

Glas Cymru Cyfyngedig
Company No: 3975719

Report and accounts 2006



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Water supply 71 operational reservoirs and 91 water treatment works 900 million litres of drinking water supplied every day through 27,000km of water mains, 550 pumping stations and 560 service reservoirs over 300,000 water supply tests carried out during the year leakage reduction target achieved.

Protecting the environment 19,000km of sewers, 1,700 sewage pumping stations, 3,300 storm water overflows and 850 wastewater treatment works completion of the new £35 million Holyhead wastewater treatment works 47 'blue flag' awards, 50 'green coast' awards and 109 'seaside awards' over 99% of customers served by wastewater treatment works that provide full treatment.

Community, customers and people 1.2 million household customers and over 100,000 business customers 12,000 school children attended one of Welsh Water's four education centres 24 hour freephone customer call centre 3,000 customers registered for additional services.

Financial review 'Customer dividend' increased to £19 regulatory capital value of £3 billion with net debt of £2.4 billion funding in place for the Company's £1.2 billion investment programme to 2010, which will bring substantial benefits to customers and the environment.



Glas Cymru is a single purpose company formed to own, finance and manage Dŵr Cymru Welsh Water. It is a 'company limited by guarantee' and because it has no shareholders, any financial surpluses are retained for the benefit of Welsh Water's customers. Under Glas Cymru's ownership, Welsh Water's assets and capital investment are financed by bonds, loans and retained financial surpluses. All day-to-day activities are carried out by specialist contract partners employed by Welsh Water following a competitive procurement process. The Glas Cymru business model aims to reduce Welsh Water's asset

financing costs, the water industry's single biggest cost, and improve service delivery by employing the best enterprises for each distinct activity in the business. Financing efficiency savings to date have largely been used to build up reserves to insulate Welsh Water and its customers from any unexpected costs and also to improve credit quality so that Welsh Water's cost of finance can be kept as low as possible in the years ahead. These savings have also funded some additional discretionary investment in service improvements and the annual 'customer dividend'.

Welsh Water is the sixth largest of the ten regulated water and sewerage companies in England and Wales, representing around 8% of the sector when measured by assets employed. It provides an essential public service to over 3 million people living in Wales and some adjoining parts of England. Its primary responsibility is to operate, maintain and upgrade its assets so as to ensure a safe and reliable supply of drinking water for customers and to deal effectively with wastewater so as to protect public health and the natural environment. Welsh Water is Glas Cymru's only trading subsidiary.

Chairman's statement

I am pleased to report another satisfactory year for Glas Cymru and its only trading subsidiary Welsh Water. Overall, we maintained high service standards for our customers and, with continuing improvements in our financial performance, we were able to increase our 'customer dividend' to £19 per customer.

Customer service and protecting the environment

On Ofwat's 'Overall Performance Assessment' we estimate that Welsh Water achieved 93% of the maximum score, slightly below the 94% we achieved in the previous year when Welsh Water was ranked equal first amongst the ten regulated water and sewerage companies. On 10 of the 15 key measures that make up the 'Overall Performance Assessment' we were at or ahead of the previous year's performance.

The areas of improvement were concentrated primarily on the water supply side. Overall, the high quality of drinking water supplied by Welsh Water was maintained and compliance with a number of measures were improved, reflecting in particular the continuing high level of capital investment on the water distribution network. Similarly, the number of low pressure problems and the number of properties suffering unplanned interruptions to supply were the lowest they have ever been. On these measures Welsh Water has become one of the leading performers in the sector.

We also achieved our leakage target which means that over the last ten years we have reduced leakage by nearly half. Welsh Water abstracts for public water supply around 3% of effective rainfall in our region, compared with over 20% (and in some parts over 50%) in the south east of England. Falling industrial demand plus reductions in leakage means that Welsh Water abstracts for public water supply some 20% less than it did ten years ago. Rainfall in the year was close to normal and our water resource position is currently satisfactory, although we do have a small number of zones where there could be a supply/demand deficit during a drought. Plans are in place to improve security of supply in each of these zones.

Wales continues to have some of the highest quality rivers and coastal waters in the UK. In 2005, 73 of the 80 designated bathing beaches around the coast of Wales achieved the high 'guideline' water quality necessary to achieve a European Blue Flag award. And as a result, for the 2006 summer season Wales won 47 Blue Flag awards, a third of the total awarded

to the UK. Welsh Water's contribution to this excellent result for our region is widely acknowledged by our stakeholders.

Compliance with discharge consents at our wastewater treatment works was maintained at 99%. This result however disguises the fact that at several key wastewater treatment sites, including Llangefni on Anglesey, Hereford and Swansea, considerable effort is required by our operating and capital partners to ensure that tight environmental standards are met over the course of the year. There were 311 sewer flooding incidents in the year, slightly higher than in the previous year, and asset breakdowns and other problems on our sewer network also caused 17 serious pollution incidents, up from 8 in the previous year. Reducing the number of wastewater treatment works at risk of non-compliance and improving the reliability of the sewer network are two of our main priorities.

Cryptosporidium outbreak in North Wales

Possibly our biggest challenge since Glas Cymru took ownership of Welsh Water came in November 2005 when a higher than usual number of cases of illness caused by cryptosporidium was linked to the tap water supplied by Cwellyn water treatment works in Snowdonia.

The Outbreak Control Team, in which we played a full part, decided that Welsh Water should issue a Boil Water Notice to the 30,000 customers supplied by Cwellyn. This conclusion was reached on the balance of probabilities despite the fact that Cwellyn water treatment works was operating normally. In order to help restore confidence in tap water we installed additional ultra violet treatment at Cwellyn over the Christmas and New Year holiday period. Once this new stage of treatment was operating satisfactorily, the Outbreak Control Team announced the lifting of the Boil Water Notice at the end of January 2006.

This incident caused serious inconvenience to a large number of our customers at a particularly busy time of year, and for this reason we made an *ex gratia* payment of £25 to every customer affected by the Boil Water Notice. It also tested the team, that was brought together from right across the Welsh Water Asset Management Alliance, and I would like to pay tribute to their efforts during a very difficult period.

Finance and the 'customer dividend'

There was significant financing activity during the year, with nearly £600 million raised at attractive rates of interest. Some £6 million a year will be saved by the refinancing of £525 million of floating rate bonds carried out during the year. Our improved financial efficiency will help us to keep down customers' bills in the years ahead.

Our key financial objective is to reduce the level of net debt as a proportion of the Company's Regulatory Capital Value. As at 31 March 2006, this measure of financial gearing was 78%, down from 93% in May 2001 when Glas Cymru acquired Welsh Water. 'Financial reserves' (defined as RCV less net debt) as at 31 March 2006 were £683 million, compared with some £150 million in 2001 when Glas Cymru completed the acquisition of Welsh Water. Given this improving financial performance, which has exceeded expectations, the Board decided to increase the 'customer dividend' from £18 to £19 bringing the total annual cost to some £24 million.

As a result of this 'customer dividend' Welsh Water's average household bill will, in real terms, be little higher in 2010 than it was in 2000, while over this same ten year period Welsh Water will have invested some £2.5 billion on maintaining its assets and improving customer service and the environment. The £19 'customer dividend' has helped to offset the price increases experienced by our customers last year as a result of the regulatory price review and is a particular help to our least well off customers. This in turn makes an important contribution to our cash collection performance, which is one of the best in the sector.

Fifth anniversary

In May this year we passed the fifth anniversary of the successful £1.9 billion bond issue that financed Glas Cymru's acquisition of Welsh Water. All who supported the transaction then, and everyone who has worked with Welsh Water since 2001, can look back over these five years with some satisfaction at what has been achieved and the considerable progress that has been made.

Welsh Water has risen to the top of Ofwat's 'Overall Performance Assessment' league table having been close to bottom five years ago. The quality of rivers and coastal waters in our region has continued to improve and now compares with the best in the UK. Since 2001 Glas Cymru has raised more than £1 billion from the capital markets - at some of the lowest rates of interest achieved by any utility since privatisation - to finance Welsh Water and its continuing large capital investment programme. As a result of much improved cost efficiency, 'financial reserves' have grown to £683 million, 22% of RCV, allowing Welsh Water to be the only utility to pay an annual 'customer dividend'.

Looking ahead

Ofwat has set Welsh Water challenging targets for further improvements in cost efficiency, both in operations and in capital investment. We believe these targets are achievable, although we are experiencing significant upward cost pressures, notably power costs that increased by some £9 million, or over 50%, in the year.

A successful transition has been made to new longer term contracts for service delivery, capital investment and billing services without adverse impact on overall performance. We have made a satisfactory start to our challenging £1.2 billion AMP4 capital investment programme for the period 2005-2010. This continuing high level of investment will bring further improvements to customer service and the environment in our

region. I am encouraged by how Welsh Water and our new partners have responded to the various challenges that we faced during the year, most notably in supporting the Outbreak Control Team during the outbreak of illness caused by cryptosporidium in north west Wales.

While much remains to be done in the years ahead, I am confident that under Glas Cymru's ownership

Welsh Water will continue to deliver improving services and better value to our customers.



Lord Burns
Chairman

1 Key performance measures

Year to 31 March 2006	Monitoring Plan target ⁵	Previous performance 2004-05	Actual performance 2005-06	At or ahead of target	At or better than previous year
Customer service					
Properties 'at risk' of receiving low pressure	242	235	221	✓	✓
Unplanned water supply interruptions	1,080	770	454	✓	✓
Properties 'at risk' of sewer flooding ¹	528	n/a	514	✓	n/a
Properties flooded due to hydraulic overload	136	108	81	✓	✓
Properties flooded due to other causes	120	108	150	X	X
Billing enquiries answered within 5 days	100%	99.9%	99.9%	X	✓
Written complaints answered within 10 days	99.9%	99.9%	99.4%	X	X
Number of written complaints received	n/a	8,202	9,948	n/a	X
Customer meters read within year	99.9%	99.9%	99.9%	✓	✓
Telephone calls abandoned	1.3%	1.5%	1.6%	X	X
Telephone calls receiving engaged tone	0%	0%	0.3%	X	X
Call handling satisfaction ²	n/a	n/a	4.59	n/a	n/a
Water quality					
Overall water quality compliance 'at the tap' ^{3C}	n/a	99.9%	99.9%	n/a	✓
Bacteriological compliance 'at the tap' ^C	n/a	99.6%	99.6%	n/a	✓
Iron compliance 'at the tap' ^C	98.9%	98.9%	99.2%	✓	✓
Operational Performance Index ^C	n/a	99.7%	99.8%	n/a	✓
Operational Performance Index (TIM) ^{4C}	n/a	99.5%	99.7%	n/a	✓
Environment					
Leakage (m ³ /km/day)	8.2	8.3	8.2	✓	✓
Number of 'category 1 and 2' pollution incidents ^C	n/a	8	17 ⁶	n/a	X
Number of 'category 3' pollution incidents ^C	n/a	195	194	n/a	✓
Wastewater treatment works complying with consents ^C	100%	100%	99.0%	X	X
Sewage sludge recycled satisfactorily ^C	100%	100%	100%	✓	✓
'Mandatory' coastal bathing water compliance ^C	100%	100%	100%	✓	✓
'Guideline' coastal bathing water compliance ^C	n/a	86%	91%	n/a	✓

¹ Classification changed in 2005, resulting in increase in numbers.

² New measure for 2005-06 score out of maximum 5.

³ This measure is now based on 'Mean Zonal Compliance'.

⁴ New measure for 2005-06 which takes into account performance against turbidity, iron and manganese.

⁵ The Monitoring Plan sets out the targets agreed with regulators at the Regulatory Price Review in 2004 and covers the five year period to 31 March 2010.

⁶ 9 of these pollution incidents resulted from 'compliant discharges', this compares to 1 in 2004-05.

^C Calendar year 2005, all other figures are for the year ended 31 March 2006.

APRIL 05
CUSTOMERS IN PEMBROKESHIRE ASSURED OF QUALITY
DRINKING WATER WITH THE START OF A £2.5 MILLION
WATER IMPROVEMENT SCHEME.

JULY 05
WORK COMMENCES IN HEREFORD ON THE £1 MILLION
SCHEME TO UPGRADE THE WATER MAINS.

Water supply

Welsh Water's principal responsibility is to provide a safe and reliable drinking water supply to its customers, 24 hours a day, 365 days a year, while ensuring our water abstractions and water supply activities do not damage the environment.

Welsh Water provides an essential public service and the importance of drinking water for public health means that our supply activities are tightly regulated. Much of what we do is governed by statutory requirements and the Drinking Water Inspectorate (DWI) monitors our compliance with these.

Monitoring the quality and reliability of the service received by our customers, particularly to ensure a supply of safe, wholesome drinking water, is achieved through the management of key performance measures.

Water resources

During the year rainfall in Welsh Water's area was around normal. Around 95% of the water abstracted is taken from rivers and reservoirs across our region. Most of the rivers are supported by releases from our impounding reservoirs in line with agreements with the Environment Agency. These agreements provide for river flows to be maintained during droughts. The remaining 5% of water is drawn from the ground through springs, wells and boreholes.

Over the last ten years leakage has been reduced by nearly half and our leakage performance is in line with the rest of the industry as measured by losses per km of water main. During the year over £6 million has been invested in leakage reduction. We have repaired an average of 50 bursts and leaks every day and around 200 staff are employed full time on leakage identification, repairs and prevention work. This combined work has resulted in a continued reduction in leakage to 8.2m³ per km of water main per day (2004-05: 8.3m³ per km per day). [2](#)

Slowly rising household demand for water has been more than offset by a reduction in non-household usage, mainly due to a decline in manufacturing and heavy industry, and this, together with the continued reduction in leakage, has reduced the amount of water we need to abstract for public water supply. Distribution input has fallen by over 10% over the last 5 years and the average distribution input for 2005-06 was 866 Ml/day. [3](#)

However the relatively strong overall water resource position does disguise a number of local areas where the balance between supply and demand is tight and where there

could be problems during drought conditions. Plans are in place to improve the security of supply in these areas. [4](#)

Drinking water quality

In line with our quality monitoring procedures over 300,000 water supply tests were carried out during the year. The number, frequency and type of samples that have to be taken are set down in the Water Supply (Water Quality) Regulations, which came into effect on 1 January 2004. Results are reported to the DWI, who undertake a series of audits to verify the data provided.

Overall, the high quality of drinking water supplied by Welsh Water was maintained during 2005 and compliance with a number of key measures was either maintained or improved.

Iron remains the main cause for discoloured water at customers' taps. The mains rehabilitation programme and improvements to operational procedures have resulted in a continued improvement on previous years' performance. Compliance with the standard for iron was 99.2% (2004: 98.9%). [5](#)

OCTOBER 05

WORK STARTS ON THE £2 MILLION INVESTMENT SCHEME THAT WILL ENSURE THE RESIDENTS OF POWYS CONTINUE TO RECEIVE A HIGH STANDARD OF DRINKING WATER.

Overall bacteriological compliance was broadly similar to 2004 **6** and performance against the main industry measure for water quality the 'operational performance index' (OPI), was one of the measures improved. OPI is the overall rating of the six main parameters for water quality that reflect operational performance at water treatment works and in the distribution networks. Performance for 2005 was 99.8% (2004: 99.7%). This reflects the focus and investment made to prevent water discolouration

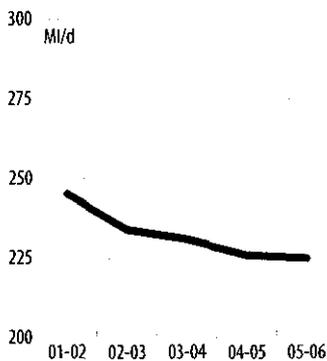
events and minimise the number of customers suffering from discolouration problems.

During the year the DWI proposed changes to the OPI measure to better reflect customers' expectations and concerns regarding the quality of their drinking water. As a result the new measure OPI (TIM) takes into account performance against turbidity, iron and manganese, which are the principal parameters for discolouration problems. **7**

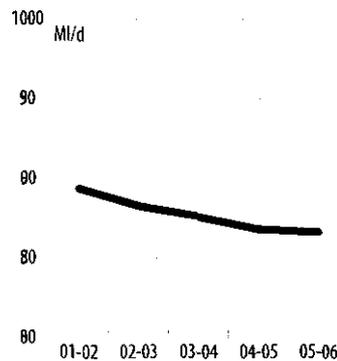
Following the implementation of the new regulations, the DWI has also replaced the measure for overall compliance 'at the tap' with a new measure - 'mean zonal compliance'. Performance for 2005 was 99.9% (2004: 99.9%).

During the year work was carried out on an £11 million scheme in the Swansea Valley, where customers had been experiencing periods of discoloured water as a result of the condition of the trunk main.

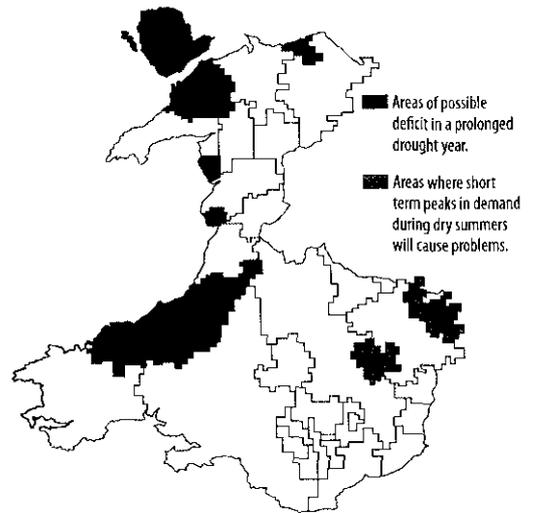
2 Leakage



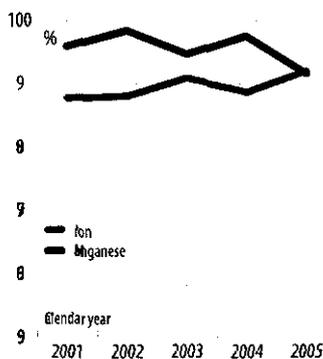
3 Distribution input



4 Supply and demand



5 Iron and manganese compliance



6 Bacteriological compliance

	Compliance 2005	Compliance 2004
Water treatment works		
Coliforms	99.9%	99.9%
E-Coli	100%	100%
Service reservoirs		
Coliforms	99.9%	99.9%
E-Coli	100%	99.9%
Compliance in water quality zones		
Coliforms	99.6%	99.6%
E-Coli	99.9%	99.9%

Calendar year

To minimise distribution and the impact on customers, the work was carried out in distinct phases and will be completed in 2006.

Cryptosporidium outbreak

In November 2005 there was a higher than usual number of cases of illness caused by cryptosporidium in north west Wales which was linked to the tap water supplied by Cwellyn water treatment works in Snowdonia. On the advice of the Outbreak Control Team, in which Welsh Water played a full part, a Boil Water Notice was issued to the 30,000 households and businesses supplied by the treatment works. This action was taken on the balance of probabilities despite the fact that Cwellyn water treatment works was operating normally. Ultra violet treatment was installed at Cwellyn over the Christmas and New Year holiday period and once this stage of treatment was operating satisfactorily the Boil Water Notice was lifted at the end of January 2006.

Quality management systems

Quality management systems are essential to the effective management and operation of daily activities of the company. Our contract partner United Utilities has ISO 9001 – 2000 accreditation and also achieved successful transition from ISO 14001 – 1996 to the new environmental standard ISO 14001 – 2004 in the year.

During the year our contract partner Severn Trent Laboratories received their sixth and seventh continuing assessment by BSI and again their ISO 9001 – 2000 accreditation has been maintained.

Reliability of supply

Welsh Water has relatively more water mains than other water companies and experiences more bursts on them than the industry average. This is mainly due to the age and overall condition of our 27,000km water distribution network and our general operating environment. We measure the instances where water supplies are cut off without warning because of a burst, third party damage or because we have over-run on planned works. Our aim is to deal with bursts quickly and to ensure that any resulting interruptions are as short as possible. Over the last five years we have reduced the number of unplanned supply interruptions lasting more than six hours (but less than 12 hours) by 70%. During the year 454 properties were affected by these unplanned supply interruptions (2004-05: 770 properties). [8](#)

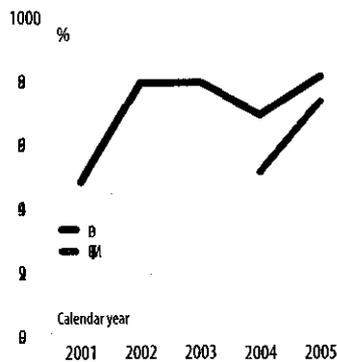
We aim to provide a minimum water pressure of 10 metres at the boundary stop tap. We monitor pressure in each of our 1,550 water distribution zones which allows us to identify possible problems and upgrade local water supply networks as necessary. Incidence of low pressure can change as new properties are connected to the water supply network and where we rationalise our assets. During the year we removed possible low pressure problems for 1,798 properties and at the end of the year there were 221 properties still at risk of having low pressure (2004-05: 235). [9](#)

Capital investment [10](#)

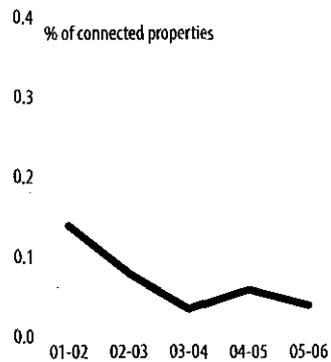
During the year we invested £107 million to improve or maintain our water assets. We refurbished over 407km of unlined water mains to improve water quality and iron compliance at customers' taps. A further 72km of water mains were replaced that were causing frequent supply interruptions to customers and 12km of mains were replaced as a result of diversions.

Work was also carried out at 83 water treatment works, 51 service reservoirs and 45 water pumping stations.

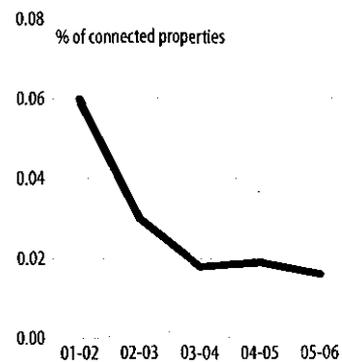
7 Operational performance index



8 Unplanned interruptions to supply



9 Risk of low pressure



10 Water investment in the year

Type of work	Spend
Water treatment works improvements	£4m
Water mains refurbishment	£45m
Meter installations	£5m
Leakage prevention	£6m
New developments	£6m
Asset maintenance	£36m
Other	£5m
Total	£107m

Protecting the environment

Communities across our region rely on Welsh Water to collect and treat the wastewater produced by households and businesses – together with surface and highway drainage in many places – in a way that safeguards public health and protects the environment.

As with drinking water, the importance of effective sewerage and wastewater treatment for public health means that Welsh Water's environmental activities are heavily regulated. Much of what we do is determined or governed by statutory requirements and our compliance with these is monitored by the Environment Agency. We manage the business against a range of regulatory and other measures of performance which together ensure the quality and reliability of service received by our customers and our compliance with environmental standards.

Reliability of sewer network

Much of Welsh Water's 19,000km sewer network is old with an average age of 60 years; around a third is more than 100 years old. It is sized to carry away surface water as well as wastewater from households and businesses. In places the sewer network cannot cope with flows after heavy rainfall and as a result overloaded sewers can cause flooding at properties. We measure the risk of this happening and also report actual sewer flooding incidents caused by overloaded sewers or other causes, such as blockages and sewer collapses.

Last year we invested almost £4 million to reduce the risk of sewer flooding. This included reducing the risk of internal flooding for 89 properties, 82 of which were on our 'at risk register'. The 'at risk register' was rebased at the start of the year to include properties which had previously been considered to be at lesser risk of flooding, and to be in line with Ofwat's methodology. We also carried out work at 85 sites to reduce the risk of external flooding. During the year 81 properties were flooded by overloaded sewers following very heavy rainfall and a further 150 properties were flooded by other causes, including blockages and sewer collapses. ^[11] At the year end 514 properties remained on the 'at risk register'. ^[12]

We have a targeted programme of sewer desilting, cleaning and inspection. During the year a total of 72km of sewers have been inspected by CCTV, which gives us a better understanding of the condition of the sewers and helps to direct investment appropriately.

Reducing the risk of sewer flooding remains a priority for Welsh Water and we will continue to address problems at properties where

flooding has occurred most frequently, although each year new incidents occur where flooding has not been experienced before. Various initiatives are under way to identify these vulnerable areas in advance of problems occurring and we have set up 'flood forums' where necessary, to work with all parties, particularly the affected residents, but also the regulators and other authorities who have responsibilities for drainage.

The number of sewer collapses in the year was 28.9 per 1,000km (2004-05: 29.2km per 1,000km). Our performance against this measure remains higher than the industry average (approximately 13 per 1,000km) although our performance has improved over the last five years. ^[13]

Storm water overflows

There are nearly 3,300 storm water overflows on Welsh Water's sewer network and the current investment programme agreed with the Environment Agency Wales will deliver necessary improvements at 460 of them which are currently unsatisfactory. 62 storm water overflows were improved during the year.

JULY 05

WORK COMPLETED ON THE £4.4 MILLION WASTEWATER INVESTMENT SCHEME IN WREXHAM.

SEPTEMBER 05

WORK CONTINUES ON THE £53 MILLION INVESTMENT PROGRAMME TO IMPROVE THE BATHING WATER AROUND BARRY.

During the calendar year 2005 Welsh Water was responsible for 17 'category 1' and 'category 2' pollution incidents. **14** These serious incidents were all caused by asset breakdowns or other problems on our sewer network. Welsh Water was also responsible for 194 'category 3' incidents which caused relatively minor environmental damage.

Improving performance on pollution incidents is a key area for the business. This year our pollution incident reduction strategy has been revised and updated, and a number

of initiatives are being introduced, including investment prioritisation, improved data systems, improved signage and reviewing the feasibility of installing telemetry units at the sites.

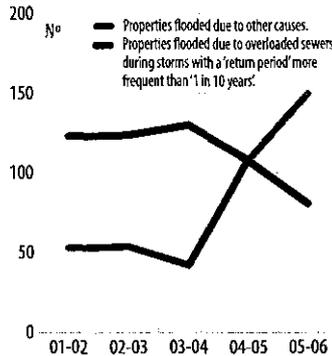
Wastewater treatment

Welsh Water operates some 850 wastewater treatment works across its region. Over 99% of our customers are now served by works that provide full treatment by biological and other processes including ultraviolet disinfection at key coastal locations.

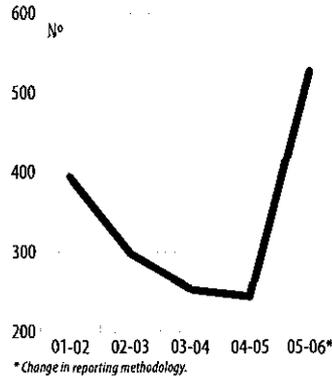
In 1996 only 59% of the wastewater collected by Welsh Water received such treatment. As a result of this improvement the wastewater we now collect can be discharged to rivers or the sea in such a way that the environment is protected.

The Environment Agency sets discharge consents to protect river and coastal water quality and monitors Welsh Water's performance against these standards. Our compliance with these standards was 99% in 2005 (2004: 99.3%). **15**

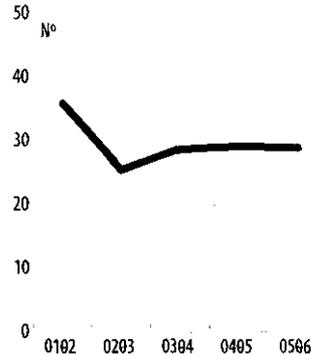
11 Sewer flooding



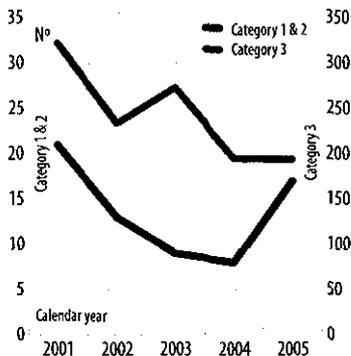
12 Sewer flooding at risk register



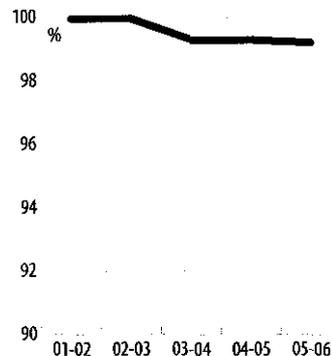
13 Sewer collapses per 1,000km



14 Pollution incidents



15 Wastewater treatment works compliance



Disinfection of final effluent from 33 of our wastewater treatment works is done by ultra violet light. Ultra violet treatment is a valuable method of reducing the number of bacteria entering shellfish beds and bathing waters. During the year all of the ultraviolet disinfection sites met the required standards compared to 2001 when only 21% of the works met the required standards.

Coastal and river water quality

We have one of the longest coastlines of any water and sewerage company in the sector. Having high quality coastal water quality is especially important for the Welsh tourism industry which employs around 100,000 people and makes a significant contribution to the Welsh economy.

In 2005 all the 80 EU designated bathing beaches around the coast of Wales achieved the mandatory bathing water standard required by legislation. In addition a record 73 beaches achieved the very high 'guideline' standard. ^[16] Following these results, Wales secured 47 'Blue Flag' awards for the 2006 season, a third of the UK total, and 50 of the rural 'Green Coast' awards. ^[17] These are the highest results achieved in Wales to date. ^[18] Since 1995 Welsh Water has invested over £1 billion on upgrading or building new wastewater treatment works right across its region which has contributed to this achievement.

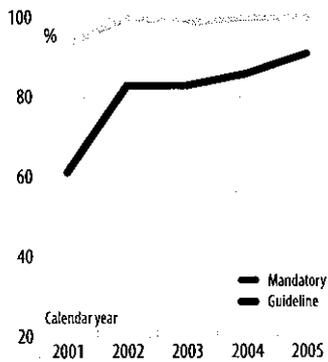
Similarly the quality of rivers in Wales is amongst the best in the UK. The Environment Agency published its survey of river water quality for 2004. This shows that, again, over 98% of rivers in Wales were good or fair on the assessment of chemical quality and over 99% were good or fair on the assessment for biological quality. ^[19]

Capital investment ^[20]

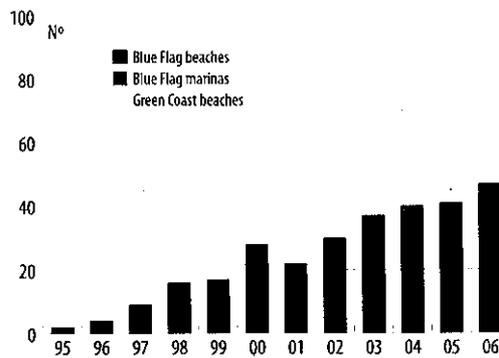
During the year we invested £130 million to improve or maintain our wastewater assets. In all, we completed quality improvement schemes at over 185 different locations and maintenance schemes at over 500 sites. Work included improvements to 86 storm water overflows, including major schemes in the Afan/Baglan and Cog Moors area, which were linked to bathing water improvements at Aberafan and Barry. Improvement works were also carried out at 81 wastewater treatment and the new Holyhead wastewater treatment works in Anglesey was completed. The scheme cost some £35 million and serves a population of 25,000. The new works, which incorporates full biological treatment, was designed and constructed in a way that minimises the impact on the environment and ecology of the area. In addition, 70km of new sewers were laid and 13km of sewers were refurbished.

During the year we have reviewed the benefits of the 23 schemes for providing first time sewerage connections identified in our monitoring plan. The assessment has concluded that we will progress with 6 schemes during the remainder of the AMP4 period.

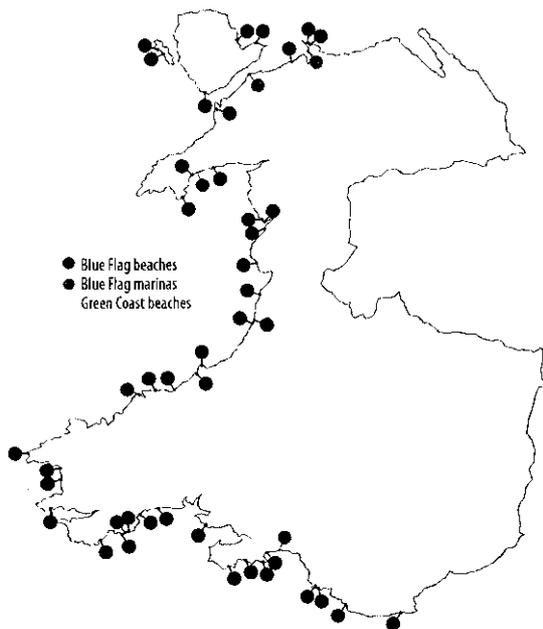
16 Bathing water quality compliance



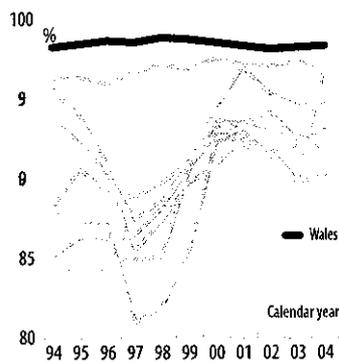
17 Award winning beaches



18 Location of award winning beaches



19 River water quality



20 Capital investment in the year

Type of work	Spend
Wastewater treatment works improvements	£45m
Combined sewer overflows upgrade	£40m
First time sewerage provision	£1m
Sewer flooding prevention	£4m
Sewer maintenance	£10m
Sludge treatment	£2m
New developments connected	£4m
Wastewater asset maintenance	£19m
Other	£5m
Total	£130m

APRIL 05
FINNISH SCHOOL CHILDREN FROM HELSINKI VISIT
WELSH WATER'S ENVIRONMENTAL EDUCATION CENTRE
AT COG MOORS.

MAY 05
300 SCHOOL CHILDREN VISIT LLANDEGFEDD
RESERVOIR NEAR PONTYPOOL, AS PART OF 'WATER
HABITAT FORTNIGHT' – AN EVENT ORGANISED IN
PARTNERSHIP WITH MONMOUTHSHIRE COUNTRYSIDE
SERVICE AND TORFAEN COUNTY BOROUGH COUNCIL.

Working in the community

Welsh Water takes very seriously its commitment to the communities we serve and to the environment.

We aim to be a valued and trusted partner in the communities we serve, and it is important to us to make a difference within these communities. We have therefore invested in a number of areas that directly benefit our customers.

Education

We continue to place considerable emphasis on supporting education. Under 'Living and Learning with Water', last year a record 12,600 children attended one of Welsh Water's environmental education centres and received free curriculum-based lessons. ²¹ Over 64,000 children have visited these centres since they opened. Designed and led by seconded teachers, these lessons teach the importance of diverse habitats and nature conservation and promote a better understanding of the importance of water in our everyday lives.

The internet has become a vital learning resource, both at home and at school, and we have developed our own educational website with online interactive resources. This website (www.livingandlearningwithwater.com) complements the water in the school website (www.waterintheschool.co.uk) developed



with certain other water companies, and provides everything required to set up and run a water conservation project. It also complements the interactive CDROM (Water-World Explorers) issued to all primary schools in our region.

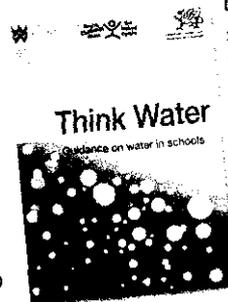
Welsh Water has also worked in partnership with the Welsh Assembly Government to support its 'Think Water – Dewis Dŵr' initiative. This has provided cooled tap water through the installation of water coolers in over 380 schools located in Communities First areas across Wales.

Recreation

Welsh Water owns more than 35,000 hectares of land in Wales, much of it both scenic and environmentally sensitive. Access is encouraged at seventeen major reservoir sites, which also provide valuable recreational and leisure resources and important support for tourism in the local economy. ²² In 2005 around a million people have enjoyed the facilities at our sites, like Llandegfedd Reservoir or attended one of our visitor centres at Llys y Fran, Elan Valley and Llyn Brenig.

Heritage

For many years Welsh Water has supported the Waterworks Museum in Hereford, which collects, restores and displays machinery associated with the history of water supply in Wales and some adjoining parts of England. This year, with Heritage Lottery Funding and the support of English Heritage and Welsh Water, the Museum has refurbished the lower pumping station at Broomy Hill wastewater treatment works, itself a scheduled ancient monument. We have also provided additional land for future expansion of the museum.



Volunteering

We continue to promote our community investment scheme to assist employees who wish to become involved in charitable or other projects within their local communities. Many of our staff, and those of our contract partners, freely give their own time to various community projects and charities.

Crime prevention

Welsh Water also works closely with various local community organisations. For several years we have worked with local police forces and other caring organisations to help combat distraction burglaries. In areas where these partnerships are established the number of distraction burglaries have fallen.

JULY 05

PANTSIDE PRIMARY SCHOOL ARE WINNERS IN WELSH WATER'S ILLUSTRATED POEM COMPETITION, WHICH HIGHLIGHTED THE BIODIVERSITY FOUND IN AND AROUND WATER IN THE ENVIRONMENT.

AUGUST 05

10 MILE LEUKAEMIA RESEARCH BIKEATHON HELD AT LLYN BRENIG RESERVOIR.

An international challenge

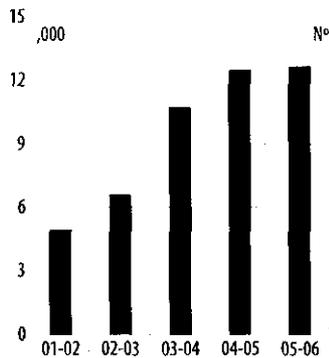
WaterAid is an international charity dedicated to extending access to safe domestic water, sanitation and hygiene education for some of the world's poorest communities. It was re-launched in Wales in 2004, and our staff are on track to meet the goal of raising £1 million by 2014 through year-round fund-raising activities, with over £100,000 raised last year. For many years the company has also operated a WaterAid lottery which is supported by staff, and each year Welsh Water customers receive an invitation to contribute to WaterAid; last year these sources donated over £33,000.

Welsh Water and the environment

Welsh Water is a major contributor to the environmental quality of life in the region we serve. Our commitment to the environment not only ensures the fulfilment of our statutory duties, but in many cases goes beyond this, and involves extensive consultation, and sometimes partnership, with community representatives and environmental and conservation bodies. This process is supported with an annual meeting of senior representatives from our environmental stakeholders.

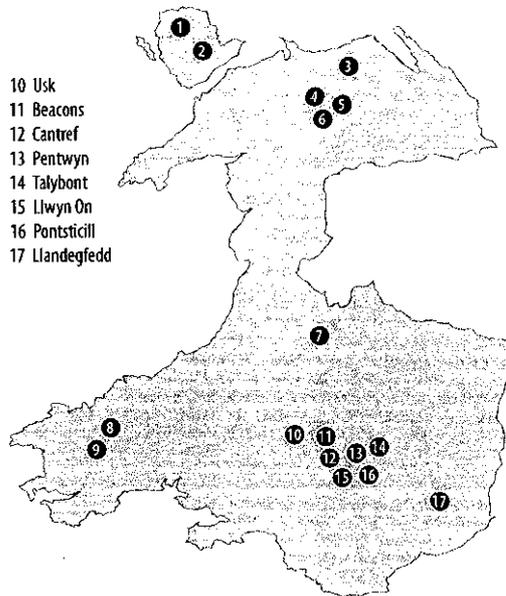
We are conscious of the potential impact of our operations and our obligation to safeguard the environment for future generations. At the most basic level we seek to minimise any immediate adverse environmental impact and any disruption for the communities we serve. Work programmes are designed to minimise the extent and duration of construction and, wherever possible, to achieve positive benefits for conservation and the wider community.

21 Educational visits



22 Main reservoir recreation sites

- 1 Llyn Alaw
- 2 Cefni
- 3 Dolwen and Plas Uchaf
- 4 Llyn Aled
- 5 Llyn Brenig
- 6 Alwen
- 7 Elan Valley
- 8 Rosebush
- 9 Llys y Frân
- 10 Usk
- 11 Beacons
- 12 Cantref
- 13 Pentwyn
- 14 Talybont
- 15 Llwyn On
- 16 Pontsticill
- 17 Llandegfedd



But there are also longer-term environmental impacts that we wish to address. Our 'environmental footprint' project, launched in 2004, has included a Carbon Management Project undertaken jointly with Carbon Trust Wales. This work was given urgency not only by the recent sharp increase in energy costs, but also by an awareness of the increased energy consumption that is likely to arise in future years from regulatory drivers such as the Water Framework Directive. The first phase of the project resulted in the updating of our environmental policies, focusing on four key themes.

Biodiversity

We encourage conservation best practice. An example of this is the development of site-specific habitat and species plans for Llandegfedd Reservoir, a popular countryside site close to Pontypool which hosts various recreational activities including an active still water fishery and sailing club. This site won first place in the Conservation Category for Major Wetland Sites in the British Trust for Ornithology Bird Challenge, recognising a number of initiatives including new reed beds and ponds, and a planting scheme designed to attract and feed birds during the winter.



Resource/waste minimisation

We pursue opportunities for resource optimisation and waste minimisation and to giving preference to efficient and sustainable waste management options, with recycling to landfill as the last option. After sewage sludge, our next biggest waste stream is construction (i.e. 'inert') waste. Our contract partner, Laing Utilities, has developed an aggregate recycling scheme, which reduces landfill volume and the need for virgin aggregates and, indirectly, reduces journey times and fuel use, whilst generating cost savings in 'aggregate levy' and 'landfill tax'.

Environmental procurement

We select contract partners who demonstrate environmental awareness and responsibility, and who embrace our environmental objectives and commitment to share best practice to protect the environment. In recent years we have sought, wherever possible, to procure energy and water efficient plant and machinery, so maximising environmental and financial benefit.

Energy management

We promote energy efficiency and awareness amongst our employees and, in particular, we promote the generation of renewable energy from our resources and business processes.

In 2005-06 three new combined heat and power (CHP) plants became operational to capture and burn 'waste' methane gas generated from wastewater treatment processes. We have already started to install a second tranche of CHP that will deliver a further 200kW of power in the next 2-4 years. The first of these will be commissioned in 2006 at Chester wastewater treatment works and should generate around 25% of the works power requirements. We have also surveyed our assets to identify potential for new hydro generation schemes, which has resulted in a recently commissioned scheme at Eithinfynydd in north Wales which generates more power than is used at the works - making it both energy (and carbon) neutral.

The environmental footprint project is gaining momentum and future attention will focus on aspects of energy management policy that can contribute to reducing carbon emissions (CO₂), including using the services of an independent consultant to assist in establishing relevant baseline data.

SEPTEMBER 05

DELEGATES FROM BOTSWANA, POLAND AND INDIA VISIT WELSH WATER TO LEARN ABOUT ITS UNIQUE BUSINESS MODEL AND ITS RELEVANCE FOR THEIR COUNTRIES.

FEBRUARY 06

VICKY WORLEY, TEAM LEADER AT WELSH WATER, VISITS BURKINA FASO ON A WATERAID LEARNING PROGRAMME.

People and partners

Welsh Water is responsible for an essential public service and delivers this with a unique business model.

Though it employs only 152 people directly, Welsh Water is at the heart of an 'Asset Management Alliance' (AMA) with approximately 3,000 people, from 15 different organisations, working together across Wales to deliver high quality services to Welsh Water's customers.

All contract partners share Welsh Water's commitment to progressive employee relations and, in particular, the 'Working Together Agreement' with staff and trade unions. This is essential to delivery of the shared vision of the AMA of being the best water operation in the UK, as measured by customers. We have also put in place strong incentives for out-performance, including the prospect of additional payments for industry leading performance on water quality, environmental quality and customer service measures.

Although the average length of service of Welsh Water staff is 16 years, and staff turnover is well below the national average, Welsh Water benefits greatly from the diversity of water industry and wider experience brought through the AMA and contract partners. This is especially important as in the next few years we face a key challenge in delivering a programme of 'IT Enabled Change' designed to optimise the way technology is used to deliver and improve customer services and the more efficient operation of Welsh Water's network of water and sewerage assets.

Employee reward & recognition is closely aligned to business performance. In the year following the announcement by Ofwat that Welsh Water was joint top of the OPA league table, employees were given a lump sum bonus in recognition of this achievement. The lump sum was the same amount for all employees, giving greater relative reward to employees on lower salaries. Compensation & Benefit packages are regularly benchmarked against the Welsh Employment market and the UK Industrial and Services market.

Training and Development is aligned to the delivery of business objectives, and all Welsh Water staff have a 'Personal Development Plan', which translates company objectives into personal objectives, against which individual performance can be evaluated. The AMA offers opportunities for staff secondments across the wider business, which is one of the ways we provide personal and professional development for staff, to ensure that the skills and experience necessary to take the business forward are retained and optimised. All employment and development opportunities are open to all people, regardless of their ethnic origin, gender, disability, race, colour, religion, sexual orientation or age.

Keeping our staff informed is important and we use a wide range of methods to communicate with staff, including monthly team meetings, bi-annual staff forums and

a quarterly magazine – 'The Link'. The Managing Director also meets quarterly with small groups of staff to discuss the latest business issues and to answer any questions. Emails and the employee intranet are used for immediate news and announcements.

Evidence that employee relations are positive is provided by our survey of staff opinion - this year 78% of employees returned the annual questionnaire - in which the top 10 responses were in the range 89-100%. However, 2005-06 was a year of significant organisational change for the business and staff also flagged a number of areas for improvement, on which we are focusing in the current year.

The health, safety and welfare of our employees and all those who work with us, is of the utmost importance. Our health and safety management system applies to all contract partners and their first tier suppliers. In 2005-06, overall, the number of health and safety reportable incidents fell by around 8%, and non-reportable incidents by over 28%. All incidents and near hits are investigated and this informs our setting of proactive targets for improving our performance. Further details of our health and safety performance and approach are available in the 2006 Health and Safety Report which is available on our website www.dwrcymru.com or on request.

Customer relations

At Welsh Water we have over 1.2 million household customers and over 100,000 business customers, and we want them to feel confident that their water supply and sewerage services are well looked after. Our aim is to get things right first time, every time and give customers a prompt, courteous and professional response every time they contact us.

Customer contact

We know that most of our customers prefer us not to use automated telephone response systems and we remain committed to telephone answering by 'real people' – only using automation where necessary. In the year we received almost 1.2 million telephone calls (an increase of 6% from 2004-05). Around 80% of these calls were from customers making payments, querying their bill or payment arrangements. The remaining 20% were related to operational queries. In addition we received almost 143,000 written queries about bills and payment options and 99.9% of these were responded to within five days. [23](#)

This year was the first year of reporting against the new Ofwat telephone contact combined measure (DG9). Overall performance was good, with only 1.6% of calls being abandoned and 0.3% of calls receiving the engaged tone. [24](#) Performance against the new call handling customer satisfaction measure was 4.59 out of a possible score of 5.

During the year we issued over 1.9 million bills and improved our overall cash collection performance. We provide a large range of payment options to customers, including direct debit, debit or credit card, payment card and online facilities. 48% of customers pay by direct debit, 27% on receipt of their bill and 25% by one of our other regular payment methods. Despite our improved cash collection performance we do recognise that a high level of arrears can hold some customers back from paying their bills. Our Customer Assistance Fund, launched in 2003 with the assistance from the Citizens Advice Bureau, who continue to manage the applications for us, has been able to assist over 550 customers with their arrears and help them return to paying their current charges on a regular basis. We also have a vulnerable group tariff that aims to ensure that all those on the tariff pay no more than our average household bill.

We are aware that some of our customers require extra help – including customers with a disability and elderly people – and we offer various additional services.

This includes large print or braille bills, bottled water during emergencies, a password scheme for home visits, and a 'knock and wait' service for those customers who require a little more time to answer the door to callers. We have almost 3,000 customers registered with us as requiring these additional services.

Currently around 30% of our customers are metered. At the year end only 116 meters remained unread by either the Company or the customer and therefore over 99.9% of customers received a bill from us based on an actual meter reading. [25](#)

The number of written complaints received this year rose by just over 20% to 9,948 (2004-05: 8,202). This increase reverses what has been a falling trend in recent years and was mainly attributable to the overall price increase at the start of the current investment period, changes to our tariff structure, sewer flooding and the cryptosporidium outbreak in late 2005. The current focus is on reducing the number of 'avoidable' complaints. [26](#)

Customer research

Since 1990 we have employed an independent market research organisation to track customer views every six months on a range of issues, in particular their satisfaction with the services provided by Welsh Water. The latest research shows that satisfaction with drinking water quality and river environmental quality continues in an upward trend. There has been a steady improvement in satisfaction with coastal environmental quality, reflecting the step change in coastal water quality by Welsh Water's

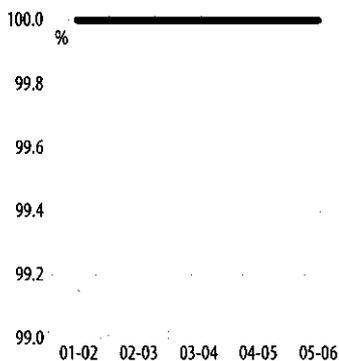
£1 billion coastal wastewater treatment improvement programme. We also track our customers' views on value for money and how this compares with other utilities. **27** **28**

We also employ independent researchers as 'mystery shoppers' who assess the performance of our telephone contact service. Welsh Water's call centres continue to perform well, beating industry benchmarks and consistently achieving satisfaction ratings of over 90%.

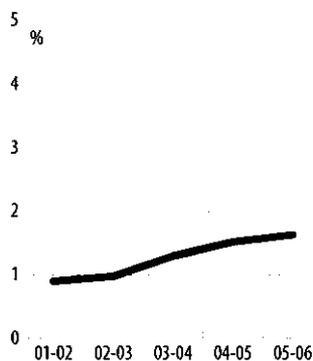
In addition, Independent surveys are also undertaken to monitor the views of customers who have contacted us. These show that more than 70% of customers are very satisfied or fairly satisfied with our overall level of service.

The research is used across the Company and informs our customer service improvement actions.

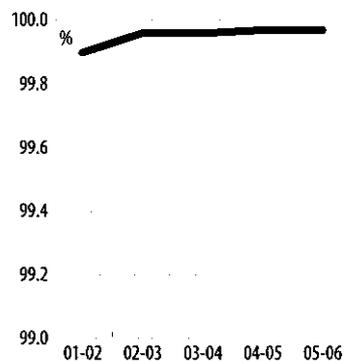
23 Billing contacts dealt with within 5 working days



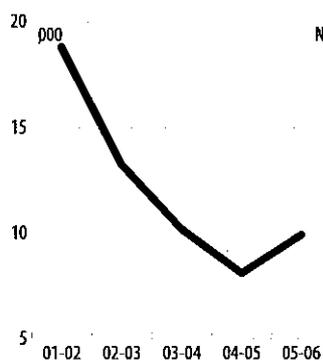
24 Calls abandoned



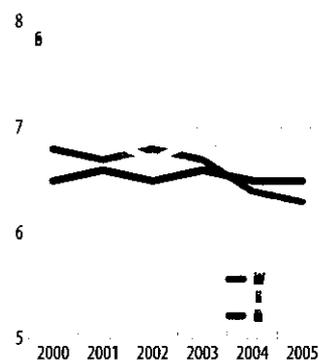
25 Meters read



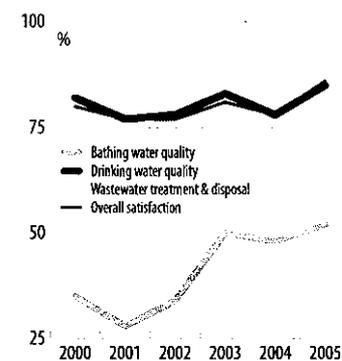
26 Written complaints received



27 Value for money score (0-10)



28 Customer research on satisfaction levels



Financial review

Glas Cymru's financial strategy is to offer a secure, low risk investment to long-term investors. By strengthening our financial position, we intend to keep our future borrowing costs low, enabling us to finance future investment in the business efficiently, whilst having the scope to return money to our customers through sustained 'customer dividends'.

Financial results

The only trading activities of the Glas Cymru Group are carried out by its principal subsidiary, Welsh Water. The report and accounts of Welsh Water (Dŵr Cymru Cyfyngedig) for the year to 31 March 2006 are published separately.

Glas Cymru's turnover in the year to 31 March 2006 was £554 million (2005: £494 million) – an increase of 12%. The increase primarily reflects the price increase of 12.6% in the year. The effect of 'customer dividends' in the year was that turnover was some £23 million (2005: £12 million) below the level that would have resulted from the full price control allowed by Ofwat. The rate of voluntary customer switching to metered charging in the year slowed somewhat to nearly 27,000 customers (2005: 31,000 customers), whilst some 10,000 new customers were added during the year, who are all metered. There was continuing success from various income initiatives, which have added some £2 million this year to the revenue base, largely by ensuring that customers are being charged correctly for all the services that they receive from the company.

Net interest charges for the year were effectively unchanged at £150 million (2005: £143 million - including a profit of £6 million on the termination of a finance lease) despite the increase in net debt during the year. In addition, under International Financial Reporting Standards, a charge of £33 million is made against the income statement for the movement in the fair value of financial instruments (2005: £8 million), which is a non-cash item. [29](#)

Profit before tax was £11 million (2005: £4 million). This profit was made after funding the 'customer dividend' of £18 for customers receiving both water and wastewater services. The Board of Glas Cymru has decided to increase the 'customer dividend' for 2006-07 to £19, and intends to maintain the 'customer dividend' at least at that level until 2010.

The tax credit for the period was £5 million (2005: £1 million), comprising of a £1 million prior year corporation tax and group relief charge and a £6 million deferred tax credit.

Continued focus on cost control

Glas Cymru's operating costs (excluding infrastructure renewals expenditure, depreciation and amortisation) were £213 million (2005: £211 million), which represents a reduction in real terms of around 1%, notwithstanding a substantial increase in energy costs, which were some £9 million (or 54%) higher than in the previous year. The costs of the £25 *ex gratia* payment to some 30,000 customers in north west Wales affected by a boil water notice are included in operating costs.

Around 70% of operating costs were incurred under outsourced service contracts. These including the contract with United Utilities Operating Services for the operation of the water network and the wastewater network in north Wales along with Kelda Water Services, effective from 1 April 2005, for the operation of the wastewater network in south Wales and Herefordshire. These new contracts operate on a target cost basis which are designed to incentivise further improvements in operating efficiency in the period up to March 2010. [30](#)

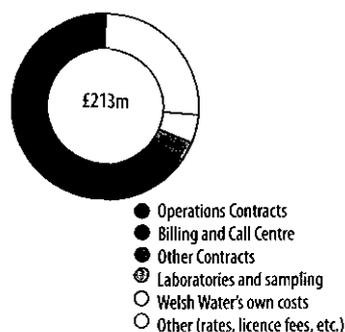
29 Interest covers

As at 31 March	2006 £m	2005 £m
EBITDA (pre - 'customer dividend')	363	295
Interest payable (excluding indexation and amortisation of issue costs):		
Senior debt	114	95
Senior debt + class C bonds	127	114
Total debt	130	124
Interest cover (EBITDA/Net interest):		
Senior debt	3.2x	3.1x
Senior debt + class C bonds	2.9x	2.6x
Total debt	2.8x	2.4x

Customer debt recovery remains subject to very close attention by Welsh Water and by Thames Water, the billing and income services contract partner. Despite a difficult environment - water companies are not allowed to disconnect supplies to domestic customers due to non-payment - cash collection performance was ahead of target. The bad debt charge for the year of £8 million (2005: £8 million) represents less than 2% of annual turnover.

Capital expenditure by Welsh Water during the year (before capital grants and developer contributions and including infrastructure renewals expenditure) was £238 million (2005: £239 million), which is broadly in line with the expected average rate of expenditure over the five-year AMP4 period. Since 1 April 2005, Welsh Water has been working with a new alliance of capital investment partners (Laing Utilities, Morrison, AMEC, Costain, Meica, and Black and Veatch) with the aim of delivering the AMP4 investment programme at the best value for money for customers. A priority during the first year of the programme has been to reappraise rigorously the design of certain key schemes with a view to achieving the reductions in unit costs assumed by Ofwat in the 2004 Price Review. At this relatively early stage, it is expected

30 Breakdown of operating costs



that investment expenditure over the AMP4 period as a whole of some £1.2 billion will be broadly in line with the allowance made by Ofwat in the Final Determination.

Financing strategy and credit rating

The Board considers that it is in the best long-term interests of Welsh Water's customers to continue to reduce the level of gearing, with a view to achieving further reductions in its average cost of finance. These financing savings can then be passed on to customers in the form of sustained 'customer dividends' or additional investment in service improvements.

The prudent financial policies of the Group and its improving financial position were reflected in the decision by Moody's earlier in the year to upgrade the rating of the class C bonds from Baa3 to Baa2. In addition, Fitch Ratings reviewed their ratings for the water sector on 16 February 2006, resulting in an upgrade of the class B bonds from A- to A and of the class C bonds from BBB to BBB+. [31]

To protect the Group's high credit quality, the Board has implemented prudent financial policies, covering the fixing of interest rates and currency exposures, and the investment of cash balances.

31 Credit ratings of Glas Cymru bonds

	Standard & Poor's	Moody's	Fitch Ratings
Class A Bonds	AAA	Aaa	AAA
Class B Bonds	A-	A3	A
Class C Bonds	BBB	Baa2	BBB+

Glas Cymru has minimised its exposure to movements in market rates, with a minimum of 85% of its liabilities being fixed rate, index linked (to UK RPI) or matched by cash balances. The Board considers that liabilities index linked to UK RPI inflation are particularly appropriate for the business, as its revenues and RCV are also linked to RPI through the regulatory system operated by Ofwat.

During the year, the Group entered into derivatives contracts totalling some £587 million, with a range of maturities from 2019 to 2040, all of which have the effect of converting floating rate liabilities under existing finance leases to RPI linked liabilities. These new derivatives brought the total RPI linked liabilities of the Group to some 54% of net debt as at 31 March 2006 (2005: 27%).

Financing activities

A key measure of financial performance for Glas Cymru is the level of gearing - the ratio of net debt to Regulatory Capital Value (RCV). By reducing the level of gearing from around 93% in the acquisition of Welsh Water in May 2001 to 78% as at 31 March 2006, the financial position of the Group has been significantly enhanced. 'Financial reserves' (RCV less net debt) now stand at £683 million (2005: £538 million). [32] [33] [34]

Net debt (throughout as defined for covenant purposes in the Common Terms Agreement for the bond programme) increased during the year by £54 million to £2,359 million, including the indexation charge of £17 million (2005: £18 million). The additional finance raised was used to fund part of the capital investment programme in the year and the redemption of floating rate bonds.

During the year Welsh Water drew down a further £114 million under finance leasing facilities with The Royal Bank of Scotland, Lloyds TSB, HSBC, Bayerische Landesbank, Norddeutsche Landesbank and Alliance and Leicester. As at 31 March 2006, total capital outstanding under finance leases was some £740 million (2005: £631 million). All of these leasing facilities offered financing costs which were competitive against equivalent rates available in the bond market.

A £100 million term loan facility with the European Investment Bank was agreed on 5 December 2005. A 15 year tranche of £25 million was drawn under this loan during the year, bringing the total drawn borrowings from this source to £60 million. These loans are used to finance a range of infrastructure investment projects, the majority of which are in European Objective One funding areas and which will all have a significant positive impact on the environment in Wales.

On 29 April 2005, Dŵr Cymru (Financing) Ltd. (DCFL) entered into a seven-year revolving credit facility with Fortis Bank for £75 million. DCFL followed this on 9 May 2005 by signing a five year revolving credit facility for £305 million with a group of banks, all of which have an ongoing financing relationship with Glas Cymru, comprising The Royal Bank of Scotland, Barclays, HSBC, Bayerische Landesbank, Norddeutsche Landesbank, ING and Sumitomo Mitsui Banking Corporation (Europe).

On 12 April 2006, all of the banks agreed to extend this facility for a further year from 2010 to 2011. In all cases, these banking facilities give the Group flexible access to funds at rates competitive with the prevailing rates available in the bond market. As at 31 March 2006, £120 million was drawn under these facilities. The existing £150 million syndicated bank facilities were cancelled on 9 May 2005.

Given the strong liquidity position of the Group and the change in the prevailing rates of interest in the capital markets since May 2001, notice was given on 16 May 2005 for the call and early redemption on 30 June 2005 of the following bond series:

Class A3 - US\$286 million (£200 million), expected maturity March 2008.

Class B2 - £100 million, expected maturity March 2008.

Class C2 - £125 million, expected maturity March 2008.

Furthermore, as anticipated, notice was given on 10 February 2006 for the call and redemption on 31 March 2006 of the final tranche of floating rate bonds:

Class A2 - £100 million, expected maturity March 2006.

A financial saving of some £6 million a year will result from this early redemption of the floating rate bonds issued in May 2001, following an earlier financial saving of around £5 million a year made on the early redemption of the class D bonds on 31 March 2005. The expected maturity of the outstanding fixed rate and index-linked bonds now ranges from 2011 to 2031, with not more than 20% falling due in any two-year period, in accordance with our refinancing policy. [55](#) [56](#)

The listed bonds issued by DCFL have continued to perform well during the year, regularly trading at margins

below many other equivalent water sector bonds of similar maturity. Glas Cymru believes that this performance reflects continued investor confidence with its performance and its improving financial position.

Cash on deposit or invested as at 31 March 2006 amounted to some £14 million which, together with undrawn bank facilities of £335 million, gave the Group a high degree of liquidity.

Introduction of IFRS

These are Glas Cymru's first set of annual financial results following the adoption of International Financial Reporting Standards (IFRS). Comparative figures for the year to 31 March 2005 have also been restated to comply with IFRS.

A comprehensive document published by the Group in September 2005 set out the impact of the adoption of IFRS which, for Glas Cymru, affects the Group's reported results and Balance Sheet but represents an accounting change only and does not affect the underlying cashflows and financial position of the Group.

Future prospects

The objective of the Board will be to continue to improve the financial performance of the company during the period to 31 March 2010, whilst seeking to at least maintain the current level of 'customer dividend'. The Board considers that the prime measures of this financial performance are the Regulatory Asset Ratio (RAR - the ratio of net debt to RCV) and the various Interest Cover Ratios (ICR - as defined in the Common Terms Agreement.) Glas Cymru has taken advantage of the favourable rates of interests available in the financial markets during 2005-06 substantially to pre-fund its capital requirements for the period to 31 March 2010, the end of the current five-year investment and price control period.

The Board believes that its financial strategy will put the company in a strong position to raise the funding for the following five-year investment programme in the period to 2015 on efficient terms, which is an important part of the company's strategy to keep down customers' bills in the long-term.

The main risks to the achievement of this financial objective involve upward cost pressures. Most notably, power costs have increased dramatically over the last two years and are expected to increase further in 2006-07 and Welsh Water, like all water and sewerage companies, has a large energy requirement, notably for pumping and treatment processes. The increase in power prices can be only partially offset by improved working practices and investment in energy efficiency schemes. In addition, the unit costs of investment

schemes are also under upward pressure. Welsh Water is seeking to mitigate these input cost increases by securing the resources for a long-term programme of work with its partners, and by revisiting designs and working methods to secure offsetting efficiency improvements.

Welsh Water and its partner, Thames Water, also maintain a tight focus on customer cash collection and have introduced a new debt recovery system for metered customers, in recognition of the continuing risk to cash collection posed by increasing water bills and the absence of a disconnection sanction. Under the target cost arrangements, these upward cost pressures are shared only to an extent between Welsh Water and its relevant partners.

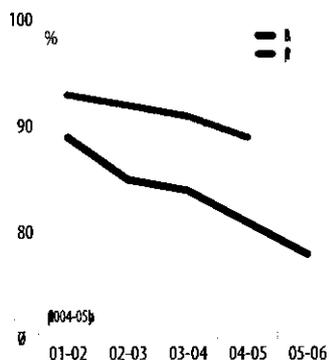
The company does not expect to pay tax on its trading profits during the

year to 31 March 2007, due to the availability of tax allowances on its investment programme. Future tax liabilities beyond that date will also be primarily influenced by this factor.

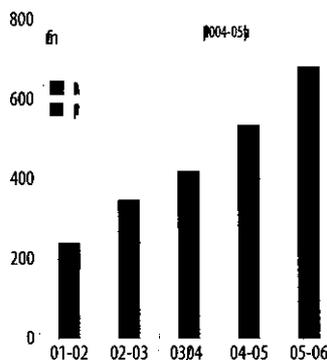
Disclaimer

This Report contains certain forward-looking statements with respect to the future business and taxation prospects and the strategies of the Glas Cymru Group. These statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

32 Gearing (net debt/RCV)



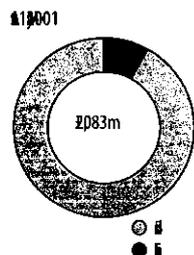
33 Growth in financial reserve



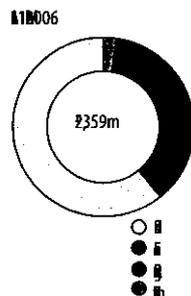
34 Net debt and reserves

As at 31 March	2006 £m	2005 £m
Regulatory Capital Value	3,042	2,843
Net Debt	2,359	2,305
'Reserves' (RCV less net debt)	683	538
Gearing (net debt/RCV)		
Senior debt	73%	72%
Senior debt + class C bonds	78%	81%
Total debt	78%	81%

35 Source of debt 2001



36 Source of debt 2006



Risk

The assessment and mitigation of risk are key priorities for the business. The Board has overall responsibility for the system of risk management and internal control, as described in the Governance Statement on page 39 of this report. Glas Cymru cannot diversify into activities unrelated to those of a regulated water and sewerage business. This means that the nature and balance of risk to be managed by the Group is different, and in many respects lower, than that of other companies in the UK utility sector.

The Quality and Environment Committee of the Board (QEC) is an important part of governance arrangements, providing critical focus on 'quality', 'service' and the management of risk in its monitoring of the performance of Welsh Water and its contract partners. The work of QEC is described in more detail in its annual report to the Board, which is available on our website or on request from the Company Secretary.

The principal risks faced by the group fall into the four broad categories of operational, regulatory, financial and procurement risks.

Operational

Operational risk is varied and may include:

The impact of major operational incidents on public health, environmental quality or customer service, whether arising from equipment failure, from natural events (e.g. 'acts of God', or contamination from naturally occurring compounds) or from

third party interference with Welsh Water assets or equipment changes in environmental, consumer protection and public health and safety law and regulation, which typically require higher standards of water quality, environmental and safety performance the impact of more extreme weather conditions on the availability of water resources during droughts and the ability of Welsh Water sewerage network to cope with severe rainfall events health and safety incidents arising from the operation of a large and complex network of assets.

Policies and operational strategies exist to mitigate each of these risks that could create an adverse effect on the reputation, operating results and financial position of Welsh Water.

In the long term, Welsh Water needs to maintain its £15 billion asset base to deliver the high standards of water and wastewater services that customers expect. The rate at which assets can be maintained, refurbished or replaced is determined by the funding allowed by Ofwat through its five yearly price determination. At the rate of investment provided in the price determination for 2005-10, the average age of Welsh Water's assets will be greater at the end of the period than at the start, which may increase risk of future asset failure and poor serviceability.

Regulatory

Regulatory risk can arise from Ofwat's price control determinations or from changes in the regulatory environment, which would affect all companies in the sector in the same way.

A price control determination may affect risk in a number of ways, for example, if it were to provide an inadequate cost of capital allowance or be based on regulatory assumptions in respect of operating costs, required capital investment and revenue forecasts that prove unrealistic. Welsh Water's business plan seeks to meet and, where possible, exceed the assumptions made by Ofwat in the latest determination for the period 2005-10. However, at this early stage in the five year regulatory period, this objective is subject to considerable uncertainty. The outcome of the next periodic review process in 2010 will also directly impact on future cashflow and profitability.

Welsh Water has to provide extensive data to the regulators each year on all aspects of its business. This responsibility is taken very seriously and processes are in place to review these data sets and to ensure that they are of appropriate accuracy and robustness.

Our Licence requires us to have strong governance arrangements, which ensure that the responsibility of Welsh Water for water quality, environmental quality and public health is clear. Further details of the Group's governance arrangements can be found in the Governance Report on pages 39 to 45.

Financial

Like any business, Welsh Water is exposed to many financial risks, in particular between regulatory price reviews. Examples include:

Revenue risk, in particular, changes in metered demand, the loss of large water business customers, and the increased introduction of competition in the water sector the collection of customer charges and non recovery of customer debt, which is a particular risk following the prohibition in 1999 of disconnection of domestic water supply for non-payment failure by Welsh Water to achieve the challenging price determination targets set by Ofwat for operating and capital efficiency or to deliver the capital investment programme which Ofwat determine to be necessary to maintain high quality services to customers external cost pressures, such as the impact of recent increase in power prices, which could also prevent the business from achieving Ofwat's operating and capital cost targets set at the last price review the overall financial risk is that the group may not be able to finance the operating and capital investment obligations of Welsh Water, which continue to be financed from cash flow from operations and debt financing.

Group policy is to ensure that the business has sufficient committed facilities available to meet at least twelve months anticipated net cash requirement. However, recognising favourable market conditions, financing risk has been significantly reduced during 2005-06 as a

result of treasury activity, which has substantially completed Welsh Water's financing requirements for the period until 2010. The group's financial position at 31 March 2006 shows a significant balance of cash and undrawn borrowing facilities available, which gives the business a high degree of liquidity.

Procurement

Procurement risk is a particular risk for Welsh Water, with some 85% of our annual operating and capital expenditure being undertaken by outsourced service providers (our 'contract partners'). Our framework for competitive outsourcing is described in a published Procurement Plan. Initial outsourced operating contracts were generally let for a period of four years, which ended on 31 March 2005. New outsourced contract arrangements for water and wastewater services were put in place following a successful competitive re-tendering, which provide for contract partners to work with Welsh Water for up to 15 years (subject to price and performance reviews). Our aim is to encourage contract partners to view their involvement with Welsh Water on a longer term basis than was previously possible, thereby reducing the risk of short term conflict of interest and encouraging longer term investment in the resources, people and systems needed to continue to deliver high levels of service to Welsh Water customers.

Other risks

Other general risks to which the Group is exposed include:

Risk associated with change.

Welsh Water plans a major programme of IT enabled change over the next five years, which will include the replacement of ageing mainframe IT systems with new and more flexible systems.

Accompanying this will be a phased review and simplification of key business processes and the development of new tools to enable Welsh Water to become more efficient in its delivery of services to customers

the need to retain and develop key people within Welsh Water to ensure the business has the appropriate competencies and experience needed to ensure all obligations can be met in the long term

rising pension costs due to factors outside the Board's control, such as rising pensioner longevity. However, with only 160 members, the closed Welsh Water defined benefit pension scheme is small relative to the size of the business the availability and terms of insurance as a key tool to mitigate business risk. Insurance policies cover property, business interruption, public liability, environmental pollution and employer's liability are generally multi-tiered, with the first tier of self insurance in the form of a deductible and the second, and often further tiers, of cover provided by external insurers in the market.

Cover photograph:
Stuart Bailes, Newport School of Art, Media and Design, University of Wales, Newport.
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Report and accounts 2006

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The Directors

The Board of Directors is responsible for the strategic direction of the Company and for reviewing operational and financial performance.

LORD BURNS, Chairman ^(M)

Appointed Chairman in July 2000. Lord Burns (62) is Chairman of Abbey National plc, Deputy Chairman of Marks and Spencer Group plc and a Non-Executive Director of Banco Santander Central Hispano SA, and Pearson Group 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 of the Governing Body of the Royal Academy of Music and former Chairman of the National Lottery Commission.

NIGEL ANNETT, Managing Director

Appointed Managing Director in January 2005. Mr. Annett (47) 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 (42) was previously Director of Regulation of Welsh Water and South Wales Electricity PLC. Before joining Welsh Water in 1995, he was a Director at National Economic Research Associates and, prior to that, worked for HM Treasury on nationalised industries and privatisation. He is a Non-Executive Director of the Principality Building Society and a Member of the Board of the Institute of Welsh Affairs.

JIM O'SULLIVAN, Operations Director ^(M)

Appointed Operations Director in September 2005, Mr. O'Sullivan (46) is a Chartered Engineer. Prior to joining the Board, he was Engineering and Safety Director at National Grid Transco and, prior to that, Technical and Quality Director at British Airways. He is also a Non-Executive Director of the Office of Rail Regulation.

JOHN BRYANT, Non-Executive Director ^{(M)(R)(N)}

Appointed a Non-Executive Director in March 2001. Mr. Bryant (62) 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.



Membership of Board Committees

(Q) Quality and Environment

(A) Audit

(R) Remuneration

(N) Nominations

ALISON CARNWATH, Non-Executive Director ^{(A)(R)(N)}

Appointed a Non-Executive Director in July 2000. Mrs. Carnwath (53) 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. She is also a former director of Vitec Group plc, QA Group plc, Arcadia Group plc, Nationwide Building Society, Manweb plc and National Power plc.

GERAINT TALFAN DAVIES, Non-Executive Director ^{(A)(R)(N)}

Appointed a Non-Executive Director in July 2000. Mr. Davies (62) is a former journalist whose career spanned both public and private sector broadcasting including Controller of BBC Wales throughout the 1990s and later as a member of the Radio Authority representing Wales. He is also Chairman of the Institute of Welsh Affairs, a Governor of the University of Wales Institute, Cardiff and a member of the BT Wales Advisory Forum, and former chairman of The Arts Council Wales (2003-2006).

DAME DEIDRE HINE, Non-Executive Director ^{(Q)(R)(N)}

Appointed a Non-Executive Director in March 2001. Dame Deidre (68) 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 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 Deidre was awarded the DBE in 1996 for services to medicine.

TONY HOBSON, Non-Executive Director ^{(A)(R)(N)}

Appointed a Non Executive Director in February 2001. Mr Hobson (58) is the Chairman of Northern Foods Plc and a Non Executive Director of HBOS Plc, and Sage Group Plc. He is a Chartered Accountant and was the Group Finance Director of Legal & General Group Plc between 1987 and 2001, and the Senior Independent Director of Thames Water Plc at the time of its acquisition by RWE in 2000.

The Members

There are presently 57 Members, including the Directors of Glas Cymru.

A key role of the Members is to ensure that the business remains focused on its primary purpose of providing efficient high quality water and sewerage services to Welsh Water's customers. In so doing Members carry out an important corporate governance role.

Members are selected in accordance with a process overseen by an independent Membership Selection Panel, which 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 personal, therefore 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.

A list of the Members of Glas Cymru, together with the Company's Membership Policy and Terms of Reference of the Membership Selection Panel, is published on the Glas Cymru website www.glascymru.com or can be obtained by writing to the Company Secretary.

The Directors present their report and the audited financial statements of Glas Cymru Cyfyngedig for the year ended 31 March 2006.

Principal activities

Glas Cymru is a company limited by guarantee and exists solely to own Dŵr Cymru Cyfyngedig ('Welsh Water') - the sixth largest of the UK's regulated water and sewerage companies, serving around 1.2 million domestic and 120,000 business customers. The Company's constitution requires that all financial surpluses generated by the Group are retained and reinvested for the benefit of Welsh Water and its customers.

The Group's existing business and future prospects are described in the Chairman's review and review of operational performance on pages 1 to 17. Financial aspects are described in the financial review on pages 18 to 21.

Financial results and 'customer dividend'

Profit before tax for the financial year ended 31 March 2006 was £11.3 million as described on page 49. In 2005-06, customers received a 'customer dividend' of £23 million, or £18 per household served by Welsh Water (£9 for water and £9 for wastewater services). Company policy is to at least maintain this level of 'customer dividend' in the period to 2010. For the financial year 2006-07, for which water bills have been issued, the 'customer dividend' was increased to £19 per household (£9.50 for water and £9.50 for wastewater services).

Directors

Details of the present Directors are given on page 26 and 27. All Directors served throughout the financial year 2005-06, except for Jim O'Sullivan who was appointed a Director on 12 September 2005. No Director has, or has had, a material interest, directly or indirectly, in any contract significant to the Company's business.

At the 2006 Annual General Meeting on 7 July 2006 ('2006 AGM') Alison Carnwath, Geraint Talfan Davies, Tony Hobson and Jim O'Sullivan will retire and seek re-election as Directors. Further details are set out in the Governance Report on page 40 and in the Notice of 2006 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 2006 on pages 32 to 38. A resolution will be proposed at the AGM to approve the 2006 Remuneration Report.

Members

At the date of this report, Glas Cymru has 57 Members including the Directors of the Company. Details of changes in the membership since the 2005 AGM, 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 in the Governance Report on page 43. 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.

Responsible business

We describe our approach to meeting our corporate social responsibilities to our customers, to the communities we serve, to our employees in the workplace and to the environment on pages 12 to 17.

Employees

At 31 March 2006 Welsh Water employed 152 people. Other than the directors of the Company, Glas Cymru has no employees.

A key part in delivering continuous improvement in the performance of the business and the level of service received by Welsh Water's customers is our ongoing investment in our people at all levels. We are committed to equality of opportunity and aim to treat all employees fairly in every aspect of employment, including recruitment, training, career development and promotion. Those who seek employment with Welsh Water are considered solely on their skills and abilities.

We believe all employees should have the opportunity to maximise their potential and individual training and development needs are assessed as part of an annual development review that applies to all our employees.

Welsh Water's outsourced procurement strategy has fundamentally changed the manner in which services have been delivered to customers since 2001 and has made a major contribution to improved levels of customer service in the last five years. This has been achieved, in large part, by the development of 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.

The success of the business is delivered through our employees, and it is important that they share in this success. We do this through a staff incentive scheme, which pays an annual bonus directly linked to the financial performance and customer service performance of the business (as measured by Ofwat's 'Overall Performance Assessment'). In addition, last year employees received a longer-term bonus linked to the overall financial performance of the business between 2001 and 2005. As a result, in 2005-06 every employee received the maximum entitlement under these schemes totalling £4,500 each.

There is nothing more important to us than the health and safety of the people who work for us, and those we affect through our work. Our commitment to health and safety and the performance of Welsh Water and its contract partners in 2005-06 is set out in our 2006 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.

Further information relating to employee matters is set out on page 15.

Environment

We are committed to improving the operational and environmental performance of the business, and this is monitored each month by the Quality and Environment Committee of the Board ('QEC'). As in previous years, a copy of the 2006 QEC 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 at page 14 and in two reports published last year, a Biodiversity Overview and an Environment Overview, which describe the framework within which we operate, our recent performance and the challenges we face.

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 R&D investment and initiatives by Welsh Water's outsourced 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 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 30 days 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 2005-06, the average payment period was 61 days (2005: 70 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.

Donations

During the year, charitable donations amounted to £33,395 (2005: £22,394). Individual donations above £200 were made to: WaterAid (£16,000), Keep Wales Tidy (£10,000), Hereford Waterworks Museum (£5,000), Wheel Chair Fund (£1,000), St John's Ambulance (£600) and NSPCC (£500). Of these, WaterAid, St John's Ambulance and NSPCC are national charities.

It is Group policy not to make donations to political parties. No payments or donations in kind have been made which are required to be disclosed under the Political Parties, Elections and Referendums Act 2000.

Welsh Language Scheme

We welcome dealing with customers and other stakeholders in Welsh or English and aim to provide an equally effective standard of service in both languages. We operate an approved Welsh Language Scheme under the provisions of the Wales Language Act 1993.

Regulatory accounts (Welsh Water)

Condition F of the Instrument of Appointment under which Welsh Water operates requires that Welsh Water publish additional financial information as an 'appointed business'. A copy of this information will be published on Welsh Water's website or will otherwise be available on request from the Company Secretary after 15 July 2006.

International financial reporting standards

During the year, Glas Cymru adopted International Financial Reporting Standards (IFRS) and this is reflected in the financial results for the year ended 31 March 2006. Glas Cymru's IFRS adoption document, including a description of the main changes to accounting policies and resulting impact on the Group's results, was published on 21 September 2005, and a copy of this document is available on the Company's website. A reconciliation of net income and net assets between IFRS and UK GAAP can be found in Note 28 to the 2005-06 Accounts.

Going concern

The Directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2006 have been prepared on a going concern basis.

Auditors

PricewaterhouseCoopers LLP acted as auditors to Glas Cymru for the accounts for the year ended 31 March 2006. As part of the audit process each Director has confirmed, as at the date of the financial statements, that as far as the Director is aware (a) there is no relevant audit information of which the Company's auditors are unaware, and (b) they have taken steps to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

PricewaterhouseCoopers LLP have expressed their willingness to continue as auditors and a resolution for their reappointment will be considered at the 2006 annual general meeting. However, the Group is currently seeking bids for the provision of external audit services for the 2006-07 financial year, with the process expected to conclude in Summer 2006 at which time, unless re-appointed, PricewaterhouseCoopers LLP will resign and the Board will appoint a new auditor to fill the resulting vacancy.

Annual general meeting

The notice convening the 2006 AGM to be held on Friday 7 July 2006 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 2006, and the re-appointment of four Directors who retire and offer themselves for re-appointment. These resolutions are matters of ordinary business for the 2006 AGM, being matters that are addressed each year. There are no matters of special business.

By order of the Board



Richard Curtis LLB, ACIS
Company Secretary
7 June 2006

Remuneration report 2005-06

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 the Members of Glas Cymru at the 2006 Annual General Meeting (2006 AGM).

In accordance with the Regulations, the Directors' emoluments table, long-term performance related bonus table and pension table on pages 36 and 37 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 39. We confirm that we have complied with the Combined Code in preparing this report.

Remuneration Committee

The Remuneration Committee (the 'Committee') is chaired by Alison Carnwath and comprises all the Non-Executive Directors. The Chairman of the Board, along with the Managing Director, attends meetings of the Committee by invitation, as appropriate. All members of the Committee are independent of management and save for their Directors' fees have no financial interest in the Group. The Committee met on five occasions in 2005-06 and details of Committee members' attendance is set out in the Corporate Governance Report on page 40.

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 the Chairman, Non-Executive Directors and Executive Directors
- to agree the terms of service contracts and remuneration for Executive Directors and senior managers
- to determine incentive 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 and Head of Human Resources attend all meetings of the Committee and provide information and advice as necessary. In addition, the Committee has sought independent external advice on certain aspects of remuneration policy and best practice. In 2005-06, advisors to the Committee were:

- New Bridge Street Consultants LLP ('New Bridge Street'), who advised on market best practice in the design of new incentive performance arrangements, the benchmarking of Executive Directors' remuneration, senior management service contracts and remuneration, and in a review of the fees payable to the Chairman of the Board. New Bridge Street also advised the Board in a review of non-executive Director fees
- Linklaters & Alliance, who provide legal advice to the Committee on directors' service contracts and pension matters. Linklaters also provide legal advice to the Group
- Barnett Waddingham LLP, who provided advice in relation to pension matters. In 2006-07 this advice will be provided by New Bridge Street.

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

Remuneration Policy

Remuneration policy has been 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; especially, the interests of the customers of Welsh Water. Accordingly, a high proportion of Directors' remuneration is dependent on performance.

Remuneration policy applies to the senior management team, as well as to Executive Directors, and has been founded on the following principles:

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

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

The above described remuneration policy ('the 2005 Remuneration Policy') was approved by the Members of Glas Cymru at the 2005 Annual General Meeting with effect from 1 April 2005. This replaced the remuneration policy adopted in 2001 for the period to 31 March 2005 ('the 2001 Remuneration Policy'), which was founded on substantially the same principles. The annual cash and long-term incentive bonuses paid to Executive Directors in October 2005, in respect of performance in 2004-05, were determined in accordance with the 2001 Remuneration Policy.

Bonus Policy: Annual Performance Related Bonus

The maximum annual cash bonus payable is 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 is payable within six months of the end of the year to which it relates.

The customer service component is determined with reference to the Overall Performance Assessment published by Ofwat ('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 ('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.

The OPA includes 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
customer service performance: e.g. speed of response to telephone and written billing enquiries and handling of written complaints.

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 is 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 cashflows 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 Ofwat's Final Determination, which is a key requirement if the business is to achieve the challenging objectives set by the Board.

The 2005-06 Accounts include an accrual of £241,833 (equivalent to 49.9 basis points) reflecting the Committee's current estimate of Welsh Water's relative performance for the year ended 31 March 2006. The Committee will make its final assessment of bonus payable for 2005-06 in October 2006 following publication by Ofwat of its Levels of Service report.

Bonus Policy: Rolling Long Term Incentive Scheme ('RLTIS')

The RLTIS is a longer-term incentive scheme introduced as part of the 2005 Remuneration Policy and operates annually from 1 April 2005 on the basis of a rolling three-year period (except during the first two years).

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.

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 that 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 until 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' (Regulatory Capital Value less net debt) at the end of the relevant year, as defined for the purposes of the quarterly Investor Report routinely published by the Company. Growth in Financial Reserves is considered the best financial measure of customers' interest in the business, as it is from Financial Reserves that the 'customer dividend' and 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 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.

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

The 2005-06 Accounts include an accrual of £213,844 (equivalent to 44.1 basis points) reflecting the Committee's current estimate of Welsh Water's relative performance for the year ended 31 March 2006. The Committee will make its final assessment of bonus payable under the RLTIS for 2005-06 in October 2006 following publication by Ofwat of its Levels of Service report.

Remuneration: 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 2006, when they were increased to:

Chairman	£172,000	(2005: £164,000)
Non-Executive Directors	£48,000	(2005: 45,000)

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 40). Fees are reviewed annually.

The Chairman and the Non-Executive Directors are appointed under letters of appointment, terminable on three months notice. Appointments may be terminated by either party, however no compensation is payable by the Company on termination of an appointment.

Remuneration - Executive Directors

Salary

At 1 April 2006, the base salaries of the Executive Directors were as below:

Nigel Annett (Managing Director)	£231,000	(2005: £220,000)
Jim O'Sullivan (Operations Director)	£178,500	(2005: £170,000) (Appointed 12 September 2005)
Chris Jones (Finance Director)	£178,500	(2005: £170,000)

Base salaries were determined by the Committee having considered the competitive market data provided by New Bridge Street, and following changes in responsibility arising from the retirement of Mike Brooker on 31 March 2005. Base salary is reviewed by the Committee on an annual basis.

Bonus

Annual performance related bonus

In October 2005 Executive Directors received an annual incentive bonus for the year ended 31 March 2005 equivalent to 77.3% of salary, of which 50% related to performance against customer service targets and 27.3% to meeting financial targets; this compared to an accrual in the 2004-05 Accounts of 60.8%.

Long Term Bonus Entitlement

In 2005-06, Executive Directors in post at 31 March 2005 received a long-term bonus under the 2001 Remuneration Policy. As described in full in the 2005 Remuneration Report, this was determined on the basis of two measures assessed over the four year period ended 31 March 2005: (i) the increases in the Company's level of 'Financial Reserves'; and (ii) changes in the rating of each class of the Company's bonds.

Under this scheme half of any award earned was paid in September 2005. The remaining half was deferred for two years and will be payable in September 2007 with no further performance conditions. However, Mike Brooker, having retired on 31 March 2005, received, in September 2005, full entitlement to the long-term bonus accrued for the four year period to 31 March 2005.

Rolling Long Term Incentive (2005)

The Rolling Long Term Incentive Scheme was introduced in April 2005 as part of the 2005 Remuneration Policy. The first payment under the RLTI will be made in October 2006.

Pensions

It is Company policy to make provision for pensions for Executive Directors. Welsh Water has a Defined Benefit pension scheme and a Defined Contribution pension scheme. NC Annett and CA Jones are members of the Defined Benefit scheme and J O'Sullivan is a member of the Defined Contribution scheme.

	Accrued pensions (per annum)	Increase in accrued pension in the year	Transfer value at 31 March 05	Transfer value equivalent of increase	Transfer value at 31 March 06	Contributions paid by director	Contributions paid by company**
NC Annett*	£51,322	£6,482	£331,267	£53,278	£421,890	£13,710	£49,585
CA Jones*	£38,720	£6,158	£183,763	£39,681	£243,621	£10,710	£38,735
J O'Sullivan ***	-	-	-	-	-	-	£23,702

* Accrued pension includes previous service in Hyder Water Pension Scheme.

** MP Brooker retired on 31 March 2005 with an unreduced pension. An accrual of £270,000 was made in the 2005 Accounts in respect of MP Brooker, which was subsequently paid to the pension scheme in the year ended 31 March 2006.

*** Jim O'Sullivan joined the company on 12 September 2005. As he is a member of the defined contributions pension scheme, there are no accrued pension liabilities.

The Company has made a provision for liabilities arising from contractual commitments to Executive Directors over the Inland Revenue 'earnings cap'. As at 31 March 2006 this liability totalled £220,000 (2005: £204,000).

The normal retirement age for Directors under the Welsh Water Pension Scheme is 60 and, for the Defined Benefit scheme, 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. Both the Defined Benefit and the Defined Contribution schemes also provide 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.

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

The table below reports emoluments receivable in respect of the year ended 31 March 2006, and includes a best estimate of the performance related annual bonus relating to customer service performance for 2005-06. The annual performance related bonus is ordinarily paid in September, following publication by Ofwat 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 2006

2005-06	Lord Burns	NC Annett	CA Jones	J O'Sullivan ¹	JM Bryant	A Carnwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary		220,000	170,000	94,808						£484,808
Bonus 2005-06 Provision										
Annual bonus ²		109,741	84,800	47,292						£241,833
Benefits in Kind ³		1,931	1,451	708						£4,090
Fees	164,000				45,000	45,000	45,000	45,000	45,000	£389,000
Total emoluments relating to 2005-06	£164,000	£331,672	£256,251	£142,808	£45,000	£45,000	£45,000	£45,000	£45,000	£1,119,731

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

2004-05	Lord Burns	MP Brooker ⁴	NC Annett	CA Jones	JM Bryant	A Carnwath	GT Davies	DJ Hine	AJ Hobson	Total
Salary ⁵		£194,958	£152,713	£139,256						£486,927
Bonus for 2004-05 as provided in Report and Accounts for 2004-05 ⁶		£118,534	£84,668	£84,668						£287,870
2004-05 Bonus adjustment		£32,169	£22,977	£22,977						£78,123
Total bonus ⁷		£150,703	£107,645	£107,645						£365,993
Benefits in Kind		£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	£155,000	£355,039	£269,970	£256,914	£41,334	£41,334	£41,334	£41,334	£41,334	£1,243,593

Notes

- 1 J O'Sullivan was appointed a Director on 12 September 2005.
- 2 The financial statements for the year ended 31 March 2006 include a provision of £241,833 (49.9% of base salary) for annual cash bonus potentially payable to Executive Directors for performance in the financial year 2005-06. This provision has been estimated on the basis that performance in Ofwat's Overall Performance Assessment for 2005-06 will be 5th. The final amount to be paid to each Director will be determined when Ofwat publishes OPA results for 2005-06 in the Autumn of 2006, and could be higher or lower.
- 3 Benefits in kind relate to receipt of private medical insurance, ill health cover and life insurance. In 2004-05, Executive Directors received a salary supplement in lieu of receiving a company car. This has subsequently been discontinued.
- 4 MP Brooker retired as a Director on 31 March 2005.
- 5 The salary includes an amount of £13,457 under payment to NC Annett during the period 1 January to 31 March 2005.
- 6 A performance bonus of £287,870 was provided for in the Report and Accounts for 2004-05 and was estimated on the basis that OPA performance in 2004-05 would be 3rd.
- 7 The actual performance bonus in respect of 2004-05 totalled £365,993 (77.3% of salary) and was paid in October 2005, following publication of Ofwat's OPA Report for 2005-06, which confirmed Welsh Water's position as joint 1st.
- 8 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, 50% of which was paid in September 2005, with the balance payable in September 2007. In 2005-06 NC Annett and CA Jones each received £111,405 (50% of entitlement) and MP Brooker received £311,932 (100% of entitlement received due to retirement).
- 9 The highest paid director in 2005-06 was NC Annett: £331,672 (2005: MP Brooker £355,039).

Directors' Earnings: Rolling Long Term Incentive Scheme

In addition to the emoluments disclosed in the table on page 36, provision is made in the 2005-06 Accounts for the first entitlement payable under the three year rolling long term incentive scheme (RLTIS) adopted from 1 April 2005 and which is payable in October 2006 for which there is no prior year comparator.

The provision of £213,844 equates to 44.1% of salary, and has been estimated on the basis that the performance in Ofwat's Overall Performance Assessment for the three year period 2003-04 to 2005-06 will be 3rd, as follows:

NC Annett	£97,040
CA Jones	£74,985
J O'Sullivan	£41,819

The final amount to be paid to each Director will be determined when Ofwat publishes its OPA results for 2005-06 in Autumn 2006, and could be higher or lower than the provision made.

Service contracts

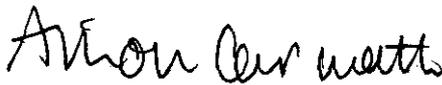
The Executive Directors have service contracts that are subject to one year's notice. Directors' service contracts do not provide for compensation to be payable in the event of early termination by the Company. At the Company's discretion, an Executive Director may be paid base salary alone in lieu of 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. Any appointment is subject to annual approval by the Committee and, subject to the Committee's agreement; a Director may retain any fees. J O'Sullivan is a Non-Executive Director of the Office for Rail Regulation. CA Jones is a Non-Executive Director of the Principality Building Society.

Recommendation

The Committee believes that the 2005 Remuneration Policy continues to provide 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 approve this 2005 Remuneration Report.



Alison Carnwath
Chairman: Remuneration Committee
7 June 2006

Glas Cymru is committed to high standards of corporate governance and this is 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 44.

The Board

The Board comprises nine Directors: a Chairman, three Executive Directors and five independent Non-Executive Directors. The Company believes the Board to be of an appropriate size and mix of experience and expertise to oversee the group's business and to maximise the effectiveness of the Board ensuring that matters are fully debated and that no individual or group dominate the Board's decision making process.

The roles of the Chairman and Managing Director are separate and their respective duties are codified in the Company's Board Control Manual. 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 leading executive management in the day-to-day management of the business and for the implementation of the business plan, policies and procedures adopted by the Board.

The Non-Executive Directors 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. The Company Secretary is an employee, but not a Director, of the Company.

Brief biographical details of each of the current Directors can be found on page 26 and 27, including respective dates of appointment and details of other significant appointments. All Directors served throughout 2005-06, save for J O'Sullivan who was appointed a director on 12 September 2005. 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 compensation. Details of Directors' remuneration are provided in the Remuneration Report 2005-06 on pages 32 to 38.

Board proceedings

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 was last updated in March 2006 and 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.

The Board and its committees meet on a regular basis. The table below summarises the number of meetings held in 2005-06 and the level of attendance at each.

	Board	Audit ^a	Remuneration ^a	QEC ^a	Nominations ^a
Number of meetings held in year	10	4	5	12	2
Number of meetings attended by:					
Lord Burns ^(N)	10	-	-	-	*2
Nigel Annett ^(Q)	10	-	-	12	-
Chris Jones	10	-	-	-	-
Jim O'Sullivan (appointed 12/09/05) ^(Q)	6	-	-	6	-
John Bryant ^(R, Q, N)	9	-	5	11	2
Alison Carnwath ^(A, R, N)	9	4	*5	-	2
Geraint Talfan Davies ^(A, R, N)	10	4	5	-	2
Dame Deirdre Hine ^(R, Q, N)	10	-	5	*11	2
Tony Hobson ^(A, R, N)	9	*4	5	-	2

* Denotes committee chairman

Election and re-election of Directors

In accordance with the Company's articles of association, all Directors must stand for re-election at intervals of no more than three years, and any new Director must stand for re-election at the first annual general meeting following his or her appointment.

At the Annual General Meeting on 7 July 2006 ('2006 AGM') three Directors, Alison Carnwath, Geraint Talfan Davies and Tony Hobson will retire by rotation. The Board has confirmed that, having reviewed their performance, each retiring Director continues to demonstrate great commitment and is highly effective as a Non-Executive Director, and continues to be 'independent' as defined in the Combined Code. In addition, Jim O'Sullivan will stand for re-election as a Director at his first AGM. The Board recommends the reappointment of each of the four Directors seeking re-election.

Information, induction and development of directors

It is the role of the Chairman, aided by the Company Secretary, to ensure that the Board, its committees and individual Directors receive timely and clear information in respect of the company's strategy and performance to ensure meaningful debate and effective decision making. The Company Secretary also advises the Board on corporate governance.

The appointment of a new Director is the responsibility of the Board, having received advice and recommendation from the Nominations Committee. In line with Principle A5 of the Combined Code, new Directors receive an induction programme to familiarise them with the business, the risks and strategic challenges, and the economic, competitive, legal and regulatory environment in which it operates.

A programme also exists to ensure that all Directors have the opportunity to continually update their skills and business knowledge. In 2005-06 this took the form of attendance on an external course by three Non-Executive Directors, and by the provision of presentations to the Board on key strategic issues such as changes in the regulatory environment in which Welsh Water operates.

Evaluation of the Board

The Board has an established process to evaluate the performance of the Board, the Chairman and the principal committees of the Board. This comprises questionnaires completed by all Directors, the conclusions of which are collated and analysed by the Company Secretary and collectively discussed at the Board. This is supplemented by one to one discussions with each Director by the Chairman, following which actions are agreed to address issues raised.

The most recent evaluation of the Board was undertaken in February 2006. This raised no material weaknesses or failings, but highlighted a number of aspects for consideration to further improve the effectiveness of the Board.

The Board also met, without the Chairman, specifically to review and evaluate the performance of the Chairman. The Chairman assesses the performance of the Managing Director after taking into account the views of other Directors. The performance of Executive Directors and Company Secretary is assessed by the Managing Director, to whom they report, under a process of annual appraisal that applies to all staff directly employed by the Group.

Committees of the Board

There are four principal 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: the Audit Committee, the Remuneration Committee, the Quality and Environment Committee and the Nominations 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 page 40. 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.

Details of the work of the Audit Committee, Quality and Environment Committee and Nominations Committee are set out below. Details of the work of the Remuneration Committee can be found in the Remuneration Report 2005-06 on pages 32 to 38. In addition to contributing to the formal committees of the Board, certain Directors have been allocated 'special responsibilities' covering important areas such as procurement (John Bryant), communications (Geraint Talfan Davies) and government and regulation (Lord Burns). In April 2006, the Board established a Finance Committee to approve finance transactions where a decision is required between formal meetings of the Board.

Audit Committee

The members of the audit committee are independent Non-Executive Directors: Tony Hobson (chairman), Alison Carnwath and Geraint Talfan Davies. Each was appointed a member of the committee in 2001. 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 Board considers that Tony Hobson, a chartered accountant and until 2001 Group Finance Director of Legal & General Group plc, has the significant, recent and relevant financial experience required to chair the Audit Committee.

The role of the committee is to receive and challenge reports from executive management and, as appropriate, from the Group's internal and external auditors; and in particular 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 Group's internal control environment, including the 'Whistleblowing' procedures
- make recommendations on the appointment and remuneration of external auditors and to monitor their performance
- 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 2005-06, the Audit Committee met on four occasions with all members present, and reported its conclusions to the Board. The Committee reviewed the draft annual and interim reports and associated preliminary and interim results announcements, focusing on key areas of judgement and significant accounting policies. The Committee also monitored the introduction by the Company of the International Financial Reporting Standards. Time is allocated at two meetings a year to review the findings of the risk management process, including a review of mitigation plans for significant business risks. Significant reports and issues arising from the risk based audit programme are discussed at every meeting.

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 present. 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.

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 (which covers the scope, authority and resources of such activity) is determined through a structured process of risk assessment and is approved by the Audit Committee. During the financial year 2005-06, the conduct, but not the management, of internal audit activity was outsourced to Grant Thornton.

The Company is currently engaged in a process for re-tendering of external audit services, which will lead to a recommendation from the Audit Committee to the Board. This process is expected to complete in summer 2006 and the successful tenderer will be appointed for the audit of the accounts for the year ending 31 March 2007.

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. This provides 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. Total auditor remuneration is analysed between audit and non-audit work in Note 4 to the Accounts on page 60.

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 2006. The Committee has unrestricted access to Company documents and staff and to external auditors and the Finance Director and Head of Business Assurance and Internal Audit each have right of direct access to the chairman of the audit committee in respect of matters they wish to bring to his attention.

Quality and Environment Committee (QEC)

QEC meets each month and comprises two Non-Executive Director members (Dame Deirdre Hine, Chair, and John Bryant) and two Executive members (Jim O'Sullivan and Tim Masters, head of asset strategy), advised by two independent experts on the public health and operational aspects of water supply and environmental management. By invitation of the chair, meetings of the committee are attended by Director level representation from Welsh Water's principal operating partners, United Utilities Operating Services and Kelda Water Services Wales. The Company Secretary acts as secretary to the Committee.

QEC is central to our governance arrangements, which recognises the critical focus of the Board on quality, service and the management of risk in its monitoring of Company performance. The role of QEC is therefore to advise the Board on matters of operational policy and practice, and to routinely review the performance of Welsh Water and its contract partners against key performance indicators, in relation to matters of public health and safety, compliance with drinking water regulations and environmental laws and regulations.

QEC produces an annual report to the Board, which is a published document. This report is also 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 QEC. The activities of QEC are 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. Copies of the 2006 QEC Report may be obtained on request from the Company Secretary or from the website www.dwrcymru.com

Nominations Committee

The Nominations Committee meets on an ad hoc basis. It 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 role of the Nominations Committee is to review the size, structure and composition of the Board and, in particular, to:

- Lead the process and, with the aid of external search and recruitment consultants, make recommendations to the Board on any Executive or Non-Executive Director appointments that may be deemed necessary
- ensure that there is a rigorous and transparent process for the appointment of new Directors
- keep under review the composition of the Board through routine evaluation mix of the skills, knowledge and experience around the board table
- ensure that plans are in place for orderly succession for appointment to the Board and to other senior executive management positions.

The Committee met on two occasions in 2005-06 with all members present. In appointing the new Operations 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 candidates, leading to a recommendation and appointment of Jim O'Sullivan as Operations Director from 12 September 2005. Discussion has now commenced in respect of a wider process for succession and refreshing the Board.

Members and other stakeholders

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. 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 2006 there were 48 Members, excluding the Directors, but including eight new Members appointed during 2005-06. Subsequent to the financial year-end, and following evaluation and recommendation by the panel 13 Members, whose initial term of office will expire at the end of the 2006 AGM, have applied for and have been reappointed for a further three-year term ending at the end of the AGM in 2009. All retiring Members elected to seek reappointment.

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

The Board attaches high importance to maintaining good relationships with Members and all key stakeholders. Members of Glas Cymru have regular opportunity to meet with Directors and all Members attended at least one of the two Members' Meetings in 2005 at which all Directors (excluding John Bryant at the 2005 AGM), 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.

In addition to an annual bondholder/investor meeting held in July 2005, there were informal meetings with bondholders and other investors, 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.

Regulatory environment

Like all the water businesses in England and Wales, Welsh Water operates within a regulatory framework prescribed by the Water Industry Act 1991. The economic regulator is The Water Services Regulation Authority (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 also 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.

On 1 September 2005, the Consumer Council for Water Wales (CCWater Wales) was established, replacing WaterVoice Wales as the independent body that represents water and sewerage customers by handling individual concerns and complaints and by seeking to influence policy at company, national and European level. Senior representatives of Welsh Water attend all public meetings of CCWater Wales.

Each year these 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 structures.

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.

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 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, internal control systems. The Company provides Directors' and officers' liability insurance giving appropriate cover against legal action brought against the Directors and an indemnity in circumstances where they are not considered to be culpable.

Risk is managed in accordance with following principles:

The system of internal control provides clear accountability for risk management and provides for assurance to successive levels of management and to the Board, including regular reporting of performance, including risk management, to the Board, the Audit Committee and the Quality and Environment Committee for all significant aspects of the Group's business

controls recognise that the nature and balance of risk changes and evolves continuously and provide a framework within which standards and policies in the Group are progressively developed to improve risk management practice in line with industry best practice

key risks and hazards are identified measured and managed to achieve an acceptable balance between risk and reward in delivery of the annual business plan, through which the Board approves the parameters of acceptable risk for the business

assurance is provided by routine external verification through independent audit and assessment of internal quality management systems. External and internal audit activity is conducted under broad risk based programmes approved by the Audit Committee, which are designed to ensure that management information is accurate timely and relevant and reflects the true position of the business

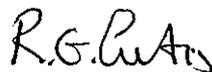
procedures exist to monitor policies for the approval and control of major items of capital expenditure, the acquisition and disposal of material assets, or the entering into of any arrangement that gives rise to, or could give rise to, a material liability

responsibility for risk is a key role of all managers in the business. For each major type of risk, we have a designated individual or team to ensure that appropriate guidance is available for managers across the business.

Executive management review the effectiveness of risk management and controls on a continuing basis through a Risk Management Group, chaired by the operations director, which includes senior managers from all parts of the business. The role of this group is to review and challenge the robustness of risk management procedures, including that of Welsh Water's contracting partners, and covers areas such as health and safety, environment, business ethics, employment and business continuity. This group also monitors internal procedures that encourage all staff to participate in open two-way dialogue to ensure that risk is captured and managed early and effectively, and to learn from our own experience and the experience of others to promote best practice, thereby improving the quality of service delivered to the customers of Welsh Water. The Risk Management Group reports to the Audit and Quality and Environment Committees of the Board at least every six months.

In judging the effectiveness of the Group's systems of internal controls and risk management, the Board considers periodic reports from the Risk Management Group, the Audit Committee and the Quality and Environment Committee, in addition to its routine monitoring of key performance indicators and monthly reports of financial and operational performance which flag variances against business plan and budget. By so doing, the Board has reviewed the effectiveness of the internal control systems over the course of the year.

By order of the Board



Richard Curtis LLB, ACIS
Company Secretary
7 June 2006

Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the Group and parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent Company financial statements for each financial year. They are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU and have elected to prepare the parent Company financial statements on the same basis.

The Group and parent Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Group and the parent Company and of the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation. In preparing each of the Group and parent Company financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently
- make judgments and estimates that are reasonable and prudent
- state whether they have been prepared in accordance with IFRSs as adopted by the EU
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, a Directors' Remuneration Report and the Corporate Governance Statement that comply with that law and those regulations.

Responsibility for the maintenance and integrity of the corporate and financial information included on its website rests with the Company. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board



Richard Curtis LLB, ACIS
Company Secretary
7 June 2006

We have audited the Group and parent Company financial statements (the 'financial statements') of Glas Cymru Cyfyngedig for the year ended 31 March 2006 which comprise the Consolidated Income Statement, the Statement of Changes in Reserves, the Consolidated and Parent Company Balance Sheets, the Consolidated Cash Flow Statement and the related notes.

These financial statements have been prepared under the accounting policies set out therein. We have also audited, at the request of the Directors, the information in the Directors' Remuneration Report that is described as having been audited.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities. The Directors are also responsible for preparing the Directors' Remuneration Report (because the Company applies the requirements of Schedule 7A to the Companies Act 1985 as if it were a listed company).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We also, at the request of the Directors, audit the part of the Directors' Remuneration Report to be audited (because the Company applies the requirements of Schedule 7A to the Companies Act 1985 as if it were a listed company). 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 into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Principal Activities section of the Directors' Report. We also report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited 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 consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited 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 and the part of the Directors' Remuneration Report to be audited.

Opinion

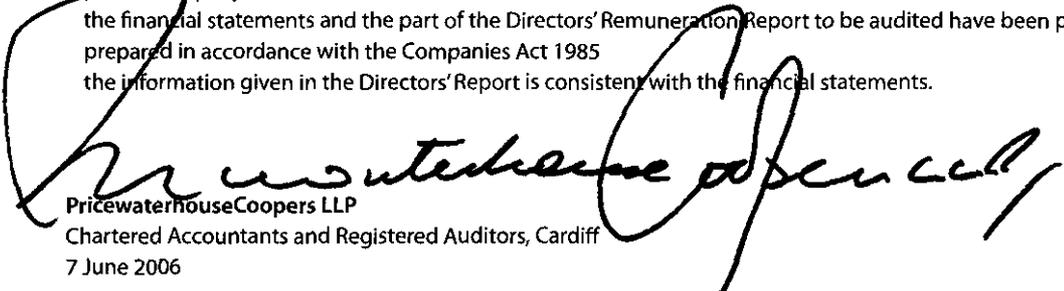
In our opinion:

The Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2006 and of its profit and cash flows for the year then ended

the Parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 March 2006

the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985

the information given in the Directors' Report is consistent with the financial statements.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors, Cardiff
7 June 2006

Primary statements

Consolidated income statement for the year ended 31 March 2006

	Note	2006 £m	2005 £m
Revenue		553.5	494.1
Operating costs			
- Operational expenditure	4	(213.2)	(210.7)
- Infrastructure renewals expenditure	4	(48.8)	(43.0)
- Depreciation and amortisation	4	(97.5)	(89.8)
- Profit on disposal of fixed assets	4	0.8	4.3
Operating profit		194.8	154.9
Financing costs			
- Interest payable and similar charges	3a	(156.9)	(158.8)
- Interest receivable	3a	6.7	16.2
- Fair value losses on financial instruments	3b	(33.3)	(8.0)
		(183.5)	(150.6)
Profit before taxation	4	11.3	4.3
Taxation credit	5	4.8	1.2
Profit for the year		16.1	5.5

Statement of changes in reserves for the year ended 31 March 2006

	2006 £m	2005 £m
Reserves at 1 April	(95.3)	(100.8)
Profit for the year	16.1	5.5
Reserves at 31 March	(79.2)	(95.3)

The group has no other recognised gains or losses in the year (2005: nil) and accordingly a statement of recognised income and expense has not been presented. There are no changes in reserves of the parent company during the year.

Primary statements

Consolidated balance sheet as at 31 March 2006

	Note	2006 £m	2005 £m
Assets			
Non-current assets			
Intangible assets	6	4.4	4.4
Property, plant & equipment	7	2,795.6	2,720.9
Investments	8a	-	-
Financial assets:			
- derivative financial instruments	14	6.3	-
		2,806.3	2,725.3
Current assets			
Trade and other receivables	9	86.7	65.5
Financial assets:			
- held to maturity investments	10	0.3	33.9
- derivative financial instruments	14	4.2	-
Cash and cash equivalents	11	14.0	235.0
		105.2	334.4
Liabilities			
Current liabilities			
Financial liabilities:			
- borrowings	13	(124.6)	(54.5)
- derivative financial instruments	14	(6.2)	(3.8)
Trade and other payables	12	(118.5)	(125.1)
		(249.3)	(183.4)
Net current (liabilities)/assets		(144.1)	151.0
Non-current liabilities			
Financial liabilities:			
- borrowings	13	(2,244.9)	(2,460.7)
- derivative financial instruments	14	(105.9)	(113.0)
Retirement benefit obligations	21	(6.6)	(7.8)
Provisions	16	(9.8)	(9.7)
		(2,367.2)	(2,591.2)
Net assets before deferred tax		295.0	285.1
Deferred tax	17	(374.2)	(380.4)
Net liabilities		(79.2)	(95.3)
Reserves			
Retained earnings		(79.2)	(95.3)
Total reserves		(79.2)	(95.3)

These financial statements were approved by the Board of Directors on 7 June 2006 and were signed on its behalf by:



N C Annett
Managing Director



C A Jones
Finance Director

Parent company balance sheet as at 31 March 2006

	Note	2006 £m	2005 £m
Assets			
Non-current assets			
Investment in subsidiaries	8b	-	-
Current assets			
Trade and other receivables	9	3.4	3.4
Cash and cash equivalents	11	0.1	0.1
		3.5	3.5
Liabilities			
Current liabilities			
Trade and other payables	12	(3.5)	(3.5)
Net assets			
Reserves			
Retained earnings		-	-
Total reserves		-	-

These financial statements were approved by the Board of Directors on 7 June 2006 and were signed on its behalf by:


 N C Annett
 Managing Director


 C A Jones
 Finance Director

Primary statements

Consolidated cashflow statement for the year ended 31 March 2006

	Note	2006 £m	2005 £m
Cash generated from operations	18	259.3	228.9
Interest received		7.2	16.6
Interest paid		(139.8)	(151.1)
Tax paid		(1.1)	-
Net cash inflow from operating activities		125.6	94.4
Cash flows from investing activities			
Purchase of property, plant and equipment		(182.5)	(231.2)
Grants and contributions received		16.8	11.2
Proceeds from sale of property, plant and equipment		0.8	0.4
Net cash used in investing activities		(164.9)	(219.6)
Net cash outflow before financing activities		(39.3)	(125.2)
Cash flows from financing activities			
Long term loans and finance leases received		113.8	308.9
Authorised loan drawdown		145.3	-
Purchase of own bonds		(3.3)	(1.0)
Bond redemption		(465.5)	(56.0)
Capital element of lease termination		-	(73.3)
Capital element of finance lease payments		(5.2)	(9.4)
Reduction in financial assets		33.6	40.8
Other loan repayments		(0.4)	(0.3)
Net cash used in financing activities		(181.7)	209.7
(Decrease)/increase in net cash	19	(221.0)	84.5
Net cash at 1 April		235.0	150.5
Net cash at 31 March	11	14.0	235.0

The parent company had no cashflows during the year.

Notes to the financial statements

1 Accounting policies, financing risk management and accounting estimates

Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and those parts of the Companies Act 1985 applicable to reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial instruments to fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the amended Companies Act 1985.

At the date of approval of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

- IFRS 6** Exploration for and Evaluation of Mineral Resources.
- IFRS 7** Financial Instruments: Disclosures; and the related amendment to IAS 1 on capital disclosures.
- IFRIC 4** Determining whether an Arrangement contains a Lease.
- IFRIC 5** Rights to interest arising from decommissioning, restoration and environmental rehabilitation funds.
- IFRIC 6** Liabilities arising from participating in a specific market - waste electrical and electronic equipment.
- IFRIC 7** Applying the restatement approach under IAS29: Financial reporting in hyperinflationary economies.
- IFRIC 8** Scope of IFRS 2.
- IFRIC 9** Reassessment of embedded derivatives.

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group except for additional disclosures that may be required on financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007.

Changes in accounting policies

The accounting policies and basis of preparation differ from those set out in the Report and Accounts for the year ended 31 March 2005, which were prepared in accordance with United Kingdom accounting standards and the Companies Act 1985 (UK GAAP).

IFRS1 'First time adoption of International Financial Reporting Standards' sets out the requirements for companies preparing financial statements under IFRS for the first time and requires the accounting policies to be applied retrospectively. IFRS1 contains the option to take advantage of certain exemptions to the retrospective application. The Group has applied the following optional exemptions:

- To establish a deemed cost for the opening balance sheet carrying value of the water and wastewater infrastructure fixed assets by reference to the fair value at the date of transition to IFRS (1 April 2004).
- to recognise in full all cumulative actuarial gains and losses relating to pension schemes within reserves at the date of transition.

The group is not taking advantage of the exemptions in respect of financial instruments and has applied IAS39 'Financial Instruments – Recognition and Measurement' and IAS 32 "Financial Instruments – Disclosure and Presentation" retrospectively.

The disclosures required by IFRS 1 for the transition from UK GAAP to IFRS are provided in note 28.

Basis of consolidation

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

Accounting policies for the year ended 31 March 2006

The principal accounting policies adopted in the preparation of these financial statements are set overleaf. These policies have been consistently applied to all the years presented.

Revenue recognition

Revenue represents the income receivable in the ordinary course of business for services provided, excluding value added tax. Where services have been provided, but for which no invoice has been raised at the year-end, an estimate of the amounts are included in revenue. See further details in the critical accounting estimates section.

Revenue recognised reflects the actual charges levied on customers in the year. The difference between the actual revenue and the level of revenue that could have resulted had the full Ofwat allowed level of charges been levied is referred to as a 'customer dividend'.

Property, plant & equipment

Property, plant and equipment are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs but excluding interest.

Property, plant and equipment comprise:

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

The carrying value of assets is reviewed for impairment if circumstances dictate that the carrying value may not be recoverable. Asset lives and residual values are reviewed annually.

Infrastructure assets

Infrastructure assets, which comprise principally of impounding reservoirs and a network of underground water and wastewater systems, are stated at fair value on the date of transition to IFRS as a deemed cost under the exemption available under IFRS1. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas reflecting the way the group operates its wastewater activities.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components, is treated as additions, which are included at cost. Expenditure incurred in repairing and maintaining the operating capability of individual infrastructure components is expensed in the year in which the expenditure is incurred.

The depreciation charge for infrastructure assets is determined for each component of the network and is based on each component's cost, estimated residual value and the expected remaining average useful life. The useful average economic lives of the infrastructure components range from 60 to 150 years.

Other assets

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

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

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

Intangible assets

Intangible assets, which comprise principally computer software and system developments, are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs but excluding interest.

The carrying values of intangible assets are reviewed for impairment if circumstances dictate the carrying value may not be recovered.

Intangible assets are depreciated over their estimated useful economic lives, which range between 3 and 15 years. These asset lives are reviewed annually.

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 capitalised and included in 'property, plant & equipment' with the corresponding liability to the lessor included within 'finance liabilities – borrowings'. Leasing payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor with the finance charge being recognised over the period of the lease based on its implicit rate so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Grants and customer contributions

Grants and customer contributions in respect of expenditure on property, plant and equipment have been offset against fixed assets.

Grants in respect of revenue expenditure are credited to the Income Statement over the same period as the related expenditure is incurred.

Capital expenditure programme incentive payments

The Group's agreements with its construction partners involved in delivering capital expenditure programmes incorporate 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 completed projects.

Target cost contracts

The Group maintains target cost contracts with its main operating partners. The Group's policy in respect of pain/gain share payments/receivables arising from these contracts is to recognise when final agreement with the relevant service partner has been achieved.

Allowance for doubtful debts

Trade receivables are first assessed individually for impairment, or collectively where the receivables are not individually significant. Where there is no objective evidence of impairment for an individual receivable, it is included in a group of receivables with similar credit risk characteristics and these are collectively assessed for impairment. Movements in the provision for doubtful debts are recorded in the income statement.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months maturity from the date of acquisition and typically include cash in hand and deposits with banks or other financial institutions, less any overdrafts.

Pension costs

The majority of the group's employees belong to the group pension scheme, which is funded by both employers' and employees' contributions and which is of the defined benefit type. Actuarial valuations of the scheme are carried out at intervals of not more than three years. Contribution rates are based on the advice of a professionally qualified actuary.

For the Group's defined benefit scheme, the net asset or liability recognised in the balance sheet represents the present value of the defined benefit obligations less the fair value of the plan's assets. In accordance with the amendment to IAS19, all cumulative actuarial gains and losses have been recognised in reserves at the date of transition to IFRS.

The full cost of providing pension benefits to employees (including the expected return on scheme assets and interest on scheme liabilities) is reported in the income statement within operating costs. All actuarial gains and losses are also recognised in the year in which they arise in determining the profit or loss for the year.

Financial liabilities – borrowings

Debt is initially measured at fair value, which is the amount of the net proceeds after deduction of directly attributable issue costs, with subsequent measurement at amortised cost. Debt issue costs are recognised in the income statement over the expected term of such instruments at a constant rate on the carrying amount.

Foreign currency borrowings are translated into sterling at the rates ruling at the balance sheet date.

Financial assets

Financial assets represent held to maturity investments that are non-derivative, with fixed or determinable payments and fixed maturities of over three months at the date of acquisition, which the group intends to hold until maturity.

Derivative 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.

Derivatives are recognised initially, and are subsequently remeasured at fair value.

The movement in the fair value between balance sheet dates is recognised in the income statement to the extent that such instruments do not qualify for hedge accounting under IAS 39. At present, no such derivatives qualify for hedge accounting.

Deferred taxation

Deferred corporation tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised in respect of all temporary differences. Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and tax losses, to the extent that they are regarded as recoverable. They are regarded as recoverable where, on the basis of available evidence, there will be suitable taxable profits against which the future reversal of the underlying temporary differences can be deducted. The carrying value of the amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all, or part, of the asset to be utilised.

Deferred corporation tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on the tax rates that have been enacted at the balance sheet date.

Provisions

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 to settle the obligation.

In the case of leases, where properties are no longer occupied by the Group, provision is made for the liabilities that are expected to arise in respect of rental payments and dilapidations, prior to disposal or termination of the lease.

Where the Group receives claims that are either not covered by insurance or where there is an element of the claim for which insurance cover is not available, a provision is made for the expected future liabilities.

Financing risk management objectives and 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. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may only be changed with the consent of Dŵr Cymru Cyfyngedig's security trustee (the 'Security Trustee'). The risk is further mitigated by limiting exposure to any one counterparty. We use financial instruments, which principally include listed bonds, finance leases, bank loan facilities and derivatives, to raise finance and manage risk from our operations.

Credit risk

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.

Interest rate/Currency risk

The Group minimises exposure to currency risk in respect of any 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 expose 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.

The 'hedges' established to manage currency risks are economic in nature, but do not satisfy the specific requirements of IAS 39 in order to be treated as hedges for accounting purposes.

Liquidity risk

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.

Critical Accounting Estimates

The preparation of financial statements to conform with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

Allowance for doubtful debts

Individual impairment losses on customer debts are calculated based on an individual assessment of the cash flows that are expected. Collective impairment losses on receivables with similar credit risk are calculated using a statistical model. The key assumption in the model is the probability of a failure to recover amounts when they fall into arrears. The probability of failing to recover is determined by past experience, adjusted for changes in external factors. The accuracy of the impairment calculation would therefore be affected by unexpected changes to the economic situation, and to changes in customer behaviour. To the extent that the failure to recover debts in arrears alters by +/-5%, the bad debt allowance would increase or decrease by £3.6 million.

Pension benefits

The present value of the pension obligations is dependent on the actuarial calculation, which includes a number of assumptions. These assumptions include the discount rate, which is used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the Group considers market yields of high quality corporate bonds, denominated in sterling, that have times to maturity approximating the terms of the pension liability. Were this discount rate to reduce or increase by 0.1%, the carrying value of the pension obligations would increase or reduce by £0.9 million.

Measured income accrual

Revenue includes an estimation of charges unbilled at the period end. The accrual is estimated using a defined methodology based upon the weighted average water consumption by tariff, which is calculated based upon historical billing information, adjusted for changes in external factors, such as weather. A 5% change in actual consumption from that estimated would have the effect of increasing/decreasing the accrual by £2.2 million.

2 Segmental information

The Directors consider that there is only one reporting segment being the operation of water and sewerage business in the UK. Therefore the disclosures for the primary segment have already been given in these financial statements.

The secondary reporting format is by geographical analysis by origin and destination. As the Group virtually only has domestic activities there is only one geographical segment. Therefore the disclosures for the secondary segment have also already been given in these financial statements.

Parent Company

The parent company's business is solely to act as a holding company and therefore it operates in a single segment.

3 Financing costs

a) Net interest before fair value losses on financial instruments

	GROUP	
	2006 £m	2005 £m
Interest payable on bonds	(91.9)	(120.3)
Indexation on index-linked bonds	(17.4)	(17.7)
Interest payable on finance leases	(31.9)	(22.3)
Interest payable on other loans	(12.8)	(3.3)
Amortisation of bond issue costs	(2.9)	(1.3)
	(156.9)	(164.9)
Termination profit on closure of finance lease	-	6.1
Interest payable	(156.9)	(158.8)
Interest receivable	6.7	16.2
Net interest payable before fair value adjustments	(150.2)	(142.6)

b) Fair value losses on financial instruments

Whilst the Group employs an economically effective policy using interest rate and currency swaps, this policy does not satisfy the stringent hedge accounting criteria of IAS39. Consequently, the Group's interest rate and currency swaps are fair valued at each balance sheet date with the movement (gains or losses) disclosed in the income statement. Over the life of these swaps, providing that there is an effective match, these fair value adjustments will reverse and reduce to zero. (See note 14 for balance sheet note in respect of derivative financial instruments).

	GROUP	
	2006 £m	2005 £m
Fair value losses on interest rate swaps	(29.8)	(8.0)
Fair value losses on index linked swaps	(3.5)	-
Fair value gains/(losses) on foreign exchange:		
- Cross-currency swaps	48.5	3.4
- Foreign denominated bonds	(48.5)	(3.4)
Fair value losses on financial instruments	(33.3)	(8.0)
Tax effect of fair value losses on financial instruments	10.0	2.4
Net of tax impact of fair value losses on financial instruments	(23.3)	(5.6)

4 Profit before taxation

The following items have been included in arriving at profit before taxation:

	GROUP	
	2006 £m	2005 £m
Operating charges from outsourced activities:		
- Operating services agreements	107.7	89.9
- Customer services agreement	19.4	19.3
- Laboratories and analytical services	7.3	7.5
- Other contracts	11.7	20.2
	146.1	136.9
Employee costs (note 20)		
- Wages and salaries	7.2	8.2
- Social security	0.7	0.8
- Severance programme and other termination costs	0.4	2.7
- Net actuarial gain (note 21)	(1.5)	-
- Pension costs (excluding actuarial gain)	2.6	1.7
Research and development expenditure	0.4	0.2
Trade receivables impairment	7.6	8.0
Rates	18.8	17.6
Environment agency charges	13.0	12.6
Fees paid to auditors (see below)	0.2	0.3
Own work capitalised	(7.3)	(4.3)
Net rents payable	0.5	0.2
Other operating charges	24.5	25.8
	213.2	210.7
Depreciation of property, plant and equipment:		
- Owned assets	60.1	58.9
- Under finance leases	33.6	27.3
Amortisation of intangible assets	3.8	3.6
Infrastructure renewals expenditure	48.8	43.0
Profit on disposal of fixed assets	(0.8)	(4.3)
	358.7	339.2

Services provided by the group's auditor

During the year the group obtained the following services from the group's auditor as detailed below:

	GROUP	
	2006 £'000	2005 £'000
Audit Services		
- Statutory audit	99	99
- Regulatory reporting	32	25
- Periodic review reporting	-	50
Further assurance services		
- IFRS transition	48	47
- Interim review	25	26
- Grant applications	6	8
- Financial modelling	12	-
Tax advisory services	10	19
	232	274

Annual regulatory audit services includes work on the Regulatory Accounts, June Return and Principal Statement.

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 (2005: £7,000).

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.

5 Taxation

Analysis of credit in the year

	GROUP	
	2006	2005
	£m	£m
Current tax		
- Adjustment in respect of prior years	(1.4)	-
Deferred tax		
- Current year movements	0.9	1.2
- Adjustment in respect of prior years	5.3	-
Taxation credit	4.8	1.2

The tax for the year is lower (2005: lower) than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	GROUP	
	2006	2005
	£m	£m
Profit before tax	11.3	4.3
Profit before tax multiplied by the corporation tax rate in the UK of 30% (2005: 30%)	3.4	1.3
Effects of:		
Expenses not deductible for tax purposes	0.2	0.1
Adjustments in respect of prior years	(3.9)	-
Other permanent differences	(4.5)	(2.6)
Total taxation credit	(4.8)	(1.2)

6 Intangible assets

Intangible assets comprise computer software and related system developments.

GROUP	Cost £m	Depreciation £m	Net book value £m
Current Year			
At 1 April 2005	49.6	(45.2)	4.4
Additions	3.8	-	3.8
Charge for the year	-	(3.8)	(3.8)
At 31 March 2006	53.4	(49.0)	4.4
Prior Year			
At 1 April 2004	48.6	(41.6)	7.0
Additions	1.0	-	1.0
Charge for the year	-	(3.6)	(3.6)
At 31 March 2005	49.6	(45.2)	4.4

The parent company owns no intangible fixed assets.

7 Property, plant and equipment

GROUP	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant equipment, computer hardware £m	Total £m
Current year					
Cost					
At 1 April 2005	32.8	1,310.6	1,959.6	184.8	3,487.8
Additions net of grants and contributions	-	64.6	95.4	8.4	168.4
Disposals	(0.1)	-	-	-	(0.1)
At 31 March 2006	32.7	1,375.2	2,055.0	193.2	3,656.1
Accumulated depreciation					
At 1 April 2005	14.8	18.8	589.1	144.2	766.9
Charge for the year	0.8	21.0	65.5	6.4	93.7
Disposals	(0.1)	-	-	-	(0.1)
At 31 March 2006	15.5	39.8	654.6	150.6	860.5
Net book value					
At 31 March 2006	17.2	1,335.4	1,400.4	42.6	2,795.6

GROUP	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant equipment, computer hardware £m	Total £m
Prior year					
Cost					
At 1 April 2004	32.8	1,236.4	1,860.4	174.9	3,304.5
Additions net of grants and contributions	-	74.2	99.2	9.9	183.3
At 31 March 2005	32.8	1,310.6	1,959.6	184.8	3,487.8
Accumulated depreciation					
At 1 April 2004	14.4	-	533.0	133.3	680.7
Charge for the year	0.4	18.8	56.1	10.9	86.2
At 31 March 2005	14.8	18.8	589.1	144.2	766.9
Net book value					
At 31 March 2005	18.0	1,291.8	1,370.5	40.6	2,720.9

Assets held under finance leases

	2006 £m	2005 £m
Cost	1,091.7	958.8
Aggregate depreciation	(156.1)	(122.5)
	935.6	836.3

Included in assets held under finance leases are infrastructure assets, with a net book value of £498.3m (2005: £402.0m) and operational structures with a net book value of £437.3m (2005: £434.3m).

Included within fixed assets is an amount £99.9m in respect of assets in the course of construction (2005: £91.1m).

The parent company owns no property plant or equipment.

8 Fixed asset investments**a) Group**

	2006	2005
Cost and net book value	£m	£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.

b) Parent Company

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%

9 Trade and other receivables

	GROUP		COMPANY	
	2006	2005	2006	2005
	£m	£m	£m	£m
a) Amounts falling due within one year:				
Trade receivables	77.0	70.5	-	-
Less provision for impairment of receivables	(49.6)	(49.1)	-	-
Trade receivables - net	27.4	21.4	-	-
Other receivables	9.8	7.6	-	-
Prepayments and accrued income	49.5	36.4	-	-
	86.7	65.4	-	-
b) Amounts falling due after more than one year:				
Amounts owed by group undertakings	-	-	3.4	3.4
Other receivables	-	0.1	-	-
	86.7	65.5	3.4	3.4

10 Held to maturity investments

	GROUP		COMPANY	
	2006	2005	2006	2005
	£m	£m	£m	£m
Investments in:				
Fixed term deposits - due within one year	0.3	33.9	-	-

The effective interest rate on held to maturity investments as at 31 March 2006 was 4.7% (2005: 4.8%) and these investments have an average maturity of 364 days (2005: 148 days).

11 Cash and cash equivalents

	GROUP		COMPANY	
	2006	2005	2006	2005
	£m	£m	£m	£m
Cash at bank and in hand	3.8	3.7	0.1	0.1
Short-term bank deposits	10.2	231.3	-	-
	14.0	235.0	0.1	0.1

The effective interest rate on short-term deposits as at 31 March 2006 was 4.7% (2005: 4.9%) and these deposits have an average maturity of 82 days (2005: 65 days).

12 Trade and other payables

	GROUP		COMPANY	
	2006	2005	2006	2005
	£m	£m	£m	£m
Trade payables	26.8	38.3	-	-
Capital creditors	45.3	39.0	-	-
Other taxation and social security	0.3	0.5	-	-
Amounts owed by group undertakings	-	-	3.5	3.5
Other creditors	46.1	47.3	-	-
	118.5	125.1	3.5	3.5

13 Financial liabilities – borrowings

	GROUP		COMPANY	
	2006 £m	2005 £m	2006 £m	2005 £m
Current				
Bonds	-	43.9	-	-
Revolving credit facilities	120.3	-	-	-
Local Authority loans	0.3	0.4	-	-
Finance lease obligations	3.7	3.0	-	-
Interest accruals	0.3	7.2	-	-
	124.6	54.5	-	-
Non-current				
Bonds	1,419.7	1,778.7	-	-
Unamortised bond premium	13.9	14.2	-	-
Unamortised loan issue costs	(7.2)	(9.9)	-	-
Finance lease obligations	736.4	628.5	-	-
European Investment Bank loans	60.0	35.0	-	-
Local Authority loans	3.4	3.7	-	-
Interest accruals	18.7	10.5	-	-
	2,244.9	2,460.7	-	-

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.

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 companies' assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

14 Derivative financial instruments

Derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IAS 39. As such, movements in their fair value are taken to the Income Statement (note 3b). Fair values are obtained by reference to actual market transactions.

GROUP - 2006	FAIR VALUES	
	Assets £m	Liabilities £m
Current		
Interest rate swaps	-	(6.2)
Index linked swaps	4.2	-
	4.2	(6.2)
Non-current		
Interest rate swaps	-	(91.9)
Index linked swaps	6.3	(14.0)
	6.3	(105.9)
Total	10.5	(112.1)

The notional value of the interest rate swaps are £625m (2005: £625m) and the indexed linked swaps £587m (2005: nil).

	FAIR VALUES	
	Assets £m	Liabilities £m
GROUP - 2005		
Current		
Interest rate swaps	-	(3.8)
Non-current		
Interest rate swaps	-	(64.5)
Cross currency swaps	-	(48.5)
	-	(113.0)
Total	-	(116.8)

In accordance with IAS 39, 'Financial instruments: Recognition and measurement', the group has reviewed all contracts for embedded derivatives that are required to be separately accounted if they do not meet certain requirements set out in the standard. Glas Cymru Cyfyngedig has no embedded derivatives as per IAS 39.

Parent Company

The parent company has no derivative financial instruments or embedded derivatives.

Interest rate swaps

At 31 March 2006 the interest rate swaps fix the interest rate on the £295 million of floating rate liabilities held by the Group.

The principal terms of the interest rate swaps are as follows:

Notional Amount (£m)	Swap Maturity	Quarterly interest rate
478	31 March 2031	5.67%
32	31 March 2021	5.82%
115	31 March 2008	5.95%
625		

Indexed-linked swaps

The indexed-linked swaps have the effect of fixing the interest rate on £630 million of finance lease liabilities by reference to the retail price index ('RPI') with effect from 31 March 2006.

The notional amount of the swaps as at 31 March 2006 is £587 million, representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2007. The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases.

All the indexed-linked swaps were entered into during the year. The principal terms are as follows:

Notional Amount:	£587 million (amortising)
Average swap maturity:	26 years
Average interest rate:	1.60% (fixed) plus RPI

15 Financial risk management

The policies of the group in respect of financial risk management are included in the accounting policies note (see note 1). The numerical financial instrument disclosures as required by IAS 32 are set out below:

a) Interest rate risk

The effective interest rates at the balance sheet dates were as follows:

	2006	2005
Assets:		
Cash and cash equivalents	4.7%	4.9%
Financial assets held to maturity	4.7%	4.8%
Liabilities:		
Bonds	5.7%	5.6%
Revolving credit facilities	4.9%	-
European Investment Bank loans	4.7%	5.1%
Local Authority loans	6.2%	6.2%
Finance lease obligations	4.5%	4.7%

Trade receivables and payables are non-interest bearing.

The effective interest rates ignore the effect of the interest rate and index-linked swaps set out in note 14.

b) Liquidity risk

Group - 2006	Within 1yr £m	1- 2 years £m	2-5 years £m	> 5 years £m	Total £m
Assets:					
Cash and cash equivalents	14.0	-	-	-	14.0
Financial assets held to maturity	0.3	-	-	-	0.3
Trade and other receivables	86.7	-	-	-	86.7
	101.0	-	-	-	101.0
Liabilities:					
Bonds	-	-	125.0	1,294.7	1,419.7
Revolving credit facilities	120.3	-	-	-	120.3
European Investment Bank loan	-	4.4	15.4	40.2	60.0
Local Authority loans	0.3	0.4	1.1	1.9	3.7
Finance lease obligations	3.7	4.6	21.0	710.8	740.1
Trade and other payables	118.5	-	-	-	118.5
	242.8	9.4	162.5	2,047.6	2,462.3

Group - 2005	Within 1yr £m	1-2 years £m	2-5 years £m	> 5 years £m	Total £m
Assets:					
Cash and cash equivalents	235.0	-	-	-	235.0
Financial assets held to maturity	33.9	-	-	-	33.9
Trade and other receivables	65.4	0.1	-	-	65.5
	334.3	0.1	-	-	334.4
Liabilities:					
Bonds	43.9	-	425.0	1,353.7	1,822.6
European Investment Bank loan	-	-	13.1	21.9	35.0
Local Authority loans	0.4	0.3	1.2	2.2	4.1
Finance lease obligations	3.0	3.5	16.7	608.3	631.5
Trade and other payables	125.1	-	-	-	125.1
	172.4	3.8	456.0	1,986.1	2,618.3

As at 31 March 2006, the Bonds maturing between 2-5 years represent £125 million of sub-ordinated Bonds with an expected maturity date of 31 March 2011. If these Bonds are not redeemed on or before 31 March 2011, the interest rate will step-up from a fixed rate of 8.174% to a floating 3-month LIBOR interest rate plus a margin 5.75%.

As at 31 March 2005, there were also £525 million of senior Bonds under which interest rates stepped-up to floating 3-month LIBOR interest rates plus margins of between 0.9375% and 3.25% if the Bonds were not redeemed before their expected maturities of 31 March 2006 and 31 March 2008. These Bonds were all redeemed at par during the year.

The minimum lease payments under finance leases fall due as follows:

	2006 £m	2005 £m
Not later than one year	31.1	31.7
Later than one year but not more than five	147.0	128.8
More than five years	1,289.4	1,139.5
	1,467.5	1,300.0
Future finance charges on finance leases	(708.4)	(650.8)
Present value of finance lease liabilities (including accrued interest)	759.1	649.2

c) Fair values

The fair values of the Group's derivative financial instruments are set out on in note 14. The following table summarises the fair value and book value of the Group's bonds.

	2006		2005	
	Book value £m	Fair Value £m	Book Value £m	Fair Value £m
Bonds (note 13)	1,419.7	1,777.2	1,822.6	2,090.4

The fair value of all other financial instruments are equal to the book values.

d) Borrowing facilities

The Group has the following undrawn committed borrowing facilities available at 31 March in respect of which all conditions precedent had been met at that date:

	2006 £m	2005 £m
Expiring within 1 year:		
Revolving credit facilities	-	150.0
Expiring in more than 1 year:		
Revolving credit facilities	259.8	-
European Investment Bank	75.0	-
	334.8	150.0

Dŵr Cymru Financing Limited also has a special liquidity facility of £150 million, which it is required to maintain in order to meet certain group interest and other obligations that cannot be funded through operating cashflow of the group, in the event of a standstill being declared by the Security Trustee. A standstill would arise in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. Dŵr Cymru Cyfyngedig also has a £20 million overdraft facility. Both of these facilities are renewable on an annual basis.

All the above facilities, including the liquidity facility, are at floating rates of interest.

16 Provisions

GROUP	Restructuring provision £m	Uninsured loss provision £m	Total £m
At 1 April 2005	4.8	4.9	9.7
Charged to Income Statement	1.1	0.9	2.0
Utilised in year	(0.6)	(1.3)	(1.9)
At 31 March 2006	5.3	4.5	9.8

The parent company has no provisions at 31 March 2006 (2005: nil).

Restructuring provision

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

Provision for uninsured losses

This provision is in respect of uninsured losses and where insurance cover does not cover a deductible amount. The utilisation period of these liabilities is uncertain due to the nature of the claims but is estimated to be five years.

17 Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 30% (2005: 30%).

The movement in the deferred tax provision is as shown below:

	GROUP		COMPANY	
	2006 £m	2005 £m	2006 £m	2005 £m
At 1 April	380.4	381.6	-	-
Credited to Income Statement	(6.2)	(1.2)	-	-
At 31 March	374.2	380.4	-	-

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

	GROUP		COMPANY	
	2006 £m	2005 £m	2006 £m	2005 £m
Effect of tax allowances over depreciation	394.6	408.5	-	-
Other tax differences	(20.4)	(28.1)	-	-
Provision for deferred tax	374.2	380.4	-	-

18 Cash generated from operations

Reconciliation of operating profit to cash generated from operations:

	GROUP	
	2006 £m	2005 £m
Operating profit	194.8	154.9
Adjustments for:		
Depreciation and amortisation	97.5	89.8
Profit on disposal of fixed assets	(0.8)	(4.3)
Changes in working capital:		
Increase in trade and other receivables	(17.9)	(5.0)
(Decrease)/increase in trade and other payables	(13.2)	5.1
Decrease in retirement benefit obligation	(1.2)	-
Increase/(decrease) in provisions	0.1	(11.6)
Cash generated from operations	259.3	228.9

19 Analysis and reconciliation of net debt

a) Net debt at the balance sheet date may be analysed as:

	GROUP		COMPANY	
	2006 £m	2005 £m	2006 £m	2005 £m
Cash and cash equivalents	14.0	235.0	0.1	0.1
Financial assets – held to maturity	0.3	33.9	-	-
	14.3	268.9	0.1	0.1
Debt due after one year	(1,497.0)	(1,831.6)	-	-
Debt due within one year	(120.6)	(44.3)	-	-
Finance leases	(740.1)	(631.5)	-	-
Accrued interest	(19.0)	(17.7)	-	-
Unamortised bond issue costs	7.2	9.9	-	-
	(2,369.5)	(2,515.2)	-	-
Net debt	(2,355.2)	(2,246.3)	0.1	0.1

b) The movement in net debt during the period may be summarised as:

	GROUP		COMPANY	
	2006 £m	2005 £m	2006 £m	2005 £m
Net debt at of start period	(2,246.3)	(2,116.3)	0.1	0.1
(Decrease)/increase in net cash	(221.0)	84.5	-	-
Decrease in financial assets	(33.6)	(40.8)	-	-
Decrease/(increase) in debt	215.3	(168.9)	-	-
Increase in net debt arising from cashflows	(39.3)	(125.2)	-	-
Movement in accrued interest	(1.3)	10.3	-	-
Amortisation of debt issue costs	(2.7)	(1.3)	-	-
Amortisation of bond issue premium	0.3	0.6	-	-
Foreign currency movement on dollar bond	(48.5)	3.4	-	-
Indexation of index-linked debt	(17.4)	(17.8)	-	-
Movement in net debt during the period	(108.9)	(130.0)	-	-
Net debt at end of period	(2,355.2)	(2,246.3)	0.1	0.1

20 Employees and directors

a) Staff costs for the group during the year

	2006 £m	2005 £m
Wages and salaries	7.2	8.2
Severance programme and termination costs	0.4	2.7
Social security costs	0.7	0.8
Other pension costs	1.1	1.7
	9.4	13.4

Of the above, £3.7 million (2005: £2.5 million) has been charged to capital. The severance programme and termination costs include £0.4m (2005: £2.2 million) in respect of pension costs. Other pension costs includes £0.5m (2005: £nil) in respect of the directors' unfunded pension liabilities.

	2006 Number	2005 Number
Average monthly number of people (including executive directors) employed by the group		
Regulated water and sewerage activities	136	146

b) Parent Company

The parent company had no employees (2005: nil) in the year.

Full details of the Directors' remuneration are included in the Directors' Remuneration Report set out on pages 32 to 38, which form part of these Financial Statements.

21 Pension commitments

Following the acquisition of Dŵr Cymru Cyfyngedig by Glas Cymru Cyfyngedig, a new funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service) was introduced on 1 December 2001, the DCWW Pension Scheme. The assets of the scheme are held in a separate trustee administered fund.

The DCWW Pension Scheme was closed to new members from the 31 December 2005 and a new defined contribution scheme, the Dŵr Cymru Defined Contribution Scheme, was introduced from the 1 January 2006. Pension costs for the defined contribution scheme are as follows:

	2006 £000	2005 £000
Defined contribution scheme	24	-

Defined benefit scheme

A full 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. This valuation was updated at 31 March 2006 and the principal assumptions made by the actuaries were:

	2006	2005
Rate of increase in pensionable salaries	3.75%	3.75%
Rate of increase in pensions in payment	2.75%	2.75%
Discount rate	5.10%	5.40%
Inflation assumption	2.75%	2.75%

The major categories of plan assets, as a percentage of total assets and the expected rates of return thereon, were as follows:

	2006		2005	
	Expected long term return	Percentage of total assets	Expected long term return	Percentage of total assets
Equities	6.50%	55%	6.70%	56%
Bonds	5.00%	35%	5.40%	44%
Other	4.50%	10%	4.75%	-

Pensions and other post-retirement obligations

The amounts recognised in the balance sheet are determined as follows:

	2006 £'000	2005 £'000
Present value of funded obligations	(37,197)	(32,406)
Fair value of plan assets	30,561	24,637
Net liability recognised in the balance sheet	(6,636)	(7,769)

The amounts recognised in the income statement are as follows:

	2006 £'000	2005 £'000
Current service cost (excluding members contribution)	1,271	1,348
Interest cost	1,779	1,558
Expected return on plan assets	(1,502)	(1,191)
Net actuarial gains recognised in year	(1,497)	(6)
Past service cost	899	2,202
Total included within staff costs	950	3,911

The total charge of £0.950m (2005: £3.911m) is included within operating costs.

Changes in the present value of the defined benefit obligation are as follows:

	2006 £'000	2005 £'000
At 1 April	32,406	26,710
Current service cost (including members contribution)	1,612	1,701
Past service cost	899	2,202
Interest cost	1,779	1,558
Benefits paid	(1,452)	(679)
Actuarial losses	1,953	914
31 March	37,197	32,406

Changes in the fair value of plan assets are as follows:

	2006 £'000	2005 £'000
At 1 April	24,637	18,873
Expected return on plan assets	1,502	1,191
Contributions (including members contribution)	2,424	2,132
Benefits paid	(1,452)	(679)
Special contribution	-	2,200
Actuarial gain on plan assets	3,450	920
31 March	30,561	24,637

Analysis of the movement in the balance sheet liability:

	2006 £'000	2005 £'000
At 1 April	7,769	7,837
Total expense as above	950	3,911
Contributions paid (excluding members contribution)	(2,083)	(1,779)
Special contribution accrued at year end	-	(2,200)
31 March	6,636	7,769

	2006 £'000	2005 £'000
Expected return on plan assets	1,502	1,191
Actuarial gain on plan assets	3,450	920
Actual return on plan assets	4,952	2,111

	2006	2005	2004	2003
Experience adjustments arising on scheme assets:				
Amount (£m)	3.5	0.9	2.0	(0.2)
Percentage of scheme assets	11%	4%	11%	(1%)
Experience adjustments arising on scheme liabilities:				
Amount (£m)	0.3	(0.3)	-	2.7
Percentage of the present value of scheme liabilities	1%	(1%)	0%	11%
Present value of scheme liabilities (£m)	37.2	32.4	26.7	24.1
Fair value of scheme assets (£m)	30.6	24.6	18.9	14.8
Deficit (£m)	(6.6)	(7.8)	(7.8)	(9.3)

The contribution expected to be paid during the financial year ended 31 March 2007 amounts to £1.5m.

22 Operating lease commitments – minimum lease payments

GROUP	LAND AND BUILDINGS	
	2006 £m	2005 £m
At 31 March 2006 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

The parent company has no lease commitments (2005: £nil).

23 Capital and other financial commitments

The group's business plan as at 31 March 2006 shows net capital expenditure of £280m (2005: £216m) during the next financial year. While only a portion of this amount has been formally contracted for, the group is effectively committed to the total as part of its overall capital expenditure programme approved by its Regulator.

24 Related party transactions

In accordance with the exemption afforded by IAS 24 there is no disclosure in the consolidated financial statements of transactions with entities that are part of the Glas Cymru Cyfyngedig group.

25 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.

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 £2.1 million (2005 £2.4 million) in respect of the Elan Valley Trust Fund.

28 Reconciliations between IFRS and UK GAAP

a) Reconciliation of net income for the year ended 31 March 2005

Note	UK GAAP £m	IAS16 £m (i)	IAS39 £m (ii)	IAS19 £m (iii)	IAS12 £m (iv)	IFRS3 £m (v)	IFRS £m
Revenue	494.1						494.1
Operating costs:							
- Operational costs	(210.3)			(0.4)			(210.7)
- Infrastructure renewals expenditure	-	(43.0)					(43.0)
- Depreciation	(118.1)	28.3					(89.8)
- Amortisation of negative goodwill	46.9					(46.9)	-
Profit on disposal of fixed assets	4.3						4.3
Operating profit	216.9	(14.7)		(0.4)		(46.9)	154.9
Interest payable and similar charges	(157.9)		(0.9)				(158.8)
Interest receivable	16.2						16.2
Fair value losses on financial instruments	-		(8.0)				(8.0)
Profit before taxation	75.2	(14.7)	(8.9)	(0.4)		(46.9)	4.3
Taxation	10.0				(8.8)		1.2
Profit for the year	85.2	(14.7)	(8.9)	(0.4)	(8.8)	(46.9)	5.5

Notes to the financial statements

b) Reconciliation of net assets at 1 April 2004

Note	UK GAAP £m	IAS16 £m (i)	IAS39 £m (ii)	IAS19 £m (iii)	IAS12 £m (iv)	IFRS3 £m (v)	IFRS £m
Assets							
Non-current assets							
Property, plant & equipment	2,636.7	(12.9)					2,623.8
Intangible assets	(46.9)	7.0				46.9	7.0
	2,589.8	(5.9)				46.9	2,630.8
Current assets							
Trade and other receivables	61.9						61.9
Financial assets:							
- held to maturity investments	74.7						74.7
Cash and cash equivalents	150.5						150.5
	287.1						287.1
Liabilities							
Current liabilities							
Financial liabilities:							
- borrowings	(22.1)						(22.1)
- derivative financial instruments	-		(3.3)				(3.3)
Trade and other payables	(144.1)	(1.1)		0.5			(144.7)
	(166.2)	(1.1)	(3.3)	0.5			(170.1)
Net current assets	120.9						117.0
Non-current liabilities							
Financial liabilities:							
- borrowings	(2,380.9)		45.1				(2,335.8)
- derivative financial instruments	-		(102.1)				(102.1)
Retirement benefit obligations	-			(7.8)			(7.8)
Provisions	(32.9)		11.6				(21.3)
Deferred Income	(35.9)	35.9					-
	(2,449.7)	35.9	(45.4)	(7.8)			(2,467.0)
Net assets before deferred tax	261.0						280.8
Deferred tax	(82.1)				(299.5)		(381.6)
Net assets/(liabilities)	178.9	28.9	(48.7)	(7.3)	(299.5)	46.9	(100.8)

c) Reconciliation of net assets at 31 March 2005

Note	UK GAAP £m	IAS16 £m	IAS39 £m	IAS19 £m	IAS12 £m	IFRS £m
		(i)	(ii)	(iii)	(iv)	
Assets						
Non-current assets						
Property, plant & equipment	2,744.7	(23.8)				2,720.9
Intangible assets	-	4.4				4.4
	2,744.7	(19.4)				2,725.3
Current assets						
Trade and other receivables	65.5					65.5
Financial assets:						
- held to maturity investments	33.9					33.9
Cash and cash equivalents	235.0					235.0
	334.4					334.4
Liabilities						
Current liabilities						
Financial liabilities:						
- borrowings	(54.5)					(54.5)
- derivative financial instruments	-		(3.8)			(3.8)
Trade and other payables	(125.2)			0.1		(125.1)
	(179.7)		(3.8)	0.1		(183.4)
Net current assets	154.7					151.0
Non-current liabilities						
Financial liabilities:						
- borrowings	(2,509.2)		48.5			(2,460.7)
- derivative financial instruments	-		(113.0)			(113.0)
Retirement benefit obligations	-			(7.8)		(7.8)
Provisions	(20.4)		10.7			(9.7)
Deferred income	(33.6)	33.6				-
	(2,563.2)	33.6	(53.8)	(7.8)		(2,591.2)
Net assets before deferred tax	336.2					285.1
Deferred tax	(72.1)				(308.3)	(380.4)
Net assets/(liabilities)	264.1	14.2	(57.6)	(7.7)	(308.3)	(95.3)

d) Notes to reconciliations of income and net assets

(i) IAS16 – Property, plant & equipment

The most significant impact of IAS16 relates to infrastructure assets. In accordance with UK GAAP (FRS15), infrastructure assets are treated as a single homogenous asset, which is subject to renewals accounting. Under renewals accounting, capital expenditure to maintain the asset (infrastructure renewals expenditure) is treated as an addition to fixed assets and the depreciation charge (infrastructure renewals charge) is the estimated level of annual expenditure required to maintain the operating capability of the network. No other depreciation was applied to the infrastructure network.

Under IAS16, infrastructure renewals accounting is not permitted and infrastructure assets are now depreciated over the estimated useful lives of identified components of the network. In addition, infrastructure renewals expenditure is now capitalised only if it represents a material replacement of a network component. If not, it is charged separately to operating expenditure rather than being treated as depreciation. As a result, there is a significant expenditure classification change, which impacts EBITDA.

In addition, rather than applying IAS16 retrospectively, a deemed cost has been established for the infrastructure assets at 1 April 2004 based on fair value in accordance with IFRS1.

Finally, there are two classification changes following implementation of IAS16. These are:

- a) Software development costs are now classified as intangible assets rather than being included as part of property, plant and equipment;
- b) Grants and customer contributions of a capital nature are now deducted from the cost of property, plant and equipment. Previously, capital grants relating to non-infrastructure assets were separately identified within creditors as deferred income.

The impact of the new accounting policy is to reduce the depreciation charge for the year ended 31 March 2005 by some £28 million and to increase operating expenditure by some £43 million. The net effect of IAS16 is to reduce operating profit by some £15 million and increase net assets at 31 March 2005 by some £14 million, but will not impact on operating cashflows for the purposes of covenanted interest cover ratios.

The accounting policies applied under UK GAAP for all other fixed assets are compliant with IFRS and continue to be appropriate.

(ii) IAS32/39 – Financial instruments

The group hedges at least 85% of its total outstanding financial liabilities 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.

Under UK GAAP, the group recognised the effect of derivatives by adjusting the interest charge on the underlying liabilities to the fixed rate hedge. The fair value of the derivative instrument was not recognised.

Whilst the group employs an effective commercial hedging policy using interest rate and currency swaps, this policy does not satisfy the stringent hedge accounting criteria of IAS39. Consequently, under IFRS, the group's interest rate and cross-currency swaps are fair valued at each balance sheet date with the movement (profit or loss) disclosed in the income statement.

IAS39 has been retrospectively adopted and results in a £58 million decrease in net assets at 31 March 2005 and a reduction in pre-tax profits for 2004-05 of some

£9 million. Looking forward, charging the movement in fair values of financial derivatives between balance sheet dates to the income statement will increase the volatility of reported results, but will not impact on the group's cash based covenanted financial ratios.

(iii) IAS19 – Pension schemes

Under UK GAAP, the measurement and recognition requirements of SSAP24 were applied to pensions for the 2004-05 report and accounts with FRS17 transitional disclosures provided in the notes.

IAS19 takes a balance sheet approach to accounting for defined benefit schemes, similar to FRS17. Therefore, under IFRS, a deficit of £7.8 million the same as that previously disclosed under FRS17 is recognised in the balance sheet at 31 March 2005, and the impact on operating profit for 2004-05 is a reduction of £0.4 million.

As permitted by IFRS 1, all cumulative actuarial gains and losses at as 1 April 2004, the date of transition to IFRS, were recognised in full. Going forward, we are not electing to apply the "corridor" treatment under IAS19 and as such, all future actuarial gains and losses will be charged in full to the income statement.

(iv) IAS12 – Deferred tax

Deferred tax under IAS12 is based on 'temporary differences' between the carrying value and tax base of the group's assets and liabilities. Under UK GAAP, deferred tax is provided on 'timing differences' that originated but had not reversed before the balance sheet date. Furthermore, IAS12, unlike UK GAAP does not permit the discounting of deferred tax liabilities.

As a result of the implementation of IAS12, an additional deferred tax liability of £308 million has been provided at 31 March 2005 and the tax credit for 2004-05 has decreased by some £9 million.

(v) IFRS3 – Negative goodwill

At 31 March 2004, £46.9 million of unamortised negative goodwill was carried on the balance sheet, which was subsequently released to the profit and loss account in 2004-05.

Under IFRS3, negative goodwill cannot be carried in the balance sheet and therefore, the amortisation of £46.9 million of negative goodwill credited to the profit and loss account under UK GAAP in 2004-05 is not recognised under IFRS.