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Glas Cymru Cyfyngedig

Directors' Report and Financial Statements for the year ended 31 March 2005

Registered Number 3975719

Registered Office:-
Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY



Report and accounts

2004-05

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Registered Number: 3975719

The Directors

Who's who

The Board of Directors is responsible for the strategic direction of the Company and for reviewing operational and financial performance. It currently comprises 8 Directors, 6 Non-Executive Directors (including the Chairman of the Board), and 2 Executive Directors.

Membership of Board Committees

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

Mike Brooker

Dr Brooker retired as an Executive Director on 31 March 2005.

Lord Burns

Chairman

Appointed Non-Executive Chairman in July 2000. Lord Burns (61) is currently Chairman of Abbey and a Non-Executive Director of Banco Santander Central Hispano, Pearson Plc and The British Land Company Plc. He was made a life peer in 1998, and is a former Chief Economic Advisor and Permanent Secretary to HM Treasury. He is also Chairman (Designate) of Marks & Spencer Plc and a former Chairman of the National Lottery Commission.

Nigel Annett

Managing Director

Appointed Managing Director in January 2005. Mr. Annett (46) has been an Executive Director of Glas Cymru since April 2000, and of Dŵr Cymru (Welsh Water) since May 2001. He was previously a Director of Welsh Water between 1992 and 2000, prior to which he held various investment banking positions with Schroders, County Natwest and Wasserstein Perella.

Chris Jones

Finance Director

Appointed Finance Director of Glas Cymru in April 2000 and of Dŵr Cymru (Welsh Water) in May 2001. Mr. Jones (41) was previously Director of Regulation of Welsh Water between 1996 and 2000. Before joining Welsh Water in 1995, he was a Director at National Economic Research Associates and, prior to that, worked for HM Treasury on utility industries and privatisation.

John Bryant

Non-Executive Director

Appointed a Non-Executive Director in March 2001. Mr. Bryant (61) is a former Chief Executive of British Steel and, until December 2000, was Joint Chief Executive of Corus Plc. He is a Non-Executive Director of Costain Group Plc, and was a Non-Executive Director of Bank of Wales Plc between 1996 and 2001.

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. Membership is, however, 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 59 Members, including the Directors of Glas Cymru. 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.glaswymru.com or can be obtained by writing to the Company Secretary.

Alison Carnwath

Non-Executive Director
Appointed a Non-Executive Director in July 2000. Mrs. Carnwath (52) is a Non-Executive Director of Friends Provident Group Plc, Gallaher Group Plc, Land Securities 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 J Henry Schroder Wagg and a Managing Director of Donaldson Lufkin Jenrette.

Geraint Talfan Davies

Non-Executive Director
Appointed a Non-Executive Director in July 2000. Mr. Davies (61) is a former journalist whose career spanned both public and private sector broadcasting including Controller of BBC Wales throughout the 1990s and later a member of the Radio Authority. He is currently Chairman of the Arts Council of Wales and the Institute of Welsh Affairs, a Governor of the University of Wales Institute, Cardiff and a member of the BT Wales Advisory Forum.

Dame Deirdre Hine

Non-Executive Director
Appointed a Non-Executive Director in March 2001. Dame Deirdre (67) is Chairman of the BUPA Foundation and the Royal Society of Medicine Press Board, a member of the House of Lords Appointments Commission and President Elect of the British Medical Association. She is a former Chairman of the Commission for Health Improvement, a former President of The Royal Society of Medicine and a former Chief Medical Officer for Wales. Dame Deirdre was awarded the DBE in 1996 for services to medicine.

Tony Hobson

Non-Executive Director
Appointed a Non-Executive Director in February 2001. Mr Hobson (57) is the Chairman Designate of Northern Foods Plc and a Non-Executive Director of HBOS Plc, The Sage Group Plc and JLT Group Plc. He is a Chartered Accountant and was the Group Finance Director of Legal & General Group Plc from 1987 to 2001, and the Senior Independent Director of Thames Water Plc until its acquisition by RWE in 2000.

Directors' report 2004-05

Principal activity and review of the year

Glas Cymru is a company limited by guarantee and exists solely to own Dŵr Cymru Cyfyngedig ('Welsh Water'). Our constitution requires that all financial surpluses generated by the group are retained and reinvested for the benefit of Welsh Water and its customers and no group company can diversify into unrelated commercial activities.

This report should be read in conjunction with the chairman's statement and review of operational and financial performance on pages 1 to 27. These describe the performance of the business during 2004-05 and likely developments. At 31 March 2005 the group had financial reserves (Regulatory Capital Value less net debt) of £538 million, exceeding the published target for 31 March 2005 of £400 million.

In December 2004, the Director General of Water Services ('Ofwat') published his 'final determination' of price limits for the next regulatory period (2005-10). This set the level of capital investment Welsh Water is required to make in maintaining and enhancing its network of water and sewerage assets in the period April 2005 to March 2010 at £1.1 billion (at 2004 prices), and determined the price limits which customers can be charged over this period. In January 2005, the Board confirmed it would not be making an appeal to the Competition Commission in respect of the final determination.

Subsequently in January 2005, Welsh Water announced a 'customer dividend' of £18 per household for the billing year 2005-06, at a cost of £23 million, thereby doubling the bill rebate from which customers benefited in each of the billing years 2003-04 and 2004-05. Welsh Water is the only company in the water sector to pay a 'customer dividend' and charge less than allowed by Ofwat.

In December 2004 and January 2005 Welsh Water also announced, following a competitive bid process, the specialist service providers who will work with Welsh Water and carry out some 80% of the company's annual operating and investment expenditure under its outsourced procurement strategy. Details of the successful service providers and further information about the procurement strategy is available on the Welsh Water website: www.dwrcymru.com.

During the year £309 million of funding was raised comprising £274 million asset lease finance and £35 million from the European Investment Bank.

Details of post balance sheet events are disclosed in Note 31 to the Accounts page 92.

Directors

Details of the present directors are given on pages 32 and 33. All directors served throughout the financial year 2004-05, although Mike Brooker retired as a director on 31 March 2005. No Director is or has been party to, or has any interest in any significant contract with any group company (other than, for Executive Directors, directors' service contracts).

Nigel Annett and Chris Jones will retire by rotation in accordance with Article 46 of the Articles of Association, and Lord Burns will retire under Article 47.2, which requires that all directors stand for re-election at least once every three years. Resolutions for their reappointment will be proposed at the Annual General Meeting on 8 July 2005 (the '2005 AGM').

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 2005 set out on pages 38 to 47. Resolutions will be proposed at the 2005 AGM to (i) receive and adopt the 2005 Remuneration Report and (ii) to approve, as special business, new incentivisation arrangements for Executive Directors, details of which are set out in the 2005 Remuneration Report and in the notice of the 2005 AGM.

Members

At the date of this report, Glas Cymru has 51 Members excluding the Directors of the Company. Details of changes in the membership since the 2004 AGM, together with information about the role of Members and the process for their appointment under the direction of an independent membership selection panel, can be found on page 33. Further information on this, and brief details of the current Members, is available on request or may be obtained from the Glas Cymru website www.glascymru.com.

Employees

Other than the directors of the Company, Glas Cymru has no employees. At 31 March 2005 Welsh Water employed 135 people.

Welsh Water takes its responsibilities to its employees seriously and the Board is committed to equality of opportunity and aims to treat all employees fairly in every aspect of employment. Those who seek employment with Welsh Water are considered solely on their skills and abilities.

We are committed to giving employees the opportunity to maximise their potential and individual training and development needs are assessed as part of an annual development review. Keeping our staff informed on our direction and performance is important and we have established ways of achieving this - these are further described on page 21.

Welsh Water's outsourced procurement strategy fundamentally changed the manner in which services have been delivered to customers and has made a major contribution to improved levels of customer service over the period since 2001. This has been achieved, in large part, by the development of the operational 'alliances' through which contract partners are encouraged to work with Welsh Water in a 'one-team' approach in the delivery of Welsh Water's business plan in a culture of continuous improvement.

The health and safety of the people who work for us, and those we affect through our work is very important. Our commitment to health and safety is further described on page 21 and additional information on this and the performance of Welsh Water and its contract partners in 2004-05 is set out in our 2005 Health and Safety Report. A copy of this document is available on request or may be obtained from the Welsh Water website www.dwrcymru.com.

Environment

We are committed to improving the operational and environmental performance of the business. This is monitored each month by the Quality and Environment Committee of the Board and, as in previous years, a copy of the 2005 Quality and Environment Committee Report is available on request or may be obtained from the Welsh Water website www.dwrcymru.com.

Further information on our commitment to the environment and to biodiversity is set out on page 20 and expanded on in two new reports published by Welsh Water in 2004-05. Our Biodiversity Overview and Environment Overview describe the framework within which we operate, our recent performance, the challenges we face and the high-level objectives we have set ourselves.

On pages 18 to 21 we describe our approach to meeting our wider corporate social responsibilities to our customers, to the communities we serve, to the environment and to our employees in the workplace.

Directors' report 2004-05

Research and development

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

Payment policy

Our policy is (and will be for the forthcoming period) to agree payment terms at the start of a relationship with a supplier, which will only be changed by agreement. Payment will be made in accordance with agreed terms, save where we advise suppliers when an invoice is contested, which we will do without unreasonable delay. We will seek to remedy disputes as promptly as possible. Standard payment terms to suppliers of goods and services will be 28 days net monthly from date of receipt of a correct invoice for satisfactory goods or services which have been ordered or received, unless other terms are agreed in a contract.

In 2004-05, the average payment period was 70 days (2004: 88 days). Regulations require that in calculating this we include within trade creditors monies retained under contract in respect of Welsh Water capital investment projects. This level of retentions varies from year to year and adversely affects the average payment period for the year.

Contributions for charitable and political purposes

During the year charitable donations amounted to £22,394 (2004: £24,570). Donations above £200 were made to: Water Aid (£5,250), Hereford Waterworks Museum (£5,000), Handicapped Anglers Trust (£1,949), and Keep Wales Tidy (£10,000). Water Aid is a national charity.

Glas Cymru does not make payments for political purposes and no such payments have been made since the formation of the company. During the last financial year, the group made no payments or donations in kind required to be disclosed under the Political Parties, Elections and Referendums Act 2000.

Welsh language policy

We welcome dealing with customers and other stakeholders in Welsh or in English and aim to provide an equally effective standard of service in both languages. During 2004-05, as in previous years, we operated a voluntary scheme which was approved by the Welsh Language Board. In January 2004, the National Assembly for Wales made an Order giving the Welsh Language Board the statutory power to require any water and/or sewerage undertaker operating in Wales to prepare a Welsh language scheme for its approval. We have agreed and submitted a new scheme to comply with that Order.

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 2005.

International financial reporting standards

Glas Cymru is well advanced in its preparations for International Financial Reporting Standards (IFRS). Glas Cymru will implement IFRS for the financial year ending 31 March 2006 (including restating the comparatives for 2005). This means that the results for the six months to 30 September 2005 will be reported under IFRS. The adoption of IFRS will impact on the group's reported results and balance sheet but represents an accounting change only and will not affect the underlying cashflows or financial position of the group.

Going concern

Having made due enquiry the Board has concluded that there is a reasonable expectation that Glas Cymru and its subsidiaries have adequate resources to continue in operational existence for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2005 have been prepared on a going concern basis.

Auditors

Having indicated their willingness to continue in office, a resolution to re-appoint PricewaterhouseCoopers LLP as auditors to Glas Cymru will be proposed at the 2005 AGM.

Annual general meeting

The notice convening the company's 2005 AGM to be held on Friday 8 July 2005 is set out in a document sent to the Members of Glas Cymru with this report.

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 2005, the re-appointment of three Directors who retire and offer themselves for re-appointment, and the re-appointment of PricewaterhouseCoopers LLP as auditors. These resolutions are matters of ordinary business for the 2005 AGM, being matters that are addressed each year. In addition, Members will be asked to approve new long-term incentivisation arrangements proposed for Executive Directors.

By order of the Board



RG Curtis LLB ACIS
Company Secretary
7 June 2005

Remuneration report 2004-05

The Remuneration Committee is pleased to submit its 2005 annual report in relation to remuneration policy and practice.

Compliance

This report complies with the requirements of the Directors' Remuneration Report Regulations 2002 (the 'Regulations'), as now incorporated in the Companies Act 1985, and has been endorsed by the Board for submission for approval by Members at the 2005 Annual General Meeting.

In accordance with the Regulations, the directors' emoluments table, long-term performance related bonus table and pension table on pages 43 and 44 have been audited; the remainder of the report has been reviewed for consistency by PricewaterhouseCoopers LLP, but is not subject to audit under the Regulations.

The approach taken by Glas Cymru to compliance with the Principles of Good Governance and Code of Best Practice (the 'Combined Code') is included in the Corporate Governance Report on page 48. We confirm that we have complied with the Combined Code in preparing this report.

Remuneration committee

The Remuneration Committee (the 'Committee') is a Committee of the Board. It is chaired by Alison Carnwath and comprises all the Non-Executive Directors, except the Chairman of the Board who along with the Managing Director attends 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 Committee met on six occasions in 2004-05 and details of Committee members' attendance is set out in the Corporate Governance Report on page 52.

The role of the Remuneration Committee is to approve, implement and keep under review the remuneration policy and practice and specifically:

- to agree with the Board the policy and framework for the remuneration of Executive Directors and senior managers
- 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.

A copy of the full terms of reference of the Committee is available on the Company's website or on request from the Company Secretary.

The Company Secretary attends all meetings of the Committee and provides information and advice as necessary. In addition, the Committee has sought independent external advice on certain aspects of remuneration policy and best practice. In 2004-05, the Committee sought advice from:

- New Bridge Street Consultants LLP ('New Bridge Street'), as regards current market best practice in relation to the design of new incentive performance arrangements and the benchmarking of Executive Directors' service contracts and remuneration arrangements. New Bridge Street are currently assisting the Committee to review the remuneration arrangements of various senior managers and in 2004-05 they also advised the Board on benchmarking fees for Non-Executive Directors
- Linklaters & Alliance, in relation to legal advice requested by the Committee on various pension and policy related matters. Linklaters also provide legal advice to the Group on various other matters
- Barnett Waddingham LLP, in relation to pension advice requested by the Committee. This organisation also advises the Group on pensions and associated actuarial related matters.

In the view of the Committee, there were no conflicts of interest in relation to these organisations advising both the Group and the Committee.

In addition, during the year the Committee also reviewed benchmarking information provided by Monks Partnership (part of the PricewaterhouseCoopers LLP network).

Remuneration policy

At the meeting of the Members of Glas Cymru held in December 2004, the Chairman of the Committee led a discussion of the principles that underpin the remuneration policy and practice that we first adopted in 2001 (the '2001 Remuneration Policy') and which has been consistently applied throughout the period from adoption to 31 March 2005.

The 2001 Remuneration Policy was designed to support the recruitment, motivation and retention of key individuals in a competitive market place and to implement remuneration arrangements that align as closely as practicable the interests of the individual with the longer-term interests of the Group and, especially, the interests of the customers of Welsh Water. Accordingly, a high proportion of directors' remuneration is dependent on performance.

Specifically, the 2001 Remuneration Policy set base salaries below market levels (assessed against a comparator group of companies of similar nature and complexity), typically around lower quartile; and set incentive bonuses across a broad range of performance measures relevant to customers. This remains unchanged under the revised incentive strategy (below) save that base salaries are set at a level such that the total remuneration package is around median total remuneration for a comparator group of companies.

For 2005-06 the comparator companies comprise the quoted water companies (AWG plc, Kelda plc, Pennon plc, Severn Trent plc and United Utilities plc), together with National Grid Transco and Scottish Power. The Committee assesses the appropriateness of the comparator group of companies on an annual basis.

Revised incentive strategy

While we believe the 2001 Remuneration Policy has worked well it was opportune to revisit it, coinciding as it did with our entering a new phase in the development of the business and a restructuring of responsibilities of the executive team following the retirement of Mike Brooker as Managing Director.

To build on the experience of the first four years of Glas Cymru's stewardship of Welsh Water and to create a remuneration framework 'fit for purpose', the Committee engaged New Bridge Street to advise on market best practice. This included the benchmarking of Executive Directors' service contracts and remuneration arrangements and, in particular, the level of salaries and the shape and scale of incentive performance arrangements. With the benefit of this advice, and in the light of re-allocation of executive responsibilities following the retirement of Mike Brooker, the Committee subsequently reviewed the salaries of Executive Directors, and the Board adopted the new executive incentivisation scheme which is recommended for approval at the 2005 Annual General Meeting (together the '2005 Remuneration Policy').

The principles that underpin the 2005 Remuneration Policy, which are to be applied to senior managers in the Group as well as to Executive Directors, build on those that underpinned the 2001 Remuneration Policy. These include that:

- overall remuneration packages shall be broadly competitive when compared to the relevant market
- the 'at-risk' performance related component of directors' remuneration shall be greater than is typical in comparator companies for the achievement of stretching performance targets
- customer service and financial performance remain the two criteria by which the success of the business is judged and shall therefore be key determinants of performance related pay

Remuneration report 2004-05

we offer the opportunity for total pay to be substantially greater than basic pay, but only in circumstances where performance is better than expected and required by our regulators, and compares favourably with our peers only by an appropriate combination of annual and longer term incentivisation arrangements can the Committee ensure that individuals are motivated and that their interests are suitably aligned with the longer term objectives of Glas Cymru and the customers of Welsh Water and the 2005 Remuneration Policy shall reflect the stated intention of the Board that Welsh Water should be one of the consistently best performing water companies in the sector, and that to earn bonuses directors must outperform the level of customer service and financial performance expected by Welsh Water's regulators.

Details of the new executive incentivisation scheme have been issued to Members separately, and a copy of this document is available on the Group's website www.glascymru.com. The major features of this scheme are detailed later in this report on page 45.

Scope of remuneration arrangements for Executive Directors

The remuneration of each Executive Director comprises a base salary (together with pension arrangements and other 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. This remains unchanged under 2005 Remuneration Policy.

Salary

Throughout the year 2004-05, the basic salaries of the Executive Directors were as below:

Mike Brooker (Managing Director)	£194,958
Nigel Annett (Executive Director)	£139,256
Chris Jones (Finance Director)	£139,256

The Committee firmly believes that, given the high levels of personal performance achieved by the Executive Directors it is necessary to provide more competitive levels of base salary for recruitment and retention purposes. Having considered the competitive market data provided by New Bridge Street in developing the 2005 Remuneration Policy, with effect 1 April 2005 the Committee set the salary of the new Managing Director and Finance Director at:

Nigel Annett (Managing Director)	£220,000
Chris Jones (Finance Director)	£170,000

Annual performance related bonus

Under the 2001 Remuneration Policy Executive Directors have the potential to earn an annual bonus of up to 80% of basic salary, of which up to 50% is assessed against delivery of targets for customer service performance, and up to 30% is assessed against the annual financial performance of the Company. Annual bonus payments are non pensionable.

The customer service element of the annual bonus is independently measured by reference to the Overall Performance Assessment published by Ofwat ('OPA'). 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 OPA are non-financial performance measures for:

- water supply: e.g. interruptions to supply, restrictions on supply and drinking water compliance
- sewerage measures: e.g. sewage flooding incidents and quality of effluent discharges to the environment and
- customer service performance: e.g. 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 reflects most of the important factors over which directors have control in the short term. 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 2004 Executive Directors received an annual incentive bonus for the year ended 31 March 2004 equivalent to 60.5% of salary, of which 44.5% related to performance against customer service targets and 16% to meeting financial targets; this compared to an accrual in the 2003-04 Accounts of 49.5%. The 2004-05 Accounts include an accrual of £287,870 (equivalent to 60.8% of salary) reflecting the Committee's current estimate of Welsh Water's relative performance for the year ended 31 March 2005. The Committee will make its final determination of bonus payable in September 2005 following publication by Ofwat of its Levels of Service report for 2004-05.

Long term performance related bonus

Under the 2001 Remuneration Policy this scheme applies to 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 'financial reserves' (Regulatory Capital Value less net debt); and (ii) changes in the rating of each class of the Company's bonds.

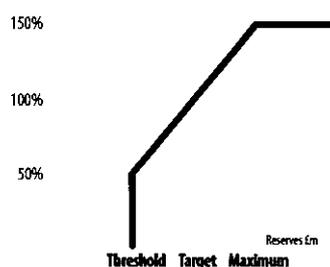
The Committee believes that growth in financial reserves is the best financial measure of customers' interest in the business, as it is from financial reserves that any 'customer dividend' and any additional investment to deliver service improvements will be funded. Growth in financial reserves therefore captures the dynamics on which the objectives of Glas Cymru were founded and aligns the financial interests of Executive Directors in a direct and simple way with those of customers.

The scheme operated over a four-year period to 31 March 2005, and assessment of performance will be taken as the average of the balance of reserves over the six months that end on 30 June 2005 (January 2005 - June 2005). As in the case of the annual performance related 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 any credit rating change over the period, announced by Standard & Poor, Moody's or Fitch (the 'Rating Agencies') on each class of bonds (providing that awards could never fall below zero).

Remuneration report 2004-05

Reserved base bonus



Ratings-based adjustments

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 more	-50%

Half of any award earned under this long-term bonus scheme will be payable in September 2005. The remaining half will be deferred for two years and will be payable in September 2007 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. In circumstances where a director is under notice to leave at that date (whether the notice has been given by the company or the director), the unpaid part of any award would be forfeited. Mike Brooker, having retired on 31 March 2005, will receive full entitlement to the long-term bonus accrued for the four year period to 31 March 2005 in September 2005.

The value of reserves at 31 March 2005 of £538 million equates to an entitlement to long-term bonus of 150% of basic salary at 31 March 2005. Following the one point improvement in rating of the Group's C class bonds announced by Moody's in April 2005, from Baa3 to Baa2, this is increased by a further 10% to a total long-term bonus of 160% of basic salary at 31 March 2005, which totals £757,552. The following payments will be made in September 2005 and in September 2007.

Director	September 2005	September 2007	Total
Nigel Annett	£111,405	£111,405	£222,810
Chris Jones	£111,405	£111,405	£222,810
Mike Brooker	£311,932	n/a	£311,932
Total	£534,742	£222,810	£757,552

Pensions

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: 2004-05

	Accrued pensions (per annum)	Increase in accrued pension in the year	Transfer value at 31 March 04	Transfer value equivalent of increase	Transfer value at 31 March 05	Contributions paid by director	Contributions paid by company***
MP Brooker*	£124,420	£7,045	£1,636,719	£691,854**	£2,328,573	£12,216	£44,150
NC Annett*	£44,840	£4,787	£278,789	£52,478	£331,267	£8,865	£32,063
CA Jones*	£32,562	£4,368	£149,707	£34,056	£183,763	£8,865	£32,063

* Accrued pension includes previous service in Hyder Water Pension Scheme

** MP Brooker retired on 31 March 2005 with an unreduced pension, which is reflected in the transfer value.

*** An accrual of £270,000 has been made in respect of MP Brooker which will be paid to the pension scheme in the year ended 31 March 2006.

The Welsh Water Pension Scheme is a final salary occupational scheme and is subject to Inland Revenue limits. The Company has made a provision for liabilities arising from contractual commitments to Executive Directors over the Inland Revenue 'earnings cap' which will not be affected by pensions tax simplifications. As at 31 March 2005 this liability totalled £204,000 (31 March 2004: £134,200). 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 also participate in a private health and medical insurance scheme.

The Committee is currently considering the impact of pensions tax simplification on existing pension arrangements for Executive Directors and the Welsh Water Pension Scheme more generally.

Directors' emoluments (excluding pension benefits and long term performance related bonus)

The table on page 44 reports emoluments receivable in respect of the year ended 31 March 2005, and includes a best estimate of the performance related annual bonus relating to customer service performance for 2004-05. The annual performance related bonus is ordinarily paid in September, following publication by Ofwat in August of its Levels of Service Report which sets out the comparative performance of the ten water and sewerage companies of England and Wales and the OPA data for the financial year in question. The extent to which this element of the bonus has been 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.

The following emoluments were earned by the directors in respect of the financial year ended 31 March 2005.

2004-05	Lord Burns	MP Brooker	NC Annett	CA Jones	JM Bryant	A Carnwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary		£194,958	£139,256	£139,256						£473,470
Bonus 2004-05 Provision ¹		£118,534	£84,668	£84,668						£287,870
Benefits in kind ²		£9,378	£9,612	£10,013						£29,003
Fees	£155,000				£41,334	£41,334	£41,334	£41,334	£41,334	£361,670
Total emoluments relating to 2004-05 ¹	£155,000	£322,870	£233,536	£233,937	£41,334	£41,334	£41,334	£41,334	£41,334	£1,152,013

(Note 7)

The following emoluments were earned by the directors in respect of the financial year ended 31 March 2004.

2003-04	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
Interim bonus as provided in Report and Accounts for 2003-04 (note 3)		£92,792	£66,281	£66,281						£225,354
Additional final bonus paid		£20,621	£14,729	£14,729						£50,079
Total bonus (note 4)		£133,413	£81,010	£81,010						£275,433
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 2003-04	£148,333	£310,272	£224,713	£224,291	£39,165	£39,165	£39,165	£39,165	£39,165	£1,103,434

Notes

- The financial statements for the year ended 31 March 2005 include a provision of £287,870 (60.8% of base salary) for bonus potentially payable to Executive Directors for performance in the financial year 2004-05. This provision has been estimated on the basis that performance in OFWAT's Overall Performance Assessment for 2004-05 will be 3rd. The final amount to be paid to each director will be determined when OFWAT publishes OPA results for 2004-05 in the Autumn of 2005, and could be higher or lower.
- Benefits in kind relate to receipt of private medical insurance and life insurance. In 2003-04 and 2004-05, Executive Directors received a non-pensionable salary supplement in lieu of receiving a company car. This has subsequently been discontinued.
- A performance bonus of £225,354 was provided for in the Report and Accounts for 2003-04 and was estimated on the basis that Welsh Water's OPA ranking in 2003-04 would be 3rd.
- The actual performance bonus in respect of 2003-04 totalled £275,433 (60.5% of salary) and was paid in September 2004, following publication of OFWAT's OPA Report for 2003-04, which confirmed Welsh Water's position as 2nd.
- In 2003-04 CA Jones and NC Annett received £25,000 being the final instalment of a £100,000 bonus in respect of the year ended 31 March 2001, which predates the company's acquisition of Welsh Water.
- The highest paid director is MP Brooker, aggregate emoluments: £322,870 (2004: £289,651 excluding the bonus of £20,621 in respect of performance in 2003-04, which was not provided for in the Report and Accounts for that year - see note 3 above.)
- The directors emoluments' table for 2004-05 does not include provision for directors' entitlement under the long term performance related bonus scheme for the four year period ended 31 March 2005, which is payable in September 2005 and September 2007, details of which can be found on page 41.

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. At the Company's discretion, an Executive Director may be paid basic salary alone in lieu of notice. As such, a significant element of mitigation is built into the Executives' contracts should the Company choose to exercise its option to make a payment in lieu of notice.

External appointments

The Board recognises the benefit of broadened experience that might be achieved through the involvement of Executive Directors in external activities. However, at the date of this report no Executive Director had any external fee paying appointment. Any future appointment would be subject to annual approval by the Committee and, subject to the Committee's agreement, an individual director may retain any fees.

Chairman and Non-Executive Directors

Responsibility for determining the fees of the Chairman of the Board and of the Non-Executive Directors sits with the Committee and with the Board respectively. These fees were last revised with effect 1 April 2005, when they were increased to:

Chairman	£164,000 (2004: £156,000)
Non-Executive Directors	£45,000 (2004: £41,600)

The increased fees were approved after consideration of benchmarking data provided by New Bridge Street and assessment of the role of the Chairman and Non-Executive Directors. No additional amount is payable to the Chairman or any Non-Executive Director for the chairmanship of, or membership of, Board Committees or for the undertaking of any special responsibilities on behalf of the Board (further details of which can be found in the Corporate Governance Statement on page 49). Fees are reviewed annually.

The Chairman and the Non-Executive Directors are appointed under letters of appointment, which were updated in line with current best practice for such agreements and re-issued. There was no material change in these terms of appointment. Appointments may be terminated by either party, and no compensation is payable by the Company on termination of an appointment.

Revised incentive scheme

In this final section of the report, we detail the main features of the new executive incentivisation scheme approved by the Remuneration Committee of the Board with effect 1 April 2005. Executive Directors will be incentivised by a combination of a short term annual bonus and a rolling three year incentive scheme, the latter of which is to be submitted for approval by Members at the 2005 Annual General Meeting.

Annual bonus scheme

The maximum annual cash bonus payable under this scheme will be 80 percentage points of base salary ('PPBS'), with 50 PPBS (62.5% of the maximum) being payable for reaching 'target' level of performance. Maximum bonus is divided equally between customer service and financial performance components, and the annual bonus will be payable within six months of the end of the year to which it relates.

Remuneration report 2004-05

The customer service component will be determined with reference solely to OPA, and can earn up to 40 PPBS for achieving 1st position in the OPA ranking of the ten water and sewerage companies of England and Wales as published by Ofwat (the 'OPA League Table'). 8 PPBS (20% of the maximum) will be payable for achieving median performance, being the average score of the 5th and 6th ranked companies, with ranking above this rewarded on a linear scale. At the discretion of the Committee, this bonus entitlement may be adjusted upward or downward by up to 10 PPBS to reflect identifiable and significant aspects of customer service performance not captured by OPA.

The financial component will be based on net cash flow (before capital expenditure but after net interest payable) and can earn up to 40 PPBS. Performance will be rewarded on a linear scale from zero for meeting the annual Cashflow target in the regulatory settlement for 2005-10 announced by Ofwat in December 2004 (the 'Final Determination'), 25 PPBS (62.5% of maximum) and 40 PPBS for reaching the respective target and maximum levels approved by the Committee. To achieve target level bonus accordingly requires that Welsh Water outperforms the Final Determination, which is a key requirement if the business is to achieve the challenging objectives set by the Board.

Rolling Long Term Incentive Scheme ('RLTIS')

The RLTIS will operate over a rolling three-year period.

The maximum bonus payable under RLTIS will be 60 PPBS, with 30 PPBS (50% of the maximum) being payable for reaching 'target' performance. Maximum bonus is divided equally between customer service and financial performance components.

The RLTIS will operate annually from 1 April 2005. Payments under RLTIS will be made within six months of the end of the final year to which they relate, but payment may be deferred at the discretion of the Committee in the event there is a significant deterioration in performance. Deferral may be for up to two years, or until the shortfall has been remedied, whichever is the earlier.

In addition, payment of up to 20 PPBS will be deferred in the event that any of the Company's bonds have been put on credit watch by any of the Rating Agencies, either until taken off credit watch or they have been downgraded, in which case the 20 PPBS shall be forfeited.

The customer service component will be determined with reference to Welsh Water's position in an adjusted OPA League Table, compiled by aggregating OPA scores for each of the last three years up to and including the relevant year of assessment. Bonus will be payable on a sliding scale of 100% (30 PPBS) for achieving 1st position, 75% for 2nd, 50% for 3rd, 25% for 4th and zero for being ranked 5th or below of the ten comparator companies.

The financial performance component will be based on 'Financial Reserves' at the end of the relevant year, as defined for the purposes of the quarterly Investor Report routinely published by the Company. The Committee will normally confirm target ranges three years in advance, however, these ranges will be subject to revision by the Committee each year in certain circumstances. These include: (a) where there are differences between actual inflation and the assumptions originally made; (b) where the Board changes the 'customer dividend' after the original forecast was made; and (c) where there is any other material influence on Financial Reserves not originally foreseen and which the Committee determines to be outside the control of Executive Directors. Payment of bonus will be measured by reference to a lower limit, the Final Determination, at which no bonus will be earned, a target level at which 50% of maximum will be earned and an upper limit, set by the Committee, at which maximum bonus will be earned. Again, to achieve target level bonus accordingly requires that Welsh Water outperforms the Final Determination, which is a key requirement if the business is to achieve the challenging objectives set by the Board.

Other key provisions

The Committee may at its discretion make adjustments to the bonus calculation, up or down, to reflect events or factors which have occurred or arisen and which are not captured by the bonus formulae described above, providing that objective justification for any such adjustment will be disclosed in the relevant annual report.

Payments to Executive Directors under both the annual bonus and the RLTIS schemes are non-pensionable.

Recommendation

The Committee believes that the 2005 Remuneration Policy provides the right balance of salary and incentives to reward and motivate Executive Directors to the attainment of the challenging goals the Board has set for the Company. Accordingly, the Committee encourages Members to adopt this 2005 Remuneration Report and to approve the RLTIS new executive incentivisation scheme submitted for approval at the 2005 Annual General Meeting.



Alison Carnwath

Chair: Remuneration Committee

7 June 2005

Corporate governance

The combined code on corporate governance

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. This report explains the key features of the company's governance structure and how it complies 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'), although not all of the provisions of the Combined Code apply to Glas Cymru as a company limited by guarantee.

As at the date of this report, the Company complies with all applicable provisions of the Combined Code, save in respect of the appointment of a senior independent director which is referred to on page 49.

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

Directors

Brief biographical details of each of the current directors can be found on page 32 and 33, including respective dates of appointment. All Directors served throughout 2004-05, although on 1 January 2005 Nigel Annett was appointed Managing Director, succeeding Mike Brooker who subsequently retired as a Director on 31 March 2005. The appointment of Nigel Annett as Managing Director followed an exhaustive process of search and selection undertaken under the direction of the Nominations Committee and with the assistance of independent search consultants. Following the retirement of Mike Brooker, the Board has determined to appoint an additional Executive Director as Operations Director, and a process of search and selection described above has already commenced in this respect.

The appointment of a Director is the responsibility of the Board on the recommendation of the Nominations Committee. In line with Principle A5 of the Combined Code, any new director will be provided with a formal induction programme to familiarise him or her with the business, the risks and strategic challenges, and the economic, competitive, legal and regulatory environment in which we operate. A programme also exists to ensure that directors continually update their skills and business knowledge.

At the Annual General Meeting on 8 July 2005 ('2005 AGM') two directors, Nigel Annett and Chris Jones will retire by rotation in accordance with Article 46 of the Articles of Association, and Lord Burns will retire under Article 47.2, which requires all directors to stand for reappointment at least once every three years. Resolutions for their re-appointment will be proposed at the 2005 AGM. Having reviewed the performance of the Chairman, the Board believes that Lord Burns continues to demonstrate great commitment and is highly effective in his role as chairman, and that he continues to be 'independent' as defined in the Combined Code. The Board recommend the reappointment of all three directors seeking reappointment.

Each of the Executive Directors has a written service contract subject to termination by the company on twelve months notice. Each of the Non-Executive Directors has a written letter of appointment subject to termination by the Board without notice. Details of Directors' remuneration are provided in the 2005 Remuneration Report on pages 38 to 47. The Company Secretary is an employee, but not a Director, of the Company.

The Board

The Board meets regularly to set the strategic direction of the business and to review the operating, financial and risk performance of the business. There is a formal schedule of matters reserved to the Board, which can only be amended by the Board. This includes approval of the annual business plan (which sets the operating and strategic objectives for the business, and the risk framework within which the business will operate), corporate policies, significant transactions above specified thresholds or outside the ordinary course of business and the delegation of Board authority to committees and executive directors. A full list of reserved matters can be found on the Glas Cymru website www.glascymru.com. The executive management of the group is responsible to the Board for developing strategy and the overall performance of the business, in line with the business plan, policies and risk appetite approved by the Board.

Throughout 2004-05 the Board comprised of three Executive Directors and six Non-Executive Directors (including the chairman) although, as previously described, on 31 March 2005 Mike Brooker retired as a Director of the Company. Accordingly, a majority of the Board are independent Non-Executive Directors and 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.

During 2004-05 the Board met twelve times at which all directors were present, except for apologies from Nigel Annett, Alison Carnwath and Deirdre Hine on one occasion each, and Geraint Talfan Davies, Tony Hobson and Chris Jones on two occasions.

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 the business plan, 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 over 90% of the Members attended at least one of the two Members' Meetings in 2004 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 to an annual bondholder/investor meeting held in July 2004, there were a dozen informal meetings held with bondholders, who may also request a meeting with an independent Non-Executive Director at any time. Regular communication is also maintained with each of the economic, quality and customer service regulators of Welsh Water.

As a result of the above, the Board has concluded that the nomination of a senior independent director would not improve governance and has 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 has an established process to evaluate the performance of the Board, the Chairman and the principal committees of the Board. This includes detailed questionnaires completed by all directors, the conclusions of which are collectively discussed at the Board, supplemented by one to one discussions with the Chairman where appropriate, and actions are agreed to address issues raised. The most recent evaluation of the Board was undertaken in March 2005.

Corporate governance

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 supporting effective decision-making and good governance. Through these and other arrangements described above, the board believes it is able to exercise control over all significant aspects of the group's business.

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, and for this reason membership is personal and Members are not appointed to represent any particular group or stakeholder interest.

Members are appointed by the Board under Glas Cymru's published Membership Policy on the advice of an independent membership selection panel (the '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 an effective Member 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. The Chairman of the panel has confirmed to the Board compliance by Glas Cymru with the terms of its Membership Policy.

At 31 March 2005 there were 43 Members, excluding the directors. During 2004-05, no new Members were appointed, and one Member resigned, bringing the cumulative number of Members who have resigned to five. Mike Brooker ceased to be a Member with his retirement as a director. As a result, the panel recommended the appointment of additional Members to maintain continuity and an overall balance in the membership. An advertisement seeking application from persons interested in becoming Members was placed in newspapers across the Welsh Water region in January 2005.

Subsequent to the financial year-end, and following evaluation and recommendation by the panel:

Thirteen Members, whose initial term of office will expire at the end of the 2005 AGM, have applied for and have been reappointed for a further three-year term ending at the end of the AGM in 2008. One Member elected not to seek reappointment; and eight new Members were appointed and will serve an initial term of office expiring at the end of the 2008 AGM. Following these appointments there are, at the date of this report, 51 Members excluding the directors.

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 Welsh Assembly Government 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 that 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.

The Welsh Assembly Government 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, which is intended to make best use of the skills and experience of Non-Executive Directors in particular, is set out on pages 32 and 33. 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.

Audit Committee

This committee comprises three independent non-executive directors and is chaired by Tony Hobson, who has significant, recent and relevant financial experience. By invitation of the chairman, meetings of the Committee are attended by the Finance Director, Head of Business Assurance and Internal Audit and selected other senior managers. The Company Secretary acts as secretary to the Committee.

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 and advise the Board on the effectiveness of the company's internal control environment, including the '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.

During 2004-05 the Audit Committee met on four occasions with all members present, with the exception of Geraint Talfan Davies (apologies for one meeting), and reported its conclusions to the Board. The Committee formally reviewed the draft interim and annual reports and associated preliminary and interim results

Corporate governance

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.

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 2005. 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 Audit Committee oversaw a re-tendering process undertaken in 2004-05 to select a service provider for internal audit services. The Committee approved the reappointment of Grant Thornton in this role, following an extensive selection process. The new contract for internal audit services commenced on 1 April 2005 and will run for up to five years.

The Audit Committee has reviewed the policies of the auditors to ensure their independence and that of their engagement partner and has applied its stated policy on non-audit fees: i.e. that the external auditor will not be used for internal audit services and all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee.

Remuneration Committee

The role of this committee is to determine 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 Company Secretary acts as secretary to the Remuneration Committee. The Committee met on six occasions during the year with all members present, except for Geraint Talfan Davies (apologies for two meetings). Further detail on the work of the Remuneration Committee, and of those who advise the Committee, is set out in the 2005 Remuneration Report on pages 38 to 47 which is to be submitted for approval by Members at the 2005 AGM.

Nominations Committee

The role of this 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. 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.

Due to the retirement of Mike Brooker as a Director, the subsequent appointment of a new Managing Director and commencement of a process to recruit an Operations Director, the Committee formally met four times in 2004-05 with all members present, except for Geraint Talfan Davies (apologies for one meeting). This included one meeting to interview prospective candidates for the role of Managing Director (for which all members were

present). Prior to this, available members of the Committee had met informally on four other occasions to meet external candidates before the Committee agreed a shortlist for interview. Whitehead Mann & Associates, external search consultants, advised the Committee throughout this process.

In appointing a new Managing Director the Committee approved a specification for the role informed by the Chairman's and Committee's assessment of the skills, experience and knowledge required. Interviews were held with a range of candidates, involving all members of the Committee, leading to a recommendation that Nigel Annett be appointed Managing Director from 1 January 2005. A similar process has been commenced for the recruitment of an Operations Director.

Quality and Environment Committee (QEC)

The role of QEC, 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. All members attended each meeting of QEC, except for Deirdre Hine, John Bryant and Nigel Annett who missed one meeting each.

QEC 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 term of office of the independent experts, who were appointed in 2001, will expire on 31 December 2006.

The annual report of QEC is issued to the Drinking Water Inspectorate and Environment Agency (the 'Quality Regulators'), and 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 QEC 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.

The finance 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 processes 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 2004-05, the conduct, but not the management, of internal audit activity was outsourced to Grant Thornton. The Audit Committee approves the annual plan for internal audit, which covers the scope, authority and resources of such activity.

Also during 2004-05, a competitive re-tendering of the internal audit service was carried out, with an initial OJEU notice being published in October 2004. Following this process, Grant Thornton were reappointed for a further period of up to five years.

By order of the Board



R Curtis LLB ACIS
Company Secretary
7 June 2005

Directors' responsibilities

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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 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
7 June 2005

Independent auditors' report

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 sheets, the cash flow statement, the reconciliation of movements in reserves 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 also, at the request of the Directors (because the Company applies the Financial Services Authority Listing Rules as if it were a listed company), review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2003 FRC 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

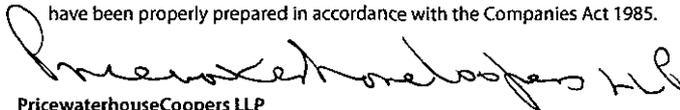
We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the directors' remuneration report. It also includes 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 2005 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

7 June 2005

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 overleaf 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, aboveground operational structures and equipment, and fixtures and fittings).

The cost of tangible fixed assets are stated at cost including cost of construction or purchase price and directly attributable costs.

The carrying value of tangible fixed assets is reviewed for impairment if circumstances indicate that it 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 & 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 capital expenditure programmes incorporates incentive bonuses payable after completion of the programmes. The cost of fixed asset additions includes an accrual for 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 contract partners, relating to targets not being achieved are only recognised on substantially completed projects.

Pension costs

The majority of the group's employees belong to a group 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.

Accounting policies

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 non-taxable 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 defined as 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 liabilities

Provision is made for all known and estimated liabilities of the group where there is a present obligation and it is probable that a transfer of economic benefits will be required.

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.

Investment

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').

Hedging

The group minimises exposure to currency risk in respect of foreign currency denominated borrowings 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 may seek to raise new debt through index-linked instruments or to enter into appropriate hedging transactions.

Liquidity

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.

Banking facilities

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.

Consolidated profit and loss account

Consolidated profit and loss account for the year ended 31 March 2005

	Note	2005 £m	2004 £m
Turnover	2	494.1	469.7
Net operating costs	3	(281.5)	(284.0)
Operating profit before depreciation and amortisation (EBITDA)		283.8	259.3
Depreciation	3	(119.5)	(122.3)
Amortisation of negative goodwill and grants	3	48.3	48.7
Operating profit		212.6	185.7
Profit on disposal of fixed assets	5	4.3	1.4
Profit on ordinary activities before interest		216.9	187.1
Net interest payable	6	(141.7)	(143.2)
Profit on ordinary activities before taxation		75.2	43.9
Taxation	7(a)	10.0	1.7
Profit on ordinary activities after taxation being retained profit for the year	22	85.2	45.6

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.

There is no difference between the above results and their historic cost equivalents.

Consolidated balance sheet

Consolidated financial statements

Consolidated balance sheet at 31 March 2005

Group	Note	2005 £m	2004 £m
Fixed assets			
Negative goodwill	8	-	(46.9)
Tangible assets	5	2,744.7	2,636.7
		2,744.7	2,589.8
Current assets			
Debtors	11	65.9	61.9
Current asset investments	12	265.2	223.1
Cash at bank and in hand		3.7	2.1
		334.8	287.1
Current liabilities			
Creditors: amounts falling due within one year	Total	(180.1)	(166.2)
Net current assets		154.7	120.9
Total assets less current liabilities			
		2,899.4	2,710.7
Liabilities			
Creditors: amounts falling due after more than one year	13 to 15	(2,509.2)	(2,380.9)
Provisions for liabilities and charges	20	(92.5)	(115.0)
Deferred income	16	(33.6)	(35.9)
Net assets		264.1	178.9
Reserves			
Profit and loss account	22	264.1	178.9
Total reserves		264.1	178.9

The financial statements on pages 58 to 92 were approved by the Board of Directors on 7 June 2005 and were signed on its behalf by:



Lord Burns
Chairman



N C Annett
Managing Director



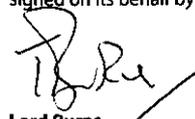
C A Jones
Finance Director

Company balance sheet

Company balance sheet at 31 March 2005

Company	Note	2005 £m	2004 £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	12	(3.5)	(3.5)
Net current assets		-	-
Reserves			
Profit and loss account	22	-	-
Total reserves		-	-

The financial statements on pages 58 to 92 were approved by the Board of Directors on 7 June 2005 and were signed on its behalf by:


Lord Burns
 Chairman


N C Annett
 Managing Director


C A Jones
 Finance Director

Consolidated cashflow statement

Consolidated cashflow statement for the year ended 31 March 2005

	Note	2005 £m	2004 £m
Cash inflow from operating activities	23	271.9	253.2
Returns on investments and servicing of finance			
Interest received		16.6	20.9
Interest paid		(132.8)	(131.3)
Interest element of finance lease payments		(18.3)	(8.8)
		(134.5)	(119.2)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(274.2)	(277.7)
Sale of tangible fixed assets		0.4	2.8
Grants and contributions received		11.2	11.4
		(262.6)	(263.5)
Cash outflow before use of liquid resources and financing		(125.2)	(129.5)
Management of liquid resources			
Net (increase)/decrease in deposits		(42.1)	28.5
Cash outflow before financing		(167.3)	(101.0)
Financing			
Long term loans and finance leases received		308.9	145.5
Purchase of own bonds		(1.0)	(42.8)
Bond redemption		(56.0)	-
Capital element of lease termination		(73.3)	-
Capital element of finance lease payments		(9.4)	(2.5)
Other loan repayments		(0.3)	(0.5)
		168.9	99.7
Increase/(decrease) in cash in the year	24	1.6	(1.3)

Reconciliation of reserves

Reconciliation of movements in reserves for the year ended 31 March 2005

Group	2005 £m	2004 £m
At 1 April	178.9	133.3
Profit for the year transferred to reserves	85.2	45.6
At 31 March	264.1	178.9

Notes to the financial statements

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 £626 (2004: £3,140 loss).

2 Segmental analysis by class of business

(a) Turnover

	2005 £m	2004 £m
Regulated water and sewerage activities	486.4	463.1
Non regulated activities	7.7	6.6
	494.1	469.7

(b) Profit on ordinary activities before taxation

	2005 £m	2004 £m
Regulated water and sewerage activities		
Operating profit	210.8	184.8
Profit on disposal of fixed assets	4.3	1.4
Net interest payable	(142.0)	(143.7)
	73.1	42.5
Non-regulated activities		
Operating profit	1.8	0.9
Interest receivable	0.3	0.5
	2.1	1.4

(c) Net assets

	2005 £m	2004 £m
Regulated water and sewerage activities	258.0	174.9
Non-regulated activities	6.1	4.0
	264.1	178.9

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

Notes to the financial statements

3 Net operating costs

	Note	2005 £m	2004 £m
Operating charges from outsourced activities:			
- Operating services agreement		89.9	94.1
- Customer services agreement		19.3	18.9
- Laboratories and analytical services		7.5	8.0
- Other contracts		20.2	17.3
		136.9	138.3
Staff costs	4(b)	13.0	9.0
Research and development		0.2	0.1
Charge for bad and doubtful debts		8.0	9.0
Rates		17.6	20.4
Environment Agency charges		12.6	11.7
Fees paid to auditors	3(a)	0.3	0.3
Own work capitalised		(4.3)	(3.4)
Net rents payable		0.2	1.1
Other operating charges		25.8	23.9
		210.3	210.4
Depreciation:			
- Own assets		45.7	55.5
- Assets held under finance leases		24.3	20.8
Infrastructure renewal charge		49.5	46.0
Amortisation of grants and contributions		(1.4)	(1.6)
Amortisation of negative goodwill	8	(46.9)	(47.1)
		281.5	284.0

3 Net operating costs cont'd

(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.

	2005 £'000	2004 £'000
Audit services:		
- statutory audit services	99	99
- regulatory audit services	75	152
- other audit services	81	27
Tax advisory services	19	34
Other non-audit advisory services	-	32
	274	344

Regulatory audit services includes work on the Regulatory Accounts, June Return and Principal Statement and also certification of the group's submissions as part of the Periodic Review. Other audit services includes work on the transition to International Financial Reporting Standards, interim review work and the audit of grant applications.

In addition to the above services, PricewaterhouseCoopers LLP acted as auditor to the Welsh Water Pension Scheme. The appointment of auditors to the pension scheme and the fees paid in respect of the audit are agreed by the trustees of the scheme, who act independently from the management of the group. The fees paid in respect of audit services to the pension scheme during the year were £7,000 (2004: £8,000).

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

Notes to the financial statements

4 Directors and employees

(a) Directors' emoluments

Detailed disclosures of directors' individual emoluments are given in the Remuneration Committee report on pages 43 and 44. These disclosures are part of the financial statements.

(b) Staff costs

	Note	2005 £m	2004 £m
Wages and salaries		8.3	7.1
Severance programme and termination costs		2.7	-
Social security costs		0.8	0.7
Pension costs	29	1.2	1.2
		13.0	9.0

Of the above, £2.5 million (2004: £2.3 million) has been charged to capital. The severance programme and termination costs include £2.2 million in respect of pension costs (see note 29).

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

	2005 Number	2004 Number
Regulated water and sewerage activities	146	144

5 Profit on disposal of fixed assets

	2005 £m	2004 £m
Profit on disposal of fixed assets	4.3	1.4

The profit disclosed above relates to the disposal of certain infrastructure assets during the year.

6 Net interest payable

	2005 £m	2004 £m
Interest receivable	16.2	15.5
Interest payable:		
On loans	(140.4)	(144.6)
On finance leases	(22.3)	(12.8)
Termination profit on closure of finance lease	6.1	-
Amortisation of bond issue costs	(1.3)	(1.3)
Net interest payable	(141.7)	(143.2)

7 Taxation

(a) Analysis of charge in year

	Note	2005 £m	2004 £m
Current tax:			
Charge for year	7(b)	-	-
Deferred Tax:			
Origination and reversal of timing differences		4.7	13.1
Increase/(decrease) in discount	7(c)	5.3	(11.4)
Total deferred tax		10.0	1.7
Tax credit on profit on ordinary activities		10.0	1.7

(b) Factors affecting current tax charge for year

	2005 £m	2004 £m
Profit on ordinary activities before tax	75.2	43.9
Profit on ordinary activities multiplied by the corporation tax rate in the UK of 30%	22.6	13.2
Effects of:		
Amortisation of negative goodwill	(14.1)	(14.1)
Capital allowances in excess of depreciation	2.2	(0.6)
Tax losses carried forward	3.9	3.2
Other timing differences	(1.8)	(1.3)
Permanent adjustments for tax purposes	(10.3)	1.8
Income not chargeable for tax purposes	(2.5)	(2.2)
Current tax charge for year	-	-

Notes to the financial statements

7 Taxation

(c) Deferred taxation

	2005 £m	2004 £m
Tax effect of timing differences		
Excess of tax allowances over depreciation	322.3	324.6
Other timing differences	(10.0)	(7.6)
Undiscounted provision for deferred tax	312.3	317.0
Discount	(240.2)	(234.9)
Discounted provision for deferred tax	72.1	82.1
Provision at 1 April	82.1	83.8
Deferred tax credit on profit and loss account for year	(10.0)	(1.7)
Provision at 31 March	72.1	82.1

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.

No provision has been made for deferred tax on the sale of property during the year. It is envisaged that any potential taxable gains will be rolled over into assets qualifying for rollover relief. The total deferred tax unprovided is estimated to be £1.0 million, however this may be a higher or lesser amount depending upon the outcome of valuation for tax purposes. It is not envisaged that tax will become payable in the near future.

As at 31 March 2005 carried forward taxable losses amounted to £24.7 million (2004: £11.6m).

8 Intangible fixed assets – negative goodwill

	2005 £m
Cost	
At 1 April 2004 and at 31 March 2005	181.7
Amortisation	
At 1 April	134.8
Released in the year	46.9
At 31 March	181.7
Net Book Value	
At 31 March 2005	-
At 31 March 2004	(46.9)

Negative goodwill has been fully 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	Infrastructure assets £m	Operational structures £m	Vehicles, plant, equipment & computer hardware & software £m	Total £m
Cost					
At 1 April 2004	32.8	1,685.3	1,860.4	224.5	3,803.0
Additions	-	129.6	99.4	9.9	238.9
Grants and contributions	-	(11.2)	-	-	(11.2)
Disposals	-	(1.2)	-	-	(1.2)
At 31 March 2005	32.8	1,802.5	1,959.8	234.4	4,029.5
Accumulated depreciation					
At 1 April 2004	14.4	443.0	533.0	175.9	1,166.3
Charge for the year	0.4	49.5	56.1	13.5	119.5
Eliminated on disposals	-	(1.0)	-	-	(1.0)
At 31 March 2005	14.8	491.5	589.1	189.4	1,284.8
Net book value					
At 31 March 2005	18.0	1,311.0	1,370.7	45.0	2,744.7
At 31 March 2004	18.4	1,242.3	1,327.4	48.6	2,636.7
Analysis of net book value at 31 March 2005					
Owned	18.0	886.3	937.1	45.0	1,886.4
Held under finance leases	-	424.7	433.6	-	858.3
	18.0	1,311.0	1,370.7	45.0	2,744.7

Tangible fixed assets at 31 March 2005 include £91.1 million (2004: £274.4m) of assets in the course of construction, which are not depreciated until completed.

Notes to the financial statements

9 Tangible fixed assets – Group cont'd

(b) The accounting treatment for grants and customer contributions in respect of infrastructure assets is described in the principal accounting policies on page 59. 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 59 has been adopted in accordance with section 227(6) of the Companies Act 1985 in order to show a true and fair view, as in the opinion of the directors, it is not appropriate to treat grants and contributions on infrastructure assets as deferred income. The fixed assets to which they relate do not have determinable finite lives and therefore no basis exists for releasing any deferred income to the profit and loss account. As a consequence, the net book value of fixed assets and deferred income is £178.3 million (2004: £167.1 million) lower than it would have been had grants and contributions been treated as deferred income indefinitely.

(c) The cost of fixed assets includes a net accrual of £nil (2004: £15.0m) in respect of capital expenditure programme incentive payments.

10 Fixed asset investments

(a) Group

Cost and net book value	2005 £m	2004 £m
At 1 April and 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.

10 Fixed asset investments cont'd

(b) Company

In addition, 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

Group	2005 £m	2004 £m
(a) Amounts falling due within one year:		
Trade debtors	21.4	19.1
Other debtors	7.6	11.7
Prepayments and accrued income	36.8	31.0
	65.8	61.8
(b) Amounts falling due after more than one year:		
Other debtors	0.1	0.1
	0.1	0.1
	65.9	61.9
	2005 £m	2004 £m
Company		
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

	2005 £m	2004 £m
Investments in:		
Fixed term and call deposits - due within one year	265.2	223.1
	265.2	223.1

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

Notes to the financial statements

13 Creditors

Group	Note	2005 £m	2004 £m
(a) Amounts falling due within one year:			
Loans	14	44.3	0.4
Obligations under finance leases	15	3.0	2.0
Trade creditors		38.3	38.7
Capital creditors		39.0	58.2
Other taxation and social security		0.5	0.4
Other creditors		55.0	66.5
		180.1	166.2
(b) Amounts falling due after more than one year			
Loans	14	1,870.2	1,917.9
Obligations under finance leases	15	628.5	438.3
Other creditors - between one and five years		10.5	24.7
		2,509.2	2,380.9
(c) Loan reconciliation			
Bonds in issue		1,978.6	1,910.0
Bonds (redeemed)/issued		(100.0)	68.6
Bond indexation		48.7	30.9
European Investment Bank (EIB) Loan		35.0	-
Local authority loans		4.1	4.4
Gross loans at 31 March		1,966.4	2,013.9
Unamortised bond premium		14.2	14.8
Unamortised loan issue costs		(9.9)	(11.2)
Bonds held within the group		(56.2)	(99.2)
Loans as above		1,914.5	1,918.3
		2005	2004
Company		£m	£m
Amounts falling due within one year:			
Amounts owed to subsidiary undertaking		3.5	3.5
		3.5	3.5

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

13 Creditors cont'd

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:

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

14 Loans

Group	2005 £m	2004 £m
Loans are repayable as follows:		
Within one year	44.3	0.4
Between one and two years	1.5	45.2
Between two and five years	439.2	482.2
After more than five years	1,429.5	1,390.5
	1,914.5	1,918.3
Repayable wholly within five years	468.9	525.8
Repayable wholly after five years	1,406.5	1,388.1
Repayable by instalments of which some repayments are after five years	39.1	4.4
	1,914.5	1,918.3
	2005	2004
Interest rates on these loans ranged as follows:		
- Index linked debt (pre indexation)	3.51% to 4.38%	3.51% to 4.38%
- Other debt	4.98% to 11.45%	6.02% to 11.45%

On 31 March 2005, the Group redeemed £100 million of its floating rate bonds. These bonds had an average interest rate of 11.45% in the year and an expected maturity of 31 March 2008.

On 16 May 2005, the Group gave notice to redeem £425 million of its floating rate bonds on 30 June 2005. These bonds had an average interest rate of 5.69% in the year and an expected maturity of 31 March 2008.

Notes to the financial statements

15 Finance leases

	2005	2004
Group	£m	£m
Amounts due under finance leases within one year	3.0	2.0
Amounts due under finance leases between two and five years inclusive	20.2	28.9
Amounts due under finance leases after more than five years	608.3	409.4
	631.5	440.3

16 Maturity of borrowings for group

The expected maturity profile of the group's borrowings was as follows:

	Expected maturity	
	2005	2004
	£m	£m
In less than one year	47.3	2.4
In more than one year but not more than two years	5.0	49.6
In more than two years but not more than five years	455.9	506.7
In more than five years	2,033.5	1,796.3
	2,541.7	2,355.0
Unamortised bond premium	14.2	14.8
Unamortised loan issue costs	(9.9)	(11.2)
	2,546.0	2,358.6

17 Financial instruments and risk management

At the time of the group's £1,910 million bond issue on 10 May 2001, the group entered into £625 million of interest rate swap contracts and £200 million of foreign currency swaps 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) Short term debtors and creditors

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

17 Financial instruments and risk management cont'd

(b) 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 2005 the notional principal amounts outstanding of the group's interest rate swap agreements were £625 million with termination dates ranging from March 2008 to March 2031. In the year ended 31 March 2005 these swaps had the effect of fixing interest rates on the floating rate bonds in the range of 6.045% to 11.45%.

At 31 March 2005 the notional principal amount outstanding of the group's currency swap agreement was GBP 200 million (USD 286 million), with a termination date of March 2008.

(c) 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:

	Fixed*	Index-Linked	Floating	Total
2005	£m	£m	£m	£m
Bonds	1,268.8	602.3	-	1,871.1
Finance leases	156.2	-	475.3	631.5
EIB Loan	-	-	35.0	35.0
Other loans	-	-	4.1	4.1
Other financial liabilities	10.5	-	-	10.5
	1,435.5	602.3	514.4	2,552.2
Unamortised bond issue costs				(9.9)
Unamortised bond premium				14.2
				2,556.5

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

Notes to the financial statements

17 Financial instruments and risk management cont'd

	Fixed £m	Index- Linked £m	Floating £m	Total £m
2004				
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

As at 31 March 2005 £268.9 million (2004: £225.2m) 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 EIB loan of £35.0 million and other loans of £4.1 million have varied from 4.98% to 6.59% during the year.

The bonds and the EIB loan 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, after taking into account the redemption of the £100 million of bonds on 31 March 2005 referred to in note 14, are:

	Weighted average interest rate	Weighted average expected maturity/ period rate is fixed
2005		
Bonds:		
- Index-linked (pre indexation)	3.83%	24 years
- Fixed interest rate	6.73%	11 years
2004		
Bonds:		
- Index-linked (pre indexation)	3.83%	25 years
- Fixed interest rate	7.06%	12 years

(d) Interest rate profile of financial assets

	Fixed £m	Floating £m	Total £m
2005			
Short-term deposits	248.0	-	248.0
Call deposit account	-	17.2	17.2
Cash	-	3.7	3.7
	248.0	20.9	268.9

17 Financial instruments and risk management cont'd

(d) Interest rate profile of financial assets cont'd

2004	Fixed £m	Floating £m	Total £m
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

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 term of deposits are set to match the interest rate terms of the floating rate debt. The time-weighted average interest on money market deposits (excluding call deposit accounts and liquidity funds) held during the year was 4.64% and the weighted average length of deposit held was 24 days.

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

(e) 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.

2005	Book value £m	Fair value £m
Non-derivatives:		
Assets:		
Current asset investments and cash	268.9	268.9
Liabilities:		
Floating rate borrowings less than 1 year	(47.3)	(47.3)
Fixed rate borrowings over 1 year	(800.0)	(891.8)
Indexed-linked borrowings over 1 year	(602.3)	(752.2)
Floating rate borrowings over 1 year	(1,092.1)	(1,092.1)
Other financial liabilities	(10.5)	(10.5)
Derivatives:		
Floating rate borrowings of £625.0 million are hedged by the interest rate and currency swaps referred to in note 17(b) above. The fair values of these swaps are as follows:		
Interest rate swaps	-	(67.8)
Currency swaps	-	(0.5)

Notes to the financial statements

17 Financial instruments and risk management cont'd

(e) Fair values of financial instruments cont'd

2004	Book value £m	Fair value £m
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 £678.8 million are hedged by the interest rate and currency swaps referred to in note 17(b) above. The fair values of these swaps are as follows:		
Interest rate swaps	-	(60.0)
Currency swaps	-	(0.3)

As at 31 March 2004 and 2005 there were no unmatched derivative financial instruments.

(f) 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 or it ceases to become an effective hedge. An analysis of these unrecognised gains and losses, which are based on valuations provided by the relevant swap counterparties, is as follows:

2005	Gains £m	Losses £m	Total net losses £m
Unrecognised gains and losses on hedges at 31 March 2005	-	(68.3)	(68.3)
Of which:			
- Gains/(losses) expected to be recognised in the year ended 31 March 2006	-	(3.8)	(3.8)
- Gains/(losses) expected to be recognised after the year ended 31 March 2006	-	(64.5)	(64.5)

17 Financial instruments and risk management cont'd

(f) Gains and losses on hedges cont'd

	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)

18 Capital commitments

Group	2005 £m	2004 £m
Contracted for but not provided in the financial statements	56.9	55.0

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 2006 amounting to approximately £240.5 million (2004: £219.7m) in the regulated water and sewerage business.

The company has no expenditure contracted for but not provided in the financial statements at 31 March 2005 (2004: £nil).

19 Leasing commitments

Group	Land and buildings	
	2005 £m	2004 £m
At 31 March 2005 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 (2004: £nil).

Notes to the financial statements

20 Provisions for liabilities and charges

Group	Note	2005 £m	2004 £m
Deferred taxation	7(c)	72.1	82.1
Restructuring provision	(a)	4.8	5.1
Contract management provision	(b)	-	0.8
Provision for uninsured losses	(c)	4.9	7.2
Provision for loss on swap closure	(d)	10.7	11.6
Provision for fair value on contract for difference	(e)	-	8.2
		92.5	115.0

(a) Restructuring provision

This provision at 31 March 2005 is in respect of payments to be made relating to surplus property, and estimated dilapidation costs which will be utilised over the next four years.

	2005 £m
At 1 April	5.1
Charge to profit and loss account	0.2
Utilised in the year	(0.5)
At 31 March	4.8

(b) Management contract provision

This provision was 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 contracts. It is not anticipated that any further costs will be incurred and the provision has been released.

	2005 £m
At 1 April	0.8
Released to profit and loss account	(0.8)
At 31 March	-

(c) 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.

	2005 £m
At 1 April	7.2
Utilised in the year	(2.3)
At 31 March	4.9

20 Provisions for liabilities and charges cont'd

(d) Provision for loss on swap closure

£2.6 million (2004: £2.8m) of this provision is the unamortised balance of a fair value provision relating to an acquired subsidiary's interest rate swap contracts.

The balance of £8.1 million (2004: £8.8m) 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 on a reducing balance basis over the life of the revised swap, which expires on 31 March 2031.

	2005 £m
At 1 April	11.6
Utilised in the year	(0.9)
At 31 March	10.7

(e) Provision for fair value on contract for difference

This is 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 prices 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 was released to the profit and loss account over the life of the CfD swap, which expired on 31 March 2005.

	2005 £m
At 1 April	8.2
Utilised in the year	(8.2)
At 31 March	-

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.

	2005 £m	2004 £m
At 1 April	35.9	37.5
Received and receivable during the year	0.2	-
Reclassified as capital creditors	(1.1)	-
Released to profit and loss account	(1.4)	(1.6)
At 31 March	33.6	35.9

Notes to the financial statements

22 Reserves

	Group Profit & Loss Account £m	Company Profit & Loss Account £m
At 1 April 2004	178.9	-
Profit retained for the year	85.2	-
At 31 March 2005	264.1	-

23 Cash flow from operating activities

	2005 £m	2004 £m
Operating profit	212.6	185.7
Depreciation of tangible fixed assets	70.0	76.3
Infrastructure renewal charge	49.5	46.0
Amortisation of negative goodwill	(46.9)	(47.1)
Increase in debtors	(5.0)	(2.1)
Increase in creditors	4.5	1.1
Decrease in provisions	(12.8)	(6.7)
Cash flow from operating activities	271.9	253.2

24 Reconciliation of net cash flow to movement in net debt

	2005 £m	2004 £m
Increase/(decrease) in cash	1.6	(1.3)
Increase/(decrease) in current asset investments	42.1	(28.5)
Increase in loans and finance leases	(168.9)	(99.7)
Write-off of bond issue costs	(1.3)	(1.3)
Write-off of bond premium	0.6	0.5
Indexation of index-linked debt	(17.8)	(17.4)
Movement in accrued interest	10.3	(11.9)
	(133.4)	(159.6)
Net debt at start of year	(2,161.4)	(2,001.8)
Net debt at end of year	(2,294.8)	(2,161.4)

25 Analysis of net debt

	At 1 April 2004 £m	Cash Flow £m	Non- Cash Items £m	At 31 March 2005 £m
Net cash:				
Bank and cash	2.1	1.6	-	3.7
	2.1	1.6	-	3.7
Liquid resources:				
Current asset investments	223.1	42.1	-	265.2
Finance leases	(440.3)	(191.2)	-	(631.5)
Other debt falling due within one year	(0.4)	0.3	(44.2)	(44.3)
Other debt falling due after one year	(1,917.9)	22.0	25.7	(1,870.2)
	(2,358.6)	(168.9)	(18.5)	(2,546.0)
Accrued interest	(28.0)	-	10.3	(17.7)
	(2,386.6)	(168.9)	(8.2)	(2,563.7)
Net debt	(2,161.4)	(125.2)	(8.2)	(2,294.8)

(a) Reconciliation of statutory net debt to net debt defined for covenant purposes under the Common Term Agreement (CTA)

	Notes	2005 £m	2004 £m
Statutory net debt	25	(2,294.8)	(2,161.4)
Unamortised bond issue costs	13(c)	(9.9)	(11.2)
Net debt (CTA basis)		(2,304.7)	(2,172.6)

(b) Committed borrowing facilities available

The group has various undrawn committed borrowing facilities. These facilities available at 31 March 2005 were as follows:

	2005 £m	2004 £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.

On 29 April 2005 the Group entered into a £75 million banking facility with Fortis Bank N.V./S.A. This facility is available to be drawn until 30 June 2012.

On 9 May 2005, the Group cancelled its £150 million authorised loan facility and replaced it with a £305 million facility. This facility is available to be drawn until 30 September 2010 and may, at the option of the banks, be extended to 30 September 2011.

Notes to the financial statements

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 balance sheet date.

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 £31.7 million, 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 £2.4 million (2004: £4.4m) 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 Waddingham, 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 £15.6 million 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 2005 was £3.4 million (2004: £1.2m). The regular cost of benefits amounted to £0.9 million 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 £0.3 million (5%).

A further £2.2 million of pension costs were incurred in relation to a voluntary severance programme in operation during the year.

At 31 March 2005 a SSAP24 provision of £2.3 million is included within creditors (2004: £0.7m).

29 Pensions cont'd

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.

Major assumptions

Investments have been valued at 31 March 2005, for this purpose, at market value. The major assumptions used by the actuary were:

	2005	2004	2003
Rate of increase in pensionable salaries	3.75%	3.75%	4.0%
Rate of increase in pensions in payment	2.75%	2.75%	2.5%
Discount rate	5.40%	5.50%	5.5%
Inflation assumption	2.75%	2.75%	2.5%

Scheme assets

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

	Long term rate of return expected at 31 March 2005	Value at 31 March 2005 £'000	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
Equities	6.7%	12,500	7.0%	11,251	7.5%	8,904
Bonds	5.4%	9,807	5.5%	3,607	6.0%	1,484
Cash	4.8%	130	4.0%	4,015	5.0%	4,454
Other	-	2,200	-	-	-	-
		24,637		18,873		14,842

Net provision liability

The following amounts at 31 March 2005 were measured in accordance with the requirements of FRS 17 'Retirement Benefits':

	2005 £'000	2004 £'000	2003 £'000
Total market value of assets	24,637	18,873	14,842
Present value of scheme liabilities	(32,406)	(26,710)	(24,111)
Deficit in scheme	(7,769)	(7,837)	(9,269)
Related deferred tax asset	2,331	2,351	2,781
Net pension liability	(5,438)	(5,486)	(6,488)

Notes to the financial statements

29 Pensions cont'd

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:

	2005 £m	2004 £m
Net assets excluding pension liability	264.1	178.9
Pension liability	(5.4)	(5.5)
Elimination of SSAP24 balance	2.3	0.7
Net assets including pension liability	261.0	174.1
Profit and loss reserve excluding pension liability	264.1	178.9
Pension liability	(5.4)	(5.5)
Elimination of SSAP24 balance	2.3	0.7
Profit and loss reserve including pension liability	261.0	174.1

Amounts recognised if FRS 17 adopted

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.

	2005 £'000	2004 £'000
Analysis of amount charged to operating profit		
Current service cost	1,348	1,020
Past service cost	395	-
Settlements and curtailments	1,807	-
Total operating charge	3,550	1,020

	2005 £'000	2004 £'000
Analysis of amount charged to other finance income/(expense)		
Expected return on pension scheme assets	1,191	1,013
Interest on pension scheme liabilities	(1,558)	(1,358)
Net expense	(367)	(345)

29 Pensions cont'd

	2005	2004
	£'000	£'000
Analysis of amount recognised in statement of total recognised gains and losses		
Actual return less expected return on pension scheme assets	920	2,028
Experience gains arising on the scheme liabilities	(305)	12
Changes in assumptions underlying present value of the scheme liabilities	(609)	(99)
Total gain recognised	6	1,941
Movement in deficit during the year	2005	2004
	£'000	£'000
Deficit on scheme at 1 April	(7,837)	(9,269)
Movement in the year:		
- current service cost	(1,348)	(1,020)
- contributions	1,779	856
- past service cost, settlements and curtailments	(2,202)	-
- other finance expense	(367)	(345)
- actuarial gain	6	1,941
- special contribution accrued at the year-end	2,200	-
Deficit on scheme at 31 March	(7,769)	(7,837)
History of experience gains and losses	2005	2004
	£'000	£'000
Difference between the actual and expected return on scheme assets:		
- Amount (£'000)	920	2,028
- Percentage of scheme assets	4%	11%
Experience gains/(losses) on scheme liabilities:		
- Amount (£'000)	(305)	12
- Percentage of present value of scheme liabilities	(1%)	-%
Total amount recognised in statement of total recognised gains and losses:		
- Amount (£'000)	6	1,941
- Percentage of present value of scheme liabilities	-%	7%

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.

Notes to the **financial** statements

31 Post balance sheet events

On 29 April 2005, the group entered into a £75 million banking facility with Fortis Bank S.A./N/V. This facility is available to be drawn until 30 June 2012.

On 9 May 2005, the group cancelled its £150 million syndicated bank facility and replaced these with a £305 million facility. This facility is available to be drawn until 30 September 2010 and, at the option of the banks, may be extended to 30 September 2011.

On 16 May 2005, Dŵr Cymru (Financing) Limited gave notice to redeem £425 million of its floating rate bonds on 30 June 2005. Consequently, on the same date, Dŵr Cymru Cyfyngedig will also redeem its inter-company loan of £425 million with Dŵr Cymru (Financing) Limited. These bonds had an average interest rate of 5.69% in the year, and an expected maturity of 31 March 2008.