

3975719

Glas Cymru Cyfyngedig
report and accounts
2003/04

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GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

GLAS CYMRU/WHO'S WHO

03/04

Glas Cymru

Glas Cymru was formed in April 2000 and completed the acquisition of Welsh Water in May 2001 following a successful £1.9 billion bond issue. Glas Cymru is a "company limited by guarantee" registered under the Companies Act 1985. Glas Cymru has no shareholders. Instead, Members carry out an important corporate governance role but they do not receive dividends nor do they have any other financial interest in the Company. This corporate structure ensures that all financial surpluses generated are retained and reinvested for the benefit of Welsh Water and its customers. Glas Cymru's constitution strictly limits its purpose to that of financing water assets in Welsh Water's area of appointment and managing Welsh Water's business so that high quality water and sewerage services are delivered at least cost to the communities served by Welsh Water. Glas Cymru cannot diversify into other unrelated commercial activities.

Welsh Water is the sixth largest of the ten water and sewerage companies in England and Wales. It provides water and sewerage services to more than three million people working and living in Wales and some adjoining parts of England. Welsh Water's primary responsibility is to ensure a clean and reliable supply of drinking water and to deal effectively with wastewater so as to protect the natural environment. Under Welsh Water's competitive procurement policy, specialist service providers are contracted to carry out much of the day to day operation of assets and service delivery. All aspects of Welsh Water's water and wastewater operations are subject to extensive performance monitoring against standards and targets set by industry regulators and by Government. Price limits, investment plans and targets are agreed with regulators every five years. Welsh Water's current plans, which include capital investment of £1.2 billion, cover the five years to March 2005. This programme is known as AMP3. Key targets for AMP3 are set out in Welsh Water's published Monitoring Plan.

who's who

THE DIRECTORS

The Board of Directors meets monthly and is responsible for the strategic direction of the Company and for reviewing the operational and financial performance. It comprises 9 members, 6 Non-Executive, including the chairman, and 3 Executive Directors.

Membership of Board Committees

- Quality and Environment
- Audit
- ▲ Remuneration
- ★ Nominations

THE MEMBERS

Members are selected in accordance with the published Membership Policy under a process overseen by an independent Membership Selection Panel. Glas Cymru is required to maintain a balanced and diverse membership, which as far as possible is broadly reflective of the range of customer and other stakeholder interests served by Welsh Water. However, membership is personal, and Members do not represent any particular group or stakeholder interest. Members do not receive fees nor do they have any other financial interest in Glas Cymru.

There are presently 54 Members, including the Directors. No new Members have been appointed since 2001, but three have resigned and have not been replaced. A list of the Members of Glas Cymru, together with the Membership Policy and Terms of Reference of the Membership Selection Panel, is published on the Glas Cymru website www.glascymru.com or can be obtained by writing to the company secretary.

the directors

Lord Burns **Mike Brooker** **Nigel Annett** **Chris Jones** **John Bryant** **Alison Carnwath** **Geraint Talfan Davies** **Dame Deirdre Hine** **Tony Hobson**

Lord Burns ★

Appointed Non-Executive Chairman of Glas Cymru Cyfyngedig in July 2000, Lord Burns (60), who was made a life peer in 1998, is a former Chief Economic Advisor and Permanent Secretary to HM Treasury. He is currently Chairman of Abbey National Plc and a Non-Executive Director of Pearson Group Plc and British Land Plc. Lord Burns is also a former Chairman of the National Lottery Commission.

Mike Brooker ■ ★

Appointed Managing Director of Glas Cymru Cyfyngedig on 11 May 2001, Dr Brooker (56) has been a Director of Dŵr Cymru Cyfyngedig since the privatisation in 1989 and Managing Director since 1997. Having joined Welsh Water in 1980 Dr Brooker, who is a scientist by qualification, has held a variety of senior roles in Welsh Water including Chief Scientist, Director of Quality and Planning, and Operations Director, South East.

Nigel Annett ■ ★

Appointed Executive Director in April 2000, Mr Annett (45) was previously a Director of Dŵr Cymru Cyfyngedig (1992–2000). Prior to joining Welsh Water, Mr Annett held various investment banking positions with Schrodgers, County Natwest and Wasserstein Perella.

Chris Jones ★

Appointed Finance Director in April 2000, Mr Jones (40) was previously Director of Regulation of Dŵr Cymru Cyfyngedig and South Wales Electricity PLC. Before joining Welsh Water in 1995, Mr Jones was a Director at National Economic Research Associates and, prior to that, worked for HM Treasury on utility industries and privatisation.

John Bryant ■ ▲ ★

Appointed a Non-Executive Director in March 2001. Mr Bryant (60) is a former Chief Executive of British Steel and until December 2000 he was Joint Chief Executive of Corus Plc. Mr Bryant, who was born and educated in Wales, is also a Non-Executive Director of Costain Group Plc. He was a Non-Executive Director of Bank of Wales Plc between 1996 and 2001.

Alison Carnwath ● ▲ ★

Appointed a Non-Executive Director in July 2000, Mrs Carnwath (51) is Chairman of Vitec Group Plc and a Non-Executive Director of Friends Provident Group Plc, Gallaher Group Plc and Man Group Plc. After qualifying as a chartered accountant, Mrs Carnwath spent 20 years working in investment banking during which time she was a Director of Schrodgers and a Managing Director of Donaldson Lufkin Jenrette.

Geraint Talfan Davies ● ▲ ★

Appointed a Non-Executive Director in July 2000, Mr Davies (60) is a former journalist whose career spanned both public and private sector broadcasting including Controller of BBC Wales throughout the 1990s. He is currently Chairman of the Institute of Welsh Affairs and the Arts Council of Wales.

Dame Deirdre Hine ■ ▲ ★

Appointed a Non-Executive Director in March 2001, Dame Deirdre (66) was, until recently, Chairman of the Commission for Health Improvement. A former President of The Royal Society of Medicine and Chief Medical Officer for Wales, Dame Deirdre was awarded the DBE in 1997 for services to medicine.

Tony Hobson ● ▲ ★

Appointed a Non-Executive Director in February 2001, Mr Hobson (56) is a chartered accountant, who was until 2001 Group Finance Director of Legal and General Group Plc, a position he held since 1987. He is Deputy Chairman of Northern Foods plc and a Non-Executive Director of HBOS Plc, Jardine Lloyd Thompson Group Plc and Liberata Plc. He was formerly the senior independent Non-Executive Director of Thames Water Plc.

GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

DIRECTORS' REPORT

03/04

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.

The operational and financial performance of the group during the year ended 31 March 2004 is described in the Chairman's Statement and the review of operational and financial performance on pages 2 to 24. These, together with the financial statements on pages 44 to 72, confirm that the financial performance of the business is ahead of the projections reported in the Information Memorandum dated 4 May 2001. The group has achieved, a year ahead of schedule, its target to deliver financial reserves (Regulatory Capital Value less net debt) of £400 million by 31 March 2005.

During the year, customers of Welsh Water benefited from the first bill rebate of £9 per household at a total cost of £12 million. This rebate is being maintained in the year to 31 March 2005.

As a result of its outsourced procurement strategy, around 85% of the annual expenditure of Welsh Water is now carried out by specialised service providers selected following a competitive bid process. During the financial year work commenced for the majority of outsourced services to select specialist service providers to work with Welsh Water from April 2005. Successful bidders will be announced in the autumn of 2004. Further information about our procurement strategy is available on the Welsh Water website: www.dwrcymru.com

During the financial year, Welsh Water continued work on preparing its strategic business plan and investment requirements and priorities for the period 2005 to 2010. In line with our policy of being open and transparent, Welsh Water published a full consultation draft strategic business plan in August 2003 and worked to try to secure a consensus with stakeholders generally as regards investment priorities and affordability of customer bills, before submitting a Final Business Plan in April 2004. A Final Determination will be announced by Ofwat in November 2004. Further information about the final strategic business plan is available on the Welsh Water website:

www.dwrcymru.com

On 16 April 2003 Dŵr Cymru (Financing) Limited issued an additional £85 million of indexed linked bonds.

DIRECTORS

The names and a short biography of each director is set out on page 27. 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).*

Mike Brooker, John Bryant and Dame Deirdre Hine will retire by rotation and submit themselves for re-appointment at the Annual General Meeting ('AGM') on 9 July 2004, 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 2004 set out on pages 31 to 35. A resolution will be proposed at the 2004 AGM to receive and adopt this report.

MEMBERS

At the date of this report Glas Cymru has 54 Members, including the Directors. Since the 2003 Annual General Meeting no new members have been appointed, but one has resigned. In addition, the initial three-year term of appointment of 15 Members will expire at the end of the 2004 AGM, of which 14 Members have applied for and have been reappointed for a further three-year term ending at the end of the AGM in 2007.

Information about the process for the appointment of Members and current Members can be found on the Glas Cymru website www.glascymru.com or may be requested from the Company Secretary.

EMPLOYEES

At the financial year end Welsh Water employed 145 people and, other than the directors of the Company, Glas Cymru has no employees. It is our policy to treat all employees without discrimination and we operate equal opportunity employment practices designed to achieve this.

Keeping our staff informed on our direction and performance is important to us and we have some well established ways of ensuring staff are up to date with what is happening in the company. Twice a year we hold an Employee Forum to which all staff are invited and, throughout the year, the Managing Director chairs a series of local luncheon

meetings, which provide staff opportunity to ask questions directly. We also hold monthly team briefings with managers and publish key messages in a monthly 'core brief'. The views of our staff are important and the Board also receives feedback on these through an annual employee satisfaction survey, which lets us know what we are doing well and where there are opportunities to improve.

We are committed to giving staff the opportunity to maximise their potential and individual training and development needs are assessed as part of an annual appraisal of all staff, although providing such development opportunity is a key challenge for us as a small company.

The Welsh Water outsourced 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 the last year, the operational 'alliances' through which partner contractors are encouraged to work with Welsh Water and develop a 'one-team' approach in the delivery of Welsh Water's business plan, have continued to work well. To further this we have established a number of working groups to promote best practice and enhanced our staff Intranet as the primary source of key business and performance information for all staff across the Welsh Water enterprise.

The health and safety of our people is an imperative and for last year we are pleased to report a 40% reduction in the number of incidents reported to the Health and Safety Executive. The 2003/04 performance of Welsh Water and its contract partners is published in a separate Health and Safety Report available from the Welsh Water website www.dwrcymru.com, or on request from the Company Secretary.

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. As in previous years, a copy of the 2004 Quality and Environment Committee Report is available on the Welsh Water website www.dwrcymru.com or on request from the company secretary.

Following a benchmark study in 2002/03, in the last year we have worked to understand more fully the direct and indirect environmental impacts of our business. Early results from this project will result in the publication of a 2004 Environment Overview, which will describe the framework within which we operate, our performance in 2003/04, and the high-level objectives we have set ourselves for 2004/05. In the autumn of 2004, we will commence work with our specialist service providers to agree specific environmental objectives for the period 2005 to 2010 covering the main environmental impacts of our business. In addition, in July 2004 at a meeting of the Wales Biodiversity Partnership, Welsh Water will publish its first Biodiversity Overview.

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 the 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 continues to benefit 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. In 2003/04, the average payment period was 88 days (2003: 90 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 £24,570 (2003: £20,600). Individual donations above £200 were made to: Water Aid (£18,420), Hereford Waterworks Museum (£5,000), Crimestoppers Cymru (£500), Cancer Research (£200) and The Joshua Foundation (£200). Water Aid and Cancer Research are national charities.

It is company policy not to make payments for political purposes, and no such payments were made during the year (2003: £nil).

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DIRECTORS' REPORT

03/04 continued

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. During 2003/04 we operated a voluntary scheme under the Wales Language Act 1993 (the Act), however in January 2004 the Welsh Assembly Government announced that it had approved an Order which would allow the Welsh Language Board to give notice to any water and/or sewerage undertaker which operates in Wales requiring that it should prepare a Welsh Language Scheme. We are currently discussing with the Welsh Language Board the changes to Welsh Water's voluntary Welsh Language Scheme that may be necessary to reflect such change in status.

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 2004.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In June 2002 The Council of the European Union announced that listed companies would adopt International Financial Reporting Standards (IFRS) from 1 January 2005. The adoption of IFRS will be reflected in our financial results for the year ending 31 March 2006. A programme of work has been approved by the Board to ensure that this timetable can be met and to understand how IFRS will impact on our reported results, with particular reference to IAS16 (Property, Plant and Equipment) and IAS39 (Financial Instruments: Recognition and Measurement).

AUDITORS

Having indicated their willingness to continue in office, a resolution to reappoint PricewaterhouseCoopers LLP as auditors to Glas Cymru will be proposed at the 2004 Annual General Meeting.

ANNUAL GENERAL MEETING

The 2004 AGM will be held at The Dylan Thomas Centre, Somerset Place, Swansea SA1 1RR at 10.30 am on Friday 9 July 2004. The Notice of Annual General Meeting (including Agenda and Explanatory Notes) is set out in a separate document.

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 2004, the re-appointment of three Directors who retire by rotation and offer themselves for re-appointment, and the reappointment of PricewaterhouseCoopers LLP as auditors. All resolutions are matters of "ordinary business" for the Annual General Meeting that will be addressed each year. There are no items of special business which require approval by Members.

This report was approved by the Board on 9 June 2004.

By order of the Board



RG Curtis LLB ACIS
Company Secretary
9 June 2004

remuneration report

The Board is pleased to submit its annual Report on Remuneration for approval by Members at the 2004 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;
- 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 Directors' remuneration is contingent and dependent on performance.

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.

The comparator group of companies used are the UK water companies listed on The London Stock Exchange and selected other companies. 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 (together with pension arrangements and other pensionable benefits in kind), 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 April 2004 when they were increased by 4% to:

Mike Brooker	£194,958
Nigel Annett	£139,256
Chris Jones	£139,256

ANNUAL 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 performance assessment published by OFWAT.

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REMUNERATION REPORT

03/04 continued

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. 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 2003 Directors received an annual incentive bonus for the year ended 31 March 2003 equivalent to 66% of salary, of which 50% related to performance against customer service targets and 16% to meeting financial targets; this compared to an accrual in the 2002/03 Accounts of 55%. The 2003/04 Accounts includes an accrual of £225,354 (equivalent to 49.5% of salary) reflecting the Committee's current estimate of Welsh Water's relative performance for the year ended 31 March 2004.

LONG TERM PERFORMANCE RELATED BONUS

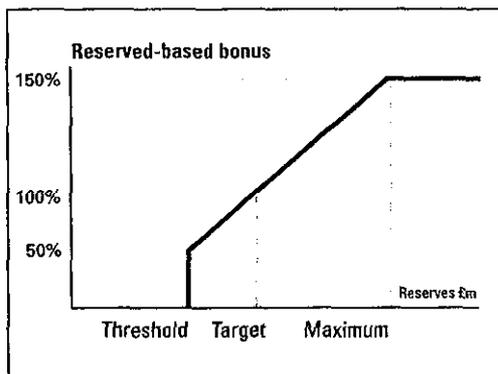
This scheme has been established for executive directors and is linked to the long-term financial performance of the Company, determined on the basis of two measures: (i) the increases in the Company's level of "reserves" (Regulatory Capital Value less net debt); and (ii) changes in the rating of each class of the Company's bonds.

Growth in reserves captures the 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 financial reserves represents a good 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 over the six months which end on 31 May 2005 (December 2004 - May 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.

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%

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.

The latest forecast of reserves at 31 March 2005 would, based on the latest rating of the company's bonds, result in directors' receiving a long term incentive bonus payment of around 100% of basic salary, reflecting achievement of Glas Cymru's objectives in the four year period 2001 to 2005. However, this forecast is still subject to considerable uncertainty and these potential bonus payments have not been accrued in the 2003/04 Annual Report and Accounts.

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.

Director's Pension Benefits – 2003/2004							
	Accrued Pensions (per annum)	Increase in accrued Pension over year	Transfer Value at 31 March 03	Transfer Value equivalent of increase	Transfer Value at 31 March 04	Contributions paid by director	Contributions paid by company
MP Brooker*	£117,375	£6,890	£1,306,247	£330,472	£1,635,719	£11,767	£23,533
NC Annett*	£40,053	£6,377	£181,746	£97,043	£278,789	£8,544	£17,088
CA Jones*	£28,194	£3,875	£106,091	£43,616	£149,707	£8,544	£17,088

* Accrued pension includes previous service in Hyder Water Pension Scheme

The Welsh Water Pension Scheme is a final salary occupational scheme and is subject to Inland Revenue limits. The Company will make a provision for liabilities arising from contractual commitments to Executive Directors over the Inland Revenue "earnings cap". As at 31 March 2004 this liability totalled around £134,200 (31 March 2003: £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 a maximum 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 spouse's 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 2004, 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 the 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 in the supplementary notes.

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REMUNERATION REPORT

03/04 continued

Directors emoluments (excluding pension benefits)										
The following emoluments were earned by the Directors in respect of the financial year ended 31 March 2004.										
2003/2004	Lord Burns	MP Brooker	NC Annett	CA Jones	JM Bryant	A Carnwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary		187,460	133,900	133,900						£455,260
Bonus 2003/04 Provision ¹		92,792	66,281	66,281						£225,354
Benefits in Kind ²		9,399	9,803	9,381						£28,583
Fees	£148,333				£39,165	£39,165	£39,165	£39,165	£39,165	£344,158
Total emoluments relating to 2003/04¹	£148,333	£289,651	£209,984	£209,562	£39,165	£39,165	£39,165	£39,165	£39,165	£1,053,355
The following emoluments were earned by the Directors in respect of the financial year ended 31 March 2003.										
2002/2003	Lord Burns	MP Brooker	NC Annett	CA Jones	JM Bryant	A Carnwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary		£182,000	£130,000	£130,000						£442,000
Interim bonus as provided in Report and Accounts for 2002/03 ³		£100,100	£71,500	£71,500						£243,100
Final bonus paid		£20,020	£14,300	£14,300						£48,620
Total bonus ⁴		£120,120	£85,800	£85,800						£291,720
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	£311,385	£228,213	£224,750	£35,000	£35,000	£35,000	£35,000	£35,000	£1,079,348
Notes										
<p>1 The financial statements for the year ended 31 March 2004 include a provision of £225,354 (49.5% of base salary) for bonus potentially payable to Executive Directors for performance in the financial year 2003/04. This provision has been estimated on the basis that performance in OFWAT's Overall Performance Assessment for 2003/04 will be 3rd compared to 2nd in respect of 2002/03. The final amount to be paid to each director will be determined when OFWAT publishes OPA results for 2003/04 in the Autumn of 2004, and could be higher or lower.</p> <p>2 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.</p> <p>3 A performance bonus of £243,100 was provided for in the Report and Accounts for 2002/03 and was estimated on the basis that OPA performance would improve from 5th position considered appropriate in 2001/02 to 4th position in 2002/03.</p> <p>4 The actual performance bonus in respect of 2002/03 was paid in September 2003, following publication of OFWAT's OPA Report for 2002/03, which ranked Welsh Water 2nd in the industry, and amounted to £291,720 (ie. 66% of salary).</p> <p>5 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.</p> <p>6 The highest paid director is MP Brooker, aggregate emoluments: £289,651 (2003: £291,365 excluding the bonus of £20,020 in respect of performance in 2002/03, which was not provided for in the Report and Accounts for that year – see note 3 above.)</p> <p>7 No accrual has been made in respect of any long term performance related bonus which may be payable in July 2005, as entitlement to such bonus is still subject to considerable uncertainty.</p>										

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 2004, 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 sit with the Board. The fees payable to the Chairman and the Non-Executive Directors were last revised from 1 June 2004, when they were increased by 4% to:

Chairman	£156,000
Non-Executive Directors	£ 41,600

Policy is that the fees payable to the Chairman and the Non Executive Directors are subject to benchmark review every two years, with the next review being due in 2005, with an inflation-linked adjustment in every other year.

The Chairman and the Non-Executive Directors are appointed under letters of appointment, which may be terminated by either party. No compensation is payable by the Company on termination of an appointment.

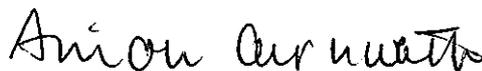
No additional amount is payable for the chairmanship of, or membership of, Board committees or for the undertaking of any special responsibilities on behalf of the Board. Non-Executive Directors do not receive any benefits in kind.

COMPLIANCE WITH REGULATION AND BEST PRACTICE ON REMUNERATION

This report complies with the Directors' Remuneration Report Regulations 2002 (the Regulations), and the Directors confirm that the Company has complied with the provisions of the Combined Code applicable to directors' remuneration throughout the financial year ended 31 March 2004.

In accordance with the Regulations, the directors' emoluments table and directors' pension table on pages 34 and 33 have been audited; the remainder of the report has been reviewed by the auditor, but is not subject to audit.

This report was approved by the Remuneration Committee on 9 June 2004.



Alison Carnwath

Chair - Remuneration Committee

9 June 2004

GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

CORPORATE GOVERNANCE

03/04

corporate governance

INTRODUCTION

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

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 the recommendation of the Nominations Committee. New directors have a formal induction programme to familiarise themselves with the business, the risks and strategic challenges, and the economic, competition, legal and regulatory environment in which we operate. A programme also exists to ensure that directors continually update their skills and business knowledge. 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) and, accordingly, a majority of the Board are independent Non-Executive Directors. Their mix of skills and experience is a major factor in the proper functioning of the Board and its committees, ensuring that matters are fully debated and that no individual or group dominate the board's decision making process. The remuneration of Non-Executive Directors 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, together with those of the executive directors, are clearly defined. The chairman is principally responsible for ensuring the effective operation of the Board and that the information it receives is sufficient to make informed judgements. The managing director is responsible for the day-to-day management of the business and for the 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 in 2003/04 every Member attended at least one of the two Members' Meetings at which all directors, including the chairmen of the key Board committees, were 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, there were formal meetings held with bondholders, who may also request a meeting with an independent Non-Executive Director at any time. Regular communication is maintained with the economic, quality and customer service regulators of Welsh Water. During 2003/04, representatives of Welsh Water and each regulator attended meetings of the Wales PR04 Forum, chaired by the Welsh Assembly government and established to discuss the investment priorities for 2005 to 2010 and the impact on customer bills of Welsh Water's consultation draft strategic business plan published in August 2003.

As a result of the above, the Board has concluded that the nomination of a senior independent director would not improve governance and have not appointed one.

In addition to contributing to the formal committees of the Board (described below) the Board has also allocated "special responsibilities" to Non-Executive Directors, covering important areas such as procurement (John Bryant), communications (Geraint Talfan Davies) and government and regulation (Lord Burns).

The Board receives regular financial and operational performance information and regular presentations and meetings with senior managers to ensure they become and remain familiar with all significant aspects of the business.

The company secretary, who can only be appointed or removed by the Board, is responsible for ensuring that Board processes and procedures are followed and support effective decision-making and good governance.

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

DIRECTORS

The names and brief biographical details of each of the current directors can be found on page 27, including respective dates of appointment. 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 ("AGM") on 9 July 2004 three directors, Mike Brooker, John Bryant and Dame Deirdre Hine 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 notice.

MEMBERS

A key role of the members of Glas Cymru is to ensure that the business remains focused on its primary purpose of providing efficient high quality water and sewerage services 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 conducted an annual review and confirmed compliance by Glas Cymru with the terms of the Membership Policy.

Membership of Glas Cymru is personal and Members are not appointed to represent any particular group or stakeholder interest. At the date of this report there are 54 Members, including the Directors. Since the 2003 AGM no new Members have been appointed, but one has resigned. In addition, the initial three year term of appointment of 15 Members will expire at the end of the 2004 AGM, of which 14 Members have applied for and have been reappointed for a further three year term expiring at the end of the AGM in 2007.

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.

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.

GLAS CYMRU CYFYNGEDIG

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CORPORATE GOVERNANCE

03/04 continued

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 26 and 27. The outcome of each committee meeting is reported to the Board by the respective chairman and the Board receives the minutes of all committee meetings. Each committee of the Board has authority to employ the services of such advisors, within and outside the company, as it deems necessary to fulfil its responsibilities.

The **Audit Committee** comprises three non-executive directors and is chaired by Tony Hobson, who has been identified by the Board as the Committee member with significant, recent and relevant financial experience. The role of the committee is 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;
- Review the effectiveness of the company's control environment, including "Whistleblowing" procedures;
- Make recommendations on the appointment and remuneration of external auditors and to monitor their performance; and to approve and monitor the policy for non-audit services provided to the Group by the external auditors to ensure that the independence of the auditors is not compromised.

The Audit Committee met four times in the year and reported its conclusions to the Board. The committee formally reviewed the draft interim and annual reports and associated preliminary and interim results announcements, focusing on key areas of judgement and significant accounting policies. Time is allocated at each meeting of the committee to review the findings of the risk management and risk based audit programmes, including a review of mitigation plans for significant business risks. In the last year particular attention was paid to procurement and IT risk.

During the year, the Audit Committee reviewed external and internal audit plans and findings, and met privately with the internal and external auditors without executives attending. The Committee reviews auditor independence annually. The Audit Committee also met with executive directors and management. On the basis of this work, the Audit Committee is able to assess the ongoing effectiveness of internal and external audit.

The terms of reference of the Audit Committee include all matters required by the Combined Code and the committee reviewed its own effectiveness through an annual self-assessment in March 2004. The committee has unrestricted access to company documents and staff and to external auditors. Members of the committee have a good balance of skills and experience, including recognised financial qualifications and relevant financial and corporate finance experience.

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 met on four occasions during the year. The 2004 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 2004 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 comprises the Non-Executive Directors and met twice during the year. Executive Directors attend meetings at the invitation of the Chairman.

The committee leads the process for making appointments to the Board; ensures that there is a rigorous and transparent process for the appointment of new directors; reviews the composition of the Board; and ensures that plans are in place for orderly succession for appointment to the Board and to other senior executive management positions.

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 exists because where a large proportion of the services of Welsh Water are provided by specialist contractors, additional attention must 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 are 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 system 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 www.dwrcymru.com.

RISK MANAGEMENT AND INTERNAL CONTROL

The Board has overall responsibility for the system of risk management and 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;
- 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.

GLAS CYMRU CYFYNGEDIG

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CORPORATE GOVERNANCE

03/04 continued

The managing director chairs a risk management group, which includes senior managers from all parts of the business. Under the risk management strategy approved by the Board, the role of this group is to review and challenge the robustness of risk management procedures within the business, including that of Welsh Water's contracting partners. This review includes areas such as health and safety, environment, business ethics, employment and business continuity. 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 experience of others to promote best practice; and to improve the quality of service delivered to the customers of Welsh Water. The risk management 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 2003/04 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 cover 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 have adequate resources to continue as a going concern for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2004 have been prepared on a going concern basis.

COMPLIANCE

Glas Cymru complied throughout the year with the applicable 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 on page 38, although not all of the provisions of the Combined Code apply to Glas Cymru as a company limited by guarantee.

A revised Combined Code was published in July 2003 that is intended to apply for reporting years beginning on or after 1 November 2003, and we will report our position against this revised Combined Code for the year ending 31 March 2005.

Members of Glas Cymru and Ofwat, Welsh Water's economic regulator, monitor compliance with the Combined Code as this 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.

By order of the Board



R Curtis LLB ACIS
Company Secretary
9 June 2004

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 Company. 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
9 June 2004

GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

INDEPENDENT AUDITORS' REPORT

03/04

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

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

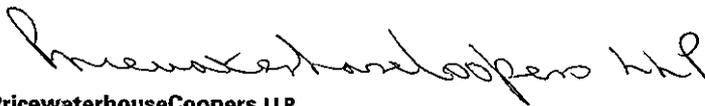
We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the directors' remuneration report. It also includes 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.

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 2004 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

Chartered Accountants and Registered Auditors

Cardiff

9 June 2004

GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

ACCOUNTING POLICIES

03/04

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 any 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
Equipment and computer hardware and software	– 7–15 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 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 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. Amounts recoverable from construction partners, relating to targets not being achieved are only recognised on completed projects.

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 are 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. Underlying instruments to which currency swap agreements and currency forward exchange contracts relate 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 all deferred tax liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. Deferred tax assets are only recognised to the extent that they are considered recoverable. Recoverability is assessed when it can be regarded as more likely than not that there will be sufficient taxable profits from which the future reversal of the timing difference can be deducted. 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.

GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

CONSOLIDATED PROFIT AND LOSS ACCOUNT

03/04

consolidated profit and loss account for the year ended 31 March 2004

	Note	2004 £m	2003 £m
Turnover	2	469.7	462.9
Net operating costs	3	(284.0)	(270.9)
Operating profit		185.7	192.0
Profit on disposal of fixed assets	5	1.4	4.2
Profit on ordinary activities before interest		187.1	196.2
Net interest payable	6	(143.2)	(128.0)
Profit on ordinary activities before taxation		43.9	68.2
Taxation	7(a)	1.7	(7.4)
Profit on ordinary activities after taxation being retained profit for the year	22	45.6	60.8

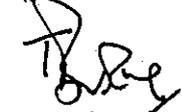
All operations are continuing.

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.

consolidated balance sheet at 31 March 2004

Group	Note	2004 £m	2003 £m
Fixed assets			
Negative goodwill	8	(46.9)	(94.0)
Tangible assets	9	2,636.7	2,500.7
		2,589.8	2,406.7
Current assets			
Debtors	11	61.9	61.8
Current asset investments	12	223.1	251.6
Cash at bank and in hand		2.1	3.4
		287.1	316.8
Current liabilities			
Creditors: amounts falling due within one year	13(a)	(166.2)	(161.4)
Net current assets		120.9	155.4
Total assets less current liabilities			
		2,710.7	2,562.1
Creditors: amounts falling due after more than one year	13(b)	(2,380.9)	(2,263.2)
Provisions for liabilities and charges	20	(115.0)	(128.1)
Deferred income	21	(35.9)	(37.5)
Net assets		178.9	133.3
Reserves			
Profit and loss account	22	178.9	133.3
Total reserves		178.9	133.3

The financial statements on pages 44 to 72 were approved by the Board of Directors on 9 June 2004 and were signed on its behalf by:



Lord Burns
Chairman



M P Brooker
Managing Director



C A Jones
Finance Director

GLAS CYMRU CYFYNGEDIG

Co. No. 3975719

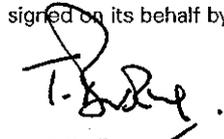
COMPANY BALANCE SHEET

03/04

company balance sheet at 31 March 2004

Company	Note	2004 £m	2003 £m
Fixed assets			
Investments	10	-	-
Current assets			
Bank and cash		0.1	0.1
Debtors – due after one year	11	3.4	3.4
		3.5	3.5
Current liabilities			
Creditors: amounts falling due within one year	13	(3.5)	(3.5)
Net current assets		-	-
Reserves			
Profit and loss account	22	-	-
Total reserves			
		-	-

The financial statements on pages 44 to 72 were approved by the Board of Directors on 9 June 2004 and were signed on its behalf by:



Lord Burns
Chairman



M P Brooker
Managing Director



C A Jones
Finance Director

consolidated cashflow statement for the year ended 31 March 2004

	Note	2004 £m	2003 £m
Cash inflow from operating activities	23	253.2	244.5
Returns on investments and servicing of finance			
Interest received		20.9	15.2
Interest paid		(131.3)	(168.5)
Interest element of finance lease payments		(8.8)	(12.2)
		(119.2)	(165.5)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(277.7)	(258.9)
Sale of tangible fixed assets		2.8	2.9
Grants and contributions received		11.4	10.2
		(263.5)	(245.8)
Acquisitions			
Adjustment to purchase consideration for subsidiary undertaking		-	2.9
		-	2.9
Cash outflow before use of liquid resources and financing		(129.5)	(163.9)
Management of liquid resources			
Purchase of commercial paper		-	(15.0)
Sale of commercial paper		-	15.0
Net decrease in deposits		28.5	131.6
Cash outflow before financing		(101.0)	(32.3)
Financing			
Long term loans and finance leases received		145.5	99.0
Purchase of own bonds		(42.8)	(41.3)
Capital element of finance lease payments		(2.5)	(6.0)
Loan repayments		(0.5)	(0.5)
		99.7	51.2
(Decrease)/increase in cash in the year	24	(1.3)	18.9

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RECONCILIATION OF RESERVES

03/04

reconciliation of movements in reserves for the year ended 31 March 2004

Group	2004	2003
	£m	£m
At 1 April	133.3	72.5
Profit for the year transferred to reserves	45.6	60.8
At 31 March	178.9	133.3

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 £3,140 (2003: £2,934 loss).

2 SEGMENTAL ANALYSIS BY CLASS OF BUSINESS

	2004	2003
	£m	£m
(a) Turnover		
Regulated water and sewerage activities	463.1	457.6
Non-regulated activities	6.6	5.3
	469.7	462.9
(b) Profit on ordinary activities before taxation		
Regulated water and sewerage activities		
Operating profit	184.8	191.1
Profit on disposal of fixed assets	1.4	3.7
Net Interest payable	(143.7)	(128.8)
	42.5	66.0
Non-regulated activities		
Operating profit	0.9	0.9
Profit on disposal of fixed assets	-	0.5
Interest receivable	0.5	0.8
	1.4	2.2
(c) Net assets		
Regulated water and sewerage activities	174.9	130.7
Non-regulated activities	4.0	2.6
	178.9	133.3

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

GLAS CYMRU CYFYNGEDIG

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NOTES TO THE FINANCIAL STATEMENTS

03/04

3 NET OPERATING COSTS

	Note	2004 Total £m	2003 Total £m
Operating charges from outsourced activities:			
- Operating services agreement		94.1	94.2
- Customer services agreement		18.9	19.2
- Laboratories and analytical services		8.0	8.0
- Other contracts		17.3	17.2
		138.3	138.6
Staff costs	4(b)	9.0	7.4
Research and development		0.1	0.1
Charge for bad and doubtful debts		9.0	10.0
Rates		20.4	20.3
Environment Agency charges		11.7	11.3
Fees paid to auditors	3(a)	0.3	0.2
Own work capitalised		(3.4)	(4.0)
Net rents payable		1.1	1.1
Other operating charges		23.9	19.0
		210.4	204.0
Depreciation:			
- Own assets		55.5	43.1
- Assets held under finance leases		20.8	17.0
Amortisation of grants and contributions		(1.6)	(1.4)
Infrastructure renewal charge		46.0	55.1
Amortisation of negative goodwill	8	(47.1)	(46.9)
		284.0	270.9

(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.

	2004 £'000	2003 £'000
Statutory audit services	99	93
Regulatory audit services	152	22
Interim review	26	22
Other audit services	1	12
Tax advisory services	34	18
Other non-audit advisory services	32	30
	344	197

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 (other than regulatory audit services specifically required by Ofwat) will be subject to prior competitive tendering and approval by the Audit Committee. The regulatory audit fees have increased in the year as a result of work undertaken on the price review process.

4 DIRECTORS AND EMPLOYEES**(a) Directors' emoluments**

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

(b) Staff costs

	Note	2004 £m	2003 £m
Wages and salaries		7.1	6.0
Social security costs		0.7	0.5
Pension costs	29	1.2	0.9
		9.0	7.4

Of the above, £2.3m (2003: £2.5m) has been charged to capital.

(c) Average monthly number of employees during the year (including executive directors)

	2004 Number	2003 Number
Regulated water and sewerage activities	144	142

5 PROFIT ON DISPOSAL OF FIXED ASSETS

	2004 £m	2003 £m
Profit on disposal of fixed assets	1.4	4.2

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

6 NET INTEREST PAYABLE

	2004 £m	2003 £m
Interest receivable	15.5	15.6
Interest payable:		
On loans	(144.6)	(129.9)
On finance leases	(12.8)	(12.5)
Amortisation of bond issue costs	(1.3)	(1.2)
Net interest payable	(143.2)	(128.0)

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NOTES TO THE FINANCIAL STATEMENTS

03/04 continued

7 TAXATION

(a) Analysis of charge in year

	Note	2004 £m	2003 £m
Current tax:			
Charge for year	7(b)	-	-
Deferred tax:			
Origination and reversal of timing differences		13.1	1.1
Decrease in discount	20(a)	(11.4)	(8.5)
Total deferred tax		1.7	(7.4)
Tax credit/(charge) on profit on ordinary activities		1.7	(7.4)

(b) Factors affecting current tax charge for year

Profit on ordinary activities before tax		43.9	68.2
Profit on ordinary activities multiplied by the corporation tax rate in the UK of 30%		13.2	20.5
Effects of:			
Amortisation of negative goodwill		(14.1)	(14.1)
Expenses not deductible for tax purposes		1.8	0.9
Capital allowances in excess of depreciation		(0.6)	(4.7)
Tax losses carried forward		3.2	-
Other timing differences		(1.3)	(0.5)
Income not chargeable for tax purposes		(2.2)	(2.1)
Current tax charge for year		-	-

8 INTANGIBLE FIXED ASSETS - NEGATIVE GOODWILL

	2004 £m
Cost:	
At 1 April 2003 and at 31 March 2004	(181.7)
Amortisation	
At 1 April	87.7
Released in the year	47.1
At 31 March	134.8
Net book value	
At 31 March 2004	(46.9)
At 31 March 2003	(94.0)

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.

9 TANGIBLE FIXED ASSETS – GROUP

(a) Analysis by type

Group	Freehold land & buildings £m	Infra- structure assets £m	Operational structures £m	Vehicles, plant, equipment & computer hardware & software £m	Total £m
Cost					
At 1 April 2003	36.2	1,537.9	1,764.4	209.8	3,548.3
Additions	–	159.9	96.6	14.7	271.2
Grants and contributions	–	(11.4)	–	–	(11.4)
Disposals	(3.4)	(1.1)	(0.6)	–	(5.1)
At 31 March 2004	32.8	1,685.3	1,860.4	224.5	3,803.0
Accumulated depreciation					
At 1 April 2003	16.5	398.0	480.6	152.5	1,047.6
Charge for the year	0.4	46.0	52.5	23.4	122.3
Eliminated on disposals	(2.5)	(1.0)	(0.1)	–	(3.6)
At 31 March 2004	14.4	443.0	533.0	175.9	1,166.3
Net book value					
At 31 March 2004	18.4	1,242.3	1,327.4	48.6	2,636.7
At 31 March 2003	19.7	1,139.9	1,283.8	57.3	2,500.7
Analysis of net book value at 31 March 2004					
Owned	18.4	1,092.1	894.3	48.6	2,053.4
Held under finance leases	–	150.2	433.1	–	583.3
	18.4	1,242.3	1,327.4	48.6	2,636.7

Tangible fixed assets at 31 March 2004 include £274.4m (2003: £198.9m) of assets in the course of construction, which are not depreciated until completed.

(b) The accounting treatment for grants and customer contributions in respect of infrastructure assets is described in the principal accounting policies on page 45. 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 45 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 £167.1m (2003: £178.6m) lower than it would have been had grants and contributions been treated as deferred income indefinitely.

(c) The cost of additions during AMP3 include a net accrual of £15.0m (2003: £13.4m) in respect of capital expenditure programme incentive payments.

(d) Asset lives relating to certain computer software assets have been revised during the year to align with all other software assets. This change has resulted in an increased depreciation charge of £10m.

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NOTES TO THE FINANCIAL STATEMENTS

03/04 continued

10 FIXED ASSET INVESTMENTS

(a) Group

Cost and net book value	2004	2003
	£m	£m
At 1 April	-	0.2
Disposal	-	(0.2)
At 31 March	-	-

Equity of less than 10% is held 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.

Principal group companies:

The Company has a £1 investment in Glas Cymru (Securities) Cyfyngedig and has 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%

11 DEBTORS

	2004	2003
Group	£m	£m
(a) Amounts falling due within one year:		
Trade debtors	19.1	21.5
Other debtors	11.7	7.8
Prepayments and accrued income	31.0	32.3
	61.8	61.6
(b) Amounts falling due after more than one year:		
Other debtors	0.1	0.2
	61.9	61.8
	2004	2003
Company	£m	£m
Amounts falling due after more than one year:		
Amounts owed by subsidiary undertakings	3.4	3.4
	3.4	3.4

12 CURRENT ASSET INVESTMENTS – GROUP**Management of liquid resources**

	2004	2003
	£m	£m
Investments in:		
Fixed term and call deposits – due within one year	223.1	221.9
Fixed term and call deposits – due after one year	–	29.7
	223.1	251.6

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.

GLAS CYMRU CYFYNGEDIG

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NOTES TO THE FINANCIAL STATEMENTS

03/04 continued

13 CREDITORS

Group	Note	2004 £m	2003 £m
(a) Amounts falling due within one year:			
Other loans	14	0.4	0.5
Finance leases	15	2.0	1.8
Trade creditors		38.7	38.7
Capital creditors		58.2	66.5
Other taxation and social security		0.4	0.4
Other creditors		66.5	53.5
		166.2	161.4
(b) Amounts falling due after more than one year			
Other loans	14	1,917.9	1,858.5
Obligations under finance leases	15	438.3	379.8
Other creditors – between one and five years		24.7	24.9
		2,380.9	2,263.2
(c) Loan reconciliation			
Original bond issue as at 10 May 2001		1,910.0	1,910.0
Add: new bonds issued in year		68.6	–
Add: premium unamortised		14.8	–
Less: bonds repurchased		(99.2)	(56.4)
Less: bond issue costs unamortised		(11.2)	(11.3)
Add: bond indexation		30.9	11.8
Add: local authority loans		4.4	4.9
Loans as above		1,918.3	1,859.0
		2004	2003
Company		£m	£m
Amounts falling due within one year:			
Amounts owed to subsidiary undertaking		3.5	3.5
		3.5	3.5

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) Cyfyngedig and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:

- 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
- 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 of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

14 OTHER LOANS

Group	2004	2003
	£m	£m
Loans are repayable as follows:		
Within one year	0.4	0.5
Between one and two years	45.2	0.5
Between two and five years	482.2	570.4
After more than five years	1,390.5	1,287.6
	1,918.3	1,859.0
Repayable wholly within five years	525.8	568.6
Repayable wholly after five years	1,388.1	1,285.5
Repayable by instalments of which some repayments are after five years	4.4	4.9
	1,918.3	1,859.0
	2004	2003
Interest rates on these loans ranged as follows:		
- Index linked debt	3.65 to 4.62%	3.55 to 4.48%
- Other debt	6.02 to 11.45%	6.0 to 11.45%

15 FINANCE LEASES

Group	2004	2003
	£m	£m
Amounts due under finance leases within one year	2.0	1.8
Amounts due under finance leases between two and five years inclusive	28.9	24.8
Amounts due under finance leases after more than five years	409.4	355.0
	440.3	381.6

A long dated interest rate swap was arranged on 1 April 1994 which had the effect of fixing the rate of interest at 7.8% on floating rate sterling finance lease obligations of £50.1m (2003: £53.8m).

This swap was terminated with effect from 31 March 2004.

16 MATURITY OF GROSS BORROWINGS FOR GROUP

The expected maturity profile of the group's gross borrowings, before unamortised bond issue costs of £11.2 million and the unamortised premium on the bonds issued in the year of £14.8m was as follows:

	Expected maturity	
	2004	2003
	£m	£m
In less than one year	2.4	2.3
In more than one year but not more than two years	49.6	2.5
In more than two years but not more than five years	506.7	593.2
In more than five years	1,796.4	1,653.9
	2,355.1	2,251.9

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NOTES TO THE FINANCIAL STATEMENTS

03/04

17 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

At the time of the group's £1,910m bond issue on 10 May 2001, the group entered into £625m of interest rate swap contracts and £200m of 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 "Security Trustee").

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.

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.

At 31 March 2004 the notional principal amounts outstanding of the group's interest rate swap agreements were £625m with termination dates ranging from March 2008 to March 2031. These swaps have the effect of fixing interest rates on the floating rate bonds in the range of 6.045% to 11.45%

At 31 March 2004 the notional principal amount outstanding of the group's currency swap agreement was GBP 200m (USD 286m), with a termination date of March 2008.

17 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)**(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:

2004	Fixed* £m	Index- Linked £m	Floating £m	Total £m
Bonds	1,325.8	584.6	–	1,910.4
Finance leases	–	–	440.3	440.3
Other loans	–	–	4.4	4.4
Other financial liabilities	24.7	–	–	24.7
	1,350.5	584.6	444.7	2,379.8
Unamortised bond issue costs				(11.2)
Unamortised bond premium				14.8
				2,383.4

*Including £625.0m floating rate interest rate liabilities swapped into fixed interest rate liabilities through the swap agreements referred to in note 17(c) above.

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
Other financial liabilities	24.9	–	–	24.9
	1,447.3	496.8	332.7	2,276.8
Unamortised bond issue costs				(11.3)
				2,265.5

As at 31 March 2004 £225.2m (2003: £255.0m) of the floating rate interest liabilities were hedged through floating rate cash balances and short term fixed deposits.

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 £4.4m have varied from 5.84% to 6.59% 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:

2004	Weighted average interest rate	Weighted average expected maturity
Bonds:		
– Index-linked	3.7%	25 years
– Fixed interest rate	7.0%	13 years
	Weighted average interest rate	Weighted average expected maturity
2003		
Bonds:		
– Index-linked	3.9%	26 years
– Fixed interest rate	7.0%	13 years
Finance leases	7.8%	11 years

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NOTES TO THE FINANCIAL STATEMENTS

03/04 continued

17 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(e) Interest rate profile of financial assets

	Fixed £m	Floating £m	Total £m
2004			
Short-term deposits	173.3	–	173.3
Call deposit account	–	49.8	49.8
Cash	–	2.1	2.1
	173.3	51.9	225.2
	Fixed £m	Floating £m	Total £m
2003			
Short-term deposits	250.3	–	250.3
Call deposit account	–	1.3	1.3
Cash	–	3.4	3.4
	250.3	4.7	255.0

The sterling money market deposits above comprise deposits placed on money markets from overnight to twelve months. Short-term deposits are at fixed interest rates. The time-weighted average interest on money market deposits (excluding call deposit accounts & liquidity funds) held during the year was 3.75% and the weighted average length of deposit held was 26 days.

The interest rate applied to the call deposit accounts and liquidity funds are variable and are calculated in accordance with market conditions.

(f) Committed borrowing facilities available

The group has various undrawn committed borrowing facilities. These facilities available at 31 March 2004 were as follows:

	2004 £m	2003 £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.

17 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)**(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.

Other financial liabilities include capital creditors and interest accruals payable after more than one year. Their fair values approximate to their book values as the impact of the time value of money on the amounts payable is not considered significant.

	Book value £m	Fair value £m
2004		
Non-derivatives:		
Assets:		
Current asset investments and cash	225.2	225.2
Liabilities:		
Borrowings less than 1 year	(2.4)	(2.4)
Fixed rate borrowings over 1 year	(800.0)	(897.0)
Indexed-linked borrowings over 1 year	(584.6)	(724.5)
Floating rate borrowings over 1 year	(968.1)	(968.1)
Other financial liabilities	(24.7)	(24.7)
Derivatives:		
Floating rate borrowings of £625.0m are hedged by the interest rate and currency swaps referred to in note 17(c) above (of which £99.2m is a hedge over own bonds purchased). The fair values of these swaps are as follows:		
Interest rate swaps	-	(60.0)
Currency swaps	-	(0.3)
	Book value £m	Fair value £m
2003		
Non-derivatives:		
Assets:		
Current asset investments and cash	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	(496.8)	(588.2)
Floating rate borrowings over 1 year	(952.9)	(952.9)
Other financial liabilities	(24.9)	(24.9)
Derivatives:		
Floating rate borrowings of £678.8m are hedged by the interest rate and currency swaps referred to in note 17(c) above (of which £56.4m is a hedge over own bonds purchased). The fair values of these swaps are as follows:		
Interest rate swaps	-	(93.6)
Currency swaps	-	(0.3)

As at 31 March 2003 and 2004 there were no unmatched derivative financial instruments.

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17 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(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 losses £m
2004			
Unrecognised gains and losses on hedges at 31 March 2004	-	(60.3)	(60.3)
Of which:			
- Gains/(losses) expected to be recognised in the year ended 31 March 2005	-	(3.3)	(3.3)
- Gains/(losses) expected to be recognised after the year ended 31 March 2005	-	(57.0)	(57.0)
	Gains £m	Losses £m	Total net 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)

18 CAPITAL COMMITMENTS

Group	2004 £m	2003 £m
Contracted for but not provided in the financial statements	55.0	64.5

In order to meet additional quality and service standards, together with growth and new demands, the group has capital investment obligations over the period to 31 March 2005 amounting to approximately £219.7m (2003: £489.5m) in the regulated water and sewerage business.

The company has no expenditure contracted for but not provided in the financial statements at 31 March 2004 (2003: £nil).

19 LEASING COMMITMENTS

Group	Land and buildings	
	2004 £m	2003 £m
At 31 March 2004 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 (2003: £nil).

20 PROVISIONS FOR LIABILITIES AND CHARGES

Group	Note	2004 £m	2003 £m
Deferred taxation	(a)	82.1	83.8
Restructuring provision	(b)	5.1	4.5
Contract management provision	(c)	0.8	0.8
Provision for uninsured losses	(d)	7.2	5.5
Provision for loss on swap closure	(e)	11.6	18.0
Provision for fair value on contract for difference	(f)	8.2	15.5
		115.0	128.1

(a) Deferred taxation

Tax effect of timing differences			
Excess of tax allowances over depreciation		324.6	335.6
Other timing differences		(7.6)	(5.5)
Undiscounted provision for deferred tax		317.0	330.1
Discount		(234.9)	(246.3)
Discounted provision for deferred tax		82.1	83.8
Provision at 1 April		83.8	76.4
Deferred tax (credit)/charge on profit and loss account for year		(1.7)	7.4
Provision at 31 March		82.1	83.8

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 group.

(b) Restructuring provision

This provision at 31 March 2004 is in respect of payments to be made relating to surplus property, which will be utilised over the next five years.

	2004 £m
At 1 April	4.5
Charge to profit and loss account	1.1
Utilised in the year	(0.5)
At 31 March	5.1

(c) Management contract provision

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

	£m
At 1 April 2003 and 31 March 2004	0.8

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NOTES TO THE FINANCIAL STATEMENTS

03/04 continued

20 PROVISIONS FOR LIABILITIES AND CHARGES (continued)

(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.

	2004 £m
At 1 April	5.5
Charge to profit & loss account	2.8
Utilised in the year	(1.1)
At 31 March	7.2

(e) Provision for loss on swap closure

£2.8m (2003: £8.5m) of this provision is the unamortised balance of a fair value provision relating to an acquired subsidiary's interest rate swap contract.

The balance of £8.8m (2003: £9.5m) 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.

	2004 £m
At 1 April	18.0
Utilised in the year	(6.4)
At 31 March	11.6

(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.

	2004 £m
At 1 April	15.5
Utilised in the year	(7.3)
At 31 March	8.2

21 DEFERRED INCOME – GROUP

Deferred income relates to grant 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.

	2004 £m	2003 £m
At 1 April	37.5	38.6
Received and receivable during the year	–	0.3
Released to profit and loss account	(1.6)	(1.4)
At 31 March	35.9	37.5

22 RESERVES

	Group Profit & Loss Account £m	Company Profit & Loss Account £m
At 1 April 2003	133.3	–
Profit retained for the year	45.6	–
At 31 March 2004	178.9	–

23 CASH FLOW FROM OPERATING ACTIVITIES

	2004 £m	2003 £m
Operating profit	185.7	192.0
Depreciation of tangible fixed assets	76.3	60.1
Infrastructure renewal charge	46.0	55.1
Amortisation of negative goodwill	(47.1)	(46.9)
Increase in debtors	(2.1)	(3.3)
Increase/(decrease) in creditors	1.1	(4.7)
Decrease in restructuring provisions	(6.7)	(7.8)
Cash flow from operating activities	253.2	244.5

24 RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	2004 £m	2003 £m
(Decrease)/increase in cash	(1.3)	18.9
Decrease in current asset investments	(28.5)	(131.6)
Increase in loans and finance leases	(99.7)	(51.2)
Write-off of bond issue costs	(1.3)	(1.2)
Write-off of bond premium	0.5	–
Indexation of index-linked debt	(17.4)	(7.3)
Movement in accrued interest	(11.9)	48.8
	(159.6)	(123.6)
Net debt at start of year	(2,001.8)	(1,878.2)
Net debt at end of year	(2,161.4)	(2,001.8)

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25 ANALYSIS OF NET DEBT

	At 1 April 2003 £m	Cash Flow £m	Non- Cash Items £m	At 31 March 2004 £m
Net cash:				
Bank and cash	3.4	(1.3)	-	2.1
	3.4	(1.3)	-	2.1
Liquid resources:				
Current asset investments	251.6	(28.5)	-	223.1
Finance leases	(381.6)	(58.7)	-	(440.3)
Other debt falling due within one year	(0.5)	0.5	(0.4)	(0.4)
Other debt falling due after one year	(1,858.1)	(41.0)	0.9	(1,898.2)
	(2,240.2)	(99.2)	0.5	(2,338.9)
Accrued interest	(16.1)	-	(11.9)	(28.0)
Indexation of index-linked debt	(11.8)	(1.7)	(17.4)	(30.9)
Bond issue costs capitalised	11.3	1.2	(1.3)	11.2
	(2,256.8)	(99.7)	(30.1)	(2,386.6)
Net debt	(2,001.8)	(129.5)	(30.1)	(2,161.4)

26 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.

27 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 £4.4 million (2003: £1.3m) in respect of the Elan Valley Trust Fund.

28 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.

29 PENSIONS

Following the acquisition of Dŵr Cymru Cyfyngedig by Glas Cymru Cyfyngedig, a new funded defined benefit pension scheme for current employees was introduced on 1 December 2001.

Disclosures required by SSAP24 "Accounting for pension costs"

An actuarial valuation of the scheme was undertaken as at 31 March 2003 by Barnett Waddington, an independent, professionally qualified actuary using the projected unit method. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rate of increase in salaries and pensions.

The key assumptions made were a rate of return on investments of 6.7%, a rate of increase in salaries of 3.5% and a rate of pension increase of 2.5%.

At the valuation date, scheme assets amounted to £15.6m and this represented 76% of the value of benefits accrued to members as at 31 March 2003. The next actuarial valuation is due at 31 March 2006.

The total pension cost for the Group during the year ended 31 March 2004 was £1.2m (2003: £0.9m). The regular cost of benefits amounted to £0.9m or 16% of pensionable salaries, and the SSAP24 treatment of spreading the deficit over the remaining service lives of the employees has led to a variation cost of £0.3m (5%).

At 31 March 2004 a SSAP24 provision of £0.7m is included within creditors (2003: £0.2m).

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. 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.

Investments have been valued at 31 March 2004, for this purpose, at market value. The major assumptions used by the actuary were:

	2004	2003	2002
Rate of increase in pensionable salaries	3.75%	4.0%	4.5%
Rate of increase in pensions in payment	2.75%	2.5%	3.0%
Discount rate	5.50%	5.5%	6.0%
Inflation assumption	2.75%	2.5%	3.0%

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29 PENSIONS (continued)

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

	Long term rate of return expected at 31 March 2004	Value at 31 March 2004 £'000	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	7.0%	11,251	7.5%	8,904	7.0%	-
Bonds	5.5%	3,607	6.0%	1,484	5.0%	-
Cash	4.0%	4,015	5.0%	4,454	4.0%	258
		18,873		14,842		258

The following amounts at 31 March 2004 were measured in accordance with the requirements of FRS 17 "Retirement Benefits".

	2004 £'000	2003 Restated £'000	2002 £'000
Total market value of assets	18,873	14,842	258
Present value of scheme liabilities	(26,710)	(24,111)	(243)
(Deficit)/surplus in scheme	(7,837)	(9,269)	15
Related deferred tax asset/(liability)	2,351	2,781	(5)
Net pension (liability)/asset	(5,486)	(6,488)	10

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

	2004 £m	2003 £m
Net assets excluding pension liability	178.9	133.3
Pension liability	(5.5)	(6.5)
Net assets including pension liability	173.4	126.8
Profit and loss reserve excluding pension liability	178.9	133.3
Pension liability	(5.5)	(6.5)
Profit and loss reserve including pension liability	173.4	126.8

29 PENSIONS (continued)

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.

	2004	2003
	£'000	£'000
Analysis of amount charged to operating profit		
Current service cost	1,020	992
Past service cost	-	11,469
Total operating charge	1,020	12,461
Analysis of amount charged to other finance income		
Expected return on pension scheme assets	1,013	29
Interest on pension scheme liabilities	(1,358)	(54)
Net charge	(345)	(25)

	2004	2003
	£'000	Restated £'000
Analysis of amount recognised in statement of total recognised gains and losses		
Actual return less expected return on pension scheme assets	2,028	(177)
Experience gains arising on the scheme liabilities	12	2,690
Changes in assumptions underlying present value of the scheme liabilities	(99)	20
Total gain recognised	1,941	2,533

	2004	2003
	£'000	£'000
Movement in surplus during the year		
(Deficit)/surplus on scheme at 1 April	(9,269)	15
Movement in the year:		
- current service cost	(1,020)	(992)
- contributions	856	669
- past service cost	-	(11,469)
- other finance expense	(345)	(25)
- actuarial gain	1,941	2,533
Deficit on scheme at 31 March	(7,837)	(9,269)

	2004	2003
	£'000	£'000
History of experience gains and losses		
Difference between the actual and expected return on scheme assets:		
- Amount (£'000)	2,028	(177)
- Percentage of scheme assets	11%	1%
Experience gains/(losses) on scheme liabilities:		
- Amount (£'000)	12	2,690
- Percentage of present value of scheme liabilities	0%	11%
Total amount recognised in statement of total recognised gains and losses:		
- Amount (£'000)	1,941	2,533
- Percentage of present value of scheme liabilities	7%	11%

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30 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.

This Annual Report has been produced by the waterless printing method. It eliminates water consumption and the release of volatile organic compounds into the air. The process reduces paper consumption and as a result saves energy in reduced paper production, so limiting the effects on the environment.

The report is printed on Revive uncoated which is composed of a minimum 80% de-inked post-consumer waste and 20% mill broke. It conforms to Government requirements for recycled paper.

design/production: hungerford design, bradford on avon ■ words: mary clark copywriting ■ printing: parklane press