

Glas Cymru Cyfyngedig

Directors' report and financial statements
for the year to 31 March 2012

Company No: 3975719



Registered office

Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY

Statement of Directors' Responsibilities

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board



R G Curtis, LLB ACIS
Company Secretary
13 June 2012

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 2012 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 [], 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 Annual Report 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 2012 and of the group's loss 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 3, 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 UK Corporate Governance Code specified for our review by the Listing Rules of the Financial Services Authority. We have nothing to report in respect of these reviews.

At the request of the directors, we have also audited the part of 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 (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cardiff
13 June 2012

Consolidated Income Statement for the year ended 31 March 2012

	Note	2012 £m	2011 £m
Continuing activities			
Revenue		695.0	676.7
Operating costs.			
- Operational expenditure	3	(272.5)	(264.6)
- Infrastructure renewals expenditure	3	(81.1)	(40.0)
- Depreciation and amortisation	3	<u>(150.0)</u>	<u>(144.6)</u>
		(503.6)	(449.2)
Operating profit		<u>191.4</u>	<u>227.5</u>
Financing costs			
- Interest payable and similar charges	4a	(189.7)	(173.5)
- Interest receivable and similar income	4a	4.9	4.1
- Fair value (losses)/gains on derivative financial instruments	4b	<u>(137.6)</u>	<u>12.3</u>
		(322.4)	(157.1)
(Loss)/profit before taxation	3	(131.0)	70.4
Taxation	5	27.0	68.1
(Loss)/profit for the year		<u>(104.0)</u>	<u>138.5</u>

Underlying profit for the year (Profit before taxation and fair value adjustments)			
		2012 £m	2011 £m
(Loss)/profit before taxation per Income Statement		(131.0)	70.4
Adjustment for			
- Fair value losses/(gains) on derivative financial statements (see note 4b)		137.6	(12.3)
Profit for the year before taxation and fair value adjustments		6.6	58.1

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 (2011: £nil).

Consolidated Statement of Comprehensive Income for the year ended 31 March 2012

	Note	2012 £m	2011 £m
(Loss)/profit for the year		(104 0)	138 5
Actuarial loss recognised in the pension scheme	20	(25 8)	(4 7)
Movement on deferred tax asset relating to pension scheme	5, 6	6 2	1 2
Total comprehensive (expense)/income for the year		<u>(123 6)</u>	<u>135 0</u>

Consolidated Statement of Changes in (Deficit)/Reserves for the year ended 31 March 2012

	2012 £m	2011 £m
Reserves/(deficit) at 1 April	46 2	(88 8)
Total comprehensive (expense)/income for the year	(123.6)	135 0
(Deficit)/reserves at 31 March	<u>(77.4)</u>	<u>46 2</u>

There were no changes in reserves of the parent company during the year (2011 none)

Consolidated Balance Sheet as at 31 March 2012

	Note	2012 £m	2011 £m
Assets			
Non-current assets			
Property, plant and equipment	7	3,231.9	3,178.9
Intangible assets	8	66.6	65.4
Financial assets			
- derivative financial instruments	14	-	2.6
		<u>3,298.5</u>	<u>3,246.9</u>
Current assets			
Trade and other receivables	10	511.9	489.3
Financial assets			
- derivative financial instruments	14	4.4	4.4
Cash and cash equivalents	11	300.5	98.3
		<u>816.8</u>	<u>592.0</u>
Liabilities			
Current liabilities			
Trade and other payables	12	(534.2)	(506.7)
Financial liabilities			
- borrowings	13	(77.5)	(26.9)
- derivative financial instruments	14	(25.0)	(44.6)
Provisions		(12.5)	(16.8)
		<u>(649.2)</u>	<u>(595.0)</u>
Net current assets/(liabilities)		167.6	(3.0)
Non-current liabilities			
Trade and other payables	12	(57.3)	(33.1)
Financial liabilities			
- borrowings	13	(2,912.6)	(2,733.9)
- derivative financial instruments	14	(277.4)	(122.8)
Retirement benefit obligations	20	(31.9)	(15.5)
Provisions	16	(7.9)	(6.6)
		<u>(3,287.1)</u>	<u>(2,911.9)</u>
Net assets before deferred tax		179.0	332.0
Deferred tax - net	6	(256.4)	(285.8)
Net (liabilities)/assets		(77.4)	46.2
(Deficit)/reserves		(77.4)	46.2

The financial statements on pages to were approved by the Board of directors on 13 June 2012 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 2012

	Note	2012 £m	2011 £m
Assets			
Non-current assets			
Investment in subsidiaries	9b	-	-
Trade and other receivables	10b	<u>3 4</u>	<u>3 4</u>
		3 4	3 4
Current assets			
Cash and cash equivalents	11	<u>0.1</u>	<u>0 1</u>
		0.1	0 1
Liabilities			
Current liabilities			
Trade and other payables	12	<u>(3 5)</u>	<u>(3 5)</u>
		(3 5)	(3 5)
Net assets			
		<u>-</u>	<u>-</u>
Reserves			
Retained earnings		<u>-</u>	<u>-</u>
Total reserves		<u>-</u>	<u>-</u>

The financial statements on pages to were approved by the Board of directors on 13 June 2012 and were signed on its behalf by



N C Annett
Managing Director



C A Jones
Finance Director

Consolidated Cash Flow Statement for the year ended 31 March 2012

	Note	2012 £m	2011 £m
Cash flows from operating activities			
Cash generated from operations	17a	337.5	388.2
Interest received		4.6	4.1
Interest paid	17b	(98.0)	(143.7)
Tax receipt		2.5	1.7
Net cash generated from operating activities		<u>246.6</u>	<u>250.3</u>
Cash flows from investing activities			
Purchase of property, plant and equipment		(185.5)	(227.4)
Grants and contributions received		9.5	14.1
Net cash used in investing activities		<u>(176.0)</u>	<u>(213.3)</u>
Net cash generated before financing activities		70.6	37.0
Cash flows from financing activities			
Long term loans received		25.0	75.0
Bond issue proceeds		128.1	-
Bond redemption		-	(125.0)
Term loan repayments		(13.5)	(8.9)
Capital element of finance lease payments		(7.7)	(128.2)
Other loan repayments		(0.3)	(0.3)
Net cash generated from/(used in) financing activities		<u>131.6</u>	<u>(187.4)</u>
Increase/(decrease) in net cash	18	202.2	(150.4)
Net cash at 1 April		98.3	248.7
Net cash at 31 March	11	<u>[300.5]</u>	<u>98.3</u>

The parent company had no cash flows during the year (2011 none)

Notes to the financial statements

1. Accounting policies, financing risk management and accounting estimates

Accounting policies for the year ended 31 March 2012

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.

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, there were no changes to the reporting framework which impact on Glas Cymru's financial statements for the year ended 31 March 2012.

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

IFRS 7	Financial Instruments Disclosures (amendment)
IFRS 9	Financial Instruments Classification and Measurement
IFRS 10	Consolidated Financial Statements
IFRS 13	Fair Value Measurement
IAS 1	Presentation of Financial Statements (amendment)
IAS 19	Employee Benefits (amendment)
IAS 32	Financial Instruments Presentation (amendment)

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.

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. Where customers have made payments in advance as at the year end, this is recognised as deferred income.

Notes to the financial statements

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

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

Other assets (including properties, overground operational structures and equipment, and fixtures and fittings)

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

1) Infrastructure assets

Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas, reflecting the way the group operates its wastewater activities.

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

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

2) Other assets

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

Freehold buildings	60 years
Leasehold properties	over the lease period
Operational structures	5 – 80 years
Fixed plant	8 – 40 years
Vehicles, mobile plant, equipment and computer hardware & software	3 – 16 years

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

Notes to the financial statements

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 38).

Intangible assets are amortised on a straight line basis over their estimated useful economic lives, which range between 3 and 20 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.

Notes to the financial statements

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 defined benefit obligation is determined by discounting the liabilities using a discount rate derived from the yield on high quality corporate bonds.

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 2012, none of the group's derivatives qualified for hedge accounting under IAS 39 (2011: 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.

Notes to the financial statements

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.

Notes to the financial statements

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. Other than £60 million of commercial paper invested with the European Investment Bank (with maturities ranging from 7 to 12 months), cash is invested for a maximum period of one month. The maximum cash investment with a single counterparty was £30m (2011: £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 £2,990m as at 31 March 2012 (2011: £2,761m), none related to floating rate debt (2011: none). The group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2012, 100% (2011: 100%) 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 £298m in the balance sheet at 31 March 2012 (2011: £160m) 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 70% 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.

Notes to the financial statements

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 £2,990m (2011 £2,761m) 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.

On 6 July 2011 the group issued £120m Class B index-linked bonds with a maturity date of 2048 (as a tap of the existing B6 issue).

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 2012, the group had committed undrawn borrowing facilities of £215m (2011 £200m) and cash and cash equivalents (excluding debt service payments account) of £238m (2011 £88m).

On 17 and 18 May 2011 the group entered into new revolving credit facilities totalling £140m with a group of six banks. £50m of these facilities remain available until May 2016, with the balance of £90m until May 2017. There is also a £10m overdraft facility (2011 £10m).

On 6 July 2011 Dŵr Cymru (Financing) Limited issued £120 million B6 series index-linked bonds with a maturity date of 2048 (as a tap of the £140 million existing B6 issue) to provide funding for Welsh Water's AMP5 investment programme. The company redeemed the last of its junior (Class C) bonds during 2010-11, and the £2.7 billion of remaining debt comprises entirely of 'A' rated Class A and B senior debt.

As at 31 March 2012 there was also a special liquidity facility of £135m (2011 £150m), this is required in order to meet certain interest and other obligations that cannot be funded through operating cashflow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants.

Capital risk management

The group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail 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 2012 gearing was 65%.

In respect of the risks detailed above, further quantitative disclosures are provided in note 15.

Notes to the financial statements

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 1%, the provision for impairment would increase or decrease by £0.5 million (2011: £0.5 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 2012 would increase or reduce by £6.1 million (2011: £4.7 million).

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. The total accrual as at 31 March 2012 was £61.6 million (2011: £63.6 million). A 1% change in actual consumption from that estimated would have the effect of increasing or decreasing the accrual by £0.6 million (2011: £0.5 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. (Loss)/profit before taxation

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

	Group	
	Total 2012	Total 2011
	£m	£m
Operating charges		
Power	34.4	33.7
Chemicals	8.8	8.5
Materials and equipment	3.0	2.9
Telephony	5.0	4.0
Vehicles and plant	8.4	7.3
Office expenses	3.9	2.3
Property costs	3.9	3.8
Insurance	4.4	5.3
Sewerage contractors	2.0	3.4
Water costs	5.7	4.8
Customer services agreement	20.1	19.8
Laboratories and analytical services	5.6	6.9
Collection commissions	4.1	3.9
IT contracts	13.3	17.8
Other bought-in services	21.1	28.4
	143.7	152.8
Employee costs (note 19)	79.5	72.0
Staff costs capitalised	(21.4)	(22.3)
Subcontracted staff costs	-	1.4
	58.1	51.1
Research and development expenditure	0.5	0.5
Trade receivables impairment	27.0	22.3
Rates	27.9	22.7
Environment Agency charges	15.1	15.0
Fees payable to auditors	0.2	0.2
	272.5	264.6
Total operational expenditure		
Infrastructure renewals expenditure	81.1	40.0
Depreciation and amortisation		
Owned assets	104.8	89.1
Under finance leases	33.9	47.9
Amortisation of intangible assets	11.4	7.7
Profit on disposal of property, plant and equipment	(0.1)	(0.1)
	150.0	144.6
	503.6	449.2

Notes to the financial statements

Services provided by the group's auditors

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

	Group	
	2012	2011
	£'000	£'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	22	23
Regulatory audit services pursuant to legislation	39	39
Bond prospectus update and bond issue	25	-
Total audit and audit-related fees	174	150
Other services		
Tax advisory services	14	-
Other	8	8
Total other services	22	8
Total cost of services provided by the group's auditors	196	158

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 £13,000 (2011: £12,000).

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. Financing costs

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

	Group	
	2012	2011
	£m	£m
Interest payable on bonds	(83.1)	(88.2)
Indexation on index-linked bonds	(52.1)	(48.2)
Interest payable on finance leases (including swaps to RPI)	(45.1)	(28.1)
Other loan interest	(12.1)	(12.0)
Other interest payable and finance costs	(3.9)	(3.1)
Net interest (charge)/credit on pension scheme liabilities	(0.1)	0.7
Capitalisation of borrowing costs under IAS 23 (2012: 6.8%, 2011: 6.3%)	6.7	5.4
	(189.7)	(173.5)
Interest receivable	4.9	4.1
Net interest payable before fair value adjustments	(184.8)	(169.4)

Notes to the financial statements

b) Fair value (losses)/gains 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 14 in respect of derivative financial instruments held on the balance sheet.)

	Group	
	2012	2011
	£m	£m
Fair value (losses)/gains on interest rate swaps	(35.3)	1.2
Fair value (losses)/gains on index-linked swaps	(102.3)	11.1
Total fair value (losses)/gains on derivative financial instruments	<u>(137.6)</u>	<u>12.3</u>

Interest rate swap losses are caused by a fall in long-term swap rates, while the index-linked swap losses result from a fall in the value of index-linked gilts and fluctuations in 3-month LIBOR.

5. Taxation

Analysis of credit in the year

	Group	
	2012	2011
	£m	£m
Current tax		
Current period	1.4	-
Adjustment in respect of prior years	2.4	2.5
	<u>3.8</u>	<u>2.5</u>
Deferred tax		
Origination and reversal of timing differences	35.4	44.9
Adjustment in respect of prior years	(30.3)	-
Effect of tax rate change	24.3	21.9
	<u>29.4</u>	<u>66.8</u>
Total taxation credit	<u>33.2</u>	<u>69.3</u>
Analysed as		
Credit to Income Statement	27.0	68.1
Credit to Statement of Comprehensive Income	6.2	1.2
	<u>33.2</u>	<u>69.3</u>

The £3.8m corporation tax refund comprises tax repayments in respect of expenditure on environmentally friendly equipment. The deferred tax credit includes £24.3m arising from the reduction of the corporation tax rate from 26% to 24%, while the prior year adjustment relates to the termination of finance leases on 31 March 2011.

Tax trading losses carried forward as at 31 March 2012 are circa £400m (2011: £387m).

Notes to the financial statements

The effective rate of tax for the year is lower (2011 lower) than the standard rate of corporation tax in the UK (2012 26%, 2011 28%). The differences are explained below

	Group	
	2012	2011
	£m	£m
(Loss)/profit before tax	(131.0)	70.4
(Loss)/profit before tax multiplied by the corporation tax rate in the UK of 26% (2011 28%)	(34.1)	19.7
Effect of		
Adjustments in respect of prior years	27.9	(34.1)
Other permanent differences	1.1	(33.0)
Effect of tax rate change	(21.9)	(21.9)
Movement on deferred tax asset relating to pension scheme	(6.2)	-
Total taxation credit	(33.2)	(69.3)

6. Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 24% (2011 26%)

The movement in the deferred tax provision is as shown below

	Group	
	2012	2011
	£m	£m
At 1 April	285.8	352.6
Credit to Income Statement	(23.2)	(65.6)
Credit to Statement of Comprehensive Income	(6.2)	(1.2)
At 31 March	256.4	285.8

	Group	
	2012	2011
	£m	£m
Effect of		
Tax allowances in excess of depreciation	450.3	435.8
Capital gains rolled over	3.8	4.1
	454.1	439.9
Deferred tax on tax losses carried forward	(114.5)	(101.0)
Deferred tax on losses on derivative financial instruments	(71.9)	(42.1)
Pensions	(7.7)	(4.0)
Other tax differences	(3.6)	(7.0)
Net provision for deferred tax	256.4	285.8

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.

The company has no deferred tax balance.

Notes to the financial statements

7. Property, plant and equipment Group

Current year	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2011	34.9	1,586.8	2,770.6	234.7	4,627.0
Additions net of grants and contributions	0.2	40.3	150.1	2.7	193.3
At 31 March 2012	35.1	1,627.1	2,920.7	237.4	4,820.3
Accumulated depreciation					
At 1 April 2011	17.3	188.4	1,037.1	205.3	1,448.1
Charge for the year	0.6	23.9	95.7	20.1	140.3
At 31 March 2012	17.9	212.3	1,132.8	225.4	1,588.4
Net book value					
At 31 March 2012	17.2	1,414.8	1,787.9	12.0	3,231.9

The net book value of property, plant and equipment includes £106.8m in respect of assets in the course of construction (2011 £119.1m)

The net book value of property, plant and equipment includes £16.6m of borrowing costs capitalised in accordance with IAS 23 (2011 £10.8m), of which £6.2m were additions in the year (2011 £5.4m)

On 1 October 2011 Dwr Cymru Cyfyngedig assumed responsibility for managing the private sewers network in its operational area. The transfer of an estimated 17,000km of private drains and sewers has significantly increased the size of the network. Little information is available to judge the condition of those sewers – and any attributable value – but they are typically expected to be poor and below the standard of assets that the industry is generally required to operate. In light of this, and the fact that they do not generate an increase in the regulatory capital value of the business, a value of £nil has been attributed to these assets in the financial statements as at 31 March 2012.

Prior year	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2010	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	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

Notes to the financial statements

Assets held under finance leases

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

Group

Current year	Infrastructure assets £m	Operational structures £m	Total £m
At 31 March 2012			
Cost	611.8	483.9	1,095.7
Accumulated depreciation	74.7	251.6	326.3
Net book value	<u>537.1</u>	<u>232.3</u>	<u>769.4</u>

Prior year	Infrastructure assets £m	Operational structures £m	Total £m
At 31 March 2011			
Cost	611.8	483.9	1,095.7
Accumulated depreciation	67.0	225.4	292.4
Net book value at 31 March 2011	<u>544.8</u>	<u>258.5</u>	<u>803.3</u>

The parent company owns no property, plant or equipment

8. Intangible assets

Group

Current year	Cost £m	Amortisation £m	Net book value £m
At 1 April 2011	129.6	(64.2)	65.4
Additions/(charge for the year)	12.6	(11.4)	1.2
At 31 March 2012	<u>142.2</u>	<u>(75.6)</u>	<u>66.6</u>

Prior year	Cost £m	Amortisation £m	Net book value £m
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	<u>129.6</u>	<u>(64.2)</u>	<u>65.4</u>

Intangible assets comprise computer software and related system developments

The net book value of intangible assets includes £12.9m in respect of assets in the course of construction (2011 £3.6m) The net book value of intangible assets includes £0.9m of borrowing costs capitalised in accordance with IAS 23 (2011 £0.4m), of which £0.5m were additions in the year (2011 £0.4m)

The parent company owns no intangible assets

Notes to the financial statements

9. Investments

(a) Group

2012 2011
£m £m

Cost and net book value

At 1 April and 31 March

- -

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

	Principal activities	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 activities	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	Dormant	England and Wales	100%

10. Trade and other receivables

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
(a) Current				
Trade receivables	487.7	463.1	-	-
Provision for impairment of receivables	(54.6)	(48.1)	-	-
Trade receivables - net	433.1	415.0	-	-
Prepayments and accrued income	66.3	63.3	-	-
Corporation tax	3.8	2.5	-	-
Other receivables	8.7	8.5	-	-
	511.9	489.3	-	-
(b) Non-current				
Amounts receivable from group undertakings	-	-	3.4	3.4
	-	-	3.4	3.4
Total trade and other receivables	511.9	489.3	3.4	3.4

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

As at 31 March 2012, based on a review of historical collection rates it was considered that £54.6m of trade receivables were impaired and these have therefore been provided for (2011 £48.1m). The impaired receivables relate mainly to measured and unmeasured water supply receivables

Trade receivables aged greater than one month are past due, the net column shows amounts deemed not to be impaired

Notes to the financial statements

The ageing of receivables was as follows

Current year	Total	Provided for	Net
Trade receivables	£m	£m	£m
Billed in advance	389.3	-	389.3
Under one month	15.9	(3.5)	12.4
Between one and six months	26.9	(11.5)	15.4
Between six months and one year	19.5	(7.5)	12.0
Between one and two years	20.8	(17.2)	3.6
Between two and three years	13.8	(13.4)	0.4
Over three years	1.5	(1.5)	-
	<u>487.7</u>	<u>(54.6)</u>	<u>433.1</u>

Prior year	Total	Provided for	Net
Trade receivables	£m	£m	£m
	As restated		As restated
Billed in advance (restated)	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)	-
	<u>463.1</u>	<u>(48.1)</u>	<u>415.0</u>

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

	2012	2011
	£m	£m
At 1 April	48.1	44.2
Charge to Income Statement	26.2	21.5
Receivables written off during the year as uncollectable	<u>(19.7)</u>	<u>(17.6)</u>
At 31 March	<u>54.6</u>	<u>48.1</u>

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 £19.7m of debt which had been provided for in full (2011: £17.6m).

Notes to the financial statements

11. Cash and cash equivalents

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Cash at bank and in hand	(15.9)	(21.4)	0.1	0.1
Short-term deposits	316.4	119.7	-	-
	300.5	98.3	0.1	0.1

The effective interest rate on short-term deposits as at 31 March 2012 was 0.7% (2011 0.6%) and these deposits had an average maturity of 31 days (2011 3 days). All cash and cash equivalents are held in sterling.

12. Trade and other payables

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Current				
Trade payables	47.7	34.4	-	-
Capital payables	27.2	31.3	-	-
Amounts due to group undertakings	-	-	3.5	3.5
Taxation and social security	2.8	2.4	-	-
Accruals and deferred income	456.5	438.6	-	-
	534.2	506.7	3.5	3.5

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Non-current				
Deferred income	57.3	33.1	-	-

13. Financial liabilities – borrowings

	Group	
	2012	2011
	£m	£m
Current		
Interest accruals	51.5	5.6
Bonds	0.0	0.0
Unamortised bond premium	0.6	0.6
Unamortised bond issue costs	(0.3)	(0.3)
European Investment Bank loans	13.5	13.5
Local authority loans	0.4	0.3
Finance lease obligations	11.8	7.2
	77.5	26.9

Notes to the financial statements

	Group	
	2012	2011
Non-current	£m	£m
Interest accruals	40.7	40.0
Bonds	1,899.3	1,718.1
Unamortised bond premium	9.0	10.6
Unamortised bond issue costs	(5.9)	(5.5)
KfW Bank loan	35.0	35.0
European Investment Bank loans	211.0	199.5
Local authority loans	1.2	1.6
Finance lease obligations	722.3	734.6
	<u>2,912.6</u>	<u>2,733.9</u>

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

- i) a first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence, and
- ii) 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 £950.5m (2011: £922.1m) 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 £949.0m (2011: £796.0m)

Notes to the financial statements

£426m (2011 £428m) 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 2013. These swaps are matched against the same liabilities as £426m (2011 £428m) 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 £549m (2011 £553m) 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 2012 is £528m (2011 £530m), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2012. 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	£528m amortising (2011 £530m amortising)
Average swap maturity	24 years (2011 25 years)
Average interest rate	1.59% fixed plus RPI (2011 1.59% 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, which have a notional value of £94m (2011 £99m) amortising over their 10 year life, 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	£120m (2011 £114.7m)
Swap maturity	45 years (2011 46 years)
Interest rate	1.35% indexed by RPI (2011 1.35% indexed by RPI)

15. Financial risk management

The policies of the group in respect of financial risk management are included in the accounting policies note on page []. 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:

	2012	2011
Assets		
Cash and cash equivalents	0.7%	0.6%
Liabilities		
Bonds	5.0%	5.2%
European Investment Bank loans	1.3%	1.2%
KfW loan	1.7%	2.6%
Local authority loans	5.1%	5.1%
Finance lease obligations	2.0%	1.3%

Trade and other receivables and payables are non interest-bearing.

Notes to the financial statements

The effective interest rates ignore the effect of the interest rate and index-linked swaps set out in note 14. They also exclude the indexation charge applicable to the index-linked bonds.

b) Liquidity risk

Group - 2012	Within 1	1 - 2 years	2 - 5 years	> 5 years	Total
	year				
	£m	£m	£m	£m	£m
Assets.					
Cash and cash equivalents	300.5	-	-	-	300.5
Trade and other receivables	511.9	-	-	-	511.9
	812.4	-	-	-	812.4
Liabilities.					
Bonds	0.6	0.7	1.8	1,905.8	1,908.9
KfW Bank loan	-	-	35.0	-	35.0
European Investment Bank loans	13.5	13.5	47.9	149.6	224.5
Local authority loans	0.4	0.3	0.5	0.4	1.6
Finance lease obligations	11.8	16.0	118.5	587.8	734.1
Trade and other payables	534.2	1.8	4.7	50.8	591.5
	560.5	32.3	208.4	2,694.4	3,495.6
Group - 2011					
	Within 1	1 - 2 years	2 - 5 years	> 5 years	Total
	year				
	£m	£m	£m	£m	£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	1,762.2	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

The minimum lease payments under finance leases fall due as follows

	2012	2011
	£m	£m
Gross finance lease liabilities		
Within one year	26.7	19.5
Between two and five years	192.0	191.2
After five years	719.8	947.3
	938.5	1,158.0
Future interest	(204.4)	(416.2)
Net finance lease liabilities	734.1	741.8
Net finance lease liabilities are repayable as follows		
Within one year (note 13)	11.8	7.2

Notes to the financial statements

Between two and five years	134.5	88.7
After five years	587.8	645.9
Total over one year (note 13)	722.3	734.6

c) Fair values

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

	2012		2011	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bonds (note 13)	<u>1,908.9</u>	<u>2,268.9</u>	<u>1,729.3</u>	<u>1,959.1</u>

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

d) Borrowing facilities

As at 31 March 2012, the group had available undrawn committed borrowing facilities of £215m expiring as set out below, in respect of which all conditions precedent had been met (2011: £200m).

	2012 £m	2011 £m
Expiring in less than 1 year		
- revolving credit facilities	-	100
- term loan facility	<u>75</u>	-
	<u>75</u>	<u>100</u>
Expiring in more than 1 year		
- revolving credit facilities	<u>140</u>	-
- term loan facility	-	<u>100</u>
	<u>140</u>	<u>100</u>
	<u><u>215</u></u>	<u><u>200</u></u>

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

The company has £140 million of revolving credit facilities, of which £50 million is available to be drawn until May 2016 and £90 million is available until May 2017.

At 31 March 2012, Dŵr Cymru (Financing) Limited ("Financing") also had a special liquidity facility of £135m (2011: £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.

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

Notes to the financial statements

e) Capital risk management

Gearing ratios

	2012 £m	2011 £m
Total borrowings	(2,990)	(2,760)
Less cash and cash equivalents	301	98
Net debt	(2,690)	(2,662)
Regulatory capital value (RCV)	4,171	3,980
Total capital ('Financial Reserves')	1,482	1,318
Less unamortised bond costs	(6)	(6)
Total capital per bond covenants	1,476	1,312
Gearing ratio	65%	67%

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

16. Provisions

Group	Restructuring provision £m	Dilapidations provision £m	Uninsured loss provision £m	Total £m
At 1 April 2011	14.7	2.0	6.8	23.5
Charged to income statement	-	0.1	3.6	3.7
Utilised in year	(4.2)	(0.1)	(2.5)	(6.8)
At 31 March 2012	10.5	2.0	7.9	20.4
Split as:				
Amounts to be utilised within one year	10.5	-	2.0	12.5
Amounts to be utilised after more than one year	-	2.0	5.9	7.9
At 31 March 2012	10.5	2.0	7.9	20.4
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

The parent company has no provisions at 31 March 2012 (2011: £nil)

Restructuring provision

This provides for the costs of terminating the outsourced contracts with United Utilities Operational Services and Kelda Water Services in the year to 31 March 2011 along with the estimated restructuring costs associated with a reduction in the headcount by some 300

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

17. Net cash inflow from operating activities

a) Cash generated from operations

Reconciliation of operating profit to cash generated from operations

	Group	
	2012	2011
	£m	£m
Operating profit	191.4	227.5
Adjustments for		
- Depreciation and amortisation	150.0	144.6
- Changes in working capital		
Increase in trade and other receivables	(22.6)	(4.9)
Increase in trade and other payables	30.2	30.1
Pension contributions in excess of operating costs	(10.6)	(6.5)
Decrease in provisions	(0.9)	(2.6)
	<u>(3.9)</u>	<u>16.1</u>
Cash generated from operations	<u>337.5</u>	<u>388.2</u>

b) Interest paid

	Group	
	2012	2011
	£m	£m
Interest payable per income statement	189.7	173.5
Less non-cash items		
- Indexation on index-linked bonds	(52.1)	(48.2)
- Amortisation of bond issue costs	(0.4)	(0.4)
- Interest (charge)/credit on pension scheme liabilities	(0.1)	0.7
- Amortisation of bond issue premium	0.6	0.6
- Effect of capitalisation under IAS 23	6.7	5.4
- Accounting profit on lease termination	-	13.5
- Increase in accruals	(46.4)	(1.4)
	<u>(91.7)</u>	<u>(29.8)</u>
Interest paid	<u>98.0</u>	<u>143.7</u>

Notes to the financial statements

18. Analysis and reconciliation of net debt

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

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Cash and cash equivalents	300.5	98.3	0.1	0.1
Debt due after one year	(2,149.6)	(1,959.3)	-	-
Debt due within one year	(14.2)	(14.1)	-	-
Finance leases	(734.1)	(741.8)	-	-
Accrued interest	(92.2)	(45.6)	-	-
	(2,990.1)	(2,760.8)	-	-
Net (debt)/cash	(2,689.6)	(2,662.5)	0.1	0.1

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

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
Net (debt)/cash at start of year	(2,662.5)	(2,663.3)	0.1	0.1
Movement in net cash	202.2	(150.4)	-	-
Movement in debt	(131.6)	187.4	-	-
Movement in net debt arising from cash flows	70.6	37.0	-	-
Movement in accrued interest	(46.4)	(1.7)	-	-
Indexation of index-linked debt	(52.1)	(48.2)	-	-
Profit on lease termination	-	13.5	-	-
Other non-cash movements	0.8	0.2	-	-
Movement in net debt during the year	(27.1)	0.8	-	-
Net (debt)/cash at end of year	(2,689.6)	(2,662.5)	0.1	0.1

19. Employees and directors

Notes to the financial statements

Staff costs for the group during the year

	2012	2011
	£m	£m
Wages and salaries	67.1	57.5
Social security costs	5.4	4.5
Other pension costs	7.0	10.0
	<u>79.5</u>	<u>72.0</u>

Of the above, £21.4m (2011: £22.3m) has been capitalised

Average monthly number of people employed by the group (including directors)

	2012	2011
	Number	Number
Regulated water and sewerage activities	<u>1,931</u>	<u>1,727</u>

20. 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-Kelda Water Services employees who elected to transfer their past service benefits. On 8 December 2010, £129m of assets were transferred into the DCWW scheme from United Utilities pension schemes (UUPS and ESPS schemes - £123m and 6m respectively), being the accrued benefits of 652 ex-United Utilities Operational Services employees who elected to transfer their past service benefits.

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2011 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 2012 and the principal assumptions made by the actuaries were:

	2012	2011
Discount rate	5.0%	5.5%
Inflation assumption	3.2%	3.3%
Rate of increase in pensionable salaries	3.7%	4.3%
Rate of increase in pensions in payment	3.1%	3.1%
Post retirement mortality (life expectancy)		
- Current pensioners aged 65 - males	87.7 years	87.0 years
- Current pensioners aged 65 - females	90.4 years	89.9 years
- Future pensioners aged 65 (currently aged 45) - males	90.7 years	88.1 years
- Future pensioners aged 65 (currently aged 45) - females	93.3 years	90.9 years

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

Notes to the financial statements

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

	2012		2011	
	Expected return	% of total assets	Expected return	% of total assets
Equities	6.5%	50.8%	7.5%	55.2%
Bonds	5.0%	13.0%	5.0%	12.6%
Other	3.0%	36.1%	3.0%	32.2%

The amounts recognised in the Income Statement are as follows

	2012	2011
	£m	£m
Current service cost (excluding member contributions)	8.9	8.6
Past service cost	1.5	4.9
Total included within staff costs	10.4	13.5
Utilisation of restructuring provision	(2.1)	(4.9)
Total included within staff costs	8.3	8.6
Interest cost	13.3	7.9
Expected return on plan assets	(13.2)	(8.7)
Total included within interest payable and similar charges	0.1	(0.8)
Total recognised in the Income Statement	8.4	7.8

Note that the defined contribution scheme charge of £0.4m (2011: £0.4m) has also been included within staff costs

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

	2012	2011
	£m	£m
Actuarial loss on plan assets	(9.5)	(8.2)
Actuarial gain/(loss) on defined benefit obligation	(16.3)	3.5
Total recognised in the Statement of Comprehensive Income	(25.8)	(4.7)

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

	2012	2011
	£m	£m
Present value of funded obligations	(272.8)	(238.6)
Plus unrecognised prior service costs	0.1	0.2
Fair value of plan assets	240.8	222.9
Net liability recognised in the Balance Sheet	(31.9)	(15.5)

Notes to the financial statements

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

	2012	2011
	£m	£m
At 1 April	238.6	55.2
Current service cost (including member contributions)	9.3	8.9
Past service cost (vested benefits)	1.4	4.7
Interest cost	13.3	7.9
Benefits paid (net of transfers in)	(6.1)	(2.2)
Bulk transfer of liabilities	-	167.7
Actuarial loss/(gain)	16.3	(3.6)
At 31 March	<u>272.8</u>	<u>238.6</u>

Changes in the fair value of plan assets are as follows

	2012	2011
	£m	£m
At 1 April	222.9	46.8
Expected return on plan assets	13.2	8.7
Contributions (including member contributions)	20.3	11.1
Benefits paid (net of transfers in)	(6.1)	(2.2)
Bulk transfer of assets	-	166.7
Actuarial gain on plan assets	(9.5)	(8.2)
At 31 March	<u>240.7</u>	<u>222.9</u>

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

	2012	2011
	£m	£m
At 1 April	15.5	8.0
Total charge to Income Statement (including utilisation of restructuring provision)	10.5	12.7
Total charge to Statement of Comprehensive Income	25.8	4.7
Bulk transfer (net liability)	-	1.0
Contributions paid (excluding member contributions)	(19.9)	(10.9)
At 31 March	<u>31.9</u>	<u>15.5</u>

	2012	2011	2010	2009	2008
Experience adjustments arising on scheme assets					
Amount (£m)	(9.5)	(8.2)	10.0	(9.3)	(4.7)
Percentage of scheme assets	(4%)	(4%)	21%	(29%)	(12%)
Experience adjustments arising on scheme liabilities					
Amount (£m)	(34.6)	3.6	11.5	(1.1)	8.0
Percentage of the present value of scheme liabilities	(13%)	2%	21%	(3%)	22%
Present value of scheme liabilities (£m)	272.8	238.4	54.8	40.1	36.8
Fair value of scheme assets (£m)	240.8	222.9	46.8	32.3	38.8
(Deficit)/surplus (£m)	(31.9)	(15.5)	(8.0)	(7.8)	2.0

The contributions paid in the year to 31 March 2012 include a special contribution of £2.6m (2011 £2.6m). A further £8.0m was paid into the scheme to augment the benefits in respect of scheme members who left the

Notes to the financial statements

company via selective voluntary severance (2011 nil) The contribution expected to be paid in line with the extant schedule of contributions during the financial year ended 31 March 2013 amounts to £2.6m

21. Capital and other financial commitments

The group's business plan at 31 March 2012 shows net capital expenditure and infrastructure renewals expenditure of £310m (2011 £273m) 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.

22. 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 (2011 none).

23. 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.

24. 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.

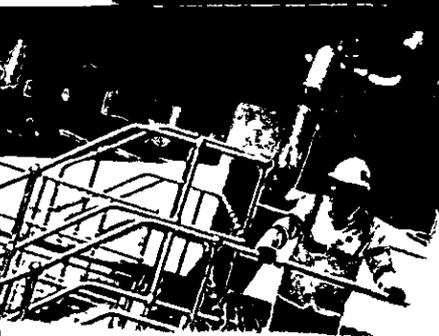
The sum of £31.7m, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Welsh Water Authority, whilst preserving the capital value of the fund in real terms. Welsh Water Authority's interest in this fund 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. As at 31 March 2012 the market value of the trust fund was £110m (2011 £98m).

Interest receivable includes £2.7m (2011 £2.2m) in respect of distributions from the Elan Valley Trust Fund.

25. Contingent liabilities

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



glas
Glas Cymru Cyfyngedig

**REPORT AND
ACCOUNTS
2012**

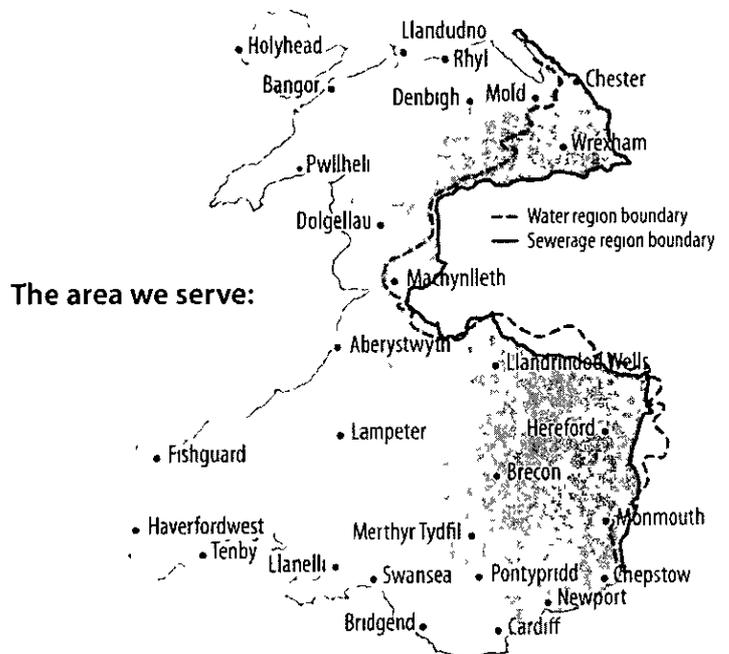
Annual Review 2012

THE GLAS CYMRU ANNUAL REVIEW PROVIDES AN OVERVIEW OF PERFORMANCE FOR THE YEAR TO END MARCH 2012. AN ELECTRONIC VERSION OF THE REPORT IS AVAILABLE AT WWW.DWRCYMRU.COM AND INCLUDES A SERIES OF CASE STUDY FILMS ABOUT OUR WORK.

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Key Facts 2011/12



1.4 million
homes and businesses served

828 million
litres of water supplied every day

27,000km
of water mains

More than
30,000km
of sewers

836
sewage treatment works

67
impounding reservoirs

99.96%
overall water quality
compliance at the tap

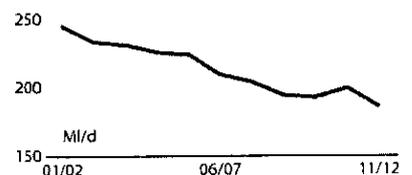
12%
reduction in carbon emissions

90%
customer satisfaction

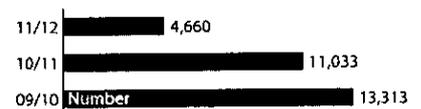
44,000
customers receiving
help with their bills

£1 billion
investment programme 2012-15

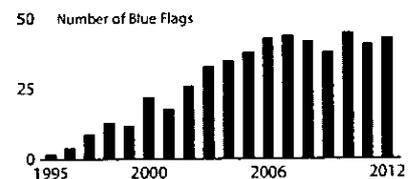
Leakage is at an all time low



Customer complaints fell by 58%



Wales has a third of UK's blue flags



Chairman's Statement

OUR AMBITION IS TO DELIVER THE BEST POSSIBLE OUTCOMES FOR OUR CUSTOMERS, SUPPLYING DRINKING WATER OF THE HIGHEST QUALITY AND SAFEGUARDING THE ENVIRONMENT THAT WE LOOK AFTER ON BEHALF OF THE COMMUNITIES WE SERVE.

We also hope to show that the unique business model we have established for the water industry in our region is working for our customers. I am pleased to report that we have made significant progress in the year towards these objectives.

Glas Cymru is a private company (limited by guarantee, not shares) and was formed in 2001 to acquire the business of Dŵr Cymru Welsh Water, the regulated water and sewerage company that serves much of Wales, Herefordshire and Deeside. Instead of shareholders we have independent Members who do not receive dividends and whose only interest is the selfless one of overseeing the performance of Dŵr Cymru against the objectives set for the business and holding the Board to account. Glas Cymru's business is limited to that of owning, financing and managing Dŵr Cymru in the interests of Dŵr Cymru's customers, both today's and future generations.

We finance Dŵr Cymru's extensive network of long lived assets and continuing large capital investment programme through long term, low risk bonds and retained financial reserves. Financing efficiency is one key advantage that has been secured by the Glas Cymru business model. Our financial reserves now stand at £1.5 billion, having grown ten-fold since we acquired Dŵr Cymru in 2001. With our financial gearing ratio (net borrowings expressed as a percentage of our regulated capital value) now down to 65% - from 93% in 2001 - we currently have the best credit ratings in the UK utilities sector.

This strong financial position has allowed us to do much more for our customers than would otherwise have been possible. In the past we paid customer dividends totalling £150 million to limit the impact of rising customer bills. But with Dŵr Cymru's household customer bills projected to fall by 7% on average in real terms between 2010 and 2015 the Board has decided that our customers' interests are best served by accelerating future planned investment to improve the reliability and quality of the essential public service our customers rely on, in particular safeguarding the quality and reliability of drinking water services.

The Glas Cymru model allows us to accelerate £100 million of investment - taking the total investment spend in the current five year regulatory period 2010-2015 to £1.5 billion, equivalent to more than £1,000 for every household customer. This investment will, for instance, see 22 water treatment works undergo major renewal and upgrade as part of our 'Go to Green' programme helping to ensure that the current very high quality of drinking water is maintained for future generations. At a time when many companies are cutting back on investment, our accelerated programme is employing some 10% of the construction sector in our region, supporting some 1,500 jobs with more than 50% of total spend going to local companies in our supply chain.

Our first priority is to our customers and to looking after our network of assets for future generations, a network with a replacement value of over £25 billion. We have been able to accelerate investment and do more for our customers while bills are falling in real terms. This both chimes with and reinforces Dŵr Cymru's customer first culture. We are improving the experience our customers receive when they deal with us. Customer satisfaction reached a record 90% and we ranked amongst the best companies on Ofwat's industry league table for customer satisfaction. Customer complaints have more than halved and have never been lower. Complimentary letters from customers have risen three fold.

Especially encouraging have been the results from two independent surveys of our largest business customers which showed that overall satisfaction with our service now stands at 89%. And at a time when household incomes are under great pressure, particularly in our region, we are pleased that we are doing more than any other water company to help, with some 44,000 of our least well off customers benefitting from one of our social tariffs or our Customer Assistance Fund.

While the Board is pleased with this progress, we have set targets which demand that we achieve still higher standards and we will not be content until Dŵr Cymru leads the industry on the measures that matter for our customers and for the environment we look after.



Our ability to deliver the best possible outcomes for our customers - and in particular to accelerate capital investment while customer bills are falling in real terms - depends crucially on a continuing stable regulatory environment. We have been able to raise bond finance for capital investment for up to 50 years at real interest rates of below 2% because we can convince long term investors that our Company and our industry is low risk. At a time of great uncertainty - when investors are looking for a 'safe haven' - maintaining the attractiveness of the water sector as a place to invest has never been more important. Changes to the regulation of our industry must not introduce unnecessary risk and uncertainty and we are reassured that both the UK and Welsh Governments are committed to making only those changes that will produce better outcomes for customers.

Tony Hobson will be stepping down from the Board at the Company's Annual General Meeting and I would like to put on record our thanks for all that he has done for the Company and the immense contribution he has made since he joined the Board as one of the founder Directors in 2001. Without Tony and the other founder Directors we would not be in the strong position that we are today. I am delighted to welcome John Warren to the Board who has joined us as a Non-executive Director and to succeed Tony as Chairman of our Audit Committee. John brings an extensive and diverse financial and business record which will be invaluable as we continue to strive to make Dŵr Cymru the leading water company in the sector.

Finally and on behalf of the Board, can I also put on record our sincere thanks to the entire 2,000 strong team at Dŵr Cymru. We have instituted wholesale change to our enterprise over the last two years in particular and throughout the commitment and indeed enthusiasm of everyone in the Dŵr Cymru team has been steadfast.

Robert Ayling, Chairman
13 June 2012

Protecting Public Health

SUPPLYING SAFE DRINKING WATER AT ALL TIMES IS OUR MOST IMPORTANT RESPONSIBILITY AND THIS MEANS THAT OUR TAP WATER MUST BE FREE FROM HARMFUL CHEMICALS AND BACTERIA AND HAVE A GOOD TASTE.

99.96%
overall water
quality compliance

£120m
programme to upgrade WTWs

17/6
significant incidents
reported to DWI

Over the course of a year some 300,000 water tests are taken and analysed under regulations monitored by the Drinking Water Inspectorate ('DWI'). In 2011 the high quality of the water we supply was maintained with 99.96% of samples taken and analysed meeting drinking water quality standards at customer taps. We also achieved our targets on four of the other five indices used by the DWI to measure water quality compliance at each point on the water supply system.

Customer complaints and contacts about discoloured water were well down once again and are a third lower than five years ago. Iron is the main cause of discolouration and our compliance with the water quality standard for iron in 2011 was 99.80% which is an improvement on the previous year when compliance was 99.56%. However, notwithstanding the water mains renewal programme of the last ten years we still have more than 6,500km of unlined iron mains which can cause discoloured water and managing and mitigating this risk is a major challenge for us.

Of the 22 events affecting water quality we notified to the DWI during 2011, just six were classified by the DWI as significant. This continues the very marked improvement on this key measure over recent years, in 2009 21, and in 2010 17, of the events we notified were classified by the DWI as significant.

Our accelerated investment programme to improve the reliability of our water supply network - based on our Drinking Water Safety Plans - continues to make good progress and last year we completed schemes at Alwen (Conwy), Cilfor (Gwynedd), Capel Curig (Conwy) and Penycefn (Dolgellau) and we are currently on sites at Llyswen (Powys), Bala (Gwynedd) and Sluvad (Torfaen). Our £120 million 'Go to Green' programme to rebuild, refurbish or upgrade 22 water treatment works across Wales has been agreed and will be delivered over the coming three years.

The Water Health Partnership for Wales, established by Dŵr Cymru in 2006, continues to be an important forum in which health and water professionals from across Wales can share learning and improve inter-agency knowledge of public health and drinking water quality issues. We also continue to host events where we work with landowners and others to identify and agree on ways in which we can work together to manage catchments and protect raw water quality.



Watch our film

CASE STUDY

Alwen water treatment works, Denbighshire, serves over 50,000 homes and businesses in Ruthin, Mold, Denbigh, Buckley and Holywell. £14 million was allocated to improve the water treatment works and work began in January 2010.

Despite the need to shutdown the works 30 times in order to install new filtration, disinfection and chlorination processes, there was no disruption to customers.

The works became fully operational in August 2011 providing a more

reliable supply and enhanced water quality for customers. A second phase will renew ancillary facilities at the works.

Nick Jones,
Water Production Manager

Reliable Sanitation

FOLLOWING THE TRANSFER OF PRIVATE SEWERS TO THE REGULATED WATER AND SEWERAGE COMPANIES IN ENGLAND AND WALES IN OCTOBER LAST YEAR WE ARE NOW RESPONSIBLE FOR MAINTAINING MORE THAN 30,000 KM OF SEWERS, POTENTIALLY DOUBLING THE LENGTH OF OUR SEWER NETWORK.

98% blockages dealt with without flooding

35 sewer improvement schemes

30,000 km of sewers

As important for public health is reliable sanitation. Much of our sewer network is old and in poor condition and one of our biggest challenges is to minimise the impact of any blockages and other problems on the network. Prior to the transfer of private sewers, we typically dealt with just over 1,000 blockages every month, some months on from the transfer of private sewers, that figure has doubled. In more than 98% of cases, by responding quickly we manage to deal with the blockage without causing property flooding or environmental pollution.

We have also commenced the process of transferring private sewage pumping stations and we estimate that by 2016 we will have to take responsibility for more than 600 stations to add to the 2,000 we currently operate. Many of these assets are in very poor condition. 2012 will also see the adoption of new 'mandatory build standards' in Wales which will require that developers build new sewerage assets to a standard that will allow Dŵr Cymru to take them over without delay. We are collecting separately all the costs associated with the transfer of private sewers and related assets and in due course we will be considering how best we recover these additional costs from our customers.

Last year the total number of incidents resulting in the flooding of properties fell from 215 to 198, which is the lowest number for some years. Just 22 of these were due to hydraulic overload which is where the sewer backs up during heavy rainfall due to lack of capacity, during the year we completed 35 sewer improvement schemes at a cost of £8 million to reduce from 267 to 218 the number of properties at risk of repeat flooding due to hydraulic overload.



Watch our film



CASE STUDY

Due to the historic development of the sewerage network, Llanelli sees nearly as much rainwater entering the system as seen in the neighbouring catchment of Swansea - despite Swansea serving three times the number of properties and drains in an area three times as large. This has put a significant number of properties at risk of being flooded. Following a detailed examination of how these

problems could be tackled and customers protected from flooding, it was clear that conventional storage solutions were not technically feasible, affordable or sustainable.

Instead our approach is to tackle the fundamental problem of too much rainfall runoff entering the sewerage system by retrofitting sustainable urban drainage systems to the existing network, making Llanelli

the first such reference site in the UK. We are investing £17million to remove about 25% of the surface water entering the network during heavy rainfall by 2015. We are also working with local planning authorities and regulators to facilitate economic development.

Fergus O'Brien,
Coastal Waters Manager

Safeguarding our Environment

WE COLLECT AND CLEAN THE WASTEWATER PRODUCED BY HOUSEHOLDS AND BUSINESSES ACROSS OUR REGION SO AS TO PROTECT PUBLIC HEALTH AND SAFEGUARD OUR RIVERS AND COASTAL WATERS FROM POLLUTION

25 km
of sewers
renewed

8/4 serious
pollution
incidents

£30 million
additional
investment

Operating our estate of ageing wastewater treatment works so that we protect our rivers and coastal waters – which are among the best in the UK – is one of our toughest jobs. In 2011, 22 of our more than 800 wastewater treatment works did not comply with the relevant numerical consent. On the measure of compliance against 'look up' tables, 99.72% of population equivalent was served by a compliant wastewater treatment works in 2011, down from 99.96% in 2010. Insufficient samples were taken at a further four works to demonstrate compliance. This is not a satisfactory performance and for Ofwat's serviceability assessment we have judged our performance on above ground wastewater assets for the year 2011 as 'marginal'.

Over the last 12 months we have 'fast tracked' a detailed turnaround plan, backed by an additional investment of £30 million, targeted at reducing the risk of failing compliance at the 47 most-at-risk works. This plan is progressing well and our performance to date in 2012 is better than in the same period last year - and we are on track to return our assessment for serviceability to 'stable'.

Continuing to renew and improve our wastewater treatment works estate will remain a priority for many years to come.

Following implementation of a wide ranging pollution reduction plan, we have reduced the total number of pollution incidents in 2011 to 246, down from 260 in 2010. There were just 4 serious pollution incidents in 2011 which was a marked improvement on previous years. Last year we self-reported 37% of all pollution incidents and have a target to increase this figure to 50% in 2012.

We continue to work hard to reduce the number of pollution incidents caused by blockages on our now much larger sewer network. Alongside upgrades and extensions to our 'early warning' telemetry system, initiatives in the year include teams of 'river rangers' who walk our sewers located close to watercourses and engaging with river users such as canoe and angling clubs.

We have also carried out a detailed analysis based on more than ten years of data to risk score our sewers based on material, size, condition, location and other criteria so as to better schedule proactive work such as sewer cleansing and reduce the risk of incidents. Key to reducing problems caused by blockages and other equipment failures is a fast response and last year our average response time was just over one hour.

We invested £32 million last year in maintaining and upgrading wastewater treatment works and during the year completed a number of schemes including Five Fords (Wrexham) and Denbigh. We are also currently on site or due to commence works at locations across our operating area, including Aberporth (Ceredigion), Narberth (Pembrokeshire) and Llanfoist (Monmouthshire). A further £6 million was invested in renewing 25km of sewers. In addition we invested £7million on private sewers and drains transferred to us in October 2011.

48

Blue Flag awards

Ensuring our treatment works and our sewer network safeguard our rivers and coastal waters from pollution is essential, not least because of the importance of our environment for the economy of our region. Wales, with only 15% of the British coastline, secured 48 Blue Flag awards – a third of the total awarded to all of the UK – for the 2012 summer season. All but one of the 88 EC designated beaches in Wales passed the mandatory European standard for coastal water quality in 2011. In addition, 53 Green Coast awards for rural beaches were won. As a result, the Marine Conservation Society has been able to recommend 121 Welsh beaches as having excellent water quality, 20% more than in the previous year and the most in Wales in the Good Beach Guide's 25 year history.

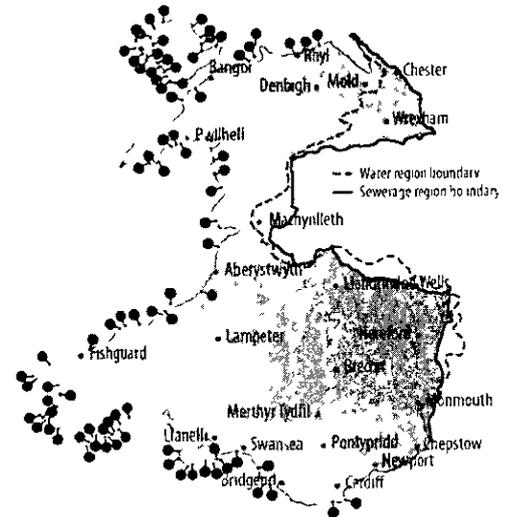
53

Green Coast Awards

The new Bathing Waters Directive introduces a new 'excellent' standard which is tighter than the current 'guideline' standard required in order to win a Blue Flag award and this, alongside new land based requirements, is expected to reduce the number of beaches that will be eligible for a Blue Flag in 2013.

We have also been working with the Environment Agency, Surfers Against Sewage and Pembrokeshire County Council to trial 'spill alerts' on three beaches in West Wales to make beach users aware of bathing water quality. This proved extremely popular and plans are now in place to extend the scheme in the year ahead.

Locations of award winning beaches



Wales continues to have some of the highest quality rivers in the UK and as well as protecting our rivers from pollution, we must also ensure that we abstract for public water supply no more than is necessary. Key to doing so is encouraging our customers to value the water we supply and use it efficiently and on our part to keep leakage under control and down to economic levels. Last year we more than recovered the sharp rise in leakage caused by the 2010 winter freeze and we achieved our target for the year, bringing leakage down to a lowest ever level.

1/2 leakage halved since 1990's

Since the 1990s, we have halved total leakage from our water supply network and this together with lower demand for water from heavy industry has led to a 25% reduction in the amount of water we abstract for public water supply. This apparently relatively strong water resource position has led once again to speculation about the scope for large scale water transfers from Wales to the South and East of England which following two very dry winters experienced drought.

Our position is that we do not, as things stand, have a surplus of water stored and available that could be exported easily for the benefit of both our customers and customers in those areas in England short of water. And with the prospect of significant reductions in our allowed river abstractions as a result of the Habitats Directive in the near term - and projections of much reduced river flows in the longer term as a result of climate change – our overall water resource position could deteriorate materially (see Looking Ahead). Building the new reservoirs and associated infrastructure that would be required for any large scale water transfer would require considerable economic and environmental justification

12% cut in carbon emissions

and would only make sense if there were no cheaper and less environmentally damaging options. While large scale, long distance water transfers might not be economic as things stand, sharing of water resources closer to our regional boundary is more likely to be and we are considering all available options with our neighbouring water companies as part of our own water resource planning for the next 25 years.

In order to maintain a healthy and sustainable water resource position, we continue to encourage sensible water use by our customers. Water efficiency is a core theme in our education programme and we promote water efficiency in other ways, including collaborative projects with the Environment Agency, the Welsh Government and the Energy Savings Trust as well as with social housing providers. Our 'Be Waterwise' communication campaign involves a series of initiatives highlighting the benefits associated with sensible water consumption.

Customers opting for meters have been offered 'Meter Welcome packs' containing water and energy saving retrofit products and advice and we have undertaken over



Carbon Reduction Company of the Year 2012 (Wales)

150 business customer water efficiency audits in the year and, where appropriate, supplied and retrofitted water saving devices. We have also implemented an incentivised winter pipe lagging and communication programme (targeting those customers affected by the harsh winter of 2010) and have retrofitted our own offices as part of a 'Do as I do' campaign.

Energy efficiency and reducing our carbon emissions continues as a priority for the business. Last year electricity imported from the national grid fell by 8%, while gas consumption reduced by 66%. As a result, carbon emissions fell by almost 35,000 tonnes (12%) driven largely by our renewable energy generation which doubled for the second consecutive year. Our new Advanced Anaerobic Digestion sites, installed at our wastewater treatment works in Cardiff and Afan (Port Talbot), convert wastewater sludge into electricity significantly reducing both carbon emissions and our energy costs.



Watch our film



CASE STUDY

Around 4,500 litres of wastewater is received at Cardiff wastewater treatment works every second of the day, rising to 6,000 litres at times of heavy rainfall. The works serve 300,000 homes and businesses and require a lot of energy to treat the volume of sewage and 'sludge' – the by-product of treated sewage. In September 2011, the First Minister, Carwyn Jones,

opened a new 'Anaerobic Digestion' plant at the Cardiff works. The plant harnesses the gas that is naturally produced in sewage and uses it to produce electricity for the works.

Prior to the opening of the processing plant, the works imported large amounts of gas and electricity. We now import 45% less electricity and 75% less gas for the site.

Along with a similar scheme at Afan (Port Talbot), these 'state of the art' plants now produce enough energy to power a town the size of Caernarfon, will save £7 million a year and will reduce our carbon emissions by 35,000 tonnes.

Rob Brown,
Generation Manager

Meeting Customer Expectations

WE CONTINUE TO IMPROVE THE DAY TO DAY SERVICE WE GIVE OUR CUSTOMERS.

90% customer satisfaction

These included setting much shorter target times for responding to sewer blockages and other network problems as well as offering more 'self-serve' options and better real time information for customers on our website. We now text customers when there is, for instance, a planned interruption to water supply or any other widespread problem to keep everyone informed and this has reduced the need for customers to call us to report a problem or ask what is happening.

A new and easy to follow bill layout – tested first with groups of customers – has contributed to the 22% reduction in customer calls and queries about the bill. By adopting new technologies we are now able to carry out planned work on our water network without interrupting supplies and last year only 116 customers experienced unplanned interruptions to supply lasting more than 6 hours which is one of the best performances in the sector and a marked improvement on the previous year when the winter freeze caused a high number of interruptions.

22% reduction in bill queries

Targeted investment meant that by the end of the year just 151 customers were at risk of receiving a low pressure water supply.

As a result of all these efforts alongside our customer first culture right across the business, customer satisfaction as measured by independent research has never been higher and now stands at 90%. The number of customer complaints has fallen by more than half and the number of written compliments has increased three-fold. Our customer satisfaction rating, as measured independently by the industry regulator Ofwat, was amongst the best in the sector with our billing team coming top for the second year in a row. Independent research with our largest business customers showed that 89% were satisfied with the service they get from Dŵr Cymru.

1/2 customer complaints halved

We are developing a range of new products and services for our larger business customers, helping them to become more water efficient through the provision of meter telemetry, water efficiency audits and the proactive detection and repair of leaks. We are also investing heavily to provide a better, web based service to property developers, following a successful Developers' Seminar with national developers, consultants and contractors. As a result, we have established joint working groups to review key issues such as the new mandatory build standard for sewers, sustainable urban drainage schemes and the forthcoming legal requirement to provide fire sprinklers in all new domestic properties in Wales.



Watch our film

CASE STUDY

Unexpected interruptions to our water supply can be frustrating and distressing for our customers, which is why we now proactively contact customers through text messages to mobile phones and automated voice messages to land lines to keep them informed of any incidents that may affect their supply.

This proactive approach has had a significant impact on call traffic. Historically, an incident such as a burst water main would generate calls from a significant proportion of affected customers.

Today, with prior warnings in place, we receive calls from far fewer. Overall, our call volumes have

reduced from 325,000 to 241,000 in 12 months. This is partly due to the milder weather conditions last year, but mass texting has also had a significant impact.

Employer of Choice

WE EMPLOY OVER 2,000 STAFF AND SUPPORT A FURTHER 1,500 JOBS IN OUR SUPPLY CHAIN TO ENSURE OUR VITAL PUBLIC SERVICES ARE MAINTAINED FOR OUR CUSTOMERS.

2,000
Staff

24/21 reportable
injuries



Responsible Company
of the Year 2012
(Runner-up, Wales)

Improving the safety and training of our workforce is crucial to our future success. The health and safety of everyone working for our Company is top of our agenda and last year on a like for like basis the number of reportable injuries fell from 24 to 21.

More encouraging was the further increase in near-miss reporting, a key indicator for a strong health and safety culture. A host of initiatives to improve the health of our staff and to reduce the risk of accidents were introduced successfully during the year including, for example, a bespoke programme of training on manual handling for more than 700 front line colleagues. We now include in our health and safety reporting much of our supply chain, which adds some 1,500 people to the 2,000 directly employed by the Company, and we now report our safety performance against this wider population.

We made real progress last year in developing our capabilities as an organisation. We have invested heavily in the training and development of our front-line operational colleagues gaining accreditation by City and Guilds for our water and waste water competent operator programmes. Our graduate and apprentice programmes are now well established, attracting high calibre individuals and are aligned to our succession plans.

A new science laboratory was established in north Wales and a much larger laboratory for South Wales will be commissioned by the end of 2012 which will not only deliver some £1 million in savings but also enhance our overall science capability. We also strengthened our leadership team with a number of key external appointments. Overall, as a result of the investment we have made in all these areas, we are today a more resilient and capable enterprise than we were a year ago.

We are starting to harness the benefits of our new Working Together Agreement, which we agreed with our trade unions last year. It provides good terms and conditions and employment security in return for employee flexibility. We are on track to achieve our cost efficiency targets and with new shift patterns we can now offer our customers evening and weekend appointments in the normal course. We have underpinned these changes with a customer service improvement training programme for our front-line employees.



Watch our film

CASE STUDY

To deliver the best possible service for our customers we require a large variety of skilled people covering a range of disciplines. We are dedicated to recruiting and developing our staff and creating employment opportunities for young people living in Wales.

Through our two-year graduate development programme we are focussed on building a pool of talented people to meet the needs of the business and also allowing new graduates to develop their knowledge and acquire skills in readiness for a permanent role with the company.

Our four year apprentice programme, which is part of the Welsh Government Apprenticeship Framework, gives apprentices the opportunity to learn their trades 'on-the-job' and allows us to develop a multi-skilled workforce.

Maria Siakovelli, Graduate

Community

WE ENCOURAGE VISITORS TO MAKE THE MOST OF OUR VISITOR CENTRES AND RESERVOIR SITES WHICH ATTRACT CLOSE TO A MILLION VISITORS EACH YEAR.

42,000
hectares
of land

We manage over 42,000 hectares of land situated in some of the most beautiful parts of Wales. At our larger reservoirs we offer a range of recreational activities including cycling, fishing, sailing, canoeing, wind-surfing and diving, as well as offering picnic areas, walks and nature trails. Three of our larger sites have visitor centres and we have submitted planning applications for a new visitor centre and water sports centre at Llandegfedd Reservoir, near Pontypool, and also for an extension to our visitor centre at Llyn Brenig to provide a cycling centre of excellence (as part of a Denbighshire-wide community project to encourage mountain biking).

Our reservoirs are looked after by a team of rangers dedicated to managing our facilities and the wildlife and special habitats that are in our care. The rangers also encourage visitors by hosting a range of activities including archaeological expeditions, stargazing evenings, fly-fishing courses, charity events and sponsored walks, boat trips, as well as guided nature walks and wildlife tracking.

1 million
visitors each year

All our main reservoirs have biodiversity management plans and we encourage conservation best practice across all our landholdings, including in the Elan Valley where a new nature reserve was created in 2010 at Dol-y-Mynach.

We continue to provide practical support for a number of conservation projects in our region, the largest example of which is the Anglesey and Llyn Fens LIFE project, a five year programme led by the Countryside Council for Wales, to bring 750 hectares of important wetland habitat into favourable or recovering condition.

We have a long established and very popular environmental education programme. In the last academic year some 14,200 school children visited one of our education centres located near Pontypridd (Cilfynydd), Barry (Cog Moors), on the Denbigh Moors (Alwen) and in the Elan Valley, and over 13,000 children received lessons

27,200
children participate in our
education programme

under an outreach programme in which our peripatetic teachers deliver water efficiency and safety lessons in schools and community groups. We also helped over 100 final year students from Newport University who spent four training days with our environmental education team.



CASE STUDY

Wales boasts some of the best rivers in the UK. We are committed to protecting our natural environment and have launched a campaign to encourage the public to contact us if they spot any evidence of sewer pollution in our rivers.

'See it, report it, stop it' was launched by TV wildlife presenter Iolo Williams and we are working with a variety of river sports clubs including canoeists, kayakers and fishermen to promote the campaign and freephone telephone number to report any potential pollution.

We have also developed a smart-phone app for the public to report sewage pollution, water leaks and odour issues and are introducing the 'See it, report it, stop it' initiative into our education programme with the aim of encouraging children to become 'Pollution Detectives'.

Looking Ahead

LAST YEAR WAS THE SECOND YEAR OF OUR AMP5 INVESTMENT PROGRAMME WHICH WILL SEE THE COMPANY INVEST A TOTAL OF £1.5 BILLION, INCLUDING £100 MILLION OF ACCELERATED INVESTMENT THAT WOULD OTHERWISE HAVE BEEN INCLUDED IN OUR PROGRAMME AFTER THE NEXT REGULATORY PRICE REVIEW IN 2014.

Our investment spend is prioritised to protect drinking water quality, safeguard our rivers and coastal waters from pollution, improve our cost efficiency and improve day to day customer service. Last year we invested £253 million (net of grants and financial contributions), split between water (£135 million) and wastewater (£118 million), and including over 180km of new water mains and schemes to reduce the risk of sewer flooding at 152 properties.

Looking ahead, one of the most important challenges we face is how best to strike a balance between the need for investment and affordability. We employ a network of assets that would cost £25 billion to replace, and just maintaining and repairing those assets so that they continue to do the job required could absorb our entire capital budget. However, standards continue to rise and European Directives are likely to have a significant impact on what is required of Dŵr Cymru with, in particular, the transition to the new Bathing Waters Directive (starting this year before it comes into full effect in 2015) and the Habitats Directive which is expected to lead to calls for significant reductions in our abstractions for public water supply from a number of sensitive rivers across Wales. This is in addition to the impact of climate change which is expected to lead to drier summers, impacting our water resource position, and more frequent high intensity storms, impacting our sewer network.

These pressures to achieve tighter environmental standards will require additional investment over and above

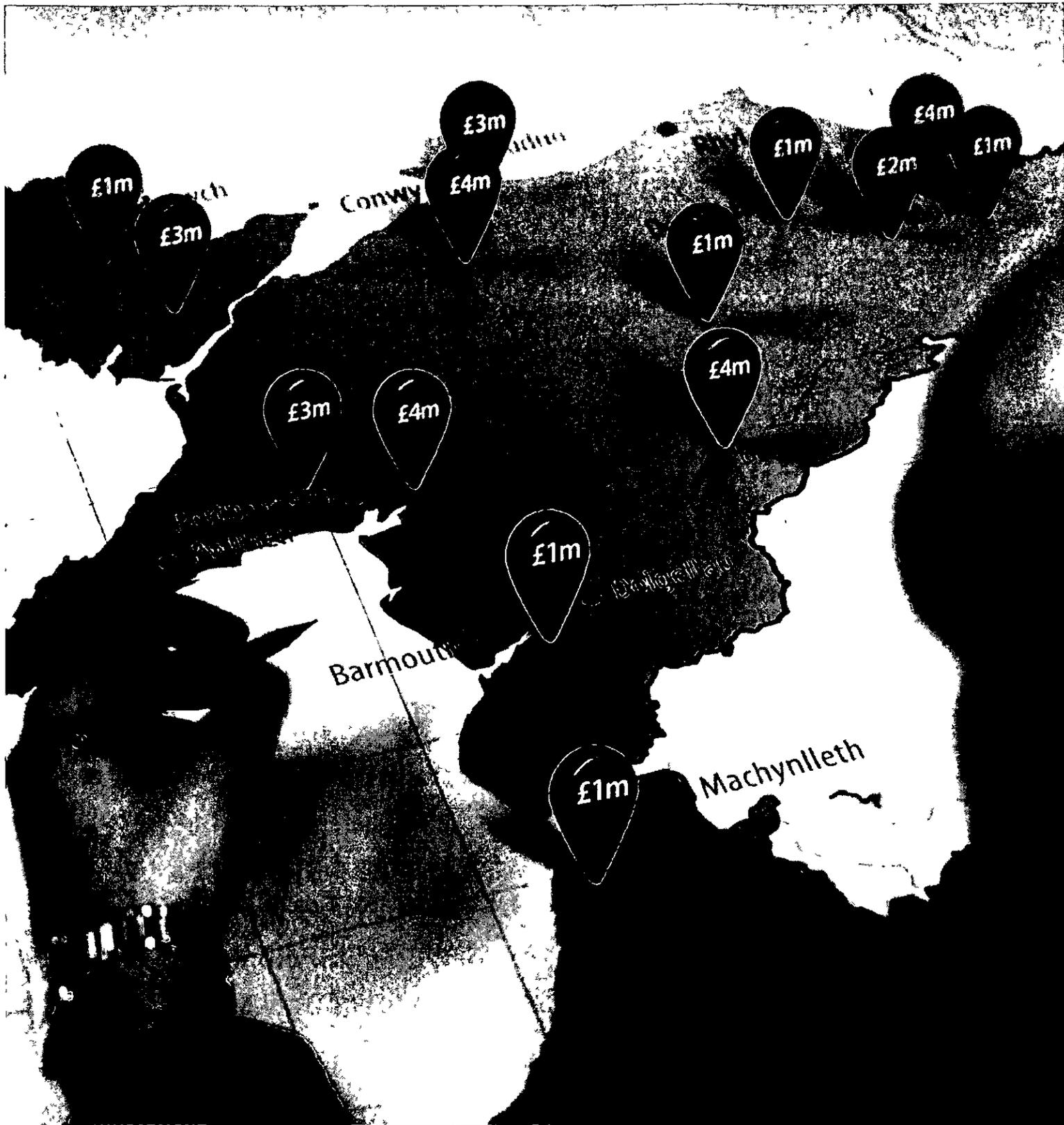
what is required to maintain the existing network and this in turn will put pressure on customer bills. Affordability matters a great deal particularly in our region where household incomes are lower with the result that some 30% of households spend 3% or more of household income on their water and sewerage bill, the second highest percentage in the sector. Some 44,000 of our least well off customers are currently benefitting from one of our social tariffs or our Customer Assistance Fund, a higher figure than for other water companies. Our goal is to secure for our 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 more important priorities.

We are better placed to secure this balance because of our particular business model and the fact that we have no competing priorities other than to deliver the best possible outcomes for our customers and the environment we look after. Since Glas Cymru acquired Dŵr Cymru in 2001 we have invested more than £2.5 billion on renewing and improving the assets we employ to deliver services to our customers and to protect our rivers and coastal waters from pollution.

We have also greatly improved the cost efficiency of our regulated operations in that time such that our operating costs are 8% lower today in real terms than they were in 2001, which is much the best track record in the sector. Financing efficiency is key and by having the strongest credit ratings in the UK utilities sector

we are able to raise long term finance from investors at low rates of interest. Our operating and financing efficiency together have allowed us to carry out high levels of investment while keeping our customer bills affordable – In 2015, Ofwat projects that our average household bill for both water and sewerage will be 6% lower in real terms compared to what it was in the year before Glas Cymru acquired Dŵr Cymru.

Considerable attention is currently being given by industry regulators and the Welsh Government and UK Governments, to the future challenges faced by the water industry and the potential role that market reform could play in meeting those challenges. Ofwat is consulting on its 'Future Price Limits' programme – wide ranging proposals that include separate price limits for 'retail' and 'wholesale', incentives for system management and water trading, more emphasis on longer term outcomes and customer endorsement of company plans and priorities. We are dedicated to looking after the water industry in our region on behalf of today's customers and future generations and we will always judge the proposed reforms in terms of the likely impact on our customers. We wholeheartedly support all efforts to put customers at the heart of regulation of the sector. Beyond that, the key test for us is that any changes 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, both now and into the future.



INVESTMENT

£1.5 billion
total investment
programme 2010/15

£253 million
invested last year

Performance Review

WE MADE REAL PROGRESS LAST YEAR ON MOST OF THE MEASURES THAT MATTER FOR OUR CUSTOMERS AND FOR THE ENVIRONMENT THAT WE LOOK AFTER ON BEHALF OF ALL THE COMMUNITIES WE SERVE.

We achieved a best ever performance on some and where performance fell short last year we have implemented turnaround plans, backed by investment, to secure the required improvements

The regulated water industry is particularly measurable which allows the Board to set targets for the business that are based on sector benchmarks and to judge where we stand compared with the best performers in the sector. We use a number of the key measures to make up our Performance Scorecard against which – alongside the achievement of cost efficiency targets – variable pay for every member of staff is calculated. Last year we achieved or beat the targets set by the Board for 15 of the 18 measures on our Performance Scorecard. This represents the best overall performance achieved by the Company in recent years.

Safe Drinking Water

Bacti compliance at WTW

2011	99.95%
2012	99.96% ✓

Reservoir Integrity Index

2011	99.97%
2012	99.97% ✓

Compliance with standard for iron at tap

2011	99.56%
2012	99.80% ✓

Mean Zonal Compliance

2011	99.97%
2012	99.96% ✓

Process Control Index

2011	100%
2012	99.96% ✓

Disinfection Index

2011	99.88%
2012	99.97% ✓

Water Quality Events - Level 3 and above

2011	17
2012	6 ✓

Safe Sanitation

Sewer flooding - Other causes

2011	136
2012	156 ✗

Sewer flooding - Hydraulic overload

2011	47
2012	30 ✓

At or better than target ✓ ✗

* In addition, insufficient samples were taken at four WwTWs to demonstrate compliance

Protecting the Environment

Leakage (MI/d)

2011	199
2012	185 ✓

Number of serious pollution incidents

2011	8
2012	4 ✓

Total number of pollution incidents

2011	260
2012	246 ✓

Population equivalent - WwTWs compliant with consent*

2011	99.96%
2012	99.72% ✗

Percentage of WwTWs compliant with numeric consent*

2011	97.14%
2012	96.27% ✗

Customer Service

Number of customers - loss of supply > 6hrs

2011	3,759
2012	116 ✓

Number of written complaints (stage 1 & 2)

2011	11,033
2012	4,660 ✓

Number of unwanted telephone calls

2011	432,101
2012	204,895 ✓

Customer Satisfaction (SIM Qualitative)

2011	4.26
2012	4.48 ✓

“ Our ambition is to deliver the best possible outcomes for our customers and the communities that we serve and to protect the environment that we look after on behalf of those communities. We also hope to show that the unique business model we have established for the water industry in our region is working for our customers. I am pleased to report that we have made significant progress in the year towards both of these objectives.

“ The Glas Cymru model means that our first priority is to our customers and to looking after our network of assets for future generations. We have been able to accelerate investment and do more for our customers while bills are falling in real terms. This both chimes with and reinforces Dŵr Cymru Welsh Water’s customer first culture.

“ While the Board is pleased with this progress, we have set targets for our business which demand that we achieve still higher standards and we will not be content until Dŵr Cymru leads the industry on all the measures that matter for our customers and for the environment we look after. ”

Robert Ayling, Chairman

Board of Directors



(1) Robert Ayling

Chairman ^{(N) (Chairman)}

Appointed a Non-Executive Director in April 2008, Robert became Chairman of Glas Cymru in July 2010. He is also Independent Chairman of HM Courts & Tribunals Service and Chairman of Dyson Limited. A solicitor by profession and with 20 years in the City of London and as a senior government legal adviser at the Department of Trade and Industry, he held a number of senior management positions at British Airways plc of which he was Group Managing Director and Chief Executive from 1993 to 2000. He is also a former Chairman of The International Dispute Resolution Centre Ltd, Sanctuary Group Plc and Holidaybreak plc and a Non Executive Director of Royal & Sun Alliance Insurance Group plc.

(2) Nigel Annett

Managing Director ^{(N) (MD)}

Appointed Managing Director in January 2005, Nigel 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 Dŵr Cymru between 1992 and 2000, prior to which he held various investment banking positions with Schroders, County Natwest and Wasserstein Perella.

(3) Chris Jones

Finance Director

Appointed Finance Director of Glas Cymru in April 2000 and of Dŵr Cymru in May 2001. Chris was previously Director of Regulation of Dŵr Cymru and South Wales Electricity Plc. Before joining Dŵr Cymru 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.

(4) Peter Perry

Operations Director ^(N)

Appointed Operations Director in July 2006, Peter 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 Dŵr Cymru and UUOS's water interests in Scotland and Ireland. Prior to joining UUOS he worked for Dŵr Cymru 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.

(5) John Bryant

Non-Executive Director and Senior Independent Director ^{(N) (S.I.D. Chairman)}

Appointed a Non-Executive Director in March 2001. John 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.

(6) Anthony Hobson

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

Appointed a Non Executive Director in February 2001, Anthony will stand down as a Director after the 2012 Annual General Meeting. He is the Chairman of The Sage Group plc and of Changing Faces, the leading UK disfigurement charity, and a non-executive director of Esure and of Dyson Limited. He was previously the Chairman of Northern Foods plc from 2005 to 2012 and the Group Finance Director of Legal & General Group plc from 1987 to 2001.

(7) Prof. Stephen Palmer

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

Appointed a Non-Executive Director in October 2009, Stephen is Professor of Epidemiology and Public Health at Cardiff University and chairs the Wales Chief Medical Officer's Health Protection Committee. From 2003-2010 he was 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 environment and health.

(8) Menna Richards

Non Executive Director ^{(N) (NED)}

Appointed a Non Executive Director in November 2010, Menna who was Director BBC Cymru Wales until February 2011, is a Non-Executive Director of Welsh National Opera, and she will join the board of the Principality Building Society later this year. She is Vice President of the Royal Welsh College of Music and Drama, and a member of the International Advisory Board of the Cardiff Business School. She is also Trustee of the ALOUD charity supporting the development of Only Men Aloud. Only Boys Aloud and Only Kids Aloud. Her previous executive roles include Controller BBC Cymru Wales, Managing Director, HTV Wales, and Director of Broadcasting HTV Group plc. Menna was awarded the OBE for services to broadcasting in 2010.

9

**(9) James Strachan**

Non Executive Director (NED Chairman)

Appointed a Non-Executive Director in June 2007 James is a Non-Executive Director of the Financial Services Authority, Towergate Insurance Limited, JP Morgan Asian Investment Trust PLC and Sarasin and Partners LLP, and he is Senior 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, Legal and General Group plc, Care UK plc and Social Finance Limited, a Board member of Ofgem (the energy regulator), chairman of the charity RNID and Managing Director of Merrill Lynch

(10) Anna Walker

Non Executive Director (NED)

Appointed a Non Executive Director in March 2011, Anna has a wealth of experience in customer service, policy making and regulation. She is Chair of the Office of Rail Regulation and she completed the independent report commissioned by government in 2008 into household water charging. Her former roles include Chief Executive of the Healthcare Commission (2004-2009), Director General – Land Use and Rural Affairs at DEFRA, Director General – Energy Group at DTI, and Deputy Director General at OfTel, the telecoms sector regulator. Anna, who was given a CB in 2003 for public service, is Chairman of the charity Young Epilepsy, and a former Non-Executive Director of Consumer Focus, the statutory consumer champion body

(11) John Warren

Non Executive Director (A Chairman Designate)(NED)

Appointed a Non Executive Director in May 2012, John is a qualified accountant with more than 25 years experience in finance roles and has extensive experience in chairing Audit Committees of major UK listed companies. Until his retirement in 2005, he was Group Finance Director for WH Smith PLC and, before that, United Biscuits PLC. He is currently the Senior Independent Director and Chairman of the Audit and Risk Committee at Spectris plc, and a Non Executive Director and Chairman of the Audit Committee for Rank Group PLC and Bovis Homes PLC

Membership of Board Committees**(N) Nominations****(A) Audit****(Q) Quality and Environment****(R) Remuneration****The Members**

A key role of the Members of Glas Cymru is to ensure that the business remains focused on its primary purpose of providing efficient high quality water and sewerage services to Dŵr Cymru'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 Dwr Cymru.

Membership is personal, and 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.

There are presently 72 independent Members of Glas Cymru. This includes 12 Members who were appointed in 2001 and who will stand down after the 2012 AGM, and 19 Members who were re-appointed earlier in 2012 for a second or final three year period. Under the Company's Articles of Association, each Director of Glas Cymru is also a Member while they hold office as a Director.

A list of the independent Members of Glas Cymru, together with our Membership Policy and the 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.

Financial Review

Glas Cymru Cyfyngedig is the holding company for the Glas Cymru Group and parent of the operational company Dŵr Cymru Cyfyngedig

Dŵr Cymru has delivered a strong financial performance during the year to 31 March 2012 cash flows, gearing and credit ratings have all improved in spite of continued economic uncertainty. Achievement of Ofwat's Final Determination targets for the regulatory period to 31 March 2015 is a big challenge, in response to which we recently restructured our business operations, resulting in improved operational efficiency.

Revenue

Dŵr Cymru's turnover in the year to 31 March 2012 was £695 million (2011 £677 million), primarily reflecting the price increase of 3.4%, which was the lowest in the sector. Additional revenue from new customers has been offset by household customers switching to metered charging. The number of customers signed up to our sector-leading range of customer assistance tariffs has continued to increase. As at 31 March 2012 some 44,000 were benefiting from one of these tariffs or our Customer Assistance Fund - which support those who have difficulty paying their bills - at an annual cost to the Company of £4 million.

Operating costs

Dŵr Cymru incurred total operational costs (excluding IRE and depreciation) of £273 million (2011 £265 million), with inflationary increases and costs associated with the private drains and sewers transfer being offset by efficiency savings - excluding private sewers and non-regulated activities we have delivered a real terms (before RPI inflation) operating cost reduction of some 3%. Ofwat's Final Determination challenged Dŵr Cymru to reduce its day-to-day operating costs by some 20%, we are making good progress to meet this target, which enables the forecast average household bill to fall by more than £30 in real terms over the five years to 2015.

All water and sewerage companies need to draw on significant energy resources, particularly for water treatment and pumping processes, and Dŵr Cymru - with its network spread across Wales's undulating topography - is no exception. Schemes to produce renewable energy from sewage sludge have been commissioned at Cardiff and Port Talbot wastewater treatment

works (as part of a £75 million anaerobic digestion programme) with enough energy being generated onsite to power 8,000 houses. Power costs during 2011/12 remained stable at £34 million (2011 £34 million), the £3 million impact of the first year of the CRC Efficiency Scheme has been offset by the increase in our onsite generation. There remains significant uncertainty over future energy costs, and we have forward purchased around 70% of the estimated power requirements of the business over the remainder of the regulatory period to 31 March 2015.

Customer debt recovery remained a high priority for Dŵr Cymru. 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 £27 million (2011 £22 million) represents 3.9% of annual turnover (2011 3.2%) and reflects a review of historical collection rates.

Infrastructure renewals expenditure

Expenditure on infrastructure renewals (IRE) has doubled on the prior year, rising from £40 million to £81 million - the higher figure reflects a greater focus on maintenance in year two of the Company's AMP5 capital investment programme (2010-2015).

There has been significant catch-up in the mains in poor condition programme and a greater number of sewer rehabilitation schemes. Leakage activities directed towards meeting our leakage target set by Ofwat cost £6 million, while private sewer-related expenditure amounted to a further £2 million.

Financing costs

Net interest payable (excluding loss on derivatives) of £185 million was £15 million higher than last year. This is predominantly the effect of a £14 million accounting profit recognised in the previous year on termination of finance leases. Retail prices index (RPI) inflation remained relatively stable on the reference dates applying to the indexation charge on our index-linked bond and finance lease inflation swaps. The average cost of debt during the period was 6.9% (2011 6.4%).

Dŵr Cymru has a number of derivative 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. Changes in market values can create volatility in the income statement and fair value losses in 2011/12 amounted to £138 million (2011 gains of £12 million). There is, however, no impact on cash flows. The Company intends to hold these swaps to the maturity of the underlying debt and, over the life of the swaps, such gains and losses will revert to zero.

Loss before taxation

The consolidated income statement reports a loss before taxation of £131 million (2011 profit of £70 million). Excluding the fair value movements discussed above, the profit before tax was £7 million (2011 £58 million). This underlying profit was made after funding a 1% real-terms reduction in customer bills and reflects in particular the higher level of investment in IRE during the year.

Taxation

The total taxation credit for the year is £33 million. The deferred tax credit arising in the year was £35 million. There was also a £24 million deferred tax credit due to the corporation tax rate reduction from 26% to 24%. In future years and a prior year deferred tax charge of £30 million relating primarily to the deferred tax treatment of finance leases.

The group has tax trading losses carried forward of approximately £400 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 changes in tax law.

Pension funding

The statement of comprehensive income reports pension scheme actuarial losses in the year of £26 million and a balance sheet liability of £32 million. However, this is on an IAS 19 basis for accounting purposes and is not consistent with the actuarial valuation of the scheme for funding purposes. The latest such valuation of the scheme, as at 31 March 2011, showed that it was 98% funded with a projected deficit of £5 million.

The sensitivity of the IAS 19 valuation to small changes in interest rate assumptions has

increased considerably following the in-sourcing of the major operational contracts in 2010/11 and some 800 employees opting to transfer their past service benefits into the scheme. If the discount rate were to change by 0.1%, the balance sheet obligation as at 31 March 2012 would increase or reduce by £6 million (2011: £5 million).

Liquidity and financial reserves

Dŵr Cymru aims to offer a secure, low risk investment to investors. By building and maintaining a strong financial position, we intend to keep our borrowing costs low, enabling us to finance future investment efficiently whilst maintaining affordability for our customers.

On Glas Cymru's acquisition of Dŵr Cymru in May 2001, gearing stood at 93%. Since then, the financial position has improved steadily, such that gearing had fallen to 65% by 31 March 2012 and 'financial reserves' (RCV less net debt) were £1.5 billion.

On 6 July 2011 Dŵr Cymru (Financing) Limited issued £120 million B6 series index-linked bonds with a maturity date of 2048 (as a tap of the £140 million existing B6 issue) to provide funding for Dŵr Cymru's AMP5 investment programme. The Company redeemed the last of its junior (Class C) bonds during 2010/11, and the £2.7 billion of remaining debt comprises entirely of 'A' rated Class A and B senior debt.

On 15 September 2011, Dŵr Cymru (Financing) Limited drew down £25 million of a £100 million facility with the European Investment Bank.

As at 31 March 2012 the Company had total available liquidity of £516 million, including cash balances of £301 million, with funding in place for the remainder of the current regulatory period which runs to 2015.

Credit ratings and interest rate management

Dŵr Cymru has the strongest credit ratings in the water sector, reflecting the group's high level of creditworthiness. The ratings of the Company's Class A and B debt at 31 March 2012 were A/A3/A from Standard & Poor's (S&P), Moody's and Fitch Ratings.

The Board has always adopted prudent financial policies, predominantly covering the fixing of interest rates and the investment of cash balances. Dŵr 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 Dŵr Cymru'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 Dŵr Cymru meets the requirements of its licence, and therefore undertakes no speculative trading.

As at 31 March 2012, approximately 65% of gross debt was index-linked via bonds and derivatives (2011: 63%), with the remainder 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

Dŵr Cymru's strong financial position has been built up over the last 11 years, and provides a stable base from which it can respond positively to the challenges of the economic recession and drive forward its continuing large capital programme.

Dŵr Cymru works with an alliance of capital investment partners to deliver the investment programme at the best value for money for customers. Dŵr Cymru is planning to invest some £1.5 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 Dŵr Cymru during the year (including IRE) was £262 million, bringing total investment during the AMP period to date to over £500 million. The group plans to invest a further £1 billion over the course of the next three years, one of our largest ever investment programmes.

Private Sewers

On 1 October 2011 Dŵr Cymru Cyfyngedig assumed responsibility for managing the private drains and sewers in its operational area, potentially doubling the size of the network. Little information is available to judge the condition of these assets – and any attributable

value – but they are typically expected to be poor and below the standard of assets that the industry is generally required to operate. In light of this, and the fact that they do not generate an increase in the regulatory capital value of the business, no value has been attributed to private drains and sewers in the balance sheet as at 31 March 2012. During the year, Dŵr Cymru incurred associated costs of £6.9 million, of which £3.3 million formed part of the capital investment programme while the remaining £3.6 million were classified as operating expenditure.

Regulatory arrangements have yet to be finalised with regard to the recovery of additional expenditure associated with this transfer. The treatment is expected to be via existing regulatory methods, at the 2014 price review or an earlier interim determination of the price control. As far as possible, it is expected that the performance of these new assets will be ring-fenced so as not to distort the assessment of the underlying performance of the business.

Looking ahead

A key part of our strategy is to maintain the affordability of customer bills in the long term while at the same time maintaining the serviceability of the Company's network of water and wastewater assets which have a replacement value of over £25 billion. The Company remains prudently financed with gearing at 65% and good liquidity in these uncertain times. The Board considers that the current level of gearing will enable the Company to efficiently fund the AMP5 investment programme to 2015.

Ofwat has set us an efficiency target of some 20 per cent in our day to day running costs. In addition to a 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 many of the previously outsourced services, and by investing in green energy and processes to reduce power costs. This involves considerable investment by the Company and forms part of our planned £1.5 billion investment programme to improve services.

In the face of these major challenges, our priority will remain the essential task of guaranteeing safe and reliable services for all our customers as well as safeguarding the environment, at an affordable cost.

Report of the Directors' and Corporate Governance

In this first part of our report we describe our business model and strategy, our regulatory and operating environment, our investment programme and priorities for the AMP5 period (2010-2015), and the key business risks that we face. We then provide a description of our corporate governance arrangements and the statutory information required by the Companies Act 2006.

References are made in this report to Glas Cymru – which is the holding company of the Glas Cymru group, and to Dŵr Cymru (Dwr Cymru Cyfyngedig) – our principal trading company. We also refer to Dŵr Cymru Financing Limited, the 'issuer' company of the group's bonds. The 2012 Annual Report (including this Directors' Report) has been prepared for the Members of Glas Cymru. It contains information of a forward looking nature with respect to the future business prospects and strategies of the Glas Cymru group which has been provided by the Directors in good faith using knowledge and information available up to the date of this report. This report also contains forward-looking statements which involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

We are a water company run solely for the benefit of our customers. Our business model is designed to deliver high quality drinking water and sewerage services to Dŵr Cymru's customers at the lowest sustainable cost – with no profits being distributed to equity shareholders. Our model has two distinct features in that (i) all financial surpluses are retained or reinvested for the benefit of Dwr Cymru's customers, and (ii) the Company's assets and capital investment programme are wholly financed by bonds, loans and retained financial surpluses. To best achieve our business goals Glas Cymru was established as a company 'limited by guarantee'. Glas Cymru has owned Dwr Cymru (the 6th largest of the UK's privatised water and sewerage companies) since May 2001.

Our role is to provide a safe and reliable supply of drinking water and deal with the wastewater generated by over 3 million people living and working in Wales and adjoining parts of England. Through these services we fulfil a vital role in protecting public health and the natural environment. Dŵr Cymru employs some 2,050 staff, owns around 42,000 hectares of land and operates one of the largest networks of long-life assets in the industry to supply some 827 megalitres (Ml) of treated water and remove and treat 570Ml of wastewater every day. Our assets have an aggregate written down replacement cost of £25 billion (excluding the recently transferred private sewer network), or equivalent to over £20,000 per household customer.

We are 'custodians' of the water industry in our region for today's customers and future generations.

Our business model commits us to operate as a single-purpose business (we do not diversify into unrelated activities) and it is designed to ensure that every decision we make promotes the delivery of high quality and reliable drinking water and sewerage services at an affordable price.

To achieve this purpose, our business model has a number of consistent objectives:

- » **Safe drinking water and safe sanitation**
The water and sewerage services we supply are essential to protect public health and the environment, so our goal is to deliver uninterrupted services that meet the highest standards.
- » **Excellent customer service** ⁽¹⁾ Everyone who works for us knows that we operate our business on behalf of our customers. This means consistently hitting performance targets and getting things right first time/ every time, delivering services that are uncomplicated and which meet the needs of our customers, and being proactive to do the right thing for our customers.

- » **Efficient operation** ⁽²⁾ We strive to use all our resources more efficiently every year. This means continuous improvement in the way we carry out our activities including targeted initiatives to lower our operational costs in real terms (subject to any significant new obligations), improve efficiency, deliver value for money in the supply chain, and develop our people to meet their full potential. It also means optimising the amount of green energy we can generate and minimising the impact of our business on the environment.

Our efficiency is constantly monitored. At its peak 80% of our total operating costs were subject to competitively tendered arrangements, including the operation and maintenance of our water and sewerage assets which we insured in 2010. Last year, to improve our efficiency and reliability of service, we insured sampling and network and development services and put in place in-house arrangements for the direct provision of laboratory services. We continue to outsource the delivery of capital investment and maintenance services, customer billing and income services and the management of our IT systems and data network services.

- » **Efficient financing** ⁽³⁾ Our business model is founded on giving bond investors a low risk and secure long term investment. This is important as the cost of finance accounts for around one third of the average household bill across the sector – which means a 1% increase in the cost of capital can add 5% to bills. A high credit rating is a key factor to keeping customer bills affordable, and information on our strategy for financing and credit rating can be found in the Financial Review.

⁽¹⁾ Ofwat surveys in 2011/12 have confirmed that 90% of customers are fairly or very satisfied with the service we provide which places us third in the industry on this key independent measure.

⁽²⁾ We are on track to deliver the £39 million operating cost efficiency target we set for the end of AMP5 period.

⁽³⁾ We have the best credit rating in the sector and in the past two years we have raised over £360 million at amongst the lowest interest rates ever achieved by a UK utility company.

Report of the Directors' and Corporate Governance

» **Strong relationships** ⁽⁴¹⁾ To succeed, we must have a constructive and open relationship with everyone we work with. Strong relationships with our regulators, with our staff and the trade unions, with our capital and supply chain partners, with our customers and those who represent their interests and with the many public health and environmental bodies who share our objectives are underpinned by regular communication in writing and in person.

» **Transparent and high standards of governance** ⁽⁴²⁾ We are a private company but we comply with the UK Corporate Governance Code that sets the standard for good governance practice for UK listed companies. We have a very experienced Board with a diverse range of skills and experiences, and the Board is held to account for our stewardship of the business by the Members of Glas Cymru, individuals appointed by an independent panel, who meet the Board in person at two Members Meetings each year.

» **Essential services provided at an affordable price** ⁽⁴³⁾ As a company owned on behalf of customers, and operating in a region where household incomes are generally lower than average for the UK, our business objectives have to be balanced with affordability (i.e. the impact on the customer's bill). This will always be a major consideration for us.

Our performance is subject to extensive monitoring by regulators and government. Each year, regulators publish reports that compare our performance against that of other regulated water companies across a wide range of measures, including water and environmental quality, customer service, affordability, and cost efficiency. The ability of the Board to benchmark our performance against independent regulatory data is a key feature in our business model.

The role of Ofwat (our economic regulator) is to set price limits for customer bills so they are no higher than they need to be. It does this by assessing the operating costs and investment we need to maintain our network of assets to meet the required standards and to deliver high quality services to customers. Ofwat also has a duty to promote the interests of customers by incentivising efficiency and good service and penalising inefficiency and poor service.

Since privatisation, price limits have been set through a process of regulatory review every five years. Under the UK Government's White Paper this would change at the next price review, in 2014, which would set prices and investment levels for the regulatory period 2015-2020 ('AMP6'). This could see the introduction of separate price limits for 'wholesale' and 'retail' activities and give some business customers the option to choose their retailer.

The Consumer Council for Water ('CCWater - Wales') is the independent body established to represent the interests of customers. It investigates complaints, champions customer concerns, and audits our more general performance on customer service, as well as influencing policy. We greatly value having an independent voice for customers in Wales.

The Welsh Government sets the framework for public policy matters for Wales, including policy on water and the environment. Drinking water quality is regulated and monitored by the Drinking Water Inspectorate and the Environment Agency regulates our environmental performance, especially the way we abstract water from rivers and reservoirs and then discharge wastewater after it has been cleaned. The Countryside Council for Wales (and, in England, Natural England) oversees our management of designated sites for nature conservation and how we conserve and improve biodiversity.

The new Natural Resources Body for Wales will bring together the Countryside Council for Wales and the functions of the Environment Agency and Forestry Commission in Wales. From 1 April 2013 it will take over the roles of the Environment Agency and the Countryside Council for Wales, and will also have a key role in providing essential advice and guidance to the Welsh Government.

During 2012, we are expecting the Welsh Government to publish an update to its Strategic Policy Position Statement on Water 2011. We support the core principles of this, which seek to ensure 'access to safe drinking water, maintaining water and sewerage services at an affordable price and compliance with statutory obligations that drive all round water quality', and the stated environment strategy outcomes, namely that:

- » the high quality of our drinking water is maintained,
- » water resources are managed sustainably meeting the needs of society without causing damage to the environment,
- » water is used more efficiently across all sectors,
- » the quality of our groundwater, rivers, lakes and coastal waters is maintained and enhanced, and
- » diffuse pollution is better understood and action is taken to reduce and manage diffuse pollution.

⁽⁴¹⁾ An example of our open approach to partnering with third party organisations is the Water Health Partnership for Wales.

⁽⁴²⁾ Our Members are critical friends – they provide a level of informed scrutiny and challenge that few (if any) of the UK's listed companies could match – around 70% of all Members attend each Members meeting.

⁽⁴³⁾ We give extra help to some of our most vulnerable customers through a range of assistance tariffs and a Customer Assistance Fund which now benefit some 44,000 households – more than any other company.

Report of the Directors' and Corporate Governance

In 2012/13 we will invest around £310 million to maintain or enhance our network of assets. Our capital investment programme is a significant element of the total construction industry investment in Wales. In the first two years of AMP5, we have invested around £500 million to maintain and enhance the assets we rely on to deliver the high levels of water quality and environmental compliance and service our customers expect. Over the next three years, we will be investing around £1 billion to further improve the reliability and performance of our assets, one of the largest investment programmes we have ever delivered.

Notwithstanding this high level of investment by the end of the AMP5 period the average bill for a water and sewerage customer has been forecast to fall by £30 per household in real terms. To achieve this we have put in place plans to significantly reduce our operating costs, and we are on track to reduce the costs we can directly manage or influence by around 20% by the end of the period. At the same time, we must maintain or improve our performance to meet the 'serviceability' targets set out in the Final Determination, which are also very challenging.

There are 20 of these measures over four service areas – and if we do not meet them, this could in some circumstances lead to financial penalties at the time of the next price review.

Under our plans for the AMP5 period we will

- » upgrade or renew facilities at 26 water treatment works (WTWs) to deal with deteriorating source water quality and other risks,
- » protect river and coastal water quality by delivering a significant reduction in sewer flooding and pollution incidents caused by breakdowns on our sewer network,
- » commission advanced sludge digestion schemes to increase our capacity to generate green energy and to significantly reduce our carbon footprint by 2015,
- » adopt more sustainable urban drainage schemes to reduce the number of spills from our assets to the environment and the risk of flooding from overloaded sewers,

	2012 (£m)	2011 (£m)		2012 (£m)	2011 (£m)
Water			Wastewater		
WTW improvement	28	41	WwTW improvement	27	12
Emergency planning/security	4	4	Intermittent discharges	14	13
Reducing leakage	14	12	Sewer maintenance	16	11
Asset maintenance	66	35	Wastewater asset maintenance	30	18
Drought mitigation	-	5	Sewer flooding	9	4
Metering	4	5	Advanced digestion	4	31
New developments	1	1	New developments	1	1
System development – IT	7	7	Systems development – IT	8	7
Other	11	10	Other	9	11
Total Water	135	120	Total	118	108
Total Wastewater	118	108			
Total investment	£253	£228			

The above shows that we are on track to deliver the AMP5 investment programme

- » address affordability by offering one of the widest ranges of tariffs and schemes available in the industry to help our least well-off customers, and
- » use the technology delivered by our £85 million AMP4 programme of IT-enabled change to improve customer service by giving first time resolution to day-to-day customer service issues and generally making Dŵr Cymru an easier company to do business with.

At the end of year 2 of AMP5 we have made good progress in meeting these goals, and only three schemes were delayed by either planning or security issues. However, we still have more to do to improve our overall environmental performance.

Output headlines for 2011/12 include

- » completion of regulatory improvements at 5 WTWs,
- » 183km of poor condition water main replaced (target 174km),
- » 9 of 11 scheduled schemes completed under Security and Emergency Measures Directive,
- » 8 of 9 scheduled wastewater schemes completed,
- » 25km of sewer rehabilitation (target 20km), and
- » the risk of sewer flooding alleviated at 152 premises (target 138)

The Board has also approved additional investment of over £100 million to improve the operation and reduce compliance risk at our WTWs, and to increase our capacity to generate 'green energy'.

Within the capital investment programme new framework agreements have been put in place for major civils, pressurised pipelines, security and emergency measures and automation which have delivered significant supply chain efficiencies – typically of 6-12% on the larger frameworks.

Managing Risk

It is essential that we manage risk effectively in order to deliver high quality and efficient services to customers

Most risks can be mitigated by ensuring that appropriate controls are in place, but there are many matters which could have a material effect on our long-term performance that are outside our control. No company is insulated from the impact of economic recession, climate change or of a changing regulatory environment. The Board therefore commits significant time to review policies and corporate and operational strategies to mitigate risk. Some of these risks are specific to Dwr Cymru or arise as a result of our unique business model, and others affect all companies in the sector but have a specific resonance for Dwr Cymru.

Company Specific Risks In the past year Board discussion focused on the significant level of organisational and cultural change that followed our decision to bring back in-house the operation and maintenance of Dwr Cymru's network of assets. This has meant creating a single business where there were previously three, and in particular establishing a new management structure and a single set of HR policies for our staff. We have done this at the same time as we are introducing major changes to our IT and operational systems - which have fundamentally changed our working practices - and in a regulatory period in which we have the toughest efficiency challenge in the sector. These changes (which include much greater mobile working) have provided opportunity to refocus all aspects of what we do as a performance led and customer focused business. We also had some specific operational challenges to address in 2011/12 including, in particular, the need to achieve our leakage target.

Sectors Risks risks that affect all water companies to a greater or lesser extent include operational, financial and regulatory risk.

Operational risks typically arise from greater variability in weather conditions, which can freeze operational assets or create rapid changes in temperature or flows through our network which cause essential equipment to fail.

Any extreme weather - hot, cold, dry or wet - can also increase occupational health and safety risk. These risks are material for companies in the sector like Dwr Cymru who have a disproportionately large number of operational assets - treatment works, pumping stations and service reservoirs - many of which are very small (which makes them especially vulnerable to changes in temperature and flow) and/or are located in remote rural areas (which can make them difficult to get to - for delivery of essential supplies or maintenance purposes).

Drought can impact on our ability to maintain services to customers as the amount of water we can abstract is tightly controlled (with little headroom), which means that we are potentially as vulnerable as any other water company to variable weather conditions.

We are also seeing an emerging risk associated with theft of copper and other metals which are causing risks directly to the operation of our works and indirectly through risk of interruption to communications networks and power supply.

Financial Risks are generally heightened at times of economic uncertainty and this is kept under regular Board review. Affordability has never been more important, particularly in the region we serve, where some 30% of households spend more than 3% of their disposable income on their water bill. Even though we have lowest bill increase in the sector and by 2015 our average combined bill will be 6% lower in real terms than in the year before Glas Cymru acquired Dwr Cymru, and are helping some 44,000 customers through our social tariffs, cash collection is becoming harder and bad debt is rising. We are also exposed to rising commodity prices, especially power costs which are around 13% of our total operating expenditure. We are mitigating this risk by appropriate cost hedging and forward purchasing of power and by maximising the green energy we can generate from our operations, which doubled last year.

Access to capital markets is also a risk during this period of regulatory uncertainty, as rating agencies report that structural changes could affect the sector's ratings and its cost of capital. This is mitigated for Dwr Cymru at least in the short term as we have strong financial liquidity and we have secured the funding for our capital investment programme at least to the end of the AMP5 period.

Regulatory Risk arises in two main areas in connection with proposals for future market reform in the water industry, and with the continuing pressure on all water companies to adopt new and tighter standards of compliance, especially for the environment.

The DEFRA 'white paper' (Water for Life) sets out some of the key challenges facing the industry in the years to come and it proposes a number of responses which together could lead to significant changes in the structure of the regulated water industry in England, including for example the possibility of allowing new market entrants to put treated water into existing water supply networks. The extent to which similar changes will affect the legal framework for the water industry in Wales is not yet known, but is likely to be clearer once the Welsh Government has published its updated Strategic Policy Position Statement on Water later this year. In addition, Ofwat plans to consult on the methodology for the next price review in the autumn of 2012. It is expected that certain changes will be proposed, including two price limits, one for retail and one for wholesale.

Our concern with new standards of compliance is that these will put upward pressure on costs which cause customer bills to rise or 'squeeze out' much needed investment to maintain and renew our existing network of assets, thereby increasing the risk of non-compliance with existing standards. It also reduces funds available to tackle other priorities - like reducing the risk of sewer flooding and providing the infrastructure needed to support economic development.

Managing Risks

Our view is that it is at least as important to the water environment in our region that we make sure our existing network of sewerage and wastewater assets does its job reliably and well. This is a big challenge (before consideration of any new obligations) because in the AMP5 regulatory settlement we have been funded to spend around £30 million a year to replace 25-30km of sewer – a rate of renewal that implies that our sewers will last for 700 years, whereas the average ‘engineering life’ may be nearer 100 years.

Our focus in this period of regulatory uncertainty is to ensure that, when they are discussing changes in structure or new standards of compliance, politicians and regulators have the information they need to consider the ‘trade-offs’ so that the best possible outcomes for customers can be agreed. We will then engage with our customers to explain what will be delivered – and, just as important, what will not – and what it will mean for service standards and bills.

A good example of changing compliance standards is the new EC Bathing Water Directive, which will come into effect in 2013. This will introduce a new and much tighter ‘excellent’ standard for bathing water quality, which will be required for the award of a Blue Flag, and will likely see bathing water compliance fall from 89% this year against the current ‘guideline’ standard (which compares to an average of 79% in England) to nearer 60% against the new ‘excellent’ standard.

Another regulatory risk arises because Ofwat’s Final Determination for Dŵr Cymru in AMP5 is one of the most challenging since privatisation – we have the toughest cost efficiency targets in the sector, despite having the best record for efficiency improvements since 2001. Furthermore, Ofwat’s cost assumptions for the sector were based on benign economic conditions in which, for example, bad debts were assumed to be no higher than they were in 2008/09.

The assumed rate of renewal of our ageing network of water and sewerage assets also has implications when Ofwat assesses our performance against the 20 measures of ‘serviceability’ – any one of which, if not met, could lead to a financial penalty at the time of the next price review in some circumstances.

Finally, in last year’s annual report we flagged the transfer of private sewers as a key risk, which in October 2011 significantly increased the length of our sewer network, adding sewers about which we have very little information as to location or condition. Notwithstanding this, the mitigation arrangements and resources we put in place have worked well and the private sewer network has been absorbed with minimal impact on our overall service to customers.

However, the workload associated with these sewers has been significant and is increasing, with more blockage clearance jobs now occurring on the former private sewers than on the public sewer network. There also remains a continuing risk as we plan ahead to the next price review and assess, given the limited information available, the future investment needed to maintain service standards to customers served by these previously private assets.

Corporate Governance

We take decisions in the long term interests of the customers of Dŵr Cymru, and this objective underpins our whole approach to corporate governance

We comply with all the provisions of The UK Governance Code that apply to a company limited by guarantee and the following information, which is referred to in this report, is available on our website www.dwrcymru.com/governance

- 1 Schedule of matters reserved for decision by the Board,
- 2 Terms of reference of the Nominations Committee,
- 3 Terms of reference of the Audit Committee
- 4 Terms of reference of the Remuneration Committee, and
- 5 Terms of reference of the Quality and Environment Committee

1 A report from the Chairman on the effectiveness of the Board

The Board of Glas Cymru currently comprises eleven Directors (including three Executive Directors) and we are collectively responsible for the long term success of the company. My role as Chairman is to ensure that the Board operates effectively to set the strategic aims of the business, to ensure that resources are in place to meet these aims, and to review management performance and key risks. This means ensuring each Director has sufficient information to make informed judgements, that matters are fully debated, and that constructive relationships are maintained within the Board and with key stakeholders. I routinely meet with the Managing Director who - supported by an executive team comprising the Finance Director, the Operations Director, and seven other senior managers - is responsible for the day-to-day management of the business.

We look to the Non-Executive Directors to use their skills and experience to scrutinise the performance of management in meeting our business objectives, to challenge and to help develop key aspects of strategy, and to monitor the integrity of our financial information and the robustness of systems of internal control and risk management.

I routinely meet privately with the Senior Independent Director and the Non-Executive Directors and I consider all our Non-Executive Directors to be independent of the company, and one another, and to have sufficient time to fulfil his or her role effectively.

In 2011/12, the Board met nine times, with six meetings held over two days. This gives the Board the time it needs to review progress against strategic objectives and to meet key business managers and, supplemented by visits to operational assets and meetings with regulators and advisors, to continually update our knowledge of the business. In the past year, topic specific meetings have focused on aspects of sustainability - succession and talent development of our people, and our energy use and capacity to generate green energy, our supply chain, improving customer service in front line delivery of water and sewerage services and in the operational control and contact centre, and changes in the regulatory environment ahead of the next price review.

We meet with our regulators to hear first hand their view of Dŵr Cymru's performance. The Chief Executive of Ofwat attended the Board in March 2012, we met the Chief Inspector of the Drinking Water Inspectorate when she attended a meeting of the Quality and Environment Committee in July 2011, and the Environment Agency Director-Wales attended the Board in June 2012.

Since their appointment to the Board in 2010/11, Menna Richards and Anna Walker have committed significant additional time to visit operational sites and meet key managers to familiarise them with the business, our risks and challenges, and the economic, competitive, and regulatory environment we operate in. The Board also has a process of continuous learning and, for example, I joined fellow Directors to receive an independent presentation from Dr Andrew Hughes of WS Atkins on reservoir monitoring and safety, which is a key issue for our business.

We are committed to promoting diversity, non-discrimination, and equality of opportunity in the way we treat employees and prospective employees, visitors, clients, customers and suppliers.

With regard to having an appropriate level of representation from women, we are making good progress toward meeting the objectives of the Davies Report. Currently, the Board includes two women directors and 20% of the first reports to one of the Executive Directors and 30% of Dŵr Cymru's wider Leadership Team are women. Diversity, in all respects, is a key factor for the Nomination Committee when planning for board and executive succession and in our appointment process.

A recent evaluation of the effectiveness of the Board was completed with assistance from Dr Tracy Long of Boardroom Review, who observed the operation of the Board and met all Directors privately before presenting her findings to the Board in November 2011. Following this, I believe we use the time the Board has together more effectively, with an increased focus on issues of strategic importance and risk, supported by a simplification of the way we review performance.

Postscript from the Senior Independent Director: the Board has met privately and confirmed it is satisfied that Robert Ayling fulfils the role of Chairman effectively and that he has the time and capacity needed to carry out all aspects of this important role.

2 Committees of the Board

The principal committees are the Nominations Committee, the Audit Committee, the Quality and Environment Committee ('QEC'), the Remuneration Committee, and a Finance Committee. After each meeting, a summary of matters discussed is reported to the Board, and committee minutes are circulated to all Directors. The Company Secretary is the secretary to each committee, which can engage the services of such advisors as it needs to fulfil its responsibilities.

In addition to chairing or being a member of a committee, Directors commit additional time and challenge on matters of public health (Stephen Palmer), operations, engineering and procurement (John Bryant), customer service and regulation (Anna Walker), finance and audit (John Warren), finance, regulation and remuneration (James Strachan), communications and Member relations (Menna Richards) and government and regulation (Robert Ayling).

Corporate Governance

(a) A report from the Chairman of the Nomination Committee

- » Chairman Robert Ayling
- » Members Each of the Non-Executive Directors and Nigel Annett

The role of this Committee is to ensure that plans are in place for orderly succession for appointment to the Board. We therefore look at the size, structure, and composition of the Board (and the skills, knowledge and experience around the Board table) and, where appropriate, recommend candidates for Board appointment.

The priority this year had been to find a successor for Anthony Hobson as chairman of our Audit Committee and in this task we have been advised by The Miles Partnership, who produced a list of exceptional candidates. John Warren came through that selection process as the strongest candidate and met most closely the high standards and the particular experience we were looking for, and he was appointed to the Board in May 2012.

In the last five years, we have seen three Non-Executive directors retire from the Board and appointed five new directors, and the final phase of our Board succession plan will conclude when John Bryant, the last of our original Non-Executive Directors, will stand down in 2013. Our priority next year will therefore be to appoint a Non-Executive director with a mix of skills and experience in operations, engineering, and procurement.

(b) A report from the Chairman of the Audit Committee

- » Chairman Anthony Hobson (John Warren – Chairman Designate)
- » Members Menna Richards, John Warren and Robert Ayling

The Audit Committee meets four times a year, including two meetings where we focus primarily on a review of the group's preliminary and interim financial results and related areas of judgement and accounting policy. At each meeting, we review the progress and findings of the external and internal audit programmes through which we challenge management's assessment of key financial and business risks and the mitigation strategies put in place to manage them.

In this we are supported (at the Committee's invitation) by the Finance Director, the Head of Internal Audit and the external auditors, who attend each meeting, and by the Managing and Operations Directors who attend at least one meeting a year.

A standing report at each meeting is an update on substantive issues relating to water industry regulation and compliance, prosecutions and matters of legal dispute. This also covers major insurance claims, tax compliance, fraud and health and safety, as well as aspects of information management. We also receive a separate report on disclosures under the Board's whistleblowing policy.

Other topics we routinely review include business continuity, the Board's quarterly report to Glas Cymru's investors, treasury policy and controls (which we reviewed twice last year given volatility in financial markets), and arrangements to ensure the integrity of regulatory reporting. In 2011/12, the Audit Committee also oversaw a second phase of external benchmarking of internal audit, a biannual review of Staff Compliance Guidelines, and we instigated a review that led to the adoption of an online training tool for policy and new obligations.

External audit services are provided by PricewaterhouseCoopers LLP. Our policy is that the external auditors 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 chairman of the Audit Committee. As a result, I am satisfied that audit independence cannot be impaired by the award of non-audit work.

The role of independent audit is to provide assurance and to advise management and the Board on the extent to which systems of internal control and arrangements to manage risk are appropriate. Audit plans are focused on areas of greatest risk to the business.

The Audit Committee has approved the external and internal audit plans for 2012/13 and has met privately with each of the auditors (without executives present) as part of an annual review of audit independence. On the basis of this work, and regular meetings with management, we have concluded that external and internal audit services continue to be effective. A change in 2011/12 was the redirection of internal audit resources - at a time of significant business change - to support continuous improvement, with up to 20% of resources at any time advising on issues such as systems development, control environment, policy and procedure and general advice. They also assisted operational colleagues in water treatment works and drinking water safety plan risk assessments, which contributed to added value outcomes in the form of staff training and development and communication. This is good use of audit resources and we have supported the continuation of this approach in 2012/13.

*Postscript from the Chairman of the Board
I am satisfied that Anthony Hobson and John Warren each has the relevant financial qualification and experience to be chairman of the Audit Committee and the time and capacity needed to fulfil this important role effectively.*

(c) A report from the Chairman of QEC

- » Chairman John Bryant
- » Members Professor Stephen Palmer, Robert Ayling, Nigel Annett and Peter Perry

We consider QEC to be unique to Glas Cymru's business model and governance. We meet every month to oversee operational performance against regulatory measures and the delivery of key strategic goals and to provide assurance to the Board that Dwr Cymru's obligations as a water and sewerage undertaker are not compromised or put at risk. QEC is also different as we are advised by two independent experts who attend all our meetings. Our advisor on the public health and operational aspects of water supply is Andrew Davies, and on matters of environmental management we are advised by Professor Lynda Warren.

Corporate Governance

At our meetings we discuss issues which enables QEC to give the Board an independent view of

- » operational policy and practice in relation to matters of public health, drinking water and environmental regulations and as regards occupational health and safety,
- » management's assessment and mitigation of operational and quality risk,
- » strategies to improve customer service or develop a more sustainable water or wastewater business based on industry best practice, and
- » the response to any significant water quality or environmental incident (or near-miss), to ensure that lessons from these, or any weakness identified through internal audit, are learned

The decision two years ago to take direct management responsibility for water and wastewater operations resulted in a significant restructuring of the business and a change in the risk profile of the business, at a time when we needed to improve in a number of areas where Dwr Cymru's relative performance had slipped. This has been evident in the QEC agenda since that time.

(d) Remuneration Committee

The membership and the role and responsibilities of the Remuneration Committee are described in the 2012 Remuneration Report which follows later in this report. This includes a summary of key issues discussed by the Committee last year and of the remuneration policy and arrangements approved for 2012/13.

(e) A report from the Chairman of the Finance Committee

Chairman: Anthony Hobson
Members: Robert Ayling, James Strachan, John Warren and Christopher Jones

The Finance Committee serves just one purpose – it is the vehicle to approve financing and treasury related transactions where a decision is required between meetings of the Board. In 2011/12, it was necessary to invoke the Finance Committee processes on three occasions.

The table below summarises the number of Board and committee meetings held in 2011/12

	Board	Remuneration (N)	Audit (A)	Quality and Environment Committee (Q)	Nomination (R)
Number of meetings held in 2011/12	9	3	4	12	3
Robert Ayling (N)(Q)(R)(A)	9*	3	3	10	3
Nigel Annett (Q)(N)	8	-	-	11	3
Christopher Jones	9	-	-	-	-
Peter Perry (Q)	9	-	-	12	-
John Bryant (N)(Q)(R)	9	3	-	12*	3*
Anthony Hobson (N)(A)(R)	8	3	4*	-	3
Stephen Palmer (Q)	9	-	-	12	3
Menna Richards (11)(N)(A)	8	-	4	-	2
James Strachan (N)(R)	8	3*	-	-	3
Anna Walker (21)(N)(R)	6	1	-	-	2

Chairman: John Warren was appointed a Director in May 2012

3 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, and procedures designed to identify and manage the significant risks faced by the business. In considering this, we look at the materiality and the relative cost/benefit associated with particular risks, having regard to position of the business and the risk to which it is exposed. The internal control systems are designed to provide reasonable (not absolute) assurance against misstatements or loss.

The key features of our system are typical for a business of our scale and complexity. They include:

- » parameters of acceptable risk that are set by the Board,
- » key risks and hazards which are identified, measured and managed to an acceptable level,
- » clear management accountability for risk management, supported by regular risk reporting,
- » controls that recognise that the nature and balance of risk changes and evolves continuously,
- » financial systems and procedures for preparing consolidated accounts, and

- » 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.

The Board receives assurance from independent work by Dwr Cymru's Reporter (Black and Veatch) and from the programme of internal and quality audit, the major findings from which are reviewed at the Audit Committee or QEC. Risk is reassessed every quarter under a process chaired by the Managing Director, which 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 includes discussion with management on significant risk issues and a review of plans for, and results from, internal and 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 relies on its routine monitoring of key performance indicators and monthly reports of financial and operational performance. Thereby, the Board reviews the effectiveness of the internal control system over the course of the year.

Corporate Governance

4 Accountability and relations with Members and Investors**Members of Glas Cymru**

The key role of our unpaid Members is to ensure that we remain focused on our primary purpose, which is to provide efficient high quality and affordable water and sewerage services to Dŵr Cymru's customers. In fulfilling this important corporate governance role our Members act in a personal capacity.

Members are appointed by the Board, but we can only appoint individuals recommended by an independent Membership Selection Panel. The role of the Panel is to recommend individuals who have shown they have the skills, experience and interests to be an effective Member. In addition, the Panel is required to ensure that overall we have a balanced and diverse membership which is, as far as possible, reflective of a broad range of customer and other stakeholder interests. A copy of Glas Cymru's Membership Policy, and further details of the current Members can be obtained from our website.

At the end of the annual general meeting ('AGM') in July 2011, 12 Members stood down having served a maximum three terms of appointment, and a further 12 Members will stand down for this reason after the 2012 AGM. Following recommendation by the Panel, the Board has recently approved the re-appointment of 19 Members whose term of office would otherwise have expired at the end of the 2012 AGM. At the date of this report, Glas Cymru has 72 independent Members, excluding the Directors of the Company who are also Members, and this will fall to 58 after the 2012 AGM.

Communication with stakeholders

Maintaining good and open relationships with Members and investors is very important. We continue to enjoy a high attendance by Members (around 70%) at our six monthly Members' meetings, which gives them regular opportunity to meet the Board. At these meetings we provide presentations on company performance, developments and prospects and all Directors, including the chairmen of the key Board committees, are available to answer questions.

After each meeting, all Members receive a written brief of issues discussed and the replies to questions asked. Between meetings, we keep Members up to date on key issues and developments through a combination of written bulletins from the Managing Director and updates delivered by email or via a confidential Members' website.

Investors receive a quarterly report from the Board and each summer we host an annual investor meeting in London. 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 board member at any time. The Board receives a report following meetings with investors.

Regular communication is also maintained with the Welsh Government and with each of the economic, water quality and environmental, and customer service regulators of Dwr Cymru.

5 Other statutory information

Business review The Companies Act 2006 requires that the Directors' Report should include a Business Review which gives a fair review of the development and performance of the business (which is provided in the Chairman's Report and Performance Review sections of this annual report) and a description of the principal risks and uncertainties that it faces (which we provided earlier in this Directors' report). Information regarding the operational performance of the business and our approach to sustainability and corporate responsibility provided elsewhere in this annual report is incorporated into this Directors' Report by reference to the extent necessary to fulfil the requirements of a Business Review.

Directors The names and brief biographical details of the Directors are given on page 22 of this document.

All Directors served throughout the year ended 31 March 2012, save for John Warren who was appointed to the Board on 3 May 2012. At the 2012 AGM, all of the Directors will stand for re-election, save for Anthony Hobson who will stand down from the Board at the end of the 2012 AGM. This will meet the requirement under our Articles of Association for John Warren to seek election at the first AGM since his appointment to the Board, and for one third of Directors to retire by rotation. It will also meet the good governance requirement that John Bryant, who has served on our Board for more than 9 years, should stand for annual re-election by Members. 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 the 2012 AGM.

No Director has, or has had, a material financial interest, directly or indirectly, in any contract significant to the Company's business and 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.

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 2012 contained in this annual report. A resolution will be proposed at the 2012 AGM to approve the 2012 Remuneration Report.

The Company has in place Directors' and Officers' insurance giving cover against legal action brought against the Directors and an indemnity in circumstances where a director has not acted fraudulently or dishonestly. The indemnity is a qualifying indemnity for the purpose of the Companies Act and is for the benefit of all Directors. No claims have been made against this policy since the date of the last report.

Corporate Governance

Employees At 31 March 2012, Dŵr Cymru had 2,053 employees. We are on track to meet the programme announced in 2010 under which by 2015 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 and in other sections of this annual report we describe how we are engaging with employees and developing the talent and core competence of the business.

Occupational health and safety We are committed to high standards of occupational health and safety and our like for like performance improved last year with fewer RIDDOR accidents, and we brought some 40 of our tier-2 subcontractors under our occupational health and management system for the first time. More information on our health and safety strategy and performance is provided in our 2012 Occupational Health and Safety Report which is available on our website.

Research and development We have 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. More generally, 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.

Payment policy Payment terms are agreed at the start of a relationship with a supplier and are only changed by agreement, and payment will be made in accordance with those terms, save where an invoice is contested. We will seek to remedy disputes promptly. 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 2011/12, the average payment period for the Glas Cymru group was 62 days (2011: 55 days). The level of capital retentions varies from year to year and this affects the average payment period for the year.

Corporate social responsibility We have a firm commitment to environmental responsibility and to being a good neighbour and a 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.

Political donations It is Board policy not to make donations to political parties or to incur political expenditure and during 2011/12 no donations or payments were made which are required to be disclosed under section 366 of the Companies Act 2006.

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

Regulatory accounts (Dwr Cymru) Condition F of the Instrument of Appointment under which Dŵr Cymru operates requires that we publish additional financial information as an 'appointed business'. A copy of this information is published on our website or is available on request from 15 July 2012.

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 2012 have been prepared on a going concern basis.

Auditors PricewaterhouseCoopers LLP acted as the auditors to Glas Cymru for the accounts for the year ended 31 March 2012. As part of the audit process we 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 be made aware of any relevant audit information and to establish that the Company's auditors are aware of that information. A resolution to re-appoint PricewaterhouseCoopers will be put to Members at the 2012 AGM.

Events after the financial year-end Save for the appointment of John Warren as a Director, there has been no post balance sheet event.

Annual General Meeting The 2012 AGM will be held on Friday 6 July 2012. The business for the AGM includes the approval of the Directors' Report and Financial Statements and the Remuneration Report for the year ended 31 March 2012, 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 2012 AGM sent to the Members of Glas Cymru with this report.



By order of the Board
Richard Curtis LLB, ACIS
Company Secretary

13 June 2012

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

Remuneration Report 2012

I am pleased to present the 2012 report from the Remuneration Committee of the Board ('the Committee') which provides details of the remuneration paid to directors in the financial year 2011/12 and our policy for 2012/13

The Committee undertook a fundamental review of remuneration arrangements in 2010/11 and adopted a policy that was appropriate for the five year regulatory period that will end in March 2015 ('the AMP5 period'). This policy was applied throughout last year and it will be applied for 2012/13 in a way that is materially unchanged from the policy we described in the 2011 Remuneration Report ('the AMP5 remuneration arrangements')

The remuneration policy is designed to align executive remuneration to the Company's strategy and to show clearly how reward is linked to performance over the AMP5 period. The current regulatory period is the most challenging since privatisation and the average combined bill for Dwr Cymru's water and sewerage customers at the end of the AMP5 period will be £20 per household lower (before inflation) than in March 2010. To deliver this, Dwr Cymru must reduce controllable operating costs by around 20% and, at the same time, improve customer service performance, meet new and challenging serviceability targets and deliver a £1.3 billion investment programme. The Committee believes that the performance measures for variable pay comprising the Corporate Performance Scorecard, Operational Expenditure cost reduction, Ofwat's SIM measure and growth in Customer Equity all support the delivery of these strategic targets. In particular, Operational Expenditure cost reduction is the key short term financial measure used to assess increases in productivity.

The Committee is also satisfied that whilst the remuneration arrangements include variable elements linked to performance, the policy does not encourage inappropriate risk taking and ensures that remuneration levels rise and fall depending on performance. The inclusion of variable elements of pay also ensures that the policy is sufficiently competitive to attract and retain high quality staff.

Remuneration paid in respect of the financial year ended 31 March 2012

This comprised a base salary (which had been increased by 3% in April 2011) and variable pay under the AMP5 remuneration arrangements.

Under the Annual Variable Pay Scheme ('AVPS') 2011/12 awards have been made equivalent to 25.9 percentage points ('%') of base salary for performance against the Performance Scorecard, 33.6% for Operational Expenditure cost reduction and 18.0% against Strategic and Personal objectives, making a total award of 77.5% of base salary. This compares with a maximum of 100% of base salary and awards of between 76.3% and 79.3% for performance in 2010/11.

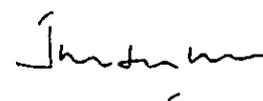
Under the Long Term Variable Pay Scheme 2010 ('LTVPS'), staged awards may be made under the Customer Equity element of the scheme and a staged award of 10% was made in respect of performance in 2010/11. A second staged award of 20% has been made in respect of 2011/12, reflecting another year of strong financial performance. Although Dwr Cymru was ranked third in the Ofwat SIM league table for 2011/12, its lower ranking in Ofwat league tables in the previous two financial years meant that there was no entitlement under the Customer Service Award, which is calculated on a rolling three-year average basis.

Remuneration policy in respect of the financial year ended 31 March 2013

The key points to highlight are

- » Executive Directors' salaries were increased by 2% in April 2012. This is broadly in line with the current executive pay market, and below the 3.2% general pay award received by staff.
- » Under the AVPS and LTVPS, the quantum of variable pay (as a percentage of salary) that can be earned in 2012/13 has not changed. 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.

Details on all these points are contained in the body of this remuneration report. A resolution for the approval of this report will be put to the 2012 Annual General Meeting ('2012 AGM') at which I will answer any questions. I hope that Members will support this resolution.



James Strachan
Chairman of the Remuneration Committee
13 June 2012

Remuneration Report 2012

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 40, and has reviewed the remainder of the report

Remuneration Committee

The Committee is chaired by James Strachan. In 2011/12 the other members of the Committee were Robert Ayling, John Bryant, Anthony Hobson and Anna Walker. John Warren was appointed a member of the Committee when he joined the Board in May 2012, and Anthony Hobson will stand down in July 2012 when he retires from the Board. 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 Director of Human Resources 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 was convened on four occasions in 2011/12.

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 and the Executive Directors and the remuneration framework for certain senior managers (the Dŵr Cymru Executive and Leadership Teams), 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 2011/12 the Committee received independent advice from New Bridge Street ('NBS', a trading name of Aon Hewitt Limited). NBS advised on market best practice in the design of incentive performance arrangements, the benchmarking of

Directors' remuneration and fees and provided general remuneration advice to the Committee. The Committee also sought advice and information from Eversheds LLP (pension strategy) and Quantum Actuarial LLP (pension data). The Committee has concluded that there are no conflicts of interest in relation to these organisations supporting both the Committee and the Company in the implementation of its decisions.

During 2011/12, the activities of the Committee included

- » approving the 2011 Remuneration Report,
- » assessing performance achieved against the conditions attached to the 2010/11 AVPS and LTVPS and agreeing awards to be made to participants,
- » reviewing salaries and AVPS for the broader executive and leadership teams,
- » determining the structure of the 2011/12 AVPS, including minor changes to the Performance Scorecard,
- » consideration of remuneration and pension trends and best practice, and
- » determining the salary of the Executive Directors and the Chairman's fee for 2012/13

Remuneration Policy

The current remuneration policy was approved by Members at the AGM in July 2011. It aims to provide a good alignment between the rewards payable to Executive Directors and the long term success of Dwr 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.

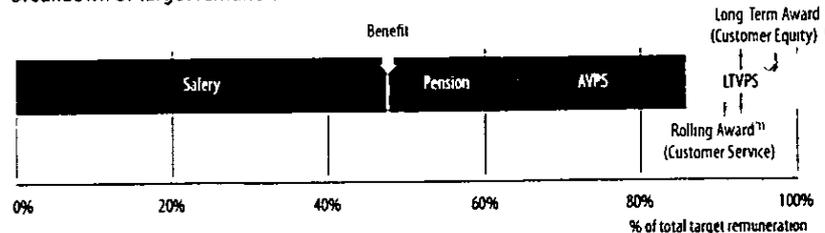
The policy is delivered by

- 1 Setting levels of base salary and total remuneration that (when assessed against periodic market benchmarking) are considered to be 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 - based on independent information published 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 arrangements 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 just over 60% of the total remuneration package is fixed, with just under 40% comprising variable pay.

Breakdown of target remuneration⁽¹⁾



⁽¹⁾ The target award for AVPS is assessed at 50% of the maximum.
⁽²⁾ The LTVPS Customer Equity target award is 150% of salary annualised over 5 years.
⁽³⁾ The LTVPS Customer Service target award is 30% of salary measured over a rolling 3 year period.

Remuneration Report 2012

Policy for base salary

Following a review in March 2012 the Committee has set the base salaries for the Executive Directors for 2012/13 as below. This was approved in the context of a staff increase of 3.2%, however, the Committee considered an increase of 2% to be more appropriate when compared to the positioning of the current base salaries and pay inflation in the executive pay market more generally.

Nigel Annett (Managing Director)

£281,622 (2011 £276,100)

Chris Jones (Finance Director)

£222,054 (2011 £217,700)

Peter Perry (Operations Director)

£211,242 (2011 £207,100)

Policy for variable pay

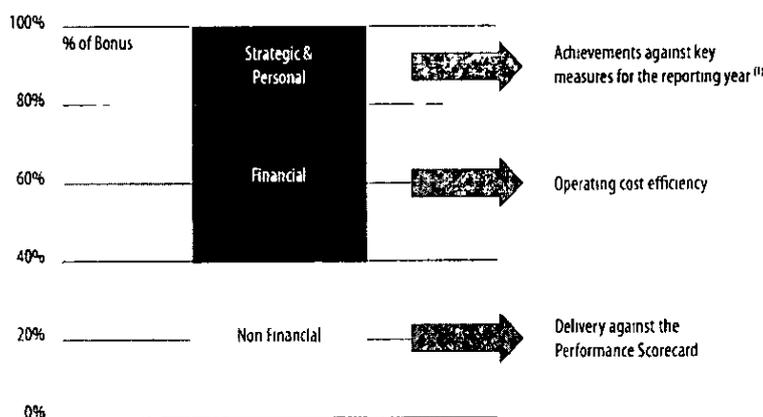
Annual Variable Pay Scheme (AVPS)

The maximum variable pay that Executive Directors can earn under the AVPS in 2012/13 is unchanged and equates to 100% of base salary. The achievement of variable pay is assessed across three components, as illustrated in the chart opposite.

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

Each key performance measure ('KPI') used in the Performance Scorecard is aligned with the Board's objectives to improve customer service and meet compliance and serviceability targets. The KPIs focus on key operational performance measures such as the provision of safe drinking water and protection of the environment. A sliding scale of performance is set for each KPI requiring stretch performance to deliver full payment for this element.

Breakdown of AVPS measures



⁽¹⁾ Standing with regulators and customers: introduction of new management structure and delivery of business change agenda, delivery of capital investment programme and personal objectives.

Financial performance is measured by reference to operating cost efficiency with payment linked to the actual level of operating costs relative to budgeted levels of costs for the year as contained within Dwr Cymru's final business plan for the last price review, Ofwat's 2009 price review Final Determination and the annual business plan approved by the Board which includes Internal Benchmarking Review efficiency projects. As with the Performance Scorecard, an operating cost element is also applied in all variable pay arrangements across the organisation.

Details of the Executive Directors variable pay awards for 2011/12 are set out under the table of directors' emoluments later in this report.

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. The awards comprise a cash payment (we are not able to use shares as Dwr Cymru is not listed). Under the LTVPS two types of cash award can be made:

- » A "Customer Equity Award", which is measured by the creation of customer equity over the regulatory period. '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), and
- » A "Customer Service Award", which is measured by the Company's average ranking in the Ofwat league table for SIM over the last three years. The Customer Service Award is therefore informed by and rewards the Company's relative performance compared with other companies in the sector.

The LTVPS performance targets reflect the Board's ambition that Dwr Cymru should rank alongside the leading companies in the industry on key measures of quality and customer service. SIM comprises two measures of customer service. 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.

Remuneration Report 2012

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

	Customer Service	Customer Equity (1-4)
Performance measure	Measured by reference to Ofwat's SIM measure (2010/11 and 2011/12) and Ofwat's OPA measure (2009/10)	Actual Customer Equity at 31 March 2015 (the end of the AMPS period) compared to budget
Rationale for selected measures	Ofwat's SIM measure of consumer experience is independent, objective and measurable, and allows relative performance to be compared against other water companies	This is the strongest financial measure of the value of the customers' interest in the business
Performance period	3 Financial Years immediately prior to the Financial Year in which an award is made	1 April 2010 to 31 March 2015
Performance target (2,4,5)	Out of UK's 10 water and sewerage 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	» 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

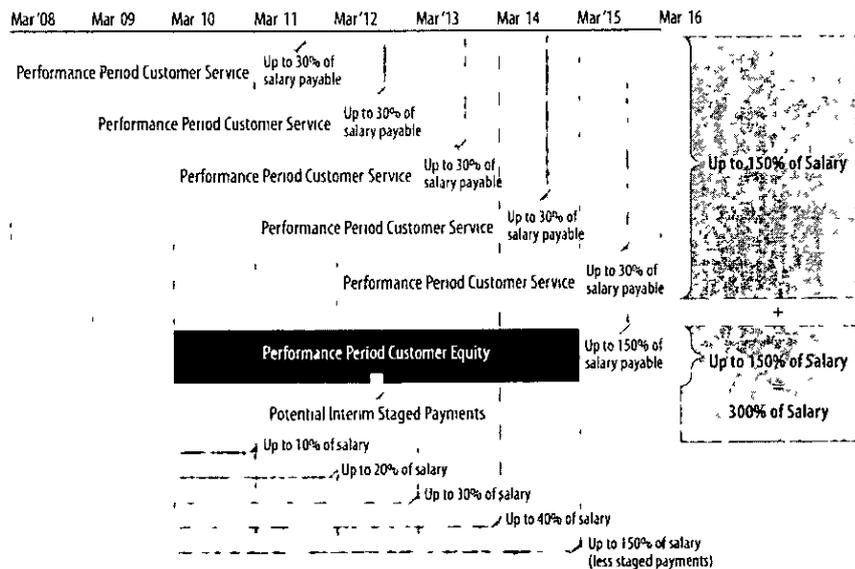
¹ The customer equity target may be amended in certain circumstances at the discretion of the Committee. These circumstances include where (i) there are differences between actual inflation and the assumptions originally made (ii) the Board had modified a relevant policy after the original forecast was 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

² 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

³ 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

⁴ 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 period over which performance is determined and the potential payment dates over the regulatory period to 31 March 2015 are illustrated in the schematic below



Details of payments made to Executive Directors under LTVPS for 2011/12 are set out under the table of directors' emoluments later in this report

Policy for Pension and Benefits

The Executive Directors are all members of the Dŵr Cymru Welsh Water Pension Scheme (the Scheme), which is a defined benefit scheme. The Normal Retirement Age for the Directors is 60 and benefits accrue at 1/45th of salary per year of pensionable service (except for Peter 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 non-contributory private health and medical insurance schemes.

As reported last year, in response to the changes in pension tax relief for high earners, 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 (EFRBS), where the cost of the pension is met by the Company after the executive's retirement.

Remuneration Report 2012

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

Policy for Chairman and Non-Executive Director Fees	Accrued pension (per annum) at 31 March 2012	Real increase in accrued pension in the year (net of inflation)	Transfer value at 31 March 2011	Transfer value equivalent of increase in accrued pension	Transfer value at 31 March 2012	Contributions paid by Director	Transfer value of real increase in accrued pension, net of member contributions
NC Annett *	126,746	3,587	1,922,625	275,718	2,198,343	24,849	37,361
CA Jones *	82,587	3,200	1,011,684	134,146	1,145,830	19,593	24,798
PD Perry ⁽¹⁾	106,050	4,437	1,400,064	199,136	1,599,200	18,639	48,274

* Accrued pensions include previous service in the Hyder Water and United Utilities Pension Schemes. Figures include both the standard entitlements under the Scheme (which are restricted in accordance with HMRC limits) and the top up benefits which are payable under the EFRBS

⁽¹⁾ The accrued pension and transfer value at 31 March 2011 and 31 March 2012 allow for Peter Perry's augmented benefits at those dates.

Policy for Chairman and Non-Executive Director Fees

Director Fees

The Committee determines the fee payable to the Chairman of the Board and, separately, the Executive Directors and the Chairman approve the fee level payable to the Non-Executive Directors

During the year the review of the fees payable to Non-Executive Directors resulted in fees being increased by around 2%. Benchmark data provided by NBS reflected the new fee as broadly in line with mid-market levels

The fees payable for the financial year that commenced on 1 April 2012 are

Chairman
£204,000 (2011 £200,000)

Senior Independent Director
£66,300 (2011 £65,000)

Non-Executive Directors
£56,000 (2011 £55,000)

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

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

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 Christopher 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 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 Dwr Cymru and the Interest of its customers. The Committee recommends this 2012 Remuneration Report for approval by the Members of Glas Cymru

Payments made to Directors in 2011/12

The table below sets out the directors' emoluments in respect of the year ended 31 March 2012 (excluding pension benefits)

2011/12 ⁽¹⁾	RJ Ayling	NC Annett	CA Jones	P Perry	JM Bryant	AJ Hobson	S Palmer	JM Strachan	M Richards	A Walker	Lord Burns	GT Davies	DJ Hine	Total
Salary		£276,100	£217,700	£207,100										£700,900
Fees	£200,000				£65,000	£55,000	£55,000	£55,000	£55,000	£55,000				£540,000
Benefits in kind ⁽²⁾		£1,203	£1,203	£1,018										£3,424
Variable pay 2011/12														
AVP ⁽³⁾		£214,254	£168,935	£160,710										£543,899
Staged payment (LTVPS) ⁽⁴⁾		£55,220	£43,540	£41,420										£140,180
Total emoluments relating to 2011/12	£200,000	£546,777	£431,378	£410,248	£65,000	£55,000	£55,000	£55,000	£55,000	£55,000				£1,928,403
Total emoluments relating to 2010/11	£157,273	£500,213	£400,397	£374,463	£54,000	£54,000	£54,000	£54,000	£4,500	£4,362	£54,197	£54,000	£14,932	£1,780,337

¹ Changes of Director in 2010/11 and 2011/12: Dame Deirdre Hine and Lord Burns retired 10 July 2010, following which RJ Ayling became Chairman of the Board, 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. After the 2011/12 financial year end John Warren was appointed a Director in May 2012. * denotes pro rata fee for financial year 2010/11

² Benefits in kind comprise private medical insurance, permanent health cover and life insurance

³ Under the Annual Variable Pay Scheme (AVPS) in respect of performance in 2011/12 award has been made in the current year equivalent to 26.0% of base salary for performance against the corporate Performance Scorecard 33.6% for financial performance and 18% against Strategic and Personal objectives making a total award of 77.6%. This compared to a maximum of 100% and awards of between 76.3% and 79.3% in 2010/11

⁴ Under the Long Term Variable Pay Scheme (LTVPS) provision has been made for a 20% staged award of the Customer Equity element of the scheme, reflecting a strong financial performance in the first two years of the regulatory period 2010-2015, but no provision was made for a Customer Service award. These awards are accrued for in the 2011/12 Accounts. In 2010/11 Executive Directors received a staged award of 10% for the Customer Equity element of the scheme and no award under the Customer Service element of the scheme

⁵ The highest paid Director in 2011/12 was NC Annett who received emoluments of £546,777 (2011 NC Annett £500,213). 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, details of which are set out in the Annual Report

Statement of Directors' Responsibilities

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

- » select suitable accounting policies and then apply them consistently,
- » make judgements and accounting estimates that are reasonable and prudent,
- » state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,
- » prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom 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
13 June 2012

Independent Auditor's 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 2012 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 Statement of Directors' Responsibilities set out on page 41, 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 Annual Report 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 2012 and of the group's loss 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 3, 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 UK Corporate Governance Code specified for our review by the Listing Rules of the Financial Services Authority. We have nothing to report in respect of these reviews.

At the request of the directors, we have also audited the part of 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 (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cardiff | 13 June 2012

Primary Statements

Consolidated Income Statement for the year ended 31 March 2012

Continuing activities	Note	2012		2011	
		£m	£m	£m	£m
Revenue			695 0		676 7
Operating costs					
- Operational expenditure	3	(272 5)		(264 6)	
- Infrastructure renewals expenditure	3	(81 1)		(40 0)	
- Depreciation and amortisation	3	(150 0)		(144 6)	
			(503 6)		(449 2)
Operating profit			191 4		227 5
Financing costs					
- Interest payable and similar charges	4a	(189 7)		(173 5)	
- Interest receivable and similar income	4a	4 9		4 1	
- Fair value (losses)/gains on derivative financial instruments	4b	(137 6)		12 3	
			(322 4)		(157 1)
(Loss)/profit before taxation	3		(131 0)		70 4
Taxation	5		27 0		68 1
(Loss)/profit for the year			(104 0)		138 5

Underlying profit for the year
(Profit before taxation and fair value adjustments)

	2012	2011
	£m	£m
(Loss)/profit before taxation per Income Statement	(131 0)	70 4
Adjustment for		
- Fair value losses/(gains) on derivative financial statements (see note 4b)	137 6	(12 3)
Profit for the year before taxation and fair value adjustments	6 6	58 1

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 (2011: £nil).

Consolidated Statement of Comprehensive Income for the year ended 31 March 2012

	Note	2012	2011
		£m	£m
(Loss)/profit for the year		(104 0)	138 5
Actuarial loss recognised in the pension scheme	20	(25 8)	(4 7)
Movement on deferred tax asset relating to pension scheme	5 6	6 2	1 2
Total comprehensive (expense)/income for the year		(123 6)	135 0

Consolidated Statement of Changes in (Deficit)/Reserves for the year ended 31 March 2012

	2012	2011
	£m	£m
Reserves/(deficit) at 1 April	46 2	(88 8)
Total comprehensive (expense)/income for the year	(123 6)	135 0
(Deficit)/reserves at 31 March	(77 4)	46 2

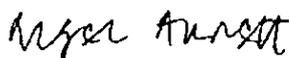
There were no changes in reserves of the parent company during the year (2011: none)

Primary Statements

Consolidated Balance Sheet as at 31 March 2012

	Note	2012 £m	2011 £m
Assets			
Non-current assets			
Property, plant and equipment	7	3,231 9	3,178 9
Intangible assets	8	66 6	65 4
Financial assets			
- derivative financial instruments	14	-	2 6
		3,298 5	3,246 9
Current assets			
Trade and other receivables	10	511 9	489 3
Financial assets			
- derivative financial instruments	14	4 4	4 4
Cash and cash equivalents	11	300 5	98 3
		816 8	592 0
Liabilities			
Current liabilities			
Trade and other payables	12	(534 2)	(506 7)
Financial liabilities			
- borrowings	13	(77 5)	(26 9)
- derivative financial instruments	14	(25 0)	(44 6)
Provisions		(12 5)	(16 8)
		(649 2)	(595 0)
Net current assets/(liabilities)		167 6	(3 0)
Non-current liabilities			
Trade and other payables	12	(57 3)	(33 1)
Financial liabilities			
- borrowings	13	(2,912 6)	(2,733 9)
- derivative financial instruments	14	(277 4)	(122 8)
Retirement benefit obligations	20	(31 9)	(15 5)
Provisions	16	(7 9)	(6 6)
		(3,287 1)	(2,911 9)
Net assets before deferred tax		179 0	332 0
Deferred tax - net	6	(256 4)	(285 8)
Net (liabilities)/assets		(77 4)	46 2
(Deficit)/reserves		(77 4)	46 2

The financial statements on pages 43 to 74 were approved by the Board of directors on 13 June 2012 and were signed on its behalf by



N C Annett
Managing Director



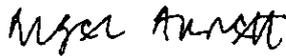
C A Jones
Finance Director

Primary Statements

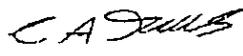
Parent Company Balance Sheet as at 31 March 2012

	Note	2012 £m	2011 £m
Assets			
Non-current assets			
Investment in subsidiaries	9b	-	-
Trade and other receivables	10b	34	34
		34	34
Current assets			
Cash and cash equivalents	11	01	01
		01	01
Liabilities			
Current liabilities			
Trade and other payables	12	(3 5)	(3 5)
		(3 5)	(3 5)
Net assets			
Reserves			
Retained earnings		-	-
Total reserves		-	-

The financial statements on pages 43 to 74 were approved by the Board of directors on 13 June 2012 and were signed on its behalf by



N C Annett
Managing Director



C A Jones
Finance Director

Primary Statements

Consolidated Cash Flow Statement for the year ended 31 March 2012

	Note	2012 £m	2011 £m
Cash flows from operating activities			
Cash generated from operations	17a	337 5	388 2
Interest received		4 6	4 1
Interest paid	17b	(98 0)	(143 7)
Tax receipt		2 5	1 7
Net cash generated from operating activities		246 6	250 3
Cash flows from investing activities			
Purchase of property, plant and equipment		(185 5)	(227 4)
Grants and contributions received		9 5	14 1
Net cash used in investing activities		(176 0)	(213 3)
Net cash generated before financing activities		70 6	37 0
Cash flows from financing activities			
Long term loans received		25 0	75 0
Bond issue proceeds		128 1	-
Bond redemption		-	(125 0)
Term loan repayments		(13 5)	(8 9)
Capital element of finance lease payments		(7 7)	(128 2)
Other loan repayments		(0 3)	(0 3)
Net cash generated from/(used in) financing activities		131 6	(187 4)
Increase/(decrease) in net cash	1b	202 2	(150 4)
Net cash at 1 April		98 3	248 7
Net cash at 31 March	11	300 5	98 3

The parent company had no cash flows during the year (2011 none)

Notes to the Financial Statements

1 | Accounting policies, financing risk management and critical accounting estimates

Accounting policies for the year ended 31 March 2012

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.

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, there were no changes to the reporting framework which impact on Glas Cymru's financial statements for the year ended 31 March 2012.

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

IFRS 7	Financial Instruments: Disclosures (amendment)
IFRS 9	Financial Instruments: Classification and Measurement
IFRS 10	Consolidated Financial Statements
IFRS 13	Fair Value Measurement
IAS 1	Presentation of Financial Statements (amendment)
IAS 19	Employee Benefits (amendment)
IAS 32	Financial Instruments: Presentation (amendment)

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.

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. Where customers have made payments in advance as at the year end, this is recognised as deferred income.

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:

- Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls), and
- Other assets (including properties, overground operational structures and equipment, and fixtures and fittings)

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

1) Infrastructure assets

Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas, reflecting the way the group operates its wastewater activities.

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

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

2) Other assets

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

Freehold buildings	60 years
Leasehold properties	over the lease period
Operational structures	5 – 80 years
Fixed plant	8 – 40 years
Vehicles, mobile plant, equipment and computer hardware and software	3 – 16 years

Notes to the Financial Statements

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 38)

Intangible assets are amortised on a straight line basis over their estimated useful economic lives, which range between 3 and 20 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 defined benefit obligation is determined by discounting the liabilities using a discount rate derived from the yield on high quality corporate bonds.

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.

Notes to the Financial Statements

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 2012, none of the group's derivatives qualified for hedge accounting under IAS 39 (2011: 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.

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.

Other than £60 million of commercial paper invested with the European Investment Bank (with maturities ranging from 7 to 12 months), cash is invested for a maximum period of one month. The maximum cash investment with a single counterparty was £30m (2011: £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 £2,990m as at 31 March 2012 (2011: £2,761m), none related to floating rate debt (2011: none). The group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2012, 100% (2011: 100%) 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 £298m in the balance sheet at 31 March 2012 (2011: £160m) 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

Notes to the Financial Statements

of power price variances. The company has forward-purchased around 70% 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 £2,990m (2011 £2,761m) 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.

On 6 July 2011 the group issued £120m Class B index-linked bonds with a maturity date of 2048 (as a tap of the existing B6 issue).

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 2012, the group had committed undrawn borrowing facilities of £215m (2011 £200m) and cash and cash equivalents (excluding debt service payments account) of £238m (2011 £88m). On 17 and 18 May 2011 the group entered into new revolving credit facilities totalling £140m with a group of six banks. £50m of these facilities remain available until May 2016, with the balance of £90m until May 2017. There is also a £10m overdraft facility (2011 £10m).

On 6 July 2011 Dŵr Cymru (Financing) Limited issued £120 million B6 series index-linked bonds with a maturity date of 2048 (as a tap of the £140 million existing B6 issue) to provide funding for Welsh Water's AMP5 investment programme. The company

redeemed the last of its junior (Class C) bonds during 2010/11, and the £2.7 billion of remaining debt comprises entirely of 'A' rated Class A and B senior debt.

As at 31 March 2012 there was also a special liquidity facility of £135m (2011 £150m), this is required in order to meet certain interest and other obligations that cannot be funded through operating cashflow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants.

Capital risk management

The group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail Prices Index and determined by Ofwat. The Board considers that it is in the best long-term interests of Dŵr Cymru's customers to maintain the level of gearing at around 70%. As at 31 March 2012 gearing was 65%.

In respect of the risks detailed above, further quantitative disclosures are provided in note 15.

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 1%, the provision for impairment would increase or decrease by £0.5 million (2011 £0.5 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 2012 would increase or reduce by £6.1 million (2011 £4.7 million).

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. The total accrual as at 31 March 2012 was £61.6 million (2011 £63.6 million). A 1% change in actual consumption from that estimated would have the effect of increasing or decreasing the accrual by £0.6 million (2011 £0.5 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 | (Loss)/profit before taxation

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

	Group	
	Total 2012 £m	Total 2011 £m
Operating charges		
Power	34.4	33.7
Chemicals	8.8	8.5
Materials and equipment	3.0	2.9
Telephony	5.0	4.0
Vehicles and plant	8.4	7.3
Office expenses	3.9	2.3
Property costs	3.9	3.8
Insurance	4.4	5.3
Sewerage contractors	2.0	3.4
Water costs	5.7	4.8
Customer services agreement	20.1	19.8
Laboratories and analytical services	5.6	6.9
Collection commissions	4.1	3.9
IT contracts	13.3	17.8
Other bought-in services	21.1	28.4
	143.7	152.8
Employee costs (note 19)	79.5	72.0
Staff costs capitalised	(21.4)	(22.3)
Subcontracted staff costs	-	1.4
	58.1	51.1
Research and development expenditure	0.5	0.5
Trade receivables impairment	27.0	22.3
Rates	27.9	22.7
Environment Agency charges	15.1	15.0
Fees payable to auditors	0.2	0.2
Total operational expenditure	272.5	264.6
Infrastructure renewals expenditure	81.1	40.0
Depreciation and amortisation		
Owned assets	104.8	89.1
Under finance leases	33.9	47.9
Amortisation of intangible assets	11.4	7.7
Profit on disposal of property, plant and equipment	(0.1)	(0.1)
	150.0	144.6
	503.6	449.2

Notes to the Financial Statements

Services provided by the group's auditor

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

	Group	
	2012 £'000	2011 £'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	22	23
Regulatory audit services pursuant to legislation	39	39
Bond prospectus update and bond issue	25	-
Total audit and audit-related fees	174	150
Other services		
Tax advisory services	14	-
Other	8	8
Total other services	22	8
Total cost of services provided by the group's auditor	196	158

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 £13,000 (2011: £12,000).

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.

Notes to the Financial Statements

4 | Financing costs

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

	Group	
	2012 £m	2011 £m
Interest payable on bonds	(83 1)	(88 2)
Indexation on index-linked bonds	(52 1)	(48 2)
Interest payable on finance leases (including swaps to RPI)	(45 1)	(28 1)
Other loan interest	(12 1)	(12 0)
Other interest payable and finance costs	(3 9)	(3 1)
Net interest (charge)/credit on pension scheme liabilities	(0 1)	0 7
Capitalisation of borrowing costs under IAS 23 (2012 6.8%, 2011 6.3%)	6 7	5 4
Interest payable	(189 7)	(173 5)
Interest receivable	4 9	4 1
Net interest payable before fair value adjustments	(184 8)	(169 4)

b) Fair value (losses)/gains 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 14 in respect of derivative financial instruments held on the balance sheet.)

	Group	
	2012 £m	2011 £m
Fair value (losses)/gains on interest rate swaps	(35 3)	1 2
Fair value (losses)/gains on index-linked swaps	(102 3)	11 1
Total fair value (losses)/gains on derivative financial instruments	(137 6)	12 3

Interest rate swap losses are caused by a fall in long-term swap rates, while the index-linked swap losses result from a fall in the value of index-linked gilts and fluctuations in 3-month LIBOR.

Notes to the Financial Statements

5 | Taxation

Analysis of credit in the year

	Group	
	2012 £m	2011 £m
Current tax		
Current period	1 4	-
Adjustment in respect of prior years	2 4	2 5
	3 8	2 5
Deferred tax		
Origination and reversal of timing differences	35 4	44 9
Adjustment in respect of prior years	(30 3)	-
Effect of tax rate change	24 3	21 9
	29 4	66 8
Taxation credit	33 2	69 3
Analysed as		
Credit to Income Statement	27 0	68 1
Credit to Statement of Comprehensive Income	6 2	1 2
	33 2	69 3

The £3 8m corporation tax refund comprises tax repayments in respect of expenditure on environmentally friendly equipment. The deferred tax credit includes £24 3m arising from the reduction of the corporation tax rate from 26% to 24%, while the prior year adjustment relates to the termination of finance leases on 31 March 2011.

Tax trading losses carried forward as at 31 March 2012 are circa £400m (2011 £387m).

The effective rate of tax for the year is lower (2011 lower) than the standard rate of corporation tax in the UK (2012 26%, 2011 28%). The differences are explained below.

	Group	
	2012 £m	2011 £m
(Loss)/profit before tax	(131 0)	70 4
(Loss)/profit before tax multiplied by the corporation tax rate in the UK of 26% (2011 28%)	(34 1)	19 7
Effect of		
Adjustments in respect of prior years	27 9	(34 1)
Other permanent differences	1 1	(33 0)
Effect of tax rate change	(21 9)	(21 9)
Movement on deferred tax asset relating to pension scheme	(6 2)	-
Total taxation credit	(33 2)	(69 3)

Notes to the Financial Statements

6 | Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 24% (2011: 26%)

The movement in the deferred tax provision is as shown below

	Group	
	2012 £m	2011 £m
At 1 April	285.8	352.6
Credit to Income Statement	(23.2)	(65.6)
Credit to Statement of Comprehensive Income	(6.2)	(1.2)
At 31 March	256.4	285.8

	Group	
	2012 £m	2011 £m
Effect of		
Tax allowances in excess of depreciation	450.3	435.8
Capital gains rolled over	3.8	4.1
	454.1	439.9
Deferred tax on tax losses carried forward	(114.5)	(101.0)
Deferred tax on losses on derivative financial instruments	(71.9)	(42.1)
Pensions	(7.7)	(4.0)
Other tax differences	(3.6)	(7.0)
Net provision for deferred tax	256.4	285.8

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.

The company has no deferred tax balance.

Notes to the Financial Statements

7 | Property, plant and equipment

Group	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant equipment, computer hardware £m	Total £m
Current year					
Cost					
At 1 April 2011	34.9	1,586.8	2,770.6	234.7	4,627.0
Additions net of grants and contributions	0.2	40.3	150.1	2.7	193.3
At 31 March 2012	35.1	1,627.1	2,920.7	237.4	4,820.3
Accumulated depreciation					
At 1 April 2011	17.3	188.4	1,037.1	205.3	1,448.1
Charge for the year	0.6	23.9	95.7	20.1	140.3
At 31 March 2012	17.9	212.3	1,132.8	225.4	1,588.4
Net book value					
At 31 March 2012	17.2	1,414.8	1,787.9	12.0	3,231.9

The net book value of property, plant and equipment includes £106.8m in respect of assets in the course of construction (2011: £119.1m)

The net book value of property, plant and equipment includes £16.6m of borrowing costs capitalised in accordance with IAS 23 (2011: £10.8m), of which £6.2m were additions in the year (2011: £5.4m)

On 1 October 2011 Dwr Cymru Cyfyngedig assumed responsibility for managing the private sewers network in its operational area. The transfer of an estimated 17,000km of private drains and sewers has significantly increased the size of the network. Little information is available to judge the condition of those sewers – and any attributable value – but they are typically expected to be poor and below the standard of assets that the industry is generally required to operate. In light of this, and the fact that they do not generate an increase in the regulatory capital value of the business, a value of £nil has been attributed to these assets in the financial statements as at 31 March 2012.

	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant equipment, computer hardware £m	Total £m
Prior year					
Cost					
At 1 April 2010	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	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

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 2012			
Cost	611.8	483.9	1,095.7
Accumulated depreciation	74.7	251.6	326.3
Net book value	537.1	232.3	769.4
Prior year			
At 31 March 2011			
Cost	611.8	483.9	1,095.7
Accumulated depreciation	67.0	225.4	292.4
Net book value at 31 March 2011	544.8	258.5	803.3

The parent company owns no property, plant or equipment

8 | Intangible assets

Group	Cost £m	Amortisation £m	Net book value £m
Current year			
At 1 April 2011	129.6	(64.2)	65.4
Additions/(charge for the year)	12.6	(11.4)	1.2
At 31 March 2012	142.2	(75.6)	66.6
Prior 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

Intangible assets comprise computer software and related system developments

The net book value of intangible assets includes £12.9m in respect of assets in the course of construction (2011: £3.6m)

The net book value of intangible assets includes £0.9m of borrowing costs capitalised in accordance with IAS 23 (2011: £0.4m), of which £0.5m were additions in the year (2011: £0.4m)

The parent company owns no intangible assets

Notes to the Financial Statements

9 | Investments

a) Group

Cost and net book value	2012 £m	2011 £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%
Dwr Cymru Cyfyngedig	Water and sewerage	England and Wales	100%
Dŵr Cymru (Financing) Limited	Raising finance	Cayman Islands	100%
Welsh Water Utilities Finance plc	Dormant	England and Wales	100%

10 | Trade and other receivables

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
(a) Current				
Trade receivables	487.7	463.1	-	-
Provision for impairment of receivables	(54.6)	(48.1)	-	-
Trade receivables - net	433.1	415.0	-	-
Prepayments and accrued income	66.3	63.3	-	-
Corporation tax	3.8	2.5	-	-
Other receivables	8.7	8.5	-	-
	511.9	489.3	-	-
(b) Non-current				
Amounts receivable from group undertakings	-	-	3.4	3.4
	-	-	3.4	3.4
Total trade and other receivables	511.9	489.3	3.4	3.4

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

As at 31 March 2012, based on a review of historical collection rates it was considered that £54.6m of trade receivables were impaired and these have therefore been provided for (2011 £48.1m). The impaired receivables relate mainly to measured and unmeasured water supply receivables.

Trade receivables aged greater than one month are past due, the net column shows amounts deemed not to be impaired.

Notes to the Financial Statements

The ageing of receivables was as follows

	Total £m	Provided for £m	Net £m
Current year			
Trade receivables			
Billed in advance	389.3	-	389.3
Under one month	15.9	(3.5)	12.4
Between one and six months	26.9	(11.5)	15.4
Between six months and one year	19.5	(7.5)	12.0
Between one and two years	20.8	(17.2)	3.6
Between two and three years	13.8	(13.4)	0.4
Over three years	1.5	(1.5)	-
	487.7	(54.6)	433.1
Prior year			
Trade receivables			
Billed in advance (restated)	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

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

	2012 £m	2011 £m
At 1 April	48.1	44.2
Charge to Income Statement	26.2	21.5
Receivables written off during the year as uncollectable	(19.7)	(17.6)
At 31 March	54.6	48.1

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 £19.7m of debt which had been provided for in full (2011: £17.6m)

Notes to the Financial Statements

11 | Cash and cash equivalents

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash at bank and in hand	(15.9)	(21.4)	0.1	0.1
Short-term deposits	316.4	119.7	-	-
	300.5	98.3	0.1	0.1

The effective interest rate on short-term deposits as at 31 March 2012 was 0.7% (2011 0.6%) and these deposits had an average maturity of 31 days (2011 3 days). All cash and cash equivalents are held in sterling.

12 | Trade and other payables

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Current				
Trade payables	47.7	34.4	-	-
Capital payables	27.2	31.3	-	-
Amounts due to group undertakings	-	-	3.5	3.5
Taxation and social security	2.8	2.4	-	-
Accruals and deferred income	456.5	438.6	-	-
	534.2	506.7	3.5	3.5
Non-current				
Deferred income	57.3	33.1	-	-

Notes to the Financial Statements

13 | Financial liabilities – borrowings

	Group	
	2012 £m	2011 £m
Current		
Interest accruals	51.5	5.6
Bonds	0.0	0.0
Unamortised bond premium	0.6	0.6
Unamortised bond issue costs	(0.3)	(0.3)
European Investment Bank loans	13.5	13.5
Local authority loans	0.4	0.3
Finance lease obligations	11.8	7.2
	77.5	26.9
Non-current		
Interest accruals	40.7	40.0
Bonds	1,899.3	1,718.1
Unamortised bond premium	9.0	10.6
Unamortised bond issue costs	(5.9)	(5.5)
KfW Bank loan	35.0	35.0
European Investment Bank loans	211.0	199.5
Local authority loans	1.2	1.6
Finance lease obligations	722.3	734.6
	2,912.6	2,733.9

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 Dwr Cymru (Holdings) Limited. The main elements of the security package are

- i) a first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence, and
- ii) 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 Dwr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC

The group's Class A Bonds of £950.5m (2011: £922.1m) 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 £949.0m (2011: £796.0m)

Notes to the Financial Statements

14 | 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 - 2012	Fair Values	
	Assets £m	Liabilities £m
Current		
Index-linked swaps	4.4	(16.3)
Interest rate swaps	-	(8.7)
	4.4	(25.0)
Non-current		
Index-linked swaps	-	(206.3)
Interest rate swaps	-	(71.1)
	-	(277.4)
Total	4.4	(302.4)

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	(87.3)
Interest rate swaps	-	(35.6)
	2.6	(122.9)
Total	7.0	(167.5)

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 2012 an interest rate swap fixes the interest rate on £192m (2011 £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, £50m (2011 £52m) 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 £50m (2011 £52m).

£426m (2011 £428m) 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 2013. These swaps are matched against the same liabilities as £426m (2011 £428m) 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 £549m (2011 £553m) 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 2012 is £528m (2011 £530m), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2012. 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	£528m amortising (2011 £530m amortising)
Average swap maturity	24 years (2011 25 years)
Average interest rate	1.59% fixed plus RPI (2011 1.59% 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, which have a notional value of £94m (2011 £99m) amortising over their 10 year life, 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	£120m (2011 £114.7m)
Swap maturity	45 years (2011 46 years)
Interest rate	1.35% indexed by RPI (2011 1.35% indexed by RPI)

Notes to the Financial Statements

15 | Financial risk management

The policies of the group in respect of financial risk management are included in the accounting policies note on page 30

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

	2012	2011
Assets		
Cash and cash equivalents	0.7%	0.6%
Liabilities		
Bonds	5.0%	5.2%
European Investment Bank loans	1.3%	1.2%
KfW loan	1.7%	2.6%
Local authority loans	5.1%	5.1%
Finance lease obligations	2.0%	1.3%

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 14

They also exclude the indexation charge applicable to the index-linked bonds

b) Liquidity risk

Group - 2012	Within 1yr £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
Assets					
Cash and cash equivalents	300.5	-	-	-	300.5
Trade and other receivables	511.9	-	-	-	511.9
	812.4	-	-	-	812.4
Liabilities					
Bonds	0.6	0.7	1.8	1,905.8	1,908.9
KfW Bank loan	-	-	35.0	-	35.0
European Investment Bank loans	13.5	13.5	47.9	149.6	224.5
Local authority loans	0.4	0.3	0.5	0.4	1.6
Finance lease obligations	11.8	16.0	118.5	587.8	734.1
Trade and other payables	534.2	1.8	4.7	50.8	591.5
	560.5	32.3	208.4	2,694.4	3,495.6

Notes to the Financial Statements

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	1,762 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

The minimum lease payments under finance leases fall due as follows

	2012 £m	2011 £m
Gross finance lease liabilities		
Within one year	26 7	19 5
Between two and five years	192 0	191 2
After five years	719 8	947 3
	938 5	1,158 0
Future interest	(204 4)	(416 2)
Net finance lease liabilities	734 1	741 8
Net finance lease liabilities are repayable as follows		
Within one year (note 13)	11 8	7 2
Between two and five years	134 5	88 7
After five years	587 8	645 9
Total over one year (note 13)	722 3	734 6

c) Fair values

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

	2012		2011	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bonds (note 13)	1,908 9	2,268 9	1,729 3	1,959 1

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

Notes to the Financial Statements

d) Borrowing facilities

As at 31 March 2012, the group had available undrawn committed borrowing facilities of £215m expiring as set out below, in respect of which all conditions precedent had been met (2011 £200m)

	2012 £m	2011 £m
Expiring in less than 1 year		
- revolving credit facilities	-	100
- term loan facility	75	-
	75	100
Expiring in more than 1 year		
- revolving credit facilities	140	-
- term loan facility	-	100
	140	100
	215	200

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

The company has £140 million of revolving credit facilities, of which £50 million is available to be drawn until May 2016 and £90 million is available until May 2017

At 31 March 2012, Dwr Cymru (Financing) Limited ("Financing") also had a special liquidity facility of £135m (2011 £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.

All of the above facilities are at floating rates of interest

e) Capital risk management

Gearing ratios

	2012 £m	2011 £m
Total borrowings	(2,990)	(2,760)
Less cash and cash equivalents	301	98
Net debt	(2,690)	(2,662)
Regulatory capital value (RCV)	4,171	3,980
Total capital ('Financial Reserves')	1,482	1,318
Less unamortised bond costs	(6)	(6)
Total capital per bond covenants	1,476	1,312
Gearing ratio	65%	67%

As set out on page 31, the group monitors its capital structure based on a regulatory gearing ratio which compares its net debt to the Ofwat-determined RCV

Notes to the Financial Statements

16 | Provisions

Group	Restructuring provision £m	Dilapidations provision £m	Uninsured loss provision £m	Total £m
At 1 April 2011	14.7	2.0	6.8	23.5
Charged to income statement	-	0.1	3.6	3.7
Utilised in year	(4.2)	(0.1)	(2.5)	(6.8)
At 31 March 2012	10.5	2.0	7.9	20.4
Split as				
Amounts to be utilised within one year	10.5	-	2.0	12.5
Amounts to be utilised after more than one year	-	2.0	5.9	7.9
At 31 March 2012	10.5	2.0	7.9	20.4
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

The parent company has no provisions at 31 March 2012 (2011: £nil)

Restructuring provision

This provides for the costs of terminating the outsourced contracts with United Utilities Operational Services and Kelda Water Services in the year to 31 March 2011 along with the estimated restructuring costs associated with a reduction in the headcount by some 300

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

17 | Net cash inflow from operating activities

a) Cash generated from operations

Reconciliation of operating profit to cash generated from operations

	Group	
	2012 £m	2011 £m
Operating profit	191.4	227.5
Adjustments for		
- Depreciation and amortisation	150.0	144.6
- Changes in working capital		
Increase in trade and other receivables	(22.6)	(4.9)
Increase in trade and other payables	30.2	30.1
Pension contributions in excess of operating costs	(10.6)	(6.5)
Decrease in provisions	(0.9)	(2.6)
	(3.9)	16.1
Cash generated from operations	337.5	388.2

b) Interest paid

	Group	
	2012 £m	2011 £m
Interest payable per income statement	189.7	173.5
Less non-cash items		
- Indexation on index-linked bonds	(52.1)	(48.2)
- Amortisation of bond issue costs	(0.4)	(0.4)
- Interest (charge)/credit on pension scheme liabilities	(0.1)	0.7
- Amortisation of bond issue premium	0.6	0.6
- Effect of capitalisation under IAS 23	6.7	5.4
- Accounting profit on lease termination	-	13.5
- Increase in accruals	(46.4)	(1.4)
	(91.7)	(29.8)
Interest paid	98.0	143.7

Notes to the Financial Statements

18 | Analysis and reconciliation of net debt

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and cash equivalents	300.5	98.3	0.1	0.1
Debt due after one year	(2,149.6)	(1,959.3)	-	-
Debt due within one year	(14.2)	(14.1)	-	-
Finance leases	(734.1)	(741.8)	-	-
Accrued interest	(92.2)	(45.6)	-	-
	(2,990.1)	(2,760.8)	-	-
Net (debt)/cash	(2,689.6)	(2,662.5)	0.1	0.1

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Net (debt)/cash at start of year	(2,662.5)	(2,663.3)	0.1	0.1
Movement in net cash	202.2	(150.4)	-	-
Movement in debt	(131.6)	187.4	-	-
Movement in net debt arising from cash flows	70.6	37.0	-	-
Movement in accrued interest	(46.4)	(1.7)	-	-
Indexation of index-linked debt	(52.1)	(48.2)	-	-
Accounting profit on lease termination	-	13.5	-	-
Other non-cash movements	0.8	0.2	-	-
Movement in net debt during the year	(27.1)	0.8	-	-
Net (debt)/cash at end of year	(2,689.6)	(2,662.5)	0.1	0.1

Notes to the Financial Statements

19 | Employees and directors**a) Staff costs for the group during the year**

	2012 £m	2011 £m
Wages and salaries	67.1	57.5
Social security costs	5.4	4.5
Other pension costs	7.0	10.0
	79.5	72.0

Of the above, £21.4m (2011: £22.3m) has been capitalised

	2012 Number	2011 Number
Average monthly number of people employed by the group (including directors)		
Regulated water and sewerage activities	1,931	1,727

20 | 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 Dwr 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-Kelda Water Services employees who elected to transfer their past service benefits. On 8 December 2010, £129m of assets were transferred into the DCWW scheme from United Utilities pension schemes (UUPS and ESPS schemes - £123m and 6m respectively), being the accrued benefits of 652 ex-United Utilities Operational Services employees who elected to transfer their past service benefits.

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2011 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 2012 and the principal assumptions made by the actuaries were:

	2012	2011
Discount rate	5.0%	5.5%
Inflation assumption	3.2%	3.3%
Rate of increase in pensionable salaries	3.7%	4.3%
Rate of increase in pensions in payment	3.1%	3.1%
Post retirement mortality (life expectancy)		
- Current pensioners aged 65 - males	87.7 years	87.0 years
- Current pensioners aged 65 - females	90.4 years	89.9 years
- Future pensioners aged 65 (currently aged 45) - males	90.7 years	88.1 years
- Future pensioners aged 65 (currently aged 45) - females	93.3 years	90.9 years

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

Notes to the Financial Statements

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

	2012		2011	
	Expected return	Percentage of total assets	Expected return	Percentage of total assets
Equities	6.5%	50.8%	7.5%	55.2%
Bonds	5.0%	13.0%	5.0%	12.6%
Other	3.0%	36.1%	3.0%	32.2%

The amounts recognised in the Income Statement are as follows

	2012 £m	2011 £m
Current service cost (excluding member contributions)	8.9	8.6
Past service cost	1.5	4.9
	10.4	13.5
Utilisation of restructuring provision	(2.1)	(4.9)
Total included within staff costs	8.3	8.6
Interest cost	13.3	7.9
Expected return on plan assets	(13.2)	(8.7)
Total included within interest payable and similar charges	0.1	(0.8)
Total recognised in the Income Statement	8.4	7.8

Note that the defined contribution scheme charge of £0.4m (2011: £0.4m) has also been included within staff costs

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

	2012 £m	2011 £m
Actuarial loss on plan assets	(9.5)	(8.2)
Actuarial gain/(loss) on defined benefit obligation	(16.3)	3.5
Total recognised in the Statement of Comprehensive Income	(25.8)	(4.7)

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

	2012 £'000	2011 £'000
Present value of funded obligations	(272.8)	(238.6)
Plus unrecognised prior service costs	0.1	0.2
Fair value of plan assets	240.8	222.9
Net liability recognised in the Balance Sheet	(31.9)	(15.5)

Notes to the Financial Statements

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

	2012 £m	2011 £m
At 1 April	238 6	55 2
Current service cost (including member contributions)	9 3	8 9
Past service cost (vested benefits)	1 4	4 7
Interest cost	13 3	7 9
Benefits paid (net of transfers in)	(6 1)	(2 2)
Bulk transfer of liabilities	-	167 7
Actuarial loss/(gain)	16 3	(3 6)
At 31 March	272 8	238 6

Changes in the fair value of plan assets are as follows

	2012 £m	2011 £m
At 1 April	222 9	46 8
Expected return on plan assets	13 2	8 7
Contributions (including member contributions)	20 3	11 1
Benefits paid (net of transfers in)	(6 1)	(2 2)
Bulk transfer of assets	-	166 7
Actuarial gain on plan assets	(9 5)	(8 2)
At 31 March	240 7	222 9

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

	2012 £m	2011 £m
At 1 April	15 5	8 0
Total charge to Income Statement (including utilisation of restructuring provision)	10 5	12 7
Total charge to Statement of Comprehensive Income	25 8	4 7
Bulk transfer (net liability)	-	1 0
Contributions paid (excluding member contributions)	(19 9)	(10 9)
At 31 March	31 9	15 5

	2012	2011	2010	2009	2008
Experience adjustments arising on scheme assets					
Amount (£m)	(9 5)	(8 2)	10 0	(9 3)	(4 7)
Percentage of scheme assets	(4%)	(4%)	21%	(29%)	(12%)
Experience adjustments arising on scheme liabilities					
Amount (£m)	(34 6)	3 6	11 5	(1 1)	8 0
Percentage of the present value of scheme liabilities	(13%)	2%	21%	(3%)	22%
Present value of scheme liabilities (£m)	272 8	238 4	54 8	40 1	36 8
Fair value of scheme assets (£m)	240 8	222 9	46 8	32 3	38 8
(Deficit)/surplus (£m)	(31 9)	(15 5)	(8 0)	(7 8)	2 0

The contributions paid in the year to 31 March 2012 include a special contribution of £2.6m (2011: £2.6m). A further £8.0m was paid into the scheme to augment the benefits in respect of scheme members who left the company via selective voluntary severance (2011: nil). The contribution expected to be paid in line with the extant schedule of contributions during the financial year ended 31 March 2013 amounts to £2.6m.

Notes to the Financial Statements

21 | Capital and other financial commitments

The group's business plan at 31 March 2012 shows net capital expenditure and infrastructure renewals expenditure of £310m (2011 £273m) 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.

22 | 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 (2011 none).

23 | 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.

24 | 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 Dwr Cymru Cyfyngedig under the provisions of the Water Act 1989.

The assets of the fund are not included in these financial statements. As at 31 March 2012 the market value of the trust fund was £110m (2011 £98m).

Interest receivable includes £2.7m (2011 £2.2m) in respect of distributions from the Elan Valley Trust Fund.

25 | Contingent liabilities

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