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Glas Cymru Cyfyngedig

Report and Accounts 2011

THURSDAY



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COMPANIES HOUSE

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It has been a good year of improvement for Welsh Water. As well as lower bills, we can point to better performance on many of the measures that matter for our customers and that are important for the environment.

This is testament to the efforts and commitment of the entire Welsh Water team. Our task – and it is a significant one – is to deliver a high quality and reliable service to our 1.3 million household and business customers while at the same time reducing our day to day costs by 20% by 2015 so that we can keep bills affordable. Last year we made an excellent start in tackling this challenge.

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Chairman's Statement

Overall, it has been a year of good progress, with lower bills for our customers, a marked improvement in performance on many of the measures that matter for our customers and for the environment together with a further strengthening of our financial position. The fact that this was achieved in a year of extensive organisational change in which we also had to deal with a number of unprecedented operational challenges - as a result of extreme weather conditions - is particularly welcome and attests once again to the calibre and commitment of the entire Welsh Water team.

At the beginning of the year we took back day to day operational control of our water and wastewater services, a step that involved the transfer of some 1,600 colleagues to the Company from our former service providers Kelda Water Services and United Utilities Operational Services. This significant change alongside other improvements to our capabilities - including the move to our new operational control and customer contact centre in St Mellons - means that we are now much better placed to tackle the challenges ahead and achieve higher standards of customer service while keeping bills affordable.

The essential basis for achieving these objectives is a strong financial position and at the year end our regulatory gearing - that is the ratio of net borrowing to our regulatory capital value - had been reduced to 67%. This compares with 93% when Dŵr Cymru Welsh Water (Welsh Water) was acquired by Glas Cymru ten years ago. We have also made good progress on improving our operational cost efficiency. Our target is to reduce our day to day operating costs by 20% in real terms by 2015 and last year we achieved a real term reduction of 5%. By operating and financing our business more efficiently every year we will be able to deliver our £1.3 billion investment programme while keeping customer bills affordable.

Last year our average household bill was £4 lower than the previous year and by 2015 it is expected to be more than £20 lower in real terms. We also give extra help to some of our most vulnerable customers through a range of assistance tariffs which now benefit more than 37,000 low income households, far more than any other company. As a company that is owned on behalf of its customers - and operating in a region where household incomes are generally lower - affordability will always be a high priority for us.

Equally important though is our performance on all the measures that matter. Safe drinking water is our most important responsibility and in 2010 the quality of drinking water remained very high. Despite one of the driest starts to the year - in the first six months of 2010 Wales had the lowest rainfall since 1927 - we did not impose any water use restrictions last year. But largely because we moved leak detection and repair teams to those areas where water resources were tightest during this very dry spell, we fell behind on our leakage reduction programme and this meant that when we were hit by the massive increase in leakage during the unprecedented freeze-thaw we experienced in December and January we were unable to get our leakage back down to the target level by the year end. The extreme freeze-thaw tested the Welsh Water team to the limit during the Christmas and New Year holiday. We were able to maintain services to 99% of our customers without interruption and where we did have problems, in and around Carmarthen in particular, our round-the-clock efforts to restore services, as well as ex gratia compensation, was complimented by many customers.

The very dry weather last year did help us to significantly reduce the number of sewer flooding incidents - the worst possible service failure. And while the number of pollution incidents was 20% lower in 2010 compared with the previous year this continues to be a measure where more improvement is required. Safeguarding the coastal waters and rivers of Wales from pollution is one of our most important responsibilities and for the 2011 summer season Wales has secured 46 Blue Flag beaches and marinas – around a third of the total awarded to all of the UK this year. This is a result that really matters for 'Wales plc' and something we are proud to have helped to achieve.

Most customers only rarely have reason to contact us, but when they do it should be both easy and a pleasure. Last year independent quarterly research carried out on behalf of industry regulator Ofwat with customers who had been in contact with us showed that 78% were satisfied with the service they got from Welsh Water. This result placed Welsh Water third on the industry league table on this measure. Our own tracking research also shows high satisfaction levels and last year the number of customer complaints was 17% lower. Our goal is that every member of the Welsh Water team acts day to day knowing that the Company is owned on behalf of our customers.

It is now ten years since Glas Cymru took over the ownership of Welsh Water and we can be justly proud with what has been achieved in those ten years. The Company is financially secure and on nearly every measure performance is considerably better. Our customers are getting much improved value for money – while our sewerage bill remains the third highest for historical reasons, ten years ago our water

bill was 21% higher than the industry average whereas now it is 3% below the industry average. Our challenge is to build on that record and demonstrate that our performance - right across the board - can compare with the very best in the industry. This is my objective and the Board's priority and we will continue to drive the business and executive team hard in pursuit of this goal.

During the year Lord Burns, Dame Deirdre Hine and Geraint Talfan Davies stepped down from the Board having been with the Company since it was formed 10 years ago. I would like to pay tribute to their enormous contributions to the Company since inception and to the Board and its work over ten years. During the year we were very pleased to announce that Menna Richards and Anna Walker had joined the Board. Both in different ways bring to our Board a wealth of experience in many areas that are key to our future success, customer service in particular.

We operate a unique 'not-for-profit' business model of which we are proud – but it must be used to drive best in class performance on all the measures that matter for our customers and never relied on as an excuse for poor performance. With our business model a strong Board is all the more important to ensure that we do continue to strive always for sector leading performance as well as cost efficiency and the best possible customer service. I would also like to thank our Members, in particular the 26 new Members who joined us during the year, who play such a key role in our governance – their continued support for the Company and their informed and constructive challenge of the Board and the executive team is so very important.

Finally, I would like to thank all the staff who work so hard for Welsh Water – it is a great team that always goes the extra mile, as this last year showed once again, and I am confident that it will tackle the challenges ahead with the same dedication and commitment.

Robert Ayling
Chairman

Managing Directors' Report

Last year was a year of great change for Welsh Water. Following the ending of our outsourced operations contracts some 1,600 colleagues transferred to Welsh Water in April and May last year, increasing our directly employed workforce several fold. This process was managed constructively by ourselves and our former partners, United Utilities Operating Services and Kelda Water Services, but was nevertheless a major undertaking. In addition, key parts of the business relocated to a new, integrated operational control and customer contact centre at the Linea building in St Mellons. Last year we also replaced our 20-year old work planning and scheduling systems with a modern SAP-based suite of customer contact and work management systems, a development which fundamentally changed the working lives of all of our front line staff. All this change required great flexibility and enthusiasm from our staff – as well as very long hours - to ensure that the short-term impact of this enormous change on day to day operations and customer service was minimised.

It was also a year of great operational challenges. The first half of 2010 was the driest since 1927 and so we instituted a wide range of operational measures to preserve water supplies, largely involving increased pumping of water to support the most stressed areas. These actions cost around £1 million but, together with an

investment of some £7 million in system reinforcement and cross connections, meant that we would have been well placed to minimise any impact on our customers and the environment had the drought persisted into the summer.

An even greater challenge was posed by the unprecedented severity of the weather in December and January when some of our operational sites had to be kept working in temperatures of 20°C below freezing for several days. The dedication and skill of our people in nursing our assets through these extremely challenging conditions - thereby minimising any impact on customers - was truly remarkable. Many of our customers had frozen pipes, leaving them without water. We also experienced a big increase in bursts on our water network and a pump failure near Carmarthen left around 2,800 customers without water for up to 3 days. These difficulties generated a huge upsurge in customer calls during the Christmas and New Year holiday period which we struggled to deal with effectively and as a result 5.5% of all calls last year were abandoned. We have reviewed all aspects of our performance during these extreme weather conditions and will be testing our ability to deal with a repeat event of this magnitude during the coming months.

Because of the big increase in bursts and leaks, mainly on our customers' own pipe-work, we supplied more water during this period than at any time in the previous ten years. The harsh winter of 2009 meant that we had a backlog of leakage to find and repair at the beginning of 2010 and this could not be recovered during the spring because we had to move some of our leakage detection and repair teams to zones where water resources were tightest. We doubled our leak detection and repair resources at the end of the summer but that was not sufficient to get us back on track before we were hit by the extreme freeze-thaw and the doubling of leakage during December and into January. Total leakage last year ended up at 199Mld, some 9Mld behind our target for the year and 3% higher than the previous year. During the year we repaired nearly 23,000 leaks and bursts, saving some 200Mld in leakage, and we currently have a team of around 400 working on leak detection and repair, this increased level of resource will remain in place until leakage is back on track to hit the key 2015 target of 184Mld. Our reservoirs were 100% full at the start of this year and our ability to maintain supplies this year has not been compromised by the higher than target level of leakage. Over the last 16 years we have reduced our leakage by more than half, from 413Mld to 199Mld.

Despite the organisational changes of last year and the challenges thrown at us by the weather, performance on nearly all the measures that matter for our customers and for the environment showed improvement

The health and safety of everyone working for Welsh Water is top of our agenda and we were able to report a 39% reduction in the number of reportable accidents last year

Supplying safe drinking water is our most important responsibility and in 2010 overall compliance with drinking water quality standards at customers' taps (as measured by mean zonal compliance) was 99.97% (2009 99.94%), a best ever result. In 2010 we also improved our performance on four of the other five indices used by the Drinking Water Inspectorate (DWI) to measure water quality compliance at each point on the water supply system. Customer complaints and contacts about discoloured water were also well down. Of the 31 events affecting water quality or sufficiency notified to the DWI during 2010, the DWI classified 17 as significant, four of which happened during December's freezing weather. This is an improvement on 2009, when 21 from 42 notified were classified as significant. Our £200 million accelerated programme to improve the reliability of our water supply network continues to make good progress and last year we completed schemes at Bryn Cowlyd, Capel Dewi, Eithin Fynydd, and Mynydd Llandygai and are currently on site at Alwen, Buckholt, Cilfor and Penycefn.

Last year the number of sewer flooding incidents fell by 32%, from 317 to 215, which is a significant improvement. We know that the very worst customer service failing is flooding from overloaded or blocked sewers and during the year we completed six schemes to reduce the risk of internal and external sewer flooding for over 38 properties.

'Look-up' compliance at our wastewater treatment works was 99.96% (2009 99.85%). There were eight serious pollution incidents, the same number as in the previous year. We did however manage to reduce the number of less serious pollution incidents by 21% from 318 in 2009 to 252 last year. We have developed a new pollution reduction strategy and the Board has allocated an additional £10 million to support a redoubling of our efforts to reduce the number of pollution incidents caused by blockages and other problems on our sewerage network in particular.

Wales, with only 15% of the British coastline, secured 46 Blue Flag awards – around a third of the total awarded to all of the UK – for the 2011 summer season, and all 81 designated beaches in Wales passed the mandatory European standard for coastal water quality. In addition, 47 Green Coast awards for rural beaches were secured. Wales continues to have some of the highest quality rivers in the UK with some 95% being classed by the Environment Agency as having good or very good chemical water quality.

Improving the day to day service we give our customers has been a particular focus for the business with the move to our new operational control and customer contact centre in St Mellons supported by the new SAP-based suite of customer contact and work management systems. In our wastewater business for instance, we now call back all customers for whom we have carried out a job like clearing a blockage and can report very high satisfaction levels. We have made good progress in updating our key customer service processes - moving house for instance – to ensure that they are as easy to use and follow as possible. The results of these efforts are beginning to come through with written complaints from customers (a third of which were emails) down by 17% last year. Independent research carried out on behalf of Ofwat shows that 78% of our customers who have had reason to contact us were satisfied with the service they received from Welsh Water last year putting us third on the industry league table for this measure.

Last year was the first year of the new five-year AMP5 investment programme (AMP5), under which we plan to invest £1.3 billion on our £25 billion network of assets to protect drinking water quality, safeguard our rivers and coastal waters from pollution, reduce our operating costs and improve day to day customer service. Last year we invested £242 million, split between water £127 million and wastewater £115 million. This included investment for three advanced anaerobic sludge digesters at Cardiff, Hereford and Port Talbot which are now generating enough electricity to power a town the size of Caernarfon in the process saving our customers some £8 million a year and reducing our carbon emissions by some 40,000 tonnes.

Our aim is to generate green energy sufficient to meet 17% of our total energy needs by 2015

The expected impact of climate change represents one of our biggest challenges in the years ahead with drier summers impacting our water resource position and more frequent high intensity storms impacting our legacy sewer network in particular. We face a number of other big challenges as well. The adoption of private sewers from October 2011 will nearly double the length of our sewer network, adding some 16,000km small diameter and mostly poor condition sewers to our existing network. European Directives are also likely to have a significant impact on what is required of Welsh Water with in particular a new EU Bathing Waters Directive coming into effect in 2015. In addition, our draft Water Resources Management Plan will be published in 2011 and will include, for consultation, proposals for significant reductions in our abstractions from sensitive rivers in Wales in order to comply with the EU Habitats Directive. These obligations will require additional investment on our network of water and wastewater assets which will in turn put pressure on customers' bills. Our goal is to secure for today's customers and future generations the best possible balance between affordability and standards, making sure that new requirements pass cost benefit tests and do not compromise other priorities, including in particular essential maintenance to minimise the risk of asset breakdown which causes problems like bursts, interruptions to supply and pollution incidents.

Since Glas Cymru acquired Welsh Water in 2001 we have invested nearly £3 billion on renewing and improving our £25 billion network of reservoirs, treatment works, pumping stations, water mains and sewers – equivalent to more than £2,500 for every household we serve. We have also greatly improved our efficiency such that our operating costs are no higher in real terms than they were ten years ago which is the best track record in the sector where on average other companies' costs have risen by 18% in real terms. In those same ten years we have been able to greatly strengthen the financial position of the business, bringing down the level of regulatory gearing from an initial 93% to 67% as at 31 March 2011. Due to our much improved financing and operating efficiency, we have been able to fund this high level of investment whilst keeping bills affordable for our customers.

If we are to be able to continue to sustain this high level of investment and deliver new higher standards in the future it is of vital importance that we continue to have access to keenly priced funding from the private capital markets. Otherwise it is going to prove impossible to deliver the service that customers in future will expect, including any new standards required by European Directives for instance, at a price that customers are likely to consider affordable.

Considerable attention is currently being given by industry regulators and governments in Wales and in England to the future challenges faced by the water sector and the potential role that market reform could play in meeting those challenges. Glas Cymru is dedicated to looking after the water industry in Wales on behalf of today's customers and future generations and we will always assess any proposed reform in terms of its likely impact on our customers as a whole.

The key test for us is that any significant market reform must not put at risk the availability of efficient, long-term funding for sustained capital investment, which we believe will continue to be the overriding requirement for a high quality, reliable and affordable service now and into the future.

Nigel Annett
Managing Director
8 June 2011

Our Performance at a Glance

For 2010-11 we adopted a new set of metrics against which the Board monitored and assessed our performance. This took the form of a performance 'scorecard' of measures based around five groupings monitored each month against targets approved by the Board in the annual business plan. The scorecard was designed so that achieving 'target' performance would deliver (or maintain) above average sector performance, and achieving a 'stretch' target would place Welsh Water at or near top of the sector.

The 20 measures chosen for 2010-11, which are further explained on page 38, were chosen because they

- » are high level metrics that are critical to measuring our success,
- » reflect metrics that are important to our regulators (Drinking Water Inspectorate, Environment Agency and Ofwat) and include key serviceability indicators, and
- » they are meaningful and recognisable to our staff.

There are also two measures under a sixth grouping, 'Our wellbeing', which are not used for the purpose of incentivisation: these are measures relating to (a) number of reportable injuries and (b) staff engagement.

The key measures of our financial performance are reported in the Financial Review on page 34. These are measures which we have reported in previous years, namely (i) credit rating of Glas Cymru bonds, (ii) gearing (net debt/regulatory capital value), and (iii) interest cover.

For 2011-12 the Board has reset the Performance Scorecard in the light of experience in the first year of operation.

The new scorecard has 18 measures, which align better to the delivery of Ofwat's serviceability metrics and the DWI's performance indices. We have retained the additional measures of 'well being' we used in 2010-11. Measures of operating cost performance no longer

form part of the scorecard, and have been replaced by separate measures of financial performance which have been given equal weighting with the scorecard. These changes will be further explained in next year's annual report.

	2009-10	2010-11	At or better than previous year
Safe drinking water			
Number of Bactr failures at WTW	8	6	✓
Bacteriological compliance at SRVs (%)	99.92	99.94	✓
Iron compliance at customers' tap (%)	99.27	99.56	✓
Number of discoloured water complaints	8,084	6,550	✓
Number of serious water quality incidents	21	17	✓
Mean Zonal Compliance	99.94	99.97	✓
Safe sanitation			
Sewer flooding - blockages	198	136	✓
Sewer flooding - hydraulic overload	73	47	✓
Protecting our environment			
Leakage (Ml/d)	192.8	199.3	X*
Number of serious pollution incidents	8	8	✓
Total number of pollution incidents	326	260	✓
WwTW Lookup compliance (%)	99.85	99.96	✓
Brilliant customer service			
Number of customers - low water pressure	194	189	✓
Number of customers - loss of supply >6hours	477	3,759	X*
Number of written complaints	13,313	11,033	✓
Number of avoidable complaints	N/A	4,524	-
Customers satisfied with our service (%)	N/A	78	-
Number of unwanted telephone contacts	566,449	432,101	✓
Delivering services efficiently			
Operating costs (£m)	-	260	-
Net energy use (savings of GWh)	-	505	-
Our wellbeing			
Number of RIDDOR reportable injuries	33	24	✓
Staff engagement	-	-	-

* Affected by December 2010 freeze/thaw event.

“
CUSTOMERS BILLS WERE LOWER LAST YEAR AND WILL CONTINUE TO FALL IN REAL TERMS
 ”

Business Review

OUR BUSINESS

Glas Cymru was formed just over ten years ago with a single purpose to acquire and manage Welsh Water in the best interests of customers

Structured as a company limited by guarantee, Glas Cymru has no shareholders and any financial surpluses are retained or reinvested for the benefit of Welsh Water's customers. Under our 'not-for-profit' business model, Welsh Water's assets and capital investment are financed by bonds, loans and retained financial surpluses. We can reduce our asset financing costs, which is the water industry's single biggest cost, by offering high quality credit to long term investors and, in this way, keep down the bills to our customers.

WE ARE THE ONLY UK WATER COMPANY OWNED AND FINANCED IN THIS WAY.

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Dŵr Cymru (Financing) was formed in 2001 and is the 'issuer' company for the group's bonds, which are listed on the Luxembourg Bourse. Details of the group's bonds can be found on page 37.

Welsh Water is a wholly owned subsidiary of Glas Cymru and is the group's principal trading company.

The company employs a large and complex network of long-life assets - with a replacement cost of £25 billion, or over £20,000 per household - to provide a safe and reliable supply of drinking water and to deal effectively with customers' wastewater. In this way, Welsh Water fulfils a vital role in protecting public health and the natural environment.

Welsh Water is the 6th largest of the UK's privatised water and sewerage companies and provides an essential public service to over 3 million people.

Through Welsh Water we employ some 1,820 staff, own some 42,000 hectares of land and operate one of the largest networks of assets in the UK water industry. We supply an average of 815 megalitres (MI) of treated water and remove and treat 570MI of wastewater every day, through a network of assets (below).

We are a single purpose business and we do not diversify into unrelated activities

Our job, working within the regulatory framework of the UK water industry, is to ensure that every decision we make promotes the delivery of high quality, value for money and reliable drinking water and sewerage services to customers at an affordable price. We act as custodians of the water industry in our region on behalf of today's customers and future generations.

Our business strategy has four underlying themes

- » **Customer FIRST.** from the outset
Glas Cymru's goal has been to manage Welsh Water in the best interests of customers. This approach was codified in our FIRST strategy in autumn 2010 which is in the process of being rolled out across the business.
- » **Efficient financing.** our strategy on financing and credit rating is addressed in the Financial Review on page 34. We report of our performance against our financial obligations to bondholders and other financial creditors in a quarterly report to investors.

POTABLE WATER SERVICES

105	water treatment works (WTW)
81	impounding reservoirs
27,000km	of water distribution mains
715	service reservoirs
532	water pumping stations

WASTEWATER SERVICES

832	Wastewater treatment works (WwTW)
19,000km	of public sewers ⁽¹⁾
1,700	sewage pumping stations
3,300	combined sewer overflows

⁽¹⁾ This network will nearly double in length when the transfer of private sewers and drains is completed in October 2011 in line with the government's announced timetable.

» **Efficient procurement.** In last year's annual report we explained the Board's decision (announced in February 2010) to end the competitively tendered arrangements under which the operation and maintenance of Welsh Water's network of water and sewerage assets has been managed by United Utilities Operating Services (UUOS) and Kelda Water Services Wales (KWS). As a result, some 1,600 staff transferred to from UUOS and KWS to Welsh Water under the Transfer of Undertakings Regulations on 1 April 2010, and 1 May 2010 respectively

In 2009-10 some 85% of Welsh Water's operating and investment expenditure was covered by outsourced contracts which, as a result of the above change, fell to 57% in 2010-11. Services that continue to be competitively procured are capital investment and maintenance and support services, billing and income, IT and laboratory services. In spring 2011, we announced we would bring back in-house Welsh Water's sampling and network development services

» **Transparent and high standards of governance** our approach to this is explained in the corporate governance report in page 45

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In January 2011 the Welsh Government published a Strategic Policy Position Statement on Water, updating the first statement published in March 2009. We support and will contribute to the delivery of the Environment Strategy outcomes set out by the Welsh Government, namely that

- » Water resources should be managed sustainably to meet the needs of society without causing damage to the environment
- » Water should be used more efficiently across all sectors
- » The high quality of our drinking water should be maintained
- » The quality of our groundwater, rivers, lakes and coastal waters should be maintained and enhanced

REGULATORY AND OPERATING ENVIRONMENT

Our 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. The ability of the Board to benchmark the comparative performance of Welsh Water against independent regulatory data is a key feature in Glas Cymru business model

Ofwat is the economic regulator and is responsible for setting the maximum increase in charges that a company can set in any year

FOCUSED | One team working together to achieve the same goal

INFORMED | Highly competent at what we do, always meeting our customer's needs and requirements

RESULTS DRIVEN | Hitting targets / getting things right first time every time

SAFE AND STRAIGHTFORWARD | Delivering an uncomplicated, secure service for all

TAKE THE INITIATIVE | Be proactive, do the right thing for the customer and the environment

Business Review

It is also responsible for promoting the interests of customers by incentivising efficiency and high standards of service and penalising inefficiency and poor service. Price limits are set through a process of regulatory review every five years, although Ofwat has established a series of working groups to review options for future price reviews, which may move away from a single 5-year price review process. In December 2009, Ofwat published its final determination for Welsh Water for the regulatory cycle from 1 April 2010 to 31 March 2015, known as 'AMP5'.

Until March 2010 Ofwat assessed companies' overall delivery of service to customers via its Overall Performance Assessment (OPA), which served two purposes: (i) it enabled comparisons of the quality of the overall service companies provide to customers, which was taken into account at each price review, and (ii) 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.

On 1 April 2010 Ofwat replaced OPA with a new framework of serviceability measures and a service incentive mechanism (SIM), designed to reward or penalise companies according to how they perform against specified consumer experience measures. Performance against the SIM measures in 2010-11, which includes number of customer contacts and complaints and an independent survey of customer satisfaction, are reported on pages 21 and 22. Preparing performance data for SIM reporting has highlighted subtle but important differences in the way that some company's record data and we welcome Ofwat's plans to issue guidance to Reporters and to use the 2011 June Return process to set minimum standards and to 'normalise' data between companies.

The Welsh Government has a key role in determining water and environmental quality standards as well as setting the framework for other public policy matters for Wales. The Drinking Water Inspectorate (DWI) is the regulator for drinking water quality. The Environment Agency (EA) regulates our environmental performance, specifically the way we abstract water from rivers and reservoirs and then discharge wastewater after it has been cleaned.

The Consumer Council for Water ('CCWater - Wales') is the independent body established to represent the interests of customers. It investigates complaints and champions customer concerns, and audits our performance on customer service more generally, as well as influencing policy. We support the continuation of an independent voice for customers of the water industry in Wales, separate from consumer bodies representing other sectors.

The Countryside Council for Wales (and, in England, Natural England) oversees our management of designated sites for nature conservation and how we meet our obligation to conserve and improve biodiversity. In January 2011, the Welsh Government announced a review that could see three of its sponsored bodies (EA-Wales, Countryside Council for Wales and Forestry Commission Wales) merged into one regulator for the environment.

OUR SECTOR REGULATORS

<http://www.ofwat.gov.uk>

<http://dwi.defra.gov.uk>

<http://www.environment-agency.gov.uk>

<http://www.ccwater.org.uk>

<http://www.ccw.gov.uk>

OUR 'AMP5' CHALLENGE

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

The AMP5 regulatory contract, in which we will invest a further £1.3 billion in the five year period ending 31 March 2015, is the most challenging we have been set since the industry was privatised. At the end of the period the average bill for a water and sewerage customer will have fallen by £20/household in real terms. In 2010-11, we announced the biggest bill reduction in the sector.

To deliver this level of bill reduction we have put in place plans to significantly reduce our operating costs, by around 20% of costs that we can directly manage or influence. At the same time, we must maintain or improve our performance to meet new 'serviceability' targets set out in the Final Determination, which are also very challenging. These new standards comprise 20 measures over 4 service areas, which, if we do not meet them, could lead to substantial financial penalties being imposed on us at the time of the next price review.

The performance of our network of water and wastewater assets underpins the service we give our customers and our ability to protect the environment from pollution. A key discussion with all our regulators during the last price review was the possible trade-off between new investment and the affordability of customer bills.

Nearly all of the critical investment we sought for the AMP5 period was recognised in the Final Determination. Our main objectives in the period are:

- » To upgrade or renew facilities at 26 WTW sites to deal with deteriorating source water quality and other risks identified in our Drinking Water Safety Plans
- » To deliver a significant reduction in sewer flooding and pollution incidents caused by breakdowns on our sewer network, and to invest in additional treatment stages at various wastewater sites to protect river and coastal water quality
- » To complete a programme of advanced sludge digestion schemes at three WwTW sites - on which we made an early start in AMP4, which will deliver a major reduction in our 'carbon footprint' by 2015

- » To deliver, through our 'Green Space Wales' strategy, sustainable urban drainage schemes to reduce the risk of flooding from overloaded sewers
- » To continue to address affordability by offering one of the widest ranges of tariffs and schemes available in the industry designed to help our least well-off customers

We have already met one objective for AMP5 when in October 2010 we opened our Linea customer service and operational control centre in St Mellons, Cardiff. At Linea we have brought together under one roof all the staff who deliver billing and operational calls services and associated work planning and scheduling, which has provided scope for additional efficiency and a better customer service. We are using the latest technology (delivered by the £85 million AMP4 programme of IT-enabled change) to anticipate service failures and improve customer service by giving first-time resolution to day to day customer service issues. Towards the end of the year, we also launched a new 'Business Development' service at Linea, which will deliver an improvement in our ability to respond to the need for infrastructure to supply new housing and to support economic development.



OUR DIRECT OPERATING COSTS ARE NO HIGHER IN REAL TERMS THAN THEY WERE TEN YEARS AGO (THE BEST TRACK RECORD IN THE SECTOR) – AND WE ARE TARGETING A REAL TERM REDUCTION OF 20% BY 2015



Market reform Household customers cannot currently choose which company delivers their water or wastewater services, but customers who use 50MI of water or more a year can take supply from any licensed water supplier. This may change as a result of an independent review of competition and innovation in water markets led by Professor Martin Cave, whose final recommendations are still being considered by government, and a series of consultation papers published by Ofwat on the potential for retail market reform.

We do not have a high concentration of non household customers and our largest 25 customers (by volume) account for less than 5% of revenue.

The Board welcomes any change to the water industry where this can be demonstrated to be in the long term interests of customers. We share the view of the Welsh Government that - based on the available evidence - the case has not been made to show it would be in the interests of Welsh Water's customers to support the separation of the retail and network businesses in Wales.

MANAGING RISK

It is a key principle of our business that Glas Cymru cannot diversify into activities unrelated to the water and sewerage business of Welsh Water.

This ensures that 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 that 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

The decision in February 2010 to end arrangements for the outsourcing of the day-to-day operation and maintenance of our network of water and sewerage assets was one of the most significant issues the Board had considered since Glas Cymru acquired Welsh Water. The decision was the Board's response to meeting the challenges set by a very tough price review, which could not be met by the outsourced model that had been used since 2001, and the need to improve some aspects of water quality and pollution prevention performance which had fallen below the average for the sector. By 1 May 2010 the previously outsourced contracts had been brought to an end and some 1,600 staff had TUPE transferred to Welsh Water.

The move to these new arrangements involved a period of additional uncertainty and risks. To address this, detailed and audited transition arrangements were put in place to ensure that public health, staff safety, customer service and environmental performance standards did not fall and we increased the level of performance reporting. The Board discussed the risk of our losing or failing to recruit key people to ensure we have the competencies and experience we need to meet our long-term obligations, and a new leadership team was put together, which included external appointments for eight key roles. The Board believes that the risks associated with the restructuring of the business have been managed well and that this is reflected in the improved performance of Welsh Water in 2010-11.

New outsourced contracts have been put in place for the AMP5 period (2012-15) for the design and construction of major capital investment schemes, and contracts continue for ICT and for customer contact and billing services, which were not affected by the above changes.

Operational risk: In the past year we have addressed two main operational risks. The impact of extreme patterns of weather on the ability of Welsh Water to maintain essential services and a high standard of service to customers, and the impact on the business of the launch of new, once in a generation changes to IT operating systems, which fundamentally changed many working practices and the way in which we deliver services to customers day to day.

Operational risks that arise from weather conditions are varied. Extreme cold weather can freeze operational assets and cause equipment to fail if temperatures fall outside of its design parameters. Any extreme weather (hot, cold, dry or wet) can increase occupational health and safety risk. Drought can also impact on our ability to maintain supplies without restrictions, albeit we have invested in significant schemes in recent years to improve the connectivity of our water distribution network, giving more flexibility in how we can respond to extended periods of dry weather.

2010 started with a prolonged period of freezing weather, was followed by the driest six months for more than 70 years, a very wet late summer and then the coldest December on record. This pattern of weather while extreme was not a one off, as similar weather patterns have caused problems in each of the past three years.

Through a process of post incident reviews discussed at the Quality and Environment Committee of the Board (QEC) we are confident that lessons are learned and the business is better prepared should similar circumstances recur. For example, following the experience of extreme cold weather in 2009, we extended our fleet of four wheel drive vehicles and gritters to ensure access to critical assets, which contributed to less disruption of services to customers in the more extreme cold spell in 2010, during which we also cancelled all non-essential operational activity and business meetings. A non weather related example followed a temporary loss of power supply to a water treatment works in early 2010 which led to a review of power supply to all critical assets. Operational risk is reassessed following any learning experience of this kind.

As a consequence of extreme weather in the past two winters, our level of leakage was 3% higher in 2010-11 and behind target. To bring leakage back on track we have maintained our 'find and fix' resources in the field at peak winter levels and we are investing in additional leak detection equipment. We are confident that the AMP5 regulatory target for leakage in 2015 will be achieved.

The roll out of new IT operating systems followed the £85 million AMP4 investment in IT enabled change. Roll out and associated training was timed (and at times delayed) to avoid periods of operational pressure and the delivery programme was phased to minimise the risk involved. The full benefit of this investment will be seen over the next few years. However, as the business becomes more reliant on modern IT systems to deliver enhanced customer service, any disruption to those systems or to the national communication network becomes a greater risk. This is a business continuity risk that we plan for and regularly test.

The Board, QEC and the Audit Committee review policies and corporate and operational strategies to mitigate each of the risks to our business and financial priorities and the service we provide for our customers. Risk is also mitigated by the availability and terms of insurance - covering property, business interruption, public liability, environmental pollution and employer's liability.

Regulatory risk. Regulatory risk can arise from Ofwat's price control determinations, from the requirement to comply with extensive data requirements and more generally from changes in the regulatory environment.

Ofwat assesses the water industry against 20 standards of serviceability, any one of which, if not met, can lead to significant financial penalty. 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, notwithstanding we have the best record for efficiency improvements since 2001. Furthermore, Ofwat's cost assumptions for the sector are based on benign economic conditions in which, for example, bad debts are assumed to be no higher than they were in 2008-09.

We have adopted strategies to achieve the required cost reduction by:

- » Streamlining processes to exploit recent investment in new operational technology
- » Eliminating duplication in management
- » Investing in green energy schemes to reduce power costs
- » A phased reduction by March 2015 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 last price review is that the Company's financial plans are subject to greater uncertainty so, at the end of the first year of the regulatory period, the Board has decided to pursue a prudent approach to issues such as the 'customer dividend' and discretionary investment until that uncertainty is resolved.

Financial risk We are exposed to a number of financial risks, many of which are heightened at a time of economic uncertainty. These include

- » Revenue risk arising from a reduction in metered demand and the loss of large business customers, and from poorer levels of collection of charges from domestic and business customers and increased non-recovery of customer debt
- » External pressures on operating costs, such as changes (and unpredictable variability) in the price of services and commodities (e.g. chemicals or power)
- » The impact on the regulatory capital value of Welsh Water (and thereby on revenues) from a negative movement in the Retail Prices Index

The risk associated with access to capital markets in the current economic climate is mitigated as we have substantially secured the finance we need in the AMP5 period

The financial strength of Glas Cymru is underpinned by

- » The group's financial position at 31 March 2011, which shows a significant balance of cash and undrawn borrowing facilities available, gives the business a high degree of liquidity
- » Welsh Water's has secured funding for its investment programme for substantially the whole of the next five-year regulatory period
- » The high proportion of index-linked debt issued by the Company

Future operational and regulatory risk

Greater variability in weather conditions is now to be expected and is, as far as possible, planned for

The effect of the transfer of private sewers to Welsh Water in October 2011 will be to nearly double the length of our sewer network. We have very little information to judge the condition of these private sewers, but we typically expect them to be poor and below the standard of assets that the industry is generally required to operate. Defra and the Welsh Government have yet to finalise all the arrangements for the transfer or the regulatory reporting requirements on the performance of the assets to be transferred. As far as possible we would expect this to be ring-fenced so as not to distort the assessment of the underlying performance of the business.

In 2011 Welsh Water will publish for consultation a revised 25 year water resource management plan, to reflect the major reductions proposed by the Environment Agency 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.

Ofwat continues to consult on market reforms that would see an expansion of retail competition, the introduction of water trading and the exposure of upstream parts of the business to market forces. If implemented, these proposals could result in the enforced legal separation of the currently vertically integrated water undertakers into retail, treatment, and network businesses.

The first of these changes is likely to occur later this year as it is widely expected that Defra will announce a reduction in the Water Supply Licence Threshold from 50MI to 5MI. The Welsh Government has stated in its response to the Cave Review "that it remained to be convinced of the case for further competition" and would not reduce the current threshold level.

The number of customers in Welsh Water's region eligible to switch providers will remain the same at less than 5% of total turnover.

The future of competition in the water industry will be set out in a Government White Paper now expected by the end of 2011. Welsh Water believes that any significant reform of the sector should only be proposed if it is clear that it would be in the interest of customers and, in particular, not put at risk the credit ratings and availability of secure long term finance to the sector to fund future sustained capital investment needs at affordable cost.

“
FUNDING IS NOW LARGELY IN PLACE FOR THE REST OF THIS 5-YEAR REGULATORY PERIOD IN WHICH WE WILL INVEST SOME £1.3 BILLION
”

Our Performance

PROTECTING PUBLIC HEALTH

Our most important responsibility is to provide safe and reliable drinking water for all our customers

The quality of the water we supply is of the utmost importance and over the course of a year some 300,000 samples are taken and analysed under regulations monitored by the DWI. In 2010 the quality of the drinking water we supplied remained at a high level. We improved our performance against five of the six indices used by the DWI to assess performance, with mean zonal compliance (the measure of water quality at the customer's tap) equalling our best ever performance.

The drop in performance against the disinfection control index is disappointing but was largely due to a number of turbidity failures at a single water treatment works (WTW). Performance against the Distribution Maintenance Index improved in 2010, but remains below industry average largely due to some 4,000 km of remaining unlined iron mains.

The overall improved performance is the result of a combination of two factors: early benefits from the £200 million programme to modernise our water treatment estate,

which we commenced in advance of the last regulatory review in 2008-09 (and which, by the end of AMP5, will have provided improved treatment at 26 WTWs), and from a greater management focus on planning and risk assessment.

This investment, with our proactive approach to catchment management, is contributing to an improvement in water quality performance and to fewer significant events being reported to the DWI in which water quality was, or could have been, compromised. There were 17 events in 2010 (2009: 21), of which 4 were linked directly to the extreme and prolonged cold weather in December 2010.

Managing water quality risk Our main focus for reducing risk to water quality has been the delivery of the WTW improvement programme and the refinement of the Drinking Water Safety Plans we have put in place for each area of supply. These record how we manage risks to water quality (and therefore public health) at all stages in the supply chain - i.e. in raw water sources and through the treatment process and distribution network to the customer's tap. The most significant risks are being managed under action plans agreed with the DWI, which require a combination of

local operational mitigations (which have been addressed) and in the medium term through a sustained programme of capital investment.

A good general measure of customers' confidence in their tap water is the number of customer contacts we receive - i.e. queries or complaints by phone call, email or letter. In 2010 we received 3.35 contacts per 1,000 customers, down from 4.2 in 2009 and 4.5 and 5.0 in the two preceding years.

Working in partnership 2010 was the third year in which we hosted a series of events to consult and work with landowners, local businesses, public health and local authorities and others to protect the quality of raw water we abstract for public supply. The Water Health Partnership for Wales (WHPW) celebrated its fifth anniversary earlier in 2011. Through an annual meeting, supported by task and finish groups, and training events the WHPW brings together representatives from Welsh Water, local authorities, Public Health Wales, Welsh Government, the DWI and the EA to improve interagency knowledge of public health and drinking water quality issues.

DWI MEASURE (INDEX)

	2009	2010
Mean zonal compliance	99.94	99.97
Disinfection control	99.98	99.88
Process control	99.94	100.00
Distribution maintenance	99.67	99.78
Building water systems	99.89	99.95
Service reservoir integrity	99.95	99.97

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Many of the same participants also joined Welsh Water in simulated exercises (in Wales and more widely in the UK) to test inter agency preparedness and emergency response arrangements, including mutual aid, following a natural disaster or major act of terrorism. In the past year we have participated in a number of exercises, including as a major player in exercise Kingfisher - which was the largest multi agency exercise since privatisation in 1989. These are important learning events which ensure that we (and others) can play an effective part in responding to an emergency situation.

Reliability of supply: Any work on our water supply network, whether to connect new properties or to reconfigure supply for water quality reasons, carries risk of interruption of supplies to customers and we work hard to keep this to a minimum. In 2010-11 we saw another year on year fall in the number of properties at risk of low water pressure (DG2) to 189 (2009-10 194), which will keep us near the top of the industry league table on this measure, but an increase in the number of properties where water supplies were cut off without warning for more than 6 hours (DG3). The decline in DG3 performance was the result of the rapid freeze/thaw weather conditions in December 2010 and January 2011,

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which affected tens of thousands of customers across the UK, as nearly all water companies saw an unprecedented level of bursts and frozen pipes in the public network and in customers' own pipe-work. The number of DG3 events increased from 477 to 3,759, of which 3,452 were related to the period of freeze/thaw.

PROTECTING THE ENVIRONMENT

We collect and treat the wastewater produced by customers in a way that protects both public health and the environment.

Overall operational performance and efficiency both improved during the year, which was the first in which we directly managed all our wastewater services. Previously, the provision of much of the service had been outsourced to various service partners.

Wastewater treatment compliance

In 2010 compliance with 'look up' discharge consents (or permits for the discharge of waste water) from the 832 WwTW we operate was 99.96%, up from 99.85% in 2009, with just two small works non compliant. However, 2010 benefited from six months of very dry weather which reduced the risk at small WwTWs which serve a population of less than 1,000 and consequently have only limited treatment processes. Welsh Water has dozens of these small WwTW, of which 10 failed look up in 2009, which remain vulnerable to unusually high wet weather flows and unauthorised connections.

550 of our WwTWs 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.

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Our Performance

Against this broader serviceability measure of compliance, we achieved 97.14% compliance in 2010 (2009 95.95%), which shows there is still more to do to improve our performance

Reliability of the sewer network:

A priority in the past year has been to reduce incidents of internal sewer flooding from 'other causes' - that is from blockage, collapse or equipment failure. While an element of this is inevitable - as one third of our sewers are more than 100 years old and analysis has showed that 90% of incidents are recorded at properties with no history of flooding - we were concerned that despite significant management attention and investment, the number of incidents had not fallen in recent years.

That trend was reversed in 2010-11 when the number of properties flooded fell by 31% to 136, which makes good progress toward our AMP5 target of reducing other cause flooding to less than 120 a year by 2015. The total number of sewer flooding events can be heavily influenced by intense rainfall, which can both overload the hydraulic capacity of our sewers and contribute to other cause flooding by washing debris into the network causing blockages.

As a result of action we took last year, 15 properties were removed from the register of properties at risk of repeat flooding following heavy rainfall, but this was offset by the addition of 32 new properties and at 31 March 2011 267 properties remained 'at-risk' (2010 250).

Pollution incidents Last year we reported an increase in the total number of incidents and that reducing this was a priority. In November we approved a £10 million strategy to reduce the number of incidents by nearly two thirds by 2014. This investment is above the AMP5 environmental programme expenditure and it will be targeted at accelerated capital maintenance and improved network monitoring. While this investment is planned, we are funding additional staff to target known hot-spots.

2010-11 saw some improvement in performance with the total number of reportable incidents down by 21%, from 326 to 260, although the number of more serious (category 1 and 2) incidents did not fall - there were 8 in 2009 and 2010. This remains a measure where more improvement is required.

River water and coastal bathing water quality Operating our wastewater assets in a way that safeguards against pollution is one of our most important responsibilities. Tourism contributes some £3 billion a year to the Welsh economy so it is important that Wales's rivers, watercourses and bathing beaches are amongst the best in the UK.

In 2010, all 81 of Wales's 'designated' beaches met the 'mandatory' EU water quality standard and 89% also met the more demanding 'guideline' water quality standard. Although this is slightly lower than the year before it means that Wales, which has only 15% of the British coastline, has secured 46 'Blue Flag' beach and marina awards for summer 2011. Wales, for the tenth year in a row, is around one third of the total awarded to all of the UK. The number of designated beaches is expected to rise ahead of the revised Bathing Water Directive, which will be implemented in phases between 2012 and 2015. 7 beaches in Wales have been newly designated for 2011 with many more preparing to apply in 2012. We are currently developing a new coastal management strategy to respond to the challenge of the new Directive and the increasing number of designated beaches in Wales.

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Wales continues to have some of the highest quality rivers in the UK with some 95% being classed by the Environment Agency as having good or better chemical water quality (which is a key indicator of organic pollution), up from 86% in 1990

Leakage Last year leakage was 199Mld (mega litres a day), 9Mld above target and 3% higher than the previous year. The last winter was one of the harshest on record and for the first time since targets were introduced by Ofwat we did not meet our target for leakage reduction. The target was missed for a number of reasons including a backlog of leakage carried at the start of 2010-11 following the very cold winter of 2009-10, the diversion of resources to find smaller leaks in water stressed zones during the developing drought conditions in spring and early summer 2010, followed by one of the harshest winters on record.

Not meeting the target is very disappointing as for the last five months of the reporting year we doubled the resource employed on leakage detection, we employed additional gangs, diverted resources and introduced seven days a week working, at an additional operating cost of some £3million.

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This resource will remain in place until we are back on track to achieve our 2015 target of 184Mld

MEETING CUSTOMERS' EXPECTATIONS

Our customers expect a high quality service - right first time - and an efficient and courteous reply every time they contact us

Improving customer service We want to continually improve our service for our customers and we listen to what our customers say in focus groups and in correspondence. In the past year we have

- » Re-launched our website with increased functionality and to provide more real time information when we are experiencing operational difficulty

- » Redesigned online forms for moving house, direct debit, meter readings and customer enquiries to be more accessible and customer friendly
- » Simplified bills for non metered customers - we have also set up a new area on our website that explains each part of the bill
- » Changed our payment reminder letters to make them simpler and easy to understand
- » Implemented a new telephony system with built in call recording functionality to improve the quality of service delivered
- » Met with four key care organisations in Wales to discuss our service

These and other changes we are planning for the website will make it easier for customers to do business with us

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“
OUR RESERVOIRS WERE FULL AT THE START OF THIS YEAR AND OUR ABILITY TO MAINTAIN SUPPLIES HAS NOT BEEN COMPROMISED BY THE HIGHER THAN TARGET LEAKAGE LAST YEAR
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Better use of the website, and an increasing number of customers who are choosing to use our automated payment line, also helped reduce the number of telephone calls we receive from customers who want to speak to us about a bill or payment plan, or have queries relating to water or sewerage services or to metering and new connection services

In autumn 2010, we opened our Linea customer contact and operations centre in St Mellons in Cardiff, with new telephony and SAP based customer contact and work management systems, a development which fundamentally changed the working patterns of all our front line staff. This new facility provides the platform for much of our future improvement plans, but it was severely tested by the volume of contacts we received over the Christmas/New Year period – twelve times higher than we have experienced before - as customers reported frozen pipe-work during the period of rapid freeze/thaw. Last winter was a significant learning experience for Welsh Water (as it was for all water companies) and we have restructured how we plan and deliver services provided from Linea, which we will robustly test ahead of next winter.

Helping customers pay their bill

We offer three assistance schemes to support customers who are experiencing financial difficulty and struggling to pay their water bill. During the past year we have worked with local authorities, housing associations, the Citizens Advice Bureau (CAB), Consumer Council for Water Wales (CCWater - Wales) and Moneyline Cymru to make our application processes as simple and accessible as possible, including the introduction of a single application form for all three schemes. We have also issued posters and leaflets to promote these tariffs through local authority and housing association offices, libraries and GP surgeries, etc.

'Welsh Water Assist' - a tariff designed to help households on low incomes and customers with particular needs - has capped the bill for 2011-12 for some 16,900 eligible water and sewerage customers at £228 (compared to a £400 cap provided by the national standard Watersure tariff). We have nearly doubled the number of participants in one year and we have over 16,000 more customers on this tariff than were previously on Watersure. The number of customers opting to join 'Water Direct' - a tariff which reduces the annual bill by £25 when

customers opt to pay by direct deduction from their Department of Work and Pensions benefits - rose by 10% to 14,300. Also, 4,500 customers benefited from a £10 reduction in their bill under the 'Water Collect' tariff, in partnership with Valleys to Coast, the social landlord.

In addition to our three assistance schemes, a Customer Assistance Fund is run with the assistance of the CAB and Moneyline Cymru. Last year over 1,900 customers who have arrears of over £150 took advantage of this scheme, which helps to reduce their debt and support ongoing payments.

Providing 'additional services'. We offer a range of additional services - including 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 11,555 customers were registered for one or more of these additional services, some 65% more than last year. We are currently working with caring organisations and CCWater - Wales to increase customer awareness of our additional services and to make them more accessible to all who need them.

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Customer satisfaction: In April 2010 Ofwat introduced SIM (Service Incentive Mechanism) as a replacement for the Overall Performance Assessment (OPA), which Ofwat had previously used to judge, compare and incentivise companies performance on a range of measures. SIM comprises two components - a quantitative score measuring the number of complaints and telephone contacts that companies receive, and a qualitative score that will measure how satisfied customers are with the quality of the service received from their company. Quantitative and qualitative scores are combined to produce a single consumer experience measure. This combined score will be used to compare companies' performance and for Ofwat to calculate any financial incentives and penalties from 2011-12 onwards.

For many years Ofwat has carried out research into customer satisfaction with telephone call handling across the sector. In the latest published results (which is the qualitative element of SIM for 2010-11) we scored slightly higher than last year - with 4.26 out of 5 (up from 4.22) – and were ranked 3rd of the 10 water and sewerage companies, where the top performing company scored 4.47.

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This demonstrates that 78% of those customers who had reason to contact us were satisfied with the way we had handled the enquiry or contact, and our customer billing service, which is provided under contract by Veolia Water, was the top performer of the 10 water and sewerage companies.

We also track customer levels of satisfaction with drinking water quality, coastal environmental quality and how our customers judge our value for money when compared to other utilities. This independent market research is conducted by Beaufort Research, which randomly selects 1,000 customers twice a year, and the latest research shows similarly high and stable levels of satisfaction on all key measures.

The quantitative element of SIM combines several elements (telephone lines busy, calls abandoned, unwanted telephone contacts, written complaints and complaints escalated for review by a Director or investigation by CCWater - Wales) with each element weighted to reflect the increasing impact on customers and the cost to the company. The lower the SIM quantitative score the better the performance, and last year we scored 397 points (2009-10 486), where the industry average for 2009-10 was estimated to be 391.

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.

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Last year, we made 1,511 GSS payments (2009-10 1,429) but the total value of compensation payments fell by 26%. The main area for improvement relates to missed appointments, which were higher last year as a result of the major system changes we implemented which inevitably led to instances where data may not have been properly recorded – wherever we were unsure we erred on the side of caution and made a GSS payment. We also wrote and apologised to almost 3,000 customers who were not entitled to compensation under the GSS regulations, but whose supplies were interrupted last winter because of problems on our water supply network, who received discretionary compensation payments totaling nearly £95,000.

Customer complaints In 2010-11 we received 11,033 written complaints, 17% fewer than last year. Around two thirds of all complaints relate to billing issues although volumes in this area have reduced 20% year on year. This has been delivered by simplifying the format of the Bill, reducing the volumes of estimated bills sent out, clearer information on the website and improved training of employees. Last year we responded to 99.8% of these written complaints within 10 working days, up from 99.6% the previous year.

The number of complaints that had to be escalated to a Director because a customer was not happy with our first reply has reduced by 38%, and represented around 3% of the total number of complaints. The number of complaints investigated by the Consumer Council for Water Wales fell from 10 in 2009-10 to 7 last year.

Preventing crime For many years Welsh Water has worked in partnership with the four Welsh police forces and Crimestoppers Wales to prevent distraction burglaries. We participate in regular promotional campaigns and all our staff will carry an identification card which can be verified by telephoning a free-phone Bogus Caller Hotline. Around 1,700 customers have also registered for the additional service password scheme which provides a more personal verification of staff identity.

Minimising the disruptive impact of our activities Before starting any major work we liaise closely with local communities, and often hold public exhibitions, to explain the work we will be carrying out and to answer questions from local residents. If water supplies are going to be interrupted, or access to customers' premises will be required,

then a comprehensive information pack is provided to those customers directly affected and a 24 hour contact telephone number is provided. Each year a number of our capital schemes receive an award under the National Considerate Construction Scheme where arrangements for public safety and community impact and liaison are independently assessed.

SUSTAINABLE OPERATIONS

We operate in a way that safeguards the environment and minimises any adverse environmental effect from our operations.

Managing water resources In spring 2010 the Environment Agency confirmed the required level of reduction in water abstractions from some rivers to comply with the EU Habitats Directive. While lower than previously reported, the level of reduction is significant and has led to changes in our draft 25 year water resource management plan, which will be published for consultation in summer 2011. This will set out where we obtain our water from and our plans to manage the balance between supply and demand, having regard to the Welsh Government's forecast changes in

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“
OUR CUSTOMER ASSISTANCE TARIFFS GIVE EXTRA HELP TO MORE THAN 37,000 LOW INCOME HOUSEHOLDS

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population, the amount of water we all use and the effects of climate change. There are a number of zones where demand will exceed available supply in drought conditions, partly as a result of the reduced abstraction levels required by the Environment Agency. We will consider measures to restore the balance in the most efficient manner possible, taking account of financial, social and environmental costs.

The first half of 2010 was the driest since 1927 and required us to take a wide range of operational measures to preserve water supplies. With nearly half the industry's geographically discrete water resource zones our ability to transfer water from one area to another can be limited. In 2010 work started on the feasibility of a major transfer scheme which would move potable water treated at Felindre WTW in west Wales to the conjunctive use system in south east Wales to help ensure that customers have sufficient water to meet their needs when they need it.

Water efficiency A key part of our plans to manage water resources is to promote sensible water use by our customers through encouraging efficient use of water. Water efficiency is a core theme

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in our education programme through schools and in the community and we provide information, advice and free devices to help save water in the workplace, home and in the garden through road shows and via our website and publications. The key message is that every small measure to save water can help offset the effects of climate change by containing any increase in overall water consumption.

Reducing our carbon footprint Last year some 88% of our carbon emissions relate to energy use so our carbon reduction plans focus on delivering a year on year reduction in net energy consumption, which we will do by using less power and by investing to increase the renewable energy we generate from our assets.

On a like for like basis, last year net carbon emissions from our operational activity fell by some 2.4% to 287,369 tonnes of CO₂ equivalent (tCO₂e).

In 2010-11, our electricity consumption from the National Grid was unchanged at 445 GigaWatt hours (1 GWh being 1,000,000 KiloWatt hours). Reduced consumption in the wastewater business was almost entirely offset by a rise of 13GWh in use by the potable water business, which is almost wholly due to the additional pumping costs during the near drought conditions in 2010 and shows how climate change can have a direct impact on our business. This is illustrated both by the total energy used in our potable water business, but also by looking at two pumping stations.

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Our Performance

Glaisfer and Llangynydr pumping stations lift water from our Talybont system to the Heads of the Valley area and, because of the height and therefore pumping cost involved, are only used when supply from reservoirs at Carno and Nantybwich are running low. These pumping stations operated six months last year compared to only once of any significance in the previous three years.

Offsetting higher electricity use, last year our renewable energy generation almost doubled to 20.5 GWh (2010: 10.7 GWh). This growth comes from our advanced digestion (AD) schemes at Cardiff and Afan WWTWs, in which we have invested £65 million in the past three years, which add to power generated from the existing smaller combined heat and power (CHP) schemes, which capture and burn 'waste' methane gas at our WWTWs. Last year these AD schemes, which convert wastewater sludge to electricity, delivered some 8 GWh of energy, but when fully operational they are expected to deliver up to 35 GWh of green energy each year. Works at two of the three AD sites will be self-sufficient for electricity supply. Overall, the AD schemes will reduce the level of electricity we purchase from the grid by 10%, and cut by a further 50% the volume of gas we use.

We continue to plan investment in renewable energy capacity and last year 5 local hydro power schemes were taken through feasibility and design and are expected to be installed in 2011-12. WTW investment schemes are also being designed, where appropriate, to have turbines on the inlet pipe to generate power and reduce onsite electricity use. The first of these will come online at Penycefn, near Dolgellau, in summer 2011. Individually, these schemes are quite small but by 2015 the programme of schemes is expected to reduce our operating costs by over £1 million a year.

Sustainability We have signed up to the Welsh Government's 'Sustainable Development Charter' joining a growing network of organisations committed to sharing best practice and learning across Wales. This builds on our long term commitment to pursue a sustainable strategy for operating our business, as first set out in 2007 in 'Our Sustainable Future'.

We are a signatory to the WRAP Utility Industry Agreement and committed to minimising our use of virgin aggregate resources and the volume of construction waste we deposit to landfill. Last year we met our target to reuse or recycle over 75% of the excavation and construction waste we generate.

Less than 0.5% of the waste we send to landfill is hazardous waste. In the past it was hard to reduce this further as there was no economically sustainable use in Wales for the 1,600 tonnes of grit we produce each year as part of the sewage treatment process. However, following a successful trial in south Wales, most of this grit will in future be transferred to a soil manufacturing company for use in their production process - without any form of washing or pre-treatment. This will both reduce our operating costs and divert waste away from landfill to sustainable use.

DELIVERING FOR THE FUTURE

Investing in our network of assets to protect public health and the environment

In last year's annual report we set out the outcome of the 2009 Price Review and the key outputs from the investment programme we will deliver in the five years to March 2015. Save for the WTW improvement programme, which will deliver additional treatment stages at 26 WTW, and the anaerobic digestion schemes at 3 WWTW, this programme has seen a significant shift in emphasis away from the construction of large new assets to a more maintenance driven programme. Maintaining above and below ground infrastructure assets is essential to maintain or improve our serviceability performance. After the first year of AMP5 we are generally on track with this programme, as summarised (right)

PROGRESS

2010

Protecting public health

✓

- » 2 improvement schemes (Mynydd Llandygar/Eithenfynydd) and 2 strategic maintenance schemes (Bryn Cowlyd/Capel Dewi) completed in Year-1 so far 7 of the 26 WTW improvement schemes have been completed due to the provision of early-start finance. Work is on site at 4 schemes and 3 are in the planning and design phase

Safeguarding the environment

✓

- » Improvement scheme completed at Eign WWTW, Hereford
- » 9 environmental investigation schemes completed to inform future investment decisions
- » 14 km of sewer mains rehabilitated
- » 2 intermittent combined sewer overflow schemes completed

Responding to climate change

✓

- » The anaerobic digestion (AD) schemes at Afan and Cardiff WWTWs are complete and generating energy ahead of schedule. This contributed to the near doubling in renewable generation to 20.5 GWh
- » Under our 'Green Space Wales' programme four trials have been established to test methods to reduce volumes of urban surface water discharging to the public sewer

Meeting customer expectations

✓

- » Customer service and operational control centre opened in St Mellons, Cardiff
- » New customer contact management and work scheduling systems implemented, allowing an improved responsiveness to customer service issues
- » Schemes completed to remove 15 properties from risk of sewer flooding
- » Maintenance schemes completed on 44 km of water mains to reduce interruptions to customer supplies from poor condition iron pipes (below target, as from November 2010 resources were diverted to leakage reduction activity)

INVESTMENT IN THE FINANCIAL YEAR 2010-11

(net of grants and capital contributions)

WATER	SPEND (£M)	WASTEWATER	SPEND (£M)
WTW improvement	41	WWTW improvement	12
Emergency planning and security	4	Intermittent discharges	13
Reducing leakage	12	Sewer maintenance	11
Asset maintenance	35	Wastewater asset maintenance	18
Drought mitigation	5	Sewer flooding	4
Metering	5	Advanced digestion	31
New developments	1	New developments	1
Systems development/IT	7	Systems development/IT	7
Other	10	Other	11
Total	£120	Total	£108

*A little rill of rain-water off the fields
is plucking its harp-strings in the sun,
and a ditch among reeds is a rising gleam,
the miracle of water's give and yield*

*Two mingling colours of glas in a stream,
help me dream that secret web of water
underfoot, down through the storeyed strata
in Earth's unmappable corridors of stone*

*While along the road the whistling water-gods,
sons of Corontina, goddess of springs and wells,
are burying miles of piping like a map
of life, an arterial stream to every tap,*

*like those rivers, reservoirs, aquifers underground,
invisible silvers silent as ultrasound*

*Gillian Clarke
National Poet of Wales*

Commissioned by Glas Cymru to celebrate the tenth anniversary of its founding

Responsible Business

KEEPING OUR PEOPLE SAFE

All our people have a right to go home safe at the end of the working day

Ensuring the occupational health and safety of all our employees and the health and safety of members of the public is always top of our agenda and a big responsibility. On any working day, construction or engineering work may be being carried out at around 150 individual sites across the Welsh Water region, and up to 4,000 procedures or operational activities are performed at our treatment works or on our network of water and wastewater pipelines.

In 2009-10 we saw an increase in RIDDOR reportable accidents for the first time in the ten years that Glas Cymru has owned Welsh Water, so it is pleasing to report this was reversed last year. In 2010-11 the number of RIDDOR reportable accidents fell by 39% to 24, and we saw good improvement in the number of minor injuries (down 19%) and the number of days lost from work and non-work related illness (down 25%). This equates to an accident incident rate (AIR, per '000,000 employees) of 660, which compares to 946 in 2008, 720 in 2009 and 805 in 2010 and a UK construction AIR in 2010 of 735.

We have adopted a new occupational health and safety strategy to reflect the operational focus of our business and to provide a clear framework to achieving our vision to be the best. It will also ensure that good occupational health and safety practices are integrated into all business activities. The strategy has 14 improvement initiatives supporting the 3 themes of 'First Standards', 'First Systems', and 'First Support Services'. These initiatives will help improve future performance, especially in terms of reducing the number of avoidable accidents – i.e. those that relate to slips trips and falls or manual handling, which involved a behavioral aspect to them, and give a new focus to staff training and awareness campaigns to improve future performance. In 2010, 28 members of the Leadership Team and 6 Directors successfully completed IOSH Safety for Senior Executives assessed training courses.

An important part of our approach to improvement is to recognise health and safety excellence. In June 2010 we held our fourth annual conference, which was attended by a cross section of 300 employees and service partners. This Conference, which was externally sponsored and received presentations from independent experts in the field,

provided our platform to present the Welsh Water annual awards to recognise health and safety excellence.

In January 2011, our occupational health and safety management system retained certification to the internationally recognised OHSAS 18001 2007 standard and a number of our partners have received RoSPA (Royal Society for the Prevention of Accidents) awards in the last 12 months whilst working for Welsh Water.

Further information on our performance can be obtained in our 2011 Health and Safety Report (available on our website)

BUILDING A SUCCESSFUL FUTURE, TOGETHER

Our employees deliver a vital, public service and so must be highly skilled, trained and motivated at all times

The past twelve months has been a challenging period for the business. In April and May 2010, some 1,600 employees previously employed by United Utilities Operating Services and Kelda Water Services transferred to Welsh Water under the Transfer of Undertaking Regulations, and we changed from a business directly

OUR PARTNERS SHARE OUR COMMITMENT TO EXCELLENT HEALTH AND SAFETY STANDARDS

RoSPA award for 5 years consecutive gold awards - Costain

RoSPA Gold award - Morgan Sindall, Imtech, Black and Veatch, Peter Duffy

RoSPA Bronze award
Daniel Pipelines

employing 220 people to one with 1,820 employees. Merging three teams with different cultures and a variety of terms of employment has not been easy, and our focus since April 2010 has been to establish a new Leadership Team and to restructure the business while ensuring that high standards of operational and customer service were maintained.

Engagement Our business objectives are clear - deliver high standards of customer service, protect public health, the environment and the health and safety of those who work for us - and we aim to have a culture in which every member of staff understands her or his contribution to attaining those goals. These key messages and our organisation integration plans were reinforced in March and April 2010 during a series of 20 road shows across our operating area. These events were attended by 95% of all staff and supported by the trade union full time officers and lay representatives.

A further series of road shows were held in October 2010 to communicate the half year business results and progress on the reorganisation of the business. Team Briefing and 'Welsh Water Weekly' (a newsletter published via email and Infozone - the staff Intranet) were

introduced to ensure staff received timely information and to provide opportunity for them to escalate questions or concerns, including via a dedicated area on Infozone.

We worked closely with full time officers and lay representatives of GMB, UNITE and UNISON under our single table collective bargaining framework (the 'Working Together Agreement') to develop policies and processes to facilitate a fair, yet efficient approach to the business restructuring. In particular, the 'no compulsory redundancy' approach to headcount reduction was maintained by developing a proactive approach to staff redeployment and a selective voluntary severance scheme.

We piloted new values for the business in our customer contact centre by conducting focus groups with cross sections of staff, and 220 line managers

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receiving contemporary training before we launched a new performance management process. Through this process, in which staff receive honest and constructive feedback on their performance, we aim to foster a customer focused performance culture. The success of this will be tested when we launch a new employee engagement survey, which will give us an understanding of engagement levels one year post insourcing of operational activities and set a base line to develop engagement for future years.

Reducing headcount Last year we announced that to meet demanding efficiency targets we would need to reduce the total number of people we employ by some 300 by 2015. Good progress has been made on this.

“

IN DECEMBER AND JANUARY SOME OF OPERATIONAL ASSETS HAD TO BE KEPT WORKING IN TEMPERATURES OF 20° BELOW FREEZING FOR SEVERAL DAYS. THE DEDICATION AND SKILL OF OUR PEOPLE IN NURSING OUR ASSETS THROUGH THESE CHALLENGING CONDITIONS – WITH MINIMAL IMPACT ON CUSTOMERS – WAS TRULY REMARKABLE.

”

We received some 263 expressions of interest in a selective voluntary severance scheme under which 84 people had left the business by April 2011, with a further 34 given agreement to leave by April 2012. We are confident that as we introduce new ways of working and optimise new technology this headcount reduction target will be met.

Working Together: A key goal was achieved when we announced to staff (in a third series of staff road shows) that a new 'Working Together Agreement' had been agreed with fulltime officers and lay representatives. This retained the essential principles of the original agreement that had remained in place since 1993. This agreement applies to all operational staff and some support functions. The new agreement has retained a 'no compulsory redundancy' approach to headcount reduction in return for greater flexibility and embracement of new working practices, e.g. increasing the working window to reflect customer requirements, more multi skilling of operators and the introduction of 'leaner' processes which are essential to meeting our business efficiency targets.

Developing our talent and core competence: Our challenge (and priority) since the reintegration of the operations business has been to amalgamate three distinctly different approaches to learning and development, whilst ensuring that best practice was retained. We immediately developed a standard approach to health and safety management and training, including programmes of mandatory training for operational staff. We have also been building a stronger and more systematic approach to operational training delivery more generally.

Significant effort has been given to reviewing our approach to 'talent management' and to building our capability, particularly in the scientific and engineering areas. This has included a review of all manpower and succession plans to identify future skills and development needs and issues arising from the ageing profile of our workforce.

As a result of this review, we are developing a new apprenticeship programme to ensure strong knowledge transfer. This will build on the graduate recruitment programme we established three years ago, as we continue to develop

our links with universities in Wales to ensure we are capable of attracting high calibre graduates and PhD students and to build a stronger 'talent pipeline' for the future. In 2010-11 we delivered a further round in our leadership programme aimed at aspiring leaders/managers within our business and, looking forward, we are in discussion with a potential partner to develop our 'core' management development programmes.

2010 saw the final stage of our phased roll out of new mobile working technology in the water services business, which involved over 2,000 days of training. This was followed up with an additional 140 days of training support in the workplace. We also delivered 440 days of IT training to support new SAP systems, and other packaged and bespoke Welsh Water applications. SAP is now core to a number of our critical business systems so we have created an internal SAP Taskforce to increase our process and systems knowledge within the business.

Pensions: Following the TUPE transfer of staff in April and May 2010, the number of active participants in our final salary pension scheme increased over nine-fold from 119 to 1,126, with a broadly neutral impact on scheme funding.

DEVELOPING TALENT – IN THE PAST YEAR WE HAVE

- ✓ Gained accreditation for our training centres and training approach. This enables us to design and accredit bespoke and company specific training.
- ✓ Designed and developed a City & Guilds accredited 'competent operator' programme for wastewater services staff. A similar programme is also under development for potable water services staff.
- ✓ Delivered an Advanced Digestion learning plan in advance of commissioning the AD schemes at Cardiff and Afan WWTWs.
- ✓ Adapted training programmes to support a new confined space qualification.
- ✓ Delivered training in line with an updated NRSWA (street works) Code of Practice to ensure minimal disruption to our customers.

This final salary scheme is closed to new entrants. At the end of 2010-11 there were 493 participants in our stakeholder pension scheme.

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Future challenges Building on the experience of the past year we are confident we can meet the challenges ahead. These are largely around completing the process of consolidating three sets of terms and conditions of employment and to develop a common pay and reward strategy and, through our refreshed training programme, building the professional and technical competence of all our employees.

SUPPORTING THE COMMUNITIES WE SERVE

We are committed to improving our links with local communities

We support the communities we serve in a number of ways - taking advantage of two of the core assets of our business: the skills, experience and enthusiasm of the people who work for us and the large landholding of which we are custodian for the people of Wales.

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 and on projects that deliver a local benefit. In the past year we have continued the schemes previously operated by Welsh Water and by two outsourced operating partners, while we seek to harness the additional value that can be derived from our now being an integrated business.

The best way we can make a difference to our communities is through employee volunteering. Our people have many essential skills and each year staff act as mentors to young people in the community, giving guidance on issues including interview support, career options and advice on developing skills, whether academic, social or personal.

We regularly support river and beach clean-up programmes and, working with Business in the Community Cymru, community challenge projects. Whether as a one-off event or as part of a graduate/management development programme, these community schemes provide an excellent way of enhancing staff skills, such as team work, leadership qualities, and negotiation skills. We also work with BITC Cymru in reading and numbers schemes, in which groups of volunteers spend time in primary schools.

Access to our landholdings

We own 81 reservoirs situated in some of the most beautiful parts of Wales and, where practicable and safe, we encourage visitors to share these resources with us. At 17 reservoirs, which attract close to a million visitors each year, we have developed facilities

OUR MAIN RESERVOIRS FOR ACCESS AND RECREATION

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

for a range of activities including cycling, fishing, sailing, canoeing, windsurfing and diving. Three of our larger sites have visitor centres and many sites have bird watching hides, picnic areas and walks and nature trails. To interpret the wildlife for our visitors we use leaflets and website links and we will develop interpretation through 'apps' for smart phones as part of the Visit Wales 'digital tourism' project. The main reservoirs are looked after by a team of rangers dedicated to managing our facilities and for looking after the special wildlife areas that are in our care. The rangers also encourage visitors by hosting a range of fun and informative activities including archaeological expeditions, stargazing evenings, fly-fishing courses, charity 'bikeathons' and sponsored walks, boat trips, and guided nature walks and wildlife tracking events.

Last year we worked with Conwy and Denbigh Councils and Forestry Commission Wales to secure funding to develop a cycling centre of excellence at Llyn Brenig (on the Denbigh Moors) in a scheme that will extend the visitor centre. We also have visitor centres at Llysyfran (near Haverfordwest) and in the Elan Valley, with a fourth facility planned at Llandegfedd Reservoir (near Pontypool),

which is close to the major population centres of Newport and Cardiff. Llandegfedd is already an international venue for game fishermen, and the new centre, which is expected to be open in 2012, will provide improved facilities for sailing, canoeing, sail boarding, angling and site visitors.

Supporting conservation We encourage conservation best practice across our landholdings and in 2010 a new nature reserve was created at Dol-y-Mynach in the Elan Valley. All our main reservoirs have biodiversity management plans and we provide practical support for a number of conservation projects in our region. A good example of this is the Anglesey and Llyn Fens LIFE project, a five year programme led by the Countryside Council for Wales to bring two SACs (special areas of conservation), comprising 750 hectares of important wetland habitat, into 'favourable' or 'recovering' condition. A smaller but longer term example would be our joint working over 20 years with the North Wales Wildlife Trust, which owns the Gors Maen Llwyd Nature Reserve that adjoins Llyn Brenig. Here we work together to conserve important habitats and improve the visitor experience at both sites.

Supporting education Last year close to 29,000 young people passed through one of our education centres or attended a school or community based event hosted under our peripatetic outreach programme, up 38% from the year before. By targeting young people (and the households they live in) our education programme supports an important business agenda by distributing information and efficiency aids and advice to schools, households and community groups to promote water efficiency, public safety and environmental conservation.

In the last academic year some 14,200 school children visited one of our education centres, our highest attendance so far. These centres are staffed by full-time seconded teachers or experienced environmental rangers and use indoor and outdoor facilities to teach primary school children about the importance of water and to take part in practical activities such as the water cycle, water efficiency, 'What No Tap?' and river studies. Our services are provided free of charge and are backed up by our education website, where teachers can download materials and information to support them in the classroom.

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Added to this, some 14,600 young people benefited from our outreach programme 10,200 in south and west Wales, 3,100 in north Wales and 1,300 who attended an event we hosted at an education partner site The Waterworks Museum in Hereford, the National Botanic Garden of Wales near Carmarthen or the National Wetlands Centre at Llanelli

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In a recent pilot with schools in Blaenau Gwent and Newport, 39 schools and 8,710 pupils were involved in outreach assembly and workshop sessions on water efficiency We will now extend these outreach sessions across our operational area to encourage pupils to become more aware of water saving initiatives and fulfill their role as 'responsible citizens' We have also been pleased to support events around Wales hosted by the Council for Education in World Citizenship - Cymru, at which close to 1,000 young people developed a greater understanding of global issues (including water conservation) through educational games and role play

Supporting charity Our business is a long term supporter of WaterAid, the international charity which works in 17 countries providing water, sanitation and hygiene education to some of the world's poorest people Employees across

our business are actively involved in fundraising activities and in the last 5 years they have raised some £700,000 - putting us on track to beat our target, which is to raise £1 million for WaterAid between 2004 and 2014 This is in addition to over £1.3 million donated by our customers since 2001 via our annual WaterAid appeal

Employees are also encouraged to organise fundraising events in local offices from which thousands of pounds are raised each year Beneficiaries include national charities such as Comic Relief, Children In Need, Help the Heroes, and cancer charities, or local children's homes or hospices, or other charities chosen by staff A good example of this is our small team of graduate employees who as part of the 'Million Makers' challenge raised over £10,000 for The Prince's Trust Cymru

<http://www.wateraid.org/uk>

<http://www.bitc.org.uk>

Financial Performance

FINANCIAL REVIEW

Glas Cymru has delivered a sound financial performance during the year to 31 March 2011 in spite of continued economic uncertainty. Achievement of Ofwat's Final Determination for the regulatory period to 31 March 2015 is a big challenge and to assist in meeting this challenge we recently restructured our business operations. While appointed revenue has fallen due to regulatory price reductions, we are continuing to deliver extensive capital investment and better customer service.

Operational expenditure (before exceptional items) was 5% lower in real terms, and capital investment in our regulated water and wastewater operations, including infrastructure renewals expenditure ('IRE'), amounted to £242 million during the year.

Revenue

Glas Cymru's turnover in the year to 31 March 2011 was £677 million (2010 £688 million), primarily reflecting the price reduction of 1% and the greater take-up of our sector leading range of customer assistance tariffs, which help support customers who have difficulty paying their bills. By 31 March 2011

some 37,000 customers were benefiting from one of these tariffs at a cost to the business of £3 million. Additional revenue from new customers has been offset by household customers switching to metered charging.

Operating expenditure

Glas Cymru's total operational costs (excluding IRE and depreciation and before exceptional items) remained stable at £265 million (2010 £266 million), inflationary increases being offset by savings following the termination of the outsourced operational contracts – a reduction in real terms of some 5%.

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. Schemes to produce renewable energy from sewage sludge have been completed at Cardiff, Hereford and Port Talbot wastewater treatment works (a £75 million anaerobic digestion programme) with onsite electricity generation now being achieved. Power costs during 2010-11 fell slightly to £34 million (2010 £35 million), largely driven by price fluctuations. There remains significant uncertainty over

future energy costs, and we have forward purchased over 60% of the estimated power requirement of the business over the remainder of the regulatory period to 31 March 2015.

Customer debt recovery remains a high priority for Welsh Water and our billing and income contract partner Veolia Water. In a difficult 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 (2010 £22 million) represents around 3% of annual turnover (2010 3%) and reflects a review of historical collections.

Expenditure on infrastructure renewals has almost halved from the prior year, the lower figure reflecting the completion of the Section 19 programme which resulted in the refurbishment of 1,800km of trunk mains over the course of the five years to March 2010.

Restructuring of business operations

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.

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The price limits for the five years to 2015, set in November 2009 by Ofwat, will allow Welsh Water to invest £1.3 billion in water quality and other improvements. But Welsh Water was also challenged to reduce its day-to-day operating costs by some 20% to enable the forecast average household bill to fall by more than £20 in real terms, over the 5 years to 2015.

In previous years, around two thirds of operational costs related to outsourced service contracts - the major contracts were with United Utilities Operating Services Limited (UUOS) (for the operation of the water network and the wastewater network in North Wales) and with Kelda Water Services (KWS) (for the operation of the wastewater network in South Wales and Herefordshire).

Included in the 2009-10 results were exceptional items totalling £30 million. These provided 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 gain/loss on derivatives) of £170 million was £72 million higher than last year. This increase was due to the high level of retail price index (RPI) inflation this year, as compared to the negative RPI for the previous year, which has affected the indexation charge on our index-linked bond and finance lease inflation swaps. This has been offset in part by a £14 million accounting profit on termination of finance leases. The average cost of debt during the period was 6.4% (2010 3.7%).

Glas Cymru has a number of swap contracts which fix the interest cost or inflation-link the cost of debt, 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 gains in 2010-11 amounted to £12 million (2010 losses of £15 million). The company intends to hold these swaps to the maturity of the underlying debt and, over the life of the swaps, these gains and losses will reverse to zero.

Profit before taxation

Profit before tax was £70 million (2010 £63 million) which will be retained in the business for the benefit of customers. Excluding fair value movements and exceptional items, the profit before tax was £58 million (2010 £107 million). This profit was made after funding a 1% reduction in customer bills and reflects in particular the higher interest charge in the year.

Taxation

The taxation credit for the year of £68 million comprises largely the effect of deferred tax movements, a current year credit of £35 million includes the impact of a reduction in the corporation tax rate from 28% to 26% (£13 million) and the termination of finance leases (£13 million), and a £32 million prior year credit principally reflects a reassessment of the requirement to provide deferred tax on rolled over capital gains (£37 million). The group has tax trading losses carried forward of approximately £387 million, which the group believes should be sufficient to eliminate tax on trading profits in the remainder of the regulatory period ending 31 March 2015, subject to any changes in tax law.

Liquidity and financial reserves

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 keeping bills affordable for our customers.

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 67% as at 31 March 2011 and 'financial reserves' (RCV less net debt) were £1.3 billion.

The company redeemed its remaining junior (Class C) bonds during the year, partly through a successful tender offer on 7 June 2010, when £113 million of the bonds were repurchased and the balance of £12 million on 31 March 2011, the expected maturity date of these bonds.

The company has therefore now redeemed all the £350 million of junior Class C (BBB-rated) and Class D (unrated) debt that was raised on the Glas acquisition of Welsh Water in May 2001, and the £2.7 billion of remaining debt comprises entirely of 'A' rated Class A and B senior debt.

On 3 March 2011, the company agreed a further £100 million facility with the European Investment Bank, and this facility remained undrawn at 31 March 2011. On 17 and 18 May 2011, the company agreed £140 million of bilateral revolving credit facilities with a group of six banks. These facilities remain available for five years to May 2016, although the banks have an option to extend these for a further year to May 2017. The existing £100 million facilities (which were due to expire in September 2011 and June 2012) were cancelled. Cash balances at 31 March 2011 were £98 million. The company is therefore in a strong liquidity position going forward.

The company also renewed its special £135 million liquidity facility on 13 April 2011 with a syndicate of four banks. This facility is a requirement of our bond covenants and can only be drawn in the event that the company is in default of its covenants and unable to pay its interest bills. The existing £150 million facility was cancelled.

Credit ratings and interest rate management

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.

The ratings of the company's Class A and B debt at 31 March 2011 were A/A3/A from Standard & Poors' (S&P), Moody's and Fitch ratings.

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

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 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 2011, approximately 63% of gross debt was index-linked via bonds and derivatives (2010 60%), with the balance of debt (37%) fixed. The expected maturity of the outstanding fixed rate and index-linked bonds ranges from 2021 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 ten years, and provides a stable base from which it can respond positively to the challenges of the recent economic recession and drive forward its continuing large capital programme.

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 £1.3 billion over the current AMP period which runs from 2010 to 2015, bringing sustained improvements to customer service, drinking water quality and the environment. Total capital expenditure by Welsh Water during the year (including IRE) was £242 million (2010 £361 million).

NET DEBT AND RESERVES

As at 31 March	2011 £m	2010 £m
Regulatory Capital Value (RCV)	3,980	3,737
Net debt	(2,668)	(2,669)
'Reserves' (RCV less net debt)	1,312	1,068
Gearing (net debt/RCV)		
Senior debt	67%	68%
Senior debt + class C bonds	67%	71%
Total debt	67%	71%

New or upgraded water treatment works have been commissioned at Bryn Cowlyd, Capel Dewi, Eithin Fynydd, and Mynydd Llandygai, providing the most up to date treatment processes to protect the public drinking water supplies to 168,000 customers. This is part of a £200 million water treatment investment programme.

Looking ahead

The Board's policy is to maintain gearing at or around 70%. A key part of our strategy is to minimise customer bills in the long term while at the same time maintaining the serviceability of the company's £25 billion network of water and wastewater assets. 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 £1.3 billion investment programme to improve services.

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	Maturity
A1	350	6.015%	Fixed rate	31 March 2028
A4	330	3.514%	Index-linked	31 March 2030
A5	107	3.512%	Index-linked	31 March 2031
A6*	100	4.473%	Fixed rate	31 March 2057
B1	325	6.907%	Fixed rate	31 March 2021
B3	160	4.377%	Index-linked	31 March 2026
B4	95	4.375%	Index-linked	31 March 2027
B5	55	1.375%	Index-linked	31 March 2057
B6	140	1.858%	Index-linked	31 March 2048

Bonds issued by Dŵr Cymru (Financing) Limited. For full details of bonds refer to Prospectus dated 19 March 2010, available on our website www.dwrcymru.com. (* Swapped to an effective index-linked rate of 1.35%)

CREDIT RATINGS OF GLAS CYMRU BONDS

	Standard & Poor's	Moody's	Fitch
Class A Bonds	A	A3	A
Class B Bonds	A	A3	A

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 (B/B3/-).

What each target means

KPI - MEASURE	WHAT IT MEANS	BASIS FOR THE TARGET
Number of Bacti failures at WTW	We take about 10,000 samples of water a year from our water treatment works and check for coliform bacteria	Achieving the target would meet the Ofwat serviceability target and would place us high in the sector league table
Bacteriological compliance at SRVs (%)	We take a weekly sample from our clean water storage tanks and check for coliform bacteria	The target is based on maintaining what we have achieved in recent years.
Iron compliance at customers' tap (%)	We randomly sample tap water at our customers' homes - iron is the main cause of discolouration	The target is based on the best we have achieved in recent years - it would also meet the Ofwat serviceability target
Number of discoloured water complaints	We record all occasions when customers complain to us about discoloured tap water	We get more complaints than most companies - achieving target would meet the Ofwat serviceability target
Mean Zonal Compliance	The DWI index used to judge overall water quality, based on random samples of tap water at customers' homes	We have been below industry average in the last few years - achieving target would take us back to industry average
Number of serious water quality incidents	The number of significant (category 3 or above) water quality events we report to the DWI	Incidents happen when we get things wrong in managing water quality - the target is a 25% reduction
Safe sanitation		
Sewer flooding - blockages	The number of times customer properties flood as a result of asset breakdown, sewer collapse or blockage	In 2009-10 we did not achieve the Ofwat serviceability target - the target was set to get us back on track
Sewer flooding - hydraulic overload	The number of times customer properties flood as a result of insufficient sewer capacity	This target is set so that we should achieve the Ofwat serviceability targets - even in a wet year
Protecting our environment		
Leakage (MI/d)	Leakage is the water lost between treatment works and customers' homes and businesses	This is the leakage target we have agreed with Ofwat and is the economic level of leakage
Number of serious pollution incidents	Category 1 and 2 pollution incidents reported by the Environment Agency	Target maintains current mid-sector performance - we have done better than this in previous years
Total number of pollution incidents	Category 1, 2 and 3 pollution incidents reported by the Environment Agency - it includes those we report ourselves	We have more incidents than most companies - target was set to get us close to the Ofwat serviceability target.
WwTW Lookup compliance (%)	This measures our compliance with the sanitary limits in WwTW discharge consents ('look-up')	Achieving target would meet the Ofwat serviceability target.
Brilliant customer service		
Number of customers - low water pressure	The number of customers who do not have the minimum pressure at their stop cock or tap.	Achieving the target would meet the Ofwat serviceability target.
Number of customers - loss of supply >6hours	The number of customers who have no water as a result of unplanned works or mains bursts	This is a performance measure where we lead the industry and meeting the target would maintain that position
Number of written complaints	The number of written complaints - including emails - we get regarding any aspect of our service	Complaints have been going up - target was set to deliver 10% improvement vs 2009-10
Number of avoidable complaints	Avoidable complaints are where we have not done what we said we would or have not kept our customers informed	Complaints have been going up - target was set to deliver 10% improvement vs 2009-10
Customers satisfied with our service (%)	This is based on Ofwat quarterly research	Achieving target should place us in the top half of the industry league table for SIM
Number of unwanted telephone contacts	These are calls that are not to do with for example moving house or any other good reasons to call us	Target was set to deliver a 25% improvement vs 2009-10 to move us closer to industry average on SIM
Delivering services efficiently		
Operating costs (£m)	The total operating cost of running the business	Target represents the annual milestone to achieve the £39m cost efficiency that has to be delivered by 2015
Net energy use (savings of GWh)	Net energy is our total consumption of electricity and gas offset by the renewable energy we generate	Achieving this target is the first stage towards a 25% cut in our carbon footprint by 2015
Our wellbeing		
Number of RIDDOR reportable injuries	These are the most serious kind of injury that must be notified to the Health and Safety Executive	We are committed to reducing the number of injuries each year. Everyone has the right to return home safe at the end of the day
Staff engagement	We have appointed an independent service provider to carry out an annual staff engagement survey (covering staff views about how things are going, what is going well and what is not, and our progress as a business) - results for 2011 are not yet available	

Report and Accounts

The Directors

Colour photo/graphic removed

Bob Ayling

Chairman Designate ^{(N/A)(A)(Q)(R)}

Appointed a Non Executive Director in April 2008, Mr Ayling (64) became Chairman of Glas Cymru in July 2010. He is also Chairman of Dyson Limited, the International Dispute Resolution Centre and Her Majesty's Courts and Tribunals Service. A solicitor by profession, and a former senior legal advisor at the Department of Trade and Industry, his former roles include Managing Director and Chief Executive of British Airways plc, Chairman of Holidaybreak plc and Non Executive Director of Royal & Sunalliance Insurance Group.

Nigel Annett

Managing Director ^{(M)(D)}

Appointed Managing Director in January 2005, Mr Annett (52) 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 (47) 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 Council of The Prince's Trust – Cymru.

Colour photo/graphic removed

Tony Hobson

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

Appointed a Non Executive Director in February 2001, Mr Hobson (63) is the Chairman of The Sage Group plc, a Non Executive Director of esure, and Chairman of Changing Faces, the UK's leading disfigurement charity. He was previously Chairman of Northern Foods plc and Group Finance Director of Legal and General Group plc.

Prof. Stephen Palmer

Non Executive Director ^{(N/A)(D)}

Appointed a Non Executive Director in October 2009, Professor Palmer (59) 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.

Menna Richards

Non-Executive Director ^{(N/A)(A)}

Appointed a Non-Executive Director in November 2010, Menna Richards was Director BBC Cymru Wales until February 2011. She is a Non-Executive Director of Welsh National Opera, Vice-President of the Royal Welsh College of Music and Drama, and Vice President of Cardiff University, where she is also a member of the International Advisory Board of the Cardiff Business School. Her previous executive roles include Controller BBC Cymru Wales, Managing Director, HTV Wales, and Director of Broadcasting HTV Group plc. Previous non-executive positions include Chair of Governors of the Royal Welsh College of Music and Drama and board member of the Cardiff Bay Development Corporation. Menna was awarded the OBE for services to broadcasting in 2010.

Colour photo/graphic removed

Peter Perry

Operations Director ^(R)

Appointed Operations Director in July 2006, Mr Perry (49) 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 and UUOS's water interests in Scotland and Ireland. Prior to joining UUOS 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.

John Bryant

Non-Executive Director and Senior Independent Director ^{(N)(R)}

Appointed a Non-Executive Director in March 2001 Mr Bryant (67) 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.

Colour photo/graphic removed

James Strachan

Non-Executive Director ^{(N)(R)}

Appointed a Non-Executive Director in June 2007 Mr Strachan (57) is a Non-Executive Director of Legal & General Group Plc, JP Morgan Asian Investment Trust, the Financial Services Authority, Sarasín 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.

Anna Walker

Non-Executive Director ^{(N)(R)}

Appointed a Non-Executive Director in March 2011, Anna has a wealth of experience in customer service, policy making and regulation and she has recently completed an independent report commissioned by government into household water charging. She is Chair of the Office of Rail Regulation (the rail regulator) and was, from its creation in April 2004 until March 2009, Chief Executive of the Healthcare Commission, the body responsible for independent regulation of healthcare in the NHS and the private healthcare sector. She was previously Director General, Land Use and Rural Affairs, at Defra, Director General, Energy Group at DTI, and Deputy Director General at Ofcom, the telecoms sector regulator. Anna is also a Non-Executive Director of Consumer Focus, the statutory consumer champion body.

The Members

There are presently 84 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.

Membership of Board Committees

(N) Nominations

(A) Audit

(Q) Quality and Environment

(R) Remuneration

Directors' Report

The Directors present their report and the audited financial statements of Glas Cymru Cyfyngedig (Glas Cymru) for the year ended 31 March 2011

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 business model whereby all financial surpluses are retained in the business as reserves, or invested in additional quality or service improvements. 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 customers of Welsh Water.

The governance structures and internal controls operated in Glas Cymru are described in the governance report on page 45 of this annual report. Through these mechanisms the Board aims to apply high standards of corporate governance and to comply with The UK Governance 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 16 to 33 of this annual 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 8. 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 2011 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

The average household bill for Welsh Water's customers was £398 which was £4 lower than the previous year. During the year, some 37,000 customers who were struggling to pay their water bill benefited from one of a range of special tariffs or the Customer Assistance Fund, at a cost to the business of £3 million.

Profit before tax was £70 million (2010: £63 million) and this will be retained in the business to fund future benefits for customers. The level of net debt has been reduced to 67% of the regulatory capital value, achieving the Board's target to reduce gearing to below

70% from the 93% at which it stood when Welsh Water was acquired by Glas Cymru in May 2001. The company maintains a robust liquidity position, with £298 million of cash and undrawn bank facilities as at 31 March 2011, meaning that the business is well funded to deliver its five-year investment programme. As a result of this strong financial position, the company has been able to redeem its £125 million of more expensive junior bonds, which will save customers some £4 million a year in future interest payments.

Directors

The names and brief biographical details of the Directors are given on page 40. With the exception of Menna Richards and Anna Walker who were appointed on 26 November 2010 and 3 March 2011 respectively, all current 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.

Robert Ayling was appointed as Chairman on 10 July 2010 when Lord Burns stood down as a Director. Dame Deirdre Hine and Geraint Talfan Davies also stood down as Directors during the year on 10 July 2010 and 31 March 2011 respectively. At the 2011 AGM, all of the Directors will voluntarily stand for re-election. This will meet the requirement under our Articles of Association for Menna Richards and Anna Walker to seek re-election at the first AGM since their appointment as a Director, and for Robert Ayling and Peter Perry to retire by rotation and seek re-election. It will also meet the good governance requirement that John Bryant and Tony Hobson, who have served on our Board for more than 9 years, should stand for annual election.

The Board has endorsed the effectiveness and commitment (and, in respect of the Non-Executive Directors, the independence) of the Directors and recommends each for re-election. Further details are set out in the Notice of 2011 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 2011 on page 49. A resolution will be proposed at the 2011 AGM to approve this report.

As permitted by the Articles of Association, the Directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006. The indemnity was in force throughout the last financial year and is currently in force. The Company also purchased and maintained throughout the financial year Directors' and Officers' liability insurance in respect of itself and its Directors. No claims have been made against this policy since the date of the last report.

Members

During 2010-11, 26 new Members were appointed on the recommendation of the independent membership selection panel and following a process of public advertisement. At the date of this report, Glas Cymru has 84 independent Members, of whom 12 will stand down at the end of the 2011 AGM having served three terms of appointment. The Directors of the Company are also Members.

Further information about Members can be found in the Governance Report on page 48. Brief details of the current Members of Glas Cymru is available on request or may be obtained from our website.

Employees

Following the ending of the outsourced contracts for the management of water and wastewater services and some associated activities, at 31 March 2011 Welsh Water employed 1,712 people (2010: 2,051). 84 people left the business during the year, which was the first year of the phased 5-year programme announced last year under which around 300 people will leave the business by a combination of retirement, natural turnover, and selective voluntary severance.

Our success is dependent upon our having a highly committed and motivated work force. On page 29 we have described how we engage, consult with and systematically provide information to employees on matters of concern to them, how we are developing the talent and core competence of the business, and the 'Working Together Agreement' that has been adopted for the next five years. We have also adopted a new incentive scheme through which all employees can share in the success of the business and receive an annual bonus linked to the financial and customer service performance of Welsh Water.

We are committed to employment policies that follow best practice, based on equal opportunities for all employees, irrespective of sex, race, colour, disability, or marital status. This includes giving full and fair consideration to applications for employment from disabled persons, having regard to their particular aptitudes and abilities.

Occupational health and safety

We are committed to achieving high standards of occupational health and safety and our performance improved in 2010-11, which was a good outcome in a year of significant organisational change. Detail of our performance is provided on page 28, and a copy of our 2011 Occupational Health and Safety Report is available on request or on our website.

Water quality and the environment

Each month the Quality and Environment Committee of the Board (QEC) meets to monitor the water quality, customer service, and environmental performance of Welsh Water. QEC tracks the development of key operational and service improvement strategies and reviews the cause of, and Welsh Water's response to, all major water quality and environmental incidents. A copy of our annual QEC Report is available on request or on our website.

Research and development

We keep abreast of research and development by selective participation 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. We have also developed relationships with university research departments and private companies to undertake investigations into issues that relate to our business objectives and priorities for our operational region.

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 2010-11 the average payment period for the group was 55 days (2010: 47 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.

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. Information on how we do this is provided on page 31.

Directors' report

During the year, charitable donations amounted to £8,150 (2010: £45,485). There were 7 beneficiaries of awards of £500 or above, ranging from payments of £500 to £2,000.

It is Board policy not to make donations to political parties or to incur political expenditure and during 2010-11 no donations or payments were made which are required to be disclosed under section 366 of the Companies Act 2006.

Institutional investors

We welcome two-way dialogue with our investors and each year, shortly after our annual general meeting, we hold an annual bondholder/investor meeting in London. We also issue a quarterly investor report for holders of the group's bonds and welcome dialogue at any time. Each year, usually following the announcement of preliminary and interim financial results, the Finance Director attends informal meetings with bondholders, which may also be attended by a Non-Executive Director. 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 11 July 2011.

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 2011 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 2011. As part of the audit process Directors have confirmed that as far as each Director is aware there is no relevant audit information of which the auditors are unaware and that 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.

After a process of competitive tender, PwC has been awarded the external audit contract for the financial years 2011-12 to 2013-14, with an option for Welsh water to extend the contract for two years. The Audit Committee interviewed a number of the UK's leading audit firms and concluded that PwC had provided the strongest bid in terms of price and quality, and that robust arrangements are in place to ensure that the objectivity and independence of the auditor. A resolution to re-appoint PwC will be put to Members at the 2011 AGM.

Events after the financial year-end

On 17 May and 18 May 2011 the group cancelled its existing £100 million of revolving credit facilities that were otherwise due to expire on 30 September 2011 (£60 million) and 30 June 2012 (£40 million), and entered into new bilateral revolving credit facilities totalling £140 million with a group of six banks. These new facilities expire on 17 May 2016 (£110 million) and 18 May 2016 (£30 million), although each bank has an option to extend its facility for a further year.

Annual general meeting

The 2011 AGM will be held on Friday 8 July 2011. 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 2011, the re-election of all 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 resolutions to reappoint the auditors and to authorise the Audit Committee to fix their fees.

These resolutions are all matters of ordinary business, there is no special business. Further information in respect of all resolutions is provided in the Notice of 2011 AGM sent to the Members of Glas Cymru with this report.

By order of the Board

Richard Curtis LLB, ACIS
Company Secretary
8th June 2011

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

Corporate Governance

Glas Cymru is committed to high standards of corporate governance. This report explains the key features of the Company's governance structure and how we voluntarily comply with the UK Corporate Governance Code (the 'Governance Code'), which sets the standard for good practice for UK listed companies. Glas Cymru complies with all the provisions of The UK Governance Code, except for those that do not apply to a company limited by guarantee.

Leadership

The Board comprises 10 Directors (a Chairman, 3 Executive Directors, and 6 Non-Executive Directors) who are collectively responsible for the long term success of the company. The Board sets the strategic aims of the business, ensures that resources are in place to meet these aims, and reviews management performance in a framework of control that allows risk to be managed effectively.

The Chairman's role is to ensure the effective operation of the Board. This means ensuring that Directors receive sufficient information to make informed judgements, that matters are fully debated (and no director or group dominates the Board's decision making process), and that constructive relationships are maintained with key stakeholders. Each year the Board considers the Chairman's availability and capacity to undertake this critical role against the background of his other commitments. The Board is satisfied that Robert Ayling fulfils this role effectively and has the capacity to carry out all necessary aspects of the role.

The Managing Director is responsible for the day-to-day management of the business and for the implementation of the strategy, policy, and procedure adopted by the Board. He is supported by an executive team of the Finance Director, Operations Director, Director of Regulation and Planning, Director of Human Resources and the Company Secretary.

The Non-Executive Directors use their combined skills and experience to scrutinise the performance of management in meeting the objectives of the business and to challenge and help develop key aspects of strategy. They also monitor the integrity of financial

information and the robustness of systems of internal control and risk management. John Bryant is the Senior Independent Director.

The Board considers that each Non-Executive Director to be independent of the Company and one another. They have access to all staff and information relating to the business, the advice and services of the Company Secretary and, if required independent external advice at the expense of the Company. There is regular opportunity for the Chairman and the Non-Executive Directors to meet privately.

The Executive Directors each have a written service contract subject to termination by the Company on 12 months' notice. The Chairman and Non-Executive Directors each have a letter of appointment subject to termination by the Board on 3 months' notice. A copy of each of these agreements is available for inspection. The Company Secretary is an employee, but not a Director, of the Company.

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 the 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.

Effectiveness

The Board met 8 times in 2010-11, including 6 meetings held over two days to allow additional time for Directors to review progress on key strategic topics and to meet key business managers. In the past year, these reviews have focused on the public health, customer service, and environment and organisational change issues that arose from resuming direct responsibility for the day to day management of Welsh Water's water and wastewater operations.

The table below summarises the number of Board and committee meetings held in 2010-11 and the level of attendance at each.

	Board	Remuneration (N)	Audit (A)	Quality and Environment Committee (Q)	Nomination (R)
Number of meetings held in 2010-11	8	5	4	12	3
Robert Ayling ^{(N)(Q)(R)(A)}	8**	5	3 of 3	10	3
Nigel Annett ^{(Q)(N)}	7	-	-	11	2
Christopher Jones	8	-	-	-	-
Peter Perry ^(Q)	8	-	-	12	-
John Bryant ^{(N)(Q)(R)}	8	5**	-	12**	3*
Anthony Hobson ^{(N)(A)(R)}	8	5	4*	-	3
Stephen Palmer ^(Q)	8	2 of 2	-	11	3
Menna Richards ^{(1)(N)(A)}	1 of 2	-	1 of 1	-	-
James Strachan ^{(N)(R)}	8	5**	1 of 1	-	3
Anna Walker ^{(2)(N)(R)}	1 of 1	-	-	-	-
Lord Burns ^{(3)(N)}	3 of 3**	-	-	-	1
Dame Deirdre Hine ^{(3)(N)(Q)(R)}	3 of 3	2 of 2	-	4**	0 of 1
Gerald Talfan Davies ^{(4)(N)(A)}	7	1 of 2	3 of 4	-	3

* Committee Chairman ** Chairman for part of year; [1] Appointed 23/11/2010; [2] Appointed 03/03/2011, [3] Stood down 10/07/2010; [4] Stood down 31/03/2011, [5] The Appointments Sub Committee of the Nomination Committee did not meet in 2010-11 and was dissolved on 10/07/2010.

Following the appointments of Menna Richards and Anna Walker an induction programme was prepared to familiarise them with the business, the risks and strategic challenges, and the economic, competitive, and legal and regulatory environment in which the group operates. All Directors update their skills and business knowledge from a combination of visits to operational assets, meetings with regulators and presentations to the Board on key strategic issues.

The annual evaluation to assess the effectiveness of the collective performance of the Board, the performance of the Chairman and the committees of the Board was deferred in 2010 following the appointment of a new Chairman and other changes on the Board. Notwithstanding this, the Board has responded to changes in the business and improved its effectiveness by (i) increasing the frequency of Board meetings in 2011-12 from 8 to 9 meetings a year, and by (ii) adopting a modified approach to the analysis and reporting of the principal risks facing the business. During 2011 an evaluation exercise is to be completed with independent assistance from Dr Tracy Long of Boardroom Review.

Committees of the Board

The main committees of the Board are the Audit Committee, the Quality and Environment Committee ('QEC'), the Remuneration Committee and the Nominations Committee. There is also a Finance Committee to approve financing and treasury transactions where a decision is required between Board meetings. After each committee meeting a summary of matters discussed is reported to the Board, and minutes are submitted to the following Board meeting. Company Secretary is the secretary to each committee, which can engage the services of such advisors as it needs to fulfil its responsibilities.

The work and membership of each committee is set out in a written terms of reference and is described below, except for the Remuneration Committee which is described in the 2011 Remuneration Report on page 50. In addition to chairing or being a member of a committee, certain Directors provide additional time and challenge in public health (S Palmer), engineering and procurement (J Bryant), customer service and

regulation (A Walker), finance and pensions (A Hobson), communications (M Richards) and government and regulation (R Ayling).

Audit Committee

The Audit Committee is chaired by Tony Hobson and met on four occasions in 2010-11. The role of the Committee is to scrutinise and challenge reports from management and 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 the internal audit function, the results of this audit work and 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, and
- » to make recommendations on the appointment and remuneration of external auditors.

The members of the Committee are Tony Hobson, Menna Richards and Robert Ayling (who is chairman of the Board and is likely to stand down as a member when current process of Board refresh is complete). The Finance Director, Head of Internal Audit and External Auditors attend each meeting by the invitation of the chairman. The Chief Executive and Operations Director also attend at least one meeting a year. Tony Hobson is a Chartered Accountant and a former Group Finance Director of Legal & General Group plc and has the significant and relevant experience required for a chairman of the Audit Committee. The terms of reference of the Audit Committee include all matters required by the UK Corporate Governance Code.

The main business at two meetings of the committee is to review the preliminary and interim financial results and related areas of judgement and accounting policy. Appropriate time is allocated at each meeting 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. This includes challenge to

management's assessment of those risks and the mitigation strategies and plans put in place to manage them.

Each meeting receives a regulatory and compliance report to provide an update on substantive issues relating to water industry regulation and compliance, prosecutions and matters of legal dispute. It also covers major insurance claims, tax compliance, fraud and health and safety, as well as aspects of information management. Each meeting also receives a report on disclosures under the Board's whistleblowing policy. Other topics routinely reviewed and subject to follow up by the committee include business continuity, the Board's quarterly report to Glas Cymru's investors, treasury policy and controls and arrangements to ensure the integrity of regulatory reporting.

During the year the Audit Committee approved external and internal audit plans and met privately with the external and internal auditors (without Executives present) as part of an annual review of audit independence. On the basis of this work, and regular meetings with management, the Audit Committee is able to assess the ongoing effectiveness of external and internal audit. The Committee also approved an Assurance Map which was developed as a tool to ensure the effective integration of internal and external audit activity.

The role of internal audit is to provide objective assurance and to advise management and the Board on the extent to which systems of internal control and arrangements to manage risk are appropriate and are operating effectively. The internal audit plan is focused on areas of greatest risk to the business and in 2010-11 this included review by a specialist and independent IT auditor of the major system and process changes introduced in the year.

During 2010-11, internal audit services were provided by a team led by the Head of Business Assurance and external auditor services were provided by PricewaterhouseCoopers LLP (PwC). The delivery of internal audit services was subject to a benchmark review which reported to the

Audit Committee and there was a change in external audit partner in line with Board policy which requires rotation at least every five years

After a process of competitive tender, the contract for external audit services for the financial years 2011-12 to 2013-14 was awarded to PwC, with an option for Dŵr Cymru to extend the contract for two years. The Committee interviewed a number of leading audit firms and concluded that PwC had provided the strongest bid in terms of price and quality, and arrangements to ensure that the objectivity and independence of the auditor were robust.

Audit independence cannot be impaired by reason of the level of non-audit work awarded to the external auditor. It is Board policy 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 on page 69 of the Accounts.

Quality and Environment Committee (QEC)
QEC is chaired by John Bryant and meets every month to oversee Dŵr Cymru's performance against regulatory measures and delivery of key operational and strategic goals. Through this activity QEC provides assurance to the Board that our obligations as a water and sewerage undertaker are not compromised or put at risk.

In particular, the committee

- » reviews performance and advises the Board on matters of operational policy and practice in relation to matters of public health, compliance with drinking water and environmental regulations and as regards occupational health and safety,
 - » reviews management's assessment and mitigation of operational and quality risk,
 - » reviews strategy designed to improve customer service or develop more sustainable water and wastewater businesses based on industry best practice, and
 - » assesses Dŵr Cymru's management of QEC.
- QEC is chaired by John Bryant and meets every month to oversee Dŵr Cymru's performance against regulatory measures and delivery of key

operational and strategic goals. Through this activity QEC provides assurance to the Board that our obligations as a water and sewerage undertaker are not compromised or put at risk.

In particular, the committee

- » reviews performance and advises the Board on matters of operational policy and practice in relation to matters of public health, compliance with drinking water and environmental regulations and as regards occupational health and safety,
- » reviews management's assessment and mitigation of operational and quality risk,
- » reviews strategy designed to improve customer service or develop more sustainable water and wastewater businesses based on industry best practice, and
- » assesses Dŵr Cymru's management of significant water quality or environmental incidents, to ensure that any lessons from these, and any weakness identified through internal audit, are learned.

The decision to take direct responsibility for the management of water and wastewater operations resulted in a significant restructuring of the business and a change in risk profile, at a time when we have needed to improve in a number of areas where relative performance had slipped. This has been evident in the QEC agenda and is reflected in the published QEC annual report, which is available on the company's website.

The members of QEC are John Bryant, Robert Ayling, Stephen Palmer, Nigel Annett and Peter Perry. The committee is advised by two independent experts on the public health and operational aspects of water supply (Andrew Davies) and environmental management (Tony Harrington) who attend all QEC meetings.

Nominations Committee

The role of the Nominations Committee is to ensure that plans are in place for orderly succession for appointment to the Board. It therefore reviews the size, structure, and composition of the Board (and the skills, knowledge and experience around the Board table) and, where appropriate, recommends candidates for Board appointment. The committee meets on an ad hoc basis and is led

by the Chairman of the Board. Each of the Non-Executive Directors and the Managing Director is a member of the committee, with other Directors attending at the invitation of the chairman.

2010-11 was a busy year for the Committee. In July 2010, Lord Burns and Dame Deirdre Hine stood down as Directors and Robert Ayling was appointed as Chairman of the Board. Menna Richards and Anna Walker were appointed Non-Executive Directors in November 2010 and February 2011 respectively, and Gerant Talfan Davies stood down as a Non-Executive Director in March 2011. In planning for Board succession, the Committee is advised by Egon Zehnder International.

In 2008 the Nominations Committee (and the Board) agreed in principle that it would be in the best interests of the Company and the customers of Dŵr Cymru to extend the term of office of some of the Non-Executive Directors who were appointed in 2001 beyond nine years. This currently applies to Tony Hobson, who will stand down during 2011 and to John Bryant, who will stand down during 2012, each of whom will stand for reappointment as a Director at the 2011 AGM. This extended term of office was to allow greater continuity on the Board in the early part of the AMP5 period (2010-15).

The Appointments Committee was a sub-committee of the Nominations Committee which was established in 2009, to oversee the process of the succession of the Chairman of the Board, and was dissolved in July 2010 when Robert Ayling became Chairman. The Appointments Committee was chaired by John Bryant and its members included each of the then Non-Executive Directors except for Lord Burns and Robert Ayling.

Internal control

The Board is responsible for the operation and effectiveness of the group's system of internal controls and risk management. This 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 addressing this, the Board has considered both materiality and the relative cost/benefit

Corporate governance

associated with particular risks, having regard to the particular position of the business and the risk to which it is exposed. The internal control systems are therefore designed to provide reasonable (not absolute) assurance against misstatements or loss.

Key features of the system are

- » that parameters of acceptable risk are set by the Board, with key risks and hazards identified, measured and managed to an acceptable level,
- » there is clear accountability for risk management, supported by regular risk reporting,
- » for each major type of risk there is a designated manager or team whose role is to ensure that appropriate risk guidance is available across the business
- » controls that recognise that the nature and balance of risk changes and evolves continuously and provide a framework within which to manage this,
- » procedures that govern 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, and
- » the group has in place effective financial systems and procedures for managing the preparation of the consolidated accounts

Dŵr Cymru's Reporter (Black and Veatch) conducts an annual review of systems of internal control, the findings of which are reported to the Board and to Ofwat, the Board also receives assurance from the programme of internal audit, the major findings from which are reviewed at the Audit Committee or QEC. Risk is routinely assessed by a leadership team chaired by the Managing Director. This group reviews and challenges the robustness of risk management procedures and submits an update to the Audit Committee and QEC every six months, and annually to the Board.

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

In fulfilling this responsibility the Board considers periodic reports from the Audit Committee, QEC and from management, and it 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 over the course of the year.

Members of Glas Cymru

The role of a Member is to ensure that the business remains focused on its primary purpose of providing efficient high quality water and sewerage services to Dŵr Cymru's customers. When fulfilling this important corporate governance role a Member acts in a personal capacity, and does 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, reflective of a broad range of customer and other stakeholder interests. A copy of our published Membership Policy, and further details of the Members of Glas Cymru, can be obtained from the Company Secretary or from the Company's website.

During 2010-11, 12 Members stood down having served a maximum three terms of appointment and 26 new Members were appointed following a process of public advertisement conducted by the panel. Subsequent to the financial year end, and following evaluation and recommendation by the panel, the Board has approved the reappointment of 7 Members whose term of office would otherwise expire at the end of the 2011 AGM. At the date of this report Glas Cymru has 84 independent Members, excluding the Directors of the Company who are also Members.

Communication with stakeholders

The Board attaches high importance to maintaining good relationships with Members and investors. Around 70% of the Members of Glas Cymru attend each of the six monthly Members' meetings, which provide regular opportunity for Members to talk to Directors. At these meetings, Members receive detailed presentations on company performance, developments and prospects and Directors, including the chairmen of the key Board committees, are available to answer questions. Subsequently, all Members receive a written brief of issues discussed and the replies to questions asked. Between meetings Members are briefed on key issues and development through a combination of written bulletins from the Managing Director and updates delivered by email or via a confidential Members' website.

Shortly after the AGM Glas Cymru hosts an annual investor meeting 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 a 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, water quality and environmental, and customer service regulators of Welsh Water.

By order of the Board

Richard Curtis LLB, ACIS
Company Secretary
8th June 2011

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

Remuneration Report 2011

I am pleased to present this year's Remuneration Committee Report which provides details of the remuneration paid to directors in 2010-11 and our policy for 2011-12

On 1 April 2010 the Company entered a new regulatory period which will be the most challenging since privatisation. The average bill for Dŵr Cymru Welsh Water's ('Dŵr Cymru') water and sewerage customers is to be reduced by over £20 per household (before inflation) by 31 March 2015. To deliver this, Dŵr Cymru must reduce controllable operating costs by around 20%, and at the same time improve customer service performance, meet new and challenging serviceability targets set out in the Final Determination, and deliver a £1.2 billion investment programme.

Against this backdrop, the Remuneration Committee of the Board ('the Committee') reviewed our remuneration policy and arrangements which culminated in a new approach to remuneration, designed to tie in reward to performance over the regulatory period to 31 March 2015. This policy was described in last year's remuneration report which, with the 'Long Term Variable Pay Scheme 2010', was approved by the Members at the annual general meeting ('AGM') in July 2010 ('the AMP5 remuneration arrangements').

The Committee continues to view the AMP5 remuneration arrangements as being well aligned with Company's strategy, providing an appropriate balance between risk and reward, and being sufficiently competitive to attract and retain high quality staff.

Our reporting of the remuneration paid in 2010-11 is complicated as it was the first year in which the AMP5 remuneration arrangements applied, but payments made in the year related to performance in the year before (2009-10) under the final year of the variable pay arrangements that members approved at the AGM in 2005 ('the AMP4 remuneration arrangements'). The AMP4 remuneration arrangements were described fully in last year's remuneration report.

Remuneration in respect of the financial year ended 31 March 2010

The remuneration paid to Directors last year included variable pay due for the financial year 2009-10. In June 2010, Executive Directors received payment under the AMP4 remuneration arrangements equivalent to

49.8% of base salary (made up of 38.2% under the cashflow element of the annual variable pay scheme and 11.6% under the rolling long term incentive scheme - 'RLTIS'). Subsequently, in November Ofwat confirmed that Dŵr Cymru's Overall Performance Assessment ('OPA') performance for 2009-10 ranked the company 7th of the 10 water and sewerage companies for the year, which equated to 5th over the 3-year period ended 31 March 2010. This meant that no further bonus was payable for 2009-10 in respect of the customer service (i.e. OPA) element of the annual variable pay scheme or under the RLTIS (which was described in detail in last year's remuneration report).

Remuneration in respect of the financial year ended 31 March 2011

This comprised a base salary (which had been increased by 3% in April 2010 following a year of no increases in 2009-10) and variable pay under the AMP5 remuneration arrangements, at least part of which is payable in the current financial year.

Under the Annual Variable Pay Scheme ('AVPS') payments have been made equivalent to 23.0 percentage points (%) of base salary for performance against the Performance Scorecard, 38.3% for financial performance and in the range of 15% to 18% against Strategic and Personal objectives, making total payments in the range of 76.3% to 79.3%. This compared to a maximum of 100%.

Under the Long Term Variable Pay Scheme 2010 ('LTVPS') the Committee has confirmed the basis on which staged payments may be made under the Customer Equity element of the LTVPS (as explained in the following report). Provision has been made for a 10% staged payment of the Customer Equity element of the scheme, reflecting a strong financial performance in the first year of the period and a confident expectation that we will exceed the Customer Equity target for March 2015, but no provision for a Customer Service Award. When added to the below 4th fourth ranking on Ofwat's league table for OPA in both 2008-09 and 2009-10, Dŵr Cymru's predicted performance against the new Service Incentive Mechanism ('SIM') in 2010-11 means that no payment is expected in respect of the "Customer Service Award" this year. Remuneration in respect of the financial year ended 31 March 2012. For the current financial year (the year ending 31 March 2012), the key points to highlight are

- » Executive Directors' salaries were increased by 3% in April 2011. This is in line with the current executive pay market, and below the 4.7% increase received by staff under the 'Working Together Agreement', which was in part offset by a 3% increase in employee pension contributions.
- » Under the AVPS, the quantum of variable that can be earned in 2011-12 has not changed, but the Committee has modified the Performance Scorecard in the light of experience in the first year - to improve the alignment between the component measures to Ofwat's serviceability metrics and the DWI performance indices. Save for this, no changes to the policy are proposed this year and, in the absence of a material change in the regulatory environment or external factors, the Committee would not expect further significant change to be recommended during the AMP5 period.

Also in respect of the current year, and in response to the reduction to the level of tax relief on pension contributions which came into effect on 6 April 2011, the future pension provision for four executives (including the three Executive Directors) has been changed. This moves from one where the accruals increase on a funded basis until the executives' retirement dates, to one where, once the respective executive reaches the annual allowance and lifetime allowance caps, the pension provision will be financed by the Company on an unfunded basis - by way of an unfunded Employee Financed Retirement Benefit Scheme ('EFRBS'). Overall this change is anticipated as being broadly cost neutral to the Company and an acceptably low risk.

Details on all these points are contained in the body of this remuneration report that follows. This has been approved by the Board and a resolution for its approval will be put to the 2011 Annual General Meeting (AGM). I hope that Members will support this resolution.

James Strachan
Chairman of the Remuneration Committee
8 June 2011

This report has been prepared in accordance with the provisions of the Companies Act 2006 and is fully compliant with provisions of The UK Corporate Governance Code ('the Governance Code'). PricewaterhouseCoopers LLP has audited the Directors' emoluments table and the pension table on page 52, and has reviewed the remainder of the report

Remuneration Committee

The Committee is chaired by James Strachan and the other members of the Committee are Robert Ayling, John Bryant, Tony Hobson and Anna Walker, who was appointed on 6 March 2011. The Board considers that all the members of the Committee are independent and, in the case of Robert Ayling that he was considered to be independent on his appointment as Chairman of the Company. The Managing Director and the HR Director attend meetings of the Committee by invitation (except where their own remuneration is discussed) and the Company Secretary acts as secretary to the Committee. The Committee met on four occasions in 2010-11.

The role of the Committee is to approve, implement and keep under review the remuneration policy of the Board and specifically (a) to agree the policy and framework and service contracts for the remuneration of the Chairman, Executive Directors and certain senior managers (the Dŵr Cymru Leadership Team), and

(b) to determine variable pay arrangements that encourage and recognise good performance and that rewards individuals in a fair and responsible manner for their contribution to the success of the Company

In 2010-11 the Committee received independent advice from Hewitt New Bridge Street ('HNBS', a trading name of Aon Hewitt Limited ('Aon')). HNBS advised on market best practice in the design of incentive performance arrangements, the benchmarking of Directors' remuneration and fees and general remuneration advice to the Committee. Aon provide no other services to Glas Cymru. In addition, during the year the Committee received information

from Mercer Limited (survey data), The Hay Group Management Limited (job evaluation and pay survey data), Linklaters & Alliance LLP (Directors' service contracts and pension matters), Eversheds LLP (pension matters) and Quantum Actuarial LLP (pension matters). These organisations also provide services and information to Dŵr Cymru (but not Glas Cymru) and the Committee has concluded that there are no conflicts of interest in relation to these organisations supporting both the Committee and the group in the implementation of its decisions.

During the year, the key issues which the Committee considered included

- » Executive Director salary and Chairman fee increases to take effect from 1 April 2011
- » Performance achieved against the conditions attached to the 2010-11 AVPS and LTVPS
- » The policy for discretionary staged payments under the new LTVPS
- » Executive pension provision in light of changing legislation
- » A scheduled review of the Executive Directors' service contracts, except for changes arising out of the pension changes, no material changes were made, although the opportunity was taken to update the wording of the contract in line with contemporary employment legislation

Remuneration Policy

The current remuneration policy was approved by Members at the AGM in July 2010. It aims to provide a good alignment between the rewards payable to Executive Directors and the long term success of Dŵr Cymru. This is achieved by paying remuneration at levels which are sufficiently competitive to recruit

and retain high quality staff and to ensure that the remuneration packages are structured so as to discourage inappropriate risk taking. The policy is delivered by

- 1 Setting levels of base salary and total remuneration that (when assessed against periodic market benchmarking) are considered fair and competitive having regard to an individual's experience and responsibility
- 2 Encouraging improved performance by having a significant proportion of total remuneration being delivered via variable pay - although the majority of the package is 'fixed' to ensure that executives are not encouraged to take inappropriate risk
- 3 Focusing incentives on the relative performance of Dŵr Cymru - as assessed and reported by Ofwat, the Drinking Water Inspectorate, the Environment Agency and the Consumer Council for Water - thereby promoting the objective of producing sector-leading performance in a transparent and accountable way

When discussing the remuneration policy the Committee considers remuneration structures across the business as a whole and considers the impact of the policy in light of broader social, environmental and governance issues

The executive remuneration package comprises five elements (base salary and benefits, two elements of variable pay (the AVPS and LTVPS) and a pension). The diagram below shows a breakdown of the value of the various elements of the remuneration package, assuming target level of performance is achieved. This shows that around 60% of the total remuneration package is fixed, with 40% comprising variable pay.

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Remuneration Executive

Directors Base salary

Following a review in March 2011, the Committee has set base salaries for the financial year 2011-12 as below

Nigel Annett (Managing Director)

£276,100 (2010 £268,000)

Chris Jones (Finance Director)

£217,700 (2010 £211,300)

Peter Perry (Operations Director)

£207,100 (2010 £201,000)

These increases are set in the context of a staff increase of 4.7%. The Committee considered an increase of around 3% to be more appropriate when compared to the positioning of the current base salaries and pay inflation in the executive pay market more generally

Variable pay

Annual Variable Pay Scheme (AVPS)

In 2010-11 the maximum AVPS that could be earned was an amount equivalent to 100% of base salary, assessed across three components as illustrated below. Details of payments made under the AVPS in respect of the financial year ended 31 March 2011 are set out later in this report

The quantum of variable pay that can be earned under the AVPS in 2011-12 is unchanged, but there has been a reduction in the number of the component measures in the Performance Scorecard (from 20 to 18) and several components have been changed. Further, operating cost efficiency is now a separate element of the AVPS with equal weighting to the Performance Scorecard to reinforce the importance of cost efficiency

The Strategic and Personal objectives and the KPI targets used in the Performance Scorecard are agreed by the Committee so as to underpin the annual business plan approved by Board. Furthermore, the Performance Scorecard is applied more widely in variable pay arrangements across the organisation in order to promote a team culture and reinforce organisational alignment, as well as demonstrating our performance assessment in a clear and concise manner

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Long Term Variable Pay Scheme 2010 ('LTVPS')

The objective of the LTVPS is to align the longer term aspects of total remuneration with Company performance over the course of the five year regulatory period ending on 31 March 2015. Under the LTVPS two types of award can be made (in each case of a cash payment)

» A "Customer Equity Award", which is measured by the creation of customer equity over the regulatory period, and

» A "Customer Service Award", which is measured by the Company's average ranking in the Ofwat league table for OPA and SIM over the last three years (i.e. for 2010-11, this means the OPA ranking 2008/9 and 2009/10 and the SIM ranking for 2010/11)

The Customer Service Award is therefore informed by and rewards the Company's relative performance compared with other companies in the sector

The performance targets under each of the LTVPS awards are shown in the table below

	Customer Service	Customer Equity ¹⁴
Performance measure	<ul style="list-style-type: none"> » 2010-11 and 2011-12 measured by reference to a combination of two Ofwat measures. Overall Performance Assessment ('OPA') and the SIM » 2012-13, 2013-14 and 2014-15, performance will be measured by reference to SIM alone 	<ul style="list-style-type: none"> » Actual Customer Equity at 31 March 2015 (the end of the regulatory period) compared to the budgeted figure
Rationale for selected measures	<ul style="list-style-type: none"> » Ofwat's measures of consumer experience are independent objective and measurable 	<ul style="list-style-type: none"> » Best financial measure of the value of the customers' interest in the business » 'Customer equity' is the group's financial reserves, i.e. regulatory capital value less net debt (as defined for the purposes of the quarterly Investor Report)
Performance period	<ul style="list-style-type: none"> » 3 Financial Years immediately prior to the Financial Year in which an award is made 	<ul style="list-style-type: none"> » 1 April 2010 to 31 March 2015
Performance target	<ul style="list-style-type: none"> » Out of 10 comparator companies. » 100% of award payable for achieving first position » 75% of award payable for achieving second position » 50% of award payable for achieving third position » 25% of award payable for achieving fourth position » 0% of award payable for a ranking of fifth or below 	<ul style="list-style-type: none"> » 100% of award payable for achieving Customer Equity on 31 March 2015 of £100m in excess of the 2010 business plan target. » 0% of the award will be payable for meeting or falling short of the 2010 business plan target » Straight-line pro rata calculation between the business plan target and £100m above this target.

¹³ The customer equity target may be amended in certain circumstances at the discretion of the Committee. These include where (i) there are differences between actual inflation and the assumptions originally made, (ii) the Board had modified a relevant policy after the original forecast was made (e.g. dispersal of customer equity by way of additional investment to deliver extra benefits for customers), and (iii) there is a material influence on financial reserves that was not originally foreseen and which the Committee determines to be outside the control of the Executive Directors.

¹⁴ 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.

¹⁵ When determining the level of any staged or final award the Committee will have regard to the 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.

¹⁶ In circumstances where the Committee makes an interim or stage payment against the Customer Equity target 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 reconciled (or 'trued up') so that any excess sums are clawed back from participants.

The LTVPS performance targets reflect the Board's ambition that Dŵr Cymru should rank alongside the leading companies on the key industry league tables for customer service. Ofwat has replaced OPA with SIM, and OPA was published for the final time for 2009-10. Whereas OPA comprised an index of a range of measures, including water quality, environmental performance and customer service, SIM comprises of two measures of customer service alone. One is a "qualitative measure" reflecting the results of independent research carried out on behalf of Ofwat to capture customer satisfaction with the service they have received, and the other a "quantitative measure" which covers customer complaints and unwanted calls.

Pension and Benefits

The Executive Directors are all members of the Dŵr Cymru Welsh Water Pension Scheme, a defined benefit scheme. The Normal Retirement Age under this scheme is 60 and benefits accrue at 1/45th of salary per year of pensionable service (except for PD Perry who accrues at 1/60th of salary for each year of pensionable service), subject to a maximum overall pension at normal retirement age of two-thirds of final pensionable salary. The scheme also provides life cover of four times pensionable pay for death in service, a pension payable in the event of ill health and a spouse's pension payable on death. Executive Directors also participate in a non-contributory private health and medical insurance scheme.

During the year, the Committee considered the impact of changes in pension tax relief for higher earners taking effect from 6 April 2011, when the pension annual allowance limit in capital terms was reduced to from £255,000 to £50,000, and the further change to come into effect on 6 April 2012 when the total value of tax privileged pension saving that can be provided on retirement (or Lifetime Allowance) will be reduced from £1.8 million to £1.5 million.

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The Committee agreed that for the four executives affected by these changes (including the three Executive Directors), instead of funding the cost of the pension provision throughout the executive's career (i.e. before retirement) the Company would provide for the additional value above the annual and lifetime allowances by way of an unfunded Employer Financed Retirement Benefit Scheme where the cost of the pension is met by the Company after the executive's retirement.

This enables the value of the pension benefit for the individual to be preserved. The funding basis is different but the Committee is satisfied that this is being done in a way that, overall, is broadly cost neutral to the Company.

The Committee determined that this should be a one-off exception and that the Company would not provide any unfunded pension arrangements for any other individuals who may be impacted by changes in pension taxation, now or in the future. New service agreements were issued to the four executives to reflect this change in pension provision.

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

	Accrued Pension (per annum) at 31 March 2011	Real increase in accrued pension in the year (net of inflation)	Transfer value at 31 March 2010	Transfer value equivalent of increase in accrued pension	Transfer value at 31 March 2011	Contributions paid by Director	Transfer value of real increase in accrued pension, net of member contributions
NC Annett*	£117,072	£5,931	£1,627,720	£294,905	£1,922,625	£24,120	£73,279
CA Jones*	£75,463	£4,677	£830,893	£180,791	£1,011,684	£19,017	£43,684
PD Perry ⁽¹⁾	£96,590	£10,642	£1,097,236	£302,828	£1,400,064	£18,090	£136,172

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

⁽¹⁾ The accrued pension and transfer value at 31 March 2010 and 31 March 2011 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.

Chairman and Non-Executive Director Fees
After taking appropriate independent advice, the Committee determines the fee payable to the Chairman of the Board. Separately, the Executive Directors and the Chairman approve the fee level payable to the Non-Executive Directors.

During the year the Board reviewed the fees payable to Non-Executive Directors and decided that the policy of paying no additional fee for chairmanship or membership of any Board Committee should continue, but that there should be a modest increase to the annual fee level. In addition, 2010-11 was the first full year in which the Board had appointed a Senior Independent Director ("SID") and the Remuneration Committee determined that from 1 April 2011 the additional responsibilities of the SID should be recognised by the payment of

an additional fee of £10,000. These fees have been benchmarked and are considered to be broadly in line with mid-market levels.

The fees payable for the financial year that commenced on 1 April 2011 are:

Chairman
£200,000 (2010: £196,000)
Non-Executive Directors
£55,000 (2010: £54,000)
Additional fee for Senior Independent Director
£10,000 (2010: £-)

The Chairman and the Non-Executive Directors are appointed under letters of appointment terminable by either party on three months' written notice.

Directors' emoluments for 2010/11 (excluding pension benefits)

The table below reports on the directors' emoluments in respect of the year ended 31 March 2011. It includes performance related payments made under the AVPS scheme and a best estimate of sums payable under the LTVPS scheme (the receipt of some elements of which is deferred until later in 2011). 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 Remuneration Committee believes the presentation of data in the emoluments table allows a direct comparison of Directors' remuneration year on year, and this is unchanged from previous years. The information required to comply with the Companies Act 2006 is provided in full and is disclosed in the table and in the supplementary notes.

Emoluments earned by the Directors in respect of the financial year ended 31 March 2011 were

2010-11 ⁽¹⁾	Lord Burns	RJ Ayling	NC Annett	CA Jones	P Perry	JM Bryant	GT Davies	DI Hine	AJ Hobson	S Palmer	JM Strachan	M Richards	A Walker	Total
Salary	-	-	£268,000	£211,300	£201,000	-	-	-	-	-	-	-	-	£680,300
Fees	£54,197	£157,273	-	-	-	£54,000	£54,000	£14,932	£54,000	£54,000	£54,000	£4,500	£4,362	£505,264
Benefits in kind ⁽²⁾	-	-	£929	£674	-	-	-	-	-	-	-	-	-	£1,603
Variable pay 2010-11														
AVP ⁽³⁾	-	-	£204,484	£167,323	£153,363	-	-	-	-	-	-	-	-	£525,170
Staged payment LTVPS ⁽⁴⁾	-	-	£26,800	£21,100	£20,100	-	-	-	-	-	-	-	-	£68,000
Total emoluments relating to 2010-11	£54,197	£157,273	£500,213	£400,397	£374,463	£54,000	£54,000	£14,932	£54,000	£54,000	£54,000	£4,500	£4,362	£1,780,337

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

2009-10	Lord Burns	RJ Ayling	NC Annett	CA Jones	P Perry	JM Bryant	GT Davies	DI Hine	AJ Hobson	S Palmer	JM Strachan	M Richards	A Walker	Total
Salary	-	-	£260,000	£205,000	£195,000	-	-	-	-	-	-	-	-	£660,000
Fees	£190,000	£52,500	-	-	-	£52,500	£52,500	£52,500	£52,500	£22,885	£52,500	-	-	£527,885
Benefits in kind	-	-	£840	£579	-	-	-	-	-	-	-	-	-	£1,419
Variable pay 2009-10														
Annual ⁽⁵⁾⁽⁶⁾	-	-	£99,320	£78,310	£74,490	-	-	-	-	-	-	-	-	£252,120
RLTIS ⁽⁷⁾	-	-	£30,160	£23,780	£22,620	-	-	-	-	-	-	-	-	£76,560
Total emoluments relating to 2010-11	£190,000	£52,500	£390,320	£307,669	£292,110	£52,500	£52,500	£52,500	£52,500	£22,885	£52,500	-	-	£1,517,984

⁽¹⁾ Changes of Director in 2009-10 and 2010-11: S Palmer appointed 26 October 2009; Lord Burns/Dame Desdrea Hine retired 10 July 2010; M Richards appointed 22 November 2010 (but did not receive a fee until 1 March 2011); A Walker appointed 3 March 2011; GT Davies retired 31 March 2011.

⁽²⁾ Benefits in kind relate to receipt of private medical insurance, ill health cover and life insurance.

⁽³⁾ The financial statements for the year ended 31 March 2011 include a provision of £525,170 (or 76.3% of base salary for Messrs Annett and Perry and 79.3% for Mr Jones) for annual variable pay payable to Executive Directors in respect of performance in the financial year 2010-11.

⁽⁴⁾ The financial statements for the year ended 31 March 2011 include a provision of £68,000 (or 10% of base salary) for an interim or staged payment under the Long Term Variable Pay Scheme 2010 in respect of performance in the financial year 2010-11.

⁽⁵⁾ The 'cashflow' element of the annual performance related payment in respect of 2009-10 was 38.2% (or 95.5% of the maximum) and totalled £252,120.

⁽⁶⁾ The 'performance' element of the annual related payment provided for in the Report and Accounts for 2009-10 was estimated on the basis that OPA performance on 2009-10 would be 5th. In autumn 2010 Ofwat confirmed Dŵr Cymru's OPA ranking for 2009-10 as 7th, which equated to 5th of the ten water and sewerage companies on a rolling three year basis. At this ranking no 'performance' element of variable pay was payable for 2009-10.

⁽⁷⁾ The variable pay under the RLTIS was 11.6% (or 38.9% of the maximum).

⁽⁸⁾ The highest paid Director in 2010-11 was NC Annett who received emoluments of £500,213 (2010: NC Annett £390,320). The increase in emoluments, and in particular in variable pay, reflects the improved financial and operational performance of the business compared to the previous year.

Accruals for annual variable pay for 2009-10

The 2010 Accounts included a provision of £227,040 for annual variable pay in respect of the financial year ended 31 March 2010. In autumn 2010, Ofwat confirmed that Dŵr Cymru's OPA performance for 2009-10 ranked the company 7th of the 10 water and sewerage companies, which meant that no additional payment was due in respect of this component of the scheme (as no award was payable for below median performance). This is reflected in the emoluments table for 2009-10 on page 53.

Accruals for long term variable pay for 2009-10

The 2010 Accounts (but not the emoluments table for 2009-10) included a provision of £152,460 as the Committee's best estimate of awards payable in 2009-10 under the Rolling Long Term Incentive Scheme ('RLTIS' - which applied to performance in the five year period ended 31 March 2010). A ranking of 7th in the Ofwat OPA league table for 2009-10 equated to a ranking of 5th over the three year period ended 31 March 2010. Accordingly no award was due for 2009-10 in respect of this component under the RLTIS. This is reflected in the emoluments table for 2009-10 on page 53. For further information in respect of the RLTIS please refer to the 2010 Remuneration Report.

2010-11 variable pay

Under the Annual Variable Pay Scheme (AVPS), payment has been made in the current year equivalent to 23.0% of base salary for performance against the corporate Performance Scorecard, 38.3% for financial performance and in the range of 15% to 18% against Strategic and Personal objectives, making a total payment in the range of 76.3% to 79.3%. This compared to a maximum of 100%.

Under the Long Term Variable Pay Scheme (LTVPS) provision has been made for a 10% staged payment of the Customer Equity element of the scheme, but no provision for a Customer Service award. A provision is made for the Customer Equity Award because at 31 March 2011 net reserves stood at some £1.3 billion, significantly ahead of the business plan, which gives a confident expectation that we will exceed the Customer Equity target.

for March 2015. In terms of customer service however, while the Company expects to be ranked high on the Ofwat league table for the "qualitative" element of SIM, it expects to be ranked below fourth on the "quantitative" element (when Ofwat publishes the SIM league table in the Autumn) which, when added to the below fourth ranking on Ofwat's league table for OPA in both 2008-9 and 2009-10, means that no payment is expected to be made in respect of the "Customer Service Award" this year.

Accordingly, the 2010-11 Accounts include an accrual for an interim payment of £68,000 (equivalent to 10% of base salary) reflecting the Committee's current estimate of performance under the LTVPS in respect of the five year period ending 31 March 2015.

Nigel Annett	£26,800
Chris Jones	£21,100
Peter Perry	£20,100

Service contracts

The Executive Directors have service contracts that are subject to a 12 month notice period and which 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.

During 2010-11 the Executive Directors' service contracts have been reviewed. Except for changes in relation to the pension provision, no material changes were made, although opportunity was taken to update the wording of some contract provisions in line with contemporary employment legislation. Changes can be tracked in the copy of the service contracts that will be on display at the AGM in July 2011.

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. Only Chris Jones currently holds such an appointment - he is a Non-Executive Director of the Principality Building Society, in respect of which he retains a fee of £35,000 per annum.

Recommendation

The Committee believes that the Remuneration Policy described in this report is aligned well with the Company's strategy, provides an appropriate balance between risk and reward and is sufficiently competitive to attract and retain high quality staff. This in turn ensures that it is well aligned to the long term success of Dŵr Cymru and the interest of its customers. The Committee recommends this 2011 Remuneration Report for approval by the Members of Glas Cymru.

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-rata 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 tried-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.

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report, the Remuneration 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
8 June 2011

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 2011 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 56, 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. In addition, we read all the financial and non-financial information in the Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2011 and of the group's profit and group 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.

Katharine Finn (Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cardiff | 8 June 2011

Primary Statements

Consolidated Income Statement for the year ended 31 March 2011

	Note	2011		2010	
		£m	£m	£m	£m
Revenue	2		676.7		688.2
Operating costs					
- Operational expenditure					
Before exceptional items		(264.6)		(265.7)	
Exceptional items	4	-		(29.5)	
	3		(264.6)		(295.2)
- Infrastructure renewals expenditure	3		(40.0)		(77.3)
- Depreciation and amortisation	3		(144.6)		(139.9)
Operating profit analysed as					
Operating profit before exceptional items			227.5		205.3
Exceptional items	4		-		(29.5)
Operating profit			227.5		175.8
Financing costs					
- Interest payable and similar charges	5a	(173.5)		(101.3)	
- Interest receivable and similar charges	5a	4.1		3.4	
- Fair value losses on derivative financial instruments	5b	12.3		(15.0)	
			(157.1)		(112.9)
Profit before taxation	3		70.4		62.9
Taxation	6		68.1		1.9
Profit for the year			138.5		64.8

Underlying profit for the year (Profit before exceptional items, taxation and fair value adjustments)		
	2011 £m	2010 £m
Profit before taxation per Income Statement	70.4	62.9
Add back		
- Exceptional items (see note 4)	-	29.5
- Fair value (gains)/losses on derivative financial statements (see note 5b)	(12.3)	15.0
Underlying profit for the year (before exceptional items, taxation and fair value adjustments)	58.1	107.4

The company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the parent company's income statement. The profit of the parent company for the year was £nil (2010: £nil).

Consolidated Statement of Comprehensive Income for the year ended 31 March 2011

	Note	2011 £m	2010 £m
Profit for the year		138.5	64.8
Actuarial loss recognised in the pension scheme	21	(4.7)	(1.5)
Movement on deferred tax asset relating to pension scheme	6	1.2	-
Total comprehensive income for the year		135.0	63.3

Consolidated Statement of Changes in Reserves/(Deficit) for the year ended 31 March 2011

	2011 £m	2010 £m
Deficit at 1 April	(88.8)	(152.1)
Total comprehensive income for the year	135.0	63.3
Reserves /(deficit) at 31 March	46.2	(88.8)

There were no changes in reserves of the parent company during the year (2010 none)

Primary Statements

Consolidated Balance Sheet as at 31 March 2011

	Note	2011 £m	2010 £m
Assets			
Non-current assets			
Property, plant and equipment	8	3,178.9	3,117.8
Intangible assets	9	65.4	60.1
Financial assets			
- derivative financial instruments	15	2.6	0.8
		3,246.9	3,178.7
Current assets			
Trade and other receivables	11	489.3	484.4
Financial assets			
- derivative financial instruments	15	4.4	4.4
Cash and cash equivalents	12	98.3	248.7
		592.0	737.5
Liabilities			
Current liabilities			
Trade and other payables	13	(506.7)	(501.2)
Financial liabilities			
- borrowings	14	(26.9)	(150.2)
- derivative financial instruments	15	(44.6)	(36.0)
Provisions	17	(16.8)	(14.8)
		(595.0)	(702.2)
Net current (liabilities)/assets		(3.0)	35.3
Non-current liabilities			
Trade and other payables	13	(33.1)	(15.9)
Financial liabilities			
- borrowings	14	(2,733.9)	(2,761.8)
- derivative financial instruments	15	(122.8)	(141.9)
Retirement benefit obligations	21	(15.5)	(8.0)
Provisions	17	(6.6)	(22.6)
		(2,911.9)	(2,950.2)
Net assets before deferred tax		332.0	263.8
Deferred tax - net	7	(285.8)	(352.6)
Net assets/(liabilities)		46.2	(88.8)
Reserves/(deficit)		46.2	(88.8)

The financial statements on pages 58 to 90 were approved by the Board of directors on 8 June 2011 and were signed on its behalf by

N C Annett
Managing Director

C A Jones
Finance Director

Primary Statements

Consolidated Balance Sheet as at 31 March 2011

	Note	2011 £m	2010 £m
Assets			
Non-current assets			
Property, plant and equipment	8	3,178.9	3,117.8
Intangible assets	9	65.4	60.1
Financial assets			
- derivative financial instruments	15	2.6	0.8
		3,246.9	3,178.7
Current assets			
Trade and other receivables	11	489.3	484.4
Financial assets			
- derivative financial instruments	15	4.4	4.4
Cash and cash equivalents	12	98.3	248.7
		592.0	737.5
Liabilities			
Current liabilities			
Trade and other payables	13	(506.7)	(501.2)
Financial liabilities			
- borrowings	14	(26.9)	(150.2)
- derivative financial instruments	15	(44.6)	(36.0)
Provisions	17	(16.8)	(14.8)
		(595.0)	(702.2)
Net current (liabilities)/assets		(3.0)	35.3
Non-current liabilities			
Trade and other payables	13	(33.1)	(15.9)
Financial liabilities			
- borrowings	14	(2,733.9)	(2,761.8)
- derivative financial instruments	15	(122.8)	(141.9)
Retirement benefit obligations	21	(15.5)	(8.0)
Provisions	17	(6.6)	(22.6)
		(2,911.9)	(2,950.2)
Net assets before deferred tax		332.0	263.8
Deferred tax - net	7	(285.8)	(352.6)
Net assets/(liabilities)		46.2	(88.8)
Reserves/(deficit)		46.2	(88.8)

The financial statements on pages 58 to 90 were approved by the Board of directors on 8 June 2011 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 2011

	Note	2011 £m	2010 £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 58 to 90 were approved by the Board of directors on 8 June 2011 and were signed on its behalf by



N C Annett
Managing Director



C A Jones
Finance Director

Notes to the Financial Statements

1 | Accounting policies, financing risk management and accounting estimates Accounting policies for the year ended 31 March 2011s

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 below under "Change of accounting policy"

Basis of Preparation

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss.

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

IFRS 1	Additional exemptions (revision)
IFRS 1	First-time Adoption of International Financial Reporting Standards (amendment)
IFRS 2	Share-based Payments – Group cash-settled share-based payment transactions (amendment)
IFRS 3	Business Combinations (revision)
IAS 27	Consolidated and Separate Financial Statements (revision)
IAS 31	Interests in Joint Ventures (amendment)
IAS 32	Financial Instruments: Presentation on classification of rights issue (amendment)
IAS 39	Financial Instruments: Recognition and Measurement of eligible hedged items (amendment)
IFRIC 17	Distributions of Non Cash Assets to Owners
IFRIC 18	Transfer of assets from customers

Except as noted under "Change of accounting policy" below in respect of IFRIC 18, 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:

IFRS 1	First-time Adoption of International Financial Reporting Standards (amendment)
IFRS 7	Financial Instruments: Disclosures (amendment)
IFRS 9	Financial Instruments: Classification and Measurement
IAS 12	Income Taxes on deferred tax (amendment)
IAS 24	Related Party Disclosures (revision)
IAS 28	Investments in Associates (revision)
IFRIC 14	IAS 19, 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments

The presentational impact of these Standards and Interpretations is being assessed, but the directors anticipate that their adoption in future periods will have no material impact on the financial statements of the group.

Change of accounting policy

Following its adoption by the European Union, IFRIC 18, 'Transfers of assets from customers', is mandatory for the first time for the financial year beginning 1 April 2010, with an application date of 1 July 2009. IFRIC 18 is an interpretation published by the IASB to clarify the accounting treatment 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. The group's accounts have not previously allocated any value to these transactions as there was no financial outlay. Following adoption of the IFRIC, the accounts contain infrastructure asset additions with a value of £18.5m (2010 as

restated £14.2m). The net book value of these assets as at 31 March 2011 is £31.7m, which is offset by deferred income of equal amount. The fair values, calculated as the cost to the business of constructing the assets, will be depreciated over the assets' estimated useful lives and the deferred income will be released over the same period. (The comparative figures for property, plant and equipment and deferred income have been restated by £13.9m, reflecting asset transfers since the IFRIC's effective date of 1 July 2009.)

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.

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'. There was no customer dividend in the year to 31 March 2011 (2010: £28.3m).

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segment, has been identified as the steering committee that makes strategic decisions.

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:

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

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
Infrastructure assets	80 years
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 amortisation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs. Research expenditure is recognised as an expense as incurred. Costs incurred on development projects are recognised as intangible assets when the relevant recognition criteria are met (as per IAS 36).

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

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 these 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 property, plant and equipment 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.

Trade receivables

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, net of 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 measured initially at fair value, being 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. Trade payables are obligations to pay for goods/services acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year, or in the normal operating cycle of the business if longer. If not, they are presented as non-current liabilities.

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 2011, none of the group's derivatives qualified for hedge accounting under IAS 39 (2010) none. These instruments are carried at fair value with changes in fair value being recognised immediately in the income statement.

Deferred taxation

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Provisions

Provisions for restructuring costs, dilapidations and uninsured losses are recognised when the group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been estimated reliably. Restructuring provisions comprise employee severance and pension fund top-up costs. 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. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligation may be small.

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 (see note 4).

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. The group uses financial instruments to raise finance and manage operational risk, these instruments principally include listed bonds, finance leases, bank loan facilities and derivatives.

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 AA-/Aa3/AA- 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. Cash is invested for a maximum period of four months. The maximum cash investment with a single counterparty was £142m (2010 £142m).

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 £2,761m as at 31 March 2011 (2010 £2,912m), none related to floating rate debt (2010 £30m).

The group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2011, 100% (2010 99%) 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 net liability of £160m in the balance sheet at 31 March 2011 (2010 £173m) 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 around 60% of the estimated power requirement of the business over the remainder of the regulatory period 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 instruments, types 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 £2,761m (2010 £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 2011, the group had committed undrawn borrowing facilities of £200m (2010 £420m) and cash and cash equivalents (excluding debt service payments account) of £88m (2010 £238m).

On 17 and 18 May 2011 the group entered into new revolving credit facilities totalling £140m with a group of six banks. These facilities are available until May 2016, although each bank has an option (exercisable by the end of the first year of the facilities) to extend for a further year to May 2017. £100m of the existing borrowing facilities at 31 March 2011 were also cancelled.

As at 31 March 2011 there was 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. On 13 April 2011, a new special liquidity facility of £135m was entered into with a syndicate of four banks. The existing £100m facility was cancelled on this date.

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 Prices Index and determined by Ofwat.

The Board considers that it is in the best long-term interests of Welsh Water's customers to maintain the level of gearing at around 70%. As at 31 March 2011 gearing was 67%.

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 IFRS 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 expected cash flows. 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 £3.6 million (2010 £3.4 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 2011 would increase or reduce by £4.7 million (2010 £1.1 million). The year-on-year increase in the sensitivity of the balance sheet obligation to changes in the discount rate is the result of former UUOS and

KWS employees transferring their existing pensions into the DCWW Pension Scheme (see also note 21).

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 (2010 £2.3 million).

2 Segmental information

The directors consider that there is only one operating segment, being the operation of water and sewerage business in the UK. As the group has only domestic activities there is also only one geographical segment, therefore, the disclosures for this segment have also already been given in these financial statements.

Notes to the Financial Statements

3 | Profit before taxation

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

	Group Total 2011 £m	Total 2010 £m
Operating charges from outsourced activities		
- Power	34.5	35.6
- Chemicals	8.5	7.7
- Materials and equipment	2.1	2.1
- Telephony	4.0	3.2
- Vehicles and plant	7.3	10.6
- Office expenses	2.3	3.0
- Property costs	7.6	6.1
- Insurance	5.3	6.3
- Sewerage contractors	3.4	4.3
- Water costs	4.8	4.8
- Customer services agreement	19.8	18.7
- Laboratories and analytical services	6.9	6.6
- Collection commissions	3.9	3.7
- IT contracts	17.8	17.0
- Other bought-in services	24.6	25.7
- Contract termination costs	-	10.8
- Restructuring and rationalisation	-	10.4
	152.8	176.6
Employee costs (note 20)	72.0	13.5
Staff costs capitalised	(22.3)	(5.9)
Restructuring and rationalisation	-	7.2
Subcontracted staff costs	1.4	38.8
	51.1	53.6
Research and development expenditure	0.5	0.5
Trade receivables impairment	22.3	22.3
Rates	22.7	26.9
Environment Agency charges	15.0	15.1
Fees payable to auditors	0.2	0.2
Total operational expenditure	264.6	295.2
Infrastructure renewals expenditure	40.0	77.3
Depreciation and amortisation		
- Owned assets	89.1	91.2
- Under finance leases	47.9	40.6
- Amortisation of intangible assets	7.7	7.7
(Profit)/loss on disposal of property, plant and equipment	(0.1)	0.4
	144.6	139.9
	449.2	512.4

Services provided by the group's auditor

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

	Group	
	2011 £'000	2010 £'000
Audit fees		
Statutory audit of parent company and consolidated financial statements	11	11
Statutory audit of subsidiary companies	77	77
Total statutory audit fees	88	88
Audit-related fees		
Review of interim financial statements	23	22
Regulatory audit services pursuant to legislation	39	39
Total audit and audit-related fees	150	149
Other services		
Tax advisory services	-	5
Services relating to bond prospectus update and bond issue	-	25
Other	8	10
Total other services	8	40
Total cost of services provided by the group's auditor	158	189

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 auditors 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 £12,000 (2010: £11,000).

The Board has adopted a formal policy with respect to services received from external auditors. The external auditors 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 items

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). In the year to 31 March 2010, restructuring costs of £29.5m were 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 included agreed payments in lieu of the profit element for year 6 and early agreement of an adjustment reflecting year 5 performance. No adjustment has been made to the provision established at 31 March 2010, and it is not anticipated that any further significant expenditure will be incurred, beyond the amounts provided, in relation to the restructuring of the business.

5 | Financing costs**a) Net interest before fair value gains/(losses) on derivative financial instruments**

	Group	
	2011	2010
	£m	£m
Interest payable on bonds	(88 2)	(84 9)
Indexation on index-linked bonds	(48 2)	9 5
Interest payable on finance leases (including swaps to RPI)	(28 1)	(18 4)
Other loan interest	(12 0)	(10 9)
Other interest payable and finance costs	(3 1)	(2 4)
Net interest credit/(charge) on pension scheme liabilities	0 7	(0 3)
Capitalisation of borrowing costs under IAS 23 (2011 6.3%, 2010 3.8%)	5.4	6 1
Interest payable	(173 5)	(101 3)
Interest receivable	4.1	3 4
Net interest payable before fair value adjustments	(169 4)	(97 9)

Between July 2009 and July 2010 the Retail Prices Index rose by 4.8% producing an indexation charge on the group's index-linked bonds (July 2008 to July 2009 fall of 1.5%, producing an indexation 'credit')

b) Fair value gains/(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	
	2011	2010
	£m	£m
Fair value gains on interest rate swaps	1 2	9 5
Fair value gains/(losses) on index-linked swaps	11 1	(24 5)
Total fair value gains/(losses) on derivative financial instruments	12 3	(15 0)
Deferred tax effect at 26% (2010 28%) of fair value gains/(losses)	(3 2)	4 2
Net of tax impact of fair value gains/(losses)	9 1	(10 8)

Notes to the financial statements

6 | Taxation

Analysis of credit in the year

	Group	
	2011 £m	2010 £m
Current tax		
- Adjustment in respect of prior years	2.5	1.7
Deferred tax		
- Origination and reversal of timing differences	44.9	0.2
- Effect of tax rate change	21.9	-
Total deferred tax (note 7)	66.8	0.2
Taxation credit	69.3	1.9
Analysed as		
Credit to Income Statement	68.1	1.9
Credit to Statement of Comprehensive Income	1.2	-
	69.3	1.9

The effective rate of tax for the year is lower (2010 lower) than the standard rate of corporation tax in the UK (2011 28%, 2010 28%). The differences are explained below

	Group	
	2011 £m	2010 £m
Profit before tax	70.4	62.9
Profit before tax multiplied by the corporation tax rate in the UK of 28% (2010 28%)	19.7	17.6
Effects of		
- Adjustments in respect of prior years	(34.1)	(17.7)
- Other permanent differences	(33.0)	(1.8)
- Effect of tax rate change	(21.9)	-
- Movement on deferred tax asset relating to pension scheme	-	-
Total taxation credit	(69.3)	(1.9)

The £34m adjustment in respect of prior years includes a £37m credit arising from a reassessment of the requirement to provide deferred tax on rolled over capital gains (the 2010 adjustment related to the agreement with HMRC for retrospective capital allowances claims). Other permanent differences predominantly relate to the termination of finance leases.

Tax trading losses carried forward as at 31 March 2011 are circa £387m (2010 £292m)

Notes to the Financial Statements

7 | Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 26% (2010: 28%)

The movement in the deferred tax provision is as shown below

	Group	
	2011 £m	2010 £m
At 1 April	352 6	352 8
Credit to Income Statement	(65 6)	(0 2)
Credit to Statement of Comprehensive Income	(1 2)	-
At 31 March	285 8	352 6

	Group	
	2011 £m	2010 £m
Effect of		
Tax allowances in excess of depreciation	435 8	454 4
Capital gains rolled over	4 1	41 6
Deferred tax liability	439 9	496 0
Deferred tax on tax losses carried forward	(101 0)	(82 5)
Deferred tax on gains/losses on derivative financial instruments	(42 1)	(48 9)
Pensions	(4 0)	(2 2)
Other tax differences	(7 0)	(9 8)
Deferred tax asset	(154 1)	(143 4)
Net provision for deferred tax	285 8	352 6

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.

In addition to the changes in rates of corporation tax disclosed above, a number of further changes to the UK corporation tax system were announced in the March 2011 UK Budget Statement. Legislation to reduce the main rate of corporation tax from 26% to 25% from 1 April 2012 is expected to be included in the Finance Act 2011. Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 23% by 1 April 2014. These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements.

The effect of the changes expected to be enacted in the Finance Act 2011 would be to reduce the deferred tax liability provided at the balance sheet date by £11m. This would increase profit by £11 and is due to the reduction in the corporation tax rate from 26 per cent to 25 per cent with effect from 1 April 2012.

The proposed reductions of the main rate of corporation tax by 1% per year to 23% by 1 April 2014 are expected to be enacted separately each year. The overall effect of the further changes from 25% to 23%, if these applied to the deferred tax balance at the balance sheet date, would be to reduce the deferred tax liability by £22m (being £11m recognised in 2013 and £11m recognised in 2014).

The 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 2010 (as restated)	34.4	1,560.2	2,605.6	227.5	4,427.7
Additions net of grants and contributions	0.5	26.6	165.0	7.2	199.3
At 31 March 2011	34.9	1,586.8	2,770.6	234.7	4,627.0
Accumulated depreciation					
At 1 April 2010 (as restated)	17.3	165.3	942.6	184.7	1,309.9
Charge for the year	-	23.1	94.5	20.6	138.2
At 31 March 2011	17.3	188.4	1,037.1	205.3	1,448.1
Net book value					
At 31 March 2011	17.6	1,398.4	1,733.5	29.4	3,178.9

The net book value of property, plant and equipment includes £119.1m in respect of assets in the course of construction (2010 £155.5m)

The net book value of property, plant and equipment includes £10.8m of borrowing costs capitalised in accordance with IAS 23 (2010 £6.1m), of which £5.4m were additions in the year (2010 £6.1m)

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 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
Restatement on adoption of IFRIC 18	-	14.2	-	-	14.2
	-	47.1	222.2	1.3	270.6
At 31 March 2010 (as restated)	34.4	1,560.2	2,605.6	227.5	4,427.7
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
Restatement on adoption of IFRIC 18	-	0.3	-	-	0.3
	0.5	34.1	83.2	15.0	132.8
At 31 March 2010 (as restated)	17.3	165.3	942.6	184.7	1,309.9
Net book value					
At 31 March 2010 (as restated)	17.1	1,394.9	1,663.0	42.8	3,117.8
At 31 March 2009	17.6	1,381.9	1,524.0	56.5	2,980.0

See note 1, 'Change of accounting policy' in respect of the restatement of the 2010 balances to reflect the application of IFRIC 18 from its effective date of 1 July 2009

Notes to the Financial Statements

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			
At 31 March 2011			
Cost	611.8	483.9	1,095.7
Accumulated depreciation	67.0	225.4	292.4
Net book value	544.8	258.5	803.3
Prior year			
At 31 March 2010			
Cost	611.8	658.1	1,269.9
Accumulated depreciation	59.3	253.4	312.7
Net book value at 31 March 2010	552.5	404.7	957.2
Net book value at 31 March 2009	560.2	437.6	997.8

The parent company owns no property, plant or equipment

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 2010	116.6	(56.5)	60.1
Additions/(charge for the year)	13.0	(7.7)	5.3
At 31 March 2011	129.6	(64.2)	65.4
Prior year			
At 1 April 2009	101.5	(55.3)	46.2
Additions/(charge for the year)	21.6	(7.7)	13.9
Disposals	(6.5)	6.5	-
At 31 March 2010	116.6	(56.5)	60.1

Intangible assets comprise computer software and related system developments

The net book value of intangible assets includes £3.6m in respect of assets in the course of construction (2010: £34.2m). The net book value of intangible assets includes £0.4m of borrowing costs capitalised in accordance with IAS 23 (2010: nil), of which £0.4m were additions in the year (2010: nil).

The parent company owns no intangible assets

10 | Investments

a) Group

Cost and net book value	2011 £m	2010 £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 (100% holding) 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	
	2011 £m	As restated 2010 £m	2011 £m	2010 £m
(a) Current				
Trade receivables	463 1	456 4	-	-
Provision for impairment of receivables	(48 1)	(44 2)	-	-
Trade receivables - net	415 0	412 2	-	-
Prepayments and accrued income	63 3	62 1	-	-
Corporation tax	2 5	1 7	-	-
Other receivables	8 5	8 4	-	-
	489 3	484 4	-	-
(b) Non-current				
Amounts receivable from group undertakings	-	-	3 4	3 4
	-	-	3 4	3 4
Total trade and other receivables	489 3	484 4	3 4	3 4

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

As at 31 March 2011, based on a review of historical collection rates it was considered that £48 1m of trade receivables were impaired and these have therefore been provided for (2010 £44 2m) The impaired receivables relate mainly to measured and unmeasured water supply receivables

Notes to the Financial Statements

The 2010 trade receivables balance has been restated to recognise February 2011 billings in advance for the year to 31 March 2012 separately from the corresponding deferred income, which is now shown within trade payables (accruals and deferred income falling due within one year). The impact is to increase trade receivables and trade payables by £370.4m, there is no impact on net current assets or net assets. Trade receivables aged greater than one month are past due, the net column shows amounts deemed not to be impaired. The ageing of receivables was as follows:

	Total £m	Provided for £m	Net £m
Current year			
Trade receivables			
Billed in advance	377.0	-	377.0
Under one month	14.6	(3.1)	11.5
Between one and six months	22.1	(10.5)	11.6
Between six months and one year	19.9	(9.1)	10.8
Between one and two years	18.1	(14.6)	3.5
Between two and three years	11.1	(10.5)	0.6
Over three years	0.3	(0.3)	-
	463.1	(48.1)	415.0
Prior year			
Trade receivables			
Billed in advance (restated)	370.4	-	370.4
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)	-
	456.4	(44.2)	412.2

The maximum exposure to credit risks at the reporting date is the carrying value of each class of receivable mentioned above. The group does not hold any collateral as security.

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

	2011 £m	2010 £m
At 1 April	44.2	70.6
Charge to Income Statement	21.5	21.6
Receivables written off during the year as uncollectable	(17.6)	(48.0)
At 31 March	48.1	44.2

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 £17.6m of debt which had been provided for in full (2010: £48.0m).

12 | Cash and cash equivalents

	Group		Company	
	2011 £m	2010 £m	2011 £m	2010 £m
Cash at bank and in hand	(21.4)	3.7	0.1	0.1
Short-term deposits	119.7	245.0	-	-
	98.3	248.7	0.1	0.1

The effective interest rate on short-term deposits as at 31 March 2011 was 0.6% (2010: 0.6%) and these deposits have an average maturity of 3 days (2010: 9 days). All cash and cash equivalents were held in sterling.

Cash at bank and in hand as at 31 March 2011 includes the effect of uncleared cheque and BACS payments.

13 | Trade and other payables

	Group		Company	
	2011 £m	As restated 2010 £m	2011 £m	2010 £m
Current				
Trade payables	34.4	21.5	-	-
Capital payables	31.3	56.5	-	-
Amounts due to group undertakings	-	-	3.5	3.5
Taxation and social security	2.4	0.5	-	-
Accruals and deferred income	438.6	422.7	-	-
	506.7	501.2	3.5	3.5
Non-current				
Deferred income	33.1	15.9	-	-

See note 1, 'Change of accounting policy' in respect of the restatement of the 2010 balances to reflect the application of IFRIC 18 from its effective date of 1 July 2009, and note 11 in respect of the reclassification of a £370.4m advance billing payables.

	2010 £m
Accruals and deferred income as originally reported	54.3
Restatement on adoption of IFRIC 18	13.9
Reclassification of advance billing payables	370.4
	438.6

Notes to the Financial Statements

14 | Financial liabilities – borrowings

	Group	
	2011 £m	2010 £m
Current		
Interest accruals	5.6	5.9
Bonds	-	125.0
Unamortised bond premium	0.6	0.6
Unamortised bond issue costs	(0.3)	(0.4)
European Investment Bank loans	13.5	8.9
Local authority loans	0.3	0.3
Finance lease obligations	7.2	9.9
	26.9	150.2
Non-current		
Interest accruals	40.0	38.0
Bonds	1,718.1	1,670.0
Unamortised bond premium	10.6	11.2
Unamortised bond issue costs	(5.5)	(5.9)
KfW Bank loan	35.0	35.0
European Investment Bank loans	199.5	138.0
Local authority loans	1.6	1.9
Finance lease obligations	734.6	873.6
	2,733.9	2,761.8

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 £922.1m (2010: £895.9m) 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 £796.0m (2010: £774.0m).

15 | Derivative financial instruments

Derivative financial instruments are held for economic hedging purposes. However, they do not qualify as accounting hedges under IAS 39 and movements in their fair value are taken to the Income Statement (see note 5b). 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 2 of the fair value hierarchy set out in IFRS 7.

Group - 2011	Fair Values	
	Assets £m	Liabilities £m
Current		
Index-linked swaps	4.4	(35.7)
Interest rate swaps	-	(8.9)
	4.4	(44.6)
Non-current		
Index-linked swaps	2.6	(87.2)
Interest rate swaps	-	(35.6)
	2.6	(122.8)
Total	7.0	(167.4)

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)

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.

Notes to the Financial Statements

Interest rate swaps

At 31 March 2011 an interest rate swap fixes the interest rate on £192m (2010 £192m) of floating liabilities held by the group. The maturity date of the swap is 31 March 2031 and the quarterly LIBOR fixed interest rate is 5.67%. In addition, £52m (2010 £56m) of finance lease liabilities have been swapped from a floating to a fixed LIBOR rate of 3.57% until March 2017. The notional amount of the swap is £54m (2010 £54m).

£428m (2010 £534m) 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 2012. These swaps are matched against the same liabilities as £428m (2010 £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 £553m (2010 £692m) of finance lease liabilities by reference to the Retail Prices Index ("RPI").

The notional amount of index-linked swaps allocated to finance leases as at 31 March 2011 is £530m (2010 £636m), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2011. 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	£530m amortising (2010 £636m amortising)
Average swap maturity	25 years (2010 23 years)
Average interest rate	1.59% fixed plus RPI (2010 1.58% fixed plus RPI)

On 31 March 2011, the group repaid two leases which were index-linked through inflation swaps with a nominal value of £99m. These inflation swaps have been reallocated to index-link an equivalent amount of European Investment Bank debt.

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	£114.7m (2010 £109.4m)
Swap maturity	46 years (2010 47 years)
Interest rate	1.35% indexed by RPI (2010 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 65 and 66. 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:

	2011	2010
Assets		
Cash and cash equivalents	0.6%	0.6%
Liabilities		
Bonds	5.2%	5.3%
European Investment Bank loans	1.2%	1.0%
KfW loan	2.6%	2.4%
Local authority loans	5.1%	4.9%
Finance lease obligations	1.3%	1.6%

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.

b) Liquidity risk

Group - 2011	Within 1yr £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
Assets					
Cash and cash equivalents	98.3	-	-	-	98.3
Trade and other receivables	489.3	-	-	-	489.3
	587.6	-	-	-	587.6
Liabilities					
Bonds	0.6	0.6	1.9	1,726.2	1,729.3
KfW Bank loan	-	-	23.3	11.7	35.0
European Investment Bank loans	13.5	13.5	41.0	145.0	213.0
Local authority loans	0.3	0.3	0.7	0.6	1.9
Finance lease obligations	7.2	11.5	77.2	645.9	741.8
Trade and other payables	506.7	1.2	3.2	28.7	539.8
	528.3	27.1	147.3	2,558.1	3,260.8

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	484.4	-	-	-	484.4
	733.1	-	-	-	733.1
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	501.2	0.8	2.4	12.7	517.1
	645.9	27.1	151.6	2,566.9	3,391.5

On 8 June 2010 the company agreed to repurchase £113m of Class C1 bonds following a tender offer to bond holders. The amount repurchased represents a take-up rate of 90% and settlement was made in cash on 7 June 2010. The remaining Class C1 bonds were redeemed on 31 March 2011.

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

	2011 £m	2010 £m
Gross finance lease liabilities		
Within one year	19.5	22.2
Between two and five years	191.2	232.3
After five years	947.3	1,164.5
	1,158.0	1,419.0
Future interest	(416.2)	(535.5)
Net finance lease liabilities	741.8	883.5

Notes to the Financial Statements

Net finance lease liabilities are repayable as follows

Within one year (note 14)	7 2	9 9
Between two and five years	88 7	103 7
After five years	645 9	769 9
Total over one year (note 14)	734 6	873 6

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.

	2011		2010	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bonds (note 14)	1,729.3	1,959.1	1,806.8	2,036.9

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

d) Borrowing facilities

As at 31 March 2011, the group had available undrawn committed borrowing facilities of £200m expiring as set out below, in respect of which all conditions precedent had been met (2010: £420m).

	2011 £m	2010 £m
Expiring in less than 1 year		
- revolving credit facilities	100	-
- term loan facility	-	75
	100	75
Expiring in more than 1 year		
- revolving credit facilities	-	345
- term loan facility	100	-
	100	345
	200	420

Dŵr Cymru Cyfyngedig also has a £10m overdraft facility renewable on an annual basis.

On 17 May and 18 May 2011 the group cancelled its existing £100m of revolving credit facilities that were otherwise due to expire on 30 September 2011 (£60m) and 30 June 2012 (£40m), and entered into new bilateral revolving credit facilities totalling £140m with a group of 6 banks. These new facilities expire on 17 May 2016 (£110m) and 18 May 2016 (£30m), although each bank has an option to extend its facility for a further year.

At 31 March 2011, Dŵr Cymru (Financing) Limited ("Financing") also had a special liquidity facility of £150m which it is required to maintain in order to meet certain group interest and other obligations that cannot be funded through operating cash flow of the group, in the event of a standstill being declared by the Security Trustee. A standstill would occur in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. No such covenant default has arisen during the year. The facility is renewable on an annual basis. On 13 April 2011, Financing cancelled its special liquidity facility of £150m and entered into a new £135m facility with a syndicate of four banks. The new facility is also renewable on an annual basis.

All of the above facilities are at floating rates of interest.

e) Capital risk management

Gearing ratios

	2011 £m	2010 £m
Total borrowings	(2,760)	(2,912)
Less cash and cash equivalents	98	249
Net debt	(2,662)	(2,663)
Regulatory capital value (RCV)	3,980	3,737
Total capital	1,318	1,074
Less unamortised bond costs	(6)	(6)
Total capital per bond covenants	1,312	1,068
Gearing ratio	67%	71%

As set out on page 66, 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 2010	28 4	2 2	6 8	37 4
Charged to income statement	-	-	1 9	1 9
Utilised in year	(13 7)	(0 2)	(2 0)	(15 9)
At 31 March 2011	14 7	2 0	6 7	23 4
Split as				
Amounts to be utilised within one year	14 7	0 1	2 0	16 8
Amounts to be utilised after more than one year	-	1 9	4 7	6 6
At 31 March 2011	14 7	2 0	6 7	23 4
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

The parent company has no provisions at 31 March 2011 (2010 £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 five years

Uninsured loss provision

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

Notes to the Financial Statements

18 | Net cash inflow from operating activities

a) Cash generated from operations

Reconciliation of operating profit to cash generated from operations

	Group	
	2011 £m	2010 £m
Operating profit	227.5	175.8
Adjustments for		
- Depreciation and amortisation	144.7	139.5
- (Profit)/loss on disposal of property, plant and equipment	(0.1)	0.4
- Changes in working capital		
Increase in trade and other receivables	(4.9)	(10.1)
Increase/(decrease) in trade and other payables	30.1	(2.1)
Pension contributions in excess of operating costs	(6.5)	(1.1)
(Decrease)/increase in provisions	(2.6)	28.2
	16.1	14.9
Cash generated from operations	388.2	330.6

b) Interest paid

	Group	
	2011 £m	2010 £m
Interest payable per income statement	101.3	174.3
Less non-cash items		
- Indexation on index-linked bonds	(48.2)	9.5
- Amortisation of bond issue costs	(0.4)	0.6
- Interest charge on pension scheme liabilities	0.7	(0.3)
- Amortisation of bond issue premium	0.6	0.6
- Effect of capitalisation under IAS 23	5.4	6.1
- Accounting profit on lease termination	13.5	-
- Increase in accruals	(1.4)	(1.7)
	(29.8)	14.8
Interest paid	143.7	116.1

19 | Analysis and reconciliation of net debt

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

	Group		Company	
	2011 £m	2010 £m	2011 £m	2010 £m
Cash and cash equivalents	98 3	248 7	0 1	0 1
Debt due after one year	(1,959 3)	(1,850 2)	-	-
Debt due within one year	(14 1)	(134 4)	-	-
Finance leases	(741 8)	(883 5)	-	-
Accrued interest	(45 6)	(43 9)	-	-
	(2,760 8)	(2,912 0)	-	-
Net (debt)/cash	(2,662 5)	(2,663 3)	0 1	0 1

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

	Group		Company	
	2011 £m	2010 £m	2011 £m	2010 £m
Net (debt)/cash at start of year	(2,663 3)	(2,620 4)	0 1	0 1
Movement in net cash	(150 4)	109 4	-	-
Movement in debt	187 4	(160 9)	-	-
Movement in net debt arising from cash flows	37 0	(51 5)	-	-
Movement in accrued interest	(1 7)	(2 0)	-	-
Indexation of index-linked debt	(48 1)	9 5	-	-
Accounting profit on lease termination	13 5	-	-	-
Other non-cash movements	0 1	1 1	-	-
Movement in net debt during the year	0 8	(42 9)	-	-
Net (debt)/cash at end of year	(2,662 5)	(2,663 3)	0 1	0 1

Notes to the Financial Statements

20 | Employees and directors

a) Staff costs for the group during the year

	2011 £m	2010 £m
Wages and salaries	57.5	10.7
Social security costs	4.5	1.1
Other pension costs	10.0	1.7
	72.0	13.5

Of the above, £22.3m (2010: £5.9m) has been capitalised

	2011 Number	2010 Number
Average monthly number of people (including executive directors) employed by the group		
Regulated water and sewerage activities	1,727	200

During the year, some 1,600 employees who worked on the previously outsourced operational contracts have transferred to Welsh Water via TUPE arrangements

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

On 20 October 2010, a bulk transfer of assets with a value of £26m was made into the DCWW Pension Scheme from the KWS Pension Scheme, being the accrued benefits of 192 ex-KWS employees who elected to transfer their past service benefits. On 8 December 2010, £129m of assets were transferred into the DCWW scheme from the United Utilities pension schemes (UUPS and ESPS schemes - £123m and 6m respectively), being the accrued benefits of 652 ex-UUOS employees who elected to transfer their past service benefits

Total pension costs in the year were as follows

	2011 £m	2010 £m
Defined contribution scheme	0.4	0.3
Defined benefit scheme - excluding actuarial loss	7.8	1.3
	8.2	1.6
Net actuarial loss recognised in year	4.7	1.5
	12.9	3.1

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2010 by Robert Davies of Quantum Advisory, an independent, professionally qualified actuary, using the projected unit method. This valuation has been updated as at 31 March 2011 and the principal assumptions made by the actuaries were

	2011	2010
Discount rate	5.5%	5.6%
Inflation assumption	3.3%	3.5%
Rate of increase in pensionable salaries	4.3%	4.5%
Rate of increase in pensions in payment	3.1%	3.3%
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

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

	2011		2010	
	Expected return	Percentage of total assets	Expected return	Percentage of total assets
Equities	7.5%	55.2%	7.5%	60.5%
Bonds	5.0%	12.6%	5.0%	39.2%
Other	3.0%	32.2%	3.0%	0.3%

The amounts recognised in the Income Statement are as follows

	2011 £m	2010 £m
Current service cost (excluding member contributions)	8.6	0.8
Past service cost	4.9	0.2
	13.5	1.0
Utilisation of restructuring provision	(4.9)	-
Total included within staff costs	8.6	1.0
Interest cost	7.9	2.5
Expected return on plan assets	(8.7)	(2.2)
Total included within interest payable and similar charges	(0.8)	0.3
Total recognised in the Income Statement	7.8	1.3

Note that the defined contribution scheme charge of £0.4m (2010: £0.3m) has also been included within staff costs

Notes to the Financial Statements

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

	2011 £m	2010 £m
Actuarial (loss)/gain on plan assets	(8 2)	10 0
Actuarial gain/(loss) on defined benefit obligation	3 5	(11 5)
Total recognised in the Statement of Comprehensive Income	(4 7)	(1 5)

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

	2011 £'000	2010 £'000
Present value of funded obligations	(238 6)	(55 2)
Plus unrecognised prior service costs	0 2	0 4
Fair value of plan assets	222.9	46 8
Net liability recognised in the Balance Sheet	(15 5)	(8 0)

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

	2011 £m	2010 £m
At 1 April	55 2	40 6
Current service cost	8 6	0 8
Employee contributions	0 3	0 4
Past service cost (vested benefits)	4 7	-
Interest cost	7 9	2 5
Benefits paid (net of transfers in)	(2 2)	(0 6)
Bulk transfer of liabilities	167 7	-
Actuarial (loss)/gain	(3 6)	11 5
At 31 March	238 6	55 2

Changes in the fair value of plan assets are as follows

	2011 £m	2010 £m
At 1 April	46 8	32 3
Expected return on plan assets	8 7	2 2
Employer contributions	10 9	2 6
Employee contributions	0 2	0 3
Benefits paid (net of transfers in)	(2 2)	(0 6)
Bulk transfer of assets	166.7	-
Actuarial (loss)/gain on plan assets	(8 2)	10 0
At 31 March	222.9	46 8

The actual return on plan assets was £1m (2010: £12m)

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

	2011 £m	2010 £m
At 1 April	8 0	7 8
Total charge to Income Statement (including utilisation of restructuring provision)	12 7	1 3
Total charge to Statement of Comprehensive Income	4 7	1 5
Bulk transfer (net liability)	1 0	-
Contributions paid (excluding member contributions)	(10 9)	(2 6)
At 31 March	15 5	8 0

	2011	2010	2009	2008	2007
Experience adjustments arising on scheme assets					
Amount (£m)	(8 2)	10 0	(9 3)	(4 7)	(0 2)
Percentage of scheme assets	(4%)	21%	(29%)	(12%)	(1%)
Experience adjustments arising on scheme liabilities					
Amount (£m)	3 6	11 5	(1 1)	8 0	(0 7)
Percentage of the present value of scheme liabilities	2%	21%	(3%)	22%	(2%)
Present value of scheme liabilities (£m)	238 4	54 8	40 1	36 8	41 0
Fair value of scheme assets (£m)	222.9	46 8	32 3	38 8	35 5
(Deficit)/surplus (£m)	(15 5)	(8 0)	(7 8)	2 0	(5 5)

The contributions paid in the year to 31 March 2011 include a special contribution of £2.6m (2010: £1.1m). The contribution expected to be paid in line with the extant schedule of contributions during the financial year ended 31 March 2012 amounts to £2.6m.

22 | Capital and other financial commitments

The group's business plan at 31 March 2011 shows net capital expenditure and infrastructure renewals expenditure of £273m (2010: £252m) 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. The parent company has not entered into transactions with any other group company during the year (2010: none).

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.

Notes to the Financial Statements

25 | 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 £2.2m (2010 £2.6m) in respect of distributions from the Elan Valley Trust Fund.

26 | Subsequent events

There were no contingent liabilities other than those arising from the ordinary course of the group's business and on these no material losses are anticipated.