

Registered Number 2366682

**YORKSHIRE WATER SERVICES LTD**

**ANNUAL REPORT AND FINANCIAL STATEMENTS**

For the year ended  
31 March 2011

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**ANNUAL REPORT AND FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2011**

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# ***Business Review***

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## **CHAIRMAN'S REVIEW**

Yorkshire Water demonstrated real resilience in 2010/11 as the company effectively managed and overcame a number of significant operational, environmental and financial challenges

A dry summer, followed by one of the longest and coldest winters on record, led to unprecedented levels of operational activity with colleagues literally working round-the-clock to protect customers' water and sewerage services, whilst minimising the impact of our activities on the environment

These severe weather events were the first real test of the new organisational structure we implemented in 2009/10 with the aim of delivering a step change in our performance in AMP5. The new organisational structure served us well, ensuring our response to these events was measured, controlled and had a minimal effect on customers' services

Despite hosepipe bans being introduced in other parts of the UK, there were no restrictions on customers' water supplies in the Yorkshire region in 2010/11

During the prolonged period of cold weather which gripped the region over the winter, relatively few customers had their water supplies interrupted for more than 12 hours as a result of problems with our pipes and treatment works

Another benefit of the new organisational structure is that it has allowed the business to recover quickly from these events and we have already renewed our focus on delivering operational excellence in everything we do

We have had one of our best ever years for compliance at our waste water treatment works, and also for the quality of water that we provide to our customers. It was the first year of the new Service Incentive Mechanism, the new Ofwat measure of customer satisfaction, against which we performed very well

Our strategic direction highlights the importance of operational excellence as the cornerstone of our success in the future. It also includes an ambition to grow the business by investing to improve service and the environment and to take on new responsibilities

There are big opportunities ahead. The revised Bathing Water Directive and the transfer from 1 October 2011 of responsibility for private sewers allow us to take responsibility for things that impact directly on our customers and on the environment. We are also continuing to contribute to the current Government debate on the future of the water industry

With all this in mind we have developed a new vision for our business, "Taking responsibility for the water environment for good". This is an evolution of our previous vision, "To be clearly the best water company in the UK", and points to growth which is centred on an economically, environmentally and socially sustainable water sector

We are developing initiatives which will articulate our vision, drive out-performance and deliver more sustainable outcomes for the business over the longer term. In addition, we have developed robust plans to address those areas where our operational performance can be improved

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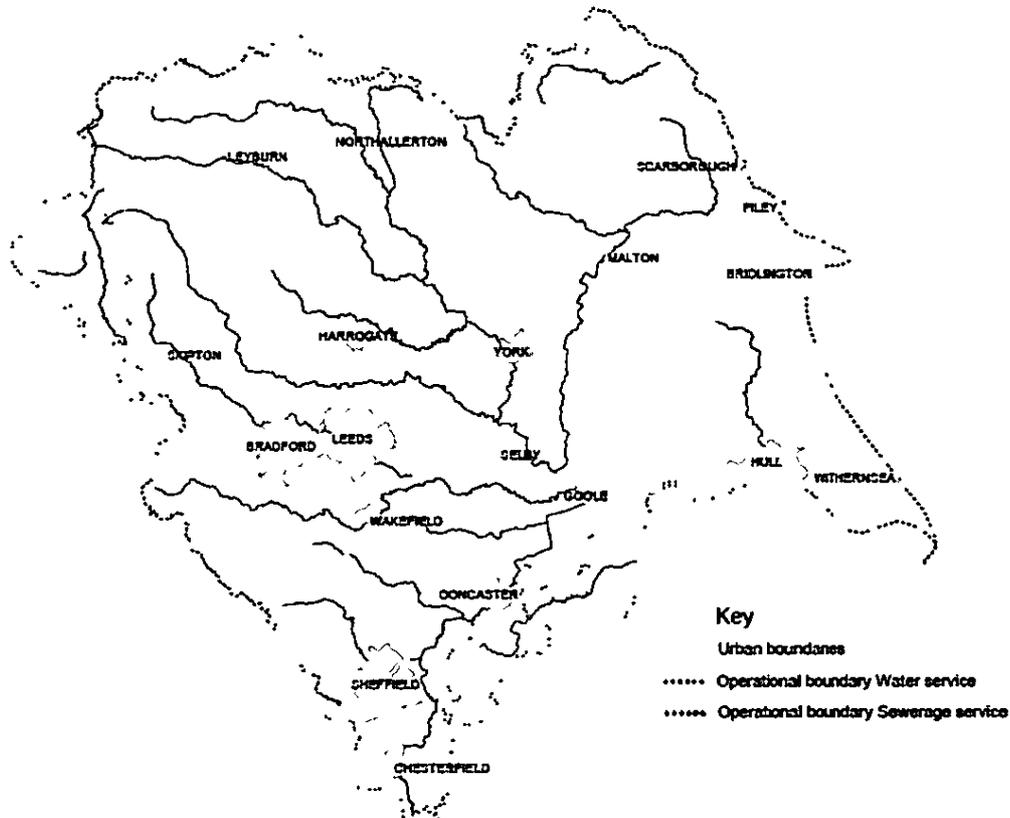
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We have a great opportunity to build on what we have learnt over the past year and are in a strong position to be an even more successful business in the future

**Kevin Whiteman**  
**Chairman**

# Business Review

## OUR BUSINESS



We serve the Yorkshire region - from Whitby in the north to Chesterfield on the edge of Derbyshire in the south, and from Bridlington on the east coast to Ingleton in the west

Yorkshire Water manages the collection treatment and distribution of the region's water. We supply around 1.24 billion litres of drinking water every day and then collect, treat and return around 1 billion litres of waste water safely back into the environment.

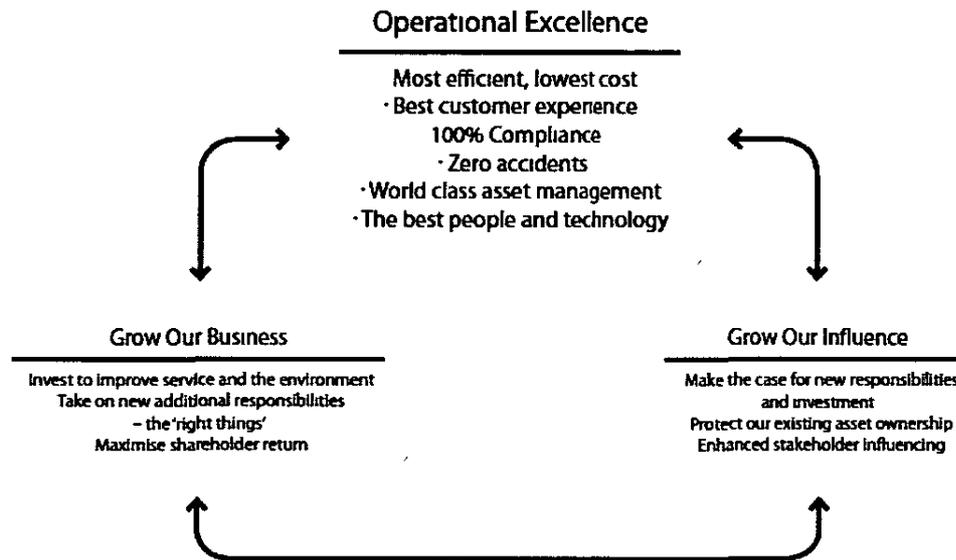
We serve a population of approximately 4.9 million people, as well as around 130,000 businesses.

Our work in managing this natural resource for the benefit of our customers and the environment requires careful, long-term planning.

Over the period 2010 to 2015 we will invest around £3.5 billion on operating and improving the region's water and sewerage infrastructure, providing a major boost to the local economy.

# Business Review

## BUSINESS STRATEGY



### Operational Excellence

This pursuit of 'operational excellence' is the foundation and cornerstone of our company's future strategy, ensuring that we are well placed to protect our existing asset ownership and to make the case for new opportunities to grow our asset base and deliver further benefits to our customers and the environment

This means being the most efficient in everything we do, providing a consistent and seamless customer experience, embedding world class asset management, achieving 100% compliance, having a zero accident culture and developing and employing the best people and technology

### Growing our business

We are a progressive and aspirational company and want to grow our business by taking on new responsibilities which will provide further benefits to our customers and the environment, whilst maximising returns for our investors

This will mean looking both outwardly for the right opportunities to grow, and inwardly by improving our research and development and knowledge of our asset base

From 1 October 2011, the responsibility for private sewers will transfer to water companies, internally we are calling this 'The Big Transfer' This is an example of the kind of new responsibilities and investment we are looking for It fits very well with our core focus on service and the environment, will benefit our customers and will increase the size of our asset base

Our focus on value and more for less will continue, ensuring we are well placed to deliver value for money to our customers, rather than simply offering the lowest price

However, it is important that we continue to 'Strike the Right Balance', a core guiding

## ***Business Review***

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principle of our 25 year Strategic Direction Statement. While we will look to grow our business and deliver further social and environmental benefits, it is important that we invest in the 'right things' and we will not pursue growth as an end in itself, if the benefits to our customers and the environment are not clearly justified.

### **Growing our influence**

To grow our business we need to be able to make the case for new responsibilities and investment with our stakeholders.

New obligations, such as the transfer and adoption of private sewers, will come from influencing Government ministers, customers and regulators to support our proposals and the case for change. In the current regulatory environment, we either need new legal obligations or must be able to demonstrate to Ofwat that customers are willing to pay for the resulting service improvements.

This activity involves tracking, understanding, assessing and mapping external issues, quantifying the extent of the opportunities and threats and understanding the views and wants of stakeholders and regulators. Based on this analysis, it will then be possible to prioritise issues and develop policy positions and influencing strategies to deliver them.

We must also protect our existing asset ownership. The company's strategy has provided value for all over recent years and demonstrated the benefits to customers, investors and the environment of integrated asset ownership.

### **Organisational changes**

In order to deliver this strategy, Yorkshire Water restructured the operational business into two new areas with effect from 1 April 2010, Production and Customer Service & Networks, and concentrated capital delivery into a new Asset Delivery Unit.

We believe that these changes, together with further investment in our people and technology, will help to create the right platform for further significant improvements in customer service, asset management and capital out-performance.

### **Vision and values**

In the light of the company's strategic direction, during 2010/11 the company's executive team reviewed the company vision.

Following the involvement of colleagues, stakeholders and customers, the new vision for the company is "Taking responsibility for the water environment for good", which builds on the success of our previous vision "to be clearly the best water company in the UK".

To date our new vision has been shared internally with colleagues and it is also the title of our influencing document, which sets out our contribution to the debate on the future of the water industry.

# Business Review

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## OPERATIONAL PERFORMANCE

2010/11 saw a good start to AMP5 (Asset Management Plan 2010-2015) despite the operational challenges discussed above. Operational excellence remains the key to unlocking new opportunities - opportunities for our people, opportunities for our customers and stakeholders, opportunities for our contract partners and opportunities for us to grow our influence and ultimately our business.

Our new business model for AMP5, coupled with a new capital investment programme, new contract partners and new, improved ways of working, provides a sound platform on which to achieve our vision.

### Key performance indicators

	Target	Current year	Previous year
Overall customer satisfaction	4.55	<b>4.36</b>	-
Overall drinking water quality	99.975%	<b>99.972%</b>	99.961%
Waste water treatment works compliance	100%	<b>99.68%</b>	100%
Accidents -			
- major and over 3 day accidents	13	<b>15</b>	11
- all accidents	75	<b>192</b>	135

Explanation of measures provided in Appendix to Business Review on pages 17 and 18

### Most efficient, lowest cost

The company's financial performance is described in detail on page 10.

We remain a financially robust and resilient business. In 2010/11 we invested an additional £6.2m to fund improvements in our leakage performance and incurred an additional £5.9m in extra costs due to the impact of the severe winter which gripped the Yorkshire region over Christmas and the New Year. These additional costs were off-set by revenue generated from increased consumption earlier in the year due to the prolonged dry weather. Also, we did not see the decline in business customer demand that was forecast at the start of the year against the backdrop of a challenging, national, economic climate.

### Best customer experience

There were no restrictions on water use in Yorkshire in 2010/11, despite the region's water resources coming under great pressure.

High summer demand combined with below average long-term rainfall saw the region's reservoir stocks fall to 60% at the end of August, with all reservoirs falling below their normal control lines.

Working closely with the Environment Agency we were able to increase the amount of water we put into supply to meet customer demand without adversely impacting on the region's water environment.

The prolonged cold spell and subsequent thaw over the Christmas and New Year period resulted in an unprecedented amount of water being put into supply. On 28 December output peaked at 1,795MI/d, with an average daily demand that week of 1,633MI/d – some 333MI/d more than we would normally expect.

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This extraordinary increase in demand meant that production rates at our water treatment works reached levels never seen before. To maximise production, many of our treatment works were manned round-the-clock.

In October 2010, Ofwat published its levels of service report for 2009/10 which confirmed that, once again, we had the lowest levels of written complaints of any of the water and sewerage companies.

Our performance in relation to Ofwat's new Service Incentive Mechanism was good, with our aggregated score for 2010/11 being 4.36, which ranks us 2<sup>nd</sup> out of the ten water and sewerage companies and 7<sup>th</sup> out of all 21 companies (including water only).

In April 2010, we launched a major communications campaign to demonstrate to customers the good value for money that their water charges represent. The campaign involved TV, radio and billboard advertising, as well as direct mail and social media.

Our 'Bin It, Don't Flush It!' campaign won a national award from the Chartered Institute of Public Relations.

Our 'One Million Green Fingers' environmental campaign won The Guardian newspaper's Public Service Award for Citizenship and Volunteering.

In October 2010 we launched 'The Green Classroom' – a brand new educational resource to teach children about the water cycle and how to use water wisely.

### **100% compliance**

2010 was yet another year-on-year improvement for waste water treatment works compliance. Three of the four quarters saw us record our lowest number of determinand failures ever. Two waste water treatment works failed their numeric consents in 2010.

In October 2010 we were informed by Ofwat that our leakage target for the previous year 2009/10 had been revised from 297Ml/d to 275Ml/d. We had out-turned at 294Ml/d.

At the same time, Ofwat also announced that the serviceability of our water network had moved from 'stable' to 'marginal', largely as a result of an increase in the number of mains bursts and interruptions to supply lasting longer than 12 hours.

In response, we announced plans to invest an additional £33m to address these issues.

The plan involved more than doubling the resources available to find and fix leaks, adopting a more proactive approach to pressure management and the roll-out of an extensive mains renewal programme to replace some of our oldest underground water mains.

Within a month we began implementing the plan with a view to reducing leakage to 297Ml/d by the end of the financial year. However with the cold winter weather of 2010/11 turning out to be even worse than that of the previous year, we finally out-turned at 325Ml/d.

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## **Zero accidents**

In 2010/11, 15 major or over 3 day accidents under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR) were reported to the Health and Safety Executive

Over the past year our health and safety activity has centred around three areas - performance, people and process. We have developed a single, company-wide health and safety performance report to improve the visibility of performance across the business. We have also reviewed our ability to provide the business with coaching and leadership on hazard identification, risk control systems and incident prevention.

From a process point of view we have made improvements to health and safety databases to allow better collection and analysis of information and we have simplified the root cause analysis documentation process. This will speed up the reporting and documenting process, improve investigation quality and allow for greater clarity of learning from the incidents that do occur.

In addition, we have been reviewing and developing our occupational health and safety management systems to understand our gaps and to make sure that we are aligned with the HSE's 'Successful Health and Safety Management' approach.

## **World class asset management**

During 2010/11 we have delivered a capital programme of £311m (gross) and £300.3m (net of all grants and contributions), including £0.2m for preparation for the transfer of private sewers. This is a 7% out-performance from the capital expenditure allowed in PR09 FD Price Limits. Within the year, we have made good progress on our drinking water quality programme and are slightly ahead in our automated meter reading programme.

In November 2010, Yorkshire Water officially launched its £110m programme of investment to not just meet but exceed the requirements of the Revised Bathing Water Directive. The company has created a new partnership board consisting of representatives from the Environment Agency, Welcome To Yorkshire and several local authorities.

## **The best people and technology**

In 2010/11 we completed the implementation of a new organisational design centred around two key business units – Production and Customer Service & Networks – and in-sourced 174 employees from Carillion, the company responsible for delivering our electrical and mechanical contract.

We continue to have high levels of employee satisfaction at Yorkshire Water, with 67% regarding it as a "great place to work".

The dedication and commitment of colleagues across the business was demonstrated during the prolonged cold spell that gripped the Yorkshire region over Christmas and the New Year.

Many colleagues worked tirelessly, often in appalling weather conditions, to answer customers' calls for help and protect their water and sewerage services. Many sacrificed their holidays and festive celebrations to do whatever was required to maintain customers' water supplies.

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Our contract partners responded in a similar fashion, quickly identifying additional resources to deal with the increase in operational activity

In preparation for the transfer of private sewers in October 2011, Yorkshire Water and Loop Customer Management Ltd launched a major drive to recruit more than 200 new employees. The transfer of private sewers is an enormous undertaking, with Yorkshire Water taking on responsibility for an estimated additional 22,000kms of sewers.

Our Information Technology Department was named 'IT Department of the Year' at the 2010 UK IT Industry Awards.

# Business Review

## FINANCIAL PERFORMANCE

### Key financial performance indicators

	2011	2010
Operating profit (£m)	313.6	373.5
Net debt (£m)	2,956.3	3,074.1
Adjusted net debt to Regulatory Capital Value (RCV)	73.7%	62.1%

Explanation of measures provided in Appendix to Business Review on page 17

### Financial performance

Turnover decreased by 0.2% to £867.4m (2010: £869.4m), compared with an average tariff decrease of 0.9%. The decline in demand for water from business customers during the year due to the continued challenging economic environment was lower than anticipated. Of the £867.4m, £402.7m related to water services, £457.0m related to sewerage services and £7.7m was from non-regulated business.

Operating profit decreased by 16.0% to £313.6m (2010: £373.5m) driven by an increase in operating costs. The increase in operating costs included increases to the non-domestic rates charge as a result of the Valuation Office five-yearly revaluation, the bad debt charge as a result of the economic climate, and a payment towards the pension deficit. The additional rates and pensions costs were allowed by Ofwat within the final determination. We still expect to outperform Ofwat's target for operating costs over the 5-year period.

Operating costs also include an exceptional cost of £5.9m relating to the severe winter weather. A prolonged and severe winter period with snowfall arriving in the Yorkshire region during November 2010 resulted in significant additional costs being incurred relating to the management and repair of burst pipes and the resulting additional pumping costs to ensure customers were not without water. The costs incurred over and above the costs anticipated for that time of the year have been classified as exceptional.

Net interest payable increased from £167.0m in 2009/10 to £231.2m in 2010/11 before exceptional items. Of the £64.2m increase, £59.5m relates to the impact on index-linked bonds and swaps of higher RPI than experienced during 2009/10. This is a combination of a higher average rate of inflation during 2010/11 of 5.0% compared to 0.5% in 2009/10, as well as the full-year impact of the whole business securitisation in July 2009 and additional index-linked debt raised in April 2010.

Yorkshire Water holds certain index-linked swaps with a nominal value of £1,289m which had a market value of £867.2m out of the money at 31 March 2011. At the balance sheet date it was concluded that 43.3% (£375.5m) of the swaps did not represent an effective hedge and an onerous contract provision has therefore been recognised within the accounts, £40.0m within borrowings and £335.5m within provisions in respect of an onerous contract provision. The onerous contract provision has increased during the year by £40.0m, which has been charged in the profit and loss account as a non-operating exceptional cost.

The tax credit of £75.3m represents a reduction of £113.6m compared to the prior year (2010: charge of £38.3m). Of this tax credit, £16.1m relates to current tax and £59.2m to deferred tax. The current tax credit reflects prior year adjustments and the receipt of group relief from other group companies free of charge. The deferred tax credit reflects the

## **Business Review**

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reduction in the deferred tax provision following the change in the future rate of corporation tax from 28% to 26%

Regulated capital investment for the year was £300.3m (2010 £262.0m). This is below the level assumed in Ofwat's Final Determination of prices due to the rephrasing of some schemes over the five year asset management plan (AMP). All regulatory outputs have been achieved with the exception of phase two of the East Coast Pipeline which is delayed due to significant archaeological finds along the route. Revised completion dates have been discussed with Ofwat.

### **Capital structure**

During April 2010 Yorkshire Water issued bonds, raising £635m, including £450m of class B debt following successful investor roadshows. The Yorkshire Water business plan for 2010/11 expected £238m of class B debt to be raised, but with significant demand from investors and low interest rate coupons available it was agreed to raise the additional funds whilst market conditions were positive.

As part of the process each Ratings Agency confirmed that the ratings for bonds issued by Yorkshire Water were stable, Class A bonds remain at "A" ratings and Class B bonds are BBB+ with Fitch, BBB with S&P and Baa3 (BBB- equivalent) with Moodys.

The proceeds of the issuance were used to repay existing drawings on the capital expenditure facility, distribute £550m to Kelda Holdco Ltd by way of internal loan, and the balance to repay the principal on the 2010 bond, due in late April.

The total net debt at 31 March 2011 was £2,956.3m (2010 £3,074.1m), this includes an upstream loan to Kelda Holdco Ltd. Adjusted net debt, excluding internal loans and unamortised debt issue costs, is used to calculate gearing ratios to comply with the bank covenants. Adjusted net debt at 31 March 2011 was £3,629.6m (2010 £2,828.3m). The adjusted debt to Regulatory Capital Value (RCV) ratio must remain less than 80% at 31 March 2011 under the terms of the bank covenant. Actual adjusted debt to RCV at 31 March 2011 was 73.7% (2010 62.1%).

Dividend payments were £46.9m during the year (2010 £211.0m). No final dividend is proposed in respect of 2010/11. At 31 March 2011 Yorkshire Water had profit and loss account reserves of £827.9m (2010 £756.5m).

### **Accounting policies**

The company accounts have been prepared in accordance with the accounting policies described in note 1 to the accounts.

### **Treasury policy**

The company's treasury operations are controlled centrally for the group by a treasury department which operates on behalf of all companies controlled by the ultimate parent. Activities are carried out in accordance with approved board policies, guidelines and procedures. Treasury strategy is designed to manage exposure to fluctuations in interest rates, preclude speculation and to source and structure the group's borrowing requirements.

The group uses a combination of fixed capital, retained profits, long term loans, finance leases and bank facilities to finance its operations. Any funding required is raised by the group treasury department in the name of the appropriate company, operating within the

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bank covenants Funds raised may be lent to or from the company at commercial rates of interest Cash surplus to operating requirements is invested in short term instruments with institutions having a long term rating of at least A- or A3 and a short term rating of at least A1 or P1 issued by Standard and Poor's and Moody's respectively

### **LOOKING FORWARD**

Our new vision, "Taking responsibility for the water environment for good", is a Kelda-wide vision and points to growth which is centred on an economically, environmentally and socially sustainable water sector

- Taking responsibility Caring for water as a precious resource
- The water environment Thinking about water and sewage in the context of the whole environment and playing a bigger role in the water environment
- For good Finding the best and most sustainable way to proceed in the long-term

We are developing initiatives which will articulate this vision and which will also drive business out-performance Focusing on asset management, carbon and energy management and water demand management will deliver efficiencies in years 3, 4 and 5 of the AMP and also drive more sustainable outcomes for the business over the longer term

Robust plans are being developed in 2011/12 for each of these initiatives which will be implemented the following year

- Asset management – This project will bring together activity currently being undertaken across the business to develop a cross company asset management strategy which will lead to a single model for asset management
- Carbon and energy – This project will ensure that we drive significant carbon and energy reduction and will ensure that risks are understood and managed
- Demand management – This project will seek to reduce the sustainable level of leakage and develop a significant customer water conservation initiative based on sound economics

### **PRINCIPAL RISKS AND UNCERTAINTIES**

None of the risks discussed below are considered likely to have a significant impact on the short or long term value of the company in the immediate future

We classify principal risks in six categories

- Changes to the regulatory environment,
- Changes in legislation,
- Climatic changes,
- Changes in technology,
- Social influences, and
- Supplier markets

# **Business Review**

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## ***Changes to the regulatory environment***

### *Transfer of Private Sewers*

From 1 October 2011 we will become responsible for an estimated additional 22,000km of pipeline on top of the 33,000km of public sewers already looked after – a significant change to our asset base

We have established a dedicated implementation project team to deliver this transfer. The team has engaged internal business stakeholders to understand the requirements for the increased activity levels and has been working closely with external stakeholders

### *Revised Bathing Water Directive*

From 2015 the EU's revised Bathing Water Directive comes into force, which aims to improve the quality of coastal waters. Bathing waters will be classified by the Environment Agency as either poor, sufficient, good or excellent. We are the only UK water company aiming for 'excellent'

Our £110 million investment programme for the east coast was launched last year to improve our assets, and how we manage them, at 20 designated beaches along 100km of coastline from Staithes to Withernsea

### *Ofwat Review*

Yorkshire Water submitted evidence to the review of Ofwat undertaken in October 2010. The review sought evidence of Ofwat's role and activities in the following areas

- Statutory framework and decision making,
- Sustainable development,
- Relations with other regulators and water and sewerage companies,
- Protecting, serving and representing customers, and
- Value for money

The government is currently considering the responses to the Ofwat Review and will bring forward any changes in its Water White Paper expected later in 2011

## ***Changes in legislation***

### *Water White Paper*

By December 2011, the Department for Environment, Food and Rural Affairs (Defra) have committed to examine the conclusions of the Cave and Walker Reviews and publish a White Paper on the reform of the water industry. The White Paper will examine more efficient uses of water and protection for poorer households. The intention is to introduce suitable legislation as soon as parliamentary time allows from April 2012

### *Natural Environment White Paper*

In June 2011 the Government published a Natural Environment White Paper setting out measures to protect wildlife, promote green spaces and wildlife corridors, value natural capital and produce an analysis of the state of the UK's natural asset base (the National Ecosystems Assessment)

# **Business Review**

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## *Environmental legislation*

Government and European policy is increasingly focused on the environmental agenda, which creates both opportunities and challenges for Yorkshire Water. New discharge standards continue to be a possibility, although the recent European Court decision to not designate the Humber Estuary as a sensitive zone means that new large scale European legislation is not imminent. However, there are a number of directives in the pipeline, focusing on drinking water standards and levels of service.

## *Local Government elections*

In May 2011 Local Government elections took place across Yorkshire. The major changes in political control were:

- The Liberal Democrats lost overall control of Hull City Council and leadership of Sheffield and York Councils,
- The Conservatives took control of Harrogate and Ryedale Councils, and
- Labour took total control of Sheffield, York, Leeds and Hull City Councils.

Yorkshire Water will engage with the political and administrative leadership of all councils as part of its annual local authority contact programme.

## **Climatic changes**

### *Climate change – carbon reduction*

Yorkshire Water is committed to managing its carbon emissions. We are investing in renewable energy generation technologies such as combined heat and power (CHP) which we use to produce low carbon energy from sewage sludge. We are also reducing our energy needs through more efficient techniques and processes.

The Carbon Reduction Commitment Energy Efficiency Scheme (CRC) came into operation in April 2010. The Government announced important changes to the scheme in October 2010, effectively introducing a new carbon tax. This change to the CRC will increase Yorkshire Water's costs.

### *Climate change – adaptation*

Yorkshire Water recognises that, in the long-term and without advance preparations, climate change could challenge our core water and wastewater services. We therefore established a strategic priority to adapt to climate change. We are carrying out many activities in this area, for example we are investing to improve the resilience of critical assets and we are carrying out significant research to develop our understanding.

The Government identified Yorkshire Water as one of ninety organisations who are responsible for assets and services of critical importance to society. We were asked to report on our preparations for climate change under the Adaptation Reporting Powers in the Climate Change Act (2008). In January 2011 we submitted our adaptation report to Defra, 'Maintaining levels of service in the changing climate'. Feedback from Defra supported our approach and agreed with our plans to continue addressing this matter.

## *Natural England*

Natural England was one of the Government Agencies identified for substantial reform under the Coalition Government. The immediate impact is a 32% reduction in their staff.

## ***Business Review***

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over two years and a review of their priorities and working procedures. In response we are discussing the management of biodiversity data and the extensive wildlife designations such as Sites of Special Scientific Interest (SSSI's) in Yorkshire to ensure we continue to have access to the latest information for our business planning, processes and decisions.

### *Water consumption*

Over the past few years local businesses and some domestic customers have made increasing efforts to manage and reduce their water consumption. Although the key driver of annual consumption remains weather patterns (e.g. hot, dry summers and cold winters), water conservation is increasingly the norm and may place further downward pressure on water consumption and income.

As part of our new vision, "Taking responsibility for the water environment for good", we recognise the value of water to our society. We are therefore working on various demand management activities, including leakage reduction and other water conservation measures.

### ***Changes in technology***

Increasingly organisations are quickly brought to account by customers and the media. This trend has been assisted by the development of social networking sites such as Facebook, YouTube and Twitter which allow pressure groups to form quickly, share their views and form opinions.

Dealing with this new form of dialogue and engagement will be an increasing challenge for our corporate communications over the next five years. We will be monitoring online conversations across social media channels to understand customer sentiment and provide help and advice where we can.

Over the last five years we have seen a 20% year on year increase in website usage, with over one million customers visiting our website each year to pay bills, send meter readings and request water saving packs.

### ***Social influences***

#### *Public confidence*

With the effects of a changing climate becoming more visible, the public are increasingly likely to demand more involvement and a stronger say in the provision of water and waste water services. Public activism will be highly relevant as we attempt to create advocacy to drive further investment and solve customers' problems.

#### *The skills agenda*

Increasingly Yorkshire Water has found it challenging to recruit new employees with appropriate skills and experience for specific parts of the business. Engineering and operational skilled labour is increasingly difficult to recruit as the pool of potential recruits shrinks, particularly those with science, technology, engineering and maths qualifications.

To help build a highly skilled workforce for the future, Yorkshire Water recruited nine apprentices in 2010 and intends to take on a further 11 in 2011.

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## *Bad debt*

In light of the current economic conditions and in particular the contraction of the public sector in Yorkshire it is predicted that higher levels of unemployment will continue. This will have an impact on our customers and their ability to pay their water bills.

## ***Supplier markets***

### *A global economy*

The national and international economic uncertainties may put pressure on Yorkshire Water's input costs. Yorkshire Water has significant and growing energy demands, thus making the business model exposed to energy price fluctuations.

As clean and waste water regulatory standards become more stringent, the energy requirements of conventional treatment techniques tend to increase. This correlation of increasing regulatory demands and energy usage will provide a challenging environment over the next ten to twenty years, particularly as the Carbon Reduction Commitment (CRC) has been implemented and we can expect increased 'carbon tax' in the future.

# **Business Review - Appendix**

## *KPI Glossary of Terms*

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### **FINANCIAL KEY PERFORMANCE INDICATORS**

#### **Operating profit**

Operating profit is disclosed in the Yorkshire Water profit and loss account

#### **Net debt**

Net debt represents the value of loans and finance leases owed to third parties and other companies within the group, offset by available cash

#### **Adjusted net debt to Regulatory Capital Value (RCV)**

The RCV is determined by Ofwat and is the value of the capital base on which a return is allowed for price setting purposes. The values are calculated and published annually by Ofwat. This ratio expresses adjusted net debt as a proportion of the RCV, both of which are published in Yorkshire Water's audited accounts.

### **NON FINANCIAL KEY PERFORMANCE INDICATORS**

#### **Overall customer satisfaction**

The company recognises the value of listening to customers in order to deliver improvements that not only meet but surpass expectations. Customer satisfaction is monitored on a regular basis using the results of a survey conducted by Ofwat.

The KPI is an average satisfaction score based on a random sample of customers surveyed by Ofwat. All respondents will have contacted the company and had their issue resolved.

The score is based on the response to the following question:

"Taking everything into account how satisfied were you with the way they handled this enquiry/contact?"

Very satisfied	5
Fairly satisfied	4
Neither satisfied nor dissatisfied	3
Fairly dissatisfied	2
Very dissatisfied	1

#### **Water quality**

The Drinking Water Inspectorate (DWI) regulates public water supplies in England and Wales. It is responsible for assessing the quality of drinking water, taking enforcement action if standards are not being met and appropriate action when water is unfit for human consumption.

The Government has set legal standards for drinking water in the Water Quality Regulations. Most of these standards come directly from European law and are based on World Health Organisation guidelines. The UK has additional standards to safeguard the already high quality of water in England and Wales. The standards are strict and generally include wide safety margins. They cover

# ***Business Review - Appendix***

## *KPI Glossary of Terms*

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- Bacteria,
- Chemicals such as nitrate and pesticides,
- Metals such as lead, and
- Appearance and taste

The measure we use is for overall drinking water quality which consists of the average compliance values for 39 different parameters

### **Waste water treatment works compliance**

The Environment Agency issues consents to allow the discharge of treated water from waste water treatment works. The three principal consented limits are for suspended solids, biochemical oxygen demand and ammonia. A range of other substances may be limited depending on the type of discharge. This indicator shows loads for the following determinands

- suspended solids, which can blanket the river bed, thereby destroying fish habitat,
- biochemical oxygen demand (BOD), which is a measure of the amount of oxygen consumed in water - usually by organic pollution - and therefore reflects the quality of the water,
- ammonia, which is toxic to fish, and
- phosphate, which promotes excessive plant growth which upon decomposition strips oxygen from the water

All waste water treatment works are monitored for compliance with their discharge consents and the receiving waters are monitored to assess their compliance with water quality targets. The frequency of monitoring depends on the size of the treatment works, small works are monitored on a quarterly basis and large works are monitored every week.

### **Reportable and notifiable accidents**

The Health and Safety Commission is responsible for health and safety regulation in Great Britain. The Health and Safety Executive and local government are the enforcing authorities who work in support of the Commission.

The Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR) places a legal duty on employers to notify and report some work related accidents, diseases and dangerous occurrences.

These include, amongst other things, accidents where employees are absent from work for three days or more.

All accidents include minor accidents which do not require reporting to the Health and Safety Executive e.g. accidents resulting in less than three days absent.

# **Directors' Report**

*For the Year Ended 31 March 2011*

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The directors present their report and the audited financial statements of the company for the year ended 31 March 2011

## **Financial results for the year**

Profit for the financial year was £117.7m (2010 £126.1m)

## **Business review**

A review of the development and performance of the business of the company, including strategy, the financial performance during the year, key performance indicators, health and safety policy, forward-looking statements and a description of the principal risks and uncertainties facing the company are set out in the business review on pages 10 to 16.

The purpose of this annual report is to provide information to the company's stakeholders and contains certain forward looking statements with respect to the operations, performance and financial condition of the company. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this report should be construed as a profit forecast.

## **Principal activities**

The directors' report should be read in conjunction with the business review. The principal activities of the company are the supply of clean water and the treatment and disposal of waste water in Yorkshire, for which the company is the water and sewerage undertaker. The majority of the company's operations are regulated by Ofwat.

## **Directors**

The directors who served during the year and up to the date of signing these financial statements, including any changes, are shown below:

Richard Flint	Chief Executive
Liz Barber (appointed 24 November 2010)	Finance & Regulation Director
Graham Dixon	
Alan Harrison	
Jonathan Hodgkin (resigned 27 May 2010)	
Mark Penny	

Charlie Haysom and Pamela Rogerson were appointed directors on 27 April 2011.

## **Non executive Directors**

Kevin Whiteman	Chairman
Roger Hyde	
Martin Havenhand	
Kathryn Pinnock	
Rhys Evenden	
Holly Koepfel	
Scott Auty (appointed 28 July 2010)	
Mark Lorkin (appointed 28 July 2010)	
Jane Seto (appointed 28 July 2010)	

# **Directors' Report**

*For the Year Ended 31 March 2011*

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The company has directors' and officers' insurance in place

## **Dividends**

The total dividend of £46.9m paid to Yorkshire Water's immediate parent company, Yorkshire Water Services Holdings Ltd, in the year related to payments to group companies to fund the payment of interest and loan repayment. This compares with £211.0m in 2009/10, of which £27.8m was to fund the payment of interest.

No final dividend for the year is proposed.

The company's dividend policy is to

- deliver real growth in dividends recognising the management of economic risks, the continuing need for investment of profits in the business and to pay additional dividends which reflect efficiency improvement, and particularly improvements beyond those assumed in the determination of price limits,
- to pay dividends in respect of the non-appointed business reflecting the profitability of those activities, and
- where it is foreseeable that the company will have sufficient profits available for distribution, to continue to pay annual dividends consistent with this policy, the company can also pay special dividends as part of any capital reorganisation which the board concludes to be in the best interests of the company and complies with its obligations under its licence.

The directors consider that the dividends paid in the year are in accordance with these principles.

## **Reserves**

The profit for the year of £117.7m has been transferred to the profit and loss reserve, bringing the balance held in this reserve to £827.9m (after dividends in the year of £46.9m and a £0.6m movement in the revaluation reserve).

## **Research and development**

The company undertakes a programme of research in pursuit of improvements in service and operating efficiency. In 2010/11, £4.5m was committed to research and development including £3.7m on fixed assets.

## **Fixed assets**

The directors are aware that the value of certain land and buildings in the balance sheet may not be representative of their market value. However, a substantial proportion of land and buildings comprises specialised operational properties and structures for which there is no ready market and it is not therefore practicable to provide a full valuation.

Movements in fixed assets are shown in note 9 to the accounts and include transfers to KeyLand Developments Ltd, which have all been made on the basis of independent external valuations obtained specifically for the purpose and approved by Ofwat. With effect from 1 April 1996, only those transfers with a value of over £500,000 have been subject to approval by Ofwat.

# **Directors' Report**

For the Year Ended 31 March 2011

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## **Revaluation of assets**

In March 2009, Yorkshire Water re-valued its non specialised land and buildings (i.e. non operational land and buildings, including offices and rural estates), resulting in an increase to fixed assets of £52.7m and a corresponding increase in reserves. The Manager of Land, Property and Planning, a member of the Royal Institution of Chartered Surveyors (MRICS), has reviewed the carrying value at 31 March 2011 of Yorkshire Water's non specialised land and buildings and considers that no impairment or uplift would be required to the accounts and the amounts booked on 31 March 2009 are not materially different to current market values.

The Directors confirm that they know of no material change to the value of Yorkshire Water's non specialised land and buildings to be disclosed within the accounts of Yorkshire Water at 31 March 2011.

These assets will continue to be revalued on a periodic basis, to coincide with valuations required for future Ofwat Periodic Reviews.

## **Capital and infrastructure renewals expenditure**

Total expenditure on regulated activities during the year amounted to £300.3m (2010 £262.0m). This excludes expenditure on non-regulated activities of £nil (2010 £0.3m).

## **Payment of suppliers**

The company's policy on the payment of suppliers is to ensure that all payments are made in accordance with the terms and conditions agreed with suppliers. For construction contracts, payment terms are covered by the appropriate Conditions of Contract, such as NEC Form of Contract, ICE 6th Edition and Model Form of Conditions of Contract for Process Plants (IChemEng).

The payment day ratio (the figure, expressed in days, which bears the same proportion to the number of days in the year as the amount owed to trade creditors at the year end bears to the amounts invoiced by suppliers during the year) is 38 days (43 days in 2010).

## **Instrument of Appointment**

Condition F of the company's Instrument of Appointment as a water and sewerage undertaker requires the company to publish regulatory accounting information in a prescribed format in addition to that required for the statutory accounts.

## **Employees and employment policies**

The company strives to create a positive working environment for all colleagues and places great emphasis on open two-way communications. It values involvement and engagement at all levels, recognising that everyone in the business is valued for their contribution and is a potential source of innovation and change. Internal consultation and communication processes provide the key to this involvement.

The company communications strategy is based on a 'face to face first' approach and all messages are delivered through 'two-way' channels, including regular 'Team Talks' and 'Talk Back' sessions with line managers and the Directors. The company magazine *Connections* is distributed throughout the business and aims to provide business news through the eyes of the company's employees.

# **Directors' Report**

*For the Year Ended 31 March 2011*

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Regular employee satisfaction surveys are undertaken throughout the company, using a variety of survey tools including telephone-based, online and paper-based surveys. These surveys highlight what is going well and provide the company with valuable information about where to place more emphasis to really make a difference to how people feel at work.

To promote successful employee relations, the company demonstrates its commitment to effective and two way communication through its information and consultation framework. In addition to collective bargaining arrangements with its recognised trade union, communication and consultative forums take place across the company, comprising elected (union and non-union) employees who meet regularly with directors and senior managers.

The company promotes freedom of association, principally through its diversity and inclusion strategy. The company's equality and diversity, 'open to all', policy covers gender, marital status, parental status, sexual orientation, race, colour, ethnic or national origin, disability, age, religion or belief and trade union membership. Yorkshire Water has previously been recognised by winning the Personnel Today award for Diversity in the Workplace and has also featured as a case study on a website created by the London Development Agency for businesses in their region. We have an active approach to keeping employees who become disabled in employment and our commitment to equal opportunities for less able job applicants has been recognised with the 'double tick' accreditation from the UK Employment Service.

Key to achieving operational excellence and delivering out-performance is ensuring that every individual understands their role and how they can make a difference whilst feeling valued for their contribution. We are committed to rewarding the right performance and we adopt a 'total reward' approach to salary and benefits which are designed to be competitive. Performance related pay gives colleagues at all levels the opportunity to share in the success of the business, through quarterly or annual bonus payments linked to the achievement of individual and business plan targets.

The company continually strives to attract, select and retain the best people. Looking to the future, there is a strong commitment and focus on proactively resourcing the business by understanding future roles and skills requirements and ensuring that plans are in place to meet our needs. Our approach includes understanding people's career aspirations, meeting development needs and actively mitigating resourcing challenges to ensure that we retain our best talent. In 2011/12 a further 11 apprentices and nine graduates will join what are already successful programmes.

The company places great emphasis on enhancing business performance by maximising individual, team and organisational potential through skills development. We are focused on developing safety, technical, behavioural and leadership capability. It is our belief that everyone can demonstrate leadership skills. This commitment is demonstrated through our focus on leadership development for managers and senior managers across the business and the company's commitment to embedding a coaching culture. This enables people to learn and grow by identifying and focusing on their own development areas. The company provides a wide range of development opportunities, including in-house and accredited programmes to help employees develop the necessary skills, knowledge, values and experience to realise their performance potential.

# **Directors' Report**

*For the Year Ended 31 March 2011*

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## **Health and safety**

Yorkshire Water is committed to achieving high health and safety standards throughout its business. The management of health and safety issues operates in the context of the health and safety policy adopted by the board and the system of internal control.

The company operates within a framework of policy/procedural requirements and must have in place appropriate health and safety policies and procedures and provide necessary information, instruction, training and supervision. In addition, the company provides occupational health, safety and welfare advisory services for employees.

Specific health and safety goals are also set within the business. These goals include a combination of reductions of accidents and working time lost as a result of accidents, training delivery, internal safety audits and health promotion and surveillance programmes.

Senior management awareness and active employee involvement in health and safety is fundamental to company success. A Think Safety First programme was launched in Yorkshire Water during 2006 and is further developed each year. This programme includes projects for sharing personal accident experiences, promoting key safety messages, managers leading by example, rewarding and recognising colleagues and implementing a behavioural safety coaching process.

Consultation with all employees via area and functional health and safety forum groups and safety committees is actively encouraged. Where possible, the intent is for local health and safety issues to be discussed and resolved with line management. In Yorkshire Water there are health and safety champions who work alongside the Trade Union safety representatives and line management. This ensures that health and safety issues are regularly discussed within each team in all business units.

Our goal is to achieve zero accidents and the measures taken by the company are intended to place emphasis on prevention and continuing vigilance. Yorkshire Water has again been awarded a Gold Medal (recognising eight consecutive Gold Awards) for Occupational Safety from the Royal Society for the Prevention of Accidents for its continued health and safety performance during 2010/11.

## **Directors' statement as to disclosure of information to auditors**

As at the date of this report, as far as each director is aware, there is no relevant audit information of which the company's auditors are unaware and each director has taken steps as he or she should have taken as a director in order to make him or herself aware of any relevant audit information, and to establish that the company's auditors are aware of that information.

# **Directors' Report**

*For the Year Ended 31 March 2011*

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## **Independent auditors**

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and the board has passed a resolution confirming their reappointment



**ON BEHALF OF THE BOARD**

Kevin Whiteman

Chairman

7 July 2011

Registered office Western House, Halifax Road, Bradford BD6 2SZ  
Registered in England no 2366682

# **Corporate Governance Report**

*For the Year Ended 31 March 2011*

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## **Corporate Governance**

Throughout the year the board remained accountable to the company's shareholders for maintaining standards of corporate governance. The following is an explanation of the measures taken by the company.

### **The board of directors**

The board held ten scheduled meetings during the year. Additional meetings were held where it was considered appropriate or where business needs required. In addition, meetings of committees of the board were held when required. The board had a schedule of matters reserved for its decision.

The board determines the company's strategic objectives and key policies, and approves the business plans for the company, interim and final financial statements, recommendations of dividends, significant investment and major new business proposals, as well as significant organisational matters and corporate governance arrangements. There are clear levels of delegated authority, which enable management to take decisions in the normal course of business.

All new directors, where applicable, received an induction and training on joining the board, including information about the company and their responsibilities, meetings with key managers, and visits to the company's operations. There is an agreed procedure for directors to take independent professional advice at the company's expense in furtherance of their duties in relation to board or committee matters. Directors have access to the company secretary who is responsible for ensuring that board procedures are followed. The directors receive full and timely access to all relevant information, including a monthly board pack of operational and financial reports. Direct access to key executives is encouraged. The company has directors' and officers' liability insurance in place.

At the end of the year, the Yorkshire Water board comprised a non executive chairman, five executive directors and eight further non executive directors.

The board has delegated certain authority to board committees as and when appropriate. The company does not have its own remuneration, nominations or audit committees but these are operated at group level by Kelda Holdings Ltd, the company's ultimate parent company.

### **Kelda Holdings Ltd audit committee**

Roger Hyde, who is an independent non executive director, sits on the Kelda Holdings Ltd audit committee and four group directors comprise the balance of the committee. The external auditors, the head of internal audit and the company secretary attend all meetings. The group finance and regulation director attends by invitation. The committee also meets with the external auditors without the presence of executive management when it considers it necessary or appropriate to do so. The committee chairman reports on the activities of the committee to the group board meeting immediately following each committee meeting.

# **Corporate Governance Report**

*For the Year Ended 31 March 2011*

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The audit committee's key tasks include

- reviewing and monitoring of the integrity of the annual financial statements,
- reviewing the company's system of internal control, including financial, operational, compliance and risk management,
- overseeing the company's relationship with the external auditors, agreeing the nature and scope of the audit and reviewing the independence and objectivity of the external auditors, and
- monitoring and reviewing the effectiveness of the internal audit function

In undertaking these tasks the committee receives and reviews work carried out by the internal and external auditors and their findings. Both the internal and external auditors work to an annual plan developed in consultation with the committee. In addition, the committee reviews specific business areas and processes from time to time.

The regular business of the audit committee includes consideration of reports on financial statements, audit planning, the activities of internal audit and its key findings, and the consideration of the operation of internal control processes.

The independence and objectivity of the external auditors is considered on a regular basis, with particular regard to the level of non audit fees.

The group has adopted an auditors independence policy which establishes procedures and guidance under which the company's relationship with its external auditor is governed so that the audit committee is able to satisfy itself that there are no factors which may, or may be seen to, impinge upon the independence and objectivity of the audit process.

## **Internal control**

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, has been established for identifying, evaluating and managing the significant risks faced by the company and this has been in place for the year under review and up to the date of approval of the annual report and accounts. Strategic, financial, commercial, operational, social, environmental and ethical risks fall within the scope of this process. The process is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss.

The company has comprehensive and well defined control policies with clear structures, delegated authority levels and accountabilities.

The company's risk management process aims to be comprehensive, systematic and continuous, and based on constant monitoring of business risk. The key features of the process include the following:

- The main risks facing the company are identified and recorded in a strategic risk register together with the control mechanisms applicable to each risk. These are collated from risk registers maintained by individual businesses,
- There is clear allocation of management responsibility for risk identification, recording, analysis and control,
- The audit committee reviews the effectiveness of the systems which are in place and reports to the group holding company board,
- An established risk management forum, chaired by the group company secretary operated during the year. This was in transition to passing responsibility for risk to

# **Corporate Governance Report**

*For the Year Ended 31 March 2011*

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operational business units throughout the group, reporting to the audit committee via the executive team,

- Business units are required to report annually on principal business risks and the operation of control mechanisms, and
- The internal audit department provides objective assurance and advice on risk management and control, and monitors the risk management process

The audit committee reviews and monitors the effectiveness of the process on behalf of the group holding company board

In addition to this process, the business is subject to a quarterly comprehensive review by the executive team, independent internal and external audits which were reported to the executive team and the audit committee, an extensive budget and target-setting process, a quarterly reporting and forecasting process reviewing performance against agreed objectives, appropriate delegated authority levels, established financial policies and procedures, and other risk management policies and procedures such as health and safety and environmental policies

## **Environment**

The environmental policy of the company recognises that a sustainable water and waste water business is dependent on environmentally sustainable operations. It is therefore committed to integrating environmental best practice and continuous improvement in environmental performance through the efficient, effective and proper conduct of its business.

Environmental performance is reported through the company's website which is regularly updated. This can be viewed at [www.yorkshirewater.com/our-environment.aspx](http://www.yorkshirewater.com/our-environment.aspx)

## **Community**

The company contributes actively to the communities which it serves. It encourages and supports colleagues in volunteering, charitable giving and community involvement. One in three employees is active in a wide range of supported community activities. These include a Speakers' Panel and support to local education ranging from governor appointments, and Right to Read in junior schools through to coaching at senior schools and mentoring university students from diverse ethnic backgrounds.

## **Going concern**

After making enquiries, the directors have a reasonable expectation, given the nature of the regulated water services business, that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

# **Profit and Loss Account**

for the year ended 31 March 2011

	Note	2011 £m	2010 £m
<b>Turnover</b>		<b>867.4</b>	869.4
Operating costs before exceptional costs	2	<b>(547.9)</b>	(493.7)
Exceptional operating costs	2	<b>(5.9)</b>	(2.2)
<b>Total operating costs</b>		<b>(553.8)</b>	(495.9)
<b>Operating profit</b>		<b>313.6</b>	373.5
Net interest payable and similar charges before exceptional costs	5	<b>(231.2)</b>	(167.0)
Non operating exceptional costs	4	<b>(40.0)</b>	(42.1)
Net interest payable and similar charges - total		<b>(271.2)</b>	(209.1)
<b>Profit on ordinary activities before tax</b>		<b>42.4</b>	164.4
Tax on profit on ordinary activities	6	<b>75.3</b>	(38.3)
<b>Profit for the financial year</b>		<b>117.7</b>	126.1

All of the above results relate to continuing activities

There is no material difference between the profit before tax and the profit for the year stated above and their historical cost equivalents. There is no material difference between the historical cost depreciation charge and the actual depreciation charge for the year as a result of the revaluation of certain tangible fixed assets.

## **Statement of Total Recognised Gains and Losses**

for the year ended 31 March 2011

There are no recognised gains and losses other than those included in the profit and loss account (2010: £nil)

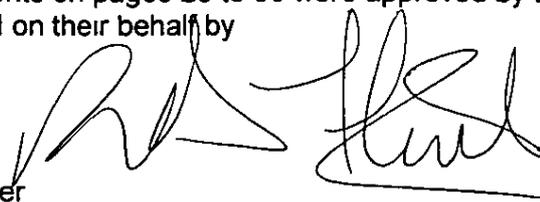
# Balance Sheet

as at 31 March 2011

	Note	2011 £m	2010 £m
<b>Fixed assets</b>			
Intangible assets	8	7.6	8.5
Tangible assets	9	4,357.8	4,280.0
Investments	10	0.1	0.1
		<u>4,365.5</u>	<u>4,288.6</u>
<b>Current assets</b>			
Stock	11	1.2	1.1
Debtors falling due within one year	12	160.0	240.7
Debtors falling due after more than one year	12	928.9	296.7
Debtors - total	12	1,088.9	537.4
Cash and short term deposits	14	45.4	58.8
		<u>1,135.5</u>	<u>597.3</u>
<b>Creditors: amounts falling due within one year</b>			
Short term borrowings	14	(63.3)	(209.3)
Other creditors	13	(333.8)	(274.1)
		<u>(397.1)</u>	<u>(483.4)</u>
<b>Net current assets</b>		<u>738.4</u>	<u>113.9</u>
<b>Total assets less current liabilities</b>		<b>5,103.9</b>	<b>4,402.5</b>
<b>Creditors: amounts falling due after more than one year</b>			
Long term borrowings	14	(3,578.6)	(2,923.6)
Other creditors	13	(134.4)	(139.7)
		<u>(3,713.0)</u>	<u>(3,063.3)</u>
<b>Provisions for liabilities and charges</b>	16	<b>(497.9)</b>	<b>(517.1)</b>
<b>Net assets</b>		<u><b>893.0</b></u>	<u><b>822.1</b></u>
<b>Capital and reserves</b>			
Called up share capital	17	10.0	10.0
Profit and loss reserve	18	827.9	756.5
Share based payment reserve	18	3.5	3.4
Revaluation reserve	18	51.6	52.2
<b>Total shareholder's funds</b>	18	<u><b>893.0</b></u>	<u><b>822.1</b></u>

The financial statements on pages 28 to 50 were approved by the board of directors on 7 July 2011 and signed on their behalf by

Richard Flint  
Chief Executive Officer



Yorkshire Water Services Ltd  
Registered in England no 2366882

# Notes to the Financial Statements

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## Notes to the financial statements for the year ended 31 March 2011

### 1. ACCOUNTING POLICIES

The following paragraphs summarise the more important accounting policies applied in the preparation of the accounts

#### ***Basis of preparation and accounting***

The company's financial statements are prepared on a going concern basis, under the historical cost convention as modified by the revaluation of certain tangible fixed assets, in compliance with all applicable United Kingdom accounting standards (Financial Reporting Standards 'FRS', Statement of Standard Accounting Practice 'SSAP' and Urgent Issues Task Force abstract 'UITF') and, except where otherwise stated in the notes to the accounts, with the Companies Act 2006

The accounting policies have been reviewed in accordance with the requirements of FRS 18. The directors consider that the accounting policies set out below remain most appropriate to the company's circumstances, have been consistently applied and are supported by reasonable and prudent estimates and judgements

The financial statements present information about the company as an individual company undertaking and do not contain consolidated financial information as the parent of a group. The company is exempt from preparing group financial statements under Section 400 of the Companies Act 2006 as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its ultimate UK parent, Kelda Eurobond Co Ltd, a company registered in England and Wales

The accounts do not include a cashflow statement because the cashflows of the company are consolidated in the cashflow statement of the Kelda Eurobond Co Ltd financial statements in accordance with FRS 1 (Revised)

#### ***Turnover***

Turnover comprises charges to customers for water, sewerage and other services excluding value added tax and is derived only from the United Kingdom

Turnover is not recognised until the service has been provided to the customer. Turnover relates to charges due in the year, excluding any amounts paid in advance. Turnover for measured water charges includes amounts billed plus an estimation of the amounts unbilled at the year end. The accrual is estimated using a defined methodology based upon daily average water consumption, which is calculated based upon historical billing information

No turnover is recognised for unoccupied properties and no bills are raised. If a bill has been issued, and the company subsequently become aware that the property is unoccupied, the bill and relevant turnover is cancelled. Generally a property is classed as void if it is unoccupied and unfurnished

#### ***Pensions***

The company accounts for its pensions in accordance with FRS 17 "Retirement Benefits". A majority of the company's employees participate in the Kelda Group Pension Plan (KGPP), a group defined benefit pension scheme as described in Note 21 of the financial statements. The KGPP is a group multi-employer scheme, such that the company's pension scheme's assets and liabilities are included with those of other companies in the KGPP. The company is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis and therefore accounts for the scheme as if it was a defined contribution scheme. The KGPP closed to new members in 2006

# Notes to the Financial Statements

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The company also provides a defined contribution scheme, Kelda Stakeholder+, which is available to new and existing employees

## **Share based payments**

### **Savings related share option scheme**

In prior years, the then ultimate parent company, Kelda Group Ltd (formerly Plc), operated a savings related share option scheme under which options were granted to employees. The fair value of options granted in exchange for employee services rendered was recognised as an expense in Yorkshire Water's profit and loss account with a corresponding credit to equity.

The total amount expensed over the vesting period was determined by the fair value of the option at the date of the grant. The fair value of the option calculated was determined by use of mathematical modelling including the Black Scholes option pricing model.

The group re-assesses its estimate of the number of options that are expected to become exercisable at each balance sheet date. Any adjustments to the original estimates are recognised in the profit and loss account (and equity). No expense is recognised for awards that did not ultimately vest, except for awards where vesting was conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition was satisfied, provided that all other performance conditions are satisfied.

During 2008/09 the scheme was closed following the acquisition of Kelda Group Plc by Saltaire Water Ltd. Certain schemes have been allowed to continue until the planned maturity, with members choosing whether to continue contributing. For any member who has taken that option, charges to the profit and loss account will continue until the maturity of the scheme. For any other member who has opted to close their scheme, charges to the profit and loss account ceased in the month that they chose to leave the scheme.

For both share options the corresponding entries to equity represent capital contributions from the parent company. When the amounts are recharged by the parent, a corresponding entry to reserves is recorded.

### **Research and development expenditure**

Research and development expenditure is written off in the profit and loss account in the financial year in which it is incurred. Expenditure on fixed assets relating to development projects is written off over the expected useful life of those assets.

### **Taxation**

The taxation charge is based on the result for the year as adjusted for disallowable and non-taxable items using current rates and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and for accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date, subject to the following:

- provision is made for gains on disposals of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets, and
- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

## Notes to the Financial Statements

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Deferred tax is calculated at the rates at which it is estimated that tax will arise based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is discounted.

### **Investments**

Other fixed asset investments are stated at cost and reviewed for impairment if there are any indications that the carrying value may not be recoverable.

### **Intangible assets**

Goodwill is the excess of the fair value of the consideration paid for a business or an associate over the fair value of the identifiable assets and liabilities acquired. Goodwill is recognised and amortised on a straight line basis over its economic useful life, which normally will not exceed 20 years. Impairment tests on the carrying value of goodwill are undertaken at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable. When it is determined that the carrying value of goodwill exceeds the recoverable amount, the excess is written off to the profit and loss account.

### **Tangible fixed assets and depreciation**

Tangible fixed assets comprised the following:

#### **Infrastructure assets**

Infrastructure assets comprise a network of systems being mains and sewers, impounding and pumped raw water storage reservoirs, dams and sea outfalls.

Expenditure on infrastructure assets to increase capacity or enhance the network and to maintain the operating capability of the network in accordance with defined standards of service is treated as a fixed asset addition and included at cost after deducting grants and contributions.

Infrastructure assets are valued at cost, which represents the purchase price, less accumulated depreciation. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network based on an independently certified asset management plan.

#### **Other tangible fixed assets**

Following a change in accounting policy during 2009, residential properties, non-specialised properties and rural estates held within land and buildings are held at valuation. Other tangible fixed assets are included at cost, which represents the purchase price, less accumulated depreciation. Finance costs incurred in respect of the construction of other tangible fixed assets are expensed as incurred.

Freehold land is not depreciated. Depreciation is charged on other tangible fixed assets (including those assets held at valuation, where appropriate) on a straight-line basis over their estimated economic lives, or the estimated useful economic lives of their individual major components, from the month following commissioning. Useful economic lives are principally as follows:

Buildings	25 - 60 years
Fixed plant	5 - 40 years
Vehicles, mobile plant and computers	3 - 10 years

Fixed plant, vehicles, mobile plant and computers are classified as plant and equipment within Note 9. Assets under construction are not depreciated until they are brought into use.

## **Notes to the Financial Statements**

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Residential properties, non-specialised properties and rural estates are held at valuation with external valuations being undertaken on a periodic basis. An interim valuation is booked in the intervening years if in the view of the directors there has been a material change.

### **Leased assets**

Assets which are financed by leasing agreements that transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised in tangible fixed assets and the corresponding capital cost is shown as an obligation to the lessor in borrowings. Depreciation is generally charged to the profit and loss account over the shorter of the estimated useful life and the term of the lease. If the operational life of an asset is longer than the lease term, and the agreement allows an extension to that term, the asset may be depreciated over its operational life. The capital element of lease payments reduces the obligation to the lessor and the interest element is charged to the profit and loss account over the term of the lease in proportion to the capital amount outstanding.

All other leases are operating leases and the rentals are charged to the profit and loss account on a straight-line basis over the term of the lease.

### **Grants and contributions**

Grants and contributions in respect of tangible assets, other than infrastructure assets as described below, are deferred and credited to the profit and loss account by installments over the expected economic useful lives of the related assets.

Grants and contributions in respect of expenditure enhancing the infrastructure network are applied in reducing that expenditure. This is not in accordance with the Companies Act 2006, which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. The presentation is adopted because infrastructure assets do not have determinable finite lives and therefore such grants and contributions would remain as liabilities in perpetuity. The directors consider that the company's presentation shows a true and fair view of the investment in infrastructure assets. The effect on the company's balance sheet of this departure is to decrease the net book value of tangible fixed assets by £393.7m (2010 £383.7m).

Grants and contributions received in respect of expenditure charged to the profit and loss account during the year are included in the profit and loss account.

### **Stock**

Stock is stated at cost less any provision necessary to recognise damage and obsolescence. Work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, and an appropriate proportion of overheads.

### **Receipts in advance**

Receipts in advance include the monies received from customers where the related turnover has not yet been recognised and also grants and contributions received in relation to capital schemes where the work has not yet commenced. They are recognised within other creditors until the related revenue or costs are recognised.

### **Foreign currencies**

Individual transactions denominated in foreign currencies are translated into sterling at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currency are translated at the exchange rates prevailing at the balance sheet date. Profits and losses on both individual currency transactions settled during the year and unsettled monetary assets and liabilities are dealt with in the profit and loss account.

# Notes to the Financial Statements

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## **Provisions**

Provisions are recognised when the company has a present obligation as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation

Provision is made in accordance with FRS 12 "Provisions, contingencies and commitments" for self insured claims, including an estimate for claims incurred but not reported

Provisions also include index linked swaps novated from Saltaire Water Ltd to Yorkshire Water in August 2008 Under the terms of the agreement, the swaps were transferred to Yorkshire Water at fair value and are held in the balance sheet as a provision This provision is being amortised over the life of the swaps (38 years) and is not discounted

## **Financial instruments**

### **Trade debtors and creditors**

Trade debtors do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated recoverable amounts There is no intention to trade the debtors Trade creditors are not interest bearing and are stated at their invoiced value

### **Interest rate swaps**

Interest rate swaps are used to hedge the company's exposure to fluctuations in interest rates on its borrowings The amounts payable or receivable in respect of interest rate swaps are accounted for on an accruals basis through adjustments to the interest expense of the corresponding liability

### **Index linked swaps**

Index linked swaps are intended to hedge Yorkshire Water's exposure to movements in RPI against its LIBOR linked borrowings

Yorkshire Water applies hedge accounting for its swaps to the extent that there is sufficient floating rate debt within Yorkshire Water, over the entire life of the swap, from existing or expected future debt To the extent that there is insufficient floating rate debt and the mark to mark valuation of the swap is negative, any exposure relating to the portion of the swap that is not hedged is provided for in the balance sheet as an onerous contract provision

The swaps have three cashflows

- Six monthly receivable elements linked to LIBOR,
- Six monthly payable elements linked to RPI, and
- An RPI-linked final bullet payment that is payable on maturity of the instruments

Interest payments and receipts are accrued in the profit and loss account The RPI bullet is calculated based on the RPI at the measurement date, accrued in the profit and loss account and recognised within long term borrowings

These swaps were novated to Yorkshire Water from Saltaire Water Ltd in August 2008 at which time the swaps were out of the money by £308.9m This value was reflected in Yorkshire Water's balance sheet as an intercompany debtor, with a provision for the same amount The onerous contract provision above takes into account the unamortized novation provision

The calculation of the onerous contract provision takes account of both the RPI swaps and the interest rate (finance lease) swaps

## Notes to the Financial Statements

The company is not required to prepare its financial statements in accordance with FRS 26 and apart from the provisions noted above its index linked swaps are not recognised in the financial statements in accordance with UK GAAP (Note 15)

### 2. OPERATING PROFIT

Operating profit (before exceptional costs) is stated after (crediting)/charging

	<b>2011</b>	<b>2010</b>
	<b>£m</b>	<b>£m</b>
Own work capitalised	<b>(31.6)</b>	<b>(26 0)</b>
Raw materials and consumables	<b>22.7</b>	17 6
Other external charges	<b>234.3</b>	222 6
Wages and salaries	<b>71.3</b>	66 1
Social security costs	<b>6.3</b>	5 7
Pension costs (note 21)	<b>25.9</b>	16 6
Depreciation of fixed tangible assets (note 9)		
On owned assets		
- infrastructure	<b>59.6</b>	47 7
- other assets	<b>151.7</b>	134 5
On assets held under finance leases		
- infrastructure	<b>2.3</b>	1 9
- other assets	<b>9.1</b>	9 3
Operating lease charges		
- plant and equipment	<b>1.9</b>	2 0
- other	<b>0.7</b>	0 4
Amortisation of grants and contributions	<b>(3.1)</b>	<b>(3 0)</b>
Amortisation of goodwill on subsidiary undertakings (note 8)	<b>0.9</b>	0 9
Restructuring costs	<b>0.2</b>	0 1
Research and development	<b>0.8</b>	0 8
Other operating income	<b>(5.1)</b>	<b>(3 5)</b>
	<b><u>547.9</u></b>	<b><u>493 7</u></b>

#### Exceptional operating costs

Exceptional operating costs in the year ended 31 March 2011 of £5.9m relate to costs incurred during the severe winter weather in December 2010. Exceptional operating costs in the year ended 31 March 2010 of £2.2m related to restructuring costs.

#### Services provided by the company's auditors

During the year the company obtained the following services from its auditors at costs as detailed below

	<b>2011</b>	<b>2010</b>
	<b>£'000</b>	<b>£'000</b>
Fees payable for the audit	<b>132</b>	114
Fees payable for taxation services	<b>16</b>	-
Fees payable for other services	<b>50</b>	-
	<b><u>198</u></b>	<b><u>114</u></b>

# Notes to the Financial Statements

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## Average number of employees

The average number of persons employed by the company during the year was

	2011	2010
	<i>Number</i>	Number
Average number of employees	<u>2,329</u>	<u>2,132</u>

## 3. DIRECTORS' EMOLUMENTS

(excluding those listed below)

	2011	2010
	£'000	£'000
Aggregate emoluments	<u>1,367</u>	<u>1,566</u>
The amounts in respect of the highest paid director are as follows		
Emoluments	<u>361</u>	<u>436</u>

Rhys Evenden, Jane Seto, Mark Lorkin, Scott Auty and Holly Koeppel are non-executive directors of Kelda Holdings Ltd and do not receive any emoluments for their service

All executives have service agreements which are terminable by the company on 12 months' notice

During 2010/11, all except one executive director were contributory members of the Kelda Group Pension Plan, a defined benefit scheme. One director was a contributory member of the Kelda Stakeholder Plus scheme (a money purchase scheme). The accrued pension benefit of the highest paid director in 2010/11 was £61,178 (2010 £42,919). No directors have exercised share options during the year (2010 nil).

## 4. NON OPERATING EXCEPTIONAL COSTS

Yorkshire Water holds certain index linked swaps with a nominal value of £1,289m which were out of the money at 31 March 2011 by £867.2m. At the balance sheet date it was concluded that 43.3% of the swaps (£375.5m of the £867.2m) did not represent an effective hedge. The unhedged portion has therefore been recognised within the balance sheet, £40.0m classified as borrowings in relation to the RPI uplift to date and £335.5m classified as an onerous contract within the accounts. The movement in the onerous contract provision during the year of £40.0m has been charged in the profit and loss account as a non-operating exceptional cost.

During the prior year Yorkshire Water incurred exceptional costs of £42.1m. As a result of the whole business securitisation in July 2009, Yorkshire Water made a £42.1m share capital injection into Yorkshire Water Services Odsal Finance Holdings Ltd (Odsal Holdings) to enable the payment of accrued interest on exchanged bonds. Yorkshire Water is required to write down the investment in Odsal Holdings at the year end as the net assets of Odsal Holdings are lower than the amount invested. The cash will be returned to Yorkshire Water over the life of the exchanged bonds. These costs were included within financing costs as they were incurred as a result of the whole business securitisation.

## Notes to the Financial Statements

### 5. INTEREST PAYABLE AND SIMILAR CHARGES BEFORE EXCEPTIONAL COSTS

	2011 £m	2010 £m
<b>Interest receivable and similar income:</b>		
Inter-company loans	(42.3)	(13.1)
Index linked swaps	(12.4)	(19.5)
Amortisation of fair value of index linked swaps (note 16)	(8.1)	(8.1)
Other	(0.7)	(1.0)
	<u>(63.5)</u>	<u>(41.7)</u>
<b>Interest payable and similar charges:</b>		
Bank loans and overdrafts	16.7	19.6
Finance leases	7.2	9.8
Inter-company loans	182.6	121.8
RPI uplift on index linked swaps	22.8	(2.5)
Interest rate swap interest	9.4	12.7
Index linked swaps coupon payable	39.3	30.3
Whole business securitisation fees	-	9.7
Other	16.7	7.3
	<u>294.7</u>	<u>208.7</u>
<b>Net interest payable</b>	<u>231.2</u>	<u>167.0</u>

### 6. TAX (CREDIT)/CHARGE ON PROFIT ON ORDINARY ACTIVITIES

	2011 £m	2010 £m
<b>Current tax:</b>		
Corporation tax at 28% (2010 28%)	14.7	52.3
Adjustments in respect of prior years	(30.8)	(0.4)
Total current tax	<u>(16.1)</u>	<u>51.9</u>
<b>Deferred tax:</b>		
Charge for timing differences arising and reversing in the year	(18.2)	5.4
Adjustments in respect of prior years	1.3	(2.0)
	<u>(16.9)</u>	<u>3.4</u>
Increase in discount	(4.8)	(17.0)
Effect of change in tax rate	(37.5)	-
Total deferred tax (note 16)	<u>(59.2)</u>	<u>(13.6)</u>
<b>Total tax on profit on ordinary activities</b>	<u>(75.3)</u>	<u>38.3</u>

Note 16 shows further detail on the discounting of the deferred tax provision

## Notes to the Financial Statements

The difference between the total current tax charge shown and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows

	<b>2011</b>	<b>2010</b>
	<b>£m</b>	<b>£m</b>
<b>Profit on ordinary activities before tax</b>	<b>42.4</b>	<b>164.4</b>
Tax on profit on ordinary activities at standard UK corporation tax rate of 28% (2010 28%)	<b>11.9</b>	46.0
Effects of		
Income not chargeable for tax purposes	<b>(0.9)</b>	(5.3)
Expenses not deductible for tax purposes	<b>5.0</b>	17.0
Capital allowances less/(in excess) of depreciation and other timing differences	<b>19.5</b>	(5.4)
Movement in short term timing differences	<b>(1.1)</b>	-
Utilisation of tax losses in other group companies	<b>(19.7)</b>	-
Adjustments in respect of prior years	<b>(30.8)</b>	(0.4)
Current tax (credit)/charge for the year	<b>(16.1)</b>	51.9

The tax charge in future periods may be affected by the following factors

- capital investment is expected to remain at similar levels. The company expects to be able to continue to claim capital allowances in excess of depreciation in future years
- changes in the medium and long-term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account

The adjustments in respect of prior years of £30.8m relates to the release of the over provision of tax provisions in previous periods. Upon agreement of the tax treatment of items with HM Revenue and Customs, these provisions have now been released. In addition there has been a reduction in the amount payable to certain group companies for the receipt of group tax losses.

In addition, industrial buildings allowance was phased out at the end of March 2011. The net impact of this change is not expected to be material.

The March 2011 Budget introduced a reduction in the rate of corporation tax from 28% to 26% from 1 April 2011. (The rate was previously to be reduced from 28% to 27% from 1 April 2011 by the Finance (No. 2) Act 2010). Further reductions in the rate of corporation tax are proposed to reduce the rate by 1% per annum to 23% by 1 April 2014.

Deferred tax assets and liabilities are measured upon this new 26% rate.

The proposed reductions of the rate of corporation tax by 1% per year to 23% by 1 April 2014 are expected to be enacted separately each year. The overall effect of the further change from 26% to 23%, if applied to the deferred tax balance at 31 March 2011, would be to reduce the deferred tax liability by £67.1m (being £22.4m provided in 2012, £22.4m provided in 2013 and £22.3m provided in 2014).

## Notes to the Financial Statements

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### 7. DIVIDENDS

No final dividend for the year has been proposed. The dividend in the year of £46.9m was paid in order to fund interest and a loan repayment on a loan from Yorkshire Water to Kelda Holdco Ltd. Of the prior year dividend of £211.0m, £27.8m was paid to fund interest and loan repayments.

### 8. INTANGIBLE ASSETS

	<i>Goodwill</i>
<b>Cost</b>	£m
Balance at 1 April 2010 and 31 March 2011	<u>17.9</u>
<b>Amortisation</b>	
Balance at 1 April 2010	(9.4)
Charge for the year	<u>(0.9)</u>
Balance at 31 March 2011	<u>(10.3)</u>
<b>Net book amount as at 31 March 2011</b>	<u><b>7.6</b></u>
Net book amount as at 31 March 2010	<u>8.5</u>

Goodwill arose on the transfer of the trade and net assets of The York WaterWorks Ltd on 1 April 2000 and is being amortised over 19 years. The directors do not believe this should be impaired as it relates to assets which are still in continuing use within the business.

# Notes to the Financial Statements

## 9. TANGIBLE ASSETS

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Under construction £m	Total £m
<b>Cost or valuation</b>					
At 1 April 2010	1,729.3	2,671.3	2,376.6	216.1	6,993.3
Additions	14.2	25.8	45.6	224.7	310.3
Transfers on commissioning	31.9	34.4	75.2	(141.5)	-
Disposals - external	(10.4)	-	(27.4)	(0.4)	(38.2)
Grants and contributions	-	-	-	(10.0)	(10.0)
<b>At 31 March 2011</b>	<b>1,765.0</b>	<b>2,731.5</b>	<b>2,470.0</b>	<b>288.9</b>	<b>7,255.4</b>
<b>Depreciation</b>					
At 1 April 2010	533.0	1,013.4	1,166.9	-	2,713.3
Disposals	(10.3)	-	(27.7)	(0.4)	(38.4)
Depreciation for the year	33.6	61.9	126.8	0.4	222.7
<b>At 31 March 2011</b>	<b>556.3</b>	<b>1,075.3</b>	<b>1,266.0</b>	<b>-</b>	<b>2,897.6</b>
<b>Closing net book amount</b>	<b>1,208.7</b>	<b>1,656.2</b>	<b>1,204.0</b>	<b>288.9</b>	<b>4,357.8</b>
Opening net book amount	1,196.3	1,657.9	1,209.7	216.1	4,280.0

At 31 March 2011 assets above held under finance leases amounted to

Cost	126.1	100.0	197.6	-	423.7
Depreciation	(33.6)	(21.7)	(125.4)	-	(180.7)
<b>Closing net book amount</b>	<b>92.5</b>	<b>78.3</b>	<b>72.2</b>	<b>-</b>	<b>243.0</b>
Opening net book amount	94.7	80.6	82.1	-	257.4

	Cost at 31 March 2011 £m	Depreciation at 31 March 2011 £m	Net book value at 31 March 2011 £m	Net book value at 31 March 2010 £m
<b>The net book amount of land and buildings comprised:</b>				
Freehold properties	1,586.0	(382.2)	1,203.8	1,195.0
Properties held on long lease	0.5	-	0.5	0.5
Properties held on short lease	5.1	(0.6)	4.5	0.8
	<b>1,591.6</b>	<b>(382.8)</b>	<b>1,208.8</b>	<b>1,196.3</b>

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets. The company's accounting policy in respect of grants and contributions is a departure from the Companies Act 2006 requirements and is adopted, as explained in the accounting policy note on page 33, in order to show a true and fair view of the investment in infrastructure assets. As a consequence, the net book amount of fixed assets is £393.7m (2010 £383.7m) lower than it would have been had this treatment not been adopted.

Certain categories of the company's land and buildings are held at valuation, on the basis of existing use, valued by independent qualified valuers in March 2009. The valuations were

## Notes to the Financial Statements

undertaken in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors in the UK. These external valuations will be re-performed on a periodic basis. An interim valuation is booked in intervening years based on directors' valuations. No changes in values have been booked during the year.

No deferred tax is provided on timing differences arising from the revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will be rolled over.

Categories of assets revalued are as follows

	Valuation	Historical cost basis
	£m	£m
Non-specialist properties	7.5	2.4
Rural estates	43.9	0.8
Residential properties	4.7	0.1
	<u>56.1</u>	<u>3.3</u>

Analysis of the net book value of revalued assets is as follows

	Valuation	Historical cost basis
	£m	£m
31 March 2009	56.1	3.3
Disposal of revalued assets	(0.3)	-
Transfer to the profit and loss account in respect of additional depreciation incurred on revaluation	<u>(0.3)</u>	<u>-</u>
31 March 2010	55.5	3.3
Disposal of revalued assets	(0.3)	-
Transfer to the profit and loss account in respect of additional depreciation incurred on revaluation	<u>(0.3)</u>	<u>-</u>
31 March 2011	<u>54.9</u>	<u>3.3</u>

### 10. INVESTMENTS

Investments of £0.1m at 31 March 2011 and 31 March 2010 includes £27,119 of 8% Unsecured Loan Stock in Water Research Centre (1989) Plc, which conducts research on behalf of the water industry.

The company has taken advantage of the exemption from preparing group accounts under section 400 of the Companies Act 2006. Consolidated accounts have been prepared by Kelda Eurobond Co Ltd, the largest UK group to consolidate these accounts. Copies can be obtained from the Company Secretary, Kelda Eurobond Co Ltd, Western House, Halifax Road, Bradford, BD6 2SZ.

### 11. STOCK

	2011	2010
	£m	£m
Raw materials and consumables	1.2	1.0
Work in progress	-	0.1
	<u>1.2</u>	<u>1.1</u>

# Notes to the Financial Statements

## 12. DEBTORS

	2011 £m	2010 £m
<b>Receivable within one year</b>		
Trade debtors	77.9	80.2
Amounts owed by group undertakings	10.6	90.1
Amounts owed to subsidiary undertakings	1.4	-
Prepayments and accrued income	59.8	60.2
Other debtors	10.3	10.2
	<u>160.0</u>	<u>240.7</u>
<b>Receivable after more than one year</b>		
Amounts owed by group undertakings	928.8	296.7
Other debtors	0.1	-
	<u>928.9</u>	<u>296.7</u>

Amounts owed by group undertakings within one year and after more than one year includes £288.6m (2010 £296.7m) in respect of the fair value of index linked swaps at the date of novation from Saltaire Water Ltd to Yorkshire Water in August 2008 and £640.2m upstream loans to Kelda Holdco Ltd (2010 £nil)

## 13. OTHER CREDITORS

	2011 £m	2010 £m
<b>Amounts falling due within one year:</b>		
Trade creditors	46.9	43.1
Capital creditors	104.4	34.9
Deferred grants and contributions on depreciating fixed assets	2.9	3.0
Amounts owed to group undertakings	17.0	22.2
Amounts owed to subsidiary undertakings	74.1	57.2
Social security and other taxes	1.9	2.0
Taxation payable	5.7	24.3
Receipts in advance	50.3	52.4
Other creditors	30.6	35.0
	<u>333.8</u>	<u>274.1</u>
<b>Amounts falling due after more than one year:</b>		
Deferred grants and contributions on depreciating fixed assets	71.0	73.4
Other creditors	63.4	66.3
	<u>134.4</u>	<u>139.7</u>

Amounts owed to group undertakings relate to amounts of debt raised by subsidiaries and lent to Yorkshire Water to finance its operations in addition to creditors for services provided

## Notes to the Financial Statements

### 14. AGGREGATE BORROWINGS AND CASH

	2011			
	<i>Bank loans and overdrafts</i>	<i>Other loans</i>	<i>Finance leases</i>	<i>Total</i>
	£m	£m	£m	£m
<b>Short term borrowings:</b>				
In one year or less or on demand	45.9	-	17.4	63.3
<b>Long term borrowings:</b>				
In more than one year, but not more than two years	41.0	-	20.1	61.1
In more than two years, but not more than five years	91.7	-	90.3	182.0
In more than five years	127.1	40.0	237.3	404.4
	<b>259.8</b>	<b>40.0</b>	<b>347.7</b>	<b>647.5</b>
<b>Cash at bank</b>				<b>(45.4)</b>
Net amounts owed to subsidiary companies				<b>2,290.9</b>
<b>Net debt at 31 March 2011</b>				<b><u>2,956.3</u></b>
	2010			
	<i>Bank loans and overdrafts</i>	<i>Other loans</i>	<i>Finance leases</i>	<i>Total</i>
	£m	£m	£m	£m
<b>Short term borrowings</b>				
In one year or less or on demand	27.1	-	12.5	39.6
<b>Long term borrowings</b>				
In more than one year, but not more than two years	43.0	-	13.2	56.2
In more than two years, but not more than five years	103.6	-	72.8	176.4
In more than five years	156.1	17.2	282.5	455.8
	<b>302.7</b>	<b>17.2</b>	<b>368.5</b>	<b>688.4</b>
<b>Cash at bank</b>				<b>(58.8)</b>
Amounts owed to parent company				80.7
Short term amounts owed to subsidiary companies				169.7
Long term amounts owed to subsidiary companies				<u>2,154.5</u>
<b>Net debt at 31 March 2010</b>				<b><u>3,074.1</u></b>

Net amounts owed to subsidiary companies includes £640.2m receivable (2010: £nil) in relation to loans to parent companies. This is disclosed within debtors receivable after more than one year.

Borrowings repayable in instalments after more than five years include £237.3m (2010: £282.5m) in respect of finance leases which have expiry dates ranging from 2018 to 2043 and carry interest rates based on 12 month LIBOR (London Interbank Offered Rate) and 6 month LIBOR. The finance lease creditors are secured on the underlying assets.

At 31 March 2011 Yorkshire Water had undrawn committed syndicated bank facilities totalling £510.0m. These facilities expire in November 2012.

# Notes to the Financial Statements

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## 15. FINANCIAL DERIVATIVES

### Interest rate swaps

Yorkshire Water holds £125.0m nominal value (2010 £290.0m) of floating to fixed rate interest swaps. These swaps had an out of the money mark to market value of £15.2m at 31 March 2011 (2010 £25.0m).

### Index linked swaps

In February 2008, Saltaire Water Ltd, at that time an intermediate parent company, entered into certain index linked ('IL') swaps, with a nominal value of £1,288.9m. These swaps were novated to Yorkshire Water in August 2008 at which time the swaps were out of the money by £308.9m. This value was reflected in Yorkshire Water's balance sheet as an intercompany debtor, receivable from Saltaire, with a provision for the same amount. The provision is amortised through the Yorkshire Water profit and loss account over a 38 year period (being the remaining weighted average life of the swaps) and for 2010/11 the amortisation charge was £8.1m.

The outstanding IL swaps have maturity dates ranging from 2026 to 2063, some with break dates exercisable by the swap counterparties prior to maturity. Provisions within the bank covenants require that break dates are arranged such that swaps with a nominal value equal to no more than 3.5% of RCV can break in any two year period and no more than 7% of RCV in any five year period, thus reducing the risk of swap maturity concentration.

There are three cashflows associated with the swaps:

- Six monthly receivable elements linked to LIBOR,
- Six monthly payable elements linked to RPI, and
- An RPI-linked final bullet that is payable on maturity of the instruments.

Interest payments and receipts are accrued in the profit and loss account. The RPI bullet accumulated at the balance sheet date is discounted using the 30 year gilt rate at the relevant date, accrued in the profit and loss account and recognised within long term borrowings.

With six month LIBOR and applicable discount rates at historically low levels in the short term, these swaps gave rise to an out of the money mark to market value of £867.2m (2010 £829.8m) at the year end date, giving a total mark to market for all swaps of £882.4m (2010 £854.8m).

Of this £40.0m (2010 £17.2m) has been recognised within long term borrowings, this represents the discounted value of the RPI bullet accrued to 31 March 2011.

A further £335.5m is included within provisions for liabilities and charges (2010 £295.5m) (note 16) which represents an onerous contract provision in relation to the unhedged portion of the interest rate and index linked swaps.

When calculating the size of the provision required at 31 March 2011, the directors have considered that:

- At the year end, the swaps are effectively hedging 56.7% of the floating rate debt held by Yorkshire Water and the further floating rate debt to be taken out by Yorkshire Water, and
- The swaps are held for the long term benefit of the business and provide a hedge against existing and future floating rate debt as Yorkshire Water gears up in the foreseeable future under the new securitised structure.

All of the swaps outlined above were valued using information provided by external consultants, using a discounted cash flow model and quoted market information. This information is reviewed by the group treasury department and discussed with relevant directors to ensure it is appropriate for use.

## Notes to the Financial Statements

### 16. PROVISIONS FOR LIABILITIES AND CHARGES

	Index linked swaps onerous contract provision £m	Deferred tax £m	Self insurance £m	Total £m
At 1 April 2009	303.6	234.9	0.3	538.8
(Credited)/charged to the profit and loss account in the year	-	(13.6)	0.3	(13.3)
Utilised in the year	(8.1)	-	(0.3)	(8.4)
At 31 March 2010	295.5	221.3	0.3	517.1
Charged/(credited) to the profit and loss account and utilised in the year	40.0	(59.3)	0.1	(19.2)
<b>At 31 March 2011</b>	<b>335.5</b>	<b>162.0</b>	<b>0.4</b>	<b>497.9</b>

#### Deferred tax

	2011 £m	2010 £m
At 1 April	221.3	234.9
Deferred tax credited to the profit and loss account	(60.5)	(11.6)
Adjustments in respect of prior years	1.3	(2.0)
<b>At 31 March</b>	<b>162.1</b>	<b>221.3</b>

Deferred tax is provided as follows

	At 31 March 2011 £m	At 31 March 2010 £m
Accelerated capital allowances	492.5	552.4
Short term timing differences	3.1	(2.3)
Undiscounted provision for deferred tax	495.6	550.1
Discount	(333.5)	(328.8)
<b>Discounted provision for deferred tax</b>	<b>162.1</b>	<b>221.3</b>

The corporation tax rate of 26% (2010 28%) has been used to calculate the amount of deferred tax. The effect of industrial buildings allowances has been excluded from the deferred tax calculations on account of the abolition of balancing allowances and charges announced in the Chancellor's Budget of March 2007 and introduced into legislation by Finance Act 2007. Other than this, provision has been made for all deferred tax assets and liabilities in respect of accelerated capital allowances and other material timing differences.

In accordance with FRS 19 in order to reflect the time value of money, the company discounts its deferred tax liability. The period of discounting runs until the underlying timing differences completely reverse. In carrying out this calculation, all future movements in the accelerated capital allowances and depreciation charges are scheduled out on a yearly basis, taking account of future depreciation rates. No account is taken of timing differences that might arise on fixed assets expected to be purchased in the future. The discount rate used is the post-tax yield on Government gilts with equivalent maturity dates and currency to those of the deferred tax balance, at the balance sheet date.

# Notes to the Financial Statements

## 17. CALLED UP SHARE CAPITAL

	<b>Authorised £</b>	<b>Allotted and fully paid £</b>
10,000,000 ordinary shares of £1 each at 31 March 2010 and 31 March 2011	<b>10,000,000</b>	<b>10,000,000</b>

## 18. MOVEMENT IN TOTAL SHAREHOLDER'S FUNDS

	Profit and loss reserve	Share- based payment reserve	Share capital	Revaluation reserve	Total shareholder's funds
	£m	£m	£m	£m	£m
At 1 April 2009	840.8	3.1	10.0	52.8	906.7
Profit for the year	126.1	-	-	-	126.1
Dividends	(211.0)	-	-	-	(211.0)
Revaluation reserve released during the year	0.6	-	-	(0.6)	-
Share-based payments amount due to parent	-	0.3	-	-	0.3
At 31 March 2010	756.5	3.4	10.0	52.2	822.1
Profit for the year	117.7	-	-	-	117.7
Dividends	(46.9)	-	-	-	(46.9)
Revaluation reserve released during the year	0.6	-	-	(0.6)	-
Share-based payments amount due to parent	-	0.1	-	-	0.1
At 31 March 2011	<b>827.9</b>	<b>3.5</b>	<b>10.0</b>	<b>51.6</b>	<b>893.0</b>

## 19. CAPITAL AND OTHER FINANCIAL COMMITMENTS

	2011 £m	2010 £m
Capital and infrastructure renewals expenditure commitments for contracts placed at 31 March were	<b>343.8</b>	<b>105.5</b>

The long term investment programme for the company, which identified substantial future capital expenditure commitments in the period 2010 to 2015, was agreed as part of the Periodic Review process which was finalised in December 2009

At the year end the company was committed to making the following annual payments during the next financial year under non-cancellable operating leases expiring as set out below

## Notes to the Financial Statements

	Land and buildings	Other	Land and buildings	Other
	2011	2011	2010	2010
	£m	£m	£m	£m
<b>Leases which expire:</b>				
Within one year	-	0.7	-	0.1
Between two and five years	0.3	1.5	0.4	2.4
After five years	-	0.0	0.4	-
	<b>0.3</b>	<b>2.2</b>	<b>0.8</b>	<b>2.5</b>

### 20. CONTINGENT LIABILITIES

The banking arrangements of the company operate on a pooled basis with other group companies and the bank balances of each subsidiary can be offset against each other. The company had guaranteed the following bonds with Yorkshire Water Services Finance Ltd, Yorkshire Water Services Bradford Finance Ltd and Yorkshire Water Services Odsal Finance Ltd at 31 March 2011

	Nominal	Coupon	Maturity	Liability
	£m	%		at 31 March 2011
				£m
<b>Fixed rate</b>				
Yorkshire Water Services Finance Ltd	6.8	5.375%	2023	6.8
Yorkshire Water Services Finance Ltd	7.4	5.500%	2027	7.4
Yorkshire Water Services Finance Ltd	0.2	6.625%	2031	0.2
Yorkshire Water Services Finance Ltd	200.0	5.500%	2037	200.0
Yorkshire Water Services Odsal Finance Ltd	29.9	6.588%	2023	29.9
Yorkshire Water Services Odsal Finance Ltd	180.8	6.588%	2023	180.8
Yorkshire Water Services Odsal Finance Ltd	135.5	6.454%	2027	135.5
Yorkshire Water Services Odsal Finance Ltd	255.0	6.601%	2031	255.0
Yorkshire Water Services Bradford Finance Ltd	275.0	6.000%	2019	275.0
Yorkshire Water Services Bradford Finance Ltd	200.0	6.375%	2039	200.0
Yorkshire Water Services Bradford Finance Ltd	100.0	6.375%	2039	100.0
Yorkshire Water Services Bradford Finance Ltd	450.0	6.000%	2025	450.0
<b>Total fixed</b>				<b>1,840.6</b>
<b>Index linked</b>				
Yorkshire Water Services Finance Ltd	0.1	3.048%	2033	0.2
Yorkshire Water Services Odsal Finance Ltd	127.8	3.307%	2033	132.3
Yorkshire Water Services Finance Ltd	65.0	1.823%	2050	72.7
Yorkshire Water Services Finance Ltd	125.0	1.462%	2051	142.4
Yorkshire Water Services Finance Ltd	85.0	1.758%	2054	95.2
Yorkshire Water Services Finance Ltd	125.0	1.460%	2056	143.4
Yorkshire Water Services Finance Ltd	100.0	1.709%	2058	111.9
Yorkshire Water Services Bradford Finance Ltd	175.0	2.718%	2039	189.3
Yorkshire Water Services Bradford Finance Ltd	85.0	2.718%	2039	92.0
<b>Total index linked</b>				<b>979.4</b>

# Notes to the Financial Statements

## 21. PENSION COMMITMENTS

The company sponsors a UK pension scheme, the Kelda Group Pension Plan (KGPP). The KGPP has a number of benefit categories providing benefits on a defined benefit basis and one category providing benefits on a defined contribution basis.

Contributions during the year ended 31 March 2011 were paid by members at 3%, 4%, 4.5%, 5% or 6% of pensionable pay (depending on benefit category). The company contributed at 22.2% (2010: 22.2%) of members' pensionable pay during the accounting year in respect of the majority of members.

The most recent finalised actuarial valuation of the KGPP was carried out as at 31 March 2010 when the market value of assets was £838.2m. The company participates in the group multi-employer scheme, such that the company's pension scheme's assets and liabilities are included with those of other subsidiary companies of Kelda Holdings Ltd. The company is unable to identify its share of the underlying assets and liabilities of the KGPP as, with the exception of Kelda Water Services (Wales) Ltd, the scheme's members are not utilised by company. The company therefore accounts for pension costs on a contribution basis.

The company's total pension charge for the year was £25.9m (2010: £16.6m). At 31 March 2011, the company had outstanding contributions of £1.4m (2010: £3.3m). An accrual for these unfunded benefits have been included in the company's accounts.

A summary of scheme position as disclosed in the Kelda Holdco Ltd accounts as at 31 March 2011 is as follows:

	2011		2010	
	Market value	Expected long term rate of return	Market value	Expected long term rate of return
	£m	%	£m	%
Fair value of scheme assets				
Equities	541.7	7.2	523.1	7.3
Bonds	251.0	4.9	246.3	5.1
Property	76.9	7.2	68.1	7.3
Other	5.3	4.4	4.5	4.6
Total value of assets	874.9		842.0	
Present value of scheme liabilities	(914.9)		(909.5)	
Net pension liability	(40.0)		(67.5)	

Pension contributions are determined with the advice of independent qualified actuaries, Mercer Human Resource Consulting, on the basis of annual valuations using the projected unit credit method and use the following assumptions:

	2011	2010
Inflation	3.4%	3.5%
Rate of increase in salaries	4.4%	4.5%
Rate of increase to pensions in payment and deferred pensions	3.4%	3.5%
Discount rate for scheme liabilities	5.5%	5.6%
Life expectancy of male pensioner aged 60 (in years)	26.4	24.9
Projected life expectancy at age 60 for male aged 40 (in years)	28.4	26.0

## Notes to the Financial Statements

### 22. ULTIMATE PARENT UNDERTAKING

The company's immediate parent company is Yorkshire Water Services Holdings Ltd. The company's ultimate parent company and controlling party is Kelda Holdings Ltd, a company registered in Jersey.

Kelda Holdco Ltd, a company registered in England and Wales, is the parent undertaking of the smallest group to consolidate these accounts. Kelda Eurobond Co Ltd, a company registered in England and Wales, is the largest UK group to consolidate these accounts.

Copies of the group accounts may be obtained from the Company Secretary, Kelda Eurobond Co Ltd, Western House, Halifax Road, Bradford BD6 2SZ.

### 23. RELATED PARTY TRANSACTIONS

The company is exempt under the terms of FRS 8 "Related party transactions" from disclosing related party transactions with entities that are part of the Kelda Holdings Ltd group.

During the year the company entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into, and trading balances outstanding at 31 March, are as follows:

Related party	Sales to related party		Amounts owed from related party	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Kelda Water Services (Defence) Ltd	-	312	-	-
Dalriada Water Services Ltd	-	3	-	-
Aberdeen Environmental Services Ltd	-	6	-	2
	-	321	-	2

As at 31 March 2009 Kelda Water Services Ltd, a wholly owned subsidiary of Kelda Group Ltd, had a 50% interest in Kelda Water Services (Defence) Ltd (formerly Brey Services Ltd) and a 50% interest in Dalriada Water Services Ltd (DWS). During 2009/10 the interest in DWS and Brey both increased to 100% as at 31 March 2010. On 26 April 2010 the remaining 50% of AES was purchased by Kelda Non Reg Holdco Ltd and is now part of the Kelda Holdings Ltd group.

### 24. SEGMENTAL INFORMATION

For statutory purposes, the directors consider there to be only one business segment, being the provision of water and sewerage services.

### 25. SHARE-BASED PAYMENTS

#### Share options

In prior years the ultimate parent company, Kelda Group Ltd (formerly plc), operated a savings related share option scheme under which options were granted to employees and provided for at an exercise price equal to the daily average market price on the date of grant less 20%. The options vested if the employee remained in service for the full duration of the options scheme (either 3 or 5 years).

## Notes to the Financial Statements

In 2008, the scheme was closed following the acquisition of Kelda Group plc by Saltaire Water Ltd. Certain schemes have been allowed to continue until the planned maturity of three or five years from grant date with members choosing whether to continue to contribute.

	2011		2010	
	<i>Options</i>	<i>Weighted average exercise price</i>	<i>Options</i>	<i>Weighted average exercise price</i>
		£		£
Outstanding at the beginning of the year	259,192	6.20	500,372	6.86
Lapsed during the year	(11,057)	6.62	(972)	7.04
Exercised during the year	(148,974)	5.72	(240,208)	5.58
Outstanding at the end of the year	<u>99,161</u>	<u>6.99</u>	<u>259,192</u>	<u>6.20</u>
Of which exercisable at the end of the year	<u>28,347</u>	<u>5.88</u>	<u>78,215</u>	<u>5.38</u>

The weighted average share price at the date of exercise for share options exercised during the year was £10.90 (2010: £10.90).

The options outstanding at 31 March 2011 had a weighted average exercise price of £6.99 and a weighted average remaining contractual life of 1.0 years.

The fair value of the share options granted is estimated as at the date of grant using the Black-Scholes statistical model. No shares were granted since 2007. The inputs to the Black-Scholes model for 2007 were as follows:

	<b>2007</b>
Share price at date of grant	926p
Exercise price	741p
Expected volatility	25%
Expected life	3 and 5 years
Risk free rate	5.08%
Expected dividends	31p

Expected volatility was determined by calculating the historical volatility of the group's share price over the last 6 years of its trade.

# **Directors' Responsibilities**

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## **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 United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). 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 UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the 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 maintenance and integrity of the Company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions.

# ***Independent Auditors' Report***

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## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF YORKSHIRE WATER SERVICES LTD**

We have audited the financial statements of Yorkshire Water Services Limited for the year ended 31 March 2011 which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

### **Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 51 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 and express an opinion on 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 company's affairs as at 31 March 2011 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- 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.

# ***Independent Auditors' Report***

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## **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, or returns adequate for our audit have not been received from branches not visited by us, or
- the 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.



Richard Bunter (Senior Statutory Auditor)  
For and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds  
7 July 2011

# Regulatory Accounting Information 2011

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### *Explanatory note*

Pages 55 to 84 include the regulatory accounting information which the company is required to publish under the company's Instrument of Appointment as a water and sewerage undertaker. The information has been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Water Services Regulation Authority (Ofwat).



## Historical Cost Profit & Loss Account

for the year ended 31 March 2011

	2011			2010		
	Appointed £m	Non- appointed £m	Total £m	Appointed £m	Non- appointed £m	Total £m
<b>Turnover</b>	<b>859.7</b>	<b>7.7</b>	<b>867.4</b>	859.2	10.2	869.4
Operating costs	(394.7)	(6.5)	(401.2)	(408.0)	(8.3)	(416.3)
Historical cost depreciation	(157.6)	-	(157.6)	(141.8)	-	(141.8)
Operating income	<u>2.6</u>	<u>-</u>	<u>2.6</u>	<u>1.3</u>	<u>-</u>	<u>1.3</u>
<b>Operating profit</b>	<b>310.0</b>	<b>1.2</b>	<b>311.2</b>	310.7	1.9	312.6
Other income	2.4	-	2.4	18.8	-	18.8
Net interest	<u>(271.2)</u>	<u>-</u>	<u>(271.2)</u>	<u>(167.0)</u>	<u>-</u>	<u>(167.0)</u>
<b>Profit on ordinary activities before taxation</b>	<b>41.2</b>	<b>1.2</b>	<b>42.4</b>	162.5	1.9	164.4
Taxation - current	16.4	(0.4)	16.0	(51.4)	(0.5)	(51.9)
Taxation - deferred	<u>59.2</u>	<u>-</u>	<u>59.2</u>	<u>13.6</u>	<u>-</u>	<u>13.6</u>
<b>Profit on ordinary activities after taxation</b>	<b>116.8</b>	<b>0.8</b>	<b>117.6</b>	124.7	1.4	126.1
Dividends	(46.9)	-	(46.9)	(211.0)	-	(211.0)
<b>Retained profit/(loss) for the year</b>	<u><b>69.9</b></u>	<u><b>0.8</b></u>	<u><b>70.7</b></u>	<u>(86.3)</u>	<u>1.4</u>	<u>(84.9)</u>

The accounting policies set out on page 30 of the statutory financial statements of Yorkshire Water Services Ltd (Yorkshire Water) apply to the historical cost regulatory accounting information, with the exception of the accounting for infrastructure assets and the investment in The York Waterworks Ltd (Note 1 on page 60)

There is no material difference between the profit before tax and the profit for the year stated above and their historical cost equivalents. There is no material difference between the historical cost depreciation charge and the actual depreciation charge for the year as a result of the re-valuation of certain tangible fixed assets.

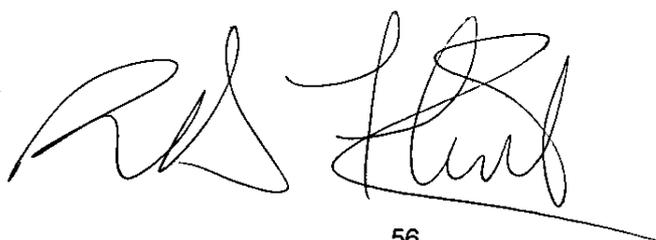
# Historical Cost Balance Sheet

As at 31 March 2011

	2011			2010		
	Appointed £m	Non- appointed £m	Total £m	Appointed £m	Non- appointed £m	Total £m
<b>Fixed assets</b>						
Tangible assets	4,372.0	4.0	4,376.0	4,298.4	4.3	4,302.7
Investment - loan to a group company	928.8	-	928.8	207.9	-	207.9
Investment - other	7.6	-	7.6	8.6	-	8.6
	<b>5,308.4</b>	<b>4.0</b>	<b>5,312.4</b>	<b>4,514.9</b>	<b>4.3</b>	<b>4,519.2</b>
<b>Current assets</b>						
Stocks	1.2	-	1.2	1.1	-	1.1
Debtors	159.0	1.1	160.1	238.0	2.8	240.8
Cash	40.4	-	40.4	58.8	-	58.8
Short term deposits	5.0	-	5.0	8.1	-	8.1
	<b>205.6</b>	<b>1.1</b>	<b>206.7</b>	<b>306.0</b>	<b>2.8</b>	<b>308.8</b>
<b>Creditors: amounts falling due within one year</b>						
Infrastructure renewals accrual	(18.2)	-	(18.2)	(22.7)	-	(22.7)
Creditors	(324.9)	(0.2)	(325.1)	(226.0)	(0.4)	(226.4)
Borrowings	(68.2)	4.9	(63.3)	(212.0)	2.7	(209.3)
Corporation tax payable	(5.4)	(0.4)	(5.8)	(44.2)	(0.6)	(44.8)
	<b>(416.7)</b>	<b>4.3</b>	<b>(412.4)</b>	<b>(504.9)</b>	<b>1.7</b>	<b>(503.2)</b>
<b>Net current liabilities</b>	<b>(211.1)</b>	<b>5.4</b>	<b>(205.7)</b>	<b>(198.9)</b>	<b>4.5</b>	<b>(194.4)</b>
<b>Total assets less current liabilities</b>	<b>5,097.3</b>	<b>9.4</b>	<b>5,106.7</b>	<b>4,316.0</b>	<b>8.8</b>	<b>4,324.8</b>
<b>Creditors: amounts falling due after more than 1 year</b>						
Borrowings	(3,578.6)	-	(3,578.6)	(2,842.9)	-	(2,842.9)
Other creditors	(63.3)	-	(63.3)	(66.3)	-	(66.3)
	<b>(3,641.9)</b>	<b>-</b>	<b>(3,641.9)</b>	<b>(2,909.2)</b>	<b>-</b>	<b>(2,909.2)</b>
<b>Provisions for liabilities and charges</b>						
Deferred tax provision	(162.0)	-	(162.0)	(221.3)	-	(221.3)
Deferred income - grants and contributions	(70.5)	(3.5)	(74.0)	(72.6)	(3.8)	(76.4)
Other provisions	(335.8)	-	(335.8)	(295.8)	-	(295.8)
	<b>887.1</b>	<b>5.9</b>	<b>893.0</b>	<b>817.1</b>	<b>5.0</b>	<b>822.1</b>
<b>Capital and reserves</b>						
Called up share capital	10.0	-	10.0	10.0	-	10.0
Profit and loss reserve	822.0	5.9	827.9	751.5	5.0	756.5
Other reserves - share based payments	3.5	-	3.5	3.4	-	3.4
Other reserves - revaluation surplus	51.6	-	51.6	52.2	-	52.2
	<b>887.1</b>	<b>5.9</b>	<b>893.0</b>	<b>817.1</b>	<b>5.0</b>	<b>822.1</b>

The regulatory financial statements on pages 55 to 79 were approved by the board of directors on 7 July 2011 and signed on their behalf by

Richard Flint  
Chief Executive Officer



# **Current Cost Profit and Loss Account for the Appointed Business**

for the year ended 31 March 2011

	<i>Note</i>	<b>2011</b> £m	2010 £m
Turnover	5	<b>859.7</b>	859 2
Current cost operating costs	6	<b>(602.1)</b>	(610 2)
Operating expense	5	<b>(7.7)</b>	(0 2)
Working capital adjustment	5	<b>(4.9)</b>	1 2
<b>Current cost operating profit</b>		<b>245.0</b>	250 0
Other income		<b>2.4</b>	18 8
Net interest		<b>(271.2)</b>	(167 0)
Financing adjustment		<b>175.2</b>	131 7
<b>Current cost profit on ordinary activities before taxation</b>		<b>151.4</b>	233 5
Taxation - current tax		<b>16.4</b>	(51 4)
- deferred tax		<b>59.2</b>	13 6
<b>Current cost profit on ordinary activities after taxation</b>		<b>227.0</b>	195 7
Dividends		<b>(46.9)</b>	(211 0)
<b>Current cost profit/(loss)</b>		<b>180.1</b>	(15 3)

# Current Cost Balance Sheet

for the year ended 31 March 2011

	Note	2011 £m	2010 £m
<b>Fixed assets</b>			
Tangible assets	8	36,300.6	34,437.9
Third party contributions since 1989/90		(454.9)	(427.2)
<b>Other operating assets and liabilities</b>			
Working capital	9	(68.9)	96.8
Cash		40.4	58.8
Short term deposits		5.0	8.1
Infrastructure renewals accrual		(18.2)	(22.7)
<b>Net operating assets</b>		<u>35,804.0</u>	<u>34,151.7</u>
<b>Non operating assets and liabilities</b>			
Borrowings		(68.2)	(212.1)
Non-trade debtors		19.5	11.7
Non-trade creditors due within one year		(115.3)	(95.4)
Investment - loan to Group company		928.8	207.9
Investment - other		7.6	8.5
Corporation tax payable		(5.4)	(44.2)
<b>Total non operating assets and liabilities</b>		<u>767.0</u>	<u>(123.6)</u>
<b>Creditors: amounts falling due after more than one year</b>			
Borrowings		(3,578.6)	(2,842.9)
Other creditors		(63.3)	(66.3)
<b>Total creditors falling due after more than one year</b>		<u>(3,641.9)</u>	<u>(2,909.2)</u>
<b>Provisions for liabilities and charges</b>			
Deferred tax provision		(162.0)	(221.3)
Other provisions		(335.8)	(295.8)
		<u>(497.8)</u>	<u>(517.1)</u>
<b>Net assets</b>		<u>32,431.3</u>	<u>30,601.8</u>
<b>Capital and reserves</b>			
Called up share capital		10.0	10.0
Profit and loss reserve		425.2	245.0
Other reserves		3.5	3.4
Current cost reserve	10	<u>31,992.6</u>	<u>30,343.4</u>
		<u>32,431.3</u>	<u>30,601.8</u>

# Current Cost Cash Flow Statement

for the year ended 31 March 2011

	Note	2011			2010		
		Appointed	Non- appointed	Total	Appointed	Non- appointed	Total
		£m	£m	£m	£m	£m	£m
<b>Net cash flow from operating activities</b>	11	628.5	0.8	629.3	484.7	0.8	485.5
<b>Returns on investments and servicing of finance</b>							
Interest received		51.6	-	51.6	61.4	-	61.4
Interest paid		(182.2)	-	(182.2)	(166.1)	-	(166.1)
Interest in finance lease rentals		(20.4)	-	(20.4)	(17.0)	-	(17.0)
<b>Net cash flow from returns on investments and servicing of finance</b>		(151.0)	-	(151.0)	(121.7)	-	(121.7)
<b>Taxation</b>							
Tax paid		(11.1)	(0.6)	(11.7)	(46.7)	(0.6)	(47.3)
<b>Capital expenditure and financing of investment</b>							
Investment in subsidiary		-	-	-	(42.2)	-	(42.2)
Gross cost of purchase of fixed assets		(174.9)	(0.2)	(175.1)	(244.3)	(0.2)	(244.5)
Receipt of grants and contributions		7.6	-	7.6	10.4	-	10.4
Infrastructure renewals		(66.1)	-	(66.1)	(43.9)	-	(43.9)
Disposal of fixed assets		1.3	-	1.3	1.2	-	1.2
<b>Net cash outflow from investing activities</b>		(232.1)	(0.2)	(232.3)	(318.8)	(0.2)	(319.0)
<b>Equity dividends paid</b>		(46.9)	-	(46.9)	(211.0)	-	(211.0)
<b>Net cash inflow/(outflow) before financing</b>		187.4	-	187.4	(213.5)	-	(213.5)
<b>Financing</b>							
Capital element in finance lease rentals		(15.7)	-	(15.7)	(14.5)	-	(14.5)
New bank loans		721.4	-	721.4	802.4	-	802.4
Repayment of bank loans		(908.7)	-	(908.7)	(533.9)	-	(533.9)
<b>Net cash (outflow)/inflow from financing</b>		(203.0)	-	(203.0)	254.0	-	254.0
<b>(Decrease)/increase in cash</b>		(15.6)	-	(15.6)	40.5	-	40.5

# Notes to the Regulatory Accounting Information

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## 1. ACCOUNTING POLICIES - CURRENT COST INFORMATION

The current cost information has been prepared for the Appointed Business of Yorkshire Water Services Ltd (Yorkshire Water) in accordance with guidance issued by Ofwat for modified real terms financial statements suitable for regulation in the water industry. Profitability is measured on the basis of real financial capital maintenance in the context of assets which are valued at their modern equivalent asset value to the business.

The accounting policies used are the same as those adopted in the statutory accounts, except as set out below.

### Infrastructure assets

As noted on page 55, FRS 12 has not been implemented in the regulatory accounts and the difference between planned and actual expenditure on infrastructure renewals is shown separately in the current cost balance sheet.

### Tangible fixed assets

Assets in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for the possible funding of future replacements of assets by contributions from third parties and, to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amount.

The modern equivalent asset values (MEA) arising from the last Periodic Review (PR09) are incorporated in the 2010/11 Regulatory Accounting Information.

The revaluation of historical cost fixed assets does not affect the current cost accounting information.

#### - Land and buildings

Non-specialised operational properties are valued on the basis of open market value for existing use and have been expressed in real terms by indexing using the Retail Price Index (RPI).

Specialised operational properties are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between periodic Asset Management Plan (AMP) reviews by adjusting for inflation as measured by changes in the RPI. The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below).

#### - Infrastructure assets

Mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost, determined principally on the basis of data provided by the AMP.

Values now reflect the AMP carried out at the last Periodic Review. A process of continuing refinement of asset records is expected to produce adjustments to existing values when periodic reviews of the AMP take place. In the intervening years, values are restated to take account of changes in the general level of inflation, as measured by changes in the RPI over the year.

## **Notes to the Regulatory Accounting Information**

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- **Other fixed assets**  
All other fixed assets are valued periodically at depreciated replacement cost. Between periodic AMP reviews, values are restated for inflation as measured by changes in the RPI.
- **Surplus land**  
Surplus land is valued at recoverable amount, taking into account that part of any proceeds to be passed on to customers under Condition B of the Instrument of Appointment.

### **Grants and other third party contributions**

Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

### **Real financial capital maintenance adjustments**

These adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

- **Working capital adjustment**  
This is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors and the provision for liabilities and charges.
- **Financing adjustment**  
This is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

### **Investment in York WaterWorks**

The intangible assets accounting policy on page 39 and note 8 of the statutory financial statements of Yorkshire Water outline the treatment of the transfer of the trade and net assets of The York WaterWorks Ltd (YWW) to Yorkshire Water in 2000.

### **Revenue recognition**

There is no difference between the turnover recognised in the statutory and regulatory accounts or in the policy for revenue recognition.

No turnover is recognised for unoccupied properties and no bills are raised. If a bill has been issued, and the company subsequently become aware that the property is unoccupied, the bill and relevant turnover is cancelled. Generally a property is classed as void if it is unoccupied and unfurnished.

Turnover is only recognised when the occupier's name is known. This policy applies to both existing and new properties. All billing is then subsequently classed as turnover.

# Notes to the Regulatory Accounting Information

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## 2. APPOINTED AND NON-APPOINTED BUSINESS

The historical cost accounting information shows separate figures for Appointed and Non-Appointed Business

The Appointed Business is defined to be the regulated activities of the Appointee, i.e. those necessary to fulfil the functions and duties of a water and sewerage undertaker. The Non-Appointed Business encompasses those activities for which Yorkshire Water is not a monopoly supplier or the activity involves the optional use of an asset owned by the Appointed Business.

## 3. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

### Allocation of costs

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

Direct costs attributable to the provision of services other than the Appointed Business are separately allocated and identified as 'Non-Appointed'. Indirect costs, relating to non-appointed activities, are recovered as a fixed percentage of direct costs based upon the analysis of operating costs.

### Borrowings or sums lent

#### *Kelda Holdco Ltd*

A long term loan was advanced by Yorkshire Water to Kelda Holdco, with Ofwat's approval, during 2008/09. This is repayable over 38 years. Balances at 1 April 2010 and 31 March 2011 were £296.7m and £288.6m respectively. Interest is payable at current market rates.

Yorkshire Water made further advances to Kelda Holdco Limited during the year ended 31 March 2011, which included repaying the short-term loan from Kelda Holdco to Yorkshire Water as follows:

- £501.5m April 2010
- £50.5m June 2010
- £77.5m September 2010
- £46.3m December 2010
- £45.1m March 2011

Balances at 1 April 2010 and 31 March 2011 were £80.7m payable and £640.2m receivable respectively. Interest is payable at current market rates.

#### *Yorkshire Water Services Finance Limited*

On 17 April 2000, £150m was lent at a fixed rate of 6.625% repayable in 2031, and on 16 November 2001 a further £90m was lent at 6.625% repayable in 2031. On 3 July 2008 Yorkshire Water Services Finance Ltd (YWSF), a subsidiary of the company, became principal debtor under the bonds which are unconditionally and irrevocably guaranteed by Yorkshire Water. As a result, the loans from Kelda Group Ltd were transferred to YWSF.

On 24 July 2009, Yorkshire Water implemented a whole business securitisation (WBS). Post the implementation of the WBS, Yorkshire Water Services Finance Limited will

## Notes to the Regulatory Accounting Information

remain the issuer in respect of the existing bonds on-lent to Yorkshire Water, but will not issue further bonds in the future

The table below sets out the amounts outstanding on the bonds remaining within YWSF

Issue Date	Nominal £m	Coupon	Maturity	Liability @ 31/03/2011 £m
<b>Fixed Rate</b>				
07/04/2000	240.0	6.625%	2031	0.6
21/02/2003	200.0	5.375%	2023	3.7
29/05/2007	200.0	5.500%	2037	194.8
29/05/2007	150.0	5.500%	2027	6.2
<b>Index Linked</b>				
21/02/2003	100.0	3.048%	2033	2.5
27/11/2006	125.0	1.462%	2051	143.3
27/11/2006	125.0	1.460%	2056	143.2
01/06/2007	85.0	1.75756%	2054	94.7
11/06/2007	100.0	1.7085%	2058	111.3
11/06/2007	65.0	1.8225%	2050	72.3
<b>Total loan with YWSFL</b>				<b>772.6</b>

### Yorkshire Water Services Odsal Finance Limited ('YWSOFL')

As stated above, during the year ended 31 March 2010 Yorkshire Water implemented a WBS. Part of this process involved certain bonds initially issued by YWSFL being exchanged for new bonds issued by a fellow subsidiary YWSOFL. These exchange bonds (shown in the table below) were issued on different terms to the existing bonds.

Exchange Bonds	Original par value YWSFL £m	Original coupon	Loan notes issued YWSOFL £m	New coupon
Fixed rate notes due April 2010 - exchanged to fixed rate notes due February 2023	29.0	6.875%	29.9	6.588%
Fixed rate notes due February 2023 - exchanged to fixed rate notes due February 2023	193.2	5.375%	180.8	6.588%
Fixed rate notes due May 2027 - exchanged to fixed rate notes due May 2027	142.6	5.500%	135.5	6.454%
Fixed rate notes due April 2031 - exchanged to fixed rate notes due April 2031	240.0	6.625%	255.0	6.601%
Fixed rate index-linked notes due July 2033 - exchanged to fixed rate index-linked notes due July 2033	122.5	3.048%	132.3	3.307%
<b>Total</b>	<b>727.3</b>		<b>733.5</b>	

## Notes to the Regulatory Accounting Information

In order to fund the change in coupon payable and differences in par values post the bond exchange, Yorkshire Water entered into a series of loans with YWSOFL

- Deep discounting loans structured such that their redemption value will be discharged by the difference between the par value paid by YWSFL in respect of the old bonds and the par value paid by the YWSOFL in respect of the new bonds, and
- Amortising loans structured such that the regular payments of principal and interest equate to the difference between the interest received from YWSFL on the old bonds and the amount payable by the YWSOFL on the new bonds

The balances outstanding as at 31 March 2011, regarding these deep discounting and amortising loans, are shown in the table below

	£m
2010 to 2023 Exchange Bonds	30.2
2023 to 2023 Exchange Bonds	6.5
2027 to 2027 Exchange Bonds	6.4
2031 to 2031 Exchange Bonds	15.4
2033 to 2033 Exchange Bonds	10.6
<b>Total</b>	<b>69.1</b>

In addition to this balance there is a short term loan from YWSOFL of £70m which is due to be repaid in 2011/12

### Yorkshire Water Services Bradford Finance Limited ('YWSBFL')

During April 2010 YWSBFL successfully raised £635m of new debt, including £450m of class B debt, this was a combination of fixed rate and indexed linked debt as shown by the table below. The proceeds (net of costs and expenses where applicable) were on-lent by YWSBFL to Yorkshire Water. The amounts outstanding as at 31 March 2011 are shown in the table below

Issue Date	Nominal £m	Coupon	Maturity	Liability @ 31/03/2011 £m
<b>Fixed Rate</b>				
24/07/2009	275.0	6.000%	2019	272.6
24/07/2009	200.0	6.375%	2039	197.8
23/04/2010	100.0	6.375%	2039	109.0
23/04/2010	450.0	6.000%	2025	446.1
<b>Index Linked</b>				
24/07/2009	175.0	2.718%	2039	189.3
23/04/2010	85.0	2.718%	2039	105.4
<b>Total Loan with YWSBFL</b>				<b>1,320.2</b>

No other material sums were lent to or borrowed from other associated companies

### Dividends paid to associated undertakings

Amounts paid to the parent company and the underlying dividend policy, are disclosed in the Directors' Report on page 20 of the statutory financial statements of Yorkshire Water

### Guarantees/securities

Until August 2008, the bankers for the Kelda Group Ltd and subsidiaries current accounts provided pooling arrangements for all accounts whereby debit and credit

## Notes to the Regulatory Accounting Information

balances were pooled with interest charged on the net group balance. Arrangements changed on 11 August 2008 and now Yorkshire Water has pooling arrangements only with YWSF and Kelda Group Ltd. Debit and credit balances are pooled with interest charged on the net group balance.

This facility is subject to provision of cross guarantees by each company within each pooling arrangement, guaranteeing each of the other companies' current account liabilities with the bank. This is provided that the aggregate of the cleared debit balances, less the aggregate of the cleared credit balances, i.e. the net amount must not exceed £10m. In addition, the aggregate of the cleared debit balances on the group accounts must not exceed £15m.

### Transfer of assets and liabilities

During the course of the year land and buildings were sold to group companies at market value. Total sale proceeds were £1.3m (2010: £0.8m).

### Supply of service

Details of services supplied to the Appointee by associates during the year are disclosed below where these exceed a materiality level of £1m (in line with RAG 5.04 requirements). No services of a material value were provided by the Appointee to associates.

Service	Associate Company	Turnover of Associate £m	Terms of Supply	Value £m
Corporate charges	Kelda Group Ltd	5.8	Cost allocation	3.5
Customer Services	Loop Customer Management	22.1	Cost allocation	20.6

The Directors declare that, to the best of their knowledge, all appropriate transactions with associated companies have been disclosed.

## 4. LINK BETWEEN DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

The remuneration policy of the company, which is set within the context of the group's remuneration policy, is to enable directors to receive remuneration which is competitive in the market and which encourages and enables upper quartile performance, taking into account individual performance, responsibilities and experience. Accordingly, the remuneration of the directors of the company is structured into three elements: base salary, annual incentive and long term incentive plan (LTIP).

### Salary

The base salary is a fixed figure and does not vary in relation to business or individual performance.

### Annual incentive plan

Under the annual incentive plan, each director has the opportunity to earn an annual incentive award based on a percentage of their salary. Awards are entirely performance related as described below.

## Notes to the Regulatory Accounting Information

Early in the 2008/09 financial year, the company implemented a new annual incentive plan based on company performance and personal contribution. Under this plan the annual incentive award is calculated as a percentage of basic salary as at 31 March as follows:

- 50% of the total maximum annual bonus payable was dependent upon delivery of agreed personal / individual objectives set at the start of the financial year
- 50% of the total maximum annual bonus payable was dependent upon delivery of agreed corporate objectives which supported the company's strategic objectives. The same corporate objectives were shared by all directors. These are set out in the table overleaf with the percentage payable.

In 2010/11 the scheme was reviewed and the percentage of the corporate bonus attributed to financial measures was increased compared to the previous year.

Strategic Theme	Measure	% of corporate bonus
Value	Financial performance	16 (20% max)
Service	Service Incentive Mechanism	5 (7.5% max)
Compliance	Water quality (mean zonal compliance) and WWTW compliance with numeric sanitary consent	2.5 (7.5% max)
Asset Management	Serviceability	2.5 (5% max)
People	Employee motivation	4.5 (5% max)
Health & Safety	Safety performance	4.5 (5% max)

Using these principles the awards for 2010/11 were determined by the group remuneration committee (the Committee) and taking account of performance against these measures and personal/individual objectives, total awards were made by the Committee in accordance with the table below:

	<b>Max. Bonus %</b>	<b>Bonus for 2010/11 %</b>	<b>Bonus for 2010/11 £</b>
Graham Dixon	70	58	88,131
Alan Harrison	70	57	114,000
Mark Penny	70	33	42,900

These payments were approved by the Committee on 30 March 2011 and were paid in June 2011.

Kevin Whiteman, Richard Flint and Liz Barber were executive directors of Kelda Holdco Ltd during 2010/11 and their emoluments are shown in the accounts of that company.

## **Notes to the Regulatory Accounting Information**

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### **Long term incentive plan (LTIP)**

The first conditional award under a revised Kelda Group LTIP, which included a link to the company's performance against Ofwat comparative efficiency measures, was made on 27 September 2007. Vesting of shares awarded under this Plan was triggered by the acquisition of Kelda Group plc (now Ltd) by Saltaire Water Ltd in February 2008 and the Plan was then closed. Details of the vesting of these shares were given in the regulatory accounts for 2007/08.

Following the acquisition, the Committee conducted a review of the group's executive incentive arrangements for executive directors. A revised cash LTIP was developed and established during the year under which the first conditional awards were granted in November 2008.

The Plan provides for a cash award based on a percentage of salary. The awards as originally granted in November 2008 were subject to two performance conditions which were to be measured over a three year period.

70% of the award is subject to the valuation of the investment made by the investors in Kelda at the end of the relevant three year performance period as determined by an independent valuer.

The remaining 30% of the award was based on the company's Operating Efficiency and Capital Maintenance Efficiency performance relative to the other nine water and sewerage companies based on Ofwat published data. Ofwat's report on 'Water and Sewerage Service Unit Costs and Relative Efficiency' (the Ofwat Report) was to be used to produce an average ranking for the company for the financial year for the four operating and capital efficiency measures.

The Ofwat Report used to contain Ofwat's assessment of each water company's operating and capital maintenance efficiency for water and, in respect of the water and sewerage companies, the same efficiency measures in respect of sewerage. These assessments are based primarily on Ofwat's econometric models and unit cost comparisons.

Based on these assessments, the Ofwat Report used to contain a ranking amongst the companies based on their relative performance for each of the four measures (Operating Efficiency - Water, Capital Maintenance Efficiency - Water, Operating Efficiency - Sewerage, Capital Maintenance Efficiency - Sewerage). For the purposes of this performance condition, the water only companies are excluded from the analysis as they do not feature in the sewerage measures, leaving the ten water and sewerage companies as the comparator group.

This process of producing an average ranking would be repeated for the next two years in the performance period to establish an average for the three years. On the basis of this overall average, a ranking is established (with the company having the lowest overall average being ranked 1<sup>st</sup> and so on).

## Notes to the Regulatory Accounting Information

Vesting of 30% of the award was to be in accordance with the table below,

<b>OFWAT Ranking:</b>	<b>Percentage of Award Vesting (for 30% of the Award):</b>
1	100%
2	100%
3 - 5	Pro rata between 0% and 100%
6 and below	0%

However, since the awards were granted Ofwat have ceased to report on Capital Maintenance Efficiency - Water and Capital Maintenance Efficiency - Sewerage, and therefore these measures have since become obsolete

As a result the Committee met in May 2009 and varied the performance condition for the 2008 awards to replace the Capital Maintenance measures with a performance condition that measures performance against the phased capital efficiency target for the relevant award year and calculates a cumulative efficiency performance over a three year period (the "Capital Efficiency Measure")

Subsequently Ofwat also ceased to report on Operating Efficiency – Water and Operating Efficiency – Sewerage although reports are available for the first two years of the term for the 2008 awards. As a result the Committee met on 2 March 2011 and varied the performance condition for the 2008 awards for the third year of the term to replace the Operating Efficiency measures with a performance condition that measures financial performance against the company's EBITDA target for that third year

As a result of these changes vesting of 30% of the 2008 award was to be in accordance with the tables below,

<b>OFWAT Ranking:</b>	<b>Percentage of Award Vesting (for 10% of the Award):</b>
1	100%
2	100%
3 - 5	Pro rata between 0% and 100%
6 and below	0%

<b>Capital Efficiency Measure</b>	<b>Percentage of Award Vesting (for 15% of the Award):</b>
100%	100%
At least 75% but below 100%	Pro rata between 0% and 100%
Below 75%	0%

## Notes to the Regulatory Accounting Information

<b>EBITDA Measure</b>	<b>Percentage of Award Vesting (for 5% of the Award):</b>
100%	100%
At least 90% but below 100%	Pro rata between 0% and 100%
Below 90%	0%

No awards will vest under the Plan unless, in the opinion of the Committee, the underlying financial performance of the company has been satisfactory over the performance period, taking into account all relevant circumstances. The Committee has the power to scale back vesting to any extent considered appropriate in light of the company's financial performance.

At its meeting in May 2009 the Committee granted a second set of conditional awards. At its meeting on 2 March 2011 the Committee granted a third set of conditional awards based on the above amended performance conditions and amended the 2009 awards to reflect the changes to the Ofwat Report.

Accordingly vesting of 30% of the 2009 award is to be in accordance with the tables below,

<b>OFWAT Ranking:</b>	<b>Percentage of Award Vesting (for 5% of the Award):</b>
1	100%
2	100%
3 - 5	Pro rata between 0% and 100%
6 and below	0%

<b>Capital Efficiency Measure</b>	<b>Percentage of Award Vesting (for 15% of the Award):</b>
100%	100%
At least 75% but below 100%	Pro rata between 0% and 100%
Below 75%	0%

<b>EBITDA Measure</b>	<b>Percentage of Award Vesting (for 10% of the Award):</b>
100%	100%
At least 90% but below 100%	Pro rata between 0% and 100%
Below 90%	0%

Vesting of 30% of the 2010 award (granted on 2 March 2011) is to be in accordance with the tables below,

## Notes to the Regulatory Accounting Information

<b>Capital Efficiency Measure</b>	<b>Percentage of Award Vesting (for 15% of the Award):</b>
100%	100%
At least 75% but below 100%	Pro rata between 0% and 100%
Below 75%	0%

<b>EBITDA Measure</b>	<b>Percentage of Award Vesting (for 15% of the Award):</b>
100%	100%
At least 90% but below 100%	Pro rata between 0% and 100%
Below 90%	0%

At a meeting on 31 May 2011 the Committee determined an overall level of vesting of the 2008 awards at 45%. Accordingly this resulted in payments to the directors in accordance with the table below and were paid in June 2011 (Note Alan Harrison was not a participant in the 2008 LTIP scheme),

	<b>Vesting %</b>	<b>Vesting £</b>
Graham Dixon	45	101,250
Mark Penny	45	22,181

The emoluments for Kevin Whiteman, Richard Flint and Liz Barber are disclosed in the Kelda Holdco Ltd accounts

## Notes to the Regulatory Accounting Information

### 5. ANALYSIS OF TURNOVER & OPERATING INCOME FOR THE APPOINTED BUSINESS for the year ended 31 March 2011

	2011			2010		
	Water services £m	Sewerage services £m	Total appointed business £m	Water services £m	Sewerage services £m	Total appointed business £m
<b>Turnover</b>						
Unmeasured	199.4	238.9	438.3	202.0	238.9	440.9
Measured	172.1	179.4	351.5	176.0	175.5	351.5
Trade effluent	0.0	7.6	7.6	-	7.7	7.7
Large user and special agreement	24.5	29.2	53.7	24.8	26.2	51.0
Rechargeable works	6.2	-	6.2	5.9	0.1	6.0
Bulk supplies/inter company	0.1	-	0.1	0.1	-	0.1
Other sources	0.4	1.9	2.3	0.5	1.5	2.0
<b>Total turnover</b>	<b>402.7</b>	<b>457.0</b>	<b>859.7</b>	<b>409.3</b>	<b>449.9</b>	<b>859.2</b>
<b>Operating income/(loss)</b>						
Current cost profit on fixed assets net of expenses	0.4	(8.1)	(7.7)	0.6	(0.8)	(0.2)
<b>Total operating income</b>	<b>0.4</b>	<b>(8.1)</b>	<b>(7.7)</b>	<b>0.6</b>	<b>(0.8)</b>	<b>(0.2)</b>
<b>Working capital adjustment</b>	<b>(2.4)</b>	<b>(2.5)</b>	<b>(4.9)</b>	<b>0.6</b>	<b>0.6</b>	<b>1.2</b>

### 6. ANALYSIS OF OPERATING COSTS AND ASSETS

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

# Notes to the Regulatory Accounting Information

## 6. ANALYSIS OF OPERATING COSTS AND ASSETS (continued)

for the year ended 31 March 2011

	Resources & treatment	Distribution	Water supply sub total	Sewerage	Sewage Treatment	Sludge Treatment & Disposal	Sewerage services sub total
	£m	£m	£m	£m	£m	£m	£m
<b>DIRECT COSTS</b>							
Employment costs	10.1	11.2	21.3	5.2	14.6	8.4	28.2
Power	10.1	10.5	20.6	2.6	16.1	4.4	23.1
Hired and contracted services	2.8	21.4	24.2	-	-	-	-
Associated companies	-	-	-	7.9	5.2	9.4	22.5
Materials and consumables	9.7	0.5	10.2	-	-	-	-
Service charges	5.6	-	5.6	0.5	2.9	4.8	8.2
Bulk supply imports	3.8	-	3.8	1.1	3.5	0.2	4.8
Other direct costs	1.5	2.4	3.9	0.9	1.2	0.7	2.8
<b>Total direct costs</b>	<b>43.6</b>	<b>46.0</b>	<b>89.6</b>	<b>18.2</b>	<b>43.5</b>	<b>27.9</b>	<b>89.6</b>
General and support expenditure	7.1	10.0	17.1	3.4	10.1	6.1	19.6
<b>Functional expenditure</b>	<b>50.7</b>	<b>56.0</b>	<b>106.7</b>	<b>21.6</b>	<b>53.6</b>	<b>34.0</b>	<b>109.2</b>
<b>BUSINESS ACTIVITIES</b>							
Customer services			13.1				15.0
Scientific services			5.3				1.7
Other business activities			1.8				2.1
<b>Business activities sub-total</b>			<b>20.2</b>				<b>18.8</b>
Local authority rates			25.7				17.5
Doubtful debts			7.8				8.5
Exceptional items			4.6				1.3
<b>Total opex less third party services</b>			<b>165.0</b>				<b>155.3</b>
Third party services - opex			11.0				0.5
<b>Total operating expenditure</b>			<b>176.0</b>				<b>155.8</b>
<b>CAPITAL MAINTENANCE</b>							
Infrastructure renewals charge	13.7	29.9	43.6	18.3	-	-	18.3
Current cost depreciation							
- service activities	34.8	32.9	67.7	21.0	91.1	28.7	140.8
- business activities			0.9				0.9
Amortisation of grants			(1.4)				(1.4)
Amortisation of intangible assets			0.9				-
<b>Total capital maintenance</b>			<b>111.7</b>				<b>158.6</b>
<b>TOTAL OPERATING COSTS</b>			<b>287.7</b>				<b>314.4</b>
							<b>602.1</b>
<b>CCA NET MEA VALUES</b>							
Service activities	4,078.3	14,283.2	18,361.5	16,383.3	1,198.9	237.9	17,820.1
Business activities			10.6				6.4
<b>TOTAL</b>			<b>18,372.1</b>				<b>17,826.5</b>

# Notes to the Regulatory Accounting Information

## 7. ANALYSIS OF OPERATING COSTS AND ASSETS

for the year ended 31 March 2010

	Resources & treatment	Distribution	Water supply sub total	Sewerage	Sewage Treatment	Sludge Treatment & Disposal	Sewerage services sub total
	£m	£m	£m	£m	£m	£m	£m
<b>DIRECT COSTS</b>							
Employment costs	4.2	7.1	11.3	3.6	5.9	5.2	14.7
Power	15.1	6.3	21.4	3.0	18.1	3.7	24.8
Hired and contracted services	5.2	13.9	19.1	8.6	10.2	10.7	29.5
Associated companies	0.1	0.1	0.2	-	0.1	-	0.1
Materials and consumables	8.4	0.2	8.6	0.1	1.0	3.7	4.8
Service charges	5.8	-	5.8	1.0	3.6	0.2	4.8
Bulk supply imports	3.5	-	3.5	-	-	-	-
Other direct costs	1.2	2.1	3.3	0.7	0.7	0.2	1.6
<b>Total direct costs</b>	<b>43.5</b>	<b>29.7</b>	<b>73.2</b>	<b>17.0</b>	<b>39.6</b>	<b>23.7</b>	<b>80.3</b>
General and support expenditure	12.4	12.1	24.5	5.8	13.1	7.5	26.4
<b>Functional expenditure</b>	<b>55.9</b>	<b>41.8</b>	<b>97.7</b>	<b>22.8</b>	<b>52.7</b>	<b>31.2</b>	<b>106.7</b>
<b>BUSINESS ACTIVITIES</b>							
Customer services			11.1				11.7
Scientific services			6.1				1.9
Other business activities			2.1				2.1
<b>Business activities sub-total</b>			<b>19.3</b>				<b>15.7</b>
Local authority rates			23.6				13.7
Doubtful debts			6.7				7.1
Exceptional items			37.5				23.4
<b>Total opex less third party services</b>			<b>184.8</b>				<b>166.6</b>
Third party services - opex			7.0				-
<b>Total operating expenditure</b>			<b>191.8</b>				<b>166.6</b>
<b>CAPITAL MAINTENANCE</b>							
Infrastructure renewals charge	7.9	23.0	30.9	18.7	-	-	18.7
Current cost depreciation							
- service activities	34.8	28.7	63.5	19.1	91.0	29.2	139.3
- business activities			0.6				0.6
Amortisation of grants			(1.3)				(1.4)
Amortisation of intangible assets			0.9				-
<b>Total capital maintenance</b>			<b>94.6</b>				<b>157.2</b>
<b>TOTAL OPERATING COSTS</b>			<b>286.4</b>				<b>323.8</b>
							<b>610.2</b>
<b>CCA NET MEA VALUES</b>							
Service activities	4,850.3	12,599.1	17,449.4	15,377.2	1,365.3	230.1	16,972.6
Business activities			11.8				4.0
<b>TOTAL</b>			<b>17,461.2</b>				<b>16,976.6</b>

# Notes to the Regulatory Accounting Information

## 8. CURRENT COST ANALYSIS OF FIXED ASSETS BY ASSET TYPE as at 31 March 2011

	Specialised operational assets £m	Non- specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
<b>WATER SERVICES</b>					
<b>Gross replacement cost</b>					
At 1 April 2010	2,461.5	96.4	16,239.2	176.6	18,973.7
AMP adjustment	-	-	-	-	-
RPI adjustment	131.7	5.1	868.8	9.5	1,015.1
Disposals	(2.4)	(0.5)	-	(6.1)	(9.0)
Additions	56.9	0.1	22.1	17.3	96.4
<b>At 31 March 2011</b>	<b>2,647.7</b>	<b>101.1</b>	<b>17,130.1</b>	<b>197.3</b>	<b>20,076.2</b>
<b>Depreciation</b>					
At 1 April 2010	1,424.4	4.6	-	83.4	1,512.4
AMP adjustment	-	-	-	-	-
RPI adjustment	76.2	0.2	-	4.5	80.9
Disposals	(2.1)	-	-	(6.1)	(8.2)
Charge for year	50.5	0.4	-	17.7	68.6
<b>At 31 March 2011</b>	<b>1,549.0</b>	<b>5.2</b>	<b>-</b>	<b>99.5</b>	<b>1,653.7</b>
<b>Net book amount at 31 March 2011</b>	<b>1,098.7</b>	<b>95.9</b>	<b>17,130.1</b>	<b>97.8</b>	<b>18,422.5</b>
Net book amount at 1 April 2010	1,037.1	91.8	16,239.2	93.2	17,461.3
<b>SEWERAGE SERVICES</b>					
<b>Gross replacement cost</b>					
At 1 April 2009	4,472.6	100.7	15,054.6	138.7	19,766.6
AMP adjustment	-	-	-	-	-
RPI adjustment	239.3	5.4	805.4	7.4	1,057.5
Disposals	(13.9)	-	-	(7.8)	(21.7)
Additions	92.5	0.8	31.4	20.5	145.2
<b>At 31 March 2011</b>	<b>4,790.5</b>	<b>106.9</b>	<b>15,891.4</b>	<b>158.8</b>	<b>20,947.6</b>
<b>Depreciation</b>					
At 1 April 2010	2,740.0	23.5	-	26.5	2,790.0
AMP adjustment	-	-	-	-	-
RPI adjustment	146.6	1.3	-	1.4	149.3
Disposals	(3.8)	-	-	(7.7)	(11.5)
Charge for year	121.5	0.6	-	19.6	141.7
<b>At 31 March 2011</b>	<b>3,004.3</b>	<b>25.4</b>	<b>-</b>	<b>39.8</b>	<b>3,069.5</b>
<b>Net book amount at 31 March 2011</b>	<b>1,786.2</b>	<b>81.5</b>	<b>15,891.4</b>	<b>119.0</b>	<b>17,878.1</b>
Net book amount at 1 April 2010	1,732.6	77.2	15,054.6	112.2	16,976.6

## Notes to the Regulatory Accounting Information

### 8. CURRENT COST ANALYSIS OF FIXED ASSETS BY ASSET TYPE (continued) as at 31 March 2011

	Specialised operational assets £m	Non- specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
<b>TOTAL</b>					
<b>Gross replacement cost</b>					
At 1 April 2010	6,934.1	197.1	31,293.8	315.3	38,740.3
AMP adjustment	-	-	-	-	-
RPI adjustment	371.0	10.5	1,674.2	16.9	2,072.6
Disposals	(16.3)	(0.5)	-	(13.9)	(30.7)
Additions	149.4	0.9	53.5	37.8	241.6
<b>At 31 March 2011</b>	<b>7,438.2</b>	<b>208.0</b>	<b>33,021.5</b>	<b>356.1</b>	<b>41,023.8</b>
<b>Depreciation</b>					
At 1 April 2010	4,164.4	28.1	-	109.9	4,302.4
AMP adjustment	-	-	-	-	-
RPI adjustment	222.8	1.5	-	5.9	230.2
Disposals	(5.9)	-	-	(13.8)	(19.7)
Charge for year	172.0	1.0	-	37.3	210.3
<b>At 31 March 2011</b>	<b>4,553.3</b>	<b>30.6</b>	<b>-</b>	<b>139.3</b>	<b>4,723.2</b>
<b>Net book amount at 31 March 2011</b>	<b>2,884.9</b>	<b>177.4</b>	<b>33,021.5</b>	<b>216.8</b>	<b>36,300.6</b>
Net book amount at 1 April 2010	2,769.7	169.0	31,293.8	205.4	34,437.9

# Notes to the Regulatory Accounting Information

## 9. WORKING CAPITAL

	2011 £m	2010 £m
Stocks	1.2	1.1
Trade debtors - measured household	25.6	25.8
- unmeasured household	31.6	31.1
- measured non-household	9.6	16.3
- unmeasured non-household	0.2	0.4
Other trade debtors	13.3	5.4
Measured income accrual	46.8	46.3
Prepayments and other debtors	12.5	100.9
Trade creditors	(47.3)	(45.8)
Deferred income - customer advance receipts	(50.4)	(52.3)
Short term capital creditors	(104.4)	(29.1)
Accruals and other creditors	(7.6)	(3.3)
<b>Total working capital</b>	<b><u>(68.9)</u></b>	<b><u>96.8</u></b>

## 10. MOVEMENT ON CURRENT COST RESERVE

	2011 £m	2010 £m
<b>Balance at 1 April</b>	<b>30,343.4</b>	<b>19,784.9</b>
AMP adjustment	-	9,258.0
RPI adjustments		
Fixed assets	1,842.5	1,451.2
Working capital	4.9	(1.2)
Financing	(175.2)	(131.7)
Grants and third party contributions	(23.0)	(17.8)
<b>Balance at 31 March</b>	<b><u>31,992.6</u></b>	<b><u>30,343.4</u></b>

## Notes to the Regulatory Accounting Information

### 11. RECONCILIATION OF APPOINTED BUSINESS OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2011 £m	2010 £m
<b>Current cost operating profit</b>	<b>245.0</b>	<b>250.0</b>
Working capital adjustment	4.9	(1.2)
Movement in working capital	90.4	(93.7)
Receipts from other income	2.4	18.8
Current cost depreciation	208.4	204.0
Current cost profit on sale of fixed assets	7.7	0.2
Infrastructure renewals charge	61.9	49.6
Other non-cash profit and loss items	7.8	57.0
<b>Net cash flow from operating activities</b>	<b><u>628.5</u></b>	<b><u>484.7</u></b>

### 12. NET DEBT ANALYSIS

	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
<b>Maturity profile</b>				
Between one and two years	17.9	-	-	17.9
Between two and five years	16.7	-	-	16.7
Between five and twenty years	519.1	-	16.3	535.4
In more than twenty years	53.9	63.2	23.7	140.8
	<u>607.6</u>	<u>63.2</u>	<u>40.0</u>	<u>710.8</u>
Cash				(45.4)
<b>Adjusted net debt at 31 March 2011</b>				<b><u>665.4</u></b>
Amounts owed to subsidiary company				2,290.9
<b>Total net debt at 31 March 2011</b>				<b><u>2,956.3</u></b>

# Notes to the Regulatory Accounting Information

## 13. RECONCILIATION BETWEEN STATUTORY AND REGULATORY ACCOUNTS

for the year end 31 March 2011

Regulatory accounts item	Statutory UKGAAP £m	Regulatory £m	
<b>Profit and loss account</b>			
Operating profit	313 6	311 2	Rental income of £2 4m classified as 'other income' in regulatory accounts
Profit before tax	42 4	42 4	Profit before tax unaffected by items shown above
<b>Balance sheet</b>			
Tangible assets	4,357 8	4,376 0	FRS15 adopted in statutory accounts does not permit infrastructure renewals accounting, as required in regulatory accounts A £18 2m accrual is netted off assets
Infrastructure renewals accrual	-	(18 2)	
Deferred income - grants and contributions	-	(74 0)	Within the statutory accounts deferred income is included within creditors due within one year (£3 0m) and creditors due after more than one year (£71 0m)
Investment - loan to a group company	-	928 8	An internal loan to a group company is included within debtors in statutory accounts
Short term deposits	-	5 0	Within the statutory accounts short term deposits are disclosed within 'cash and short term deposits'
Borrowings (due within one year)	(63 3)	(63 3)	At 31 March 2011 there are no internal loans due within 1 year Therefore borrowings due within one year are aligned within the statutory and regulatory accounts
Corporation tax payable	-	(5 4)	Included within creditors in statutory accounts, but itemised separately in regulatory accounts
Debtors	1,088 9	160 1	Internal loans to group company included within investment and short term deposits in regulatory accounts
Creditors (due within one year)	(333 8)	(325 1)	As above, internal loans and corporation tax treatment differs between the statutory and regulatory accounts
Creditors (due after more than one year)	(134 4)	(63 3)	As above, deferred income treatment differs between the statutory and regulatory accounts

# Notes to the Regulatory Accounting Information

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## 14. REGULATORY CAPITAL VALUES AT 2010/11 PRICES

	2011 £m
Opening regulatory capital value for the year	* 4,556
Price review opening adjustment	25
Indexation	245
Capital expenditure (excluding IRE)	* 311
Infrastructure renewals expenditure	79
Infrastructure renewals charge	(59)
Grants and contributions	(12)
Depreciation	(184)
Outperformance of regulatory assumptions (5 years in arrears)	(37)
<b>Closing regulatory capital value</b>	<b>* 4,924</b>
<b>Average regulatory capital value</b>	<b>4,749</b>

\* The table shows the regulatory capital value as published by Ofwat in April 2011, at March 2011 prices, with the exception of the average RCV, which is shown at average prices. The differences from the actual capital expenditure, depreciation etc will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation for the next periodic review.

# **Regulatory Operating and Financial Review**

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## **INTRODUCTION**

The requirements of the Regulatory Operating and Financial Review are set out in this section and, where noted by cross reference below, in the Business Review and Directors' Report that accompany the statutory financial statements of Yorkshire Water

The Business Review on page 3 of the statutory financial statements of Yorkshire Water contains a description of the business, its strategy and review of financial and operational performance in the year, together with key performance indicators, based on the statutory accounts. It also sets out forward-looking statements and the principal risks and uncertainties facing the business.

This review contains additional information and disclosures on regulatory financial information.

The Directors' Report on page 19 of the statutory financial statements of Yorkshire Water sets out the principal activities of the company, subsequent events and company's policy in respect of employees, employment practices, environment and community matters.

The Regulatory Operating and Financial Review in the Regulatory Accounts is required by Ofwat. The contents, including the cross-referencing to the statutory financial statements where appropriate, have been prepared following the Accounting Standards Board's Reporting Statement, as supplemented by additional Ofwat requirements.

## **FINANCIAL PERFORMANCE**

Profit before tax has decreased by £122.1m to £42.4m and operating profit has reduced by £1.5m to £311.2m since 2009/10. Excluding the impact of the exceptional items of £5.9m in 2010/11 and £60.9m in 2009/10, operating profit has reduced by £53.5m. This underlying reduction is due to an increase in certain operating cost items which have seen a step increase between AMP4 and AMP5. In addition to the step increases, the underlying cost base was also impacted by an average RPI increase of 5.0%.

Total regulated turnover for 2010/11 amounted to £859.7m, an increase of £0.5m (0.05%) over the 2009/10 total of £859.2m. 2010/11 appointed income out turned at £859.7m (£851.1m main charges and £8.6m other revenues respectively). This income is £0.6m higher than the income anticipated within the Final Determination (FD) when restated for actual RPI.

An increase on main charges income against the FD is largely offset by a decrease in other income. The main charges income increase reflects:

- A lower level of domestic meter optants than assumed,
- Improved income generation activities, and
- A lower level of decline on our commercial customers than assumed.

Operating costs reduced by £13.3m to £394.7m, which comprised regulated operating costs of £326.9m (2010: £297.5m), exceptional costs of £5.9m (2010: £60.9m) and an infrastructure renewals charge of £61.9m (2010: £49.6m).

Regulated operating costs increased by £29.4m (9.9%) from 2009/10. The year on year movement has arisen as follows:

- Increase of £14.9m in relation to a year on year movement in RPI,
- £6.2m additional expenditure on leakage management,
- £9.2m in relation to a pension deficit payment,
- £1.9m additional bad debt costs,

## Regulatory Operating and Financial Review

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- £4.2m increase in the non domestic rates bill subsequent to the five yearly revaluation,
- £4.7m increase from change in accounting for leakage costs,
- £3.1m decrease from a reduction in the wholesale energy price, and
- £8.6m other savings identified

The infrastructure renewals charge of £61.9m represents a £12.3m increase compared to 2009/10. The increase in the IRC from previous years has resulted from the forecast infrastructure renewals expenditure for the period 2010 - 2020 being updated following receipt of the Final Determination. The calculation covers the period 2005 - 2020 as more robust information is now available for the AMP6 period.

The interest charge of £271.2m was £104.2m higher than 2009/10. £59.5m of the increase was driven by the RPI uplift on index linked swaps and bonds (£72.6m in 2010/11 compared to a £13.1m uplift in 2009/10). In addition a £40.0m exceptional interest cost has been recognised in 2010/11 in relation to the movement in an onerous contract provision in relation to index linked swaps which are out of the money and do not fully hedge floating rate debt.

The tax charge for the year includes a current corporation tax credit of £16.4m, based on tax on profit on ordinary activities at 28% as a result of prior year adjustments, and a deferred tax credit of £59.2m, reflecting the impact on deferred tax provisions of the reduction to the future corporation tax rate from 28% to 26%.

### Exceptional items

The severe winter weather event led to the following exceptional costs:

Employment costs	£0.9m	One off payments and overtime to staff who worked exceptional hours over the Christmas period
Power costs	£1.0m	Additional winter pumping
Hired and contracted services	£2.9m	Payments to service partners for additional resource over the winter period
Associated companies	£0.2m	Additional staff required at Loop to cover higher level of calls received due to the weather conditions
Materials and consumables	£0.5m	Bottled water and other materials required
Other direct costs	£0.4m	£0.3m of additional insurance payments £0.1m of compensation payments to customers
<b>Total</b>	<b>£5.9m</b>	

### Atypical costs

The dry summer conditions, as described in the board overview, led to net additional costs of £0.6m, comprising additional clean water pumping costs of £1.1m offset by reduced pumping costs associated with waste water assets of £0.5m. These have been included as atypical.

### Donations to charitable trusts

£0.1m donations (2010: £nil) were made by the company during the year to various charitable organisations including the Pakistan Earthquake appeal and One Million Green Fingers "OMGF" community projects. In addition, £0.6m was donated by Kelda Group Ltd, a company owned by the ultimate parent to the Yorkshire Water Community Trust.

### Dividends

Dividend payments of £46.9m were made during the year (2010: £211.0m). No final dividend is proposed in respect of 2010/11.

## ***Regulatory Operating and Financial Review***

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### **Cautionary statement**

The purpose of this annual report is to provide information to members of the company and contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this report should be construed as a profit forecast.

# ***Directors' Responsibilities***

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## **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The Directors are responsible under Condition F of the Instrument of Appointment by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Act 1991 for

- a) ensuring that proper accounting records are kept by the Appointee as required by paragraph 3 of Condition F of the Instrument and having regard to the terms of any guidelines notified from time to time by Ofwat,
- b) preparing on a consistent basis in respect of each financial year accounting statements in agreement with the Appointee's accounting records and in accordance with the requirements of Condition F and any guidelines notified from time to time by Ofwat to the Appointee. So far as reasonably practicable these should have the same content as the annual accounts of the Appointee prepared under the Companies Act 2006 and be prepared in accordance with the formats and the accounting policies and principles which apply to those accounts,
- c) preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued to the Appointee from time to time

## **DISCLOSURE OF INFORMATION TO THE AUDITORS**

As stated on page 51, as far as each director is aware there is no relevant audit information of which the company's auditors are unaware and each director has taken such steps as he or she should have taken as a director in order to make him or herself aware of any relevant audit information and to establish that the company's auditors are aware of the information

The maintenance and integrity of the Company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites

Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdiction

## **Other Regulatory Declarations**

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### **RING FENCING**

In the opinion of the Directors, the company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year. This relates to the availability of rights and assets in the event of a special administration order.

### **DIRECTORS' CERTIFICATE - CONDITION F**

The Directors declare that, in their opinion

- i) the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, its regulated activities (including the investment programme necessary to fulfil its obligations under its appointments), and
- ii) the company will, for at least the next 12 months, have available to it
  - a) management resources, and
  - b) systems of planning and internal control

which are sufficient to enable it to carry out those functions

In making this declaration, the Directors have taken into account -

- a) the net worth of the company and the strength of key performance indicators as shown in the audited accounts for the year ended 31 March 2011 and the company's business plan for 2011/12,
- b) borrowing facilities which include significant committed undrawn bank facilities,
- c) parental support provided by the holding company which will provide financial support to the company to enable it to meet its liabilities as they fall due,
- d) the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners, and
- e) the company's employment policies and strategy as described in detail in the Directors' Report on pages 21 and 22 of the statutory financial statements of Yorkshire Water

The Directors also declare that in their opinion all contracts entered into with any Associated Company, include all necessary provisions and requirements concerning the standard of service to be supplied to the company to ensure that it is able to meet all its obligations as a water and sewerage undertaker, as required in Section 6A.2A(3) of Condition F of the Instrument of Appointment. This opinion has been formed following examination of the documents in question.

# ***Independent Auditors' Report on the Regulatory Accounting Information***

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## **Independent Auditors' report to the Water Services Regulation Authority (the Authority, referred to as the "WSRA") and the Directors of Yorkshire Water Services Limited**

We have audited the regulatory accounts of Yorkshire Water Services Limited ("the Company") for the year ended 31 March 2011 on pages 55 to 79 (the "Regulatory Accounts") which comprise

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between the statutory financial statements and the Regulatory Accounts, and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes including the Statement of Accounting Policies

These Regulatory Accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the Statement of Accounting Policies

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F") Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed

### **Respective responsibilities of the WSRA, the Directors and Auditors**

As explained more fully in the Statement of Directors' Responsibilities set out on page 83, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

### **Scope of the audit of the Regulatory Accounts**

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts sufficient to give reasonable assurance that the Regulatory Accounts 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 Regulatory Accounts In addition, we read all the financial and non-financial information in the Regulatory Accounts to identify material inconsistencies with the audited Regulatory Accounts If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report

# ***Independent Auditors' Report on the Regulatory Accounting Information***

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We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

## **Opinion on Regulatory Accounts**

In our opinion the Regulatory Accounts

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 60 the state of the Company's affairs at 31 March 2011 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended, and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies

## **Basis of preparation**

Without modifying our opinion, we draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 55 and 56 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 33.

## **Opinion on other matters prescribed by Condition F**

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F, and
- the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts

## **Other matters**

The nature, form and content of Regulatory Accounts are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

## ***Independent Auditors' Report on the Regulatory Accounting Information***

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Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2011 on which we reported on [x] June 2011, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.



PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds  
7 July 2011