

glas
Glas Cymru Cyfyngedig

Report and Accounts 2010

Glas Cymru Cyfyngedig
Company Number 3975719



Full colour version available from our website dwrcymru.com

INTRODUCTION

Our aims

Our ambition is to be recognised by our customers as the best water company in the UK.

To achieve this we must:

- » Deliver high quality and reliable drinking water and sewerage services
- » Meet customers' expectations and give value for money
- » Safeguard the environment
- » Look after the water industry for future generations.

GLAS CYMRU is the single purpose company formed 10 years ago to own, finance and manage Welsh Water on behalf of today's customers and future generations

The purpose of the company is to manage Welsh Water in the best interests of customers, which means providing the best possible standard of service - whilst keeping the customer bill affordable

Structured as a company limited by guarantee, Glas Cymru has no shareholders - any financial surpluses are therefore retained or reinvested for the benefit of customers

Under our 'not-for-profit' business model, Welsh Water's assets and capital investment are financed by bonds, loans and retained financial surpluses. In this way we aim to reduce Welsh Water's asset financing costs, the water industry's single biggest cost, by offering high quality credit to long term investors

We are the only UK water company owned and financed in this way

WELSH WATER is the sixth largest of the 10 regulated water and sewerage companies in England and Wales and provides an essential public service to more than 3 million people living in Wales and some adjoining parts of England

To do this we employ a large and complex network of often very long-life assets - with a replacement cost of £25 billion, or around £20,000 per household

By managing these assets to provide a safe and reliable supply of drinking water and deal effectively with customers' wastewater, Welsh Water fulfils a vital role in protecting public health and the natural environment

HIGHLIGHTS

Protecting public health

- » High level of water quality compliance - 99.94% mean zonal compliance
- » 3 schemes commissioned in the early start to £200 million programme to upgrade 26 water treatment works by 2013 to ensure continued high quality drinking water

Safeguarding the environment

- » 50 Blue Flags awarded around the coast of Wales for 2010
- » 21,000 young people go through our environmental education programme

Meeting customers' expectations

- » Sewer flooding caused by hydraulic overload reduced by 20 %
- » New customer contact and operations control centre opening in Cardiff

Affordability and value for money

- » Customer bills to fall by £30 (before inflation) by March 2015
- » Water bills capped at £250 for over 8,000 customers in trial of 'Welsh Water Assist' tariff

Employer of choice

- » Successful TUPE transfer of nearly 1,600 employees from previously outsourced operations contracts
- » 95% of staff attend a road show event at which the Managing Director reinforced our focus on protecting public health, the environment and the safety of those who work for us

Responding to climate change

- » Welsh Water awarded Carbon Trust Standard in 2009
- » First of four schemes in £110 million green energy programme commissioned at Eign in Herefordshire

Financing the business

- » Successful £140 million bond issue to meet Welsh Water's financing needs for the next five years
- » Financial reserves or 'customer equity' amounting to almost £1.1 billion at the end of the last five year regulatory period

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CHAIRMAN'S STATEMENT

As Glas Cymru approaches its tenth anniversary it is a pleasure to be able to report another year of solid progress for Welsh Water, with real improvements in a number of key areas supported by a record investment for the longer term. Since this has been the final year of one of the industry's recurring five-year regulatory cycles and also my last Chairman's statement, it is a fitting time to stand back and assess what Glas Cymru's very special structure has achieved since we acquired Welsh Water in May 2001.

I believe that we have come a long way in that time and have established that 'not-for-profit' ownership of a long term industry providing an essential public service can work and work well. Under Glas Cymru's ownership Welsh Water is now financially secure and has delivered a step change improvement in performance for our customers in terms of bills, service standards and the quality of their environment. The Company is well placed to tackle the significant challenges it now faces following Ofwat's price determination that will see average household bills in the region £30 lower in real terms in five years' time than they were last year.

Ten years ago Welsh Water had the highest water bill in the industry and the second highest sewerage bill, something that our customers found difficult to understand in such a wet part of the country. This year our water bill is below the industry average and our sewerage bill is closer to the industry average – an achievement that has been possible only because of Welsh Water's sector-leading record of cost reduction that also made possible an annual 'customer dividend' that has been unique in the industry.

Financing efficiency has been one of our most important successes, and is the key to ensuring that the public service we provide is affordable. Under Glas Cymru's ownership we have created financial reserves of over £1 billion by reducing gearing from 93% at the acquisition of the company in 2001 to 71% today, funded 'customer dividends' of more than £150 million and achieved the best credit ratings in the sector. With 60% of our total borrowings being index-linked, interest costs last year fell by a third and a £140 million index-linked bond issue in March 2010 put the Company in a strong liquidity position with its capital expenditure requirements for the next regulatory period now largely pre-funded.

But financing efficiency is only part of the picture. In the regulated water industry much of what matters to customers and to the environment can be measured, compared and judged. Welsh Water was one of the poorest performers on this basket of measures 10 years ago, but by 2005 had improved to the best in the industry. In the years since 2005 we have suffered some setbacks, but we have been determined to rectify any shortfalls and to invest whatever is necessary to restore Welsh Water's position as a consistently leading water company on all the measures that matter for customers and for the environment.

I am delighted that Bob Ayling will be taking over as Chairman following this year's AGM. I would like to take this opportunity to thank my colleagues on the Board for all the support they have given me as Chairman over the years and for their continuing dedication to and enthusiasm for the Company and what we have set out to achieve. This commitment is exemplified by Dame Deirdre Hine who is also standing down as a Non-Executive Director at this year's AGM, after nearly 10 years on the board. Deirdre has been chair of our Quality and Environment Committee throughout that period and her contribution to the Board has been immense.

I must also thank the Members of the Company, who perform such an important corporate governance role, and who have brought the right mix of support and informed challenge to their task throughout.

Finally, I would like to thank all the staff who work so hard for Welsh Water, whether they are employed directly by the Company or not. It is a great team that always goes the extra mile and I am confident that it will again rise to the challenges that lie ahead and that Welsh Water and its customers will prosper as a result.

Lord Burns

MANAGING DIRECTOR'S REPORT

The past year has been an important one for Welsh Water: the conclusion of Ofwat's five-yearly price review has set significant challenges for us, and we have had to take difficult decisions on the future shape of the business in order to meet them. At the same time we can report another year of solid progress, including record capital investment, all designed to improve our service to customers, to safeguard the environment, and to bring our performance up to the high level to which the whole team aspires.

Performance

Our most important responsibility is safe drinking water. Overall compliance with water quality standards in 2009 remained very high at 99.94%, and there were fewer water quality incidents in 2009 although still more than the average for the water sector. To improve the reliability of our water supply network we have accelerated £200 million of investment to refurbish and upgrade 26 water treatment works, with priority given to those, mostly in North Wales, that previously have relied on single stage treatment of high quality source waters.

Schemes totalling £83 million at Cwellyn, Harlech and Penybont in North Wales and at Crai, Cwmbran and Talybont in South Wales, were completed during the year. Pending completion of this major improvement programme, we also installed additional ultra violet treatment at 23 sites to protect against the risk to public health posed by cryptosporidium in particular.

Wales, with only 15% of the British coastline, secured a record 50 Blue Flag awards – more than a third of the total awarded to all of the UK – for the 2010 summer season, and all 81 designated bathing beaches in Wales passed the mandatory European standard for coastal water quality. In addition, a record 48 Green Coast awards for rural beaches were secured. Wales also continues to have some of the highest quality rivers in the UK with more than 90% being classed by the Environment Agency as having good or very good chemical and biological water quality.

On the wastewater side compliance with discharge consents at our wastewater treatment works slipped to 99.9%, from 100% in 2008, and there were seven serious pollution incidents caused by asset breakdown, compared with just three in the previous year but 17 in the year before that. Getting back to sector-leading performance on environmental protection, which Welsh Water has achieved in the past, is a high priority.

Our relatively strong water resource position was reinforced during the year by the completion of a £7 million scheme in Anglesey to link two supply zones thereby further reducing the risk of shortages during droughts. Alongside water efficiency, managing leakage is important to ensure that we are able to maintain supplies during droughts and last year we again achieved Ofwat's leakage reduction target despite a doubling of the number of bursts following the freezing weather at the start of 2010.

Customer satisfaction, as measured by quarterly tracking research, reached a record high, with 83% of customers saying they were satisfied with the overall service provided by Welsh Water. This high standing was confirmed by Ofwat's independent research into customer satisfaction, with Welsh Water ranked as the second highest of the 10 water and sewerage companies.

Against this encouraging picture, we still have more complaints than average about discoloured tap water. Moreover, we judge that more than half of the contacts we received last year from our customers could have been avoided – and one of the most important benefits we will secure from our £100 million IT modernisation programme will be to equip our customer facing staff with the information they need to deliver outstanding customer service. A key element of this programme is the establishment of a new operational control centre at St Mellons near Cardiff which will open towards the end of 2010.

Last year the number of sewer flooding incidents fell by nearly 20%, from 392 to 317. We know that the very worst customer service failing is flooding from overloaded or blocked sewers and during the year we completed 92 schemes to reduce the risk of internal and external sewer flooding for over 460 properties, cutting the 'at risk' register to 250. Over the last five years we have invested £67 million on upgrading our sewer

network reducing the risk of repeat flooding for over 1,200 properties. The Consumer Council for Water uses 'Leading Edge Tables' to identify areas of good practice and last year Welsh Water came top for the level of service it provides when dealing with a problem caused by flooding from a public sewer.

Value for money

As our Chairman states, Welsh Water has made great strides in reducing bills to something much closer to the average across England and Wales. Sector-leading cost reduction and financing efficiency has allowed us to sustain an annual 'customer dividend' that is unique in the industry. Last year the 'customer dividend' reduced each bill by £22 and brought the total sum returned to our customers in this way to more than £150 million since 2003.

Affordability has been at the heart of our plans since the start and it is very clear to us that many of our customers face real hardship in paying their water bill, particularly in the current economic climate. So, we have developed a unique range of customer assistance tariffs which, together with our Customer Assistance Fund, have helped 27,000 customers to afford their water bill.

The Ofwat price review has set some very challenging targets for us for the next five years. While our plans for £1.3 billion of capital investment were largely endorsed, we have been set the demanding target of reducing our controllable operating costs by 20%. As a result, the average household customer's bill will fall in real terms over the next five years. With bills falling, and in order to marshal our financial resources in what is still a very difficult economic environment, the Board has decided to postpone any further 'customer dividends' until it is once again prudent to do so.

Outsourcing strategy

Since Glas Cymru acquired Welsh Water in 2001, we have employed an outsourcing strategy to ensure that our customers get the best value for money from a competitive marketplace for each element of the value chain. To date, around 85% of our costs have been covered by outsourcing arrangements.

Our key contracts with United Utilities and Kelda for the operation of Welsh Water's water and wastewater assets provided for a 'price and performance review' to coincide with Ofwat's Final Determination of price limits for the next five years. After an exhaustive process, we were not able to agree terms that were acceptable to United Utilities and Kelda while satisfying us that we could reach our targets for both cost reduction and improved customer service. As a result, the contracts with both United Utilities and Kelda were terminated by agreement with effect from 1 April 2010 and 1 May 2010 respectively and nearly 1,600 staff transferred to the direct employment of Welsh Water in accordance with TUPE legislation.

United Utilities since 2001 and Kelda Water Services since 2005 have made an enormous contribution to improving the performance and especially the efficiency of Welsh Water. The business is in better shape to tackle the new challenges ahead than it would have been but for this important contribution from both companies.

Despite bringing the asset operations under the direct control of Welsh Water, some 60% of annual operating and capital expenditure will remain subject to competitive tender, still the highest percentage in our sector.

Looking ahead

The challenge of reducing our costs, while continuing to improve our service to customers and ensuring a high degree of sustainable protection for the environment, will be testing. But I am confident that with the commitment of our newly unified team, together with our commercial partners, we will rise to the challenge. The way in which our staff right across the business have responded to the significant challenges that arose during the year is remarkable. Their continuing commitment and enthusiasm is the key to our success in serving our customers and to looking after this long term and important industry for future generations.

Finally, I would like to add my particular thanks to two people: to Dame Deirdre Hine for her leadership of our Quality and Environment Committee, combining great wisdom and insight as well as calm authority on all matters and, in particular, those to do with public health and, of course, to Lord Burns for his unflagging leadership, support, guidance and inspiration over the last decade. Glas Cymru would not have come into being without his insight and commitment. We are all in his debt and my thanks to him are profound.

Nigel Annett

HOW WE DELIVER SERVICES

Our job is to deliver high quality and reliable drinking water and sewerage services to Welsh Water's customers at an affordable price, and to look after the water industry in our region on behalf of today's customers and future generations.

Regulation of the water industry

The water industry in England and Wales, and the important public service for which it is responsible, is highly regulated

Ofwat is the economic regulator and is responsible for setting an upper limit on the price that each regulated water and sewerage company can charge its customers. It is also responsible for promoting the interests of customers by incentivising efficiency and high standards of service and penalising inefficiency and poor service. Every five years Welsh Water, like all the other water companies, prepares its plans for the years ahead, setting out what needs to be done, what it will cost and what it means for bills. Ofwat scrutinises and challenges these plans and sets a maximum price that companies can charge to deliver an agreed amount of work as efficiently as possible. In December 2009, Ofwat published its final determination for Welsh Water for the regulatory cycle from 2010 to 2015, known as AMP5 (see - The 2009 Price Review)

For many years Ofwat had assessed companies' overall delivery of service to customers via its Overall Performance Assessment (OPA), which served two purposes. Firstly, it enabled comparisons of the quality of the overall service companies provide to customers, which is taken into account at each price review. Secondly, it informed customers - and other interested parties - about the overall performance of their local water company. The OPA assessment reflected a broad range of services including water supply, wastewater services, customer service and environmental impact. However, on 1 April 2010 Ofwat replaced OPA with a new framework of serviceability measures and a service incentive mechanism (SIM), and we will report our performance against this next year.

The **Drinking Water Inspectorate (DWI)** is the regulator for drinking water quality, while the **Environment Agency (EA)** regulates Welsh Water's environmental performance, specifically with regard to the way in which it abstracts water from rivers and reservoirs and then discharges wastewater after it has been cleaned.

The **Countryside Council for Wales** and, in England, **Natural England**, oversee Welsh Water's management of designated sites for nature conservation and how the Company meets its obligation to conserve and improve biodiversity.

The **Consumer Council for Water** is the independent body established to represent the interests of customers. It investigates complaints and champions customer concerns, and audits Welsh Water's performance on customer service more generally, as well as influencing policy.

The **Welsh Assembly Government** has a key role in determining water and environmental quality standards as well as setting the framework for other public policy matters.

All aspects of Welsh Water's water and wastewater operations are subject to extensive performance monitoring against standards and targets set by regulators and government. Each year, regulators publish reports that assess and compare the performance of the regulated water companies across a wide range of measures, including water quality, environmental quality, customer service, affordability and cost efficiency. Each regulator has powers that can sanction Welsh Water in the event that performance falls short of required standards.

The 2009 Price Review

The regulatory contract that Welsh Water is required to deliver in the five year period ending on 31 March 2015 is the most challenging the Company has been set since the industry was privatised in 1989. Under Ofwat's Final Determination the average bill for Welsh Water's water and sewerage customers will reduce over the period to 31 March 2015 by £30 (before inflation). To deliver this level of bill reduction Welsh Water will need to significantly reduce operating costs, by around 20% of costs that can be managed or influenced by management, whilst at the same time improving customer service performance to meet new serviceability targets set out in the Final Determination - which are also very challenging - and delivering a £1.3 billion capital investment programme.

Following careful consideration, Welsh Water decided not to appeal against Ofwat's Final Determination to the Competition Commission. However, the sharp reduction in revenues has meant that the progressive 'customer dividend', which was appropriate when customer bills were rising - and which between 2003 and 2010 returned some £150 million to customers - is not appropriate at the start of this next regulatory period. This also recognises that Ofwat has adopted new standards of 'serviceability', comprising 20 measures over 4 service areas, which, if they are not met, could lead to substantial financial penalties being imposed at the time of the next price review.

More information on the price review and the capital investment programme that we will deliver by March 2015 can be found on page 40

Delivering services for customers

Since 2001 many of the regulatory and customer service activities of Welsh Water have been delivered by partners under contracts secured through competitive tender. Control of these activities remained with Welsh Water and the Company retained its access to the staff, information and knowledge required to meet legal and regulatory obligations. Welsh Water determined asset strategy and retained responsibility for decisions on key assets. Each contract specifies performance measures that reflected the quality and service standards by which Welsh Water's performance is judged. In 2009-10, some 85% of Welsh Water's operating and investment expenditure was covered by these contracts, which were let in 2005.

The operation and maintenance of the group's network of water and sewerage assets has been managed by United Utilities Operating Services Limited (UUOS) and Kelda Water Services Wales Limited (KWS) since 2005. In the regulatory period 2005-10, these operating partners helped Welsh Water improve the quality of service received by customers and reduce the Company's operating costs. However, following a review of contract price and performance, it became clear that the existing contract arrangements could not achieve the cost efficiencies and service improvements Welsh Water has to meet over the next five years. Despite considerable efforts by all parties, it was not possible to reach agreement on terms for continuing the contracts for those next five years.

As a result, Welsh Water announced that agreement had been reached with UUOS and KWS and nearly 1,600 staff successfully transferred to Welsh Water (under the Transfer of Undertakings Regulations) on 1 April 2010, and 1 May 2010 respectively.

How we measure our performance

	Monitoring plan target ⁽¹⁾	Previous performance 2008-09	Actual performance 2009-10	At or better than previous year
Water quality				
Overall water quality compliance 'at the tap' ⁽¹⁾⁽²⁾	n/a	99.9%	99.9%	✓
i Bacteriological compliance 'at the tap' ⁽³⁾ (see page 10)	n/a	99.8%	99.8%	✓
Iron compliance 'at the tap' ⁽³⁾	99.1%	99.4%	99.3%	✗
Operational Performance Index ⁽⁴⁾	n/a	99.9%	99.8%	✗
Operational Performance Index (TIM) ⁽²⁾⁽⁴⁾	n/a	99.8%	99.7%	✗
Environment				
Leakage (m ³ /km/day)	7.5	7.2	7.1	✓
Number of 'category 1 and 2' pollution incidents ⁽³⁾	n/a	3	7	✗
Number of 'category 3' pollution incidents ⁽³⁾	n/a	230	318	✗
Population served by wastewater treatment works assessed as complying with 'look up' table ⁽³⁾	n/a	100%	99.9%	✗
Sewage sludge recycled satisfactorily ⁽³⁾	100%	100%	100%	✓
'Mandatory' coastal bathing water compliance at EU designated bathing beaches ⁽³⁾	100%	99%	100%	✓
'Guideline' coastal bathing water compliance at EU designated bathing beaches ⁽³⁾	'Stable'	77%	91%	✓
Customer service				
i Customer satisfaction (see page 22)	n/a	80%	83%	✓
Properties 'at risk' of receiving low pressure	242	197	194	✓
Properties affected by unplanned water supply interruptions lasting more than 6 hours	1,080	894	477	✓
Properties 'at risk' of sewer flooding	308	265	250	✓
Properties flooded due to hydraulic overload	106	106	73	✓
Properties flooded due to other causes	120	186	198	✗
Billing enquiries answered within 5 days	100%	100%	100%	✓
Written complaints answered within 10 days	99.9%	99.3%	99.6%	✓
Number of written complaints received	n/a	12,486	13,313	✗
Customer meters read within year	99.9%	99.9%	99.9%	✓
Telephone calls abandoned	1.3%	4.7%	2.1%	✓
Telephone calls receiving engaged tone	0%	0.04%	0.9%	✗
Call handling satisfaction (score out of 5)	n/a	4.65	4.72	✓
People				
i Reportable accidents (see page 27)	n/a	34	39	✗
Finance				
i Bond credit rating ⁽⁴⁾ (see page 36)	n/a	Class B bonds A/A3/A		✓
i Customer dividend (see page 34)	n/a	£21	£22	✓
i Gearing (see page 36)	n/a	72%	71%	✓
i Interest cover (see page 36)	n/a	3.4	4.5	✓
Overall performance				
i Ofwat's OPA score (see page 44)	n/a	406	404	✗

(1) This measure is based on 'Mean Zonal Compliance'

(2) Incorporates performance against turbidity, iron and manganese

(3) The Monitoring Plan sets out the targets agreed at the Regulatory Price Review in 2004 for the period 2005-10

(4) Standard & Poor's, Moody's and Fitch respectively

(C) Calendar year 2009, all other figures are for the year ended 31 March 2010

i Key performance indicators identified by the Board, further information can be found on page 44

DRINKING WATER SUPPLY

Our biggest obligation is to protect public health by providing a safe and reliable supply of drinking water to our customers at all times.

Supplying water is a complex operation and to do this we employ a large network of assets. 87 water treatment works supply over 800 million litres of water a day to 1.2 million households and some 100,000 business customers through a network of around 550 service reservoirs and 27,000km of water mains.

Drinking water quality

The quality of the water we supply is assessed against the results of some 290,000 tests which we take each year. These measure our performance against a combination of health-based and aesthetic-based standards set by EU directives and national legislation, and cover all stages in the process - from the treatment works to the customers' tap. All results are submitted to the DWI for assessment and provide a broad picture of the quality of the tap water we supply to our customers.

The overall quality of the drinking water we supplied in 2009 remained at a high level and, while the number of water quality events reported to the DWI reduced only slightly (to 21), there was a 50% reduction in events relating to the disinfection process at water treatment works. This helped us to deliver

- » bacteriological compliance at the tap of 99.77% (the same as in 2008)
- » stable mean zonal compliance with 99.94% of tests meeting the required quality standards
- » an improved performance against the DWI's disinfection control index at 99.98% (up from 99.88% in 2008)

In 2010 we aim to maintain or improve our performance against each of the DWI's six indices which assess our overall performance - last year we improved against two, were stable against two but declined slightly against two others.

Two precautionary boil water notices were issued in 2009 following detection of very low levels of E. coli in routine sampling. The first was at Alwen water treatment works, which affected

75,000 customers and was lifted after seven days, and the second followed a burst main at Penyffordd in north Wales, which affected 363 properties and was lifted after five days. Neither incident was associated with illness in the community.

The number of customer contacts we receive - queries or complaints by phone call, email or letter - is a good measure of customer confidence in their tap water. Last year we received 4.2 contacts per 1,000 customers, down from 4.5 in 2008 and 5.0 the year before that.

We are confident our performance will get better as we deliver a £200 million programme to improve our water treatment works over the next five years. Schemes at Cwellyn, Penybont and Rhiwgoch water treatment works have already been completed under early start funding made available under the Glas Cymru business model, and the aim is to complete the whole programme by 2013. Until then, the risk associated with a gradual deterioration in the quality of the raw water we abstract for the public water supply is being mitigated by additional ultra violet treatment installed as a precautionary measure during 2008 and 2009 to protect against the threat to public health posed by cryptosporidium.

Managing water quality risk

We have a Drinking Water Safety Plan for each of Welsh Water's areas of supply, which document all potential risks to water quality (from source to tap). These plans are continually reviewed and updated. Our approach to managing water quality risk includes the holding of events on catchment management to consult and engage with landowners, local businesses, public health and local authorities and others whose activities can have an effect on catchments that are used for abstraction of drinking water. The aim is to increase understanding of the potential risks to water supply and public health, and how we can best work together to minimise those risks.

Water Health Partnership for Wales

The annual meeting of the Water Health Partnership for Wales (WHPW) approved three training events across Wales in spring 2010. 76 people attended with representation from most Local Authorities, the National Public Health Service and the EA. The events were designed to improve inter-agency knowledge of public health and drinking water quality issues and included discussion of the common causes of customer complaints and on health issues associated with lead and cryptosporidium in water. Each was followed by a visit to a local water treatment works.

Initiated by Welsh Water four years ago, the WHPW is a good example of the 'working together' approach we prefer to adopt.

Reliability of supply

Welsh Water is near the top of the industry league tables for some key measures of customer service. In 2009:

- » the number of properties at risk of low water pressure was 194 (or 0.014% of the 1.3 million properties we supply)
- » the number of properties where water supplies were cut off without warning for more than 6 hours (because of a burst pipe, third party damage or over-run on planned work) fell from 894 to 477, and, of these, the properties affected by an interruption of more than 12 hours was 40 (down 90% from 411).

A burst main incident at Treharris showed a weakness in our telephony arrangements when customers struggled to contact us. As a result, we have brought forward the introduction of a £3.8 million telephony system (part of our £100 million programme of IT enabled change) which will go live in autumn 2010.

We also monitor water pressure at the tap in each of our supply zones because pressure can change as new properties are connected to the network or the distribution network is re-configured for water quality reasons. Last year, we dealt with possible low pressure problems at over 2,000 properties.

SAFEGUARDING THE ENVIRONMENT TODAY

It is our responsibility to collect and treat our customers' wastewater in a way that protects public health and the environment - in many places this is made more difficult by the volume of highway and surface water that drains into the public sewer network.

We collect and treat 5% of the UK's total wastewater flow yet operate 13% of the UK's treatment works – over 800 of them. Because of our topography, we employ more assets per customer than most other water companies in England and Wales. In our 19,000 km sewer network we have some 1,800 pumping stations and 3,500 combined sewer overflows. How we manage these assets is monitored by the EA 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.

Wales can boast of some of the highest quality rivers and coastal waters in the UK. We are proud of the part we have played in securing this outcome. We have invested more than £2 billion over the last 15 years to protect this high quality environment, which has contributed to the number of Blue Flags awarded to Wales rising from 2 to 50, but maintaining this will continue to be a real challenge.

Wastewater treatment compliance

All of our wastewater treatment works have discharge consents which are regulated by the EA. Some 550 of them also have more detailed consents where the treated water discharge is sampled over the course of the year and tested against parameters, including biological oxygen demand, suspended solids and ammonia.

Compliance with what are called 'look up' discharge consents – permits for the discharge of waste water – was 100% in 2008, but slipped to 99.85% in 2009 after 10 small wastewater treatment works failed to meet the required standard, most of them for the first time in many years. Most of these serve a population of less than 500 and have biological treatment processes that are vulnerable to surface water flows during severe wet weather and to unauthorised connections. These works simply could not cope with the heavy rain and high storm water flows we saw in 2009.

We have therefore looked again at this risk at all our small works, and during the coming five years, we will be investing further to protect Wales's river and coastal environment.

Reliability of the sewer network

In 2009, the number of sewer flooding incidents caused by blockages, collapsed sewers or an overload of wastewater, fell by around 20% – despite periods of prolonged heavy rainfall, and that fact that around a third of our sewer network is more than 100 years old. However, the number of sewer collapses we dealt with – 28 for every 1,000km of main – remains one of the highest rates of asset breakdown in the industry. Reducing the risk of flooding and pollution from asset breakdown remains one of our biggest challenges.

Over the last regulatory period 2005-10, we invested £67 million to reduce the risk of repeat flooding for over 1,200 properties. As a result of investment or intervention we made last year, 117 properties were removed from the register of properties at risk of repeat flooding following heavy rainfall, but this was offset by the addition of 102 new properties. The register at 31 March 2010 comprised 250 properties (2009: 265). We recognise that this is the most serious service shortfall we can have and that it is especially hazardous to public health, so we are pleased that Welsh Water came top in the Consumer Council for Water's assessment of company responses to sewer flooding. In the next five years we will be spending around £60 million to further reduce the risk of sewer flooding.

Disappointingly, the number of serious pollution incidents caused by asset breakdown and problems on our sewer network rose from three in 2008 – one of the best performances in the industry – to seven last year, the same as in 2007. The total number of pollution incidents also went up last year to over 300. We have already invested £6 million to increase the remote monitoring of flows in our sewers, which is helping us to

predict sewer overload and blockages
We have set aside a further £20 million for schemes to substantially reduce the number of pollution incidents caused by our operations over the next five years

Coastal and river water quality

In 2009 all of Wales's 81 EU-designated beaches passed the 'mandatory' bathing water standard - and 91% of them, the highest proportion for any region of the UK, passed the much higher 'guideline' standard. This result has helped secure 50 Blue Flag beach and marina awards for the 2010 bathing season (2009 47), which is again over one third of the total awarded for the UK. Wales also secured 48 Green Coast awards for rural beaches. This is important to the Welsh tourist industry, because Welsh Assembly Government statistics tell us that the tourist industry employs 8% of the Welsh workforce and contributes some £3 billion a year to the Welsh economy.

The quality of rivers in Wales continues to be amongst the best in the UK. The latest available survey of river water quality, published by the EA, confirmed that more than 90% of rivers in Wales were classed as having good or very good chemical and biological water quality.

Water abstraction and leakage

Water is a valuable resource and we abstract from our rivers no more than we need to for public water supply.

We are committed to keeping leakage – in other words, wastage - to a minimum. With 27,000km of mains network, the average age of which is more than 60 years, this requires a continuous cycle of work. Last year we repaired on average 50 bursts and leaks every day.

In 2009-10 we met our mandatory target for leakage reduction, and over the last five years we have reduced leakage by 33 mega litres a day (MI/d) or 15%. This means that leakage in our region, once one of the highest in the UK, is now in line with the water industry average. Achieving the leakage target was a big challenge because there was again a sharp increase in leakage from burst pipes in the thaw following a period of prolonged freezing weather in December and January. At one stage we were putting nearly 20% more

water into supply, around the same as the peak summer demand for water in the past two years. To hit the leakage target required a major reallocation of resources and round-the-clock seven-day working, at an additional cost of some £2 million.

The saving achieved in leakage reduction last year is reflected in a drop in the average amount of water leaving our treatment works (known as distribution input) of 13MI/d. At 816MI/d, distribution input last year was 52MI/d lower than in 2004-05.

Wastewater investment in the year

	Spend £m
Wastewater treatment works improvements	17
Combined sewer overflows	50
Sewer flooding prevention	15
Sewerage maintenance	13
Wastewater asset maintenance	21
Sludge development (AD)	36
New development	5
Other	30
Total	187

SAFEGUARDING THE ENVIRONMENT FOR TOMORROW

We aim to operate our business in a sustainable way that safeguards the environment and, where an impact is unavoidable, in a way that minimises any adverse environmental effect.

We place a strong emphasis on the careful management of the water resources in our area, and we are working to mitigate the expected impact of climate change on our industry as well as to reduce Welsh Water's carbon footprint

Managing water resources

Our job is to ensure that our customers have sufficient water to meet their needs today and in the future. In terms of water resources, we are in a relatively strong position in Wales, but we have a number of zones where demand is exceeding – or is forecast to exceed – available supply in drought conditions. This is complicated by the fact that Welsh Water has nearly half the industry's discrete water resource zones, which can mean that our ability to transfer water from one area to another can be limited.

Where we obtain our water from and our plans to manage the balance between supply and demand are set out in our draft 25-year water resource management plan, but this is to be republished following confirmation by the EA of substantial reductions in water abstraction from some rivers to comply with the Habitats Directive. In this plan we have to consider all the factors which could potentially impact upon either the availability of water supplies or the demands made on our resources. This also includes forecast changes in population, the amount of water we all use and the effects of climate change.

Water efficiency

We promote water efficiency through our 'Be Waterwise' campaign, through which we encourage customers to use water wisely and avoid waste - in the interests of both the environment and customers. Our core message is 'use as much drinking water as you need, but please don't waste it', and that small measures to save water can, when aggregated, help manage the effects of climate change and contain any increase in overall water consumption.

As part of the 'Be Waterwise' campaign we attend events and roadshows around our region, where we give customers advice and free water saving cistern devices called 'hippo-bags'. Information is also available via our website and publications on how to save water in the home and the garden. Water efficiency is a core theme in our education programme through schools and in the community (see page 30).

Climate change and carbon

The pattern of greater variability in weather conditions and more extreme weather events, which we have seen in each of the past three years, was repeated in 2009-10. Irrespective of whether this can be attributable to climate change, it is having a significant impact on our business. Last year saw failures at a number of small wastewater treatment works where problems have not been seen before, and we are investigating why variable weather conditions appear to be having more of an impact in some parts of our region than in others.

Treating and pumping water and wastewater across a large region of variable terrain makes Welsh Water a high energy user and one of the top carbon emitters in Wales. Each year there is an upward pressure on energy use arising from investment in new assets and in treatment processes required to meet higher drinking water quality and environmental standards. On a like for like basis, last year carbon emissions rose by under 1% to 252,760 tonnes of CO₂ equivalent (tCO₂), although a further 63,000tCO₂ needs to be added to total emissions following a change in the DEFRA Guidelines which no longer allow credits for electricity bought from good quality CH sources (often referred to as 'brown energy'). This shows how difficult it will be to meet our aim of reducing carbon emissions by 25% by 2015.

Reducing our carbon footprint

Welsh Water was one of seven organisations awarded the Carbon Trust Standard in 2009 after demonstrating our commitment to carbon reduction. The Carbon Trust commended the company's programme including the trialling of low carbon treatment, sustainable urban drainage schemes and surface water management, our investment in advanced sludge digestion and renewable energy generation, and a wide ranging energy efficiency programme.

80% of Welsh Water's carbon emissions relate to energy use, so control of energy costs has both financial and environmental benefits. After a review of the efficiency of the aeration process at our largest wastewater treatment works in Cardiff, the lessons learnt have been extended to five other works and, in the first full year of operation, this will save over six gigawatt hours of energy, or more than £300,000.

In 2009-10, Welsh Water increased its renewable energy generation by over 30% to 10.7MWh. This comes mainly from combined heat and power (CHP) schemes, which capture and burn 'waste' methane gas at 12 wastewater treatment works. But it also includes the first of our advanced digestion schemes - which convert wastewater sludge to electricity - being commissioned under a broader £110 million programme.

This is at Eign in Herefordshire, which has been generating power since October 2009. Two further schemes will be completed by Spring 2011 at our Cardiff and Afan works which, with Eign, will deliver around 35GWh of green energy.

Also in 2009-10

- » feasibility studies for 2 hydro-generation schemes were completed, for which we have set aside some £6 million over the next five years to provide micro hydro capacity at up to a dozen sites
- » small improvements in efficiency are important too, especially in such a large network of assets. At our wastewater works at Llanina in west Wales we invested £6,500 to replace a blower, saving £9,000 in operating costs each year. We monitor closely the operational and energy efficiency of all plant - replacing an inefficient pump, of which Welsh Water has many thousands, can save up to 20% in energy use.

Recycling waste

Each year Welsh Water uses some 200,000 tonnes of aggregate and needs to dispose of around 300,000 tonnes of excavation and construction waste. We signed up in 2008 to the government-sponsored WRAP Utility Industry Agreement, which promotes good practice to minimise the unnecessary use of virgin aggregate resources and the deposit of construction waste to landfill. We can report that in 2009-10 the proportion of waste we diverted from landfill - i.e. reused or recycled - increased to around 70%, and that less than 0.5% of the waste we send to landfill is hazardous. Our goal will be to maintain and, where possible, build on this level of performance in the coming five years.

MEETING CUSTOMERS' EXPECTATIONS

We want all our customers to feel confident that their water supply and sewerage services are well looked after.

Improving customer service

During 2010, Welsh Water is opening a new customer contact and operations centre in Cardiff, which will see the benefits of our five-year £100 million programme to update a number of key IT systems and working practices. Staff at the new centre will have more real-time information available to them, enabling us to deal with customer queries and problems more efficiently. Our aim is to get things right first time and give our customers a prompt and courteous response every time they contact us.

Last year we dealt with nearly 1.3 million telephone calls, slightly up on the previous year. Over 70% of the calls we get are from customers wanting to pay their bill or who have a bill or payment plan query, a quarter relate to water or sewerage services and the remaining calls relate to metering and new connection services. More customers are continuing to contact us as a result of the current difficult economic climate, and many calls are taking longer than in the past to deal with.

Mainly because of a single incident at Treharris, the total number of calls during the year that got an engaged tone because all staff were busy on another call rose to around 1%, from the more typical 0.3%. We have responded to this by bringing forward investment in a new telephony system which will come online in our new contact and operations centre in autumn 2010.

Helping customers pay their bill

Last year we introduced Welsh Water Assist - a new tariff designed to help households on low incomes and customers with particular needs. In its first year this new tariff capped the bill for over 8,000 eligible customers at £250.

A further 13,000 customers also took advantage of our other assistance tariff, Water Direct, which reduces the bill by £25 when customers opt to pay

their water bill by direct deduction from benefits. In addition, over 3,000 customers have so far benefited from our Customer Assistance Fund. This scheme is run with the assistance of the Citizens Advice Bureau to help customers who have fallen into arrears with their bills, and by 31 March 2010 the total value of this help provided had reached over £2 million. All our assistance tariffs are designed to be self funding.

Additional Services

Many of our customers may have other needs for which we offer a range of additional services. These include large print or Braille bills, bottled water during emergencies, a password scheme for home visits and a 'knock and wait' service for those who need a little more time to answer the door. At the end of the year 6,690 customers were registered for one or more of these additional services, significantly more than the year before.

Customer satisfaction

The industry regulator, Ofwat, carries out independent research into customer satisfaction with telephone call handling across the sector, and last year we again scored one of the best results in the industry - 4.72 out of 5 (up from 4.65). We also commission independent market research (Beaufort Research randomly select 1,000 customers twice a year) to track customer views and satisfaction levels on a range of issues and services, including satisfaction with drinking water quality, coastal environmental quality and how our customers judge Welsh Water's value for money when compared to other utilities. The latest research shows that satisfaction with drinking water quality remains high. Holden Pearmain also carries out quarterly research on how we deliver services to customers who have had reason to contact us with a problem. The output from these studies helps inform our strategies and target initiatives for the future.

Guaranteed Standards

All the water companies in England and Wales have to maintain certain minimum guaranteed standards, and compensation payments are made if those standards are not met. Last year, Welsh Water made 1,429 payments under the industry's guaranteed standards, nearly 50% fewer than the year before. 34% of payments related to missed appointments.

Customer complaints

In 2009-10 we received 13,313 written complaints, an increase of 5.6% on last year. Around two thirds of all complaints relate to billing issues (we now meter 485,000 customers compared to 314,000 five years ago), and 22% of complaints are now received by email – five years ago these were a rarity. Last year we responded to 99.6% of these written complaints within 10 working days, up from 99.3% the previous year.

We are targeting action to improve our performance at the nearly 50% of complaints which we judge as avoidable – where a customer has had to complain because we have not done what we promised to do or have not kept them informed. Most of the remaining complaints are about disputed bills, charging policy or our debt recovery activities.

The number of written complaints that had to be escalated to a Director because a customer was not happy with our first reply was around 5%, and the number of complaints investigated by the Consumer Council for Water Wales fell from 41 in 2008-09 to 10 this year.

EMPLOYER OF CHOICE

We want everyone who works for Welsh Water to recognise the importance of the job we do for the three million people who rely on us.

In 2009-10 the 220 people directly employed by Welsh Water were responsible for financial management, strategic asset planning and investment, managing regulatory issues and ensuring that our outsourced working arrangements delivered an efficient and high quality service to Welsh Water's customers. This changed in April and May 2010 when almost 1,600 staff who deliver day-to-day operations and maintenance services to customers, who were previously employed by UUOS and KWS, transferred to Welsh Water under the Transfer of Undertaking Regulations (for more information see page 7). Merging three teams with different cultures is an additional challenge for the company and ensuring that customer service and safety standards are maintained during this period of change is a top priority for us.

The final quarter of last year was committed to planning the transition for this major restructuring of the business, and included the appointment of a new leadership team reporting to the Directors. The new team covers some 20 key roles, of which a quarter has been filled by individuals from outside of Welsh Water and its service partners. The new structure is designed to ensure that we take full advantage of the operating systems and procedures introduced under our programme of IT-enabled change and will support our continued drive to improve service standards and efficiency still further - building on our strong track record since 2001.

There are some things that will not change under this new structure. Our focus stays firmly fixed on protecting public health, the environment and the occupational health and safety of those who work for us. Our culture will remain one in which all our people understand the vital purpose of Welsh Water and their role in achieving this purpose, where they feel they accomplish something worthwhile at work and regard Welsh Water as a good employer. These key messages were reinforced

by our Managing Director in a series of 20 roadshow events in March and April 2010, attended by 95% of all staff.

To meet the challenging efficiency targets set for the next five years, we will need to reduce the total number of people employed by Welsh Water by some 300. This will be achieved under our Working Together Agreement with the trade unions, the essential principles of which have remained in place since they were first established in the mid 1990's. Wherever possible, staff reduction will be achieved by a combination of retirement, natural movement and voluntary severance.

At the same time, we will maintain the progress of recent years through continued investment in operator training and management development training. We will continue our graduate recruitment programme through which we aim to attract potential leaders for the future with appropriate skills in engineering and scientific disciplines. To achieve this, we have further strengthened our ties with a number of universities to enable us to attract strong candidates from the disciplines we most need.

Asset Management Alliance

For the past five years, the Welsh Water Asset Management Alliance (AMA), which includes Welsh Water and its capital investment and other service partners, has set a high standard in partnership working - and we will not lose this under our new structure. We will continue to take a collaborative approach with all parties working together to deliver a common set of business objectives. The AMA supports these objectives by promoting a safe and stimulating working environment for our staff, by focusing on continuous improvement to deliver the right balance of 'best in class' and value of money customer service, and by promoting Welsh Water as a credible and responsible business in terms of our impact on the environment.

Health and safety

In the past five years we have reduced the number of reportable accidents by 15% and we have one of the best safety records in the sector. But 2009-10 was disappointing because performance slipped, although the number of non-reportable accidents reduced to 7,289 (2008-09 7,898). Last year, there were 39 reportable accidents. Returning to an improving trend is our priority for next year.

We operate a 'Journey to Zero' strategy and a no-blame safety culture, which encourages near-hit reporting - an event that could have caused injury to staff but which did not on this occasion - so that lessons for continuous improvement can be taken on board. We keep the focus of staff across the business on occupational health and safety through a risk-based programme. In 2009-10 this involved delivering 171 local improvement plans, which focus on the major risks in each part of the business and which are overseen by managers who hold a NEBOSH (National Examination Board in Occupational Safety and Health) accredited health and safety qualification. This strategy and approach has not changed under our new structure.

We have maintained our certification to the OHSAS (Occupational Health and Safety Advisory Services) 18001 2007 international standard for occupational health and safety management with an extended scope of service. Through a new system introduced last year the health and safety performance of all main contractors and sub-contractors is immediately visible to Welsh Water, including the results of independent audits conducted on our behalf. In 2009-10, six partners were audited under an externally awarded contract which audits all partners at least once in every three years. In addition there were over 40 reviews under Welsh Water's programme of cross-audit in which contract partners audit each other to share best practice and drive improvement - there have been 280 of these reviews since 2001. Last year, Welsh Water's annual health and safety conference was attended by over 300 staff from across the AMA, when three health and safety awards were issued and staff were able to gain from the experience of prominent independent speakers.

Further details of our health and safety performance and approach are available in our '2010 Health and Safety Report' which is available on our website.

RESPONSIBLE BUSINESS

We are committed to being a good neighbour and a trusted partner in the communities we serve.

Managing our community assets

We are the custodian of a national asset in Wales - some 40,000 hectares of scenic land that is rich in both biodiversity and heritage. This land base also provides significant opportunity for public recreation, and each year almost a million people visit one of the 17 major reservoir sites where we provide a variety of sporting, recreational and leisure resources. This makes a valuable contribution to tourism and the local economy, and encourages public health and well being.

We encourage conservation best practice across the business. A good example of this is at Talybont in Powys, where in 2009 we commissioned a £17 million refurbishment of our treatment works and where staff in our graduate development programme are working with the Brecon Beacons National Park to provide a new wetland and wildflower conservation area. This followed a review of the site-specific habitat and species plan which we implement at all our major reservoirs, and gave Welsh Water the opportunity to support the delivery of the biodiversity action plans of the National Park.

Minimising the impact of our activities

We cannot deliver essential water and sewerage services without having to dig up roads to lay and refurbish pipes, have materials delivered to our construction sites or have waste removed from our treatment works. It is pleasing therefore that a number of our schemes have received an award under the National Considerate Construction Scheme where our arrangements for public safety and community impact and liaison are independently assessed. It is always the aim of Welsh Water to minimise the disruptive impact of our activities.

Supporting education

Last year was another successful year for our education service, with some 21,000 primary school children taking part in our education activities under our Living and Learning with Water programme, and almost 12,000 children visited one of our four education centres, down slightly because of the poor weather last year. These 'hands on' lessons, provided free of charge and designed and delivered by qualified teachers, are aimed at pupils from 7-11 years old and cover different aspects of science, geography, history and sustainable development. Lessons are backed up by our education website (www.livingandlearningwithwater.com) where teachers can download materials and information to support them in the classroom.

The range of free education resources was extended last year with the launch of a new education pack for GCSE and BTEC students of applied science. Designed in collaboration with science teachers from across Wales to fit closely with the curriculum, the new resource provides students with an insight into how science is used in the workplace and where there are opportunities for science-based employment.

Our peripatetic community programme delivers vital messages on water conservation and public safety to the wider community and to schools and community groups unable to visit one of our centres. In the last academic year, this service delivered 85 community-based sessions, reaching some 9,000 additional young people and adult learners, including events supported by the Hereford Waterworks Museum and the National Botanical Gardens, two of Welsh Water's six education partners.

Over 1,600 schools in our region are registered with Eco-Schools (who are also an education partner), for who we sponsor a 'water efficiency award' Working with Eco-Schools we encourage water efficiency by

- » issuing water efficiency packs
- » providing advice through the Eco-Schools handbook and website

At schools where trials have been conducted, it has been demonstrated that involving schoolchildren in water efficiency measures and the adoption of water efficient devices can reduce metered consumption by up to 40% in both primary and secondary schools

Over 100 teacher placement students in their final year at UWIC (Cardiff) spent two days at Cog Moors Living and Learning with Water Centre finding out

about the delivery of environmental education and the resources that will be available when they secure teaching positions in the future In addition, last year 90 teachers attended environmental education awareness events at one of Welsh Water's four centres

Supporting community projects

As befits our 'not-for-profit' business model, we do not engage in corporate sponsorship Instead we focus on supporting staff in community schemes Through a 'World of Work' scheme our staff provide business mentoring and interview support for young people about to leave school and, under our management development programme, staff take part in a volunteer project to enhance their skills and help the local community

Supported by Business in the Community's 'Cares Scheme', 12 staff tackled an environmental project at Treforest Wholefood Association, a social enterprise committed to educating and training people in sustainable horticulture, including groups of excluded 16-18 year-olds, unemployed and school children This involved staff in planning, financing and helping to restore and conserve a community allotment and local pond habitat

WaterAid

We support WaterAid, the international charity, which brings sustainable water and sanitation schemes and hygiene education to some of the world's poorest communities in Africa and Asia Last year staff at Welsh Water raised almost £130,000 for the charity

FINANCIAL REVIEW

The Board considers that maintaining gearing at around 70% will provide best value for money for customers, balancing the cost of funding the business with continued investment in important projects to improve customer service, drinking water quality and the environment.

While Glas Cymru has not been immune to the impact of the recent economic recession, we have delivered a sound financial performance during the year to 31 March 2010. However, achievement of Ofwat's Final Determination for 2010 to 2015 is a big challenge and, as a result, we are making a major change to our business operations.

Appointed revenue has grown due to regulatory price increases which support our extensive capital investment and the delivery of better customer service, after taking into account the 'customer dividend' of £22 per customer. Operational expenditure (before exceptional items) has fallen due to lower power costs, partly offset by an increase in the bad debt charge.

Capital investment in our regulated water and wastewater operations, including infrastructure renewals expenditure ('IRE'), amounted to £361 million during the year. This is 2% higher than last year, and represents a record level of investment spend for Glas Cymru.

Revenue

Glas Cymru's turnover in the year to 31 March 2010 was £688 million (2009: £657 million), an increase of 4.7% on last year. This increase primarily reflects the price increase of 5.4%, however our 'customer dividend' policy means that our total charges were some £28 million lower than if we had applied the full price increase determined by Ofwat (2009: £27 million lower). Additional revenue from new customers has been offset by household customers switching to metered charging.

Our unique range of customer assistance tariffs has continued to help support customers who have difficulty paying their bills. By 31 March 2010, some 27,000 customers were benefiting from one of these tariffs.

Operating expenditure

Glas Cymru's total operational costs (excluding IRE and depreciation and before exceptional items) were £266 million (2009: £267 million), lower power costs being offset by an increase in the provision for bad debts.

In the years to 31 March 2010, around two thirds of operational costs related to outsourced service contracts. The major contracts were with UUOS (for the operation of the water network and the wastewater network in North Wales) and with KWS (for the operation of the wastewater network in South Wales and Herefordshire). These contracts included a target cost mechanism aimed at enhancing operating efficiency to the end of the AMP4 regulatory period in 2010.

All water and sewerage companies need to draw on significant energy resources, particularly for water treatment and pumping processes, and Welsh Water – with its network spread across Wales's undulating topography – is no exception. This year we have experienced reductions in energy prices which have seen power costs fall by around 20% to £35 million (2009: £43 million).

Customer debt recovery remains a high priority for Welsh Water and our billing and income contract partner, Veolia Water. In a challenging economic environment, in which water companies have no sanction to disconnect supplies to non-paying domestic customers, cash collection has continued to be challenging. The bad debt charge for the year of £22 million (2009: £19 million) represents around 3% of annual turnover (2009: 3%), and reflects an increase in the provision based on a review of historical collections and having regard to the deterioration experienced, particularly during the first half of the year.

IRE has fallen by some 24% on the prior year, the lower charge reflecting the completion of the Section 19 programme.

which has resulted in the refurbishment of 1,800km of trunk mains over the course of the five years to March 2010

Exceptional operational expenditure

On 9 February 2010 it was announced that Welsh Water was to undertake the biggest restructuring of the company since it was bought by Glas Cymru and became a 'not-for-profit' company – to meet the toughest efficiency targets the company has ever faced

The price limits for the next five years, set last November by Ofwat, will allow Welsh Water to invest £1.2 billion in water quality and other improvements. But Welsh Water must also reduce its day-to-day operating costs by some 20% to enable the average household bill to fall by £30 before inflation.

Since 2001, UUOS and then also KWS have helped us to cut our operating costs by more than any other water and sewerage company in the regulated water industry in England and Wales. But in order to deliver the price reductions required over the next five years we must make a further step change in our cost efficiency.

Over the past year we have had lengthy discussions with UUOS and KWS through the five-yearly price and performance review of the contracts we undertook with both companies. We recognise and appreciate the considerable efforts made by both companies to meet our requirements. However, it did not prove possible to reach agreement with either company in relation to the terms for a continuation of those contracts for a further five years.

In light of this, we reached agreement with both UUOS and KWS that their staff would transfer to Welsh Water. On 1 April 2010, 1,093 UUOS employees transferred, followed by 476 KWS employees on 1 May 2010.

We have also announced, as part of the drive to cut our operating costs by 20%, a phased reduction, over the next five years, of around 300 in the number of people required to deliver water and wastewater services to Welsh Water's customers. We are working closely with staff and our trade union colleagues and intend to achieve this through a combination of retirements, natural staff turnover and voluntary severance.

Net debt and reserves

As at 31 March	2010 £m	2009 £m
Regulatory Capital Value (RCV)	3,737	3,626
Net debt	(2,669)	(2,625)
'Reserves' (RCV less net debt)	1,068	1,001
Gearing (net debt/RCV)		
Senior debt	68%	69%
Senior debt + class C bonds	71%	72%
Total debt	71%	72%

Included in the 2009-10 results are exceptional items totalling £30 million. These provide for the costs of terminating the UUOS and KWS contracts and for the estimated severance pay and pension top-up required to achieve our planned headcount reduction. These are necessary enabling costs which will help us to create the efficiencies required to meet Ofwat's challenging target.

Financing costs

Net interest payable (excluding loss on derivatives) of £98 million is £68 million lower than last year. The impact of lower interest rates has been combined with an indexation credit in respect of the group's index-linked bonds (calculated using July 2008 to July 2009 RPI). The average cost of debt during the period was 3.7% (2009 6.6%).

In response to the crisis in the banking markets, the Company tightened its criteria for investing cash deposits such that maximum deposits with any single counterparty were reduced and the maximum term limited to 3 months. Consequently, the average interest receivable rate has fallen from 3.9% to 0.4% and remains below the average 3 month LIBOR over the same period (which fell from 4.4% to 0.8%).

Glas Cymru has a number of swap contracts and, while these are effective commercial hedges, they do not qualify for hedge accounting under IAS 39. Although there is no impact on cash flows, there is significant volatility in the income statement and fair value losses in 2009-10 amounted to £15 million (2009 £87 million). This has resulted in a total liability of £173 million in the balance sheet but, assuming that the swaps are held to maturity, this will ultimately reduce to nil.

Profit before taxation and 'customer dividend'

Excluding fair value movements and exceptional items, the profit before tax was £107 million (2009 loss before tax of £11 million). This profit was made after funding the 'customer dividend' of £22 for all customers receiving both water and wastewater services, at a total of £28 million (2009 £21 per customer, totalling £27 million). Since 2003, 'customer dividends' have totalled some £152 million.

Taxation

The taxation credit for the year of £2 million comprises a current year deferred tax charge of £16 million, offset by a prior year tax credit of £18 million. The prior year tax credit is principally due to the agreement of tax allowances on the Company's water mains refurbishment programme. The group has tax trading losses carried forward of approximately £288 million, which the group believes should be sufficient to eliminate tax on trading profits in the five years ending 31 March 2015, subject to any changes in tax law.

Liquidity

Glas Cymru aims to offer a secure, low risk investment to long-term investors. By building and maintaining a strong financial position, we intend to keep our borrowing costs low, enabling us to finance future investment in the business efficiently, whilst retaining the scope to return money to our customers and keep bills affordable.

The company had strong liquidity as at 31 March 2010 - cash balances of £249 million, together with an undrawn European Investment Bank ('EIB') facility of £75 million and undrawn revolving credit facilities of £345 million. The cash balances include the proceeds of the £140 million index-linked bond issue on 31 March 2010.

On 7 May 2010, in view of the very high level of available liquidity (£669 million), the level of undrawn revolving credit facilities was reduced to £100 million and on 3 June 2010 the Group agreed to repurchase £113 million of Class C1 bonds following a tender offer to bond holders. The amount repurchased represents a take-up of 90% and settlement will be made in cash on 7 June 2010.

Gearing and financial reserves

On Glas Cymru's acquisition of Welsh Water in May 2001, gearing stood at 93%. Since then, its financial position has improved steadily, such that gearing had fallen to 71% as at 31 March 2010 and 'financial reserves' (RCV less net debt) were almost £1.1 billion.

Credit ratings and bond spreads

The strong credit quality of the business is reflected in credit ratings which are now the highest in the water sector, despite a very challenging Final Determination. On 8 March 2010 Standard & Poor's placed Glas Cymru's ratings on negative outlook, reflecting their assessment of the potential impact of Ofwat's Final Determination following the 2009 Price Review.

There has been a significant downward reduction in the spread differential to Government gilts during the year across the water sector, reflecting an easing of the difficult credit conditions over the last year. Glas Cymru bonds continue to trade at spread differentials generally below those of equivalent water sector bonds of similar maturities.

Debt financing and interest rate management

Despite difficult conditions in the borrowing and capital markets, on 31 March 2010 Glas Cymru issued £140 million of 2048 index-linked series B bonds. A further £35 million of funding, provided by KfW bank, was drawn on 15 December 2009.

To protect Glas Cymru's high credit quality, the Board has always adopted prudent financial policies, predominantly covering the fixing of interest rates and the investment of cash balances. Glas Cymru's policy is to minimise its exposure to movements in market rates, with a minimum of 85% of its liabilities being fixed rate, index-linked to the UK Retail Price Index ('RPI') or matched by cash balances. The Board considers that linking debt to UK RPI inflation is particularly appropriate, as Welsh Water's revenues and Regulatory Capital Value are also linked to RPI through the regulatory system operated by Ofwat. Implementation of the policies is delegated to a small team of specialists which operates to ensure that Welsh Water meets the requirements of its licence, and therefore undertakes no speculative trading. As at 31 March 2010, approximately 60% of gross debt was index-linked via bonds and derivatives (2009 58%).

The expected maturity of the outstanding fixed rate and index-linked bonds ranges from 2011 to 2057, with not more than 20% falling due in any two year period, in accordance with our refinancing policy.

Capital investment

Glas Cymru's strong financial position has been built up over the last eight years, and provides a stable base from which it can respond positively to the challenges of the recent economic recession and

drive forward its largest ever capital programme. Over £1.5 billion has been invested since April 2005, bringing sustained improvements to customer service, drinking water quality and the environment.

Total capital expenditure by Welsh Water during the year (including IRE) was a record £361 million (2009 £355 million), bringing the total expenditure over the five year AMP4 period to £1,521 million. Welsh Water works with an alliance of capital investment partners to deliver the investment programme at the best value for money for customers. Welsh Water is planning to invest some £1.2 billion over the next AMP period which will run from 2010 to 2015.

Looking ahead

The Board's policy is to reduce gearing to around 70%, and maintain it at around this level. A key part of our strategy is to minimise customer bills in the long term, and the Board judges that this level of gearing will enable the company to efficiently fund the AMP5 investment programme which will run to 2015.

Ofwat has set us an efficiency target of a reduction of some 20 per cent in our day to day running costs. In addition to the headcount reduction, we will do this by exploiting our recent large investment in new technology, by eliminating the profit element, overhead and contract management costs of the previously

outsourced services, and by investing in 'green energy' and processes to reduce power costs. This involves considerable expenditure by the Company and forms part of our planned £1.2 billion investment programme to improve services over the next five years. In the face of these major changes, our priority will remain the essential task of guaranteeing safe and reliable services for all our customers, as well as safeguarding the environment.

Disclaimer

This report contains certain forward looking statements with respect to the future business 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.

Key characteristics of the bonds currently in issue

Bond class	Nominal (on issue) £m	Interest rate (on issue)	Interest basis	Expected maturity	Legal maturity
A1	350	6.015%	Fixed rate	31 March 2028	31 March 2028
A4	330	3.514%	Index-linked	31 March 2030	31 March 2030
A5	107	3.512%	Index-linked	31 March 2031	31 March 2031
A6*	100	4.473%	Fixed rate	31 March 2057	31 March 2057
B1	325	6.907%	Fixed rate	31 March 2021	31 March 2021
B3	160	4.377%	Index-linked	31 March 2026	31 March 2026
B4	95	4.375%	Index-linked	31 March 2027	31 March 2027
B5	55	1.375%	Index-linked	31 March 2057	31 March 2057
C1**	140	8.174%	Fixed rate	31 March 2011	31 March 2036

Bonds issued by Dŵr Cymru (Financing) Limited. For full details of bonds refer to Prospectus dated 19 March 2010, available on our website www.dwrwymru.com

* Swapped to an effective index-linked rate of 1.35%

** On 7 June 2010 following a formal tender offer, Dŵr Cymru (Financing) Limited redeemed £112.9 million of the Class C1 bonds.

Credit ratings of Glas Cymru bonds

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

The ratings of the Class A bonds, which have the benefit of a financial guarantee from MBIA, are the higher of the underlying ratings of these bonds (A3/A/A) and the ratings of MBIA (BB+/B3/-).

PLANNING FOR THE FUTURE

The investment decisions we make today will be felt for decades to come.

Every five years Ofwat carries out a periodic price review, and in December 2009 Ofwat made its Final Determination setting the price limits and investment programme which Welsh Water will be required to deliver in the next five years, from April 2010 to March 2015

Customer bills and investment

Much of what Welsh Water does to deliver a high quality and reliable customer service every day of the year involves operating and maintaining a large network of often very long-life assets - reservoirs, treatment works, pumping stations, mains and sewers. The performance of the network is key to the service we give our customers as well as our ability to protect the environment from pollution. The key discussion, therefore, with our economic and quality regulators during the periodic price review was the trade-off between investment in our network of assets and customer affordability.

Under Ofwat's Final Determination, the average customer bill for water and sewerage services in the Welsh Water region will have fallen by £30 (before inflation) by March 2015. Ofwat also confirmed the capital investment programme Welsh Water will be required to deliver by March 2015, which at £1.2 billion is about the same size as the programme for the last five years. This has struck a good balance between affordability on the one hand and quality and reliability of service on the other, one we believe our customers will recognise as good value for money.

What we will deliver between 2010 and 2015

Nearly all of the critical investment we set out in our Final Business Plan for 2010-15, which we regarded as necessary to protect public health and the environment in the region we serve, has been confirmed in Ofwat's Final Determination. This will enable us to begin to make progress towards the goals set out in 'Our Sustainable Future',

published in 2007, which set out our long-term vision for the water industry in our region.

- » **Protecting public health**
Our biggest responsibility is to provide a safe and reliable drinking water supply to our customers at all times. In the next five years we plan to improve facilities at 26 water treatment sites to deal with deteriorating source water quality and other risks to the quality of drinking water identified in our Drinking Water Safety Plans.
- » **Safeguarding the environment**
In the next five years we are targeting a significant reduction in flooding and pollution incidents caused by breakdowns on our sewer network, plus additional treatment stages at various wastewater sites to protect river and coastal water quality.
- » **Responding to climate change**
Work is already well advanced on advanced sludge digestion schemes at three wastewater sites by which, with improved energy efficiency, we are seeking to achieve a 25% reduction in our 'carbon footprint' by 2015. Through our Green Space Wales strategy in the next five years, we will also invest in sustainable urban drainage schemes to reduce the risk of flooding from overloaded sewers, providing added protection in locations at most risk of flooding.
- » **Meeting our customers' expectations**
In autumn 2010, we will be opening our new customer service and operational control centre in Cardiff, where the latest technology delivered under our £100 million programme of IT-enabled change will make it possible to anticipate service failures and improve customer service by giving first-time resolution to daily problems. The new centre will also improve our ability to respond to the need for infrastructure to supply new housing and to support economic development.

» Looking after our assets

Our priorities and long-term investment decisions are determined using our Strategic Investment Planning System. The priorities of Welsh Water are reviewed and updated annually.

» Financing the business

We are targeting gearing at around 70% and an 'A grade' corporate rating to help drive down the level of customer bills, which we will achieve by continuing with our financing strategy (see page 36).

» Employer of choice

In the final quarter of 2009-10, we announced we would bring the people who deliver water and sewerage services into the direct employment of Welsh Water – which was successfully completed on 1 May 2010. Our priority for the next five years is to invest in the training and development of this highly skilled team of people, who are committed to high quality customer care and looking after our industry for future generations.

» Affordability and value for money

Affordability will always be a top priority for Welsh Water. In 2001 Welsh Water's average bill was the second highest in the industry, but now it is close to the UK average bill. By March 2015 it will be £30 lower than March 2010, following Ofwat's Final Determination. We will continue to address affordability through one of the widest range of tariffs and schemes available in the industry designed to help our least well-off customers.

MANAGING RISK

Glas Cymru cannot diversify into non-core activities, but otherwise we face the same risks as any other company in the UK utility sector.

It is a key principle of our business model that Glas Cymru cannot diversify into activities unrelated to the water and sewerage business in the region served by Welsh Water. This ensures we cannot be distracted from the single purpose for which Glas Cymru was established and also serves to contain the range of risks that we face. Many of the risk factors affecting the Company are business risks which can be mitigated by ensuring that appropriate controls are in place. However, the Company is affected by many risks outside our control which could have a material effect on our long-term performance. No company is insulated from the impact of economic recession, climate change or of a changing regulatory environment. The most important risks facing Welsh Water are described below.

Business Operations Changes

Following the decision to end arrangements for the outsourcing of the day-to-day operation and maintenance of our network of water and sewerage assets, the proportion of annual operating and capital expenditure that will be undertaken by service partners working for Welsh Water under contract through competitive tender has been significantly reduced. However, significant outsourced contracts remain in place for the design and construction of major capital investment schemes, for ICT and for customer contact and billing.

The above change was the Board's response to meeting the challenges set by a very tough price review. The move to these new arrangements involved a period of additional uncertainty and risks and arrangements were put in place to ensure that public health, staff safety, customer service and environmental performance standards did not fall. This included detailed and audited transition project plans and governance, and the successful closure of the previously outsourced contracts which enabled the TUPE transfer of staff to be completed for UUOS and KWS on 1 April 2010 and 1 May 2010, respectively. There was limited additional risk associated with the management of business systems and data as operating partners had always used Welsh Water's core systems and processes.

Regulatory risk

Regulatory risk can arise from Ofwat's price control determinations, from the requirement to comply with Ofwat's extensive data requirements and more generally from changes in the regulatory environment. The changing nature of regulatory risk was illustrated in the 2009 regulatory price review in which Welsh Water was subject to a shortfall adjustment of £12 million for failing, by only a small margin, one of the asset serviceability standards set retrospectively by Ofwat for 2005-10. In the period 2010-15 Ofwat will assess the water industry against 20 standards of serviceability.

Ofwat's Final Determination of price limits for the period 2010-15 is one of the most challenging Welsh Water has been set since privatisation – and we have the toughest efficiency targets in the sector. Furthermore, Ofwat's cost assumptions for the sector are based on benign economic conditions in which, for example, power prices and bad debts are no higher than they were in 2008-09.

Welsh Water aims to achieve this cost reduction by

- » exploiting recent large investment in new technology
- » eliminating duplication in management
- » investing in green energy processes to reduce power costs
- » a phased reduction over the next five years of around 300 in the number of staff required to deliver water and wastewater services, to be achieved by a combination of retirement, natural staff turnover and voluntary severance.

The net effect of the price review is that the Company's financial plans will be subject to greater uncertainty and so the company has decided to pursue a prudent approach to issues such as the 'customer dividend' until that uncertainty is resolved.

One significant regulatory risk was removed in December 2009 when the European Court of Justice determined that stretches of the north east Irish Sea would not be designated as 'sensitive waters' under the Urban Wastewater Treatment Directive. This means that Welsh Water will not have to extend coastal wastewater treatment works, avoiding the need for substantial significant investment.

A number of other regulatory risks remain. The expected transfer of private sewers to Welsh Water will increase our sewer network by more than 70%, and we judge that the condition of these private sewers is poor – below the standard of assets that the industry is generally required to operate. The Welsh Assembly Government has indicated that this transfer will take place sometime after April 2011.

The EA has indicated that Welsh Water should plan for major reductions in the volumes of water we abstract from a number of rivers, mostly in South Wales, in order to comply with the EU Habitats Directive.

These potential changes to our obligations, which together could require a very large increase in investment expenditure, are not included in our investment programme for 2010-15 and, if confirmed, may fall to be funded through an 'interim determination' of price limits or 'logged up' to be taken into account at a subsequent price review

Welsh Water has to provide extensive data to regulators each year in respect of all aspects of our business. Failure to provide reliable, accurate and complete data would trigger regulatory sanctions and fines, and all regulatory data is subject to significant independent scrutiny and due diligence. In 2008, our process of data collation and verification was accredited to ISO 9001:2000, and this accreditation has been retained with an extended scope of service.

Ofwat has a duty to promote competition where it judges it to be in the best interests of customers, and in 2009 judicial clarification was given on an important point of principle following Ofwat's grant of an inset appointment – the appointment of a new company to supply water and sewerage services to a specific area – to a new entrant in the water industry.

Ofwat's proposal that the industry accounts for each element in the 'value chain' separately, as a possible precursor to legal separation of distinct activities, would require changes to the current legal framework. The Welsh Assembly Government has indicated it will consult on the conclusions of the Cave Review of competition in water markets. Some of the Review's conclusions would, if adopted, lead to a change in the structure of the industry and have serious implications for the Company. The competitive market in Wales is currently limited to business customers using more than 250 megalitres of water per annum (50 megalitres in England) – of which Welsh Water has some 120 customers who account for around 4% of total turnover.

Operational risk

We have reassessed operational risk following the experience of the last few years where we have experienced more extreme patterns of weather, particularly storms and periods of prolonged freezing conditions. Wales is currently one of the least constrained parts of the UK in terms of water resources (subject to the regulatory risk to abstraction licence review referred to above), but customers in our region are not immune from the effects of periods of drought.

More generally, 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 – such as 'acts of God' or more extreme weather events as a possible consequence of climate change
- » changes in environmental, consumer protection and public health and safety law and regulation, which typically require ever higher standards of performance
- » the health and safety risk associated with the operation of a large and complicated network of water and sewerage assets
- » the risk of losing and failing to recruit key people in Welsh Water to ensure we have the competencies and experience needed to meet our long-term obligations
- » the changes associated with our programme of IT-enabled change which is upgrading old IT systems and introducing simplified and more robust business processes

The Board has approved policies and operational strategies to mitigate each of the risks to the reputation, operating results and financial position of Welsh Water. Business risk is also mitigated by the availability and terms of insurance – covering property, business interruption, public liability, environmental pollution and employer's liability.

Financial risk

Welsh Water is exposed to a number of financial risks, many of which are heightened at a time of economic recession. These include

- » revenue risk, such as a reduction in metered demand and the loss of large business customers
- » the collection of customer charges and non-recovery of customer debt
- » external cost pressures, such as changes in the price of chemicals or power pricing
- » deflation and the impact on both revenues and regulatory asset value from a negative Retail Prices Index
- » access to capital markets while the business needs to finance a continuing large capital investment programme and to refinance some existing debts

The overall financial risk is that Glas Cymru 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 – in other words, customers' bills – and the raising of finance from the capital markets. Under our funding arrangement we are required to ensure that the business has sufficient committed facilities available to meet at least 12 months anticipated net cash requirement.

Financial risk is mitigated in three ways

- » the group's financial position at 31 March 2010 shows a significant balance of cash and undrawn borrowing facilities available, which gives the business a high degree of liquidity
- » following the successful £140 million bond issue in March 2010, Welsh Water has funding for its investment programme for substantially the whole of the next five-year regulatory period
- » the impact of deflation is mitigated by the high proportion of index-linked debt issued by the Company

DEFINITION, PURPOSE AND TARGET FOR EACH KPI

Each year we report on Welsh Water's performance against a wide range of measures. From this wide range of measures the Board identified eight key performance indicators for the regulatory period 2005-10 (KPIs) to measure the overall success of the business and the progress of its key strategies.

These strategies are designed to deliver long-term financing efficiency and improve customer service, while always ensuring that everyone who works for us is able to return home safely at the end of each day.

Measure	Purpose	Source/Target	Performance	Progress in 2009-10
Overall bacteriological water quality Strategy: Customer service	An important measure of the quality of water supplied to customers is compliance with bacteriological standards. There is also a correlation between failures in bacteriological quality and unsatisfactory water supplied to customers.	Drinking Water Inspectorate Target: 100%	Compliance was 99.77% in 2009	✓
Customer satisfaction Strategy: Customer service	The Board monitors customer satisfaction with the services provided by Welsh Water via a six monthly research undertaken by Beaufort Research. Although customer opinion can be influenced (often adversely) by media coverage of events elsewhere in the industry, this is an important indicator of the Company's progress.	Independent survey by Beaufort Research Target: To maintain consistent high level of customer satisfaction	Customer satisfaction levels were maintained in 2009-10	✓
Accident Incident Rate (AIR) Strategy: Occupational health and safety	AIR is a statistical index used by the Health and Safety Executive (HSE) to benchmark company and sector relative performance. It is the number of reportable incidents occurring in a reported period per 100,000 employees.	June Return Target: To have one of the best AIR in the UK water and sewerage sector and to compare favourably with appropriate HSE benchmarks	AIR increased from 700 to 805 in 2009-10	✗
Bond credit rating Strategy: Financing	A direct way of further reducing Welsh Water's financing cost is to improve the credit rating of the group's corporate bonds. Executive Directors are penalised for failure to maintain bond ratings.	Moody's, Standard & Poor's and Fitch Ratings apply their own definition and methodology in assessing bond credit rating. Target: Corporate credit rating of 'A' grade	Glas Cymru bonds are rated by Moody's, S&P and Fitch as A3/A/A respectively	✓
AMP4 Customer Dividend Strategy: Customer value	As well as improving credit quality, financing efficiency has been used to build up reserves to insulate Welsh Water and its customers from unexpected costs. Through the 'customer dividend', customers have shared in the success of the business in AMP4.	Glas Cymru Audited Accounts. Target for AMP4: Progressive 'customer dividend'	In 2009-10 the 'customer dividend' was increased to £22 per customer (2008-09: £21)	✓
Gearing Strategy: Financing	Glas Cymru's business model aims to reduce Welsh Water's asset financing cost – and maintaining strong credit quality is key to achieving this objective. Gearing is the ratio of Net Debt to Regulatory Capital Value of Welsh Water.	Glas Cymru Investor Report. Target: To reduce gearing to around 70%	At 31 March 2010 gearing was 71% (2009: 72%)	✓
Interest cover Strategy: Financing	Meeting interest cover covenants is key to maintaining investor confidence and to keeping Welsh Water's cost of finance as low as possible. Interest cover is the ratio of operating cashflow (before maintenance) to net interest (excluding indexation).	Glas Cymru Investor Report. Target: To maintain interest cover consistent with target credit rating	Senior interest cover at 31 March 2010 was 4.5 (trigger level: 2.0)	✓
Overall Performance Assessment (OPA) Strategy: Customer service	OPA is a measure used by Ofwat to assess each company's overall delivery of service to customers. It reflects a broad range of services across key areas of water supply, sewerage service, security of supply, customer service and environmental impact.	Ofwat. Target: Upper quartile performance relative to the ten water and sewerage companies in England and Wales. 2009-10 is the final year for which Ofwat will publish OPA data	We will not know if this has been achieved until Ofwat publishes OPA data in Autumn 2010. Estimated score for 2009-10 is 404 points (2008-09: 406)	-

The measures of performance reported on page 7 derive from Welsh Water's annual regulatory report to Ofwat (the 'June Return') and are measures defined and monitored by Ofwat, the Drinking Water Inspectorate or the Environment Agency. An Overview of the latest June Return is available on request or from our website www.dwrcymru.com. The Board will select a new set of key performance indicators for the regulatory period 2010-15.

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THE DIRECTORS

Full colour version available from our website dwrcymru.com

Lord Burns Chairman ^(N)

Appointed in July 2000, Lord Burns (66) will stand down as Chairman after the Company's AGM in July 2010. He is chairman of Abbey National Plc, Alliance & Leicester Plc and of Channel 4 Television Corporation, and a Non-Executive director of Banco Santander and Pearson Group Plc. Formerly he was Chairman of the National Lottery Commission and of Marks and Spencer Group Plc, and a Non-Executive Director of Legal & General Group Plc and The British Land Company Plc. A former Chief Economic Adviser and Permanent Secretary to HM Treasury, he was made a life peer in 1998.

Nigel Annett Managing Director ^{(M)(O)}

Appointed Managing Director in January 2005, Mr Annett (51) 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 (46) 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. He is a Non-Executive Director of the Principality Building Society and Deputy Chairman of The Prince's Trust - Cymru.

Peter Perry Operations Director ^(O)

Appointed Operations Director in July 2006, Mr Perry (48) has a civil engineering background and was formerly the Chief Operating Officer for United Utilities Operational Services (UUOS), having previously been the Operations Director for UUOS with responsibility for the operational contract with Welsh Water. Earlier in his career he worked for Dŵr Cymru (Welsh Water) for over 17 years. He is also a Director (representing Wales) at The Water Regulations Advisory Service, the national body specifying standards for materials and workmanship used in potable water supply.

Dame Deirdre Hine Non-Executive Director ^{(N)(O)(R)}

Appointed a Non-Executive Director in March 2001, Dame Deirdre (72) is Chairman of the BUPA Foundation, Chairman of the Public Inquiry into the outbreak of Clostridium difficile in hospitals in Northern Ireland and President of the Royal Medical Benevolent Fund. She is a past President of the British Medical Association and The Royal Society of Medicine, a former Chairman of the Commission for Health Improvement, and a former Chief Medical Officer for Wales. Dame Deirdre was awarded the DBE in 1996 for services to medicine.

Tony Hobson Non-Executive Director ^{(N)(A)(R)}

Appointed a Non-Executive Director in February 2001, Mr Hobson (62) is the Chairman of The Sage Group Plc and Northern Foods Plc, and of Changing Faces – the UK charity that supports people who have disfigurements of the face or body. A Chartered Accountant, he was previously Group Finance Director of Legal & General Group Plc for fifteen years until his retirement in 2001.

James Strachan Non-Executive Director ^{(N)(A)(R)}

Appointed a Non-Executive Director in June 2007, Mr Strachan (56) is a Non-Executive Director of Legal & General Group Plc, JP Morgan Asian Investment Trust, the Financial Services Authority, Sarasin and Partners LLP and Social Finance Limited. He is a Visiting Fellow in risk and regulation at LSE. Former roles include Chairman of the Audit Commission, a Non-Executive Director of the Bank of England, and of Care UK Plc, a Board member of Ofgem (the energy regulator), chairman of the charity RNID and Managing Director of Merrill Lynch.

Bob Ayling Chairman Designate ^{(M)(O)(R)}

Appointed a Non-Executive Director in April 2008, Mr Ayling (63) will become Chairman of Glas Cymru after the Company's AGM in July 2010. He is also Chairman of Dyson Limited and of the International Dispute Resolution Centre. A solicitor by profession, with 20 years in the City of London and as a senior government legal advisor at the Department of Trade and Industry, he was Managing Director and Chief Executive of British Airways plc from 1993 to 2000. He is also a former Chairman of Holidaybreak Plc and non-Executive Director of Royal & Sun Alliance Insurance Group.

John BryantSenior Independent Director ^{(N)(Q)(R)}

Appointed a Non-Executive Director in March 2001. Mr Bryant (66) 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.

Geraint Talfan DaviesNon-Executive Director ^{(N)(A)(R)}

Appointed a Non-Executive Director in July 2000, Mr Davies (66) is a former journalist whose career spanned both public and private sector broadcasting (including Controller of BBC Wales throughout the 1990s). He is Chairman of the Institute of Welsh Affairs and of the Welsh National Opera. A trustee of The Media Standards Trust and also a former Chairman of the Arts Council of Wales.

Membership of Board Committees**(N)** Nominations**(A)** Audit**(Q)** Quality and Environment**(R)** Remuneration**Prof Stephen Palmer**Non-Executive Director ^{(N)(Q)(R)}

Appointed a Non-Executive Director in October 2009, Professor Palmer (58) is Professor of Epidemiology and Public Health at Cardiff University and chairs the Wales Chief Medical Officer's Health Protection Committee. Since 2003 he has been Director of the Health Protection Agency's chemical hazards division, local and regional services division, and Head of Epidemiology. A fellow of the Faculty of Public Health and the Royal College of Physicians, he has been an influential figure in public health for over 25-years. He has a long CV of previous public health professional functions and has written many books and peer-reviewed papers on infectious diseases and chemical hazards.

The Members

There are presently 81 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 our website www.dwrcymru.com or can be obtained by writing to the Company Secretary.

DIRECTORS' REPORT

The Directors present their report and the audited financial statements of Glas Cymru Cyfyngedig (Glas Cymru) for the year ended 31 March 2010

Principal activities

Glas Cymru is a company limited by guarantee and is the holding company of the Glas Cymru group. Dŵr Cymru Cyfyngedig (Welsh Water) is the one of the regional water and sewerage companies in England and Wales and is the group's principal trading company

Welsh Water is the only UK utility to be operated under a 'not-for-profit' business model, whereby all financial surpluses are retained in the business as reserves, invested in additional quality or service improvements or returned to customers in the form of a 'customer dividend'. Glas Cymru exists only for one purpose - to create the financing and operating conditions for Welsh Water that will allow the company to provide high quality water and sewerage services to more than 3 million people at the least cost

Welsh Water's primary purpose and responsibility is to operate, maintain and upgrade the company's network of assets so as to ensure a safe and reliable supply of drinking water and also to deal effectively with wastewater in order to protect public health and the natural environment

The Board's approach to governance

As a single purpose company, our long term success has only one measure - the extent to which we deliver value for the customers of Welsh Water. As Glas Cymru has no shareholders, when exercising judgement and discretion, Directors seek to enhance customer value and take decisions in the long term interests of the customers of Welsh Water

The key governance structures and internal controls operated in Glas Cymru are described in the governance report on page 52 of this report. Through these mechanisms the Board aims to apply high standards of corporate governance and to meet the spirit of the Combined Code in a manner framed to suit our single purpose business model

Business review

The Companies Act requires that the Directors' Report should include a Business Review, which gives a fair review of the development and performance of the business and a description of the principal risks and uncertainties that it faces

The operational performance of the business and our approach to sustainability and corporate responsibility are described on pages 7 to 31 of this report. The financial performance is described in the Financial Review on page 34. A statement of the principal risks of the business can be found on page 42. The information contained in these sections is incorporated into this Directors' Report by reference to the extent necessary to fulfil the requirements of a Business Review

The Business Review includes a description of our key stakeholders. Consideration of the interests of these stakeholders and other factors likely to impact on the success of the business is an integral part of the Board's decision-making process

The 2010 Annual Report (including this Directors' Report) has been prepared for the Members of Glas Cymru. It contains certain information of a forward looking nature, which has been provided by the Directors in good faith using knowledge and information available up to the date of this report. Forward looking statements should be regarded with caution because of the inherent uncertainties in economic trends and business risks

Financial performance and Final Determination

In 2009-10, customers benefited from a 'customer dividend' of £28 million, or £22 per customer served by Welsh Water (£11 for water and £11 for wastewater services), bringing the total 'customer dividend' paid since its introduction in 2003 to over £150 million

Under Ofwat's Final Determination for Welsh Water for the five-year regulatory period ending 31 March 2015 (the Final Determination) the average bill for water and sewerage customers will reduce over this period by £30 (before inflation)

Following this, the Board concluded that application of the 'customer dividend' policy would not be necessary, or appropriate, in the first year of the new regulatory period

After payment of the 'customer dividend', the profit before tax for the financial year ended 31 March 2010 (excluding the fair value movement on derivative financial instruments) was £107 million (2009 loss of £11m). At 31 March 2010 reserves stood at £1,068 million and net debt as a percentage of regulatory capital value of Welsh Water was 71% (2009 72%). We also had a robust liquidity position with £669 million of cash and undrawn bank facilities, including the proceeds of a £140 million index linked B series bond issue on 31 March 2010. This means that the business is well funded for the period from 2010 to 2015. Exposure to floating rates of interest is negligible with 99% of borrowings either fixed or linked to RPI

Following publication of the Final Determination Welsh Water has finalised its investment plans and priorities for the regulatory period 2010 to 2015. At £1.2bn the level of capital expenditure is similar to that for the period 2005 to 2010, and the programme includes important investment to enhance the protection of drinking water quality, mitigate the worst impacts of sewer flooding, substantially reduce the carbon footprint of its activities and improve customer service

Directors

The names and brief biographical details of the Directors are given on page 46. With the exception of Stephen Palmer who was appointed on 26 October 2009, all Directors served throughout the financial year. No Director has, or has had, a material interest, directly or indirectly, in any contract significant to the Company's business. The Board has not been requested to use, and has not used, its discretion under Article 57 of Glas Cymru's Articles of Association which allows the approval of a potential conflict of interest

On 8 March 2010 it was announced that Bob Ayling had been appointed Chairman Designate and that Lord Burns would stand down as Chairman of the Board at the 2010 Annual General Meeting ('2010 AGM') Subsequently, it was announced in June 2010 that Dame Deirdre Hine would also stand down as a Director at the 2010 AGM

At this year's AGM all of the Directors will stand for re-election consistent with the commitment made at the 2009 AGM, except for Lord Burns and Deirdre Hine who are standing down from the Board This will meet the requirement for three directors to seek re-election under the Articles of Association Stephen Palmer (Article 44 - first AGM since his appointment) and Nigel Annett and Chris Jones (Article 46 - retirement by rotation)

The Board has endorsed the effectiveness and commitment of the Directors (and, in respect of the Non-Executive Directors, their independence) and recommends each for re-election Further details are set out in the Notice of 2010 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 2010 on page 57 Resolutions will be proposed at the 2010 AGM to approve this report and to approve a scheme of incentivisation for the regulatory period 2010 to 2015

The Company has in place Directors' and Officers' insurance giving cover against legal action brought against the Directors and an indemnity in circumstances where a Director has not acted fraudulently or dishonestly The indemnity is a qualifying indemnity for the purpose of the Companies Act and is for the benefit of all Directors No claims have been made against this policy since the date of the last report Details of our internal control and governance arrangements are set out in the Governance Report on page 55

Members

At the date of this report, Glas Cymru has 70 independent Members, of whom 12 will stand down at the end of the 2010 AGM having served three terms of appointment The Directors of the Company are also Members In July 2010, Glas Cymru will commence a further round of Member recruitment by public advertisement

Further 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 56 Further information on membership, along with brief details of the current Members, is available on request or may be obtained from our website

Employees

At 31 March 2010 Welsh Water employed 205 people (2009 191) Other than the Directors of the Company, Glas Cymru has no employees

On 9 February 2010, Welsh Water announced a major restructuring of the business On 1 April 2010 and 1 May 2010 1,093 and 476 employees transferred to Welsh Water under the Transfer of Undertakings (Protection of Employment) Regulations 2006 ('TUPE') - these employees having been previously employed by United Utilities Operating Services Limited and Kelda Water Services Wales Limited, respectively At the date of this Directors' Report, the number of Welsh Water employees is 1,784 Over the next five years there will be a phased reduction of around 300 in the number of employees, which it is intended will be achieved by a combination of retirement, natural turnover and selective voluntary severance

Welsh Water remains committed to 'Working Together', the framework agreement established with trade unions and staff representatives that has successfully operated since the early 1990's, and to continuing to invest at all levels in the highly committed and motivated work force which is crucial to achieving Glas Cymru's sole purpose We are also committed to equality of opportunity and aim to treat all employees (including disabled persons) 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

In 2009-10, Welsh Water's employee pay and benefits package compared favourably with the local employment market and all staff shared in the success of the business via a staff incentive scheme, which pays an annual bonus linked to the relative financial and customer service performance of Welsh Water These arrangements are being reviewed currently following the reorganisation of Welsh Water

Under 'Working Together' Welsh Water employees receive an inflation linked general pay award In April 2009 this led to an increase of 3% and in April 2010 to a further 0.3% The Welsh Water defined benefit pension scheme was closed to new entrants on 31 December 2005 and last year employee contribution rates were increased from 6% to 9% This - coupled with additional cash contributions by Welsh Water and an increase in employer future service contributions over a number of years (from an original 12% to 20% last year) - is projected to address the deficit in the pension fund within a reasonable period of time New employees are invited to join a defined contributions pension scheme to which staff contribute 6% and Welsh Water 11%

Occupational health and safety

The Board is committed to achieving high standards of occupational health and safety - nothing is more important than the health and safety of the people who work for us, and those we affect through our work

During 2009-10, the company's process of health and safety management, which also covers Welsh Water's principal contractors, retained certification to the OHSAS 18001 2007 - the international standard for occupational health and safety management Our health and safety performance in 2009-10, which disappointingly saw a rise in the number of reportable accidents - for the first time under Glas Cymru's ownership - and our plans to improve on this level of performance are described in our 2010 Health and Safety Report A copy of this report is available on request or on our website

DIRECTORS' REPORT

Water quality and the environment

The Quality and Environment Committee of the Board (QEC) meets each month to monitor the water quality, customer service and environmental performance of Welsh Water. QEC tracks the development of key operational strategies, as we aim to develop a more sustainable water and wastewater business based on developing best practice and knowledge. QEC also reviews the cause of and Welsh Water's response to all major water quality and environmental incidents. A copy of the 2010 QEC Report is available on our website.

In 'Welsh Water Our Sustainable Future' we have set out our ambition for the business for the next 25 years. A copy of this report is available on the company's website or on request.

Research and development

Welsh Water monitors and selectively participates in water industry research initiatives, most notably through membership of UK Water Industry Research Limited, which manages and coordinates the research interests of UK water companies. Where appropriate, we also sponsor university research departments and private companies to undertake investigations into issues that relate to our business objectives and priorities for our operational region. The findings from all research initiatives are disseminated through Welsh Water and its contract partners under a reciprocal sharing arrangement.

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 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 2009-10, the average payment period for the Glas Cymru group was 47 days (2009 51 days). Regulations require that in calculating this we include within trade creditors monies retained under contract in respect of Welsh Water capital investment projects. The level of retentions varies from year to year and affects the average payment period for the year.

Corporate social responsibility

We have a clear and firm commitment to environmental responsibility and in being a good neighbour and trusted partner in the communities we serve. To earn this trust we have to show that we behave fairly and responsibly in the interests of customers, that we use resources wisely, and that we make an appropriate contribution to community. This approach to 'responsible business' is an essential part of our not for profit business model and further information is provided on page 30 of this report.

During the year, charitable donations amounted to £45,485 (2009 £44,212). There were four beneficiaries of awards of above £500 ranging from £1,120 to £31,567.

It is Board policy not to make donations to political parties or to incur political expenditure and during 2009-10 no donations or payments have been made which are required to be disclosed under section 366 of the Companies Act 2006.

Institutional investors

Glas Cymru welcomes the Institutional Shareholder Committees code of responsibility for investors and the call for more two-way dialogue. Since 2001 Glas Cymru has facilitated this dialogue by holding an annual bondholder/investor meeting in London, shortly after the company's annual general meeting, and by the issue of a quarterly investor report for holders of the group's bonds. We welcome written dialogue at any time and following the announcement of preliminary or interim financial results for any period the Finance Director, often accompanied by an independent Non-Executive Director, will hold informal meetings with bondholders. All issues discussed at meetings with investors are reported to the Board.

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. Our Welsh Language Scheme is an approved 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 is published on our website or is available on request from 12 July 2010.

Going concern

The Directors are satisfied that the business has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2010 have been prepared on a going concern basis.

Auditors

PricewaterhouseCoopers LLP (PwC) acted as the auditors to Glas Cymru for the accounts for the year ended 31 March 2010. As part of the audit process Directors have confirmed that as far as each 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. A resolution to re-appoint PwC will be put to Members at the 2010 AGM. The current external audit contract expires at the completion of the statutory accounts for the financial year ending 31 March 2011 and this contract will be re-tendered during 2010-11.

Events after the financial year-end

On 1 April 2010 1,093 employees transferred from United Utilities Operating Services Limited to Welsh Water. On 15 April 2010 £75 million was drawn down under a European Investment Bank financing facility. On 1 May 2010 476 employees transferred from Kelda Water Services Wales Limited to Welsh Water. Deirdre Hine will stand down as a non-executive director at the 2010 AGM.

Annual general meeting

The 2010 AGM will be held on Friday 9 July 2010. The business of this meeting includes the approval of the Directors' Report and Financial Statements and the Remuneration Report for the year ended 31 March 2010, the re-election of Directors, a resolution to authorise the Company to make donations to EU political organisations and/or incur EU political expenditure up to defined limits and a resolution to reappoint the auditors. These resolutions are matters of ordinary business for the 2010 AGM. There is one item of special business - the approval of an incentivisation scheme for the executive directors for the period 2010 to 2015. Further information in respect of all resolutions is provided in the Notice of 2010 AGM sent to the Members of Glas Cymru with this report.

By order of the Board

Richard Curtis LLB, ACIS
Company Secretary
4 June 2010

All documents which are stated as available on the Company's website can be obtained from www.dwrcymru.com

CORPORATE GOVERNANCE

Glas Cymru is committed to high standards of corporate governance. This is essential if we are to be regarded as a well-managed provider of an essential public service in the eyes of Welsh Water's customers and regulators, bondholders and other stakeholders.

This report explains the key features of the Company's governance structure and how it complies with the Combined Code on Corporate Governance 2008 (the 'Combined Code'), which sets the standard for good practice for UK listed companies. The Company complies with all the provisions of the Combined Code, save for those that are not applicable to a company limited by guarantee.

The Board

The Board comprises 11 Directors: a Chairman, 3 Executive Directors and 7 Non-Executive Directors. Directors collectively provide a broad base of experience and expertise appropriate to oversee the business and to maximise the effectiveness of the Board, ensuring that all matters are fully debated and that no individual or group dominates the Board's decision making process. No Non-Executive Director has any business or other relationship that could materially interfere with the exercise of their judgement, and the Board considers each of the Non-Executive Directors to be independent of the Company and each other.

The roles of the Chairman and Managing Director are separate and clearly defined. The Chairman is responsible for ensuring the effective operation of the Board, that the information the Board receives is sufficient to make informed judgements, and for ensuring that constructive relationships are maintained with key stakeholders. As part of its regular evaluation, the Board considers the Chairman's availability and capacity to undertake the role against the background of his other commitments. The Board remains satisfied that the Chairman fulfils his role effectively and has the capacity to be available when unforeseen circumstances arise. The Managing Director is responsible for the day-to-day management of the business and for the implementation of the strategy, policies and procedures adopted by the Board.

The Managing Director is supported by two Executive Directors and by an executive team comprising the heads of specialist functions.

The Non-Executive Directors have access to all information relating to the business, 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.

Each of the Executive Directors has a written service contract subject to termination by the Company on 12 months' notice. The Chairman and each of the Non-Executive Directors has a written letter of appointment subject to termination by the Board on three months' notice. A copy of each of these agreements is available for inspection at the Company's registered office and at the annual general meeting.

Under the Articles of Association any new Director must stand for election at the first annual general meeting following his or her appointment, and each Director is subject to re-appointment by the Members of Glas Cymru at intervals of not more than

three years. In addition, and in accordance with corporate governance best practice, any Non-Executive Director who has served on the Board for more than nine years shall retire and, if appropriate, seek re-election on an annual basis.

Board proceedings

The Board met nine times in 2009-10, including four meetings held over two days, to collectively set the strategic direction of the business and to review the operating and financial performance and risk management of the business. There is a formal schedule of matters reserved to the Board, which is reviewed annually and which can only be amended by the Board. This includes approval of the annual business plan (which sets the operating and strategic objectives for the business, and the risk framework within which the business will operate), corporate policies, significant transactions above specified thresholds or outside the ordinary course of business and the delegation of Board authority to committees and Executive Directors.

The table below summarises the number of Board and committee meetings held in 2009-10 and the level of attendance at each.

	Board	Nomination (N)	Audit (A)	Quality and Environment Committee (Q)	Remuneration (R)	Appointments (Ap)
Number of meetings held in 2009-10	9	1	4	12	4	4
Lord Burns ^(N)	9*	1*	-	-	-	-
Nigel Annett ^{(N)(Q)}	9	1	-	12	-	-
Chris Jones	9	-	-	-	-	-
Peter Perry ^(Q)	9	-	-	11	-	-
Bob Ayling ^{(N)(Q)(R)}	9	1	-	12	4	-
John Bryant ^{(N)(Q)(R)(Ap)}	9	1	-	11	4*	4*
Geraint Talfan Davies ^{(N)(A)(R)(Ap)}	9	1	4	-	4	4
Dame Deirdre Hine ^{(N)(Q)(R)(Ap)}	9	1	-	11*	4	4
Tony Hobson ^{(N)(A)(R)(Ap)}	9	1	4*	-	4	4
James Strachan ^{(N)(A)(R)}	9	1	3	-	4	4
Stephen Palmer ^{(N)(Q)(R)(Ap)} (Appointed 26/10/09)	4 ^B	-	-	5 ^C	2 ^C	4

* Denotes committee Chairman | B of possible 5 meetings | C. all meetings since appointed

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 support meaningful debate and effective decision making. The Company Secretary also advises the Board on corporate governance. To support the independence of Non-Executive Directors, and to enable them to discuss the performance of the executive management team, there is regular opportunity for the Chairman and the Non-Executive Directors to meet privately.

New Directors Induction and training
Appointments to the Board are made following recommendation from the Nominations Committee or, in the case of the appointment of a Chairman, from the Appointments Committee. Each new Director receives an induction programme to familiarise him or her with the business, the risks and strategic challenges, and the economic, competitive, legal and regulatory environment in which it operates. Introductory visits are arranged to company sites and to key suppliers (contract partners) and other stakeholders.

A programme also exists to ensure that all Directors have the opportunity to continually update their skills and business knowledge. This can take the form of visits to strategic operational assets or meetings with stakeholders, by the provision of information and presentations to the Board on key strategic issues, and by a Director's occasional attendance on an external course.

Evaluation of the Board
Directors participate in an annual evaluation to assess the effectiveness of the collective performance of the Board, the performance of the Chairman and of the principal committees of the Board. The conduct of this process is overseen by the Chairman and comprises questionnaires completed by Directors, the conclusions of which are collated and analysed by the Company Secretary and collectively discussed at the Board. This is supplemented, as appropriate, by one to one discussions between each Director and the Chairman, following which actions are agreed to address issues raised.

Following the last review the number of Board meetings was reduced from nine to eight a year, but with more meetings held over two days to allow discussion of strategic issues inside and outside of the formal boardroom environment. These extended meetings also enable Directors to meet and build relationships with key senior managers and staff below Board level. Six of the eight meetings a year are held over two days, including two that incorporate a meeting of the Members of Glas Cymru. The 2009 evaluation raised no material weaknesses or failings, but highlighted certain minor aspects for further consideration to improve the effectiveness of the Board. The next review will be undertaken in autumn 2010.

The Board reviews and evaluates the performance of the Chairman without the Chairman present. The Chairman assesses the performance of the Managing Director after taking into account the views of other Directors. The performance of the Executive Directors and the Company Secretary is assessed by the Managing Director, under a process of annual appraisal that applies to all employees.

Committees of the Board
There are four principal committees of the Board. Each has a written term of reference that defines the role and responsibility of the committee and which is reviewed annually. These are the Audit Committee, the Quality and Environment Committee, the Remuneration Committee and the Nominations Committee. During 2009-10 a sub-committee of the Nominations Committee – the Appointments Committee – was established to oversee the Board governance associated with the appointment of a new Chairman of the Board. The Board also has an ad-hoc Finance Committee to approve financing and treasury transactions where a decision is required between formal meetings of the Board.

The membership of each committee is intended to make best use of the independent challenge and skills and experience of the Non-Executive Directors. Save in respect of the Appointments Committee, after each committee meeting a summary of matters discussed is reported to the Board, and the Board subsequently receives the formal minutes. Each committee 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 and membership of the Audit Committee, the Quality and Environment Committee and the Nomination and Appointment Committees is set out below. The work of the Remuneration Committee is described in the 2010 Remuneration Report on page 57. In addition to contributing to the formal committees of the Board, during 2009-10 certain Directors provided additional time and challenge in procurement (John Bryant), communications (Geraint Talfan Davies), legal and regulation (Bob Ayling) and government and regulation (Lord Burns).

Audit Committee
The members of the Audit Committee are independent Non-Executive Directors Tony Hobson (Chairman), Geraint Talfan Davies and James Strachan. By invitation of the Chairman, meetings of the committee are attended by the Finance Director, Head of Business Assurance, Internal and External Auditors and selected other senior managers. The Chairman and Managing Director attend at least one meeting of the Audit Committee each year. The Company Secretary acts as secretary to the Committee. The Board considers that Tony Hobson, a Chartered Accountant and former Group Finance Director of Legal & General Group Plc, has the significant and relevant financial experience required to chair the Audit Committee.

CORPORATE GOVERNANCE

The role of the Committee is to receive and challenge reports from executive management and, as appropriate, from internal and external auditors, and in particular

- » to review and advise the Board on Glas Cymru's interim and annual financial statements, its accounting policies and on the control of its financial and business risks
- » to review the nature and scope of the work to be performed by the external auditors and internal audit function, the results of their audit work and of the response of management
- » to review and advise the Board on the effectiveness of the internal control environment in the business, including the 'Whistleblowing' procedures
- » to make recommendations on the appointment and remuneration of external auditors and to monitor their performance
- » to approve and monitor the policy for non-audit services provided by the external auditors to ensure that the independence of the auditors is not compromised

The Audit Committee meets on at least four occasions each year. Two of the meetings focus on review of the annual and interim reports and associated preliminary and interim results announcements, and related areas of judgement and significant accounting policies. Time is allocated at other meetings to review the findings of the external and internal audit programme and to assess the processes for the management and control of financial and business risks, including challenge to the Executive Directors' assessment of those risks and their mitigation strategies and action plans to manage those risks. Significant reports and issues arising from Welsh Water's risk based audit programme are discussed at every meeting of the Committee.

During the year, the Audit Committee approved external and internal audit plans, and met privately with the internal and external auditors without executives present as part of its annual review of audit independence. On the basis of this work, and regular meetings with executive management, the Audit Committee is able to assess the ongoing effectiveness of internal and external audit.

The role of internal audit is to provide independent and objective assurance and to advise management and the Board on the extent to which systems of internal control are effective and 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 to ensure that it is focused on areas of greatest risk to the business, and is approved by the Audit Committee.

During 2009-10, external auditor services were provided by PricewaterhouseCoopers LLP and internal audit services, which in the previous year were provided under contract by Grant Thornton, were provided by an internal Business Assurance team.

The Committee is confident that the objectivity and independence of the auditors is not impaired by reason of their non-audit work and had adopted controls to ensure that this independence is not compromised. These controls include the continued monitoring of the independence and effectiveness of the audit process. Audit partners are rotated every five years, with the next change taking place in the financial year ending 31 March 2011. In addition, the Audit Committee has adopted a specific policy on audit independence and audit tendering and an external audit tender will take place during the financial year ending 31 March 2011 (as the current contract expires at the completion of the statutory accounts for the year ending 31 March 2011).

The Audit Committee has reviewed the policies of the external auditor to ensure their independence and that of their engagement partner and that Board policy on non-audit fees has been met. This provides that the external auditor will not be used for internal audit services, and that all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee. Total external auditor remuneration is analysed between audit and non-audit work in note 3 to the Notes to the financial statements on page 76.

The terms of reference of the Audit Committee include all matters required by the Combined Code. The Committee has unrestricted access to Company documents and staff and to external auditors, and the Finance Director and Head of Business Assurance and external auditors each have a 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 four Non-Executive Directors (Dame Deirdre Hine, Chairman, John Bryant, Bob Ayling and Stephen Palmer) and two Executive Directors (Nigel Annett and Peter Perry). QEC is advised by two independent experts on the public health and operational aspects of water supply and environmental management, and by Welsh Water's Head of Water Quality and Head of Operational Performance and Customer Service who, with the Company Secretary, attend all meetings.

QEC plays a central role in the governance of Welsh Water recognising that a major element of Glas Cymru's business model is an outsourcing strategy, which in 2009-10 meant that some 85% of Welsh Water's operating and capital expenditure was incurred by third party partners through competitively let contracts.

The role of QEC is to oversee Welsh Water's performance, which targets 'top quartile' overall performance on key regulatory measures for water quality, customer service and efficiency and environmental performance, while delivering the best available combination of cost efficiency, value for money and quality of service. Through its oversight QEC provides assurance to the Board that Welsh Water's obligations as a water and sewerage undertaker are not compromised or put at risk.

In particular, QEC

- » advises the Board on matters of operational policy and practice, and routinely reviews the performance of Welsh Water against key performance indicators, in relation to matters of public health, compliance with drinking water regulations and environmental laws and regulations and occupational health and safety
- » reviews the development of key operational strategies, as Welsh Water aims to develop more sustainable water and wastewater businesses based on industry best practice
- » reviews executive management's assessment of operational and quality risk
- » assesses Welsh Water's management of and response to significant water quality or environmental incidents, and any weakness identified under the internal audit quality programme of work

QEC produces an annual report to the Board, which is published on our website

Nominations Committee

The Nominations Committee meets on an ad hoc basis. It is chaired by the Chairman of the Board and comprises all of the Non-Executive Directors and the Managing Director. Other Executive Directors attend meetings at the invitation of the Chairman. It is the responsibility of the Nominations Committee to ensure that plans are in place for orderly succession for appointment to the Board. Its role is therefore to review the size, structure and composition of the Board (i.e. the skills, knowledge and experience around the Board table) and, where appropriate, to recommend candidates for Board appointment. In planning for Board succession, for part of 2009-10 the Nominations Committee was advised by Russell Reynolds & Associates and Egon Zehnder International. Stephen Palmer was appointed a Non-Executive Director in October 2009 following recommendation by the Nominations Committee.

The Board meets the requirements of the Combined Code that the majority of Directors should be independent of the Company (i.e. that they are individuals who the Board determines to be independent in character and judgement and who have no relationships

or circumstances which are likely to affect, or could appear to affect, the Director's judgement). We have previously reported that the Nominations Committee and the Board have agreed in principle that it would be in the best interests of the Company (and of the customers of Welsh Water) to extend the term of office of some of the Non-Executive Directors who were appointed in 2001 beyond nine years. This would allow continuity as the Board of Welsh Water moves into the next regulatory investment period (2010 to 2015) and in the early phases of the business reorganisation announced by the Company in February 2010. Any Non-Executive Director whose appointment was extended beyond nine years would become subject to annual re-appointment by the Members of Glas Cymru and the Chairman of the Board would ensure that any Non-Executive Director to be appointed beyond nine years continues to be independent in character and judgement.

Appointments Committee

This Committee was established as a sub-committee of the Nominations Committee and met on four occasions in 2009-10 to oversee the process of the succession of the Chairman of the Board, culminating in the announcement in February 2010 of Bob Ayling as Chairman Designate. The Committee is chaired by John Bryant and its members include each of the Non-Executive Directors except for Lord Burns and Bob Ayling. The Committee, which received independent advice from Egon Zehnder International, will be dissolved in July 2010 when Bob Ayling becomes Chairman.

Internal control and risk management

The Board is responsible for the operation and effectiveness of the Group's system of internal controls and risk management. This system is designed to manage the risk of failure to achieve business objectives, and comprises audited policies, procedures and processes designed to identify, evaluate and manage the significant risks faced by the business, and provide reasonable 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, particular risks. The internal control systems are designed to meet the Group's particular needs and the risks to which it is exposed, and by their nature can only provide reasonable (not absolute) assurance against misstatements or loss.

Key features of the system are:

- » the Board sets parameters of acceptable risk and key risks and hazards are identified, measured and managed to an acceptable level
- » clear accountability for risk management is embedded in the business, and supported by regular risk reporting
- » managing risk is a responsibility for all managers in the business. For each major type of risk, there is a designated individual or team to ensure that appropriate guidance is available for managers across the business
- » the system of internal control is reviewed by Welsh Water's Reporter who submits an annual report to the Board and to Ofwat to confirm compliance with Ofwat's guidance for the UK water industry on internal control
- » controls that recognise that the nature and balance of risk change and evolve continuously and provide a framework within which to manage these
- » assurance is provided by independent audit and assessment of internal quality management systems. All audit activity is conducted under a broad risk-based programme approved by the Audit Committee or QEC, designed to ensure that management information is accurate, timely and relevant and reflects the true position of the business
- » procedures exist for the approval and control of major items of capital expenditure, the acquisition and disposal of material assets, and the entering into of any arrangement that gives rise to, or could give rise to, a material liability
- » the Group also has in place effective financial systems and procedures for managing the preparation of the consolidated accounts

CORPORATE GOVERNANCE

The process used by the Audit Committee to review the effectiveness of the systems of internal control includes discussions with management on significant risk issues identified and the review of plans for, and results from, internal and external audit. The Audit Committee reports the results of the review to the Board which then draws its collective conclusion on the effectiveness of the system of internal controls.

Business risk is routinely assessed by a risk management group chaired by the Managing Director. This group reviews and challenges the robustness of risk management procedures, including that of Welsh Water's contract partners, and includes areas such as public health, environment, business ethics, employment, occupational health and safety and business continuity. The risk management group encourages staff to participate in two way dialogue to ensure that risk is understood and managed early and effectively, and to learn from our own experience and the experience of others to promote best practice. The Audit Committee and QEC receive an update on our principal risks and process of risk management every six months, and this is reviewed annually at the Board.

In judging the effectiveness of the business's system of internal controls, the Board considers periodic reporting from the risk management group, the Audit Committee and QEC. The Board also routinely monitors key performance indicators and monthly reports of financial and operational performance, which flag variances against the agreed business plan and budget. By so doing, the Board reviews the effectiveness of the internal control system during the course of the year.

Members 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 the communities served by Welsh Water. When fulfilling this important corporate governance role Members act in a personal capacity – they do not represent any particular group or stakeholder interest.

Members are appointed by the Board, but only individuals recommended by an independent membership selection panel (the 'panel') can be considered for appointment. The role of the panel is to recommend 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 overall 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 published Membership Policy.

At the date of this report, Glas Cymru has 70 independent Members, excluding the Directors of the Company who are also Members. Subsequent to the financial year end, and following evaluation and recommendation by the panel, the Board has approved the reappointment of two Members whose term of office would otherwise expire at the end of the 2010 AGM and appointed two new Members. Further details of the Membership Policy and the Members of Glas Cymru can be obtained from the Company Secretary or from our website.

Communication with stakeholders

The Board attaches high importance to maintaining good relationships with Members and investors. The Members of Glas Cymru have opportunity to meet with Directors at the two Members' Meetings held each year. At these meetings, Directors, including the chairmen of the key Board committees, are available to answer questions. All Members, including those unable to attend any meeting, receive a written brief of issues discussed at each meeting.

For investors, Glas Cymru hosts an annual event in London, and immediately following the announcement of interim and preliminary results for any period there are informal meetings with major bondholders and other investors, who may also request a meeting with an independent Non-Executive Director at any time. The Board receives a report following meetings with investors.

Regular communication is also maintained with each of the economic, quality and customer service regulators of Welsh Water.

By order of the Board

Richard Curtis LLB, ACIS
Company Secretary
4 June 2010

All documents which are stated as available on the Company's website can be obtained from www.dwrcymru.com

REMUNERATION REPORT 2010

Compliance

This report has been prepared in accordance with the provisions of the Companies Act 2006 and, in line with the Board's commitment that Glas Cymru shall report as if it were a listed company, and consistent with high standards of governance taking into account the remuneration guidelines published by the Association of British Insurers, the National Association of Pension Funds and other governance bodies. The report has been approved by the Board and will be put to the Members of Glas Cymru for approval at the 2010 Annual General Meeting (the AGM).

PricewaterhouseCoopers LLP has audited the Directors' emoluments table, rolling incentive scheme information and the pension table on pages 60 - 61, and has reviewed the remainder of this report.

Remuneration Committee

The Remuneration Committee (the 'Committee') is chaired by John Bryant and comprises all the Non-Executive Directors. A copy of the terms of reference of the Committee is available on the Company's website. The Chairman of the Board, the Managing Director and the HR Director, attend meetings of the Committee only by invitation. The Company Secretary acts as secretary to the Committee. The Committee met on four occasions in 2009-10.

The role of the 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 and senior managers
- » to agree the terms of service contracts and remuneration for Executive Directors and senior managers, and
- » to determine variable pay arrangements that encourage and recognise good performance and reward individuals in a fair and responsible manner for their contribution to the success of the Company

The Committee has sought independent external advice on certain aspects of remuneration policy and best practice. The firms named below advised the Committee in 2009-10, and have been reappointed to advise the Committee in 2010-11.

- » Hewitt New Bridge Street ('HNBS'), who advise on market best practice in the design of incentive performance arrangements, the benchmarking of Directors' remuneration and fees and senior management service contracts and remuneration and in relation to pension matters, and
- » Linklaters & Alliance, who provide legal advice to the Committee on Directors' service contracts and pension matters

The Committee also received pensions information and advice from Quantum Actuarial LLP. In the view of the Committee, there were no conflicts of interest in relation to these organisations advising both the Committee and the Company in the implementation of its decisions.

Remuneration Policy

The Committee considers the principles and provisions of The Combined Code on Corporate Governance - June 2008 ('the Combined Code') when setting the policy and terms for senior executive remuneration and believes it is fully compliant. The Committee also considers the remuneration structures (strategy, policy and approach) across the Group as a whole and to any broader social, environmental and governance issues.

The aim of the remuneration policy, which is broadly consistent for employees, is to support recruitment, retention and motivation and reward high performance – thereby ensuring that the business is managed by high calibre executives who are incentivised to produce sector-leading performance. The policy is designed to align as closely as practicable the interests of the individual with the longer-term interests of the business and, especially, the interests of the customers of Welsh Water. A high proportion of Executive Directors' remuneration is variable and dependent on Welsh Water's performance in terms of protecting public health, protecting the environment and customer service.

The executive remuneration package comprises four elements: base salary and benefits, two elements of variable pay – an annual incentive and a longer term performance related incentive, and a pension.

The general remuneration policy applies to Executive Directors and to the senior leadership team and has been founded on the following principles:

- » when setting levels of pay the Remuneration Committee exercises judgement such that, having regard to an individual's experience and responsibility, total remuneration shall be fair and competitive when compared to the relevant market and the organisation generally
- » basic salary is the only element of total remuneration that is pensionable and is reviewed annually
- » Ofwat and other stakeholders judge the success of the business against water and environmental quality, customer service standards and financial performance – and these are the hard, auditable and comparable performance criteria and determinants that underpin the remuneration policy
- » the remuneration policy shall reflect the intention of the Board that Welsh Water should be one of the best performing companies in the sector – a significant proportion of the Directors' remuneration should therefore be variable and dependent on the achievement of stretching performance targets
- » performance targets for variable pay will be set to ensure that the interests of management are aligned with the objectives of the Board and of customers and reflect Welsh Water's role as custodian of important aspects of public health and the environment
- » annual variable pay will have a strong focus on operating efficiency and service standards measured against targets set by the Committee, and
- » there will be a clawback applicable to all aspects of variable pay where awards are made on the basis of performance that later proved to be misstated

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When setting remuneration, the Remuneration Committee is advised by HNBS in respect of remuneration policy in the UK water companies (both quoted and unquoted) taking into account, amongst others, turnover and business complexity (e.g. regulatory versus non regulatory business and international exposure) of the comparator companies. In addition, reference is made to remuneration practice in the FTSE 250. The Committee may also have regard to a Director's function and job size and to individual and company performance.

As explained at last year's Annual General Meeting, the Committee has reviewed the remuneration policy and has made some material changes to the chosen performance metrics that will apply during the next five years. Accordingly the next two sections of this report describe the variable pay arrangements that applied during 2009-10 and then a description is given of the revised remuneration policy that is in place for 2010-11.

Annual variable pay in 2009-10

In 2009-10, the maximum annual variable pay payable was 100 percentage points of base salary ('PPBS'), with payment of the maximum available amount divided across three components: customer service performance (40 PPBS), financial performance (40 PPBS) and performance against four specific operational measures (20 PPBS, 5 PPBS per measure).

The customer service component is determined with reference to the 'Overall Performance Assessment' ('OPA') published by Ofwat. 40 PPBS would be earned for achieving 1st position in the OPA ranking of the ten water and sewerage companies of England and Wales ('OPA League Table'), and 8 PPBS (20% of the maximum for this element) would be payable for achieving median performance, being the average score of the 5th and 6th ranked companies, with ranking above this (but not below) rewarded on a linear scale.

The OPA includes non-financial performance measures for

- » water supply including drinking water quality compliance, interruptions to supply and restrictions on supply
- » sewerage measures including sewage flooding incidents and a quality of effluent discharges to the environment that meets legal and regulatory standards, and
- » customer service performance including speed of response to telephone and written billing enquiries and handling of written complaints.

At the discretion of the Committee, this element of variable pay may be adjusted up or down by up to 10 PPBS to reflect identifiable and significant aspects of customer service performance not captured by OPA. In November 2009 the Committee reduced the amount payable in respect of the financial year 2008-09 by 5 PPBS to reflect the higher number of water quality incidents experienced by Welsh Water in 2008.

The financial component of the annual performance related variable pay was based on net cash flow (before capital expenditure but after net interest payable) and can earn up to 40 PPBS. Performance is rewarded on a linear scale from zero for meeting the annual cash flows in the regulatory settlement for 2005-10 announced by Ofwat in December 2004 (the 'Final Determination'), 25 PPBS (62.5% of maximum for this element) and 40 PPBS for reaching the respective target and maximum levels approved by the Committee. To achieve target level payment requires that Welsh Water outperform the Final Determination.

The specific operational measures are determined by the Committee on an annual basis and are structured as absolute measures and as such dependent on improved performance by Welsh Water, and not simply good relative performance. The Committee set challenging targets to be met to earn this element of variable pay with no amount being payable for performance at or below performance in 2008-09 and (except for measure (a) below) to earn maximum payment would have required performance equal to the best performance in the sector.

The measures and targets selected by the Committee for 2009-10 were

- (a) Avoidable customer complaints, being complaints that relate to a service failure by Welsh Water, which shall not include complaints as regards matters of Board policy or activity relating to the collection of customer charges
- (b) Sewer flooding attributed to 'other causes', i.e. other than due to hydraulic overload of the sewer network
- (c) Category 3 pollution incidents, any environmental damage is a concern and all of these less significant pollution events are investigated as a 'near-hit' for a significant event to ensure that lessons are learned
- (d) The Operational Performance Index ('OPI'), is the Drinking Water Inspectorate index used by Ofwat as a measure to assess overall drinking water quality.

The 2009-10 Accounts include an accrual of £227,040 (equivalent to 34.4 PPBS) reflecting the Committee's current estimate of Welsh Water's relative performance for the year ended 31 March 2010. The first element of annual variable pay will be paid in June 2010 and the Committee will make its assessment of amounts payable in respect of service performance for 2009-10 in the autumn 2010, following publication by Ofwat of its annual Levels of Service Report.

Rolling Long Term Incentive Scheme in 2009-10

2009-10 was the final year in which awards could be made under the longer-term incentive scheme introduced on 1 April 2005 (the 'RLTIS'). Five annual awards have been made under the RLTIS. The maximum amount payable under RLTIS in 2009-10 is 60 PPBS, with 30 PPBS (50% of the maximum) being payable for reaching 'target' performance. This is divided equally between customer service and financial performance components.

Payments will normally be made within nine 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 earlier. In addition, payment of up to 20 PPBS will be deferred in the event that the underlying rating of any of the Company's bonds has 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 is 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. This 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 10 comparator companies.

The financial performance component is based on 'Financial Reserves' (Regulatory Capital Value less net debt) as at 31 March 2010, as defined for the purposes of the quarterly Investor Report routinely published by the Company. For the period 2005-2010, growth in Financial Reserves was 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 has been funded.

Under RLTI, the target range for 2009-10 was set three years ago, subject to consideration by the Committee of circumstances that might, at the discretion of the Committee, require the target range to be revised. These include (a) where there are differences between actual inflation and the assumptions originally made, (b) where the Board modified relevant policy 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. Amounts payable for 2009-10 will be measured by reference to a lower limit, the Final Determination for the period 2005-2010, at which no payment 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 payment will be earned. To achieve target level payment therefore requires that Welsh Water outperform the Final Determination.

The Committee may also, at its discretion, adjust any payment calculation up or down to reflect events or factors that are not captured by the formulae described above, providing that justification for any such adjustment is disclosed in the next annual remuneration report.

The 2009-10 Financial Statements include an accrual of £152,460 (equivalent to 23.1 PPBS) reflecting the Committee's current estimate of Welsh Water's relative performance for the three-year period ended 31 March 2010. The Committee will make its final assessment of amounts payable under the RLTI for 2009-10 in the autumn 2010 following publication by Ofwat of its Levels of Service Report for the year.

Remuneration policy for 2010-11

The Committee has agreed that a new framework for variable pay is needed to reflect the regulatory contract that Welsh Water is required to deliver in the five year regulatory period ending on 31 March 2015, which is the most challenging the Company has been set since the industry was privatised in 1989. Under Ofwat's Final Determination the average bill for Welsh Water's water and sewerage customers will reduce over the period to 31 March 2015 by around £30 (before inflation). To deliver this level of bill reduction Welsh Water would need to significantly reduce those operating costs that can be managed or influenced by management ('controllable costs') by around 20%, whilst at the same time (i) improving customer service performance, (ii) meeting new serviceability targets set out in the Final Determination which are also very challenging, and (iii) delivering a £1.2 billion capital investment programme, which includes a number of 'named outputs'.

The following table summarises the new remuneration policy for the executive directors.

Element of remuneration	Purpose	Policy	How it works
Base salary	<ul style="list-style-type: none"> » Help recruit and retain key employees » Reflect individual role/experience 	<ul style="list-style-type: none"> » Recognise individual experience/responsibility » Set at level so total pay is fair relative to market and organisation generally 	<ul style="list-style-type: none"> » Paid monthly (cash) » Reviewed annually » Nominal benefits in kind » Any increases to be reflective of staff pay
Pension	<ul style="list-style-type: none"> » Reward sustained contribution 	<ul style="list-style-type: none"> » Provide competitive post retirement benefits » No compensation for public policy/tax changes 	<ul style="list-style-type: none"> » Competitive defined benefits pension scheme » Benefits accrue relative to length of service at retirement » Remuneration Committee reviewing alternatives for directors in response to tax changes.
Annual variable pay (for 2010-2011)	<ul style="list-style-type: none"> » Incentivise delivery of specific predetermined goals » Reward ongoing good stewardship of business » Promote team culture 	<ul style="list-style-type: none"> » 3 elements (40% new scorecard – see below, 40% operating cost efficiency - 20% strategic and personal measures) » Maximum of 100% base salary » Remuneration Committee has discretion to adjust (range -10% to +10%) to give a fair result. 	<ul style="list-style-type: none"> » Paid annually (cash) » Measured vs. annual targets set by Remuneration Committee » Subject to claw-back if found to be flawed
Long term variable pay scheme (for 2010-2015)	<ul style="list-style-type: none"> » Incentivise long term performance/business outcomes aligned to interest of Welsh Water's customers. 	<ul style="list-style-type: none"> » Half subject to relative customer service performance, annual awards of up to 30% of salary to be made » Half subject to creation of customer equity in excess of business plan, up to 150% of salary can be earned across five years 	<ul style="list-style-type: none"> » Paid or accrued in phased annual instalments (cash) » Customer service measured annually on a relative basis across 3 years » Customer equity measured over the 5 year regulatory period (2010-2015)

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The total variable pay opportunity for the new regulatory period has not been increased, but as shown above changes have been made to some of the metrics upon which it will be assessed. There are two major changes to the annual plan. Relative OPA has been replaced with a new corporate 'scorecard' of some 20 measures based around six groupings:

- 1 Our own wellbeing
- 2 Safe drinking water
- 3 Safe sanitation
- 4 Protecting our environment
- 5 Brilliant customer service
- 6 Delivering cost efficiency

This set of measures will apply across the organisation, from Executive Director to operator level through a reward scheme which is available to all staff who are not on personal contracts. This, together with routine communication of performance against the scorecard via newsletters, staff briefings and presentations, should promote a team culture and create organisational alignment - as well as demonstrate our performance assessment in a clear and concise manner. The second change in annual variable pay is the introduction of strategic and personal objectives, of up to 20% of basic pay, which would be approved by the Committee following discussion of a recommendation made by the Chairman of the Board (who is not a member of the Remuneration Committee).

The Committee has agreed and has put in place a new long term variable pay scheme, which, while capable of revision at any time, is intended to operate for a five year period commencing on 1 April 2010 (the 'LTVPS'). A summary of the terms of the LTVPS, which is submitted for approval by the Members of Glas Cymru at the 2010 AGM, is provided on page 63.

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 are reviewed annually. There was no change in the fees of the Chairman and the Non-Executive Directors in 2009-10

reflecting the economic conditions prevailing at that time.

Following a two year benchmark review undertaken in February 2010, the fees payable for the financial year 2010-11 are:
Chairman £196,000 (2009 £190,000)
Non-Executive Directors £54,000 (2009 £52,500)

No additional amount is currently 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. The Chairman and the Non-Executive Directors are appointed under letters of appointment, terminable by either party on three months' written notice.

Remuneration Executive Directors Salary

Consistent with the decision of the Committee in respect of the Chairman's fees, the salaries of the Executive Directors for 2009-10 were unchanged from the previous year.

Following a two year benchmark review undertaken in February 2010, the base salaries payable for the financial year 2010-11 are:
Nigel Annett (Managing Director) - £268,000 (2009 £260,000)
Chris Jones (Finance Director) - £211,000 (2009 £205,000)
Peter Perry (Operations Director) - £201,000 (2009 £195,000)

There are nine executives, for whom the remuneration policy is broadly consistent with that followed for executive directors, whose basic salary exceeds £100,000.

Annual performance related pay (2008-09)

In autumn 2009 Executive Directors received an annual performance related payment for the year ended 31 March 2009 equivalent to 25.7 PPBS (compared to an accrual in the 2008-09 Accounts of 50.6 PPBS). This movement was due to Welsh Water being ranked 5th in terms of OPA performance - for accrual purposes a ranking of 4th had been assumed.

RLTIS (2008-09)

In autumn 2009 Executive Directors received payment under the RLTIS in respect of the period ended 31 March 2009 equivalent to 32.0 PPBS, which was the sum accrued in the 2008-09 Accounts.

Pensions

The Executive Directors are all members of the DCWW Pension Scheme, a defined benefit scheme. Their normal retirement age under this scheme is 60 and benefits accrue at 1/45th of salary per year of pensionable service, subject to a maximum overall pension at normal retirement age of two-thirds of final pensionable salary. The scheme also provides life cover of four times pensionable pay for death in service, a pension payable in the event of ill health and a spouse's pension payable on death. Executive Directors are also entitled to participate in a private health and medical insurance scheme. There was no change in pension provision in 2009-10, save that, following a review of benefits, on 1 October 2009 employee contribution rates increased from 6% to 9% and employer future service contribution rates reduced from 21.3% to 20%, (see note 21 to the accounts).

The pension benefits earned by the Directors during the year are shown in the table below.

	Accrued Pension (per annum) at 31 March 2010	Real increase in accrued pension in the year (net of inflation)	Transfer value at 31 March 2009	Transfer value equivalent of increase in accrued pension	Transfer value at 31 March 2010	Contributions paid by Director	Transfer value of real increase in accrued pension, net of member contributions
NC Annett*	£107,799	£5,778	£1,293,760	£333,960	£1,627,720	£19,500	£67,747
CA Jones*	£68,658	£4,556	£637,361	£193,532	£830,893	£15,375	£39,759
PD Perry**	£83,363	£10,342	£794,155	£303,081	£1,097,236	£14,625	£121,503

*Accrued pensions include previous service in Hyder Water and United Utilities Pension Schemes.

**The accrued pension and transfer value at 31 March 2009 and 31 March 2010 allow for Peter Perry's augmented benefits at those dates. The augmentation is based on the reinstatement, over a five year period, of a full salary link to benefits transferred into the scheme from his previous employer.

Directors' emoluments (excluding pension benefits and RLTIIS)

The table on this page reports emoluments in respect of the year ended 31 March 2010, and includes a best estimate of the performance related annual payment relating to customer service performance for 2009-10. Annual variable pay is paid in part in June, with the element that relates to service performance being assessed and paid in the autumn, following publication by Ofwat of its Levels of Service Report which sets out the comparative performance of the 10 water and sewerage companies of England and Wales. The extent to which this element of the variable pay has been over or under estimated will be disclosed in the Remuneration Report for next year.

The Committee believes the presentation of emoluments adopted in the table below 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.

Directors' earnings RLTIIS

In addition to the disclosed emoluments, provision is made in the Financial Statements for the payment under the RLTIIS, which is payable in autumn 2010.

The provision of £152,460 equates to 23.1 PPBS, and has been estimated on the basis that the performance in Ofwat's Overall Performance Assessment for the three year period 2007-08 to 2009-10 will be 4th, as below. The final amount to be paid will be determined when Ofwat publishes its OPA results for 2009-10 in autumn 2010, and could be higher or lower than the provision made.

Nigel Annett £60,060

Chris Jones £47,355

Peter Perry £45,045

For the three year period ended 31 March 2009 Welsh Water was ranked 4th in OPA performance of the 10 water and sewerage companies. Following publication of this report, in November 2009 payments were made to Executive Directors totalling £211,200 (equivalent to 32 PPBS): Nigel Annett £83,200, Chris Jones £65,600 and Peter Perry £62,400. These payments were at the level provided for in the 2008-09 Accounts.

Service contracts

The Executive Directors have service contracts that are subject to a 12 month notice period. 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. A significant element of mitigation is built into the contract should the Company choose to exercise its option to make a payment in lieu of notice.

Emoluments earned by the Directors in respect of the financial year ended 31 March 2010 were

2009-10 ⁽¹⁾	Lord Burns	NC Annett	CA Jones	P Perry	RJ Ayling	JM Bryant	GT Davies	DJ Hine	AJ Hobson	S Palmer	JM Strachan	Total
Salary	-	£260,000	£205,000	£195,000	-	-	-	-	-	-	-	£660,000
Variable pay 2009-10												
Annual provision ⁽²⁾		£89,440	£70,520	£67,080	-	-	-	-	-	-	-	£227,040
Benefits in kind ⁽³⁾	-	£840	£579	-	-	-	-	-	-	-	-	£1,419
Fees	£190,000	-	-	-	£52,500	£52,500	£52,500	£52,500	£52,500	£22,885	£52,500	£527,885
Total emoluments relating to 2009-10	£190,000	£350,280	£276,099	£262,080	£52,500	£52,500	£52,500	£52,500	£52,500	£22,885	£52,500	£1,416,344

Emoluments earned by the Directors in respect of the financial year ended 31 March 2009 were

2008-09	Lord Burns	NC Annett	CA Jones	P Perry	RJ Ayling	JM Bryant	GT Davies	DJ Hine	AJ Hobson	S Palmer	JM Strachan	Total
Salary	-	£260,000	£205,000	£195,000	-	-	-	-	-	-	-	£660,000
Variable pay 2008-09												
Annual provision ⁽⁴⁾	-	£131,560	£103,730	£98,670	-	-	-	-	-	-	-	£333,960
2008-09 adjustment (reduction)		£64,740	£51,045	£48,555	-	-	-	-	-	-	-	£164,340
Total variable pay⁽⁵⁾		£66,820	£52,685	£50,115								£169,620
Benefits in kind ⁽³⁾	-	£554	£532	-	-	-	-	-	-	-	-	£1,086
Fees	£190,000	-	-	-	£52,163	£52,500	£52,500	£52,500	£52,500	-	£52,500	£504,663
Total emoluments relating to 2008-09	£190,000	£327,374	£258,217	£245,115	£52,163	£52,500	£52,500	£52,500	£52,500	-	£52,500	£1,335,369

(1) Changes of Director in 2008-09 and 2009-10: RJ Ayling was appointed a Director on 3 April 2008 and S Palmer was appointed a Director on 26 October 2009.

(2) The financial statements for the year ended 31 March 2010 include a provision of £227,040 (34.4 PPBS of base salary) for annual variable pay potentially payable to Executive Directors for performance in the financial year 2009-10. This provision has been estimated on the basis that performance in Ofwat's Overall Performance Assessment for 2009-10 will be 6th. The final amount to be paid to each Director will be determined when Ofwat publishes OPA results for 2009-10 in the autumn of 2010, and could be higher or lower.

(3) Benefits in kind relate to receipt of private medical insurance, ill health cover and life insurance.

(4) An annual performance related payment of £333,960 was provided for in the Report and Accounts for 2008-09 and was estimated on the basis that OPA performance on 2008-09 would be 4th.

(5) The actual annual performance related payment in respect of 2008-09 totalled £169,620 and was paid in November 2009, following publication of Ofwat's OPA report for 2008-09, which confirmed Welsh Water's position as 5th. The highest paid Director in 2009-10 was NC Annett who received emoluments of £350,280 (2009: NC Annett £327,374).

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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. Chris Jones is a Non-Executive Director of the Principality Building Society, in respect of which he retains a fee of £32,000 per annum.

Recommendation

The Committee believes that the Remuneration Policy provides the right balance of fixed and variable pay to retain and reward Executive Directors for the attainment of the challenging goals the Board has set for the Company. Accordingly, the Committee recommends the Members of Glas Cymru to approve this 2010 Remuneration Report.

John Bryant

Chairman, Remuneration Committee

4 June 2010

SUMMARY OF THE PRINCIPAL TERMS OF THE GLAS CYMRU LONG-TERM VARIABLE PAY SCHEME 2010 (THE 'SCHEME')

Introduction

Over the five year period that commenced on 1 April 2010, Executive Directors will be incentivised by a combination of annual and long term variable pay arrangements. The latter of these has been approved by the Remuneration Committee of the Board of Directors of the Company (the 'Committee'). The long term variable pay arrangements, which are set out in the rules of the Scheme, are detailed below.

Operation

The Committee will supervise the operation of the Scheme. This will include determining who participates, setting the quantum of awards, determining the conditions to apply to the awards and the extent to which these conditions are ultimately met.

Eligibility

Only employees (including Executive Directors) of the Company and its subsidiaries will be eligible to participate in the Scheme at the discretion of the Committee. The Chairman, Non-Executive Directors and consultants cannot participate. The intention is to limit participation to the Executive Directors and senior executives who directly report to them consistent with our previous policy and market practice.

Type of awards

An award will comprise a cash payment that is assessed either over a rolling three year performance period ('a rolling award') or over a fixed five year performance period ('a long-term award') - see 'Performance conditions' below for further details. Rolling awards and the long term award are collectively referred to as 'awards' in this summary.

The Scheme shall govern payments to be made in respect of the five year regulatory period that commenced on 1 April 2010. The first awards will be paid out in autumn 2011 in respect of the financial year ending on 31 March 2011. Each year an award will comprise an annual payment of the rolling awards (as described below). Awards are not transferable, except on death. Any payment made pursuant to an award shall not be counted for pension purposes.

Individual limit

The maximum variable pay that may be paid out over the life of the Scheme is 300 percentage points of base salary ('PPBS'). The maximum PPBS is divided equally between two performance components - customer service and financial performance. Further details on these components can be found below.

Performance conditions

There are two measures of performance which will determine the amount paid out under the awards.

Customer service (rolling awards)

The first is customer service, which in years 1 and 2 will be measured by reference to a combination of two Ofwat measures - the Overall Performance Assessment ('OPA') and the service incentive mechanism ('SIM'). In years 3 to 5 performance will

be measured by reference to SIM alone. SIM is the Ofwat measure which is based on both quantitative and qualitative measures of consumer experience, and which replaced OPA from the start of the financial year 2010-11. Similar to OPA, Ofwat will publish data for each of the water and sewerage companies in England and Wales and the Company's relative position will be compiled by aggregating the SIM (and, where appropriate, OPA) scores for each of the three years of the performance period up to and including the relevant year of assessment, which will determine the extent to which this target is met.

The customer service performance condition will apply to the rolling awards. Consistent with the Company's previous policy, rolling awards will be subject to a three year performance period. This means that the maximum 150 PPBS to which the customer service performance condition applies is split into five annual grants of rolling awards of 30 PPBS each. Payments will normally be made within nine months of the end of the financial year to which they relate, although 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.

A rolling award will be payable on a sliding scale of 30 PPBS (i.e. 100% of the annual grant) for achieving 1st position, 22.5 PPBS for 2nd position, 15 PPBS for 3rd position, 7.5 PPBS for 4th position and zero for being ranked 5th or below of the water and sewerage companies in England and Wales.

Customer equity (long-term awards)

The Committee considers that the best financial measure of customers' interest in the business is the creation of customer equity over the five year period of the Scheme. Customer equity is the Company's financial reserves, i.e. its Regulatory Capital Value less net debt (as defined for the purposes of the quarterly Investor Report published by the Company) in excess of that provided for in the business plan approved by the Board.

The customer equity performance condition which applies to the long term award is to create £100m or more of customer equity in excess of the 2010 business plan target set by the Board between 1 April 2010 and 31 March 2015. On the achievement of this stretch target, the maximum 150 PPBS will be payable. Zero PPBS will be payable for meeting or falling short of the 2010 business plan target, and there will be straight-line pro rating between these two points.

Progress against this five year target may be acknowledged at the discretion of the Committee by permitting interim or staged accruals or payments to be made. These are capped as follows: up to 10 PPBS in respect of the 2010/11 financial year, up to 20 PPBS in respect of the 2011/12 financial year, up to 30 PPBS in respect of the 2012/13 financial year and up to 40 PPBS in respect of the 2013/14 financial year. If any of the staged payments described above are not paid out, they may be rolled up and paid out in any subsequent financial year.

The final entitlement (of up to 150 PPBS after taking into account any previous staged payments) will be payable following Ofwat's Final Determination for the next regulatory period (2015-2020) at the end of the 2014 Price Review process or such later date as the Committee may determine.

Consistent with the incentivisation scheme that applied between 2005-2010, when determining the level of any staged or final award under the new scheme the Committee will have regard to, amongst other things, the performance and rating of the Group's bonds and may at its discretion defer all or part of an award if the Group's bonds have been put on credit watch or downgraded.

In circumstances where the Committee makes an interim (or stage) payment against the target to participants but the final customer equity figure at the end of the five year performance period is less than the sum of the interim payment or payments, then such payments will be 'trued-up' so that any excess sums are clawed back from participants.

The customer equity target may be amended in certain circumstances at the discretion of the Committee. These circumstances include:

- (a) where there are differences between actual inflation and the assumptions originally made,
- (b) where the Board has modified a relevant policy after the original forecast was made, and
- (c) where there is any other material influence on financial reserves that was not originally foreseen and which the Committee determines to be outside the control of the Executive Directors.

Leaving employment

An award will lapse upon a participant ceasing to hold employment or be a Director within the Group. Any awards that have been paid before the date of cessation may be retained by the participant.

Corporate events

In the event of a change of legal status or dissolution of the Company or a substantial change to the Company's constitution, the Committee may allow outstanding awards to be paid early to the extent determined by the Committee in its discretion. Alternatively, the Committee may require the awards to continue, after being appropriately modified to reflect the event in question. Any awards that have been paid before the date of the corporate event may be retained by the participant.

Alterations to the Scheme

The Committee may, at any time, amend the Scheme or any of the performance conditions in any respect, provided that the maximum award provided by this Scheme shall not be exceeded. Any amendment will be reported to Members and confirmed in the next published Remuneration Report.

DIRECTORS' RESPONSIBILITY

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. Under that law the Directors have elected to prepare the Group and parent Company financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the parent Company and of the profit of the Group for that period.

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 applicable IFRSs as adopted by the EU have been followed, subject to any material departures disclosed and explained in the financial statements, and
- » 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 2006. 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 a Corporate Governance Statement that comply with that law and those regulations.

The Company is responsible for the maintenance and integrity of the corporate and financial information included on its website. 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
4 June 2010

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF GLAS CYMRU CYFYNGEDIG

We have audited the group and parent company financial statements (the 'financial statements') of Glas Cymru Cyfyngedig for the year ended 31 March 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Reserves, the Consolidated and Parent Company Balance Sheets, the Consolidated Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 64, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion

- » the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2010 and of the group's profit and group's and parent company's cash flows for the year then ended
- » the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union
- » the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- » the financial statements have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- » adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- » the parent company financial statements are not in agreement with the accounting records and returns, or
- » certain disclosures of directors' remuneration specified by law are not made, or
- » we have not received all the information and explanations we require for our audit

Other matters

The directors have requested, (because the company applies Listing Rules 9.8.6R.5 and 6 of the Financial Services Authority as if it were a listed company), that we review the parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review by the Listing Rules of the Financial Services Authority. We have nothing to report in respect of this review.

At the request of the directors, we have also audited the Directors Remuneration Report that is described as having been audited. In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Stephen W Harrison (Senior Statutory Auditor) for and on behalf of PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors, Cardiff | 4 June 2010

PRIMARY STATEMENTS

Consolidated Income Statement for the year ended 31 March 2010

	Note	2010 £m	2009 £m
Revenue		688.2	657.2
Operating costs			
- Operational expenditure			
Before exceptional items	3	(265.7)	(266.9)
Exceptional items	4	(29.5)	-
		(295.2)	(266.9)
- Infrastructure renewals expenditure	3	(77.3)	(101.1)
- Depreciation and amortisation	3	(139.5)	(133.5)
- Loss on disposal of fixed assets	3	(0.4)	(0.8)
Operating profit analysed as			
Operating profit before exceptional items		205.3	154.9
Exceptional items	4	(29.5)	-
Operating profit		175.8	154.9
Financing costs			
- Interest payable and similar charges	5a	(101.3)	(174.3)
- Interest receivable	5a	3.4	8.6
- Fair value losses on derivative financial instruments	5b	(15.0)	(86.5)
		(112.9)	(252.2)
Profit/(loss) before taxation	3	62.9	(97.3)
Taxation credit/(charge)	6	1.9	(5.6)
Profit/(loss) for the year		64.8	(102.9)

	2010 £m	2009 £m
Underlying profit/(loss) for the year		
Profit/(loss) before taxation per Income Statement	62.9	(97.3)
Add back		
- Exceptional items (see note 4)	29.5	-
- Fair value losses on derivative financial statements (see note 5b)	15.0	86.5
Underlying profit/(loss) for the year (before exceptional items, taxation and fair value adjustments)	107.4	(10.8)

Consolidated Statement of Comprehensive Income for the year ended 31 March 2010

	Note	2010 £m	2009 £m
Profit/(loss) for the year		64.8	(102.9)
Actuarial loss recognised in the pension scheme	21	(1.5)	(10.4)
Movement on deferred tax asset relating to pension scheme	6	-	2.9
Total comprehensive income/(expenditure) for the year		63.3	(110.4)

Consolidated Statement of Changes in Reserves for the year ended 31 March 2010

	2010 £m	2009 £m
Reserves at 1 April	(152.1)	(41.7)
Total comprehensive income/(expenditure) for the year	63.3	(110.4)
Reserves at 31 March	(88.8)	(152.1)

There were no changes in reserves of the parent company during the year (2009 none)

PRIMARY STATEMENTS

Consolidated Balance Sheet as at 31 March 2010

	Note	2010 £m	2009 £m
Assets			
Non-current assets			
Property, plant and equipment	8	3,103.9	2,980.0
Intangible assets	9	60.1	46.2
Investments	10a	-	-
Financial assets			
- derivative financial instruments	15	0.8	-
		3,164.8	3,026.2
Current assets			
Trade and other receivables	11	114.0	102.2
Financial assets			
- derivative financial instruments	15	4.4	26.0
Cash and cash equivalents	12	248.7	139.3
		367.1	267.5
Liabilities			
Current liabilities			
Trade and other payables	13	(130.5)	(129.5)
Financial liabilities			
- borrowings	14	(150.2)	(20.0)
- derivative financial instruments	15	(36.0)	(2.1)
Provisions	17	(14.8)	-
		(331.5)	(151.6)
Net current assets			
		35.6	115.9
Non-current liabilities			
Trade and other payables	13	(2.3)	(3.0)
Financial liabilities			
- borrowings	14	(2,761.8)	(2,739.7)
- derivative financial instruments	15	(141.9)	(181.7)
Retirement benefit obligations	21	(8.0)	(7.8)
Provisions	17	(22.6)	(9.2)
		(2,936.6)	(2,941.4)
Net assets before deferred tax			
		263.8	200.7
Deferred tax - net	7	(352.6)	(352.8)
Net liabilities			
		(88.8)	(152.1)
Deficit			
		(88.8)	(152.1)

The financial statements on pages 66 to 96 were approved by the Board of directors on 4 June 2010 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 2010

	Note	2010 £m	2009 £m
Assets			
Non-current assets			
Investment in subsidiaries	10b	-	-
Trade and other receivables	11b	3 4	3 4
		3 4	3 4
Current assets			
Cash and cash equivalents	12	0 1	0 1
		0 1	0 1
Liabilities			
Current liabilities			
Trade and other payables	13	(3 5)	(3 5)
		(3 5)	(3 5)
Net assets			
		-	-
Reserves			
Retained earnings		-	-
Total reserves		-	-

The financial statements on pages 66 to 96 were approved by the Board of directors on 4 June 2010 and were signed on its behalf by



N C Annett
Managing Director



C A Jones
Finance Director

PRIMARY STATEMENTS

Consolidated Cash Flow Statement for the year ended 31 March 2010

	Note	2010 £m	2009 £m
Cash flows from operating activities			
Cash generated from operations	18a	330 6	309 1
Interest received		3 5	9 8
Interest paid	18b	(116 1)	(129 4)
Net cash inflow from operating activities		218 0	189 5
Cash flows from investing activities			
Purchase of property, plant and equipment		(281 4)	(257 0)
Grants and contributions received		12 3	13 6
Costs of sale of property, plant and equipment		(0 4)	(0 8)
Net cash used in investing activities		(269 5)	(244 2)
Net cash outflow before financing activities		(51 5)	(54 7)
Cash flows from financing activities			
Long term loans and finance leases received		35 0	85 0
Bond issue proceeds		139 3	-
Revolving credit facility and term loan repayments		(4 4)	(4 4)
Capital element of finance lease payments		(8 6)	(10 4)
Other loan repayments		(0 4)	(0 3)
Net cash generated from financing activities		160 9	69 9
Increase in net cash	19	109 4	15 2
Net cash at 1 April		139 3	124 1
Net cash at 31 March	12	248.7	139 3

The parent company had no cash flows during the year (2009 none)

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 2006 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 Companies Act 2006.

In the current year, Glas Cymru has applied the following Interpretations which are or have become effective:

IFRS 7	Financial Instruments – Disclosures (amendment)
IFRS 8	Operating Segments (revision)
IAS 1	Presentation of Financial Statements (revision)
IAS 23	Borrowing Costs (revision)
IAS 27	Consolidated and Separate Financial Statements (revision)
IAS 32	Financial Instruments Presentation (revision)
IAS 39	Financial Instruments Recognition and Measurement (revision)

Except as noted under 'Changes of accounting policy' below in respect of IAS 23, the application of these Interpretations has no material effect on the preparation or presentation of the results or financial position for the current or prior accounting periods, and accordingly no prior period adjustment has been required.

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:

IAS 1	Presentation of Financial Statements (revision)
IAS 27	Consolidated and Separate Financial Statements (revision)
IAS 38	Intangible Assets (revision)
IFRIC 18	Transfers of Assets from Customers

The application of IFRIC 18, effective for Glas Cymru's financial statements for the year ending 31 March 2011, will require the recognition of income in the financial statements when a property developer lays a pipe to connect a new development to the network and transfers the asset to the water company for no charge. Such assets will be recorded at their fair value on the balance sheet with the credit recognised immediately as revenue, on the basis that once the company has connected the development to the network there is no further obligation arising for the company.

The presentational impact of the other Standards and Interpretations is being assessed, but 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.

Change of accounting policy

During the year, a revision to IAS 23, 'Borrowing costs' became applicable. The revision removes the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale, and Glas Cymru is therefore required to capitalise borrowing costs as part of the cost of such assets (see 'Property, plant and equipment' below). In respect of the year ended 31 March 2010, £6.1m of borrowing costs have been capitalised and will be amortised over the useful economic lives of the related assets. The revision to IAS 23 has been applied prospectively from 1 April 2009 and no adjustment is required to prior periods.

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 2010

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been applied consistently to all the years presented, except as noted above under 'Change of accounting policy'.

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 value is included in revenue. See the critical accounting estimates section for further details.

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 and 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 and, in respect of capital projects commenced after 1 April 2009, borrowing costs in accordance with IAS 23.

Property, plant and equipment comprise:

- infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls), and
- 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.

NOTES TO THE FINANCIAL STATEMENTS

1) Infrastructure assets

Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. 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, 'infrastructure renewals expenditure', 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 principally from 60 to 150 years.

2) Other assets

Other assets are depreciated on a straight line basis over their estimated useful economic lives, which are as follows:

Freehold buildings	60 years
Leasehold properties	over the lease period
Operational structures	10 – 80 years
Fixed plant	8 – 40 years
Vehicles, mobile plant, equipment and computer hardware and 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 amortised on a straight line basis 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 and equipment' with the corresponding liability to the lessor included within 'financial 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 receivables/payables arising from these contracts is to recognise gain payables over the period to which the charge relates, and pain receivables as income only when final agreement with the relevant service partner has been achieved.

Trade receivables and their impairment

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost less provision for impairment. They 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 assessed collectively for impairment based on their ageing. Movements in the provision for impairment 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

1) Defined benefit scheme

A majority of the group's employees belongs to the group's defined benefit pension scheme, which is funded by both employer's and employees' contributions. 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.

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.

The group's defined benefit scheme service cost, being the increase in the present value of the liabilities expected to arise from employee service in the period, is included in operating costs. The expected return on scheme assets and interest on scheme liabilities are included in financing costs in the income statement. Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the Statement of Comprehensive Income.

2) Defined contribution scheme

The group also operates a defined contribution scheme for those employees who are not members of the defined benefit scheme. Obligations for contributions to the scheme are recognised as an expense in the Income Statement in the period in which they arise.

Financial liabilities

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.

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 interest rate and inflation 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 subsequently re-measured at fair value (based on market price data from relevant counterparties).

During the year to 31 March 2010, none of the group's derivatives qualified for hedge accounting under IAS 39 (2009) none. These instruments are carried at fair value with changes in fair value being recognised immediately in the income statement.

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 substantially enacted at the balance sheet date (2010 and 2009 28%).

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.

Exceptional items

Exceptional items are those significant items which are disclosed separately by virtue of their size and/or nature to enable a full understanding of the group's financial performance.

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. Financial instruments, which principally include listed bonds, finance leases, bank loan facilities and derivatives, are used to raise finance and manage risk from our operations.

NOTES TO THE FINANCIAL STATEMENTS

Credit risk

The group has a prudent policy for investing cash and short term bank deposits ('cash investments'). Counterparties for cash investments must meet minimum short term and/or long term credit ratings as published by Standard & Poor's ('S&P'), Moody's Investor Service Limited ('Moody's') and Fitch Ratings Limited ('Fitch'). The minimum short term rating, for cash deposits of up to one year, is A1/P1/F1 and the minimum long term rating, for cash deposits over one year, is A+/A3/A+ each for S&P, Moody's and Fitch respectively. The Board reviews counterparties annually for cash investments and the credit limit assigned to each.

The group has continued to follow a cautious policy for investing cash deposits as a response to the situation in the banking market. In consequence all new cash investments must meet the minimum long term rating and have a maximum investment period of three months. The maximum cash investment with a single counterparty was £142m (2009 £69m).

Interest rate risk

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 floating rate interest 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 exposes 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 group analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. Of total borrowings of £2,912m as at 31 March 2010 (2009 £2,760m), only £30m related to floating rate debt (2009 £156m). The group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2010, 99% (2009 94%) of the group's gross debt was at fixed or index-linked ('RPI') rates of interest after taking into account interest rate and RPI swaps. The "hedges" established to manage interest rate 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. Accordingly, all movements in the fair value of derivative financial instruments are reflected in the income statement. This has resulted in a total liability of £173 million in the balance sheet at 31 March 2010 (2009 £158 million) but, assuming that the swaps are held to maturity, this will ultimately reduce to nil.

Power price hedges

The company enters into contracts which fix the price of a proportion of future power purchases in order to reduce the impact of power price variances. The company has forward-purchased approximately a third of the estimated power requirement of the business over the regulatory period from 1 April 2010 to 31 March 2015. These contracts neither qualify as financial instruments under IAS 39 nor as onerous contracts under IAS 37 and, consequently, are not included in the financial statements until the contracts are effective.

Refinancing risk

Refinancing 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 of £2,912m can fall due in any 24 month period.

Liquidity risk

We maintain committed banking facilities in order to provide flexibility in the management of the group's liquidity.

Under the Common Terms Agreement which governs the group's obligations to its bond holders and other financial creditors, the group is required to have cash available to fund operations for a duration of 18 months. As at 31 March 2010, the group had committed undrawn borrowing facilities of £420m (2009 £420m) and cash and cash equivalents (excluding debt service payments account) of £238m (2009 £124m). On 7 May 2010 the group reduced its undrawn facilities by £245m following the Board's conclusion that these were surplus to requirements.

There is also a special liquidity facility of £150m, this is required 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.

Capital risk management

The group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail Price Index and determined by Ofwat.

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 cost of finance. The Board intends ultimately to reduce gearing to around 70% and to maintain it at that level, but recognises that the recent economic recession will prevent this in the short term.

In respect of the risks detailed above, further quantitative disclosures are provided in note 16.

Critical accounting estimates

The preparation of financial statements which conform to 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.

Provision for impairment of trade receivables

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 provision for impairment would increase or decrease by £34 million (2009 £5.0 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 as at 31 March 2010 would increase or reduce by £1.1 million (2009 £0.7 million). Subsequent to the year-end, it is likely that the size of the pension scheme will increase significantly as employees transferring into Welsh Water become eligible to transfer their existing pensions into the DCWW Pension Scheme (see subsequent events note 27). This will increase the sensitivity of the balance sheet obligation to changes in the discount rate.

Measured income accrual

Revenue includes an accrual for unbilled charges at the year-end. The accrual is estimated using a defined methodology based upon the weighted average water consumption by tariff, which is calculated using 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 or decreasing the accrual by £2.3 million (2009 £2.3 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 geographical analysis by origin and destination. As the group has only domestic activities there is only one geographical segment, therefore, the disclosures for the secondary segment have also already been given in these financial statements.

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

NOTES TO THE FINANCIAL STATEMENTS

3 f Profit/(loss) before taxation

The following items have been included in arriving at the profit/(loss) before taxation

	Group			
	Before exceptional items 2010 £m	Exceptional items (note 4) 2010 £m	Total 2010 £m	Total 2009 £m
Operating charges from outsourced activities				
- Operating services agreements	131.2	(5.0)	126.2	138.4
- Customer services agreement	18.7	-	18.7	19.5
- Laboratories and analytical services	6.6	-	6.6	6.7
- Other contracts	14.1	-	14.1	14.2
- Contract termination costs	-	10.8	10.8	-
- Restructuring and rationalisation	-	15.4	15.4	-
	170.6	21.2	191.8	178.8
Employee costs (note 20)				
- Wages and salaries	10.7	-	10.7	10.7
- Social security	1.1	-	1.1	1.0
- Pension costs (excluding actuarial loss)	1.7	-	1.7	1.0
- Restructuring and rationalisation	-	7.2	7.2	-
	13.5	7.2	20.7	12.7
Research and development expenditure	0.5	-	0.5	0.5
Trade receivables impairment	22.3	-	22.3	18.8
Rates	26.9	-	26.9	25.5
Environment Agency charges	15.1	-	15.1	14.9
Fees payable to auditors	0.2	-	0.2	0.2
Staff costs capitalised	(5.9)	-	(5.9)	(5.7)
Other operating charges	22.5	1.1	23.6	21.2
Total operational expenditure	265.7	29.5	295.2	266.9
Infrastructure renewals expenditure	77.3	-	77.3	101.1
Depreciation and amortisation				
- Owned assets	91.2	-	91.2	89.1
- Under finance leases	40.6	-	40.6	40.7
- Amortisation of intangible assets	7.7	-	7.7	3.7
	139.5	-	139.5	133.5
Loss on disposal of fixed assets	0.4	-	0.4	0.8
	482.9	29.5	512.4	502.3

Services provided by the group's auditor

During the year, the group obtained the following services from the group's auditor

	Group	
	2010 £'000	2009 £'000
Non-discretionary audit fees		
Statutory audit of parent company and consolidated financial statements	11	11
Statutory audit of subsidiary companies	77	75
Total statutory audit fees	88	86
Review of interim financial statements	22	21
Regulatory audit services pursuant to legislation	39	33
Review of draft business plan (required by Ofwat)	-	81
Total audit fees	149	221
Other services		
Tax advisory services	5	10
Services relating to bond prospectus update and bond issue	25	-
Other	10	2
Total other services	40	12
Total cost of services provided by the group's auditor	189	233

Regulatory audit services include audit work on the Regulatory Accounts, June Return and Principal Statement. In addition to the above services, PricewaterhouseCoopers LLP acted as auditor to the DCWW 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 £11,000 (2009: £13,000).

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.

4 | Exceptional restructuring costs

On 9 February 2010 Glas Cymru announced its intention to restructure Welsh Water following the decision to bring back in house the operational activities which had been outsourced (for further information, see Operating and Financial Review). Restructuring costs of £29.5m are considered exceptional by nature and are disclosed separately in note 3 to the financial statements. These include the costs of terminating the outsourced contracts along with the estimated restructuring costs associated with a reduction in the headcount by some 300. Contract termination costs include agreed payments in lieu of the profit element for year 6 and early agreement of an adjustment reflecting year 5 performance. It is not anticipated that any further significant expenditure will be incurred in relation to the restructuring of the business.

NOTES TO THE FINANCIAL STATEMENTS

5 | Financing costs

a) Net interest before fair value losses on derivative financial instruments

	Group	
	2010 £m	2009 £m
Interest payable on bonds	(84.9)	(86.1)
Indexation on index-linked bonds	9.5	(41.4)
Interest payable on finance leases	(18.4)	(37.1)
Other loan interest	(10.9)	(7.4)
Other interest payable and finance costs	(2.4)	(2.5)
Net interest (charge)/credit on pension scheme liabilities	(0.3)	0.2
Capitalisation of borrowing costs under IAS 23 (2010 3.8%, 2009 nil)	6.1	-
Interest payable	(101.3)	(174.3)
Interest receivable	3.4	8.6
Net interest payable before fair value adjustments	(97.9)	(165.7)

Between July 2008 and July 2009 the Retail Prices Index fell by 1.5% producing an indexation 'credit' on the group's index-linked bonds (July 2007 to July 2008 rise of 5.0%)

b) Fair value losses on derivative financial instruments

Derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IAS 39. Consequently, the group's interest rate and index-linked swaps are fair valued at each balance sheet date with the net loss or gain disclosed in the income statement. Over the life of these swaps, if held to maturity, these fair value adjustments will reverse and reduce to zero. (See note 15 in respect of derivative financial instruments held on the balance sheet.)

	Group	
	2010 £m	2009 £m
Fair value gains/(losses) on interest rate swaps	9.5	(28.3)
Fair value losses on index-linked swaps	(24.5)	(58.2)
Total fair value losses on derivative financial instruments	(15.0)	(86.5)
Deferred tax effect at 28% (2009 28%) of fair value losses	4.2	24.2
Net of tax impact of fair value losses	(10.8)	(62.3)

6 } Taxation

Analysis of credit/(charge) in the year

	Group	
	2010	2009
	£m	£m
Current tax		
- Adjustment in respect of prior years	17	-
Deferred tax		
- Current year movements	(158)	303
- Adjustment in respect of prior years	160	40
- Effect of abolition of Industrial Buildings Allowances	-	(370)
	02	(27)
Taxation credit/(charge)	19	(27)
Analysed as		
Credit/(charge) to Income Statement	19	(56)
Credit to Statement of Comprehensive Income	-	29
	19	(27)

The £16m deferred tax adjustment in respect of prior years relates to the agreement with HMRC of a land remediation claim for the group's Section 19 mains rehabilitation programme

The effective rate of tax for the year is lower (2009 higher) than the standard rate of corporation tax in the UK (2010 and 2009 28%) The differences are explained below

	Group	
	2010	2009
	£m	£m
Profit/(loss) before tax	629	(973)
Profit/(loss) before tax multiplied by the corporation tax rate in the UK of 28% (2009 28%)	176	(272)
Effects of		
- Adjustments in respect of prior years	(177)	(40)
- Other permanent differences	(18)	(02)
- Effect of abolition of Industrial Buildings Allowances	-	370
- Movement on deferred tax asset relating to pension scheme	-	(29)
Total taxation (credit)/charge	(19)	27

7 } Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 28% (2009 28%)

The movement in the deferred tax provision is as shown below

	Group	
	2010	2009
	£m	£m
At 1 April	3528	3501
(Credit)/charge to Income Statement	(02)	56
Credit to Statement of Comprehensive Income	-	(29)
At 31 March	3526	3528

NOTES TO THE FINANCIAL STATEMENTS

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. Under the current tax regime, trading tax losses carried forward will be available to offset trading profits in future periods.

	Group	
	2010 £m	2009 £m
Effect of		
Tax allowances in excess of depreciation	454.4	443.7
Capital gains rolled over	41.6	41.6
Deferred tax on tax losses carried forward	(82.5)	(80.1)
Deferred tax on losses on derivative financial instruments	(48.9)	(44.7)
Pensions	(2.2)	(2.2)
Other tax differences	(9.8)	(5.5)
Provision for deferred tax	352.6	352.8

The parent company has no deferred tax balance.

8 | 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 2009	34.4	1,513.1	2,383.4	226.2	4,157.1
Additions net of grants and contributions	-	32.9	222.2	1.3	256.4
At 31 March 2010	34.4	1,546.0	2,605.6	227.5	4,413.5
Accumulated depreciation					
At 1 April 2009	16.8	131.2	859.4	169.7	1,177.1
Charge for the year	0.5	33.8	83.2	15.0	132.5
At 31 March 2010	17.3	165.0	942.6	184.7	1,309.6
Net book value					
At 31 March 2010	17.1	1,381.0	1,663.0	42.8	3,103.9

The net book value of property, plant and equipment includes £155.5m in respect of assets in the course of construction (2009: £160.9m).

The net book value of property, plant and equipment includes £6.1m of borrowing costs capitalised in accordance with IAS 23 (2009: nil), of which £6.1m were additions in the year (2009: nil).

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 2008	33 0	1,457 4	2,232 5	222 9	3,945 8
Additions net of grants and contributions	1 4	55 7	150 9	67 4	275 4
Disposals	-	-	-	(64 1)	(64 1)
At 31 March 2009	34 4	1,513 1	2,383 4	226 2	4,157 1
Accumulated depreciation					
At 1 April 2008	16 3	98 8	772 9	164 4	1,052 4
Charge for the year	0 5	32 4	86 5	10 5	129 9
Released on disposal	-	-	-	(5 2)	(5 2)
At 31 March 2009	16 8	131 2	859 4	169 7	1,177 1
Net book value					
At 31 March 2009	17 6	1,381 9	1,524 0	56 5	2,980 0

Assets held under finance leases

Included within the above are assets held under finance leases, analysed as below

Group	Infrastructure assets £m	Operational structures £m	Total £m
Current year			
Cost			
At 1 April 2009 and at 31 March 2010	611 8	658 1	1,269 9
Accumulated depreciation			
At 1 April 2009	51 6	220 5	272 1
Charge for the year	7 7	32 9	40 6
At 31 March 2010	59 3	253 4	312 7
Net book value			
At 31 March 2010	552 5	404 7	957 2

Group	Infrastructure assets £m	Operational structures £m	Total £m
Prior year			
Cost			
At 1 April 2008	611 8	598 1	1,209 9
Additions	-	60 0	60 0
At 31 March 2009	611 8	658 1	1,269 9
Accumulated depreciation			
At 1 April 2008	43 9	187 5	231 4
Charge for the year	7 7	33 0	40 7
At 31 March 2009	51 6	220 5	272 1
Net book value			
At 31 March 2009	560 2	437 6	997 8

The parent company owns no property, plant or equipment

NOTES TO THE FINANCIAL STATEMENTS

9 | Intangible assets

Intangible assets comprise computer software and related system developments

Group	Cost £m	Amortisation £m	Net book value £m
Current year			
At 1 April 2009	101.5	(55.3)	46.2
Additions	21.6	(7.7)	13.9
Disposals	(6.5)	6.5	-
At 31 March 2010	116.6	(56.5)	60.1
Prior year			
At 1 April 2008	76.7	(51.6)	25.1
Additions	24.8	(3.7)	21.1
At 31 March 2009	101.5	(55.3)	46.2

The net book value of intangible assets includes £34.2m in respect of assets in the course of construction (2009 £18.1m)

The majority of this relates to assets which will have an estimated life of around 20 years once commissioned

The parent company owns no intangible fixed assets

10 | Fixed asset investments

a) Group

Cost and net book value	2010 £m	2009 £m
At 1 April and 31 March	-	-

Equity of less than 10% is held in the following unlisted company

	Principal activity	Country of incorporation	Holding
Water Research Centre (1989) Plc	Water research	England and Wales	'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%

11 Trade and other receivables

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
a) Amounts falling due within one year				
Trade receivables	86 0	109 4	-	-
Provision for impairment of receivables	(44 2)	(70 6)	-	-
Trade receivables - net	41 8	38 8	-	-
Prepayments and accrued income	62 1	62 0	-	-
Corporation tax	1 7	-	-	-
Other receivables	8 4	1 4	-	-
	114 0	102 2	-	-
b) Amounts falling due after more than one year				
Amounts owed by group undertakings	-	-	3 4	3 4
	-	-	3 4	3 4
Total trade and other receivables	114 0	102 2	3 4	3 4

All non-current receivables are due within five years from the balance sheet date

As at 31 March 2010, based on a review of historical collection rates it was considered that £44.2m of trade receivables were impaired and these have therefore been provided for (2009 £70.6m). The impaired receivables relate mainly to measured and unmeasured water supply debtors.

The ageing of receivables was as follows

	Total £m	Provided for £m	Net £m
Current year			
Trade receivables			
Under one month	18.4	(3.6)	14.8
Between one and six months	22.6	(10.3)	12.3
Between six months and one year	19.0	(9.2)	9.8
Between one and two years	16.1	(12.0)	4.1
Between two and three years	9.6	(8.8)	0.8
Over three years	0.3	(0.3)	-
	86.0	(44.2)	41.8
Prior year			
Trade receivables			
Under one month	10.1	(3.4)	6.7
Between one and six months	18.0	(8.2)	9.8
Between six months and one year	21.4	(7.2)	14.2
Between one and two years	21.9	(16.3)	5.6
Between two and three years	15.9	(13.6)	2.3
Over three years	22.1	(21.9)	0.2
	109.4	(70.6)	38.8

NOTES TO THE FINANCIAL STATEMENTS

Movements in the provision for impairment of trade receivables are as follows

	2010 £m	2009 £m
At 1 April	70 6	58 8
Charge to Income Statement	21 6	18 1
Receivables written off during the year as uncollectable	(48 0)	(6 3)
At 31 March	44 2	70 6

The creation and release of provision for impaired receivables have been included in operational expenditure

The other classes within trade and other receivables do not contain impaired assets. All trade and other receivables are denominated in sterling.

During the year the group has written off £48 0m of debt which had been provided for in full (2009 £6 3m)

12 J Cash and cash equivalents

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Cash at bank and in hand	3 7	3 0	0 1	0 1
Short-term deposits	245 0	136 3	-	-
	248 7	139 3	0 1	0 1

The effective interest rate on short-term deposits as at 31 March 2010 was 0.6% (2009 0.6%) and these deposits had an average maturity of 9 days (2009 8 days). All cash and cash equivalents were held in sterling.

13 J Trade and other payables

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Current				
Trade payables	21 5	28 2	-	-
Capital payables	56 5	53 4	-	-
Amounts due to group undertakings	-	-	3 5	3 5
Other taxation and social security	0 5	0 4	-	-
Accruals and deferred income	52 0	47 5	-	-
	130 5	129 5	3 5	3 5
Non-current				
Deferred income	2 3	3 0	-	-

14 Financial liabilities – borrowings

	Group	
	2010	2009
	£m	£m
Current		
Interest accruals	5.9	6.9
Bonds	125.0	-
Unamortised bond premium	0.6	0.5
Unamortised bond issue costs	(0.4)	(0.7)
European Investment Bank loans	8.9	4.4
Local authority loans	0.3	0.3
Finance lease obligations	9.9	8.6
	150.2	20.0
Non-current		
Interest accruals	38.0	35.0
Bonds	1,670.0	1,664.5
Unamortised bond premium	11.2	11.8
Unamortised bond issue costs	(5.9)	(4.2)
KfW Bank loan	35.0	-
European Investment Bank loans	138.0	146.8
Local authority loans	1.9	2.3
Finance lease obligations	873.6	883.5
	2,761.8	2,739.7

The parent company has no borrowings

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

- 1) 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
- 2) a 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

The group's Class A Bonds of £895.9m (2009 £902.3m) benefit from a guarantee from MBIA UK Insurance Limited ('MBIA')

MBIA's credit rating has been reduced to B3 and BBB+ by Moody's and S&P respectively, and is no longer rated by Fitch

The credit rating of the Class A bonds has therefore defaulted to the higher underlying rating of these bonds, of A3/A/A from

Moody's, S&P and Fitch respectively. The underlying rating reflects the standalone credit quality of these bonds without the

benefit of the MBIA guarantee, and is the same as the credit ratings of the group's Class B bonds of £759.1m (2009 £637.2m)

NOTES TO THE FINANCIAL STATEMENTS

15 | 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 (see note 3b). The fair values of all derivative financial instruments held by the group are the result of mark-to-market pricing by the issuing counterparties and as such fall within level 1 of the fair value hierarchy set out in IFRS 7.

Group - 2010	Fair Values	
	Assets £m	Liabilities £m
Current		
Index-linked swaps	4.4	(24.4)
Interest rate swaps	-	(11.6)
	4.4	(36.0)
Non-current		
Index-linked swaps	-	(105.5)
Interest rate swaps	0.8	(36.4)
	0.8	(141.9)
Total	5.2	(177.9)

Group - 2009	Fair Values	
	Assets £m	Liabilities £m
Current		
Index-linked swaps	18.6	(1.4)
Interest rate swaps	7.4	(0.7)
	26.0	(2.1)
Non-current		
Index-linked swaps	-	(119.7)
Interest rate swaps	-	(62.0)
	-	(181.7)
Total	26.0	(183.8)

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

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

Interest rate swaps

At 31 March 2010 the interest rate swaps fix the interest rate on £192m (2009 £192m) of floating rate liabilities held by the group. The maturity date of the swap is 31 March 2031 and the quarterly fixed interest rate is 5.67%. In addition, £56m (2009 £nil) of finance lease liabilities have been swapped from a floating to a fixed rate of 3.567% until March 2017. The notional amount of the swap is £54m (2009 £nil).

£534 million (2009 £563m) of finance lease liabilities are converted from 3 month to 12 month floating for a period of one year, the swaps expire on 31 March 2011. These swaps are matched against the same liabilities as £534m of the finance lease index-linked swaps noted below.

Index-linked swaps

Finance lease swaps

The index-linked swaps have the effect of index-linking the interest rate on £692m (2009 £617m) of finance lease liabilities by reference to the Retail Prices Index ('RPI').

The notional amount of the swaps as at 31 March 2010 is £636 million (2009 £563m), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2010. The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases.

The principal terms are as follows:

Notional amount	£636m (amortising)
Average swap maturity	23 years
Average interest rate	1.58% (fixed) plus RPI

Bond swap

The index-linked swaps have the effect of index-linking the interest rate on £100m of fixed rate bonds by reference to the RPI.

The principal terms are as follows:

Indexed notional amount	£109.4m
Swap maturity	47 years
Interest rate	1.35% (indexed by RPI)

16 | Financial risk management

The policies of the group in respect of financial risk management are included in the accounting policies note on pages 73 and 74. The numerical financial instrument disclosures as required by IFRS 7 are set out below.

a) Interest rate risk

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

	2010	2009
Assets		
Cash and cash equivalents	0.6%	0.6%
Liabilities		
Bonds	5.2%	5.6%
European Investment Bank loans	2.4%	2.1%
Local authority loans	4.9%	5.3%
Finance lease obligations	1.6%	5.1%

Trade and other 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 15. They also exclude the indexation charge applicable to the index-linked bonds.

NOTES TO THE FINANCIAL STATEMENTS

b) Liquidity risk

Group - 2010	Within 1yr £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
Assets					
Cash and cash equivalents	248 7	-	-	-	248 7
Trade and other receivables	112 4	-	-	-	112 4
	361 1	-	-	-	361 1
Liabilities					
Bonds	125 6	0 6	1 8	1,678 8	1,806 8
KfW Bank loan	-	-	11 7	23 3	35 0
European Investment Bank loans	8 9	13 5	42 9	81 6	146 9
Local authority loans	0 3	0 3	1 0	0 6	2 2
Finance lease obligations	9 9	11 9	91 8	769 9	883 5
Trade and other payables	130 5	0 5	1 5	0 3	132 8
	275 2	26 8	150 7	2,554 5	3,007 2

Group - 2009	Within 1yr £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
Assets					
Cash and cash equivalents	139 3	-	-	-	139 3
Trade and other receivables	102 2	-	-	-	102 2
	241 5	-	-	-	241 5
Liabilities					
Bonds	0 5	125 6	1 8	1,548 9	1,676 8
European Investment Bank loans	4 4	8 9	40 4	97 5	151 2
Local authority loans	0 3	0 3	1 0	1 0	2 6
Finance lease obligations	8 6	9 9	51 1	822 5	892 1
Trade and other payables	129 5	0 3	0 3	2 4	132 5
	143 3	145 0	94 6	2,472 3	2,855 2

As at 31 March 2010, the bonds maturing within 1 year represent £125 million of subordinated 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 change from a fixed rate of 8.174% to a floating 3 month LIBOR interest rate plus a margin of 5.75%.

On 3 June 2010 the Group agreed to repurchase £113 million of Class C1 bonds following a tender offer to bondholders. The amount repurchased represents a take-up rate of 90% and settlement will be made in cash on 7 June 2010.

The minimum lease payments under finance leases fall due as follows

	2010 £m	2009 £m
Gross finance lease liabilities		
Within one year	22 2	30 9
Between two and five years	232 3	175 9
After five years	1,164 5	1,165 5
	1,419 0	1,372 3
Future interest	(535 5)	(480 2)
Net finance lease liabilities	883 5	892 1
Net finance lease liabilities are repayable as follows		
Within one year (note 14)	9 9	8 6
Between two and five years	103 7	61 1
After five years	769 9	822 4
Total over one year (note 14)	873 6	883 5

c) Fair values

The fair values of the group's derivative financial instruments are set out in note 15. The following table summarises the fair value and book value of the group's bonds.

	2010		2009	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bonds (note 14)	1,806 8	2,036 9	1,676 8	1,603 0

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

d) Borrowing facilities

As at 31 March 2010, the group had available undrawn committed borrowing facilities of £420m expiring as set out below, in respect of which all conditions precedent had been met (2009 £420m).

	2010 £m	2009 £m
Expiring in less than 1 year		
- term loan facility	75	-
Expiring in more than 1 year		
- revolving credit facilities	345	345
- term loan facility	-	75
	345	420
	420	420

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. No such covenant defaults have arisen during the year. Dŵr Cymru Cyfyngedig also has a £20 million overdraft facility. Both of these facilities are renewable on an annual basis. All of the above facilities, including the liquidity facility, are at floating rates of interest.

In view of the strong liquidity position, £245m of revolving credit facilities were cancelled on 7 May 2010.

NOTES TO THE FINANCIAL STATEMENTS

e) Capital risk management

Gearing ratios

	2010 £m	2009 £m
Total borrowings	(2,912)	(2,759)
Less cash and cash equivalents	249	139
Net debt	(2,663)	(2,620)
RCV	3,737	3,626
Total capital	1,074	1,006
Less unamortised bond costs	(6)	(5)
Total capital per bond covenants	1,068	1,001
Gearing ratio	71%	72%

As set out on page 74, the group monitors its capital structure based on a regulatory gearing ratio which compares its net debt to the Ofwat determined RCV

17 | Provisions

	Restructuring provision £m	Dilapidations provision £m	Uninsured loss provision £m	Total £m
At 1 April 2009	-	1 4	7 8	9 2
Charged to income statement	28 4	0 8	0 7	29 9
Utilised in year	-	-	(1 7)	(1 7)
At 31 March 2010	28 4	2 2	6 8	37 4
Split as				
Amounts to be utilised within one year	12 9	0 2	1 7	14 8
Amounts to be utilised after more than one year	15 5	2 0	5 1	22 6
At 31 March 2010	28 4	2 2	6 8	37 4

As at 31 March 2009, all provisions were expected to be utilised after more than one year. The parent company has no provisions at 31 March 2010 (2009: nil).

Restructuring provision

This provides for the costs of terminating the outsourced contracts along with the estimated restructuring costs associated with a reduction in the headcount by some 300 (see note 4).

Dilapidations provision

This provision relates to estimated dilapidation costs, which will be incurred over the next two years.

Provision for uninsured losses

This provision is in respect of uninsured losses and instances where insurance does not cover a deductible amount.

The utilisation period of these liabilities is uncertain due to the nature of claims, but is estimated to be within five years.

18 j Net cash inflow from operating activities

a) Cash generated from operations

Reconciliation of operating profit to cash generated from operations

	Group	
	2010 £m	2009 £m
Operating profit	175.8	154.9
Adjustments for		
- Depreciation and amortisation	139.5	133.5
- Loss on disposal of fixed assets	0.4	0.8
- Changes in working capital		
(Increase)/decrease in trade and other receivables	(10.1)	11.1
(Decrease)/increase in trade and other payables	(2.1)	8.1
Pension contributions in excess of operating costs	(1.1)	-
Increase in provisions	28.2	0.7
	14.9	19.9
Cash generated from operations	330.6	309.1

b) Interest paid

	Group	
	2010 £m	2009 £m
Interest payable per income statement	101.3	174.3
Less non-cash items		
- Indexation on index-linked bonds	9.5	(41.4)
- Amortisation of bond issue costs	0.6	(0.7)
- Interest (charge)/credit on pension scheme liabilities	(0.2)	0.2
- Amortisation of bond issue premium	0.7	0.5
- Effect of capitalisation under IAS 23	6.1	-
- Decrease in prepayments	-	(3.7)
- (Increase)/decrease in accruals	(1.9)	0.2
	14.8	(44.9)
Interest paid	116.1	129.4

19 j Analysis and reconciliation of net debt

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

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Cash and cash equivalents	248.7	139.3	0.1	0.1
Debt due after one year	(1,850.2)	(1,821.2)	-	-
Debt due within one year	(134.4)	(4.5)	-	-
Finance leases	(883.5)	(892.1)	-	-
Accrued interest	(43.9)	(41.9)	-	-
	(2,912.0)	(2,759.7)	-	-
Net debt	(2,663.3)	(2,620.4)	0.1	0.1

NOTES TO THE FINANCIAL STATEMENTS

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

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Net debt at start of year	(2,620 4)	(2,524 4)	0 1	0 1
Increase in net cash	109 4	15 2	-	-
Increase in debt	(160 9)	(69 9)	-	-
Increase in net debt arising from cashflows	(51 5)	(54 7)	-	-
Movement in accrued interest	(2 0)	0 2	-	-
Indexation of index-linked debt	9 5	(41 4)	-	-
Other non-cash movements	1 1	(0 1)	-	-
Movement in net debt during the year	(42 9)	(96 0)	-	-
Net debt at end of year	(2,663 3)	(2,620 4)	0 1	0 1

20 | Employees and directors

a) Staff costs for the group during the year

	2010 £m	2009 £m
Wages and salaries	10 7	10 7
Social security costs	1 1	1 0
Other pension costs	1 7	1 0
	13 5	12 7

Of the above, £5 9 million (2009 £5 7 million) has been charged to capital

	2010 Number	2009 Number
Average monthly number of people (including executive directors) employed by the group		
Regulated water and sewerage activities	200	187

Some 1,600 employees who worked on the previously outsourced operational contracts have transferred to Welsh Water via TUPE arrangements post year-end (see note 27)

b) Parent company

The parent company had no employees (2009 nil) in the year. Full details of the directors' remuneration are included in the Remuneration Report set out on pages 57 to 62, which forms part of these Financial Statements

21 | Pension commitments

The group operates a funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service), 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 31 December 2005 and a new defined contribution scheme, the Dŵr Cymru Defined Contribution Scheme, was introduced from 1 January 2006

Subsequent to the end of the year, on 1 April 2010 1,093 United Utilities Operational Services ('UUOS') employees transferred to Welsh Water, followed by 476 Kelda Water Services ('KWS') employees on 1 May 2010. Around 1,000 UUOS and KWS employees transferring to Welsh Water are entitled to transfer their existing defined benefit pensions into the DCWW Pension Scheme. In aggregate the transfer is likely to be fully-funded on an actuarial basis, although this result is uncertain and the assumptions used may differ from the calculation under IAS 19.

Assuming that all 1,000 members transfer their pensions into the DCWW Pension Scheme, this would increase scheme assets as at 31 March 2010 by around £177m. Assuming that all members commute the maximum possible pension for cash at retirement, the IAS 19 liability as at the same date would be broadly similar. Scheme membership would increase from around 150 to a total of around 1,150 members.

In the event that the IAS 19 valuation varies from the funded actuarial valuation at the date of transfer, any differences will be taken to the income statement for the year to 31 March 2011.

See also subsequent events note 27.

Total pension costs in the year were as follows:

	2010 £'000	2009 £'000
Defined contribution scheme	273	122
Defined benefit scheme - excluding actuarial loss	1,287	927
	1,560	1,049
Net actuarial loss recognised in year	1,512	10,400
	3,072	11,449

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2009 by Robert Davies of Quantum Advisory, an independent, professionally qualified actuary, using the attained age method. This valuation has been updated as at 31 March 2010 and the principal assumptions made by the actuaries were:

	2010	2009
Discount rate	5.6%	6.2%
Inflation assumption	3.5%	2.7%
Rate of increase in pensionable salaries	4.5%	3.7%
Rate of increase in pensions in payment	3.3%	2.7%
Post retirement mortality (life expectancy)		
- Current pensioners aged 65 - males	87.0 years	87.0 years
- Current pensioners aged 65 - females	89.9 years	89.9 years
- Future pensioners aged 65 (currently aged 45) - males	88.1 years	88.1 years
- Future pensioners aged 65 (currently aged 45) - females	90.9 years	90.9 years

Post retirement mortality assumptions are based on those in published actuarial tables 'PA92', relevant to members' year of birth with medium cohort adjustments.

NOTES TO THE FINANCIAL STATEMENTS

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

	2010		2009	
	Expected return	Percentage of total assets	Expected return	Percentage of total assets
Equities	7.5%	60.5%	8.0%	59.0%
Bonds	5.0%	39.2%	5.0%	39.8%
Other	3.0%	0.3%	3.0%	1.2%

The amounts recognised in the income statement are as follows

	2010 £'000	2009 £'000
Current service cost (excluding member contributions)	852	878
Past service cost	151	151
Effect of curtailments or settlements	-	99
Total included within staff costs	1,003	1,128
Interest cost	2,538	2,353
Expected return on plan assets	(2,254)	(2,554)
Total included within interest payable and similar charges	284	(201)
Total recognised in the Income Statement	1,287	927

Note that the defined contribution scheme charge of £273,000 (2009 £122,000) has also been included within staff costs

The amounts recognised in the Statement of Comprehensive Income are as follows

	2010 £'000	2009 £'000
Actuarial gain/(loss) on plan assets	9,977	(9,301)
Actuarial loss on defined benefit obligation	(11,489)	(1,099)
Total recognised in the Statement of Comprehensive Income	(1,512)	(10,400)

The total recognised in the Balance Sheet is made up as follows

	2010 £'000	2009 £'000
Present value of funded obligations	(55,171)	(40,577)
Plus unrecognised prior service costs	375	526
Fair value of plan assets	46,773	32,283
Net liability recognised in the Balance Sheet	(8,023)	(7,768)

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

	2010 £'000	2009 £'000
At 1 April	40,577	37,416
Current service cost (including member contributions)	1,209	1,241
Interest cost	2,538	2,353
Benefits paid (net of transfers in)	(642)	(919)
Settlement	-	(613)
Actuarial loss	11,489	1,099
At 31 March	55,171	40,577

Changes in the fair value of plan assets are as follows

	2010 £'000	2009 £'000
At 1 April	32,283	38,786
Expected return on plan assets	2,254	2,554
Contributions (including member contributions)	2,901	1,875
Benefits paid (net of transfers in)	(642)	(919)
Settlement	-	(712)
Actuarial gain/(loss) on plan assets	9,977	(9,301)
At 31 March	46,773	32,283

Analysis of the movement in the amount recognised on the balance sheet

	2009 £'000	2008 £'000
At 1 April	7,768	(2,047)
Total charge to Income Statement	1,287	927
Total charge to Statement of Comprehensive Income	1,512	10,400
Contributions paid (excluding member contributions)	(2,544)	(1,512)
At 31 March	8,023	7,768

	2010	2009	2008	2007	2006
Experience adjustments arising on scheme assets					
Amount (£m)	10.0	(9.3)	(4.7)	(0.2)	3.5
Percentage of scheme assets	21%	(29%)	(12%)	(1%)	11%
Experience adjustments arising on scheme liabilities					
Amount (£m)	11.5	(1.1)	8.0	(0.7)	(2.0)
Percentage of the present value of scheme liabilities	21%	(3%)	22%	(2%)	(5%)
Present value of scheme liabilities (£m)	54.8	40.1	36.8	41.0	37.2
Fair value of scheme assets (£m)	46.8	32.3	38.8	35.5	30.6
(Deficit)/surplus (£m)	(8.0)	(7.8)	2.0	(5.5)	(6.6)

The contributions paid in the year to 31 March 2010 include a special contribution of £1.1m (2009: £nil). The contribution expected to be paid during the financial year ended 31 March 2011 amounts to £4.1m (based on scheme membership as at 31 March 2010).

NOTES TO THE FINANCIAL STATEMENTS

22 | Capital and other financial commitments

The group's business plan at 31 March 2010 shows net capital expenditure and infrastructure renewals expenditure of £252m (2009 £350m) 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.

23 | 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.

24 | 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.

25 | 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.

26 | Elan Valley Trust Fund

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

The sum of £31.7m, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Welsh Water Authority, whilst preserving the capital value of the fund in real terms. Welsh Water Authority's interest in this fund was vested in Dŵr Cymru Cyfyngedig under the provisions of the Water Act 1989.

The assets of the fund are not included in these financial statements.

Interest receivable includes £2.6m (2009 £2.3m) in respect of distributions from the Elan Valley Trust Fund.

27 | Subsequent events

On 9 February 2010 Welsh Water announced its intention to restructure the business by terminating the outsourced operational contracts with United Utilities Operational Services ('UUOS') and Kelda Water Services ('KWS') and by implementing a phased headcount reduction of around 300 people.

Subsequent to the end of the year, negotiations relating to the termination of the contracts have been finalised, and on 1 April 2010 1,093 UUOS employees transferred to Welsh Water, followed by 476 KWS employees on 1 May 2010.

Around 1,000 UUOS and KWS employees transferring to Welsh Water are entitled to transfer their existing defined benefit pensions into the DCWW Pension Scheme. In aggregate the transfer is likely to be fully-funded on an actuarial basis, although this result is uncertain and the assumptions used may differ from the calculation under IAS 19.

Assuming that all 1,000 members transfer their pensions into the DCWW Pension Scheme, this would increase scheme assets as at 31 March 2010 by around £177m. Assuming that all members commute the maximum possible pension for cash at retirement, the IAS 19 liability as at the same date would be broadly similar.

In the event that the IAS 19 valuation varies from the funded actuarial valuation at the date of transfer, any differences will be taken to the income statement for the year to 31 March 2011.

The financial statements contain exceptional items of £29.5m relating to the costs of terminating the contracts and reorganising the business (see notes 3 and 4).