamentally changed the manner in which services are delivered to customers and made it an imperative that we develop effective two-way communications with all individuals involved in service delivery. During 2002/03 we have further developed "alliances" in which partner contractors are encouraged to work with Welsh Water and develop a "one-team"

Directors' Report cont'd

approach in the delivery of Welsh Water's business plan. To aid this objective, all key contractor staff have access to our staff Intranet as the primary source of key business and performance information.

Environment

We are committed to improving the operational and environmental performance of the business, and this is monitored each month by the Quality and Environment Committee of the Board. During 2002/03 we commenced a study to benchmark the wider environmental performance of our business with companies in the water sector and other leading environmental performers. The output from this exercise will be the publication of new environmental targets covering all the main environmental impacts of our business.

Research and development

All expenditure on research and development is incurred by Welsh Water, which continues to monitor and selectively participate in water industry R&D initiatives, most notably through membership of UK Water Industry Research Limited. Through this we aim to maintain Welsh Water's achievements in improving operational efficiency, and to ensure continued compliance with appropriate national and international standards for potable water, sewage effluent and sludge treatment. Welsh Water also benefits from a sharing of best practice from the R&D investment and initiatives of our outsourced service partners.

Payment to suppliers

The policy of all group companies is to comply with terms of payment negotiated with suppliers. A copy of Welsh Water's published Procurement Policy is available on request from the Company Secretary and may be obtained from Welsh Water's website (www.dwrcymru.com).

The average payment in the period was 90 days (2002: 96 days). Regulations require that in calculating this we include within trade creditors monies retained under contract in respect of capital investment projects. This level of retentions varies from year to year and adversely affects the average payment for the year.

Contributions for charitable and political purposes

During the year charitable donations amounted to £20,600 (2002: £16,000). Glas Cymru policy is to target any donations on conservation and education, and to community projects connected with Welsh Water's capital investment programme. No payments were made, directly or indirectly, for political purposes, save in respect of nominal value relating to members of staff who have been permitted time off to undertake duties as local councillors.

Welsh language policy

All group companies welcome dealing with customers and other stakeholders in Welsh or English and aims to provide an equally effective standard of service in both languages.

Regulatory accounts

Condition F of the Instrument of Appointment under which Welsh Water operates requires that Welsh Water publish separate regulatory accounts. These accounts will be published on Welsh Water's website or will otherwise be available on request from the Company Secretary after 31 July 2003.

Auditors

During the year PricewaterhouseCoopers became a limited liability partnership (LLP). As a consequence on 7 February 2003 PricewaterhouseCoopers resigned as auditors of each group company and the directors appointed PricewaterhouseCoopers LLP to fill the casual vacancy created by this resignation. Having indicated their willingness to continue in office, a resolution to appoint PricewaterhouseCoopers LLP as auditors to Glas Cymru will be proposed at the Annual General Meeting.

Annual General Meeting

The Annual General Meeting will be held at The National Botanic Garden of Wales, Middleton Hall, Llanarthne, Carmarthen, SA32 8HG at 11.00 am on Friday 4 July 2003. The Notice of Annual General Meeting (including Agenda and Explanatory Notes) is set out in a separate document.

Directors' Report cont'd

The business of the AGM includes the approval of the Directors' Report and Financial Statements and the Remuneration Report for the year ended 31 March 2003, the re-appointment of three Directors who retire by rotation and offer themselves for re-appointment, and the appointment of PricewaterhouseCoopers LLP as auditors. There is also a resolution to comply with the Political Parties, Elections and Referendums Act 2000. All resolutions are matters of "ordinary business" for the Annual General Meeting that will be addressed each year.

Post balance sheet events

On 16 April 2003 Dŵr Cymru (Financing) Limited issued an additional £85 million of indexed linked bonds, and on 28 April 2003 Welsh Water published version 2 of its Procurement Plan.

By order of the Board



R. G. Curtis LLB ACIS
Company Secretary
12 June 2003

Remuneration Report

The Board is pleased to submit its second Report on Remuneration for approval by the Members of Glas Cymru at the 2003 Annual General Meeting.

Remuneration Committee

The committee is chaired by Alison Carnwath and comprises all the Non-Executive Directors, except the Group Chairman. The Managing Director and Group Chairman attend meetings of the Committee by invitation. All members of the Committee are independent of management and save for their Directors' fees have no financial interest in the Company.

The role of the Remuneration Committee is to approve and implement the remuneration policy and specifically:

- To review annually and agree with the Board the broad policy and framework for the remuneration of executive management and senior employees;
- To agree the terms of Executive Directors' service contracts and remuneration; and
- To determine the nature and scale of short and longer term incentive performance arrangements that encourage enhanced performance and reward individuals in a fair and responsible manner for their contribution to the success of the company.

In its work the Committee considers the Principles of Good Governance and Code of Best Practice (the Combined Code). The Company Secretary attends all meetings and provides information and advice for the Committee as necessary from within and outside the Company, including from the principal professional advisors to the Committee, Monks Partnership, Barnett Waddingham and Linklaters & Alliance.

Remuneration Policy

The remuneration policy is designed to support the recruitment, motivation and retention of employees in a competitive market place and to implement remuneration arrangements which align as closely as practicable the interests of the individual with the interests of the customers of Welsh Water. Accordingly, a high proportion of the remuneration of executive directors is "at risk".

Specifically, the remuneration policy:

- Sets base salaries initially below market levels (assessed against a comparator group of companies of similar nature and complexity), typically around lower quartile; and

- Sets incentive bonuses across a broad range of performance measures relevant to customers.

Currently the comparator group of companies comprises the UK water companies listed on The London Stock Exchange and other comparable companies in the FTSE250. The Remuneration Committee assesses the appropriateness of the comparator group of companies used in determining remuneration policy on an annual basis.

Scope of remuneration arrangements for executive directors

The remuneration of each Executive Director comprises a basic salary, a potential annual performance related bonus and a potential separate long-term performance related bonus. The performance related bonus arrangements are designed to align any executive bonuses with improved customer service and the financial performance of the business.

Salary

Salaries are reviewed annually and were last reviewed in September 2002 when they were increased by 4% to:

Mike Brooker	£182,000
Nigel Annett	£130,000
Chris Jones	£130,000

Performance Related Bonus

Executive Directors may earn an annual bonus of up to 80% of basic salary of which up to 50% is assessed against delivery of customer service performance targets and up to 30% is assessed against the annual financial performance of the Company. Annual bonus payments are non pensionable.

The customer service performance element of the annual bonus is measured by reference to an overall service assessment published by OFWAT.

The extent to which awards will be earned under this element of the bonus will depend on the relative ranking of Welsh Water compared to the other water and sewerage companies. Both absolute ranking and improvement in ranking will be rewarded, and a fall in the Company's ranking will be penalised.

Remuneration Report cont'd

The Remuneration Committee has reserved the discretionary power to modify this element of the scheme to reflect any revision by OFWAT of its service performance measures.

Included within the overall service assessment are non-financial performance measures for:

- Water supply: interruptions to supply, restrictions on supply and drinking water compliance
- Sewerage measures: sewage flooding incidents and quality of effluent discharges to the environment
- Customer service performance: speed of response to telephone and written billing enquiries and handling of written complaints.

The financial performance element of the annual bonus is measured against pre-capital expenditure cash-flow targets, after net interest payable. Cash-flow is the clearest single measure of financial performance that captures the short-term drivers of the business. Each year the Remuneration Committee determines appropriate cash-flow targets and the level at which maximum bonus should be paid, and the level below which no bonus would be paid.

In September 2002, Executive Directors received an annual incentive bonus for the year ended 31 March 2002 equivalent to 55.3% of salary. Of this 39% related to performance against customer service targets and 16.3% to meeting financial targets.

Long term performance related bonus

This scheme has been developed recognising that under the Glas Cymru structure share based incentives are neither appropriate nor possible. The scheme which has been established for Executive Directors is linked to the long-term financial performance of the Company, determined on the basis of two measures:

- the increases in the Company's level of reserves, together with rebates paid to customers; and
- changes in the rating of each class of the Company's bonds.

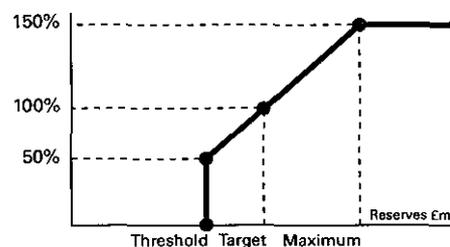
Growth in reserves captures the fundamental dynamics on which the objectives of Glas Cymru were founded. Improved performance and

efficiency in the way the business is financed and operated will all be captured by growth in financial reserves, the main use of which will, over time, be to deliver lower bills to the customers of Welsh Water. This therefore aligns the financial interests of Directors and senior managers in a direct and simple way with those of customers.

The level of accumulated reserves represents the best measure of the Company's long-term financial success. The scheme operates over a four-year period to 31 March 2005. The assessment of performance will be taken as the average of the balance of reserves at six month-ends – three either side of March 2005.

As in the case of the annual bonus scheme, vesting of any award will occur on a sliding scale against 'threshold' and 'maximum' level of performance targets set by the Remuneration Committee.

Reserves - Based Bonus



The award based on the level of reserves will then be adjusted (up or down) according to the credit rating change over the period on each class of bonds (providing that awards could never fall below zero).

Ratings - Based Adjustment

Improvement	Award
+4 points or more	+50%
+3 points	+30%
+2 points	+20%
+1 point	+10%
No change	0%
-1 point	-10%
-2 points	-20%
-3 points	-30%
-4 points or fewer	-50%

Remuneration Report cont'd

Half of any award earned under the long-term bonus scheme will be payable in July 2005 (i.e. at the end of the performance period in the month following publication of the Company's audited financial results). The remaining half will be deferred for two years and be paid on the second anniversary of the award with no further performance conditions. If a Director were to leave the company before that date (other than for retirement, redundancy, or reasons of ill health) the unpaid part of any award would be forfeited.

Pensions and Benefits

It is company policy to make provision for pensions for Executive Directors in respect of their basic salaries, but not in respect of annual bonuses or benefits. ³⁵

The Welsh Water Pension Scheme is a final salary occupational scheme and is subject to Inland Revenue limits. The Company has made a contractual commitment to two executive directors over the Inland Revenue "earnings cap". As at 31 March 2003, this liability totalled around £71,000.

The normal retirement age for Directors under the Welsh Water Pension Scheme is 60 and benefits accrue at 1/45th of salary per year of pensionable service, subject to an overall pension at normal retirement age of two-thirds of final pensionable salary.

The scheme also provides life cover of four times pensionable pay for death in service, a pension payable in the event of ill health and a spouses' pension payable on death.

Executive Directors receive a salary supplement (currently £8,500 per annum) in lieu of a company car and participate in a private health and medical insurance scheme.

Directors' emoluments (excluding pension benefits)

The table on page 34 reports emoluments payable in respect of the year ended 31 March 2003, and includes a best estimate of the performance related annual bonus relating to customer service performance. Performance related bonus is ordinarily paid in September, following publication by Ofwat in August of its annual Levels of Service Report which sets out the comparative performance of the ten water and sewerage companies of England and Wales. The extent to which this element of bonus is over or under estimated will be disclosed in the Remuneration Report for next year.

The Committee believes the presentation adopted to be the most meaningful as it allows a direct comparison of Directors' remuneration year on year. The information required to comply with the Companies Act is provided in full and is disclosed in the table and the supplementary notes. ³⁶

³⁵ Executive Directors' pensions

	Accrued Pensions (per annum)	Increase in accrued pension over year	Transfer value at 31 March 2002	Transfer value equivalent on increase	Transfer value at 31 March 2003	Contributions paid by director	Contributions paid by company
MP Brooker	£110,478	£9,633	£1,192,335	£113,912	£1,306,247	£11,439	£22,878
NC Annett	£33,670	£9,006	£133,341	£48,405	£181,746	£7,800	£15,600
CA Jones	£24,313	£8,361	£70,698	£35,393	£106,091	£8,310	£16,620

Remuneration Report cont'd

36 Directors, emoluments (excluding pension benefits)

The following emoluments were earned by the Directors in respect of the financial year ended 31 March 2003.

2002/2003	T Bums	MP Brooker	NC Annett	CA Jones	JM Bryant	A Camwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary	-	£182,000	£130,000	£130,000	-	-	-	-	-	£442,000
Bonus 2002/03 Provision ¹	-	£100,100	£71,500	£71,500	-	-	-	-	-	£243,100
Benefits in Kind ²	-	£9,265	£12,413	£8,950	-	-	-	-	-	£30,628
Fees	£140,000	-	-	-	£35,000	£35,000	£35,000	£35,000	£35,000	£315,000
Total emoluments relating to 2002/03	£140,000	£291,365	£213,913	£210,450	£35,000	£35,000	£35,000	£35,000	£35,000	£1,030,728

The following emoluments were earned by the Directors in respect of the financial year ended 31 March 2002.

2001/2002	T Bums	MP Brooker	NC Annett	CA Jones	JM Bryant	A Camwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary	-	£158,933	£118,167	£118,167	-	-	-	-	-	£395,267
Interim bonus as provided in Report and Accounts for 2001/02 ³	-	£54,250	£38,750	£38,750	-	-	-	-	-	£131,750
Final bonus paid ⁴	-	£42,525	£30,375	£30,375	-	-	-	-	-	£103,275
Total bonus	-	£96,775	£69,125	£69,125	-	-	-	-	-	£235,025
Benefits in Kind ²	-	£7,517	£12,265	£7,105	-	-	-	-	-	£26,887
Fees	£140,000	-	-	-	£35,000	£35,000	£35,000	£35,000	£35,000	£315,000
Total emoluments relating to 2001/02	£140,000	£263,225	£199,557	£194,397	£35,000	£35,000	£35,000	£35,000	£35,000	£972,179

Notes

- The financial statements for the year ended 31 March 2003 include a provision of £243,100 (55% of base salary) for bonus potentially payable to Executive Directors for performance in the financial year 2002/03. This provision has been estimated on the basis that performance on Ofwat's Overall Performance Assessment (OPA) will improve to 4th position from 5th position considered appropriate in respect of 2001/02 (see note 4 below). The final amount to be paid to each director will be determined when OFWAT publishes OPA results for 2002/03 in the Autumn of 2003 and could be higher or lower.
- Benefits in kind relate to receipt of car and fuel benefits, private medical insurance and life insurance; Executive Directors can receive a non-pensionable salary supplement in lieu of receiving a company car.
- A performance bonus of £131,750 was provided for in the Report and Accounts for 2001/02 and was estimated on the basis that OPA performance would improve from 7th position in 2000/01 to 6th position 2001/02.
- The actual performance bonus in respect of 2001/02 was paid in September 2002, following the publication of Ofwat's OPA report for 2001/02, and amounted to £235,025 (i.e. 55% of salary). The Remuneration Committee decided that it was appropriate to pay the performance related bonus on the basis of a ranking of 5th place, rather than the 3rd place published by Ofwat, due to a change to the basis of assessment proposed by Ofwat in respect of UV treatment compliance.
- In 2001 CA Jones and NC Annett were each awarded £100,000 bonus in respect of the year ended 31 March 2001, which predates the company's acquisition of Welsh Water. This bonus was payable 50% in 2001/02, with 25% being deferred and payable in each of 2002/03 and 2003/04.
- The highest paid director is MP Brooker, aggregate emoluments: £291,365 (2002: £263,225, including the bonus of £42,525 in respect of performance in 2001/02 which was not provided for in the Report and Accounts for that year (see note 4 above).

Remuneration Report cont'd

Service Contracts

The Executive Directors have service contracts that are subject to one year's notice.

Directors' service contracts do not provide for compensation to be payable in the event of early termination by the Company, and the policy of the Remuneration Committee in the event of termination would be to mitigate any contractual liability to the fullest extent possible.

External appointments

At 31 March 2003, no Executive Director had any external fee paying appointment. However, the Company recognises the benefit of broadened experience that might be achieved through involvement in external activities. Any such appointments would be subject to annual approval by the Remuneration Committee and, subject to the Committee's agreement, an individual director may retain any fees.

Remuneration Policy for non-executive directors

Responsibility for determining the fees of the Chairman and of the Non-Executive Directors sits with the Board. The fees payable to the Chairman and the Non-Executive Directors are determined through comparison with fees paid to directors of UK companies of similar size and complexity. The fees have been set to reflect the time commitment of Directors to the affairs of Glas Cymru. Fees were reviewed with effect from 1 June 2003, having originally been fixed in May 2001 for two years.

Chairman	£150,000	(£140,000)
Non-Executive Directors	£40,000	(£35,000)

No additional amount is payable for the chairmanship of, or membership of, Board committees or for the undertaking of any special responsibilities on behalf of the Board. Non-Executive Directors do not receive any benefits in kind.

The Chairman and the Non-Executive directors are appointed under letters of appointment, which may be terminated by either party on three month's notice. No compensation is payable by the company on termination of an appointment.

Compliance with the Combined Code

The Directors confirm that the Company has complied with the provisions of the Combined Code relating to Directors' remuneration throughout the financial year ended 31 March 2003.

Alison Camwath
Chair - Remuneration Committee
12 June 2003



Corporate Governance

Introduction

Glas Cymru is committed to high standards of corporate governance. This has been, and remains, critical to maintaining our credentials as an efficient, low-risk provider of an essential public service in the eyes of the Welsh Water's customers and regulators, and Glas Cymru's bondholders and other stakeholders.

Glas Cymru complied throughout the year with the Principles of Good Governance and Best Practice as annexed to the Listing Rules of the United Kingdom Listing Authority (the "Combined Code"), except in respect of the formal appointment of a senior independent director which is referred to below. Not all of the provisions of the Combined Code apply to Glas Cymru as a company limited by guarantee.

Corporate Governance is monitored by the Members of Glas Cymru and by Ofwat, Welsh Water's economic regulator, as compliance with the Combined Code is a regulatory obligation enshrined in the Licence of Welsh Water. In addition, bondholders and other stakeholders use compliance with the Combined Code, alongside our financial performance, as critical tests of the performance of the Board.

The Board

The role of the Board is to set the strategic direction of the business and to review its operating and financial performance. The Board meets monthly and has adopted a formal schedule of matters reserved to the Board, which can only be amended by the Board.

Appointments to the Board are the responsibility of the full Board on recommendation of the Nominations Committee. New directors have a formal induction programme. All directors submit themselves for re-election at the annual general meeting at least once every three years.

The Board is comprised of three executive directors and six non-executive directors (including the chairman). Accordingly, a majority of the Board are independent non executive directors with a wide and relevant business experience and whose remuneration consists only of fees. They have access to all information relating to the Group; the advice and services of the company secretary; and, as required, independent external advice at the expense of the company.

There is a clear division of responsibility between the chairman and the managing director whose roles, with those of the executive directors, are clearly defined so as to give no individual unfettered powers of decision. The managing director is responsible for the day-to-day management of the business and for implementation of policies and procedures adopted by the Board.

The Board attaches high importance to maintaining good relationships with all key stakeholders. Members of Glas Cymru have regular opportunity to meet with directors and all Members attended at least one of the three Members Meetings since April 2002. Board members, including the chairmen of the key Board committees, attend meetings and are available to answer questions. All Members, including those unable to attend any meeting, receive a written brief of issues discussed; including questions either asked of directors at the meeting or pre-registered in advance.

In addition, bondholders may request a meeting with an independent non-executive director at any time. Regular communication is also maintained with the economic and quality regulators of Welsh Water, and during the year the Board met with the Director General of Water Services, the Director Wales of the Environment Agency and with the Chairman of Water Voice (Wales). As a result of these opportunities the Board has concluded that the nomination of a senior independent director would not improve governance and have not appointed one.

In addition to the formal committees of the Board described on pages 38 and 39 the Board has also designated "special responsibilities" to a number of non-executive directors, covering important areas such as procurement, communications and government and regulation.

The Board receives a rolling programme of presentations and meetings with senior managers to ensure they become and remain familiar with all significant aspects of the business, and external training for directors is provided where appropriate.

Together these arrangements enable the Board to exercise control over all significant aspects of the group's business.

Corporate Governance cont'd

Directors

The names and brief biographical details of each of the current directors can be found on pages 24 and 25 of the annual report, including respective dates of appointment as directors. Directors are appointed by the Board on the recommendation of the Nominations Committee. All directors receive a formal induction programme on appointment.

At the annual general meeting three directors, Alison Carnwath, Geraint Talfan Davies and Tony Hobson will retire and seek re-election in accordance with the Glas Cymru's articles of association. Directors are required to stand for re-election at least every three years.

Each of the executive directors has a written service contract subject to termination on twelve months notice. Each of the non-executive directors has a written letter of appointment subject to termination by the Board without payment of compensation.

Members

The role of the members of Glas Cymru is to ensure the business remains focused on its primary purpose of providing high quality water and sewerage services at least cost to the communities served by Welsh Water. In doing this, members carry out an important corporate governance role.

Members are appointed by the Board under Glas Cymru's published Membership Policy on the advice of an independent membership selection panel. No individual can be appointed a member without having first been recommended by the panel. The role of the panel is to recommend for membership individuals who in a written application have shown they have the skills, experience and interests to be effective members of Glas Cymru. In addition the panel is required to ensure that a balanced and diverse membership is maintained, which is as far as possible broadly reflective of the range of customer and other stakeholder interests served by Welsh Water.

During the year the panel reviewed the composition of the Membership and concluded that no change in number or composition of members was necessary or appropriate. The chairman of the panel also reviewed and confirmed compliance by Glas Cymru with the terms of the Membership Policy and surveyed the views of all members as regards the quality and frequency of information provided by the Company.

Membership of Glas Cymru is personal and Members are not appointed to represent any particular group or stakeholder interest. No new Members were appointed during 2002/03; however, two Members have resigned and have not been replaced at this time.

Details of the membership policy and the members of Glas Cymru can be obtained from the company secretary or from the Glas Cymru website (www.glascymru.com.)

Other stakeholders

Like all the other water businesses in England and Wales, Welsh Water operates within a regulatory framework prescribed by the Water Industry Act 1991. The economic regulator is Ofwat, which is responsible for setting the limits on the prices that Welsh Water can charge, and overseeing Welsh Water's overall performance.

The regulator with responsibility for drinking water quality is the Drinking Water Inspectorate, which is part of the Department of the Environment Food and Rural Affairs and acts on behalf of the National Assembly for Wales in respect of Welsh Water.

The Environment Agency oversees Welsh Water's environmental performance, especially with regard to the way in which it abstracts water from rivers and reservoirs, and then disposes of wastewater after it has been treated. All aspects of Welsh Water's water and wastewater operations are subject to extensive performance monitoring against targets set by regulators and Government.

Water Voice Wales is an independent committee which represents water and sewerage customers by handling individual concerns and complaints and by seeking to influence policy at company, national and European level. Representatives of Welsh Water attend all Water Voice Wales public meetings.

Corporate Governance cont'd

Each year the regulators publish reports commenting on and comparing the performance of water companies across a full range of measures, including cost efficiency, customer service, water quality and environmental quality.

The National Assembly for Wales has a key role in determining the priorities for water quality and environmental quality standards and improvements, as well as setting the framework for other public policy matters such as social considerations arising from water tariff structure, metering and competition.

All of these regulators have strong powers at their disposal that can be used in the event that Welsh Water's performance is not up to standard.

Committees of the Board

There are four formal committees of the Board each of which has written terms of reference, which define the role and responsibilities of the committee and which are reviewed annually. These are the Audit Committee, the Remuneration Committee, the Nominations Committee and the Quality and Environment Committee. Membership of the various committees is set out on pages 24 to 25 of the annual report. The respective chairman reports the outcome of each committee meeting to the Board and the Board receives the minutes of all committee meetings.

The Audit Committee comprises three non-executive directors and is chaired by Tony Hobson. It meets at least four times a year to:

- Review and advise the Board on the Group's interim and annual financial statements, its accounting policies and on the control of its financial and business risks;
- Review the nature and scope of the work to be performed by the external auditors and outsourced internal audit function, the results of their audit work and of the response of management;
- Make recommendations on the appointment and remuneration of external auditors and to monitor their performance; and to review the non-audit services provided to the Group by the external auditors to ensure the independence of the auditors is not compromised.

Both the Board and the external auditors have safeguards in place to prevent the compromise of the auditor's independence and objectivity. The Audit Committee meets with executive directors and management, as well as privately with both external and internal auditors. The terms of reference of the Audit Committee include all matters required by the Combined Code.

The role of the Remuneration Committee is to determine and agree with the Board the broad policy and framework for the remuneration of executive directors and senior managers. This committee also determines the nature and scale of incentive performance arrangements that encourage enhanced performance and which reward individuals in a fair and responsible manner for their contribution to the success of the business. The committee is chaired by Alison Carnwath and consists of all the non-executive directors, all of whom are independent of management. The committee meets as required, but at least twice in any financial year. The 2003 Remuneration Report approved by the Remuneration Committee is set out between pages 31 and 35 of the annual report and will be submitted for approval by Members at the Annual General Meeting.

The role of the Nominations Committee is to review the size, structure and composition of the Board and to make recommendations to the Board on any appointments that may be deemed necessary. This committee is chaired by the Chairman of the Board and meets as required. All the directors are members of this committee, although the chairman of any meeting must be an independent non-executive director and there must be a majority of independent non-executive directors at all meetings of the committee.

The role of the Quality and Environment Committee, which is chaired by Dame Deirdre Hine and meets each month, is to advise the Board on any issue relating to operational policy and practice in relation to compliance with drinking water regulations and environmental laws and regulations. This committee also reviews the performance of Welsh Water against agreed key performance indicators, with particular regard to matters of public health, health and safety and environmental impact.

The Quality and Environment Committee was established in recognition that where a large

Corporate Governance cont'd

proportion of the services of Welsh Water are provided by specialist contractors, that additional attention should be paid to the assessment and handling of hazard and risk. Members of this committee include two non-executive directors (including the chairman of the committee), two executive directors and two independent experts on the public health and operational aspects of water supply and environmental management.

The findings of the Quality and Environment Committee will be attached to Welsh Water's annual report to the Drinking Water Inspectorate and Environment Agency (the "Quality Regulators"). The Board is required to notify the Quality Regulators at once if it does not implement any recommendation made by this committee.

The operation of the committee is also subject to review by Welsh Water's Reporter (the independent consultant appointed by Welsh Water with the approval of Ofwat) who will report to Ofwat and the Quality Regulators on the effectiveness of Welsh Water's systems of internal control.

The annual report of the Quality and Environment Committee to the Board is a published document. Copies may be obtained on request from the company secretary or from the website.

Internal control

The Board has overall responsibility for the system of internal control and for monitoring its effectiveness. The implementation and maintenance of the internal control systems are the responsibility of executive directors and senior management.

Internal control systems are designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss. In assessing what constitutes reasonable assurance, the board has regard to materiality and to the relationship between the cost of and the benefit from the internal control systems.

Key features of the system of internal control include:

- An organisation with clearly defined lines of authority and accountability and established policies and procedures, reviewed annually, for all significant aspects of the company's business;
- A clear business process for the identification, evaluation and mitigation of hazard and risk, including regular reporting to the Board, the Audit Committee and the Quality and Environment Committee, and routine external verification through independent audit and internal quality management system procedures;
- A comprehensive annual budget and business plan and a clear process of monthly reporting to the Board of all aspects of the business's performance against that plan. Revised financial forecasts are prepared quarterly.
- Clear policies for the approval and control of major items of capital expenditure and for the acquisition and disposal of material assets or entering into of any arrangement that gives rise to, or could give rise to, a material liability for the company; and
- Effective arrangements for an internal audit function to carry out reviews of information systems and business and contract management control procedures, under a broadly based programme of activity approved by the Audit Committee. The internal audit programme is devised using risk assessment techniques having regard to all key aspects of the business.

The managing director chairs a risk management group, which includes senior managers from all parts of the business. Under a risk management strategy approved by the Board, the role of the risk management group is to review and challenge the robustness of risk management procedures within the business, including that of Welsh Water's contracting partners. Internal procedures encourage all staff (and contracting partners) to participate in open two-way dialogue so as to ensure that risk is captured and managed early and effectively, to learn from our own experience and the

Corporate Governance cont'd

experience of others to promote best practice and to improve the quality of service delivered to the customers of Welsh Water. Through the managing director, this group reports to the Board and to the Audit and Quality and Environment Committees of the Board at least every six months.

The results from the ongoing monitoring of financial, operational and compliance controls and the risk management process have been reported to the Board. The Board has consequently reviewed the effectiveness of the internal control systems over the course of the year.

Internal audit

It is the role of internal audit to advise management and the Board on the extent to which systems of internal control are effective and to provide independent and objective assurance that the process by which significant risks are identified, assessed and managed are appropriate and effectively applied. The internal audit work-plan is determined through a structured process of risk assessment and is approved by the Audit Committee.

During the financial year 2002/03 the conduct, but not the management, of internal audit activity was outsourced to Grant Thornton. The Audit Committee approves the annual plan for internal audit, which covers the scope, authority and resources of such activity.

Going concern

Having made due enquiry the Board has concluded that there is a reasonable expectation that the Glas Cymru and its subsidiaries has adequate resources to continue as a going concern for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2003 have been prepared on a going concern basis.

By order of the Board



R Curtis LLB ACIS
Company Secretary
12 June 2003

Directors' responsibilities for the financial statements

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and group as at the end of the financial year and of the profit or loss of the company and group for the year. In preparing the financial statements, the directors ensure that appropriate accounting policies have been adopted and applied consistently, and that reasonable and prudent judgements have been made. The directors also confirm that applicable accounting standards have been followed and that reasonable and prudent judgements and estimates have been made.

It is the directors' responsibility to maintain adequate accounting records and to institute and maintain systems and controls designed to safeguard the assets of the company and group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the Glas Cymru website is the responsibility of the directors. 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 report since it was initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

By order of the Board



R Curtis LLB ACIS
Company Secretary
12 June 2003

Independent auditors' report to the members of Glas Cymru Cyfyngedig

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 statement of accounting policies. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the *directors' remuneration report* ("the auditable part").

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration 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 and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report including the opinion has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to 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 whether the financial statements and the auditable part of the director's remuneration report have been 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, the unaudited part of the directors' remuneration report, the chairman's statement, the operating and financial review and the corporate governance statement.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

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 and the auditable part of the directors' remuneration report 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.

Independent auditors' report to the members of Glas Cymru Cyfyngedig *cont'd*

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;

the financial statements have been properly prepared in accordance with the Companies Act 1985; and

those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and
Registered Auditors.
Cardiff.

12 June 2003

Accounting Policies

A summary of the Group's principal accounting policies which have been consistently applied are set out below.

Basis of accounting

The financial statements are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions comply with the Companies Act 1985. An explanation of this departure from the requirements of the Companies Act 1985 is given in the "Grants and customer contributions" section and note 9(b).

Basis of consolidation

The consolidated financial statements include the financial statements of the company and all of its subsidiaries. The results of companies and businesses acquired during the year are dealt with in the consolidated financial statements from the date of acquisition. Intra-group transactions and profits are eliminated on consolidation.

Turnover

Turnover represents the income receivable in the ordinary course of business for services provided and excludes value added tax.

Goodwill

Negative goodwill arising on the acquisition of subsidiary undertakings and businesses, represents the difference between the fair value of the consideration given and the fair value of all the identifiable assets and liabilities acquired. Negative goodwill is included in the balance sheet and is amortised to the profit and loss account over its expected useful economic life.

Tangible fixed assets and depreciation

Tangible fixed assets comprise:

- (i) infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls); and
- (ii) other assets (including properties, overground operational structures and equipment, and fixtures and fittings).

The carrying value of tangible fixed assets is reviewed for impairment if circumstances dictate that they may not be recoverable.

Infrastructure assets

Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity, enhancements or replacements of the network is treated as additions which are 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 relevant subsidiary company's independently certified asset management plan.

Other assets

Other assets are included at cost less accumulated depreciation. Freehold land is not depreciated.

Other assets are depreciated over their estimated useful economic lives, which are principally as follows:

Freehold buildings	- up to 60 years
Leasehold properties	- over the lease period
Operational structures	- 40-80 years
Fixed plant	- 20-40 years
Vehicles, mobile plant, equipment and computer hardware & software	- 3-16 years

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

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 charges being written off to the profit and loss account over the period of the lease in reducing

Accounting Policies cont'd

amounts in relation to the written down amount. The assets are depreciated over the shorter of their estimated useful life and the lease period. All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the profit and loss account in the year to which they relate.

Grants and customer contributions

Grants and customer contributions relating to infrastructure assets have been offset against fixed assets (see note 9(b)). Grants and customer contributions in respect of expenditure on other 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.

Capital expenditure programme incentive payments

The group's agreement with its construction partners involved in delivering the capital expenditure programme incorporates incentive bonuses payable after completion of the programme in 2005. The cost of fixed asset additions includes an accrual for the proportion of incentive bonuses earned to date, relating to projects substantially completed at the year end, where the likelihood of making the incentive payment is considered probable.

Pension costs

The majority of the Group's employees belong to a pension scheme, which is funded by both employers' and employees' contributions and which is of the defined benefit type. Contributions are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the company. Contribution rates is based on the advice of a professionally qualified actuary. Any difference between the charge to the profit and loss account and contributions paid is shown as an asset or liability in the balance sheet.

Debt and debt issue costs

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. Debt issue costs are recognised in the profit and loss

account over the term of such instruments at a constant rate on the carrying amount.

Investments

Long term investments held as fixed assets are stated at cost less amounts written off or provided to reflect permanent diminution in value. Those held as current assets are stated at the lower of cost and net realisable value.

Financial instruments

Derivative instruments utilised by the group are currency swaps, currency forward exchange contracts and interest rate swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the group. Currency swap agreements and currency forward exchange contracts are translated at the rates ruling in the agreements and contracts.

Interest differentials, under swap arrangements used to manage interest rate exposure on borrowings and current asset investments, are recognised by adjusting interest payable or receivable as appropriate.

Research and development

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

Taxation

The charge for current taxation is based on the profit for the period as adjusted for disallowable and nontaxable items. In accordance with FRS19 "Deferred Tax" full provision is made for deferred tax arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. In adopting FRS19, the Group has chosen to discount deferred tax assets and liabilities.

Provision for insurance liabilities

Provision is made for all known and estimated liabilities arising from uninsured claims against the group where there is a present obligation that will result in transfer of economic benefits.

Consolidated profit and loss account for the year ended 31 March 2003

	Note	2003 £m	2002 £m
Turnover	2	462.9	406.1
Net operating costs	3	<u>(270.9)</u>	<u>(223.2)</u>
Operating profit		192.0	182.9
Profit on disposal of fixed assets	5	<u>4.2</u>	<u>0.8</u>
Profit on ordinary activities before interest		196.2	183.7
Net interest payable	6	<u>(128.0)</u>	<u>(110.4)</u>
Profit on ordinary activities before taxation		68.2	73.3
Taxation	7(a)	<u>(74)</u>	<u>(0.8)</u>
Profit on ordinary activities after taxation being retained profit for the year	22	60.8	72.5

All operations are continuing.

The group has no recognised gains and losses other than shown above, and therefore no separate statement of total recognised gains and losses has been presented.

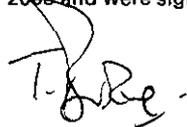
The 2002 comparatives include the results of Dŵr Cymru Cyfyngedig only from its acquisition on 11 May 2001.

Operating profit before interest, taxation, depreciation and amortisation (EBITDA) was £260.3 million (2002: £222.3 million).

**Consolidated balance sheet
at 31 March 2003**

Group	Note	2003 £m	2002 £m
Fixed assets			
Negative Goodwill	8	(94.0)	(138.0)
Tangible assets	9	2,500.7	2,358.1
Investments	10	-	0.2
		<u>2,406.7</u>	<u>2,220.3</u>
Current assets			
Debtors	11	61.8	64.0
Current asset investments	12	251.6	383.2
Cash at bank and in hand		3.4	-
		<u>316.8</u>	<u>447.2</u>
Current liabilities			
Creditors: amounts falling due within one year	13	(172.9)	(247.8)
Net current assets		<u>143.9</u>	<u>199.4</u>
Total assets less current liabilities		<u>2,550.6</u>	<u>2,419.7</u>
Creditors: amounts falling due after more than one year			
Creditors: amounts falling due after more than one year	13	(2,251.7)	(2,179.5)
Provisions for liabilities and charges	20	(128.1)	(129.1)
Deferred income	21	(37.5)	(38.6)
Net assets		<u>133.3</u>	<u>72.5</u>
Reserves			
Profit and loss account	22	133.3	72.5
Total reserves		<u>133.3</u>	<u>72.5</u>

The financial statements on pages 43 to 74 were approved by the Board of directors on 12 June 2003 and were signed on its behalf by:



Lord Burns
Chairman



M P Brooker
Managing Director



CA Jones
Finance Director

Company balance sheet at 31 March 2003

Company	Note	2003 £m	2002 £m
Fixed assets			
Investments	10	-	-
Current assets			
Bank and cash		0.1	-
Debtors - due after one year	11	3.4	5.2
		3.5	5.2
Current liabilities			
Creditors: amounts falling due within one year	13	3.5	(5.2)
Net current assets		-	-
Reserves			
Profit and loss account	22	-	-
Total reserves		-	-

The financial statements on pages 43 to 74 were approved by the Board of directors on 12 June 2003 and were signed on its behalf by:



Lord Bums
Chairman



M P Brooker
Managing Director



CA Jones
Finance Director

Consolidated cashflow statement for the year ended 31 March 2003

	Note	2003 £m	2002 £m
Cash inflow from operating activities	23	244.5	249.4
Returns on investments and servicing of finance			
Interest received		15.2	11.2
Interest paid		(168.5)	(57.6)
Interest element of finance lease payments		(12.2)	(9.0)
		(165.5)	(55.4)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(258.9)	(187.5)
Sale of tangible fixed assets		2.9	3.1
Grants and contributions received		10.2	7.4
		(245.8)	(177.0)
Acquisitions			
Adjustment to purchase consideration for subsidiary undertaking		2.9	-
Purchase of subsidiary undertaking		-	(4.2)
Cash balances acquired with subsidiary undertaking		-	49.5
		2.9	45.3
Cash (outflow)/inflow before use of liquid resources and financing		(163.9)	62.3
Management of liquid resources			
Purchase of commercial paper		(15.0)	(96.7)
Sale of commercial paper		15.0	98.0
Net decrease/(increase) in deposits		131.6	(179.2)
		131.6	(177.9)
Cash outflow before financing		(32.3)	(115.6)
Financing			
Long term loans received		99.0	120.0
Purchase of bonds		(41.3)	(15.0)
Capital element of finance lease payments		(6.0)	(4.3)
Loan repayments		(0.5)	(0.4)
		51.2	100.3
Increase/(decrease) in cash in the year	24	18.9	(15.3)

**Reconciliation of movements in reserves
for the year ended 31 March 2003**

	2003	2002
	£m	£m
At 1 April	72.5	-
Profit for the year transferred to reserves	60.8	72.5
At 31 March	<u>133.3</u>	<u>72.5</u>

Notes to the financial statements

1 Company profit and loss account

As permitted by section 230 of the Companies Act 1985, the parent company's profit and loss account has not been included in these financial statements. The parent company's retained loss for the year is £2,934 (2002 £27,142 loss).

2 Segmental analysis by class of business

(a) Turnover	2003 £m	2002 £m
Regulated water and sewerage activities	457.6	401.0
Non regulated activities	5.3	5.1
	462.9	406.1

(b) Profit on ordinary activities before taxation	2003 £m	2002 £m
Regulated water and sewerage activities		
Operating profit	191.1	182.7
Profit on disposal of fixed assets	3.7	1.4
Net Interest payable	(128.8)	(111.2)
	66.0	72.9
Non-regulated activities		
Operating profit	0.9	0.2
Profit /(loss) on disposal of fixed assets	0.5	(0.6)
Interest receivable	0.8	0.8
	2.2	0.4

(c) Net assets	2003 £m	2002 £m
Regulated water and sewerage activities	130.7	72.1
Non-regulated activities	2.6	0.4
	133.3	72.5

All turnover and profit before taxation, by origin and destination, was attributable to the UK.

Notes to the financial statements cont'd

3 Net operating costs

	Note	2003 Total £m	2002 Total £m
Operating charges from outsourced activities:			
- Operating services agreement		94.2	84.4
- Customer services agreement		19.2	16.6
- Laboratories and analytical services		8.0	7.5
- Other contracts		17.2	13.3
		138.6	121.8
Staff costs	4(b)	7.4	5.5
Research and development		0.1	0.1
Charge for bad and doubtful debts		10.0	8.7
Rates		20.3	18.0
Environment Agency charges		11.3	10.0
Rentals under operating leases		-	0.2
Fees paid to auditors	3(a)	0.2	0.2
Amortisation of grants and contributions	21	(1.4)	(1.3)
Own work capitalised		(4.0)	(3.2)
Net rents payable		1.1	1.6
Other operating charges		19.0	22.2
		202.6	183.8
Depreciation:			
- Own assets		43.1	35.3
- Assets held under finance leases		17.0	13.0
Infrastructure renewal charge		55.1	31.9
Amortisation of negative goodwill	8	(46.9)	(40.8)
		270.9	223.2

(a) Auditors' remuneration

Auditors during the period were PricewaterhouseCoopers LLP. They were used primarily for audit services, including regulatory audit services carried out to meet Ofwat reporting requirements.

	2003 £'000	2002 £'000
Statutory audit services	93	135
Regulatory audit services	22	21
Interim review	22	35
Other audit services	12	4
Tax advisory services	18	10
Other non-audit advisory services	30	-
	197	205

The Board has adopted a formal policy with respect to accounting services. The external auditor will not be used for internal audit services and all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee.

Notes to the financial statements cont'd

4 Directors and employees

(a) Directors' emoluments

Detailed disclosures of directors' individual emoluments are given in the Remuneration Committee report on pages 33 and 34. These disclosures are part of the financial statements.

(b) Staff costs	Note	2003 £m	2002 £m
Wages and salaries		6.0	4.8
Social security costs		0.5	0.1
Pension costs	30	0.9	0.6
		7.4	5.5

Of the above, £2.5m (2002: £2.0m) has been charged to capital.

(c) Average monthly number of employees during the year (including executive directors)	2003 Number	2002 Number
Regulated water and sewerage activities	142	136

5 Profit on disposal of fixed assets

	2003 £m	2002 £m
Profit on disposal of fixed assets	4.2	0.8

The profit disclosed above relates to the disposal of land and buildings during the year.

6 Net interest payable

	2003 £m	2002 £m
Interest receivable	15.6	12.9
Interest payable:		
On loans	(131.1)	(114.6)
On finance leases	(12.5)	(8.7)
Net interest payable	(128.0)	(110.4)

Notes to the financial statements cont'd

7 Taxation

(a) Analysis of charge in year	Note	2003 £m	2002 £m
Current tax:			
Charge for year	7(b)	-	-
Deferred Tax:			
Origination and reversal of timing differences		1.1	(5.7)
(Decrease)/increase in discount	20(a)	<u>(8.5)</u>	4.9
Total deferred tax		<u>(7.4)</u>	<u>(0.8)</u>
Tax charge on profit on ordinary activities		<u>(7.4)</u>	<u>(0.8)</u>

(b) Factors affecting current tax charge for year	2003 £m	2002 £m
Profit on ordinary activities before tax	<u>68.2</u>	<u>73.3</u>
Profit on ordinary activities multiplied by the corporation tax rate in the UK of 30%	20.5	22.0
Effects of:		
Amortisation of negative goodwill	(14.1)	(12.2)
Expenses not deductible for tax purposes	0.9	1.9
Capital allowances in excess of depreciation	(4.7)	(9.7)
Other timing differences	(0.5)	1.2
Income not chargeable for tax purposes	(2.1)	(2.6)
Tax losses utilised	-	(0.6)
Current tax charge for year	<u>-</u>	<u>-</u>

(c) Factors that may affect future tax charges

Based on current capital investment plans, the group expects to continue to be able to claim capital allowances in excess of depreciation in future years but at a slightly lower level than in the current year.

Notes to the financial statements cont'd

8 Intangible fixed assets – negative goodwill

	2003 £m
Cost:	
At 1 April 2002	(178.8)
Adjustment to purchase consideration	(2.9)
At 31 March 2003	(181.7)
Amortisation	
At 1 April 2002	40.8
Released in the year	46.9
At 31 March 2003	87.7
Net Book Value	
At 31 March 2003	(94.0)
At 31 March 2002	(138.0)

Negative goodwill is being released to the profit and loss account on a straight-line basis over the period from acquisition of the relevant subsidiary to 31 March 2005.

Notes to the financial statements cont'd

9 Tangible fixed assets - Group

(a) Analysis by type

Group	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Vehicles, plant, equipment & computer hardware & software £m	Total £m
Cost					
At 1 April 2002	40.9	1,393.4	1,664.8	195.7	3,294.8
Additions	-	154.3	102.4	14.1	270.8
Grants and contributions	-	(8.8)	-	-	(8.8)
Disposals	(4.7)	(1.0)	(2.8)	-	(8.5)
At 31 March 2003	36.2	1,537.9	1,764.4	209.8	3,548.3
Accumulated depreciation					
At 1 April 2002	17.9	343.9	433.3	141.6	936.7
Charge for the year	0.4	55.1	48.8	10.9	115.2
Eliminated on disposals	(1.8)	(1.0)	(1.5)	-	(4.3)
At 31 March 2003	16.5	398.0	480.6	152.5	1,047.6
Net book value					
At 31 March 2003	19.7	1,139.9	1,283.8	57.3	2,500.7
At 31 March 2002	23.0	1,049.5	1,231.5	54.1	2,358.1
Analysis of net book value at 31 March 2003					
Owned	19.7	989.7	934.1	57.3	2,000.8
Held under finance leases	-	150.2	349.7	-	499.9
	19.7	1,139.9	1,283.8	57.3	2,500.7

Tangible fixed assets at 31 March 2003 include £198.9m (2002: £158.4m) of assets in the course of a net construction, which are not depreciated until commissioned.

(b) The accounting treatment for grants and customer contributions in respect of infrastructure assets is described in the principal accounting policies on page 44. This treatment is not in accordance with Schedule 4 to the Companies Act 1985, which requires fixed assets to be shown at the purchase price or production cost and hence grants and contributions would be presented under the Act as deferred income. The treatment explained on page 44 has been adopted in accordance with section 227(6) of the Companies Act 1985 in order to show a true and fair view, as in the opinion of the directors, it is not appropriate to treat grants and contributions on infrastructure assets as deferred income. The fixed assets to which they relate do not have determinable finite lives and therefore no basis exists for releasing any deferred income to the profit and loss account. As a consequence, the net book value of fixed assets and deferred income is £178.6m (2002: £169.8m) lower than it would have been had grants and contributions been treated as deferred income indefinitely.

(c) The cost of additions include a net accrual of £13.4m (2002: £1.4m) in respect of capital expenditure programme incentive payments.

Notes to the financial statements cont'd

10 Fixed asset investments

(a) Group

Cost and net book value	2003 £m	2002 £m
At 1 April	0.2	-
On acquisition	-	0.2
Disposal	(0.2)	-
At 31 March	-	0.2

Equity of less than 10% in the following unlisted company:-

	Nature of Business	Country of Incorporation	Description of Holding
Water Research Centre (1989) plc	Water Research	Great Britain	"B" Ordinary Shares of £1

In addition, the group holds 5% Convertible Unsecured Loan Stock 2014 at a cost of £23,326 in Water Research Centre (1989) plc.

(b) Company

Cost and net book value	2003 £m	2002 £m
At 1 April	-	-
Additions	-	-
At 31 March	-	-

Principal group companies:-

The Company has a £1 investment in Glas Cymru (Securities) Cyfyngedig and has direct or indirect investments in the following subsidiary undertakings:-

	Principal Activity	Country of Incorporation	Holding
Dŵr Cymru (Holdings) Limited*	Holding company	England and Wales	100%
Dŵr Cymru Cyfyngedig*	Water and sewerage	England and Wales	100%
Dŵr Cymru (Financing) Limited*	Raising finance	Cayman Islands	100%
Welsh Water Utilities Finance Plc*	Raising finance	England and Wales	100%

* Indirect Holdings

Notes to the financial statements cont'd

11 Debtors

Group	2003 £m	2002 £m
(a) Amounts falling due within one year:		
Trade debtors	21.5	26.5
Other debtors	7.8	4.9
Prepayments and accrued income	32.3	32.4
	61.6	63.8
(b) Amounts falling due after more than one year:		
Other debtors	0.2	0.2
	61.8	64.0
Company	2003 £m	2002 £m
Amounts falling due after more than one year:		
Amounts owed by subsidiary undertakings	3.4	5.2
	3.4	5.2

12 Current asset investments - Group

Management of liquid resources

	2003 £m	2002 £m
Investments in:		
Fixed term and call deposits - due within one year	221.9	376.2
Fixed term and call deposits - due after one year	29.7	7.0
	251.6	383.2

Cash generated from operating activities and from long-term borrowings in advance of future capital expenditure obligations is invested. These investments include long-term deposits and corporate bonds. It is group policy that investments are restricted to deposits and securities, which have a recognised investment grade credit rating.

Notes to the financial statements cont'd

13 Creditors

Group	Note	2003 £m	2002 £m
(a) Amounts falling due within one year:			
Bank overdrafts		-	15.5
Other loans	14	0.5	0.6
Finance leases	15	1.8	1.1
Trade creditors		38.7	36.4
Capital creditors		33.9	35.6
Accruals		32.6	32.0
Other taxation and social security		0.4	2.8
Other creditors		65.0	123.8
		172.9	247.8
(b) Amounts falling due after more than one year			
Other loans	14	1,858.5	1,891.8
Obligations under finance leases	15	379.8	287.5
Other creditors - between one and five years		13.4	0.2
		2,251.7	2,179.5
(c) Loan reconciliation			
Original bond issue as at 10 May 2001		1,910.0	1,910.0
Add: Local authority loans		4.9	5.4
Less: bonds repurchased		(56.4)	(15.0)
Less: bond issue costs unamortised		(11.3)	(12.5)
Add: bond indexation		11.8	4.5
Loans as above		1,859.0	1,892.4
		2003	2002
Company		£m	£m
Amounts falling due within one year:			
Amounts owed to subsidiary undertaking		3.5	5.2
		3.5	5.2

As part of the group's bond programme a security package was granted by Dŵr Cymru Cyfyngedig (DCC) for the benefit of holders of senior bonds, finance lessors and other senior financial creditors.

The obligations of DCC are guaranteed by the company, Glas Cymru (Securities) Limited and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:

- i) A first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence; and
- ii) Fixed and floating security given by the guarantors referred to above which are accrued on each of these company's assets including, in the case Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

Notes to the financial statements cont'd

14 Other loans

Group	2003 £m	2002 £m
Loans are repayable as follows:		
Within one year	0.5	0.6
Between one and two years	0.5	0.6
Between two and five years	1.8	1.6
After more than five years	1,856.2	1,889.6
	1,859.0	1,892.4
Repayable wholly within five years	-	-
Repayable wholly after five years	1,854.1	1,887.0
Repayable by instalments of which some repayments are after five years	4.9	5.4
	1,859.0	1,892.4

	2003	2002
Interest rates on these loans ranged as follows:		
- Index linked debt	3.55% to 4.48%	3.54% to 4.42%
- Other debt	6.03% to 12.0%	6.03% to 12.0%

Costs directly attributable to the raising of debt are capitalised in accordance with FRS4 and are amortised to the profit and loss account over the term of the debt.

15 Finance leases

Group	2003 £m	2002 £m
Amounts due under finance leases within one year	1.8	1.1
Amounts due under finance leases between two and five years inclusive	24.8	11.2
Amounts due under finance leases after more than five years	355.0	276.3
Total	381.6	288.6

A long dated interest rate swap was arranged on 1 April 1994 which has the effect of fixing the rate of interest at 7.8% on floating rate sterling finance lease obligations of £53.8m. This obligation reduces over a term of 11 years.

Notes to the financial statements cont'd

16 Maturity of gross borrowings for group

The expected maturity profile of the group's gross borrowings, before unamortised bond issue costs of £11.3 million was as follows:

	Expected maturity	
	2003 £m	2002 £m
In less than one year	2.3	1.7
In more than one year but not more than two years	0.5	2.3
In more than two years but not more than five years	595.2	96.1
In more than five years	1,653.9	2,080.9
	2,251.9	2,181.0

17 Financial instruments and risk management

As part of the group's £1,910m bond issue on 10 May 2001, the group entered into £625m of interest rate and foreign currency swap contracts. The purpose of these swap contracts was to minimise the group's exposure to interest rate and currency risk.

The group only uses financial instruments, including derivatives, to manage financial and operational risk and does not undertake any speculative transactions nor does it use any complex financial instruments.

(a) Treasury policies

Treasury activities are managed within a formal set of treasury policies and objectives, which are reviewed regularly and approved by the Board. The policy specifically prohibits any transactions of a speculative nature and the use of complex financial instruments. We use financial instruments, including derivatives, to raise finance and manage risk from our operations.

Surplus cash is invested in short and medium term sterling financial investments. The Board annually establishes the investment criteria, which is restricted to banks and other financial institutions meeting required standards assessed by the major credit rating agencies. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may only be changed with the consent of Dŵr Cymru Cyfyngedig's security trustee (the "SecurityTrustee").

The group minimises exposure to currency risk in respect of foreign currency denominated borrowing by using appropriate derivative instruments to hedge these liabilities into sterling obligations.

The group hedges at least 85% of its total outstanding financial liabilities, including finance leases, into either index-linked or fixed rate obligations. For this purpose interest rate liabilities on floating rate liabilities are hedged through a combination of derivative instruments and cash balances. The regulatory framework, under which revenues and the regulatory asset value are indexed also exposed the group to inflation risk. Subject to market constraints and Board approval the group therefore seeks to raise new debt through index linked instruments or by entering into appropriate hedging transactions.

Liquidity risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of currencies, instruments, type and maturities. Our policy is to ensure that the maturity profile does not impose an excessive strain on our ability to repay loans. Under this policy no more than 20% of the principal of group borrowings can fall due in any twenty-four month period.

Notes to the financial statements cont'd

17 Financial instruments and risk management cont'd

We maintain committed banking facilities in order to provide flexibility in the management of the group's liquidity. There is also a special liquidity facility, which we are required to maintain in order to meet certain interest and other obligations that cannot be funded through operating cashflow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants.

(b) Short term debtors and creditors

These have been excluded from the financial instruments disclosures set out in the following paragraphs.

(c) Interest rate and currency swaps

The group has entered into swap agreements in order to manage the interest rate and currency exposure of its financial liabilities and not for trading or speculative purposes.

At 31 March 2003 the notional principal amounts outstanding of the group's interest rate swap agreements were £678.8m with termination dates ranging from March 2008 to March 2031 and interest rates ranging from 5.67% to 7.80%.

At 31 March 2003 the notional principal amount outstanding of the group's currency swap agreement was GBP 200m (USD 286m), with a termination date of March 2008.

(d) Interest rate profile of financial liabilities

The fixed, index-linked and floating rate interest profile of the group's financial liabilities after taking account of derivative instruments is:

2003	Fixed* £m	Index-Linked £m	Floating £m	Total £m
Bonds	1,368.6	496.8	-	1,865.4
Finance leases	53.8	-	327.8	381.6
Other loans	-	-	4.9	4.9
	<u>1,422.4</u>	<u>496.8</u>	<u>332.7</u>	<u>2,251.9</u>
Unamortised bond issue costs				(11.3)
				<u>2,240.6</u>

*Including £678.8m floating rate interest rate liabilities swapped into fixed interest rate liabilities through the swap agreements referred to in note 17(c) above.

2002	Fixed £m	Index-Linked £m	Floating £m	Total £m
Bank overdraft	-	-	15.5	15.5
Bonds	1,410.0	489.5	-	1,899.5
Finance leases	55.3	-	233.3	288.6
Other loans	-	-	5.4	5.4
	<u>1,465.3</u>	<u>489.5</u>	<u>254.2</u>	<u>2,209.0</u>
Unamortised bond issue costs				(12.5)
				<u>2,196.5</u>

Notes to the financial statements cont'd

17 Financial instruments and risk management cont'd

As at 31 March 2003 £251.6m (2002: £254.2m) of the floating rate interest liabilities were hedged through floating rate cash balances.

The floating rate interest liabilities on the finance leases are based on agreed margins to LIBOR and will therefore fluctuate from year to year. Interest rates on the other loans of £4.9m have varied from 6.4% to 7.8% during the year.

The bonds were issued by a subsidiary company, Dŵr Cymru (Financing) Limited. The finance leases and other loans are obligations of Dŵr Cymru Cyfyngedig.

The weighted average interest rates and expected maturities of the fixed rate financial liabilities are:

2003	Weighted average interest rate	Weighted average expected maturity
Bonds:		
- Index-linked	3.9%	26 years
- Fixed interest rate	7.0%	13 years
Finance leases	7.8%	11 years
<hr/>		
2002	Weighted average interest rate	Weighted average expected maturity
Bonds:		
- Index-linked	3.8%	27 years
- Fixed interest rate	7.1%	14 years
Finance leases	7.8%	12 years

(e) Interest rate profile of financial assets

2003	Fixed £m	Floating £m	Total £m
Short-term deposits	250.3	-	250.3
Call deposit account	-	1.3	1.3
Cash	-	3.4	3.4
	<hr/> 250.3	<hr/> 4.7	<hr/> 255.0
<hr/>			
2002	Fixed £m	Floating £m	Total £m
Short-term deposits	350.5	-	350.5
Call deposit account	-	32.7	32.7
	<hr/> 350.5	<hr/> 32.7	<hr/> 383.2

The sterling money market deposits above comprise deposits placed on money markets from overnight to twenty-eight months. Short-term deposits are at fixed interest rates. The weighted average interest rate on commercial paper and money market deposits held during the year was 4.5% and the weighted average length of deposit held was 20 days.

Notes to the financial statements cont'd

17 Financial instruments and risk management cont'd

The interest rate applied to the call deposit account is variable, and is calculated in accordance with market convention.

(f) Committed borrowing facilities available

The group has various undrawn committed borrowing facilities.

These facilities available at 31 March 2003 were as follows:

	2003 £m	2002 £m
Authorised loan facilities	150.0	150.0
Overdraft	20.0	20.0
Liquidity facility	150.0	150.0
	320.0	320.0

The authorised loan facilities expire on 9 May 2006. The overdraft is repayable on demand.

The liquidity facility is renewable on an annual basis. The facility may be drawn if and to the extent that a liquidity provider does not renew the facility and is unable to find a replacement liquidity provider.

(g) Fair values of financial instruments

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

In the table below, the fair value of current asset investments, and borrowings less than one year approximates to book values due to the short maturity of these instruments.

The fair value of borrowings, over one year has been determined by reference to prices available from the financial markets on which these borrowings are traded.

Notes to the financial statements cont'd

17 Financial instruments and risk management cont'd

2003	Book value £m	Fair value £m
Non-derivatives:		
Assets:		
Current asset investments	255.0	255.0
Liabilities:		
Borrowings less than 1 year	(2.3)	(2.3)
Fixed rate borrowings over 1 year	(800.0)	(904.7)
Indexed-linked borrowings over 1 year	(485.0)	(588.2)
Floating rate borrowings over 1 year	(952.9)	(952.9)
Derivatives:		
Floating rate borrowings of £678.8m are hedged by the interest rate and currency swaps referred to in note 17(c) above. The fair values of these swaps are as follows:		
Interest rate swaps	-	(93.6)
Currency swaps	-	(0.3)
<hr/>		
2002	Book value £m	Fair value £m
Non-derivatives:		
Assets:		
Current asset investments	383.2	383.2
Liabilities:		
Borrowings less than 1 year	(1.7)	(1.7)
Fixed rate borrowings over 1 year	(800.0)	(839.4)
Indexed-linked borrowings over 1 year	(485.0)	(551.6)
Floating rate borrowings over 1 year	(917.3)	(917.3)
	(15.5)	(15.5)
Derivatives:		
Floating rate borrowings of £678.8m are hedged by the interest rate and currency swaps referred to in note 17(c) above. The fair values of these swaps are as follows:		
Interest rate swaps	-	(40.3)
Currency swaps	-	0.8
<hr/>		

As at 31 March 2002 and 2003 there were no unmatched derivative financial instruments.

Notes to the financial statements cont'd

17 Financial instruments and risk management cont'd

(h) Gains and losses on hedges

Changes in the fair value of instruments used as hedges are not recognised in the financial statements unless the hedge contract is terminated before maturity. An analysis of these unrecognised gains and losses, which are based on valuations provided by the relevant swap counterparties, is as follows:

	Gains £m	Losses £m	Total net gains/losses £m
2003			
Unrecognised gains and losses on hedges at 31 March 2003	-	(93.9)	(93.9)
Of which:			
- Gains/(losses) expected to be recognised in the year ended 31 March 2004	-	(5.8)	(5.8)
- Gains/(losses) expected to be recognised after the year ended 31 March 2004	-	(88.1)	(88.1)
2002			
Unrecognised gains and losses on hedges at 31 March 2002	0.8	(40.3)	(39.5)
Of which:			
- Gains/(losses) expected to be recognised in the year ended 31 March 2003	(3.3)	(8.2)	(11.5)
- Gains/(losses) expected to be recognised after the year ended 31 March 2003	4.1	(32.1)	(28.0)

18 Capital commitments

Group	2003 £m	2002 £m
Contracted for but not provided in the financial statements	<u>64.5</u>	<u>77.8</u>

In order to meet additional quality and service standards, together with growth and new demands, the group has capital investment obligations over the next two years amounting to approximately £489.5m, (2002: £740m) in the regulated water and sewerage business.

The company has no expenditure contracted for but not provided in the financial statements at 31 March 2003 (2002: £nil).

Notes to the financial statements cont'd

19 Leasing commitments

Group	Land and buildings	
	2003 £m	2002 £m
At 31 March 2003 there were revenue commitments, in the ordinary course of business in the next year for the payment of rentals on non cancellable operating leases expiring:		
after five years	0.4	0.4
	0.4	0.4

The company has no lease commitments (2002: £nil).

20 Provisions for liabilities and charges

Group	Note	2003 £m	2002 £m
Deferred taxation	(a)	83.8	76.4
Restructuring provision	(b)	4.5	5.1
Contract management provision	(c)	0.8	0.9
Provision for uninsured losses	(d)	5.5	4.0
Provision for loss on swap closure	(e)	18.0	20.0
Provision for fair value adjustment	(f)	15.5	22.7
		128.1	129.1

(a) Deferred taxation

	2003 £m	2002 £m
Tax effect of timing differences		
Excess of tax allowances over depreciation	335.6	335.8
Other timing differences	(5.5)	(4.6)
Undiscounted provision for deferred tax	330.1	331.2
Discount	(246.3)	(254.8)
Discounted provision for deferred tax	83.8	76.4
Provision at 1 April	76.4	-
On acquisition of subsidiary	-	75.6
Deferred tax charge on profit and loss account for period	7.4	0.8
Provision at 31 March	83.8	76.4

The undiscounted provision for deferred tax represents the tax effect of timing differences which are expected to crystallise over periods of up to 85 years. This provision has been discounted using UK Government gilt rates to reflect the impact of such long time periods on the value of the liability to the company.

Notes to the financial statements cont'd

20 Provisions for liabilities and charges cont'd

(b) Restructuring provision

This provision at 31 March 2003 is in respect of payments to be made relating to surplus property, which will be utilised over the next six years.

	2003 £m
At 1 April	5.1
Utilised in the year	(0.6)
At 31 March	<u>4.5</u>

(c) Management contract provision

This provision is in respect of expected costs of terminating sewerage management contracts on 31 March 2001 and the TUPE arrangements of the employees within that contract. It is anticipated that the provision will be utilised over the next twelve months.

	2003 £m
At 1 April	0.9
Utilised in the year	(0.1)
At 31 March	<u>0.8</u>

(d) Provision for uninsured losses

This provision is in respect of uninsured losses and its utilisation period is uncertain due to the nature of insurance claims.

	2003 £m
At 1 April	4.0
Charge to profit & loss account	2.7
Utilised in the year	(1.2)
At 31 March	<u>5.5</u>

(e) Provision for loss on swap closure

£8.5m (2002: £9.8m) of this provision is the unamortised balance of a fair value provision relating to an acquired subsidiary's swap. At the time of acquisition the subsidiary held an interest rate swap contract with a contracted rate significantly higher than market rates prevailing at that time. In accordance with accounting standards a provision was made to reflect the liability arising from the higher contracted rate. The provision is being released to the profit and loss account over the life of the swap which expires on 31 March 2031.

The balance of £9.5m (2002: £10.2m) is the unamortised balance of a liability that arose on the cancellation of certain interest rate swap contracts. These contracts were redeemed early and the loss arising on redemption was settled by setting a higher rate on another swap contract. This provision is being released to the profit and loss account over the life of the revised swap, which expires on 31 March 2031.

Notes to the financial statements cont'd

20 Provisions for liabilities and charges cont'd

(e) Provision for loss on swap closure cont'd

	2003 £m
At 1 April	20.0
Utilised in the year	(2.0)
At 31 March	<u>18.0</u>

(f) Provision for fair value on contract for difference

This provision is the unamortised balance of a fair value provision relating to Dŵr Cymru Cyfyngedig's Contract for Difference (CfD) swap contract. This fixed the price of the operations and customer outsourcing contracts before the contracts were awarded in 2001. Subsequently, the actual price of the outsourcing contracts were in total below the CfD price. In accordance with accounting standards a fair value provision was made to reflect the loss arising on the CfD swap. This provision is being released to the profit and loss account over the life of the CfD swap, which expires on 31 March 2005.

	2003 £m
At 1 April	22.7
Utilised in the year	(7.2)
At 31 March	<u>15.5</u>

21 Deferred Income - Group

Deferred income relates to income received and receivable upon completion of assets under construction and will be credited to the profit and loss account over the lifetime of those assets.

	2003 £m	2002 £m
At 1 April	38.6	-
Deferred income arising on acquisition of subsidiary	-	39.3
Received and receivable during the year	0.3	0.6
Released to profit and loss account	(1.4)	(1.3)
At 31 March	<u>37.5</u>	<u>38.6</u>

22 Reserves

	Group Profit & Loss Account £m	Company Profit & Loss Account £m
At 1 April 2002	72.5	-
Profit retained for the year	60.8	-
At 31 March 2003	<u>133.3</u>	-

Notes to the financial statements cont'd

23 Cash flow from operating activities

	2003 £m	2002 £m
Operating profit	192.0	182.9
Depreciation of tangible fixed assets	60.1	44.3
Infrastructure renewal charge	55.1	35.9
Amortisation of negative goodwill	(46.9)	(40.8)
(Increase)/decrease in debtors	(3.3)	43.7
Decrease in creditors	(4.7)	(10.5)
Decrease in restructuring provisions	(7.8)	(6.1)
Cash flow from operating activities	<u>244.5</u>	<u>249.4</u>

24 Reconciliation of net cash flow to movement in net debt

	2003 £m	2002 £m
Increase/(decrease) in cash in the year	18.9	(15.3)
Debt acquired with purchase of subsidiary	-	(2,088.7)
Bank deposits and commercial paper acquired with purchase of subsidiary	-	205.3
Movements in bank deposits and commercial paper during the year	(131.6)	177.9
Increase in loans during the year	(51.2)	(100.3)
Bond issue costs acquired with subsidiary	-	13.6
Write-off of unamortised bond issue costs	(1.2)	(1.1)
Indexation of index-linked debt	(7.3)	(4.5)
	<u>(172.4)</u>	<u>(1,813.1)</u>
Net debt at start of year	<u>(1,813.3)</u>	<u>(0.2)</u>
Net debt at end of year	<u>(1,985.7)</u>	<u>(1,813.3)</u>

Notes to the financial statements cont'd

25 Analysis of net debt

	At 1 April 2002 £m	Cash Flow £m	Non- Cash Items £m	At 31 March 2003 £m
Net cash:				
Bank and cash	-	3.4	-	3.4
Bank overdraft	(15.5)	15.5	-	-
	(15.5)	18.9	-	3.4
Liquid resources:				
Current asset investments	383.2	(131.6)	-	251.6
Finance leases	(288.6)	(93.0)	-	(381.6)
Debt falling due within one year	(0.6)	0.5	(0.4)	(0.5)
Debt falling due after one year	(1,899.8)	41.3	0.4	(1,858.1)
	(2,189.0)	(51.2)	-	(2,240.2)
Bond issue costs capitalised	12.5	-	(1.2)	11.3
Indexation of index-linked debt	(4.5)	-	(7.3)	(11.8)
	(2,181.0)	(51.2)	(8.5)	(2,240.7)
Net debt	(1,813.3)	(163.9)	(8.5)	(1,985.7)

As defined in the bond covenants, net debt (including accrued interest and capitalised bond issue costs) was £2,013 million as at 31 March 2003 (2002: £1,884 million).

26 Acquisition of subsidiary undertakings

On 11 May 2001 Glas Cymru (Securities) Cyfyngedig, a 100% owned subsidiary of Glas Cymru Cyfyngedig acquired the entire issued share capital of Dŵr Cymru (Holdings) Limited, the parent company of Dŵr Cymru Cyfyngedig, Dŵr Cymru (Financing) Limited and Welsh Water Utilities Finance plc.

Last year the fair value adjustments were disclosed as provisional. Since that date there have been no further fair value adjustments.

27 Directors' and officers' loans and transactions

No loans or credit transactions with any directors, officers or connected persons existed during the year or were outstanding at the year end.

Notes to the financial statements cont'd

28 Elan Valley Trust Fund

In 1984 Welsh Water Authority entered into a conditional sale and purchase agreement with Severn Trent Water Authority for the sale of the aqueduct and associated works by which the bulk supply to Severn Trent reservoirs is conveyed.

The sum of £31.7m, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Welsh Water Authority, whilst preserving the capital value of the fund in real terms. Welsh Water Authority's interest in this fund was vested in Dŵr Cymru Cyfyngedig under the provisions of the Water Act 1989. The assets of the fund are not included in these financial statements.

Interest receivable includes £1.3m (2002: £1.2m) in respect of the Elan Valley Trust Fund.

29 Related party transactions

In accordance with the exemption afforded by FRS 8 there is no disclosure in these financial statements of transactions with entities that are part of the Glas Cymru Cyfyngedig group.

30 Pensions

Following the acquisition of Dŵr Cymru Cyfyngedig by Glas Cymru Cyfyngedig a new pension scheme for current employees was introduced on 1 December 2001. Under these arrangements, employees had the right to transfer their past service and benefits to the new scheme. Subsequent to the year end on 29 April 2003, these transfers were completed in respect of all employees who formally elected to transfer during the year.

As at 31 March 2003, the membership of the scheme consisted of 136 active members, 1 deferred pensioner and 1 pensioner. Furthermore, the expected future working lifetimes of the active members is around 12 years.

The first formal valuation of the new scheme is due in September 2003. An informal actuarial valuation of the new scheme as at 31 March 2003 but taking into account the transfer discussed above, identified an actuarial deficit of approximately £6m. The current company contribution is 12% per annum but this will be revisited when the formal valuation is complete. The pension cost during the year was £0.9m (2002: £0.3m).

Disclosures required by FRS17 "Retirement benefits"

Additional disclosures regarding the defined benefit pension scheme are required under the transitional provisions of FRS 17 "Retirement benefits" and these are set out below. The disclosures relate to the second year of the transitional provisions. They provide information which will be necessary for the full implementation of FRS 17.

Taking into account the characteristics of the scheme, the use of discount rates prescribed by FRS17 would be expected to generate a significant difference between the FRS17 valuation of the scheme and an actuarial valuation.

Notes to the financial statements cont'd

30 Pensions cont'd

An informal valuation of the new scheme at 31 March 2003 has been performed by a qualified actuary using revised assumptions that are consistent with the requirements of FRS 17. This was adjusted to include the transfer of past services and benefits which occurred on 29 April 2003. Investments have been valued at 31 March 2003, for this purpose, at market value. The major assumptions used by the actuary were:

	2003	2002
Rate of increase in pensionable salaries	4.0%	4.5%
Rate of increase in pensions in payment	2.5%	3.0%
Discount rate	5.5%	6.0%
Inflation assumption	2.5%	3.0%

The assets in the scheme and the expected rate of return were:

	Long term rate of return expected at 31 March 2003	Value at 31 March 2003 £'000	Long term rate of return expected at 31 March 2002	Value at 31 March 2002 £'000
Equities	7.5%	8,904	7.0%	-
Bonds	6.0%	1,484	5.0%	-
Cash	5.0%	4,454	4.0%	258
		<u>14,842</u>		<u>258</u>

The following amounts at 31 March 2003 were measured in accordance with the requirements of FRS 17 "Retirement Benefits".

	2003 £'000	2002 £'000
Total market value of assets	14,842	258
Present value of scheme liabilities	<u>(27,010)</u>	<u>(243)</u>
(Deficit)/surplus in scheme	(12,168)	15
Related deferred tax asset/(liability)	<u>3,650</u>	<u>(5)</u>
Net pension (liability)/asset	<u>(8,518)</u>	10

Excluding the transfers completed on 29 April 2003, the deficit in the scheme would have been £367,000.

Notes to the financial statements cont'd

30 Pensions cont'd

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

	2003 £m	2002 £m
Net assets excluding pension liability	133.3	72.5
Pension (liability)/asset*	(8.5)	-
Net assets including pension liability	124.8	72.5
Profit and loss reserve excluding pension liability	133.3	72.5
Pension reserve	(8.5)	-
Profit and loss reserve	124.8	72.5

* In 2002 the net assets and profit and loss reserve of the company would increase by £10,300.

Additionally, if the pension costs had been recognised in accordance with FRS17, the following components of the pensions charge would have been recognised in the income and expenditure account and statement of recognised gains and losses for the year ended 31 March 2003.

	2003 £'000
Analysis of amount charged to operating profit	
Current service	992
Past service cost	11,469
Total operating charge	12,461

Analysis of amount charged to other finance income

Expected return on pension scheme assets	29
Interest on pension scheme liabilities	(54)
Net return/(charge)	(25)

Analysis of amount recognised in statement of total recognised gains and losses

Actual return less expected return on pension scheme assets	(177)
Experience losses arising on the scheme liabilities	(114)
Changes in assumptions underlying present value of the scheme liabilities	(75)
Total loss recognised	(366)

Notes to the financial statements cont'd

30 Pension contributions cont'd

Movement in surplus during the year	2003 £'000
Surplus on scheme at 1 April 2002	15
Movement in the year:	
- current service cost	(992)
- contributions	670
- past service cost	(11,469)
- other finance expense	(25)
- actuarial loss	(366)
Deficit on scheme at 31 March 2003	<u>(12,167)</u>

History of experience gains and losses	2003 £'000
Difference between the actual and expected return on scheme assets:	
- Amount (£'000)	(177)
- Percentage of scheme assets	1%
Experience gains/(losses) on scheme liabilities:	
- Amount (£'000)	(114)
- Percentage of present value of scheme liabilities	0%
Total amount recognised in statement of total recognised gains and losses:	
- Amount (£'000)	(366)
- Percentage of present value of scheme liabilities	1%

31 Post balance sheet events

On 16 April 2003 Dŵr Cymru (Financing) Limited issued an additional £85m of index linked bonds and on 28 April 2003 Welsh Water published version 2 of its procurement plan.

32 Status of the company

The company is limited by guarantee and does not have any share capital. In the event of the company being wound up, the liability of the members is limited to £1 each.