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Annual report and financial statements

Northumbrian Water Group plc

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Northumbrian Water Group plc
is an independent company
quoted on the **FTSE 250 Index**
of the **London Stock Exchange**.
The Group principally works in
the provision of water and
waste water services.

Our vision
To be the national leader in the
provision of sustainable water
and waste water services.

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Cautionary statement

This annual report contains certain statements with respect to the future operations, performance and financial condition of the Group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those forecast. Such statements reflect knowledge and information available at the date of preparation of this annual report and the Company undertakes no obligation to update such statements. Nothing in this annual report should be construed as a profit forecast. Certain regulatory performance data contained in this annual report is subject to regulatory audit.

Highlights

The directors of Northumbrian Water Group (NWG or the Company) are pleased to present their report on the affairs of the Company, along with the audited financial statements and the auditors' report for the year ended 31 March 2011.

Revenue 2011

£738.1m

2010 £704.7m

Profit before interest 2011

£304.2m

2010 £275.8m

Profit before tax 2011

£181.0m

2010 £170.2m

Profit for the year 2011

£178.4m

2010 £122.9m

Financial highlights

- Strong financial performance with a 6.3% increase in profit before tax
- Regulated business operating costs are better than target reflecting good progress on our efficiency programme and fixing of power prices to March 2015
- Net interest charges increased by £17.4 million, largely reflecting RPI increases on index linked bonds, net cash interest charges increased by £2.6 million
- Capital investment in the period of £219.9 million for the Group, capital investment for the regulated business of £221.5 million
- New loan facilities in place, £100.0 million US private placement completed for the Company in April 2011 and £150.0 million approved by the European Investment Bank (EIB) for the regulated business
- Funding and approved facilities in place to meet the requirements of the business to March 2014, cash and short term deposits at 31 March 2011 £141.7 million

- Proposed final dividend of 9.57 pence (2010 8.85 pence) per share to be paid on 9 September 2011, giving a full year ordinary dividend of 14.29 pence (2010 13.24 pence) per share, an increase of 7.9%

Operational highlights

- Continued high levels of customer satisfaction
- Excellent levels of drinking water quality
- Water resource situation is good with no plans for restrictions, expansion of Abberton reservoir to secure supplies for the Essex region for 25 years is progressing well
- Industry-leading waste water compliance
- Construction commenced on advanced anaerobic digestion plant at Howdon, on Tyneside, a further step towards our target of generating 20% of our energy from renewable sources by 2015
- Achievement of Government's Skills Pledge with 90% of the workforce trained to at least National Qualification Framework Level 2

NWG at a glance

Northumbrian Water Group plc

NWG owns a number of companies which, together with NWG, form the Group. The largest of these companies, Northumbrian Water Limited (NWL), is one of the ten regulated water and sewerage businesses in England and Wales. The emphasis given to NWL throughout this report, reflects its importance to the overall performance of the Group.

Northumbrian Water Limited

NWL operates in the north east of England, where it trades as Northumbrian Water, and in the south east of England, where it trades as Essex & Suffolk Water. Northumbrian Water currently provides water and sewerage services to 2.7 million people and Essex & Suffolk Water provides water services to 1.8 million people in a combined area of over 12,260 square kilometres.

Key facts

47	impounding reservoirs
57	water treatment works
346	water pumping stations
338	water service reservoirs
25,624km	water mains
414	sewage treatment works
731	sewage pumping stations
16,181km	sewers

NWL is licensed to provide these services and currently supplies over 1,250 megalitres of water per day. This water is drawn from reservoirs, where it is collected and stored, rivers and groundwater sources. It is treated at our works before it is delivered by a network of pipes to homes and businesses.

In the north east of England, where NWL also provides sewerage services, waste water is then collected from these properties via the sewerage network and treated at our works before it is returned to the environment as either clean water or sludge which can be recycled as fertiliser or used to generate energy.

Our water and sewerage services in the north east cost an average householder 92 pence per day and in Essex and Suffolk area, 66 pence for a water only service.

The Water Services Regulation Authority (Ofwat), as the economic regulator, sets price limits for companies in England and Wales every five years. 2010/11 was the first year in the current five year investment plan. This regulation is performance based and companies are measured in terms of efficiencies related to operating costs, capital programmes and financing as well as their general operations. The regulated revenue of the company is set by reference to the rate of inflation, measured by the Retail Price Index (RPI), as well as an adjustment factor referred to as 'k'. The profile of 'k' for the current five year period is shown below.

	2010/11	2011/12	2012/13	2013/14	2014/15
k (%)	5.0	3.8	0.9	0.0	(1.0)

NWL has a long term agreement with RWE npower for it to operate and sell the energy from NWL's hydroelectric power station at Kielder Water, which is the largest in England.

Water and waste water contracts

NWG controls a number of special purpose companies which have water and waste water contracts in Scotland, Ireland and Gibraltar.

Other

SA Agrer NV (Agrer) carries out project work in developing countries through a number of overseas aid-funded agencies.

North east England

Northumbrian Water provides water and sewerage services to 2.7 million people in the north east of England. The major population centres of Tyneside, Wearside and Teesside are in our area but we also serve large rural areas in Northumberland and County Durham (provision of waste water services only in Hartlepool)

South east England

Essex & Suffolk Water provides water services to two separate supply areas

Our Essex area, which has a population of 1.5 million, is part rural and part urban with the main areas of population being in Chelmsford, Southend and the London Boroughs of Barking and Dagenham, Havering and Redbridge

We serve a population of 0.3 million in our Suffolk area, which is mainly rural with the biggest towns being Great Yarmouth and Lowestoft

Chairman's statement

This was the first year of the five year regulatory cycle 2010-2015. We have made a good start, delivering value for shareholders and customers. Equally important, we have established plans and taken actions to ensure we can deliver over the whole period and beyond.

The new regulatory cycle introduces new performance standards for the period and, in this report, we indicate the substantial progress we are already making. Profit has improved, as is needed to ensure we can attract the funding required to deliver our ambitious investment programme.

This was also the first year with Heidi Mottram as our Chief Executive Officer (CEO). Heidi's review of the year is in pages 6 to 9 of this report. It gives a sense of the energy and determination she has brought to the Group. Our strategy has been reviewed and our values reset. All our employees have been engaged in the work. The result is not a change in our direction. Rather, it is a change in the pace and scale of improvements sought and in our ambition against benchmarks.

We are building on strengths developed over many years but we recognise that the future will pose new challenges and uncertainties, often outside our control. An example is the weather and its impact on our environment. Another is possible reform to the regulatory regime although, in that case, we are seeking to influence change to ensure the company can deliver its, and the Government's, objectives efficiently and effectively. The Board reviews all identified strategic risks regularly, they are detailed on pages 50 and 51 of this report. We seek to judge and to manage the impact of risk on the business, financially and operationally.

The strong financial performance, delivered in difficult and uncertain economic conditions, has enabled the Board to recommend a dividend for the year in line with the objective we established in 2005. Annual real increases of 3.0% have consistently been provided since then. The economic climate remains uncertain although we were pleased to note the agreement by Sahaviriya Steel Industries (SSI) to take over the Corus plant on Teesside and Hitachi's decision to build its high speed train assembly plant in Durham. These, and other developments, should help us to stabilise our demand in the future.

Yet again, the weather had a huge impact on our operations during the year. The worst winter in over 100 years posed many challenges for us. Due to the extraordinary work of teams across the company, supplies to our customers were not affected. I must pay tribute to those who worked in exceptionally hard conditions to guarantee supplies and to deal with the inevitably increased leakage quickly, although, in these circumstances, it was not possible to achieve our leakage target in the north.

A number of reviews of our regulators are under consideration. We also expect a White Paper for Water. This does create uncertainty for the industry. We believe that, overall, the model for the industry has worked well. Much of the necessary change can be made by the industry in association with Government and regulators without potentially disruptive change. Regulatory change must not undermine the confidence of our investors.

Our focus remains on our customers and the trust they put in us to deliver for them each and every day and for the long term. Ofwat has introduced the Service Incentive Mechanism (SIM) in this five year period and in the two year trial period we have improved our score significantly. Our aim is to improve much further. We monitor the company's performance closely and, in this report, show the balanced scorecard we have introduced to do that. It is also the base against which the remuneration of all senior management will be assessed.

Our long term commitment to service to customers, and to achieving efficiency and environmental targets, requires long term investment. The extension of Abberton reservoir is a perfect example and there is a case study of the project on page 43. It will help secure the long term supply of water to our customers in Essex. Also worthy of note is the commencement of work on our second advanced anaerobic digestion plant, at Howdon, on north Tyneside. This follows the successful operation of the plant at Bran Sands, on Teesside. Together they will significantly increase our use of renewable energy.

The work of our people during the winter was exceptional. Their unstinting efforts throughout the year are always evident and are the basis of our successes. We thank them for all they do and we seek to ensure they have the right environment and personal development opportunities. We were listed as a 'company to watch' in the Sunday Times 'Best Companies to work for' survey. This was a significant result as it was the first time we had taken part. However, this was not a surprise as our employee survey showed that levels of satisfaction are high.

Our employees are active in our 'Just an hour' volunteering scheme, working in the communities we serve. These communities are important to us and we have developed significant partnerships to ensure that we support and help to sustain them. That work is part of a corporate responsibility programme covering all aspects of our business and seeking to embed sustainability at all levels.

I must thank my fellow directors for their support during the year. I would particularly like to thank Claude Lamoureux, who leaves the Board after this year's Annual General Meeting (AGM), for his five years on the Board. He has provided us with wisdom and an international dimension. Anita Frew and Alastair Balls both left the NWL board after nine years of dedicated service. We wish them all well. We have welcomed Paul Rew to the Board since last year's AGM as well as Simon Lyster, who has been a member of the NWL board for five years. The board has considerable strength, drawn in part from the diverse backgrounds and experience of the directors.

Sir Derek Wanless
Chairman
 31 May 2011

Chief executive officer's review

This review highlights our business activity during my first year as CEO of NWG.

It has been a hugely enjoyable year, and also a very interesting one, as I took time to understand the business, listen to its stakeholders and employees and work with them to develop a way forward.

I joined a company which already had a good reputation and I was impressed immediately by the loyalty and commitment of the workforce. It was the start of a new five year investment period for NWL and I have taken the opportunity to couple that plan with a review of our strategy, vision and values.

NWL had previously stated its vision to 'be the national leader in the provision of sustainable water and waste water services', and our commitment to this is reaffirmed. We want to continue to deliver value to customers and other stakeholders by focusing on our core competencies of water and waste water management. We underpin our drive to be the best with five strategic themes containing goals and targets that, when reached, will see our vision and our values delivered. In the autumn, 'Our Vision Our Values Our Way' was introduced to all our employees during a series of interactive roadshows and, as a result, there is clarity and energy throughout the company which is driving the business forward.

The five themes described below are mutually supportive and achieving the right balance between them is essential to our success and reputation.

Customer focuses on delivering industry-leading customer service. Our relationship with customers is core to the success of our business and it is essential that they trust our service. Customer service is at the heart of the company and all employees have a clear focus on getting things 'right first time every time'. Although we are required to meet regulated standards for customer service, this should not define our aspiration as the quality of our service must go beyond that.

Competitiveness will drive us to greater efficiency and, indeed, to be the most efficient water company. It is not just about driving cost down but using innovation to support our activity.

People are our greatest asset and we want to be recognised as a great company to work for with high levels of satisfaction from our employees. We will provide support and training and promote excellent employee relations.

Environment is critical to us and our stakeholders and we acknowledge our responsibilities to protect and enhance the natural environment. Our carbon management plan will help reduce our carbon footprint and we will adopt good environmental practice in all aspects of our activity.

Communities are important to us and we want to build strong relationships with the communities we serve. We will ensure that corporate responsibility is embedded in performance management and that we benchmark ourselves against the best companies.

We have agreed specific goals to help us achieve our vision against these themes, and have clear accountability for their achievement throughout the company. These are measured in a balanced scorecard which assesses our performance against key performance indicators (KPIs). This is reviewed by the Board, management team and all employees on a monthly basis.

I believe that clear direction and goals are key to success, but just as important is a clear sense of values, and how we do things 'around here'. So at the same time as reviewing our vision, we have made a clear commitment to five core values.

One team – we work together consistently, promoting co-operation, to achieve our corporate objectives.

Customer focused – we aim to exceed the expectations of our external and internal customers.

Results driven – we take personal responsibility for achieving excellent business results.

Creative – we continuously strive for innovative and better ways to deliver our business.

Ethical – we are open and honest in meeting our commitments, with a responsible approach to the environment and our communities.

Chief executive officer's review

continued

2010/11

The company was successful in meeting many of the targets in its balanced scorecard during the year. Out of 26 targets we improved in 18, which is a very good start. Most notable were the improvements in sewer flooding, our SIM score for customer service as well as the reduction in the number of interruptions to supply. We were also very proud to retain our industry-leading position in sewage treatment. Our independent customer satisfaction scores still show that customers are satisfied with the service we provide as well as value for money although we were disappointed that this was not reflected at the same level in the research undertaken by the Consumer Council for Water (CCWater) this year.

The report will also focus on many highlights throughout the year but the development of our work to extend Abberton reservoir and commence our second advanced anaerobic digestion plant at Howdon, after the successful operation at Bran Sands, are particularly notable. The worst winter for over 100 years challenged our employees but they responded magnificently ensuring that no supplies were interrupted. This was a fantastic achievement and I am very proud and grateful for the commitment and hard work of so many of our employees in truly dreadful weather conditions.

The company also continued to receive external recognition for its activity. This year, Ethisphere listed NWG in its top 110 most ethical companies in the world, one of only five companies chosen in the UK. This recognises the impact we have on underpinning the communities in which we operate and also recognises our longstanding relationships with key industrial and commercial customers.

We continue to be actively involved in the business community in all operating areas through direct membership and involvement in the councils/boards of the Confederation of British Industry (CBI), Chambers of Commerce and other similar organisations. For my part, I have been getting involved in a number of organisations which I believe can influence the future of the company and locally I am a member of the CBI Council and have been asked to join their national Infrastructure Group. I have also joined the Government's Green Economy Council as the water industry representative and I hope that the Council can bring a real influence to the development of policy relating to a low carbon economy.

This year, industrial demand has stabilised and we were particularly pleased with the signing of the agreement by SSI from Thailand to secure the future of the Corus plant on Teesside. There is evidence of some industrial growth particularly with the confirmation that Hitachi will develop a site in Durham to assemble its high speed trains. Metering of our domestic customers continues to increase, although at a different pace in our various areas of supply, and domestic demand is also steady. The collection of income remains a key focus for us, particularly in a difficult economic climate.

Private drains and sewers

One of the major challenges we face in 2011/12 is the transfer of private drains and sewers to the industry in October. This will almost double our sewerage network overnight and much work is already in hand to assess what is needed in terms of staffing, building effective data, information sharing and communications to customers. We don't fully know the impact of the transfer yet, but it will lead to higher costs, in the order of £20 million a year initially, which we will need to recover in this five year investment period. The industry has worked well in partnership, via Water UK, to come up with the most practical cost effective way forward for customers.

Legislative changes

We look forward to publication of the Government's White Papers on Water and the Natural Environment later this year. The former should bring greater clarity in areas such as water resource planning, metering, social tariffs and broader market reform. We have worked with the industry, through Water UK, to set out a vision of how the Government can achieve many of its objectives without legislation or with only minor legislative changes. NWL has held frequent meetings with Defra and contributed ideas on water trading and abstraction reform including a joint project ('Trading theory for Practice') with Anglian Water, Cambridge Water and Veolia. We remain committed to any moves that can deliver clear and demonstrable improvements for customers, other stakeholders and the wider environment.

The Water White Paper will be an opportunity to end unhelpful speculation around the future regulatory regime and provide a clear vision for the future of the water industry that retains the confidence of customers and investors alike.

In addition, we await the publication for consultation of draft Regulations from Defra to introduce a duty on landlords to provide water companies with relevant details so that accurate bills can be issued to tenants. This should assist in collecting income from the private rented sector where bad debts have been relatively high.

Regulatory reform

We welcome the conclusions of the Defra review of Ofwat and CCWater conducted by David Gray. We also welcome the view that the overall regulatory framework, including the continued role for a separate customer body, is generally fit for purpose. We support the call for regulatory simplification and a reduced reporting burden which is already being championed enthusiastically by Ofwat. We also support further clarification of the respective roles of Government and regulators and a call for more transparency in consultation processes.

We strongly support the move by Ofwat to significantly reduce the burden of regulatory reporting and move towards risk-based regulation. A useful start was made in the simplified 2011 June Return reporting requirements but we support the proposal for more radical change in 2012. We have been working in partnership with Ofwat to pilot a set of high level KPIs to be reported by companies in place of the current detailed and prescriptive reporting requirements.

Ofwat has published a series of consultation and discussion papers on the subject of 'Future price limits'. We have responded to these papers and also engaged in a range of workshops, meetings and informal discussions with Ofwat. We believe the more focused approach to regulation should be reflected in the approach to future price reviews as well as the annual reporting cycle. We welcome Ofwat's intention to adopt a more outcome-focused approach to price setting and have made suggestions as to how the price setting methodology could be simplified and made more transparent. We look forward to responding to Ofwat's formal consultation paper outlining its proposals for future price reviews later in the year.

The Office of Fair Trading has announced a market study looking at whether the market for treatment of organic waste is working effectively to deliver the best outcomes for customers. NWL was an early investor in advanced anaerobic digestion technology and we welcome this review as it should provide the clarity required to inform investment decisions.

Summary

This has been a very good year for the Group. We are reporting a strong set of results, we have a clear vision and goals to deliver and have made good progress in performance in many areas. There is a strong sense of energy, commitment and accountability in the business and I am confident of further success in 2011/12.

Heidi Mottram
Chief Executive Officer
31 May 2011

Our corporate responsibility

In previous years, in line with many other companies, we have reported on corporate responsibility separately within this report. During the year, a review of our vision, values and strategy has given us the opportunity to truly embed sustainability throughout our business. Reflecting the importance of sustainability to our business we believe that we should report sustainability issues alongside our core business activities and we have decided to highlight sustainability areas throughout our annual report in green. We recognise that this is an innovative approach and would welcome any feedback. This activity is extensive and it is not possible to include everything here. As a result, key sustainability issues appear in green boxes and are linked to our Sustainability Highlights document, a partner document to this annual report, which contains more detailed information on our responsible business practice policies, plans, KPIs and case studies.

NWL is expected to provide a secure supply of water, a basic necessity for health, and to protect or enhance the environment when we return waste to it. Our stakeholders also expect us to

- behave fairly and responsibly,
- use resources wisely,
- improve quality of life, and
- contribute to economic development

We believe that sustainability helps to improve the performance of the company and to achieve our business strategy and objectives. This is reflected in our business plan where our sustainability objectives are woven into our core business strategy. Our credentials for our work have been recognised and these are outlined on page 44. Business in the Community (BITC) has highlighted that those companies participating in their Corporate Responsibility Index outperform other FTSE 250 companies and Ethisphere highlights similar outperformance for ethical companies. NWG's share price has outperformed against the FTSE 250 over the last five years as highlighted on page 78.

Our customer research also highlights that customers value the work of NWL in the community and for the environment and it helps to build their trust in our work. Each aspect of the highlighted work in this report has a direct benefit to the company, its community and its environment, such as cost saving, carbon reduction, environmental impact, skills development or leverage. Case studies throughout our annual report, for example on advanced anaerobic digestion or use of reed beds in water treatment, demonstrate the tangible business benefits such as reduced costs and power consumption.

To ensure that sustainability runs throughout the business, all parts of the Company are involved from the Board through to all employees. Governance of our sustainability activity is led by our Corporate Responsibility Committee (CRC), a subcommittee of the NWL board. The CRC comprises non-executive directors, executive directors, the CEO (who is directly accountable to the NWL and NWG boards for both the environment and sustainable development policies) and senior managers from across the business. In addition, a CR Advisory Group (CRAG) acts as a critical friend, helping to validate, guide and challenge NWL's sustainability strategy and activities. The CRAG is made up of senior representatives from partner organisations to reflect the key areas of our communities strategy.

"Northumbrian Water Group's driving commitment to sustainability demonstrates that strong leadership and ambition can make a tangible difference to communities and the environment."

Simon Lyster, Chair, CRC

"Northumbrian Water Group has an open and inclusive approach to working with a wide array of external partners to develop extremely impressive social and environmental initiatives."

Norma Hope, Chair, CRAG

Our performance measures

The Group monitors performance using a range of financial and non-financial KPIs. Performance against these indicators is reported within the 'our financial performance' and 'our operating performance' sections later in this report.

Looking forward, the financial KPIs remain unchanged for 2011/12. However, in order to measure delivery of the Company business plan and goals, a balanced scorecard of KPIs has been introduced, which replaces the existing non-financial KPIs. These indicators are spread across the themes of customer, competitiveness, people, environment and communities and targets have been set on a trajectory to deliver the company vision of being 'the national leader in water and waste water services'.

In order to ensure alignment of the management team, this balanced scorecard now represents 80% of the criteria contributing to their annual bonus, with a further 20% available for the achievement of bespoke personal targets.

The table below details those KPIs and the targets that have been set for 2011/12. A full explanation of each target follows.

Strategic theme	Scorecard measure	Target 2011/12	% Contribution to available bonus
Customer	Customer satisfaction		
	– SIM quantitative score	174	2
	– SIM qualitative score	4.4	2
	Unplanned interruptions >6 hours		
	– north	900	4
	– south	600	
	Coliform incidents (no)	15	4
Competitiveness	Profit before tax	Set by Board	36
	Capital efficiency	Set by Board	4
People	Engagement and satisfaction index (%)	81	4
	Lost time reportable accidents (no)	11	4
Environment	Leakage (Mld)		
	– north	147	4
	– south	66	
	Sewage treatment works compliance (%)	100	4
	Pollution incidents (categories 1 & 2)	3	4
Communities	FTSE4Good accreditation	Retain	4
	BITC Platinum Plus accreditation	Retain	4
Personal targets	Bespoke	Bespoke	20

Measure	Definition of measure
Customer Customer satisfaction – SIM quantitative score	SIM quantitative measure, based on customer contacts. Contacts are normalised per thousand connected properties and multiplied by a weighting factor for each 'unwanted' category. Categories include unwanted customer calls, abandoned calls, first stage written complaints, second stage written complaints and CCWater investigations. The lower the score the higher the customer satisfaction.
Customer satisfaction – SIM qualitative score	SIM qualitative measure, assessing satisfaction of consumers across their experience from first correspondence to final resolution, through independent surveys. Surveys are carried out four times a year for water, waste water and billing contacts and the average score taken. A score of 5 indicates maximum satisfaction.
Unplanned interruptions >6 hours	A weighted scoring of the number of properties affected by interruptions to supply of more than six hours' duration which are unplanned, unwarned (excluding overruns of planned and warned interruptions) except for those caused directly by third parties. It includes interruptions for which customers are notified less than 48 hours in advance. The scoring weights interruptions which exceed 12 hours, and heavily weights those which exceed 24 hours.
Coliform incidents	Total number of coliform failures in regulatory samples at water treatment works and service reservoirs. One coliform or more is a failing sample.
Competition Profit before tax	Actual profit before tax compared to the budget approved by the Board, adjusted for the impact of variances related to indexation on index linked bonds, which depends on the July RPI in the year. Profit before tax has been chosen because it is a primary financial measure for the Group for which the executive directors are accountable.
Capital efficiency	An annual assessment of the efficiency of the NWL capital investment programme is undertaken by the Board.
People Engagement and satisfaction index (%)	The Engagement and Satisfaction Index is calculated from scores for 13 items selected from the annual employee survey. These items align to the Sunday Times Best Companies survey and give a measure of employee satisfaction.
Lost time reportable accidents (no)	Accidents reportable to the Health and Safety Executive resulting in more than three days lost from work.
Environment Leakage (Mld)	Water network leakage for the financial year, as reported to Ofwat.
Sewage treatment works compliance (%)	Percentage of population equivalent served by sewage treatment works compliant with Environment Agency (EA) look-up table consents.
Pollution incidents (categories 1 & 2)	Number of category 1 and 2 pollution incidents in the calendar year, as defined by the EA. Category 1 is a major water pollution incident and category 2 is a significant water pollution incident.
Communities FTSE4Good accreditation	Accreditation by FTSE4Good index series, which has been designed to objectively measure the performance of companies that meet globally recognised corporate responsibility standards.
BITC Platinum Plus accreditation	Accreditation by BITC at Platinum Plus level, the highest level in their corporate responsibility index. BITC is a national business-led charity which advises, challenges and supports its members to create a sustainable future for people and the planet and to improve business performance.

Our market

The largest of NWG's businesses, NWL, operates in the north east and south east of England. The two areas have very different economic, demographic and water resource characteristics.

Our external environment

In the north east, there has been a gradual fall in overall water demand in recent decades as a consequence of a reduction in industrial demand for water. This trend is expected to continue but the pace of decline has now stabilised after some industrial closures during the economic recession. The north east compares well to the rest of the country as far as water resources are concerned and our major regional rivers can all be supported by Kielder Water. This provides very high security of supply for our customers. We also provide the highest levels of compliance for waste water across this area ensuring that we can return the water and sewage sludge to the environment satisfactorily whilst meeting the demands of all customers. Bran Sands is particularly important in this respect as it supports the heavily industrialised area within Teesside by treating its waste. The advanced anaerobic digestion plant there is now operating effectively and helping us to build our use of renewable energy.

NWL's southern operating area is in a water scarce region that is forecast to experience further economic and population growth in the medium term. While this area has also seen a reduction in demand from heavy industry, and the recession is likely to dampen housing growth in the near future, we have a current deficit, meaning supplies are not secure in a severe drought. Future growth will intensify the pressure on the balance between supply and demand. NWL is implementing long term plans to ensure the availability of water supplies to meet both current and future demand in the region. After approval from the EA, the project to increase the capacity of Abberton reservoir, near Colchester, coupled with ongoing demand management measures, will secure supplies to the Essex area for the foreseeable future.

The current pressures within financial markets have been well documented and the credit crunch has resulted in reduced availability of certain types of finance. It is highly unlikely there will be a return to the exceptionally low cost of debt experienced from late 2005 to early 2007. Although market conditions have improved in recent months, some uncertainty remains. With the financing we have already put in place, we are sheltered from this uncertainty in the short term as we will not need to raise any new debt before March 2014.

Regulatory and legislative framework

As a monopoly supplier of an essential public service, the UK water industry operates within a demanding regulatory environment.

Ofwat regulates prices and levels of customer service, while the Drinking Water Inspectorate (DWI) monitors drinking water quality and the EA covers environmental protection. Customers' interests are represented by CCWater.

NWL aims to maintain good working relationships with its regulators and with regional organisations, such as local authorities, which have an interest in the services it provides and can influence the company's business. This is particularly important following Government reviews of the regulators, changes in regulatory reporting and proposals to legislate in the sector following the publication of a White Paper later in the year.

Our financial performance

NWG and NWL use a range of financial KPIs to monitor the financial standing of the businesses and to ensure that strong credit ratings are maintained. The definition, purpose and source of each KPI are shown on page 52.

Performance against the financial KPIs is set out below:

	Target		Performance			
			Current year		Previous year	
	NWG	NWL	NWG	NWL	NWG	NWL
Gearing to RCV (%)	<75	<70 ¹	63 ²	56 ³	66	61
Cash interest cover (times)	>2.5	>3.0	3.2	4.0	3.3	3.9
Cash flow to net debt (%)	>13	>13	16	20	15	18

Notes

1 Less than 65% for the regulated business of NWL

2 NWG's pro forma Regulatory Capital Value (RCV) at 31 March 2011 was £3,643.1 million (2010: £3,420.5 million) (see below)

3 NWL's RCV as advised by Ofwat, at 31 March 2011 was £3,318.4 million (2010: £3,095.0 million)

The pro forma Group RCV includes £219.1 million (2010 £218.8 million) and £105.6 million (2010 £106.7 million) for the Kielder securitisation and private finance initiative (PFI) contracts, respectively. Adding these to NWL's RCV of £3,318.4 million (2010 £3,095.0 million), results in a pro forma Group RCV of £3,643.1 million (2010 £3,420.5 million).

The Group's gearing on this pro forma basis has decreased from 66% to 63%, with net debt increasing by £41.1 million (1.8%) to £2,303.5 million over the year, while pro forma Group RCV has increased by 6.5% due principally to the increase in RPI.

Gearing at NWL, and for the regulated business, has reduced to 56% from 61% and 60% respectively. This is due to the impact of the high RPI increase on the RCV and a reduction in net debt reduced over the period of £28.5 million to £1,868.3 million, due to the timing of intra-Group dividends which were paid after the balance sheet date.

The Group also prepares detailed medium term business plans and annual budgets, which are reviewed and submitted to the Board for approval. Targets are set to measure performance and regular financial forecasts are made. Business plans and budgets include an assessment of the key risks and success factors facing each business unit. On a monthly basis, management compares the actual operational and financial performance of each business with plan and budget and this is reported to the Board.

Financial results and dividends

	Year to 31 3 2011 £m
Profit for the year	178.4
Interim dividend paid (ordinary – 4.72 pence per share)	24.5
Final dividend proposed (ordinary – 9.57 pence per share)	49.6

NWG

Revenue for the year ended 31 March 2011 increased by 4.7% to £738.1 million (2010 £704.7 million). Water and sewerage charges at the Group's principal subsidiary NWL, increased in line with the price review (final determination) allowance of 5.0% plus the November 2009 RPI of 0.3%. Income from the Group's water and waste water contracts increased by 4.4%.

Operating costs increased by £5.0 million (1.2%) to £433.9 million, principally reflecting movements at NWL, which are detailed below, and the one-off recovery of claim costs by Caledonian Environmental Services (CES) in the prior year. Profit on ordinary activities before interest for the year was £304.2 million (2010 £275.8 million), an increase of 10.3%.

Net interest charges increased by £17.4 million within which net cash interest charges increased by £2.6 million. The non-cash element of the increase principally reflects inflation of the principal on the index linked bonds (£28.5 million) and an increase in the interest cost of pension plan obligations (£7.2 million). These were partially offset by better than expected returns on pension assets (£13.9 million) and one-off credits in respect of the acquisition of the remaining 25.0% subordinated loan stock in CES not already held by the Group (£4.6 million) and a termination discount on the transfer of a finance lease to a new counterparty (£2.9 million).

Profit on ordinary activities before tax for the year was £181.0 million, 6.3% higher than the previous year (2010 £170.2 million). The current tax charge reduced to £33.1 million (2010 £37.8 million) principally reflecting increased profitability more than offset by adjustments in respect of prior periods.

The deferred tax credit of £30.5 million (2010 charge of £9.5 million) reflects a decrease in the Group's deferred tax liability of £46.3 million following the enactment of a reduction in the UK corporation tax rate from 28.0% to 26.0% with effect from 1 April 2011.

The effective tax rate for the period was 1.4% (2010 27.8%) reflecting the impact of the deferred tax rate change. In the absence of the rate change, and other prior year items, the effective rate would have been 28.5%.

Capital investment for the Group was £219.9 million (2010 £236.3 million restated), including recognition of £13.9 million for assets adopted at £nil cash consideration, as required under IFRIC 18 Transfers of Assets from Customers (2010 £14.0 million).

Our financial performance continued

NWL

Revenue was £689.4 million for the year ended 31 March 2011 (2010 £657.8 million). The increase is mainly due to the application of the final determination increase of 5.0%, and 0.3% in respect of RPI, on water and sewerage charges. Demand from both domestic and industrial customers has remained steady.

Operating costs increased by £2.9 million (0.7%) to £391.8 million, principally reflecting increases in depreciation, pension charges and water efficiency costs, partially offset by savings on power (£6.1 million), other efficiencies and one-off charges in the prior year both for restructuring costs (£5.4 million) and for bad debt relating to the closure of a major customer (£1.7 million).

Profit on ordinary activities before interest for the year was £297.6 million (2010 £268.9 million).

Capital investment in the regulated business for the period was £221.5 million, under regulatory accounting guidelines (2010 £218.3 million). This is slightly lower than the final determination profile, deflated by the Construction Industry Price Index (COPI), due to some delays in maintenance investment as a result of the severe winter weather, but this should be recovered in future years. It is difficult to assess any potential outperformance over the AMP5 period at this early stage given the volatile nature of COPI but we remain focused on delivering our regulatory programme.

We have recently tendered our major procurement arrangements covering water treatment, waste water treatment and waste water networks and have appointed 19 contractors and consultants to framework agreements covering an estimated £1.5 billion of investment over the next ten years, commencing 1 April 2011. In addition, we are currently undertaking a tender process to appoint additional contractors in readiness for the transfer of responsibility for private drains and sewers on 1 October 2011.

Early in the year, we instigated an efficiency programme focused on identifying and implementing sustainable operating cost efficiencies in order to achieve our medium term goal of being in the top efficiency band for both water and sewerage, as measured by Ofwat, by 2013/14. This programme has progressed well and, as a result, we are ahead of our final determination profile. Further information on this programme is provided on page 28.

Water and waste water contracts

Our water and waste water contracts in Scotland, Ireland and Gibraltar are all performing well and are in line with expectations. Revenue for the contracts increased to £40.0 million for the year ended 31 March 2011 (2010 £38.3 million), principally as a result of the settlement of outstanding claims and indexation on revenue tariffs, both at CES. Profit on ordinary activities before interest was £9.5 million (2010 £10.2 million), reducing as a result of a one-off recovery of claim costs in the prior year, partially offset by the increased revenues.

The Group is involved in two projects to deliver long term PFI contracts with Scottish Water for waste water treatment. In April 2010, the Group acquired the remaining 25% non-controlling equity interest in CES for a nominal sum resulting in an increase of £0.6 million in equity shareholders' funds. It also purchased the remaining 25% subordinated loan stock for a consideration of £0.4 million which, when compared to the book value of the loan stock of £5.0 million, resulted in a £4.6 million gain that has been recognised in net finance costs in the period.

At CES, the Group now has a 100% shareholding in both project and operating companies and the benefit of a 40 year contract. Funding was provided through a 37 year fixed interest rate corporate bond with the principal amortising from 2008.

In Ayrshire, the Group has a 75% shareholding in the project company and a 100% shareholding in the company that operates the three effluent treatment plants that comprise this 30 year contract. Finance was provided through a 27 year loan on a fixed interest basis with the principal amortising from 2003.

In Ireland, the Group is part of a contractual consortium that designed and built a waste water treatment plant for Cork City Council. Under the consortium agreement, the Group has responsibility for a 20 year contract for the operation and maintenance of the plant. During the year, the Group added to its Irish project portfolio by signing a 20 year operation and maintenance contract for the Fermoy and Mallow waste water treatment works, with Cork County Council, commencing in May 2011.

AquaGib Limited, which is two thirds owned by the Group in a joint venture with the Government of Gibraltar, operates Gibraltar's dual drinking water and sea water distribution systems under its 30 year contract with the Government of Gibraltar.

Other Agrer

Revenue for the year to 31 March 2011 was £8.3 million (2010 £8.5 million). During the year, Agrer has signed new contracts and extensions with a total gross margin of €1.7 million. At 31 March 2011, the gross margin of the order book is in excess of €2.1 million.

The most significant new contracts signed during the year include provision of technical assistance to a local development and management of natural resources programme in Chad (€1.3 million – 54 months), improvement of the agricultural products value chains in Mali (€0.5 million – 20 months), a country evaluation of Nepal, Nicaragua and Tanzania (€0.5 million – six months) and a new Framework contract for the European Commission Lot 1 Studies and technical assistance in all sectors (four years). In the technical assistance to the Good Governance programme in Burundi, a significant extension has been signed (€0.9 million – 28 months).

Earnings per share and dividends

Basic and diluted earnings per share (EPS) for the year were 34.44 pence and 34.38 pence respectively (2010 23.67 pence and 23.62 pence respectively).

The directors consider that EPS adjusted for the volatility inherent in some deferred tax items gives a better indication of the Group's underlying performance. In previous years, an adjustment has been made for total deferred tax. However, the directors have concluded that the ongoing deferred tax charge forms part of underlying performance and it is more appropriate to only adjust for significant non-recurring deferred tax items. For the current period, EPS from continuing operations, adjusted for the deferred tax credit relating to the corporation tax rate reduction, were 25.50 pence (2010 restated 23.67 pence).

A final dividend of 9.57 pence per share for the year ended 31 March 2011 will be recommended by the Board to shareholders at the AGM on 28 July 2011 and, if approved, will be paid on 9 September 2011 to shareholders on the Company's Register of Members at the close of business on 12 August 2011. Together with the ordinary interim dividend of 4.72 pence per share, the ordinary dividends paid and proposed for the year will be 14.29 pence per share (2010 13.24 pence per share). This represents an increase of 7.9%, based on average inflation over the year of 4.9%, on the ordinary dividends for the previous year and is consistent with the Board's decision to maintain a progressive dividend policy with real increases of 3.0% per annum. The dividend cover for the year, excluding significant, non-recurring deferred tax, was 1.9 times (2010 1.8 times).

The board of our main subsidiary, NWL, has proposed a dividend policy consistent with the underlying growth assumptions adopted by Ofwat at the price review in 2009.

Northumbrian Water Share Scheme Trustees Limited, which at the date of this report held 765,962 shares to be used in the future to satisfy the vesting and exercise of awards under the Company's Long Term Incentive Plan (LTIP), has waived the right to all dividends on the shares it holds. Further details of the LTIP can be found in the directors' remuneration report.

Our financial performance continued

Accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union as it applies to the financial statements of the Group for the year ended 31 March 2011

Capital structure and liquidity

As at 31 March 2011 the Group and NWL's regulated business debt structure remain largely unchanged from the previous year end date

In February 2011, the Group agreed a new £100.0 million US private placement with a ten year maturity at a coupon of 5.82%, the proceeds of which were received on 14 April 2011. On the same date, this and existing cash reserves were used to refinance £125.0 million of holding company debt maturing in May 2011. NWL has also received approval for a new £150.0 million facility from the EIB which will be drawn in three £50.0 million tranches, in the calendar years 2011 to 2013, at interest rates to be determined at the time of drawdown.

The Group and NWL's regulated business debt structure remain largely unchanged with 74% (NWL 70%) fixed at an average rate of 5.80% (NWL 5.96%), 20% (NWL 23%) index linked at an average real rate of 1.85% (all NWL) and 6% (NWL 7%) on a variable rate basis. The blended average rate for the Group and NWL's regulated business for the year ended 31 March 2011 was 5.80% and 5.93% (2010 4.62%, 4.45%), respectively, reflecting increased RPI.

Cash interest cover has remained stable for the year as have the credit ratings for NWL at BBB+ stable (Fitch and Standard & Poors) and Baa1 stable (Moody's).

Total cash, cash equivalents and short term cash deposits available at 31 March 2011 amounted to £141.7 million. This, and the new EIB facility, is sufficient to meet the requirements of the business through to the end of March 2014.

Treasury policy

The main purposes of the Group's treasury function are to assess the Group's ongoing capital requirement, to maintain short term liquidity, ensuring access to medium term committed back up facilities, and to raise funding, taking advantage of any favourable market opportunities.

It also invests any surplus funds the Group may have, based on its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process, but the Group's policies prohibit their use for speculation. Full details are provided in note 20 to the financial statements. The Group is operating in compliance with its policies.

Pensions

The Group operates both a defined benefit pension scheme, which is closed to new entrants, and an occupational defined contribution arrangement.

The deficit (under International Accounting Standard (IAS) 19 Retirement Benefits) of the defined benefit scheme has decreased from £133.1 million, at 31 March 2010, to £46.0 million at 31 March 2011. This is due to a reduction in the liabilities of the scheme (£37.2 million) and an increase in the value of scheme assets (£49.9 million). The valuation of the scheme liabilities has taken account of legislative changes which mean that future statutory deferred revaluations and statutory pension increases will be linked to the Consumer Price Index (CPI). As a consequence, CPI increases have been applied for deferred pensions in all sections of the scheme and to those sections where the scheme rules link increases to the Government's pension increase orders. This has given rise to a reduction in the scheme liabilities of around £36.0 million.

Following the 2004 actuarial valuation the Group prepaid contributions for the period to 31 December 2010. In place of recommencing regular contributions from 1 January 2011, the Group agreed to pay further advance contributions to the scheme totalling £70.0 million for the period to 31 March 2015. Amounts totalling £22.9 million were paid in the period to 31 March 2011 and a further £47.1 million was paid in April 2011. These payments comprise employers' contributions and the deficit recovery funding assumed in the final determination.

A full actuarial valuation of the scheme as at 31 December 2010 is underway.

Our operating performance

We use a range of KPIs to measure non-financial performance in the business and these indicators are reviewed by the management team each month. Performance for the year is reported in this section. The definition, purpose and source of each KPI are shown on pages 52 to 53.

These measures have been reviewed in the year, as outlined in 'our performance measures' on page 12, and a new balanced scorecard of KPIs has been introduced for 2011/12.

Customer

Putting customers first

Customer service is at the heart of the company and the culture of getting things 'right first time every time' is embedded in the business. We keep customers informed about our activities through leaflets with bills and our websites at www.nwl.co.uk and www.eswater.co.uk. The sites include information about our services and now allow customers to ask questions and investigate work being carried out in their area. If customers are directly affected by any work, we give advance warning and explain the need for the timing of such work. We also communicate more broadly with local communities through public meetings and customer information events.

Customer satisfaction

We measure the views of our customers with quarterly tracking research alongside qualitative work in focus groups. This helps us to understand their views on service, value for money and other issues as well as their general perception of the company. NWL measures its performance for domestic customers in two key ways, customer research and performance against standards.

Customer research is carried out each quarter in the regions served and the table below shows the key results for overall satisfaction with service and value for money.

	Target 2010/11	Performance 2010/11
Overall service (%) ¹	91	89
Value for money (%) ¹	87	85

Note

1 Satisfaction measured on a net basis (see appendix to the directors' report – business review)

Customer service

The performance against standards of service is shown below.

	North (N) South (S)	Target 2010/11	Performance 2010/11
Properties at risk of low pressure	N S	256 55	230 41
Properties subject to unplanned interruption of six hours or more	N S	1,700 1,100	1,573 700
Properties subject to hosepipe bans at any time during the year	N/S	0	0
Properties subject to sewer flooding (other causes)	N	150	253
Properties at risk of sewer flooding (once in ten years or twice in ten years)	N	688	487
Billing contacts responded to (within five working days) (%)	N S	99.3 99.3	99.3 99.7
Written complaints responded to (within ten working days) (%) ¹	N S	n/a n/a	99.9 99.8
Bills based on meter readings (%)	N S	99.9 99.9	99.87 99.83

Note

1 New SIM measures were introduced in 2010/11 which incorporate this KPI, therefore no separate target set.

Our operating performance

Customer continued

In addition, Ofwat introduced the SIM in the year, which monitors both quantitative and qualitative aspects of customer service. This new mechanism financially incentivises the best performing companies and penalises the worst, endeavouring to simulate competition and encourage excellent service throughout the industry. Our aim is to be the leading company for SIM.

The quantitative aspect of SIM includes metrics for all lines busy and abandoned calls, unwanted calls, written complaints and CCWater investigations, each of which are worth a number of penalty points depending upon the severity. Results across all metrics improved during the year, customer complaints continue to reduce and our quantitative SIM score for 2010/11 was 211, a significant improvement compared to 2009/10 when our score equated to 331.

The qualitative aspect of SIM takes the form of a survey, which is conducted each quarter across every water company and asks customers who have made contact with us about their experience. Our cumulative score for the four quarterly surveys was 4.14 out of 5, an improvement on the previous year's score of 4.10.

The way we handle customer complaints is reviewed annually by CCWater who assess cases against a range of criteria. During 2010/11, 96% of all cases reviewed were assessed as good. We value the feedback CCWater provide us and actively use their suggestions to further improve the customer experience.

Affordability

We aim to provide accurate, clear and timely bills which encourage prompt payment. Customers who deliberately avoid paying charges are actively pursued. In the current economic climate, we know that affordability continues to be a genuine concern for many customers and we continue to be considerate of their circumstances, ensuring they can choose suitable payment options and that our recovery techniques are appropriate and effective. However, customers who deliberately avoid paying charges are actively pursued and we are working closely with Ofwat and Defra to seek changes to legislation which will assist the industry to identify those responsible for charges more easily.

The Flood and Water Management Act 2010 outlines how sewerage service providers may operate concessions for surface water drainage charges, to protect certain community groups and premises from unaffordable charges. We have decided to introduce an interim concessionary charge for the charging year 1 April 2011 to 31 March 2012 and will carry out consultation with CCWater to determine the longer term future of any concessions in the coming months.

Business customers

The economic situation has had a significant impact on some business sectors which are important in our operating regions and NWL has been working closely with major customers in those sectors to mitigate the impact where possible. NWL has always tried to

work with its major customers in partnership and the case study on page 27 highlights such work at KP Foods. While economic conditions remain challenging, industrial demand has stabilised this year following, for example, the development of the former Artenius site by Lotte Chemical UK Limited. The agreement for the takeover of the Corus site by SSI should help stabilise industrial demand going forward.

NWL is active in the business communities where it operates as a member of the CBI and Chambers of Commerce. By supporting these and smaller groups, NWL can help business growth and development in the areas it serves as well as retaining contact with organisations which represent customers. Business customer satisfaction is also tracked on a regular basis and levels of satisfaction are high.

Leisure customers

NWL continues to develop its leisure facilities at all strategic sites including investment in fishing facilities, holiday accommodation and supporting 'access for all'. Occupancy of the log cabins at Kielder was 85% and we have 5,814 fishing members registered. The combined activity of our reservoirs rates this business the largest of its kind in the UK, with a high customer satisfaction at all sites. NWL is also an active member of the Kielder Water & Forest Park Development Trust.

Strategy in action – Customer

Working in partnership

We always aim to exceed the expectations of our customers by taking personal responsibility for delivering and communicating a good service and keeping promises. We have many examples of 'right first time every time', two of these are outlined below.

Many of our domestic customers have meters and pay bills based upon how much water they use. Having a meter can help save money, however, for those who have larger families, big gardens or use lots of water, this can be more difficult.

This was exactly the case for the Young family from Stockton-on-Tees. Father of two, Stephen Young contacted us to discuss his metered bill and seek advice about ways to reduce his charges. Stephen already used water butts to store rainwater, however, following our advice, Stephen and his family made some simple changes including turning off the tap while brushing their teeth, taking shorter showers and using NWL's water efficiency pack containing a variety of water saving devices.

Commenting on the help and advice he received, Stephen said "Getting in touch with NWL is easy. I know my call will be answered straight away, which is amazing these days that I will be able to speak to someone who cares and relates to my concerns." Vikki Anstey, our customer advisor who talked to Stephen, said "It's all about listening to each customer's concerns and then making sure you meet their needs and go the extra mile to help them."

We aim to work in partnership with our major business customers as we know that a key factor for them in their business is reliability and security of our services.

Tees Valley crisp manufacturer KP Foods (KP) is a major customer of NWL's Billingham sewage treatment works. To improve KP's economic performance and enhance the sustainability of its operations, KP proposed to construct a membrane bioreactor to enable water to be treated and re-circulated at its plant. NWL's account manager worked with KP to ensure that the proposed development did not detrimentally impact on NWL's sewage treatment works compliance while providing advice and support. Both parties have benefited from the close, honest working relationship which has resulted in a great deal of trust and respect.

- water consumption has been reduced meaning less abstraction, treatment and pumping for NWL and lower water bills for KP, and
- the trade effluent discharge is cleaner and requires less treatment, reducing the cost of power and de-sludging for NWL, resulting in lower trade effluent discharge costs for KP.

NWL and KP have each increased their competitiveness by improving their efficiency.

Our operating performance

Competitiveness

Early in the year we instigated an efficiency programme focused on identifying and implementing sustainable operating cost efficiencies in order to achieve our medium term goal of being in the top efficiency band for both water and sewerage, as measured by Ofwat.

Efficiency programme

The efficiency programme has identified around 100 projects and initiatives from across the whole business, ranging from large scale strategic reviews to smaller improvements at a local level. Examples of some of the changes underway include consolidating all chemical analysis for our northern operating region at one laboratory, the implementation of site-specific energy management plans to reduce energy usage, increasing the capability of our website to enable improved customer self-service, investigating opportunities for co-digestion of external waste streams at our advanced anaerobic digestion plant at Bran Sands and insourcing activities where it is more efficient and effective to do so.

These efficiencies are additional to the benefits already secured through procuring our full energy requirements to March 2015 and the headcount reductions resulting from severances and early retirements, for which provision was made last year.

Delivery of the programme is on schedule and, as a result, we are ahead of the final determination profile. However, these benefits are partially offset by the impact of the changes to the Carbon Reduction Commitment Energy Efficiency Scheme announced by the Government in its Comprehensive Spending Review in October 2010, which is expected to increase energy costs by around £3.0 million next year with further increases of up to £1.5 million by 2014/15, and which was not funded in the final determination.

Other aspects of performance in relation to our competitiveness theme are included in 'our financial performance' on pages 16 to 21.

Research and development

As part of its competitiveness theme, NWL runs a programme of research and development linked to its operations, which includes the development of technical solutions for water and waste water management, collaborative research within the sector and partnerships with academic and research organisations and actively encourages innovation. This has supported the invention, development, trial and/or implementation of

- advanced automatic control systems for waste water treatment process,
- a device for reducing flooding and pollution,
- microbial fuel cells and electrochemical cells, which, respectively, generate electricity or hydrogen from waste water,
- novel instruments for monitoring the quality of waste water effluent,
- beneficial re-uses for water treatment sludge,
- low power de-watering and thickening of water treatment sludge,
- internal inspection of water distribution pipes while in service,
- lining systems for extending the life expectancy of water distribution pipes,
- water efficient and rapid disinfection of water mains,
- novel processes for drinking water production and waste water treatment,
- renewable energy production using biogas,
- regeneration of brownfield land using water treatment by-products,
- early warning system for leaks and bursts, and
- remote pipeline condition assessment

During the year, the Group invested £2.3 million (2010: £2.1 million) in research and development.

Research carried out by London Economics for Professor Martin Cave's 'Independent Review of Competition and Innovation in Water Markets' found that, in terms of innovation infrastructure, NWL was one of the companies best equipped to promote innovation in terms of the resources it dedicates.

Strategy in action – Competitiveness

World first at Hanningfield

An initial stage of water treatment involves removing silts and algae from raw reservoir water, a process which creates around two million litres of a ferric (iron) based liquid sludge every day. Around 99.8% of this is water which, once separated, can be recycled back to the reservoir for re-use. In this case, innovation is clearly linked to our competitiveness.

Traditionally, sludge was discharged into lagoons storing the solids whilst allowing clear water to overflow back into the reservoir. At Hanningfield, our largest water treatment works, the last lagoon was near the end of its life and although it would have been quicker and easier to have specified traditional mechanical treatment, a considerable amount of work over three years was undertaken to prove that reed beds could provide a sustainable and effective alternative for water sludge treatment – a world first for a project of this scale.

Natural England strongly supports the reed bed project at Hanningfield reservoir because it will provide a sustainable, energy and carbon-efficient solution to the long-term disposal of water treatment sludge. It will also create a significant reed bed within a few hundred metres of Hanningfield reservoir which will be designated as a site of special scientific interest that will be of use in its own right for a variety of wildlife, including reed bed invertebrates, birds and foraging bats. It will also provide a regular water supply for a disused sludge lagoon within the site of special scientific interest which the company has recently restored very successfully as a wildlife-rich mosaic of reed bed, open water, wet scrub and woodland.

Our operating performance

People

Employee policy

Each company within the Group has developed its own employee policies, reflecting the framework set out in NWG's 'Our Code of Conduct'. These policies are tailored to specific business objectives and operating environments. Each company aims to recruit and retain the best people, with a diverse range of skills, experience and backgrounds, who are committed to making the company successful. In return, each company aims to provide opportunities and training for employees to develop their skills and capabilities to equip them to meet the challenges of their roles, while rewarding the contributions of both teams and individuals. The CEO has responsibility at Board level for human resources issues. The Human Resources Director, Sarah Salter, reports directly to the CEO.

Employees

Throughout the Group we employ 3,031 people, as set out below.

Group business unit	Average number of employees	%
NWL	2,875	95
Water and waste water contracts	132	4
Other	24	1
Total employees	3,031	100

NWG ensures its terms and conditions both attract and retain the best people in the areas it serves. NWL employee turnover is relatively low at 5.8%, below the UK water industry average of 9.4%.

NWL's current level of sickness absence is 3.1%, which is well below the norm for the sector.

	Target 2010/11	Performance 2010/11
Employee turnover (%)	9.4 ¹	5.8
Lost time reportable accidents (per 1,000 employees)	4.3	4.1
Sickness absence (%)	2.9	3.1

Notes

1 No target set. Industry average provided for information.

The active involvement and engagement of everyone across the business is an important part of delivering performance and NWL continues to seek the views of employees through an annual employee engagement survey. This year's survey had the largest response rate ever, at 75%, and the feedback covered working life, training, communications, managers and the company. All employees were invited to workshops to consider the results and identify areas for improvement in their working practices and environment, the outputs contributing to the development of departmental action plans. In addition, 80% of respondents told us they are proud to work for the company, 81% would recommend working for the company and 77% believe that NWL is a great organisation to work for.

For the first time NWL took part in the Sunday Times Best Companies survey and achieved 'one to watch' status, an excellent achievement on first time entry.

NWL employees also have access to a scheme which provides a wide range of benefits including tax efficient benefits such as childcare vouchers, water services, cars for personal use and discounted store vouchers. Currently 73% of employees participate in the scheme, up from 72% last year.

Equality and diversity

The Group operates an equal opportunity policy designed to ensure that no job applicant or employee receives less favourable treatment on the grounds of age, gender, marital status, disability, race, ethnic or national origin, religion or sexual orientation. NWL monitors its workforce profile against census and sector data and aims to be recognised as an employer of choice within the diverse communities it serves, ensuring it takes full advantage of the rich backgrounds and abilities of current and potential employees.

NWL welcomes employment applications from people with disabilities and, where existing employees develop disabilities, they are supported to remain in employment, wherever practicable, by providing appropriate adjustments to their roles and/or effective redeployments. Occupational health physicians assist this process with professional medical advice.

Consultation and engagement

Each Group company engages with its employees through a variety of means appropriate to its working environment. The importance of an inclusive and engaging management style is fully recognised.

In 2010, NWL continued to build on its award-winning approach by engaging with all employees over some 120 departmental workshops facilitated by senior managers and 51 interactive roadshows facilitated by the directors. These were all structured to outline our vision and values, encourage a dialogue on improvements to working practices and environment and to seek views on its people strategy. This has been further developed to include leadership events held bi-annually engaging the most senior managers in the continuous development of plans to enable the achievement of the vision.

Training and development

All Group companies train and develop their employees to benefit both the company and the individual. Annual appraisals are given high priority, as is the identification of training needs, in recognition of the importance of training and development in achieving the Group's goals and policies. In NWL, a 360° feedback mechanism, which evaluates performance against the company values, has been introduced for all senior managers. The results of the feedback are discussed at annual appraisal meetings.

Our operating performance

People continued

Our people are the key to our business success. Our aim is to build and maintain a culture which values, encourages and recognises outstanding performance, where we share a commitment to our objectives and to delivering our personal best. From corporate induction days and induction planning, to individual coaching, accreditation of skills through national vocational qualifications, and management and leadership programmes, we provide the resources needed to help employees reach their full potential.

We signed the Government's Skills Pledge at the end of 2007, publicly committing to develop 90% of the workforce, around 2,600 employees, to at least National Qualification Framework (NQF) Level 2 – the equivalent of five GCSEs at grades A to C – by the end of 2010. This was achieved by July 2010 with 90.2% qualified to NQF Level 2 or above. National Vocational Qualifications continue to be delivered in customer and operational areas. In addition, we currently have seven graduates on our Graduate Development Programme and 29 apprentices.

NWL continues to implement its Management Development Framework which is structured (see diagram on page 33) to cover the training needs of those who show the potential for management right through to development at director level. As part of this framework we are working in partnership with Newcastle Business School to provide qualifications, from a Diploma to a Masters degree, in leadership and management. In 2010, we introduced our LEADer programme, which is the next step in our Management Development Framework, to some of our operational departments. This development programme for supervisors, team leaders and works managers includes assessment against NQF Levels 2, 3 and 5 management standards, as appropriate, supported by formal development and coaching.

Recognising our employees' academic achievements, the fifth annual skills awards were celebrated this year. Attended by senior managers from around the business, and with guest speaker Kriss Akabusi, the events were again motivational and memorable.

Communication

The Group uses a wide range of communication methods including magazines, brochures, leaflets, newsletters, intranet, notice boards and regular team meetings. NWL issues all employees with a series of information booklets clearly explaining areas such as the company's vision and values, terms, conditions and benefits of employment, and occupational health and wellbeing programmes.

Disclosure (Whistleblowing)

The Group encourages open feedback and is committed to protecting employees who wish to voice concerns about behaviour or decisions that they believe to be illegal or unethical. The Audit Committee regularly reviews the disclosure policy.

Health and safety

NWG places great emphasis on health and safety and a safe working environment. Employees are actively encouraged to be involved in identifying and eliminating hazards in the workplace. This has resulted in a significant reduction in accidents over recent years.

A health and safety policy is maintained and implemented at each subsidiary.

Our emphasis on the importance of health and safety within NWL has resulted in major improvements to our safety record in recent years. This year we experienced nine reportable accidents and incidents per 1,000 employees, which continues the improving trend achieved over the last seven years.

We have established a medium term plan for taking health and safety forward in the company to 2015. We aim to further reduce the number of accidents by 10% each year and to maintain and improve the safety culture in the company.

NWL proactively supports and encourages employees to strive for high standards of health and wellbeing by providing a wide range of services, support and resources relating to occupational health, with the Group's medical advisor providing comprehensive occupational health services, general health promotion and stress management. NWL employees also have on and off-site access to specialist advice and treatment to support recovery from musculoskeletal disorders (MSD). We have reduced sickness absence due to MSD by 39% over the year. In 2010, we introduced NWL Support. Part of this service is an Employee Wellbeing Programme which gives employees and their immediate family access to face to face or telephone counselling on a range of subjects regardless of whether or not the issues are work related. In addition, it also provides a telephone based case management service for employees who have either a stress related or mental health condition. We have reduced stress related sickness absence by 16% in the first year.

We continue to promote healthy eating, hydration and to discourage smoking in our workforce and offer excellent health screening and medical insurance schemes. Around 2,200 employees have been through our health screening and fitness standards programmes, both of which now include lifestyle advice elements.

Quality

The company has successfully extended its scope of certification to the international occupational health and safety management standard OHSAS 8001:2007 to include Scientific Services, thus now ensuring company-wide coverage.

Employee Share Incentive Plan (SIP)

The directors believe that employee investment strengthens the ties between the Group and its employees. More than a third of employees participate in the SIP, and together have an interest in 0.6% of the issued share capital. The scheme provides one free matching share for every three shares bought by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants. There are no performance conditions attached to the SIP, but free shares not held in trust for at least 12 months are forfeited. Employees participating in the SIP are given the opportunity to exercise their voting rights through the Trustee.

Chris Loftus received the Essex Young Achiever of the Year Award

Strategy in action – People

Growing in water – investing in our people

As a company we are committed to investing in training and development to ensure that our people are competent and safe in their current roles, to support them to develop skills and knowledge to help take the business forward and, where people are career orientated, to help them develop for future roles. We have many examples of our people in the business who have developed their career within NWL.

Tony Erskine, our customer manager, joined us aged 17 on the young person's development programme, a youth training scheme, and began studying for a higher national certificate qualification. He is now in his final year of NWL's bespoke BA (Hons) in Leadership and Management and will graduate in July.

Tony said "The BA course is the best thing that I have ever done. It has been a real eye opener and enabled me to learn new skills, get different perspectives and learn from others. It's been a massive benefit to me as a manager and I believe makes me a more effective leader. It's been a lot of hard work but I have gained a lot from it and so will the company."

Chris Loftus, leakage assistant, was unemployed and not sure of what he wanted to do with his life when he saw the poster advertising The Prince's Trust Get into Water programme in the window of his local Jobcentre. He found his age and lack of experience a real hindrance until he joined us on a three week course designed to provide unemployed 16-25 year olds with the opportunity to learn about the water industry and get some valuable hands-on work experience, before hopefully moving into employment. He has now been with NWL for three years and has become a young ambassador for the Princes Trust while receiving the Essex Young Achiever of the Year Award.

Kathryn Waugh, distribution operations controller, joined the accelerated graduate development programme in 2001 following her degree in physical geography. She undertook a series of strategic projects and business support placements to develop her knowledge of business processes and gain a broad overview of the company and its operations. After further development roles in water and waste water works management, she has now taken a senior role in operations. Kathryn said "I find working with people to make positive improvements to the operations and maintenance side of the business very rewarding. I really enjoy my job and working for NWL."

Our operating performance

Environment

Water quality

The quality of water is critical to our customers and samples are taken on a daily basis for analysis under regulations monitored by the DWI. The quality in all areas served remained high.

	North (N) South (S)	Target 2010/11	Performance 2010/11
DWI Mean Zonal Compliance (%)	N S	99.85 99.95	99.95 99.94
DWI Operational Performance Index (%)	N S	99.65 99.98	99.84 99.97
Distribution Maintenance Index (%)	N S	99.70 99.85	99.70 99.93

Compliance at water treatment works has improved significantly in 2010 with fewer microbiological failures than any previous year. This reflects the work being undertaken to achieve internal medium term targets for performance. In addition, service reservoir maintenance has been enhanced, with inspection rates now three times higher than historical frequencies. The aim of this work is to sustain a higher level of microbiological compliance while ensuring the integrity of the asset base for the long term.

Work using new cleaning techniques to refurbish more than 150 kilometres of the large diameter pipe network is well advanced. The network supplies drinking water to over half a million customers in south east Northumberland and parts of Tyneside. The majority of the cleaning works have now been delivered and the programme is due to be completed in June 2011, achieving a significant reduction in customer complaints of discoloured water. Progress has been maintained despite the unusually harsh winter.

Water resources

Water resource availability is a key issue in our Essex and Suffolk areas. Work continued throughout 2010 on increasing the capacity of Abberton reservoir, near Colchester, by 58%. Good progress was made and the project remains on programme.

In early 2011, construction of two new pipelines to bring water from Norfolk commenced. The one remaining part of the overall Abberton Scheme that requires permissions is the variation of abstraction licences at Denver and Blackdyke, in Norfolk, and we are working closely with the EA on progressing this. Once this scheme is operating, in 2014, we do not expect to have to develop further major resources in Essex for the next 25 years.

In addition to improving the supply of water, we believe it is important to manage the demand for water so that it does not exceed levels that can be supplied in a sustainable way. Metering has an important role to play in this regard. For several years we have been installing water meters upon change of occupier in properties in the Essex area. This is in addition to the optional metering scheme available to all customers. Around 48% of domestic households in Essex and 60% in Suffolk are now metered. In the north east, where supplies are more plentiful, 24% of households are metered.

New water efficiency targets were introduced in 2010/11 to reduce per capita consumption across the company's domestic customers by one litre per property per day. These targets apply in all areas served and the award-winning work previously carried out in Essex was extended to the rest of the company. New initiatives have been developed, including an innovative theatre production called 'Little Green Riding Hood' with Fame Factory Spotlight, which took the water efficiency message to 36,500 school children over the last year. NWL met its water efficiency targets early, before the end of the year.

We continue to monitor the weather patterns and the early part of 2011 has proved to be dry with little rainfall. The resource situation is still good with adequate resources in storage to meet demand. There are no plans for restrictions although the company will continue to use awareness campaigns to encourage customers to control demand in dry periods.

Our assets, once again, proved very resilient during the most severe December weather for more than 100 years in the north east of England. It proved very challenging but we were able to maintain supplies to customers largely due to the exemplary efforts of our employees who worked tirelessly in difficult conditions. The severe freeze and subsequent thaw, inevitably resulted in a significant increase in burst pipes and leakage both on our own network and customer premises. As a result, in our northern operating region, the water lost over the winter period meant we, along with other companies, did not meet our annual leakage target. In our southern region, conditions were not quite so severe and we achieved our target. We have recovered from the effects of the winter through implementing an action plan which will position us well to meet the target in the following year.

Waste water

NWL's exceptional performance for sewage treatment works continued with all numerically consented works again remaining compliant for the year.

(Northern operating area only)	Target 2010/11	Performance 2010/11
Sewage treatment works (%)	100	100
Bathing waters Mandatory Standard (%)	100	97
Pollution incidents (category 1, 2 and 3)	102	101

The advanced anaerobic digestion plant at Bran Sands is now fully operational and generating the expected volumes of biogas and electricity. The re-organisation, to operate the plant at much lower manning levels than previously, has been successfully implemented. Construction is now underway on a similar plant at Howdon, on Tyneside, to process the remainder of NWL's sludge.

A total of 33 of the 34 bathing waters in the north east passed the required mandatory standard and 28 met the more demanding guideline standard. The single mandatory failure was Saltburn and NWL is carrying out a detailed investigation on whether any of our assets could be contributing to this and is working with other agencies to determine how they may be impacting on this bathing water.

The number of properties experiencing internal flooding due to hydraulic overloading reduced significantly in 2010/11. This can be attributed to a combination of less frequent and intense summer storms in 2010 and the cumulative effect of our sewer flooding investment programme. Enhanced resolution rain radar has now been in place in the north east since 2009 allowing us to identify severe weather across the region.

During 2010/11 we completed 43 schemes at a cost of £17.5 million that resulted in the removal of 178 properties from flooding registers. Planning to identify schemes for coming years forms a key part of our investment programme and is well advanced, with a further 270 properties to be addressed in 2011/12. Additionally, in line with our serviceability action plan for sewer flooding, we have embarked on a programme of increased mitigation. This covers not only properties where a scheme is not cost beneficial but also properties where a solution may not be implemented quickly.

Our operating performance

Environment continued

The number of properties flooded due to other causes also reduced significantly in 2010/11. This reduction has been influenced by increased sewer cleansing activity as well as better weather.

Carbon management plan

The water industry is one of the largest users of energy in the UK and we aim to play a full part in support of Government's plans to reduce emissions. We have been working hard over recent years to reduce our carbon footprint while preparing ourselves for the future challenges of a change in climate and the weather events we may face as a consequence.

NWL has published its carbon management plan to meet its target of a 35% reduction in operational emissions by 2020, from a 2008 base.

The carbon management plan includes energy efficiency, renewable energy generation and water efficiency and supports our activities to help us adapt to a changing climate. It represents a sustainable and responsible way forward for the business, our customers and the environment. The projects which will help us to achieve our carbon reduction target are outlined below:

- our £33.0 million investment in thermal hydrolysis advanced anaerobic digestion at Bran Sands, which provides 50% (c. 4.7 MW) of the energy requirements of the site. This enables waste water sludge to generate methane to fuel gas engines and produce green electricity. A similar plant will be constructed at Howdon, which is planned for completion in 2013/14. Together these plants will help meet our target of generating 20% of our energy needs from renewable energy, as well as reduce our overall energy demand,

- hydroelectric installations at five reservoirs including the UK's largest man-made reservoir, Kielder Water. A recently commissioned £2.5 million hydroelectric project at our Selsel reservoir that will generate up to 750 kilowatts of electricity – 4,000 megawatt hours a year. Renewable energy is also being generated with hydroelectric plants at Derwent, Lartington and Wear Valley reservoirs in addition to biogas combined heat and power plants at Stressholme, Hexham and Aycliffe,
- limiting tertiary ultraviolet disinfection outside the bathing water season at five major works reduces energy consumption and carbon emissions with no detrimental effect on the marine environment, and
- encouraging customers, through our 'using water wisely' campaign, to recognise that if they waste water, they also waste energy (information and tools are available for customers on our websites).

Through these projects, and by reviewing the efficiency of our pumps across the business, we have reduced the amount of energy used by almost 9% over the last five years.

NWL has successfully achieved the Carbon Trust Standard for its efforts in reducing greenhouse gas emissions. The standard provides an objective benchmark against which our commitment and success in addressing our climate change impact was assessed and is significant as it demonstrates progress against our ambitious carbon management plan.

Changing weather patterns

The water cycle and the changing weather have a direct influence on the provision of water and waste water services. NWL's employees are experienced in managing the effects of too much or too little rainfall, but changing weather patterns will present a growing challenge for the business.

In past years, we have carried out research into the likely impact of climate change on all our assets and water resources and this has been incorporated in our climate change policy as part of our corporate responsibility work. This work is continuing, based on the latest UKCP09 projections published in 2009 by the UK Climate Impacts Programme.

Over the course of the past year we have incorporated this work into our response to the new adaptation reporting power granted to the Government by the 2008 Climate Change Act. This work has highlighted that increasing rainfall intensity is the most significant short term threat that we will face as a result of the changing climate. This represents a serious challenge if we are to manage successfully the higher level of risk of sewer flooding that will result. We have already begun to take actions that will better prepare us for this challenge, including investment in weather radar, remote monitoring of the sewer network and joint working with other drainage agencies. These will all contribute to our better understanding and management of the threat.

More positively we have found that the anticipated drier summers of the future are less of a concern for NWL than for many other companies in our industry. The ongoing investment to increase the capacity of Abberton reservoir plays a big part in this for our Essex operating area. Work is now underway on this project that has been in development for over 15 years, a reflection of the long lead times for such environmentally sensitive schemes. The presence of Kielder Water helps protect the north east region to an even greater extent. Despite this, we anticipate that we will need to monitor and formally update our understanding of the threat from the changing weather at regular intervals.

Quality

NWL has maintained its certification to the international quality standard ISO 9001:2008 and to the international environmental standard ISO 14001:2004 across all areas of the business, including operational sites and office based teams.

Strategy in action – Environment

Good progress for the Abberton Scheme

Essex is the driest county in the UK. In a dry year demand already outstrips supply and due to population rise this situation is expected to get worse

After 17 years in the planning the £150 million Abberton construction scheme to help secure water supply to 1.5 million customers in Essex made good progress in its first year

The reservoir, near Colchester, will be enlarged by 58% with its footprint extended by 40%, and the increased capacity will be in service in 2014. Over the last year, significant progress has been made and two important milestones have now been reached. Water is now flowing into the reservoir via the newly completed reservoir inlet structure at Broadmeadows and work has begun on the construction of two major raw water pipeline routes. These 1.2 metre diameter, 16 kilometre long, steel pipelines will transfer water from the River Stour at Wormingford to Abberton.

Abberton is a site of international environmental significance, designated under the Ramsar convention on wetlands. In designing our proposals, working closely with Natural England, the RSPB and Essex Wildlife Trust, we have gone beyond what is required to not only maintain the environmental significance of the site but to enhance it. The new reservoir will have existing concrete edging removed, will include more marginal shallow waters, as well as a new re-sited visitor centre and an extensive wetland area at the western end of the reservoir. The new proposals will improve biodiversity as well as enhance the amenities for visitors.

Our operating performance

Communities

NWL supports the communities we serve in a number of different ways. We have been widely recognised as leaders in our support for projects that make the areas we serve better places in which to live, work or invest. This year the company has been re-accredited by FTSE4Good and is awaiting re-accreditation as a Platinum Plus company by Business in the Community. The Queens Award for Industry is still in place as it is awarded for a five year period. This year, the company was also recognised by Ethisphere, an American-based international think-tank, as one of the 110 most ethical companies in the world and was one of only five UK-based companies.

The support we give to our communities focuses on five broad areas:

Investment in our communities

This year the Group made charitable donations totalling £152,000. In addition, and in line with previous years, we have contributed resources with a value equivalent to at least 1% of our annual pre-tax profits (through cash, employee time and expertise, or use of our facilities) to projects which benefit the communities we serve. Our employees fundraised £69,000 for charities this year.

The 'Care for safety' scheme, which encourages employees to reduce accidents and associated lost time, has triggered payments over £16,000 for our charities nominated by employees (Great North Air Ambulance Service, Royal National Lifeboat Institution (RNLI), Myelin Project, Zoe's Place, Macmillan Cancer Support, St Cuthbert's Hospice and East Anglian Children's Hospice). Since it began in 2004 over £326,000 has been raised for charity.

Community Foundations covering our areas of supply hold endowment funds totalling nearly £1.0 million contributed by NWL over the last 19 years. These are long term investments with the income from the funds used to support community and environmental initiatives. Community groups are chosen by committees of our own employees (44 recipients this year).

In addition to cash donations, NWL seeks to support many projects through in-kind giving and support. Through 'Good Moves' we aim to put NWL estates into productive community use. Working in partnership with artist groups CoExist and Metal, we have developed a temporary art project at our empty Southend complex to provide space for a temporary gallery, studio and small creative business complex.

We have focused on developing affordable rural housing to contribute to the sustainability and vitality of those communities, including support of the Prince of Wales' Affordable Rural Housing Initiative since it was launched in 2003. As part of this commitment we are working with Hastoe Housing on a project for 12 houses on land close to Hanningfield water treatment works in Essex and these are due for completion in 2011.

The Kielder Partnership was created in 1994 and consisted of private, public and voluntary sector partners committed to the development of Kielder Water & Forest Park as a tourism, leisure and recreation destination. Activity has focused on delivering the Partnership's vision – 'Kielder Big Picture' – including the use of the fabulous tracks and trails developed in 2008/09.

The 26 mile Lakeside Way, a multi-user track, is now used by 45% of all visitors. This trail was used for the first Kielder Marathon in October 2010, dubbed the most beautiful in Britain, organised by Olympic athlete Steve Cram. This, combined with other activities including the development of mountain bike trails and the increasingly popular Kielder Observatory, has helped to increase visitor numbers between 2008 and 2010 by 9.4% to 306,250, creating an additional 66 direct and indirect jobs and boosting the spend in the local economy by 20% to £15.5 million.

In December 2010, the structure of the Partnership was formalised by forming a registered charity called the Kielder Water & Forest Park Development Trust which will continue to deliver the vision and 25 year investment plan for the area. The website www.visitkielder.com provides further details of all facilities.

Participation in our communities

As part of NWL's in-kind giving, we encourage employees to volunteer their time, skills and expertise through our 'Just an hour' volunteering scheme. We support our people to actively participate in their local communities by giving them work time to volunteer in projects of their choice. During the year our people have helped hundreds of community projects, completing tasks as varied as beach clean ups, organising charity balls and taking on ambitious gardening and decorating challenges.

For example, a group of employees volunteered their time to support people with disabilities to participate in an activity weekend organised by the charity Leonard Cheshire Disability. Together, volunteers and service users enjoyed outdoor activities including abseiling and taking a zip wire across a river. Further highlights came from the Essex based employees who collected over 1,000 boxes of food supplies as part of the Harvest for the Hungry campaign 2010. This important contribution helped the humanitarian campaign to provide an essential lifeline to villages and communities scattered across Eastern Europe.

Currently 27% of employees participate in the 'Just an hour' volunteering scheme and last year gave over 7,600 hours to the community. Over 870 different organisations were given financial and in-kind support during the year.

Our operating performance

Communities continued

Educating our communities about their environment

Key partnerships have been developed by NWL to help the conservation of biodiversity on our sites, to facilitate public access and to develop conservation education. Our contribution includes funding project officers and providing expertise to the organisations. Our current partnerships include:

- Northumberland Wildlife Trust (Kielder and Bakethin),
- Durham Wildlife Trust,
- Essex Wildlife Trust (Hanningfield),
- Broads Authority (Lound and Trinity Broads), and
- Davy Down Trust (North Stifford, Essex)

A wide range of targeted educational materials are available on our websites for children and teachers. We promote the use of these materials and celebrate innovative approaches to environment and health education via our support of the Northumbrian Water Schools Awards in the north east and Cash for Schools Awards in Essex.

We also lead on specific environmental education initiatives such as the innovative 'Northumbrian Water GLOBE' project. This year the project, in collaboration with The Climate Change Schools Project, ClimateNE, EA and GLOBE UK, is supporting five schools to take control of capturing and analysing local weather data, patterns and extreme events (using weather stations and training provided by NWL). Ultimately, children involved will become 'community scientists' to drive behavioural change at local levels.

Supporting healthy communities

NWL continues to promote the health benefits of drinking tap water and our 'Water for health' campaign aims to encourage people to lead a healthy lifestyle. To date, over £341,000 has been provided to fund free mains-fed water coolers in schools and around 740 have been supplied in nearly 410 schools. We also continue to promote bottle-free water coolers as a sustainable alternative to bottle-fed coolers. Similarly, we use our 'tap into' initiative to donate bottled tap water to community sporting events in order to promote the importance of rehydration during exercise. This year we donated 82,300 bottles of tap water to events.

Working with a wide and diverse range of sporting partners is a natural extension of our 'Water for health' campaign and we work with them to support grassroots sporting activities to get people active as well as educating them on healthy eating and good hydration.

Through our partnerships we have reached over 96,000 children and adults. We provide:

- links and networks to enable sporting partners to get together to share ideas and resources,
- financial support of approximately £50,000 per annum which then levered over £600,000 from other sources,
- advice and marketing support on programme development,
- bottled tap water, sports bottles, water jugs or mains-fed bottle-free coolers to reinforce the importance of drinking tap water to rehydrate during sporting activities, and
- help with fundraising and raising the profile of the partnerships to attract additional investment.

We have linked our 'Good moves' initiative and our 'Water for health' campaign to develop Healthworks. This is a unique project utilising one of our redundant buildings to help tackle the poor long term health of the residents in Easington, County Durham, by granting a 99 year lease to County Durham Primary Care Trust and working in partnership to develop services for the local community in an area where census records show one of the worst health records in the country.

We are represented on the steering group for Healthworks and provide research, marketing and communications support. The centre has received almost 20,000 visits to date and now provides over 58 health and community support services including a GP led walk-in health centre open 8am to 8pm 365 days a year. It acts as a community focal point where service providers and community groups can come together to address issues that affect the quality of life in their local community.

Supporting developing communities through WaterAid

NWL has continued to raise funds and awareness for the work of WaterAid which brings sustainable water and sanitation solutions, as well as hygiene education, to the poorest parts of Africa and Asia, as it has since the charity was formed by the water industry in 1981.

The employee fundraising committee has raised more than £4 million, since 1997, with the help of the company and last year focused its fundraising support on specific projects in Ethiopia. We support our employees to become ambassadors for the charity and encourage annual supporter trips to see WaterAid projects. This year, Asset Manager Craig Holliday visited Bangladesh and saw first hand how our adopted international charity saves lives.

Strategy in action – Communities

A*

performance

at Castle

View

Castle View Enterprise Academy, in Sunderland, completed its first year of operations during the year

NWL is the lead sponsor and wanted to create a centre of excellence with a clear focus on raising standards of academic performance to enable every student to achieve their personal best in all areas of academy life within a safe, secure and stable environment. NWL formed a new trust board to govern the school, recruited an inspirational head teacher and helped her to form a new leadership team, design an engaging curriculum and implement a set of new policies which would fundamentally change and improve school life for the students.

During the first year, Castle View Enterprise Academy students achieved 43% A*–Cs in GCSEs English and Maths (up from 26% in the old Castle View School) and 86% five or more GCSEs A*–Cs (up from 63%). Persistent absences decreased from 10% in the old Castle View school, to 6.3% in the new academy's first year of operation. In March 2011, the new academy undertook Ofsted assessment and from being a failing school previously is now a school making good progress.

Indeed, sixteen students at Castle View Enterprise Academy have gained amongst the highest grades possible in the January 2011 GCSE Mathematics examinations – six months ahead of schedule. Eight of the sixteen gained grade A* and the other eight gained grade A.

In addition to the excellent teaching in the academy and after school tutorials, these more able students were also coached by one of our graduate trainees, David Bullin, who has a maths degree. David has given his time under our employee volunteering scheme, just an hour, on Wednesdays after school and more recently on Saturday mornings.

Our risks and uncertainties

The NWG Board requires all subsidiaries within the Group to identify and assess the impact of risks to their business using a standard risk model. For each risk identified, the model records the uncontrolled magnitude and likelihood of the risks occurring as well as the controls in place to mitigate those risks before assessing the controlled magnitude. The Board's view of acceptable risk is based on a balanced view of all of the risks in the operating environment. It aims to ensure an appropriate balance between risk aversion and opportunities.

The Board sets the tone for risk management within the Group and determines the appropriate risk appetite. The Board monitors the management of fundamental risks and approves major decisions affecting the Group's risk profile. Senior management implements policies on risk management and internal control.

For NWL, the management team reviews the approach to risk management in detail every year and the Audit Committee considers the outcome. The management team reviews the significant risks every month and a full review of the model for emerging significant risks is carried out quarterly. Any issues that arise from these management team reviews are reported by the CEO to the board.

Apart from NWL, none of the subsidiaries has risks considered to be significant to the Group's short and long term value.

The system of internal control incorporates risk management. It encompasses a number of elements that together facilitate an effective and efficient operation, enabling the company to respond to a variety of risks. These elements include:

Policies and procedures

Attached to fundamental risks are a series of policies that underpin the internal control process. Written procedures support the policies where appropriate.

Business planning and budgeting

The business planning and budgeting process is used to set objectives, agree action plans and allocate resources. Progress against meeting business plan and budget objectives is monitored regularly.

Risk register

The risk register identifies key risks, each with a risk owner who is responsible for evaluating the risk on a regular basis. As a way of ensuring that risk management is embedded into the business, the risk owners have the management of these risks as a personal KPI.

Strategic risk model

Risks that are known but not yet well defined enough for the likelihood and consequence to be reasonably foreseen are included in a strategic risk model.

Audit Committee

The Audit Committee reports to the Board on internal controls and alerts the Board to any emerging issues. In addition, the Audit Committee oversees internal audit, external audit and management, as required, in its review of internal controls.

Last year, the Audit Committee commissioned an additional risk and assurance mapping report from

Ernst & Young, the objective of which was to provide NWL management and the Audit Committee with a view of the different assurance functions within the company and the extent to which they provide assurance that the control activities are operating. An assurance map now forms a permanent part of the process and, for each risk, highlights who provides assurance that the control activities are in place and operating effectively.

Risk description	Mitigation measures
Funding and liquidity risk	The financial ratios, financial results, liquidity position and credit ratings are described in the financial performance section on pages 16 to 21. In addition, note 20 to the financial statements, on pages 118 to 123, includes details on the Group's strategy and treasury operations for managing its capital, its exposures to liquidity risk, interest rate risk, foreign currency risk and counterparty risk, and details of its financial instruments. The Board reviews the treasury strategy periodically and approves specific proposals.
Unfavourable changes to the regulatory structure, as a result of the Water White Paper	We play a leading role in the policy debate, through Water UK, direct lobbying and forging positive relationships with relevant parties. We respond positively to consultation papers.
Unfavourable changes to the regulatory structure or price setting mechanism by Ofwat	We play a leading role in consultation groups with Ofwat and other stakeholders. We respond positively to consultation papers.
Impact of the transfer of private drains and sewers is greater than anticipated	An internal project team has been established to understand and prepare the business for the transfer. We maintain sound financial documentation to support a future claim for tariff increases in order to recover additional costs borne. We maintain close liaison with the rest of the industry and have had constructive dialogue with Ofwat regarding the process.
Unexpected shift in climate change impact	We have processes in place to anticipate and plan for the impact of climate change. While these have long time horizons, they are reviewed regularly to ensure that any changes are identified early.
Loss of supply due to failure of strategic water main. This covers catastrophic failure that is greater than the response capability of the company	In most cases, duplicate mains and diversion of supplies would limit supply consequences. Comprehensive plans exist to provide a minimum emergency service to customers until repairs are completed, including mutual aid arrangements with other water companies. A proactive inspection regime is in place along with longer term reviews of network resilience.
Sewer flooding failures	A sewer flooding group, comprising stakeholders from various teams, is responsible for managing the process, flood reporting, network capacity studies and prioritisation of investment to reduce risk. Significant additional capital expenditure has been invested to address affected properties. The recently constructed rain radar station for the region is now operational and provides improved data. However, controls are not yet sophisticated enough to predict or prevent consequences of severe rainfall.
Pesticides lead to prescribed concentration or value failure and possible enforcement action	Undertakings have been agreed with the DWI to carry out certain actions to mitigate pesticide issues (metaldehyde and clopyralid). While specific treatment processes, such as carbon dosing, are undertaken at treatment works, proactive catchment management is also being carried out. This involves working with farmers, regulators and other stakeholders to advise on improved storage and application techniques for such pesticides. This is a more sustainable solution than the alternative of constructing major new treatment processes.
Loss of income through closure of large customers or lower industrial volumes	It is not possible to directly influence industrial volumes, however, our account managers liaise closely with significant customers to provide support where possible.
Incident at Bran Sands waste water treatment works causes business interruption	We have a number of contracts to treat industrial waste streams at our Bran Sands works. The liability under each contract is capped except, in certain cases, where NWL is in willful breach. A site-specific management regime is in place incorporating additional monitoring and a greater amount of standby assets.
Risk of increasing pension contributions resulting from increasing longevity and the impact of economic conditions on investment returns	The defined benefit scheme was closed to new entrants, benefits restructured and employee contributions increased in 2008. Advance contributions have been made to the scheme, including deficit funding allowed in the final determination. The scheme Trustee determines investment policy and monitors performance of investment managers. Triennial actuarial valuations of the scheme are carried out, with the latest currently underway.
Health and safety prosecution	Our health and safety policy and safety management system define clear arrangements and responsibilities for implementation and management throughout the Company. This is audited as part of our quality and environmental management system. Visible high level support for health and safety is provided by the Board and management team. Long term plans and targets are set to promote continuous improvement.

Appendix to the directors' report – business review

Financial KPIs

Gearing to RCV (NWG)

Definition and calculation: The ratio of Group net debt to a pro forma RCV, calculated as NWL's RCV plus the level of debt associated with the Kielder securitisation and the PFI contracts. The NWL RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews.

Purpose: The RCV generates most of the revenue stream of the Group and regulatory gearing is an important factor in credit ratings.

Source of underlying data: NWL's RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to five years ahead, based on its last price determination. Group net debt is disclosed in the audited financial statements.

Gearing to RCV (NWL)

Definition and calculation: The ratio of NWL net debt to NWL's RCV. The NWL RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews.

Purpose: The RCV generates most of the revenue stream of the Group and regulatory gearing is an important factor in credit ratings.

Source of underlying data: NWL's RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to five years ahead, based on its last price determination. NWL's net debt is disclosed in the audited regulatory accounts.

Cash interest cover (NWG and NWL)

Definition and calculation: Cash generated from operations less tax divided by net interest paid.

Purpose: Measures the ability of the Group or company to service its debt.

Source of underlying data: Audited financial statements.

Cash flow to net debt (NWG and NWL)

Definition and calculation: Cash generated from operations less tax paid divided by net debt.

Purpose: Indicates the Group's, or company's, ability to reduce debt in the absence of need for additional investment, without resorting to asset disposal.

Source of underlying data: Audited financial statements.

NWL non-financial KPIs

Customer satisfaction

Definition and calculation: Domestic customers' satisfaction with overall service and overall value for money, expressed as satisfaction averaged over the surveys carried out during the year. Average satisfaction is based on a scale of 1 to 10 using the score of 6 and above as satisfied. Net scores are used to show true satisfaction by taking into consideration those who are dissatisfied who score between 1 and 3.

Purpose: To enable tracking of perception of reputation, service and value for money over time.

Source of underlying data: Independent surveys of 500 customers (300 north, 200 south) chosen at random, but representative of the customer base, carried out each quarter – a total of 2,000 customers.

Customer – levels of service

Definition and calculation: Customer service standards are established by Ofwat and calculated using source data in the company.

Purpose: To monitor customer service performance of NWL.

Source of underlying data: Information collected by the company and submitted to Ofwat. It is independently certified.

Employee turnover

Definition and calculation: Number of leavers within the year as a percentage of average headcount.

Purpose: To track the employee turnover within the business to ensure that it is within benchmark data.

Source of underlying data: Current employees' details are held within the human resources management system – reports show leavers against headcount.

Lost time reportable accidents

Definition and calculation: Injury accidents that are reported to the Health & Safety Executive as required by the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995. Calculated as the number of accidents reported in financial year per 1,000 employees.

Purpose: To monitor the safety performance of NWL over time.

Source of underlying data: Completed NWL accident/incident report forms. Employee numbers are provided by the human resources department.

Sickness absence

Definition and calculation. Sickness absence days as a percentage of total working days multiplied by the end of month headcount

Purpose. To track and trend sickness absence levels across the organisation

Source of underlying data: Statement of Fitness for Work (fit note), return to work interviews and weekly returns by managers

Water quality

Definition and calculation. Compliance with drinking water regulations as monitored by the DWI

Purpose. To monitor drinking water quality

Source of underlying data: Samples recorded by NWL and audited by the DWI

Sewage treatment works

Definition and calculation: Percentage of population equivalent served by non-compliant works failing look-up table consents, as defined by the EA

Purpose. To monitor the performance of NWL's sewage treatment works and their impact on the environment

Source of underlying data: Information recorded by NWL and the EA and reported on by the latter

Bathing waters Mandatory Standard

Definition and calculation: Percentage of bathing waters complying with Mandatory Standards

Purpose: To monitor the impact of NWL's coastal treatment works on the environment

Source of underlying data. Information recorded and reported by the EA

Pollution incidents

Definition and calculation: Number of category 1, 2 and 3 pollution incidents in the calendar year as defined by the EA

Purpose: To monitor the performance of NWL's sewerage system and its impact on the environment

Source of underlying data. Information recorded and reported to Ofwat by the EA

Board directors' biographies

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1 Claude Lamoureux

Non-executive Director
Claude Lamoureux was appointed to the boards of NWG and NWL on 1 December 2006. Claude was, until 1 December 2007, President and CEO of the Ontario Teachers' Pension Plan Board (OTPP). Previously he spent 25 years as a financial executive with Metropolitan Life in Canada and the US. He is a Director of Xstrata plc, Industrial Alliance Insurance and Financial Services Inc., Maple Leaf Foods Inc., Atrium Innovations Inc., The Learning Partnership and the York University Foundation. OTPP holds 27% of the issued share capital of NWG and Claude is, therefore, not regarded as an independent Director. Claude will retire from the boards of NWG and NWL on 28 July 2011.

2 Paul Rew (from 1 October 2010)

Independent Non-executive Director
Paul Rew was appointed to the boards of NWG and NWL on 1 October 2010. Paul is a member of the Audit and Nomination Committees and of NWL's Corporate Responsibility Committee. Paul, a chartered accountant, was a partner in

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PricewaterhouseCoopers LLP (PwC) from 1987 until March 2010 and was lead partner for a diverse range of FTSE 100 clients and for PwC's UK energy, utilities and mining sector practice. Most recently, he was PwC's sustainability and climate change assurance leader and renewables leader. He is a Non-executive Director of both the Met Office and the Sustainable Development Commission and chairs their Audit Committees.

3 Martin Nègre

Independent Non-executive Director
Martin Nègre was appointed to the Board in May 2003 and to the board of NWL in January 2006 and is a member of the Audit, Remuneration and Nomination Committees. He was, between April 2000 and April 2001, the CEO of the former Northumbrian Water Group plc and the chief corporate representative of its parent company, Suez, in the UK. He currently chairs Ecofin Global Utilities Hedge Fund Limited, Ecofin Special Situations Utilities Fund, Ecofin North American Hedge Fund and Ecofin China Power & Infrastructure Fund. His other directorships include Ecofin

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Water & Power Opportunities plc, Hansen Transmissions International NV, Bolux Utilities (Sicav Luxembourg), Mercurius Utilities (Liechtenstein), EFMI Funds plc and Ecofin Global Long/Short Fund. All the above funds are focused on utilities. In 2005 he became a Director of Promethean plc, an AIM-listed investment company and sits on the supervisory board of Banque Jean-Philippe Hottinguer & C^o.

4 Simon Lyster (from 1 April 2011)

Independent Non-executive Director
Simon Lyster was appointed to the Board of NWG on 1 April 2011 having joined the board of NWL in September 2006. He is a member of the Nomination Committee and chairs NWL's Corporate Responsibility Committee. Simon is a lawyer by training, qualified in both the UK and the USA and has been Chief Executive of LEAD International since 2005. Before joining LEAD (which he will leave during July 2011), Simon was Director General of The Wildlife Trusts, one of the largest nature conservation organisations in the UK, for seven years. Before that, Simon worked for World

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Wildlife Fund (WWF) for nine years, where he was responsible for WWF's global policy work on international conventions. Simon is a Trustee of Conservation International – UK, the World Land Trust and the Kilverstone Wildlife Conservation Trust.

5 Margaret Fay CBE (from 1 June 2010)

Independent Non-executive Director
Margaret Fay was appointed to the boards of NWG and NWL on 1 June 2010 and is a member of the Remuneration and Nomination Committees. She is also a member of NWL's Corporate Responsibility Committee. Margaret was formerly Managing Director of Tyne Tees Television until she took early retirement in December 2003 to become Chairman of One North East, a position she held until August 2010. She is Deputy Chairman of The Sage Gateshead, a Governor of the University of Sunderland, Patron of Tees Valley Community Foundation and the Prince of Wales' Ambassador for the north east of England. Margaret was awarded an OBE for services to broadcasting in 2004 and, in 2010, a CBE for services to regional development.

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6 Heidi Mottram OBE

Chief Executive Officer
Heidi Mottram was appointed to the boards of NWG and NWL on 1 March 2010 and became CEO on 1 April 2010. Heidi is a member of the Nomination Committee and NWL's Corporate Responsibility Committee. Heidi was Commercial Director for Arriva Trains Northern from January 2004, before joining Serco-NedRailways in November 2004 as Managing Director Northern Rail Limited. She was named Rail Business Manager of the Year in 2009 and was awarded an OBE for services to the rail industry in 2010.

7 Sir Derek Wanless

Chairman
Sir Derek Wanless was appointed to the Board as an Independent Non-executive Director in December 2003. He joined the board of NWL in January 2006 and, in July 2006, became Chairman of NWG and NWL. Sir Derek chairs the Nomination Committee and is a member of the Remuneration Committee. He became a director of National Westminster Bank in 1991 and its Group Chief Executive in 1992. He retired from that position in 1999. Sir Derek is currently

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Chairman of Legal and General plc's Longevity Science Advisory Panel and a member of the Board for Actuarial Standards at the Financial Reporting Council.

8 Chris Green

Finance Director
Chris Green was appointed to the boards of NWL in April 2000 and NWG in May 2003. Chris qualified as a chartered accountant and after ten years in the accounting profession he joined the former Northumbrian Water Group plc in January 1990. He was initially involved in the Group's diversified business activities before being appointed as Group Finance Director in 1997. Chris is Chair of Trustees for the Northumbria Calvert Trust, a charity devoted to providing outdoor activities for the disabled, and is Deputy Chair of Governors at the University of Sunderland.

9 Alex Scott-Barrett

Independent Non-executive Director
Alex Scott Barrett was appointed to the Board of NWG in September 2006 having joined the board of NWL in November 2005. He chairs the Remuneration Committee and is a member

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of the Audit and Nomination Committees. Alex qualified as a chartered accountant in 1981 and joined Cazenove, a city corporate stockbroker, in 1982. He worked initially as an analyst and transferred to the corporate finance department in 1986, becoming a partner in 1988. In 1996 he became a director of the firm's fund management division and from 2000 to 2003 was the Chief Operating Officer of that division. Alex left Cazenove in 2003. He is a Non-executive Director of Lighthouse Group plc and is a Trustee of L'Arche and Help for Heroes.

10 Sir Patrick Brown

Senior Independent Non-executive Director
Sir Patrick Brown was appointed to the Board in May 2003 and to the board of NWL in January 2006. Sir Patrick chairs the Audit Committee and is a member of the Nomination and Remuneration Committees. He held various positions in the Department of Transport and the Department of the Environment, becoming Second Permanent Secretary and Chief Executive of the Property Services Agency in 1990. He was Permanent Secretary for

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the Department of Transport from 1991 to 1997. Sir Patrick became a Non-executive Director of the Go Ahead Group plc in 1999 and its Chairman in 2002. He is also Chairman of the Advisory Committee of Alexander Proudfoot UK and a Non-executive Director of Camelot UK Lotteries Limited.

11 Martin Parker (not pictured)

General Counsel and Company Secretary
Martin Parker was appointed as Company Secretary of NWG in May 2003. Martin joined the former Northumbrian Water Group plc in 1990, concentrating on acquisitions overseas projects and contracts with industrial customers, before being appointed Head of Group Legal Services in 1998 and General Counsel and Company Secretary of NWL in 2000. Martin is Secretary of all the Board committees.

Statutory disclosures

Directors' report – business review and governance

In accordance with s417 of the Companies Act 2006, the directors' report – business review, on pages 1 to 53, contains a review of the performance of the Group's business during the year and the position at the end of the year with analysis using KPIs. A description of the Group's future prospects, research and development, the principal risks and uncertainties facing the business and details of the Group's use of financial instruments are also contained within the business review.

Pages 54 to 70 of this section of the directors' report contain the Board of directors' biographies, together with such other statutory disclosures, as required by s416 and s418 of the Companies Act 2006 and Schedule 7 to the Large and Medium sized Companies and Group's (Accounts and Reports) Regulations 2008, as are not already referred to in the business review section of the report. The corporate governance statement explains how the Company has applied the principles of the Combined Code during the year and also complies with the requirements of Disclosure & Transparency Rule 7.2.

Principal activities

The principal activities of the Group during the year were the provision of water and waste water services.

Political

During the year, the Group has worked with politicians of all major parties, officials and opinion formers. This work has included making representations on issues which NWL feels are important to our customers and communities such as competition, the review of regulators, the Water White Paper, adoption of private sewers, 'Water for health', climate change, the Water Framework Directive and other legislative issues which could affect our customers.

We do not support any political party and we do not, directly or through any subsidiary, make what are commonly regarded as donations to any political party or other political organisation. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the Group and political parties and political organisations. These activities include attending party conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. The costs associated with these activities during 2010/11 were as follows:

Name of political party	£
Conservative	6,845
Labour	8,208
Liberal Democrats	3,312
Total	18,365

Shareholder authority to permit the Company to continue with these activities until the 2012 AGM will be sought at this year's AGM.

Creditors

The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. The Company's policy is to make payment not more than 30 days after receipt of a valid invoice, except as otherwise agreed. The ratio, expressed in days, between the amount invoiced by its suppliers during the year and the amount owed to its trade creditors at 31 March 2011, was 30 days (2010 21 days)

Directors' remuneration and interests

Information about directors' remuneration and their interests in the shares of the Company is contained in the directors' remuneration report

Indemnification of directors

The Company has in place directors' and officers' insurance and, on 28 November 2005, entered into a deed of indemnity to grant the directors further protection against liability to third parties, subject to the conditions set out in the Companies Act. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report

Auditors

Ernst & Young LLP has indicated its willingness to continue in office and a resolution proposing its re-appointment as auditors will be put to shareholders at the AGM

Directors' declaration

As required under s418 of the Companies Act 2006, so far as each current director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

Going concern

The Group has sufficient funding and facilities in place to meet its requirements to March 2014. The directors believe that the Group is well placed to manage its business risks successfully and, accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements

Corporate governance statement

The Board believes best practice in corporate governance is an important tool in helping it meet its responsibilities. The Board considers that, during the year and up to the date of this report, it has complied with the main principles and provisions of the Combined Code 2008 (the Code). The Code is available to download from the Financial Reporting Council's (FRC) website at www.frc.org.uk/corporate/ukcgcode.cfm or, alternatively, printed copies can be obtained free of charge from FRC publications, tel 020 8247 1264, email customer.services@cch.co.uk and online at www.frcpublications.com.

This statement, together with the directors' remuneration report, describes how the Company has applied the principles of the Code during the year. The board of NWL also maintains high standards of corporate governance and endeavours to comply with the Code, wherever practicable.

In June 2010, the FRC introduced a new UK Corporate Governance Code, which will apply to the Company's financial year ending 31 March 2012. The Board has considered the requirements of the new code and believes that the Company is well positioned to achieve compliance. Some of the main principles, such as the annual re-election of all directors, have already been implemented.

The Board has a code of ethics, 'Our Code of Conduct' which is available on the Company's website, covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators.

Board composition

As at 31 March 2011, the directors of the Company were Sir Derek Wanless, Sir Patrick Brown, Heidi Mottram, Chris Green, Claude Lamoureux, Martin Negre, Alex Scott-Barrett, Margaret Fay and Paul Rew, who all served throughout the year, except for Margaret Fay and Paul Rew who were appointed on 1 June and 1 October 2010, respectively.

Simon Lyster, who has been a Non-executive Director of NWL since 26 September 2006, was appointed as a Non-executive Director of NWG on 1 April 2011.

In accordance with the Company's Articles of Association (the Articles), Paul Rew and Simon Lyster, having been appointed as directors by the Board since the last AGM, will be eligible for election at this year's AGM. All other directors holding office on the day of the notice convening the AGM will retire from office and offer themselves for re-election, with the exception of Claude Lamoureux who will retire from office at the end of this year's AGM.

NWL's Instrument of Appointment (usually called its 'Licence') requires NWL to have at least three independent directors with an understanding of the interests of customers and a connection with the areas in which the company operates. Until 31 March 2011, these roles were held by Anita Frew, Alastair Balls and Simon Lyster, none of whom were directors of NWG. Prior to the retirement of Anita Frew and Alastair Balls from the NWL board on 31 March 2011, NWL and Ofwat agreed that the independent directors of NWL, for the purposes of the Licence, may also be non-executive directors of NWG. Ofwat considered that, given NWG's focus on the core business, such cross-directorships would not create a conflict of interest. Ofwat will review its position on this if the nature of NWG's business changes significantly. The directors in question must still, of course, demonstrate the necessary experience and understanding. Ofwat agreed that Margaret Fay and Alex Scott-Barrett would be suitable for these roles, in addition to Simon Lyster. Anita Frew and Alastair Balls have, therefore, not been replaced on the NWL board. Apart from streamlining the work of the two main boards, which now have common non-executive membership, this reduction in the number of non-executive directors brings a significant saving in fees and expenses.

Board responsibilities and processes

The Board sets and implements the Company's strategy and ensures compliance with Group policies and legal and regulatory obligations. The Group's vision, values and strategy are set out in the Chief Executive Officer's review. Board agendas are proposed by the CEO and Company Secretary, with input from NWL's management team, for approval by the Chairman.

The Company has adopted terms of reference which set out the matters reserved to the Board for approval and matters which are, or can be, delegated to the committees and management. The Company has also adopted financial approval rules which set out the authorisation processes and financial limits to be applied to financial transactions within the Company. NWL has adopted its own version of these guidelines. Standing or Executive Committees can take decisions not delegated to specific committees between Board meetings. All directors receive notice of Standing Committee meetings and may participate if they wish. Decisions taken by the Standing or Executive Committees are reported at the next Board meeting.

The following table sets out the attendance of directors at Board and committee meetings during 2010/11

	Board	Nomination	Remuneration	Audit
Number of meetings	6	4	3	3
Sir Derek Wanless	6	4	3	3 ¹
Sir Patrick Brown	5	4	2	3
Margaret Fay ²	5	3	2	–
Chris Green	6	–	–	3 ¹
Claude Lamoureux	4	1 ¹	–	–
Heidi Mottram	6	4	3 ¹	3 ¹
Martin Nègre	6	4	3	1
Paul Rew ³	4	2	–	2
Alex Scott-Barrett	6	4	3	3
Jenny Williams ⁴	1	1	–	1

Notes

- 1 Not a member but attended at the invitation of the Committee chairman
- 2 Appointed to the Board on 1 June 2010
- 3 Appointed to the Board on 1 October 2010
- 4 Retired from the Board on 29 July 2010

The NWG Board meets at least every two months, usually immediately following meetings of the NWL board. As NWL is so significant within the Group, it may be helpful to provide an insight as to how the NWL board works. Typically, the CEO provides an overview of performance since her last report, highlighting issues to which the board needs to pay particular attention. She also reports on regulatory and other developments affecting the sector. NWL's performance is captured by means of a balanced scorecard which shows performance against a series of KPIs. Achievement against this scorecard will also be a key element of NWG and NWL directors' bonuses in 2011/12 and future years. The CEO's overview also contains detailed reports on finance, regulation, operations and human resources. Reports are provided from chairmen of committees which have met since the last board meeting. Health and safety performance is addressed at each meeting. The NWL board considers papers seeking approval of contracts worth over £2.0 million and capital projects (which may in time require a series of contracts) over £5.0 million. Papers seeking investment approval are required to contain sections on sustainability and risk. For example, a paper seeking investment approval for a scheme to alleviate sewer flooding would need to demonstrate that the solution proposed is sustainable.

Corporate governance statement continued

As well as the reports described above, the NWL board receives risk reports and approves budgets, financial plans, reports to Ofwat, accounts, dividends payable and a range of other matters. The NWL board also sets time aside during its meetings to consider forward-looking strategy, and meets on separate strategy days to develop that work. The papers submitted to the board are used as the basis for discussion, rather than as an end in themselves. The Chairman ensures that, wherever possible, the board avoids becoming too immersed in detail and that the meetings are used to generate ideas and to constructively challenge the management. Non-executive directors readily question the assumptions of the management team and bring new perspectives from their experience elsewhere.

Non-executive directors are encouraged to meet employees in order to gain a closer understanding of the issues they face. On 30 March 2011, six of NWG's non-executive directors (and the CEO) held an open forum with employees at NWL's offices at Hanningfield, in Essex. This event was successful and will be repeated at other venues.

The NWG Board works in a very similar way. The members of the NWG Board all sit on the NWL board, and therefore the NWG Board does not need to become too involved in NWL's operational issues. The NWG Board's focus is strategic. It sets the future direction of all Group companies, with a particular emphasis on the medium and long term, including funding.

The NWG Board also oversees the non-NWL businesses, and particularly the PFI contracts in Scotland, the operating contracts in Ireland, AquaGib and Agrer.

During the year, the non-executive directors met formally once without the executive directors and are in regular contact with each other throughout the year. The non-executive directors also met once without the Chairman but did not consider additional formal meetings to be necessary.

Authorisation of directors' conflicts of interest

Directors have a statutory duty, under s175 of the Companies Act 2006, to avoid a situation in which they have, or could have, a conflict of interest with the Company's interests. However, there is no breach of this duty if the Board has authorised the matter in question. The Articles permit directors (other than the director having the interest in question) to authorise any situation giving rise to a known or potential conflict. A register of the interests which have been authorised is maintained by the Company Secretary and is available at every Board meeting. The Company will follow emerging best practice in line with the General Counsel 100's guidance paper.

Board balance and independence

Ten directors served during the year – the Chairman, two executive directors, the Senior Independent Non-executive Director and six other non-executive directors. Sir Derek Wanless is the non-executive Chairman. The executive directors are Heidi Mottram (CEO) and Chris Green (Finance Director). Sir Patrick Brown is the Senior Independent Non-executive Director and the other independent non-executive directors who served during the year were Margaret Fay, Martin Nègre, Paul Rew, Alex Scott-Barrett and Jenny Williams. Claude Lamoureux is also a Non-executive Director but is not independent as he was, until 1 December 2007, President and CEO of OTPP, which holds 27% of the issued share capital of the Company. Jenny Williams retired from the boards of NWG and NWL on 29 July 2010.

The Company complies with the Code's requirement that half of the directors, excluding the Chairman, are independent non-executive directors. The Chairman was independent on appointment. Biographical details of the directors appear on pages 54 and 55 and details of their service contracts are in the directors' remuneration report.

The Chairman and CEO have clearly defined written responsibilities which have been agreed by the Board. The Chairman leads the Board and creates the conditions for overall Board and individual director effectiveness, both inside and outside the boardroom. The CEO is responsible for running the Company's business on a day to day basis.

Sir Patrick Brown, as Senior Independent Non-executive Director, is available to shareholders who wish to raise any concerns and leads the non-executive directors in their evaluation of the Chairman's performance

The non-executive directors bring to the Board many years of business experience as well as financial expertise and the ability and willingness to challenge and support the executive directors

The General Counsel and Company Secretary, Martin Parker, assists the Board to ensure that good corporate governance compliance is achieved. He is also Company Secretary of NWL and is secretary to all Board committees

The NWG Board supports the findings of Lord Davies' recent review, 'Women on Boards'. Over the coming months the Board will review its procedure for the appointment of directors (including the impact of the approach taken to management development at a less senior level) and consider which of the Davies recommendations should be adopted, whether or not they become formally binding on companies. Following this year's AGM, if Heidi Mottram and Margaret Fay are re-elected, two (22%) of the nine directors will be female

Information and professional development

All directors have access to independent professional advice to assist them in the performance of their duties, at the Company's expense, and to the Company Secretary for advice and assistance. The Chairman, with the assistance of the Company Secretary, monitors the induction and training requirements of directors. All new directors receive an induction information pack and are encouraged to make site visits and to arrange meetings with managers. Since joining the Company in June 2010, Margaret Fay has visited Birtley sewage treatment works (STW), Lumley water treatment works (WTW) and Bran Sands STW. Since joining in October 2010, Paul Rew has visited Bran Sands STW, Lumley WTW, Kielder, Hanningfield and Abberton reservoirs and the Pity Me customer contact centre

Managers from within the Group submit papers or give presentations at Board meetings. Water industry representatives meet the NWL board to discuss current issues

The Company Secretary ensures that directors are kept informed and that information flows effectively within the Group by

- keeping in regular contact with directors,
- sending Board papers to directors before each Board meeting,
- sending briefing packs to directors in the months when Board meetings are not held, and
- providing a directors' team room intranet site containing Board and committee papers, minutes, analysts' reports and reference and regulatory documents, to which all directors have access

Directors attend conferences and seminars where this will help them in the performance of their duties

Performance evaluation

A full evaluation of the performance of the Board and its committees was conducted during the year by an external consultant, who observed board meetings of NWG and NWL, and a meeting of the Audit Committee. Each director completed a detailed questionnaire prior to a one-to-one meeting with the consultant. The questionnaire was designed to address strategic issues and succession planning, as well as the approach of the Board to operational and financial matters, the role of the non-executive directors and the quality of information received by the Board. The performance of NWL's board and its committees was evaluated at the same time. The Chairman used the evaluation to assist with his evaluation of each director

The results of the external evaluation were generally very positive and a number of actions were agreed, with a view to further improving the performance of the boards. Although the Board discussions are already lively and vigorous, the consultant encouraged directors to be even more challenging in their approach

Corporate governance statement

continued

In relation to Board papers, it was agreed that some could be a little more incisive and state their main points more clearly

As well as commenting on the contributions from the directors and the processes adopted at Board and committee meetings, the consultant made certain practical observations. The consultant felt, for example, that a meeting of the Audit Committee was hampered by the fact that some people (who were not members of the Committee) participated by video conference. It was agreed that this was not helpful and the schedule of meetings was immediately adjusted to avoid the need for this in future.

It was agreed that the Board's time would be more tightly focused on strategic issues, so that maximum value is added.

The Board has also considered the FRC's 'Guidance on Board Effectiveness', published in March 2011. The directors consider that the work of both the NWG and NWL boards and the roles played by the Chairman, the Senior Independent Non-executive Director and the other directors are consistent with both the practical content and underlying philosophy of the Guidance.

The Chairman's comments on the evaluation of the directors seeking election and annual re-election at the AGM are provided in the Notice of Meeting. The comments of the Senior Independent Non-executive Director on the evaluation of the Chairman are also provided in the Notice.

External appointments

Executive directors have generally only accepted non-executive positions outside the Group where this would benefit either the Group or the local community. These positions have tended to be with educational institutions, economic regeneration groups or similar bodies. The Board has agreed that executive directors of the Company who are appointed to non-executive directorships of a more commercial nature may retain the fees, subject to obtaining the Chairman's consent before an appointment is accepted. Only one such external appointment per director will generally be permitted.

Board committees

The Board has Audit, Nomination and Remuneration Committees to assist it in the performance of its duties. The Board sets the terms of reference of the committees and receives regular reports from their chairmen at Board meetings. The terms of reference of committees are available on the Company's website or from the Company Secretary.

Remuneration Committee

The work of the Remuneration Committee, and details of the directors' remuneration, are set out in the directors' remuneration report.

Nomination Committee

The main duty of the Nomination Committee is to identify and nominate candidates to fill Board vacancies for approval by the Board. The Committee also reviews succession planning for the Board, NWL board and senior appointments and will make recommendations to the Board when appropriate. The Committee's usual policy is to use external recruitment consultants or to advertise in order to identify suitable candidates.

During the year, the Committee recommended to the NWG and NWL boards the appointments of Margaret Fay and Paul Rew, as additional independent non-executive directors. The Committee felt that an additional non-executive with strong business and political contacts, especially in the north east, would be a valuable addition to the boards. Margaret Fay was regarded by the Committee as an ideal candidate for this role and she was, therefore, approached by the Company to discuss the opportunity. Paul Rew was appointed for his first class finance skills and experience and particular expertise in sustainability. The Committee considered that these attributes and Paul Rew's all-round understanding of business made him an excellent addition to the two principal boards. Leading executive search consultants assisted the Committee with Paul Rew's appointment. Simon Lyster, a Non-executive Director of NWL since 26 September 2006, was appointed to the NWG Board on 1 April 2011. Simon Lyster brings very significant experience of sustainability issues, as well as excellent analytical skills and a first-hand understanding of NWL's Essex operating area.

The Committee also considered extensions to the appointments of non-executive directors on the NWG and NWL boards whose contracts for services expired during the year. Non-executive directors are appointed for a term of one year and all directors are subject to annual re-election at the AGM.

The members of the Nomination Committee are now Sir Derek Wanless (Chairman), Sir Patrick Brown, Margaret Fay, Heidi Mottram, Martin Negre, Paul Rew, Alex Scott-Barrett and Simon Lyster, and the membership is compliant with the Code.

Audit Committee

The Audit Committee members during the year were Sir Patrick Brown (Chairman), Martin Nègre, Alex Scott-Barrett, Paul Rew (from 1 October 2010) and Jenny Williams (until 29 July 2010). Paul Rew and Alex Scott-Barrett are chartered accountants and the Board is satisfied that they both have recent and relevant financial experience. It is proposed that Paul Rew will take over as Chairman of the Audit Committee on 28 July 2011, following the AGM. Paul Rew was a senior partner with PwC until March 2010. The Committee's membership complies with the Code. The Chairman and executive directors are invited to Audit Committee meetings, with the permission of its Chairman, but have no right of attendance. Managers from within the Group are invited to Audit Committee meetings to discuss issues relating to their areas of the business. During the year, the Committee met with both the external Audit Partner and Internal Audit Manager to discuss audit business, without the executive directors being present. The Committee remains satisfied that the internal audit function is able to operate with independence and is not under any pressure from the executive management of the Company to produce particular results.

The Committee members receive regular briefings from the external auditors to enable them to keep up to date on financial reporting standards.

The purpose of the Audit Committee is to assist both executive and non-executive directors of NWG to discharge their individual and collective responsibilities in relation to

- ensuring the financial and accounting systems of NWG and its subsidiaries are providing accurate and up to date information on their current position,
- ensuring NWG's published financial statements represent a true and fair reflection of this position, and
- assessing the scope and effectiveness of the Group's risk management systems and the integrity of its internal financial controls.

Corporate governance statement continued

During the year its work included

- monitoring the integrity of the financial statements of the Company,
- reviewing the Company's internal controls (both financial and information systems) by considering reports of both the internal and external auditors, directing questions to management and reviewing the financial risks and controls information provided to them on an annual basis,
- monitoring and reviewing the effectiveness of the internal audit function by reviewing the scope of the annual audit plan, the results of those audits and monitoring the completion of actions identified during the audits,
- monitoring and reviewing the performance and effectiveness of the external auditors, in particular, by reviewing the scope and costs of the audit process,
- reviewing the external auditors' independence by monitoring the extent of the provision of non-audit services and receiving reports from the external auditors,
- monitoring the potential impact and management of significant risks to the business using a risk methodology (meeting the recommendations of the 2005 Turnbull Review Group guidance) which sets out and rates all identified risks, including operational, external, financial, environmental, social and governance risks,
- reviewing the Committee's terms of reference,
- reviewing the Group's financial approval rules,
- reviewing the Group's tax strategy,
- reviewing NWL's contract terms,
- reviewing the Group's accounting and treasury policies, and
- reviewing the Company's interim management statements, half-yearly and preliminary results announcements and final published annual report and financial statements

The Committee has now assumed responsibility for the practical work being done to ensure that the Group's procedures designed to prevent bribery are adequate (having regard to the provisions of the Bribery Act 2010 and the official guidance published in relation to that Act). This builds on significant work done by the NWG Board, with advice from the Company Secretary and Internal Audit Manager, to assess the bribery risk faced by the Group, clarify policies and map the procedures to be put in place.

Given the importance of NWL to the Group's business, the Committee works closely with the Audit Committee of NWL. In particular, both committees review significant regulatory reports for Ofwat and regularly review NWL's debt recovery strategy and performance. In addition, meetings were held with the Ofwat Reporter during the year to discuss the June Return process.

The Audit Committee Chairman reports to the Board following each meeting of the Committee and Committee minutes are circulated to the Board.

External auditors

Ernst & Young LLP have been the Group's auditors since 2003. The audit engagement partner is subject to change every five years and was last changed in 2008.

Non-audit services

The Committee has approved a procedure for the approval of non-audit services to safeguard the objectivity and independence of the external auditors, which complies with the requirements of the Auditing Practices Board's revised Ethical Standard No. 5. The external auditors are not permitted to provide bookkeeping, financial information systems design and implementation, or internal audit outsourcing services. Permitted services require prior approval, either from the Audit Committee Chairman, if under £50,000, or from the Audit Committee, if over £50,000. The Company requires the auditors to report annually details of all non-audit services provided. A breakdown of the cost of audit and non-audit services provided by the auditors is set out in note 4 to the financial statements.

On 25 May 2011, Ernst & Young LLP confirmed to the Audit Committee, in accordance with ISA 260 (Communication of audit matters to those charged with governance), that they have considered their relationship with the Company and that, in their professional judgement, the objectivity of the audit engagement partner and audit staff is not impaired

Review of internal control

The Board believes that, as explained below, there are effective systems in place to identify and manage significant risks and that it receives sufficient information to enable it to assess these risks

The Board has overall responsibility for maintaining a sound system of internal control and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives. Regular reviews of the effectiveness of the internal control system are carried out in accordance with the 2005 Turnbull Review Group guidance. The actions necessary to address weaknesses and otherwise improve the system of internal control are communicated to management. Internal audit monitors implementation of these actions and reports back to the Audit Committee. This process has been in place throughout the year and up to the date of approval of the 2010/11 annual report and financial statements. There are inherent limitations in any system of internal control and even the most effective system can only provide a reasonable, and not absolute, assurance against material mis-statement or loss.

The use of our standard accounting manual by finance teams throughout the Group ensures that transactions and balances are recognised and measured in accordance with prescribed accounting policies and that information is appropriately reviewed and reconciled as part of the reporting process. The use of a standard reporting pack by all entities in the Group ensures that information is gathered and presented in a consistent way that facilitates the production of the consolidated financial statements.

The Board has reviewed the effectiveness of the Group's system of internal control, as follows, during the year. The internal audit team manages a process whereby all of the financial controls within the Group are identified and certified by the relevant manager as having operated for the full year. As part of a programme of work, which is agreed with the Audit Committee, these controls are tested throughout the year. A report detailing any areas of concern is produced after each audit. As part of the same process all of the key business risks are identified. Each risk is assessed on an unmanaged basis, the controls in place to mitigate the risks are detailed and the risk is then re-assessed after these controls.

Internal audit's findings and recommendations are presented to the Audit Committee along with agreed actions. Internal audit updates progress against any agreed actions until the control weakness is resolved.

Organisational structure

The trading subsidiaries have their own boards of directors (the Subsidiary Boards) which are responsible for the operational and financial control of their own businesses. The Subsidiary Boards report to the executive directors and to the Company's Board on matters including major strategic, financial, organisational, compliance and regulatory issues.

The NWL management team manages the major business of the Group and consists of Heidi Mottram (CEO), Chris Green (Finance Director), Graham Neave (Operations Director and on NWL board), Ceri Jones (Regulation & Scientific Services Director and on NWL board), John Devall (Water Director), Ian Donald (Customer Services Director), Sarah Salter (HR Director from 4 January 2011), Colin Price (Technical Director) and Henry Wilson (Wastewater Director). NWL's former HR Director, Diane Morton, resigned on 30 September 2010. The NWL management team meets monthly to consider and discuss progress against annual and monthly financial and operational targets. It prepares an annual budget and business plan for consideration and approval by the NWL board. NWL operates a balanced scorecard which monitors progress against KPIs and which covers all areas of operation of the business.

Corporate governance statement

continued

The Board is able to monitor the impact of environmental, social and governance matters on the Group's business, to assess the impact of significant risks on the business and to evaluate methods of managing these risks through reports it receives from the Subsidiary Boards and the Audit Committee. The environmental risks considered to be significant by the Board are described on page 51, together with a summary of how NWL is managing these risks.

For a number of years, the Subsidiary Boards have performed a full annual business risk analysis to meet the recommendations of the 2005 Turnbull Review Group guidance. This methodology is described above in relation to the work of the Audit Committee. The results of the risk reviews are reported in detail to the Audit Committee and a summary is reported to the Company's directors. Accompanying the risk model is a detailed review of each company's internal financial controls along with either confirmation that the controls have operated throughout the year or details of any exceptions. Action points arising from these reviews are followed up as part of the internal audit process.

Some subsidiaries, such as NWL, consider risks more frequently. The executive directors consider significant risks in a structured way on a monthly basis, assessing the likelihood and potential impact of the relevant risks both before and after risk management measures have been put in place. Further details about how risks and uncertainties facing the Group are assessed and managed are included in the directors' report – business review on pages 50 and 51.

On a monthly basis, the executive directors compare the actual operational and financial performance of each business with its plan and budget. Targets are set to measure performance and regular forecasts are made.

Information and reporting system

Each Subsidiary Board holds a copy of the Company's financial approval rules and terms of reference, which contain full details of the procedures for distribution of information and financial reporting. Each Subsidiary Board has developed financial control systems appropriate to its activities.

Budgets and business planning

The Group prepares detailed medium term business plans and annual budgets which are reviewed by the executive directors and submitted to the Board for approval. Business plans and budgets include an assessment of the key risks and success factors facing each business unit.

The approval of the Board is required for major investments, including those in new markets, and large capital expenditure programmes. The treasury strategy, which is approved by the Board, requires that investments are limited to certain money market and treasury instruments, and that the Group's exposure to any single bank, building society or market is controlled, with maximum deposits allowed with any single counterparty. The Group's investment strategy aims to fix interest rates for part of the Group's borrowings and investments for periods determined by the forecast cash flow of the individual businesses. This manages the exposure to the risk of changes in short term interest rates. Foreign currency exposure is also managed as part of the treasury strategy approved by the Board.

Investor relations

The Company welcomes constructive communication with all its shareholders. Our main communication with shareholders is through the publication of the annual report and financial statements, half-yearly financial report, interim management statements and through information on the Company's website. In addition, the executive directors have regular contact with the Company's large institutional investors, as well as giving presentations to analysts and stockbrokers. During the year, the executive directors held 36 meetings with a range of institutional investors. Investor feedback reports from investor meetings, prepared by the Company's advisers, are considered at Board meetings and analysts' notes on the Company are made available to all directors on the Board's intranet team room. The Board believes that these methods of investor feedback provide the Senior Independent Non-executive Director and the other non-executive directors with a balanced understanding of the issues and concerns of major shareholders. The Senior Independent Non-executive Director is available to shareholders who wish to raise any matters of concern and the Chairman welcomes contact with any shareholders who have matters they wish to discuss. The Company has not received any requests from institutional shareholders to meet with non-executive directors.

All shareholders are encouraged to contact the Company with queries or suggestions. A welcome letter is sent to all new non-corporate shareholders, which includes information on services available to shareholders.

AGM

Shareholders are encouraged to attend the Company's AGM at which they can meet and question the directors. The Company will make a presentation at the AGM to highlight the key business developments and events during the year. The full Board is expected to be available at the AGM to answer shareholders' questions. Voting at the AGM will be on a show of hands but the proxy votes cast on each resolution will be displayed after each resolution has been voted on. If the voting on a show of hands produces a different result from that which would have been achieved on a poll, the Chairman will call a poll so that the result of the voting on that resolution reflects the wishes of the majority of shareholders. The proxy votes cast at each AGM are disclosed on our website. The notice convening the AGM, to be held on 28 July 2011, has been sent to shareholders together with an explanation of the business to be conducted at the meeting and a form of proxy.

Information pursuant to the Takeovers Directive**Structure of the Company's share capital**

As at 31 March 2011, the Company had 518,623,845 ordinary 10 pence shares admitted to trading.

Rights and obligations attaching to the shares

The rights attaching to the shares in the Company are set out in the Articles and may be changed with the approval of the shareholders. Subject to the provisions of the Companies Acts, shares may be issued with or have attached thereto such preferred, deferred, qualified or other rights or such restrictions, whether in regard to dividend, voting, return of capital or otherwise, as the Company may by ordinary resolution determine or, if there has not been any such determination, as the Board may determine.

Shareholders are entitled to requisition a general meeting of the Company and to attend, vote and speak at general meetings, in accordance with the Companies Acts and the Articles. Shareholders have the right to appoint proxies.

Corporate governance statement

continued

Restrictions on the transfer of shares

Any shareholder may transfer a certificated share, as defined in the Articles, by an instrument of transfer in the usual form or in such other form as the Board may approve. However, the transfer of an uncertificated share, as defined in the Articles, need not be in writing and shall comply with any rules adopted by the Board under Article 13.7. The Board may, however, in its absolute discretion and without assigning any reason, decline to register any transfer of any share that is not a fully paid up share or on which the Company has a lien, provided that such discretion may not be exercised in such a way as to prevent dealings in the shares from taking place on an open and proper basis. The Board may also decline to register any transfer unless

- in the case of a certificated share, the instrument of transfer, duly stamped, is lodged with the Company accompanied by the certificate for the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer,
- in the case of a certificated share, the instrument of transfer is in respect of only one class of share, and
- in the case of a transfer to joint holders of a certificated or uncertificated share, the number of joint holders to whom the share is to be transferred does not exceed four

If the share to be transferred is an uncertificated share, the Board may refuse to register a transfer if the Uncertificated Securities Regulations 2001 allow it to do so.

Additionally, where a member or other person on whom a Disclosure Notice has been served (pursuant to s793 of the Companies Act 2006) and has not, within the period specified, supplied to the Company the information required in respect of any shares, the Board may impose a sanction declining to register any transfer of shares, other than a sale to a bona fide unconnected third party.

Significant shareholdings

Details of shareholders with significant holdings in the Company's issued share capital are set out below.

	Number of shares at 31.3.2011	% share capital	Number of shares at 31.5.2011	% share capital
Ontario Teachers' Pension Plan Board	138,776,864	26.76	138,776,864	26.76
Pictet Asset Management Ltd	38,770,495	7.48	40,787,412	7.86
Artemis Investment Management LLP	Below 3%	–	15,654,522	3.02
Legal & General Investment Management Ltd (UK)	16,319,467	3.15	15,573,103	3.00

The holdings include, where applicable, the aggregate of investment management clients' interests within the respective asset management companies and may have since changed without triggering a further notification.

Restrictions on voting rights

In accordance with the Articles, no member shall, unless the Board otherwise determines, be entitled to be present or to vote, either personally or by proxy, unless all calls or other sums presently payable by him in respect of shares in the Company have been paid.

Additionally, where a member or other person on whom a Disclosure Notice (pursuant to s793 of the Companies Act 2006) has been served and has not, within the period specified, supplied to the Company the information required in respect of any shares, the Board may impose a sanction preventing the member from attending and voting at any general meeting.

Shares required to fulfil vested awards made under the Northumbrian Water Group plc Employee Trust are acquired through Northumbrian Water Share Scheme Trustees Limited. In line with Association of British Insurers (ABI) Guidelines, dividends and voting rights are waived on these shares. At 31 March 2011, the Employee Trust held a total of 765,962 shares.

The deadline for delivering either written or electronic proxy voting forms is 48 hours before the appointed time of the meeting.

Appointment and replacement of directors

The Company may, by ordinary resolution, appoint any person to be a director. The Board may also appoint directors, either to fill casual vacancies or as an addition to the Board, but any director so appointed shall hold office only until the next AGM and shall then be eligible for election. Paul Rew and Simon Lyster, who were appointed to the Board since the last AGM, will be eligible for election at this year's AGM. Additionally, the Articles provide for the annual re-election of all directors. Details of all the directors seeking re-election at this year's AGM are set out in the Notice of Meeting.

The main duty of the Nomination Committee is to identify and nominate candidates to fill Board vacancies for approval by the Board. The work of the Nomination Committee is described above.

The Company may, by special resolution, or by ordinary resolution of which special notice has been given in accordance with the provisions of the Companies Acts, remove any director before the expiration of his period of office and may, by ordinary resolution, appoint another person in his place. Any person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed a director.

Amendments to the Company's Articles

The Company may amend its Articles by passing a special resolution of its members.

Powers of the Board

The Articles provide that the business of the Company shall be managed by the Board, which may exercise all such powers of the Company as are not required (by the Companies Acts or the Articles) to be exercised by the Company in general meeting. Subject to the Companies Acts, the Articles and any directions given by special resolution, the Board may, inter alia:

- establish local or divisional boards or agencies to manage any of the Company's affairs and appoint any persons to be members of such local or divisional boards, or agents, and fix their remuneration,
- appoint attorney(s) for such purposes and with such powers, authorities and discretions, and for such period and subject to such terms and conditions, as it may think fit,
- delegate its powers to any director,
- sign, draw, accept, endorse or otherwise execute all cheques, promissory notes, drafts, bills of exchange and other instruments and all receipts for moneys paid to the Company in such manner as the Board shall from time to time determine, and
- exercise all of the powers of the Company to grant and pay pensions, annuities, gratuities, superannuation or other allowances and benefits in favour of any person.

Allotment of shares

Subject to the provision of the Companies Acts, the Articles and any authorising resolutions passed in general meeting, the shares of the Company shall be at the disposal of the Board, which may offer, allot, grant options over or otherwise dispose of them to such persons, at such times, for such consideration and upon such terms and conditions as the Board may determine. The directors will again be seeking authority from shareholders at this year's AGM for the directors to allot shares during the ensuing year although, at present, the Company has no intention of doing so.

Corporate governance statement

continued

Purchase of own shares

Subject to the provisions of the Companies Acts and the Articles and to any confirmation or consent required by law, the Company may from time to time purchase its own shares. The Company will again be seeking authority from shareholders at this year's AGM to purchase its own shares during the ensuing year although, at present, the Company has no intention of doing so.

Significant agreements

As at 31 March 2011, NWL had £344.7 million of loans provided by the EIB and the applicable terms include change of control clauses. If, after consultation with NWL, the EIB is of the opinion that a change of control has had, or is likely to have, a material adverse effect, then the EIB could give 30 days notice of requesting early repayment of the loans plus, in certain circumstances, a premium depending on prevailing market interest rates.

By order of the Board



Martin Parker
General Counsel and Company Secretary
31 May 2011

Northumbrian Water Group plc
Registered office: Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ
Registered in England and Wales No. 4760441

Directors' remuneration report

In this report, which will be submitted for approval at the AGM on 28 July 2011, we describe how the Chairman, executive and non-executive directors are remunerated. Those parts of the remuneration report which are subject to audit by Ernst & Young LLP are marked 'audited'

The Remuneration Committee

The role of the Remuneration Committee

The Remuneration Committee of the Board (the Committee) determines the remuneration and terms of employment of the Chairman of the Company, executive directors of NWG and NWL and a further six senior managers, in accordance with a remuneration policy approved by the Board. The terms of reference of the Committee are published on our website at www.nwg.co.uk (in the 'about us corporate governance' section) or a copy can be requested from the Company Secretary.

The Committee is always available to engage with major shareholders and their representatives to discuss remuneration matters.

Remuneration Committee members

The Committee members are Alex Scott-Barrett (Committee Chairman), Sir Patrick Brown, Martin Negre and Margaret Fay, who are all considered by the Company to be independent, and Sir Derek Wanless. The membership of the Committee was, therefore, compliant with the Code throughout the year. Martin Parker, the Company Secretary, is secretary to the Committee.

External advice

The Committee continued to receive advice during the year from its appointed advisers, Hewitt New Bridge Street (HNBS), and also from the CEO (although never about her own remuneration). The Human Resources Director, Sarah Salter, who joined the Group on 4 January 2011, also attends Committee meetings to provide expert advice. HNBS was paid £33,399 for these services in 2010/11 and continues to assist the Committee in maintaining best practice in relation to remuneration. HNBS did not provide any other services to the Company during the year.

The Committee's work over the past year

The Committee met three times during the year with 100% attendance by all members, except for Sir Patrick Brown who was not present at the March 2011 meeting and Margaret Fay who did not join the Committee until June 2010, to

- agree bonus payments for 2009/10,
- set performance targets for executive directors and senior managers,
- agree salaries for 2011/12,
- determine the vesting percentage to be applied to the LTIP awards made on 13 December 2007 which vested on 13 December 2010,
- grant LTIP awards on 8 December 2010 (to vest, subject to performance and continued service, on 8 December 2013),
- consider the impact of changes to the tax treatment of pensions, and
- review the pension contributions payable in respect of executive members of the Company's defined contribution pension scheme.

Following the year end, the Committee wrote to its largest shareholders and the major representative bodies to consult on a number of changes to executive remuneration arrangements for 2011/12. In summary, these changes were to introduce an executive tier to the defined contribution pension scheme, expand the range of annual bonus metrics to include a balanced scorecard, increase maximum bonus potential for executive directors from 70% to 100% of base salary and introduce bonus deferral and clawback. Further details of the changes are set out below. No changes were made to long term incentive provisions.

As the Committee works closely with NWL's remuneration committee, Committee papers and minutes are circulated to all NWG and NWL non-executive directors, who can give their views direct to the Committee Chairman and can attend meetings if they wish.

Directors' remuneration report

continued

Remuneration policy

The Committee considers the principles and provisions of the Code when setting its policy and believes it is fully compliant. The policy of the Company is to provide remuneration that is sufficient to attract, retain and motivate directors of the quality required to run the Company successfully, while paying fairly. Although HNBS provides the Committee with detailed comparative data on other companies in the utilities sector and more widely, the Committee uses this data with caution given the lack of direct comparators and to avoid remuneration being ratcheted up as a result of benchmarking exercises.

Consistent with its fair pay policy, when considering the remuneration packages of senior executives and directors, the Committee takes into account the pay and employment conditions of other employees in the Group. However, it does not consider that a formulaic approach to the pay differentials between directors and other employees would, of itself, be helpful. It recognises, however, that excessive pay differentials would be divisive and would undermine the Group's core value of working as 'one team'. The Committee is determined to ensure that executive's remuneration continues to be set at a level which is reasonable and appropriate. The directors have been awarded the same 3.71% increase in their basic pay as nearly all other employees for 2011/12.

The Committee also considers environmental, social, risk management and governance issues when setting remuneration terms.

The remuneration policy of the Committee is that

- the setting of base salaries is largely influenced by individual contributions and internal relativities rather than external comparators (although for 2010/11 and 2011/12 the Committee was influenced by general economic conditions),
- the annual bonus plan recognises the interests of all of the Company's stakeholders (including shareholders, customers and employees) rather than being focused solely on profit, and
- management shares in the longer term value created for the Company's investors and the serviceability of the Company's regulated assets.

Elements of remuneration

The remuneration of the executive directors comprises

- basic salary,
- benefits (including pension and participation in the Company's SIP),
- a performance related annual bonus, and
- annual LTIP awards.

In addition to reviewing each constituent element, the Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure and quantum. The chart below shows the composition of the CEO's remuneration (as a percentage of basic salary) both at 'target' and 'maximum' levels of performance. Maximum performance assumes the achievement of maximum bonus and full vesting of LTIP awards.

Basic salary and benefits

Basic salary is reviewed annually based on individual contributions and internal relativities. The Committee also has regard to market practice in other quoted water companies and similar sized companies more generally.

Current basic salaries, together with the previous year's salaries, are set out below.

	As at 14 2011	As at 14 2010	As at 14 2009
Heidi Mottram	£331,872	£320,000	n/a
Chris Green	£236,459	£228,000	£225,000

For 2011/12, salaries for senior executives have been increased by 3.71%. This is the same as for nearly all other employees.

Benefits provided to the executive directors comprise membership of pension schemes (as detailed below), car allowance and healthcare.

Pensions

The main features of the Northumbrian Water Pension Scheme are set out in note 24 to the financial statements. Basic salary is the only pensionable element of the executive directors' remuneration packages.

The executive directors' pensions were modified with effect from 1 January 2008, in line with the changes proposed for the pension scheme as a whole, and the executive pension arrangements were closed to new entrants on that date. In 2010/11, Heidi Mottram received an employer's contribution of 8% of salary to the defined contribution section of the Northumbrian Water Pension Scheme and made an employee contribution of 5%. The employer's contribution of 8% was the same as was available to any other employee making a 5% contribution during 2010/11. Following consultation with the Company's largest shareholders and major representative bodies, the employer contributions on behalf of executive members of the defined contribution scheme have been increased from 8% to 15% of salary, with employee contributions increased from 5% to 8%, from 1 April 2011. This was thought necessary in order to make the remuneration packages available for senior recruits market competitive. Heidi Mottram is the only executive director of the Company in the defined contribution scheme.

Annual bonus

The annual bonus plan has been designed to reflect the interests of all of the Company's stakeholders. The maximum annual bonus potential for the executive directors for 2010/11 was 70% of salary.

Directors' remuneration report

continued

Actual performance against the 2010/11 targets was as follows

Bonus metric	Maximum bonus (% of salary)	Chris Green actual bonus (% of salary)	Heidi Mottram actual bonus (% of salary)
Profit before tax (PBT) ¹	40	39	39
Overall performance assessment (OPA) rating ²	5	2	2
Percentage time lost through sickness ³	5	–	–
Bespoke personal targets ⁴	20	20	20
Total	70	61	61

Notes

- The PBT bonus is based on actual PBT performance compared to the budget PBT set by the Board at the beginning of the year. PBT has been chosen because it is a primary financial measure for the Company, for which the executive directors are accountable. The calculation of PBT performance is adjusted to exclude the impact of any variance between the actual and budget interest charge on index linked bonds issued by Northumbrian Water Finance plc which depends entirely on RPI in July of each year and is therefore outside of management control.
- The directors' remuneration report for 2009/10 stated that the bonus metrics to be used in 2010/11 would be the same as in the previous year. Therefore, although Ofwat no longer publishes an OPA rating, the Committee has estimated NWL's OPA score for 2010/11 on the same basis as before as 362. This has been placed in a range for bonus purposes of 351 to 426 being the published range of performance across the 10 water and sewerage companies in 2009/10.
- The year end percentage of time lost through sickness was 3.1%, against a range for bonus purposes of 2.7% to 2.99%.
- In 2010/11, Heidi Mottram's personal targets related principally to maintaining key financial ratios and measures, ensuring that good relationships were maintained with major investors and analysts, increasing operating and capital maintenance efficiencies, identifying business development opportunities, ensuring that investment needs were properly quantified, refreshing the risk model and preparing a high level strategic risk matrix. Chris Green's personal targets were focused mainly on maintaining key financial ratios and measures, maintaining good relationships with major investors and analysts, ensuring treasury management achieved an appropriate balance between risk and reward, reviewing and developing strategy in relation to market reform and competition, identifying business development opportunities, ensuring that investment needs were properly quantified, refreshing the risk model, preparing a high level strategic risk matrix and identifying further opportunities to impact the cost base and investment programme of NWL.

Following consultation with the Company's largest shareholders, the range of annual bonus metrics has been expanded to include a balanced scorecard to align annual incentive pay more closely with stakeholders' wider interests for 2011/12. In addition to the introduction of the balanced scorecard, the maximum annual bonus potential for the executive directors in 2011/12 will be increased from 70% to 100% of salary and will be apportioned as follows:

Bonus metric	(% of salary)
PBT	36
Balanced scorecard measures	44
Bespoke personal targets	20
Total	100

The new metrics are firmly linked to the Company's strategic goals (customer, competitiveness, people, environment and communities). The PBT performance metric reflects 'competitiveness', along with an assessment of capital efficiency, while the other elements of the balanced scorecard are linked to the other strategic goals. The 'customer' goal underpins targets based on customer satisfaction, unplanned interruptions and water quality. The 'people' goal is reflected in targets for employee engagement and lost time reportable accidents. The 'environment' goal targets comprise leakage, sewage treatment performance and pollution incidents, while 'communities' targets are based on external recognition of the Group's corporate social responsibility achievement. Definitions of these measures are outlined on pages 12 and 13.

The PBT element of the bonus will be scored on a sliding scale around the target figure. A simple pass/fail measure will apply to the other targets and most of the targets have been set at levels which would require significant improvements over the 2010/11 actual results. The Remuneration Committee considers the overall bonus metrics to be appreciably more stretching than before, and that they reflect operational performance and delivery to customers in a more structured way. A similar approach has been adopted in relation to executives below board level and senior managers, albeit at varying levels of bonus opportunity.

Bespoke personal targets have been set for Heidi Mottram and Chris Green for 2011/12. For Heidi Mottram these include maintaining key financial ratios in line with the NWG and NWL approved budgets, maintaining good relationships with investors and analysts, delivering the operating efficiency plans for 2011/12 (and keeping the remainder of the plans for 2014/15 on track) and progressing the Group's strategy on advanced anaerobic digestion, co-digestion and renewable energy. Chris Green's targets include maintaining key financial ratios, maintaining good relationships with investors and analysts, refreshing the risk model and preparing a high level strategic risk matrix and work on current cost depreciation and its impact on return on capital employed.

Bonus deferral

Following the increase in bonus potential, the Company has introduced bonus deferral for executive directors. Of the total bonus awarded, 70% will be payable in cash and 30% will be payable in shares, deferred for three years.

Bonus and LTIP clawback

As part of the changes introduced for 2011/12, the Committee has introduced a clawback provision which will apply in the event that results on which bonuses are paid, or LTIPs are awarded, are subsequently found to be inaccurate or there has been relevant misconduct on the part of the employee.

LTIP

Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Company worth up to 100% of annual salary at grant, although only the executive directors of NWG participate at the 100% level. All awards have three year pre-vesting performance conditions.

Conditional awards made on 8 December 2010 to Heidi Mottram and Chris Green were

	Number of conditional awards granted	Value of awards granted as a % of salary ¹
Heidi Mottram	96,212	99%
Chris Green	68,551	99%

Note

1 Based on a closing share price on 7 December 2010 of 328.5 pence

Directors' remuneration report continued

Details of the pre-vesting performance conditions for awards made during 2010 are

Performance metric	Weighting	Description	Calibration
Total shareholder return (TSR)	50%	Relative TSR against the FTSE 250 excluding investment trusts and companies in the following sectors: banks, financial services, life insurance, non-life insurance, real estate investment and services and real estate investment trusts, oil and gas producers and oil equipment and services. In addition, awards will only vest if the Committee is satisfied that the Company's TSR performance is consistent with the underlying business performance of the Company.	30% of this part of an award (i.e. 15% of the total award) will vest for median performance increasing on a straight line so that 100% (i.e. 50% of the total award) vests for upper quartile performance.
Return on capital employed (ROCE)	20%	Average absolute ROCE for NWL over the three financial years starting from 1 April immediately preceding grant date.	30% of this part of an award (i.e. 6% of the total award) will vest for average three-year ROCE of 6.3%, increasing on a straight line so that 50% (i.e. 10% of the total award) will vest for average three year ROCE of 6.45% and on a straight line so that 100% (i.e. 20% of the total award) will vest for an average ROCE of 6.75%.
Serviceability	20%	Ofwat serviceability targets for the four asset classes (i.e. water non-infrastructure, water infrastructure, sewerage non-infrastructure and sewerage infrastructure) in the final year of the relevant three year performance period. Serviceability is measured by Ofwat based on a number of indicators which include asset performance indicators, water quality compliance, environmental compliance and consumer service.	50% of this part of an award (i.e. 10% of the total award) will vest for 'stable' assessments in three out of the four asset classes. 100% of this part of an award (i.e. 20% of the total award) will vest for 'stable' assessments in all four asset classes. No awards would vest under this part of an award for less than three 'stable' assessments.
Customer	10%	Results of NWL's independently run customer satisfaction index, measured as the average score for the surveys carried out during the relevant three year performance period.	30% of this part of an award (i.e. 3% of the total award) will vest for a customer satisfaction index of 83%, increasing on a straight line so that 100% of this part of an award (i.e. 10% of the total award) vests for a customer satisfaction index of 93% or above.

The Committee is satisfied that the above metrics and targets remain appropriate for the following reasons:

- a significant part of the award based on TSR ensures alignment with investors,
- the use of an absolute ROCE target for part of the awards ensures that reward is directly linked to the management's delivery of the business plan,
- the serviceability targets recognise that the maintenance of NWL's regulated assets is critical to the longer term returns for shareholders, and
- customer satisfaction is a key objective for NWL and customers are important stakeholders.

In the event of a change of control, the Committee would determine the extent to which the performance conditions had been met and the proportion of the performance period that had elapsed in deciding whether or not any vesting of awards would take place

The LTIP award granted on 13 December 2007 became available to vest on 13 December 2010. The Committee instructed HNBS to assess the level of vesting of this award. HNBS reported that 48.84% of the award was available to vest (being 97.68% of the award relating to the Company's TSR performance against the FTSE 250 Index and 0% of the award relating to the Company's ROCE performance against the other water companies). Prior to vesting, the Committee satisfied itself that the recorded TSR performance was a genuine reflection of the Company's underlying performance. Details of the number of awards which lapsed and those which were exercised by the directors of the Company are shown in table 3.

Full details of past award levels and performance conditions are shown in table 2.

Share ownership guidelines

The NWG Board has introduced a guideline requesting NWG directors to build up (over a maximum of five years) shares in the Company with a value equal to one year's basic salary (in the case of the executive directors) or one year's fees (in the case of non-executive directors).

Responsible investment

The Committee is aware of Guideline 3.2 of the ABI Guidelines on Responsible Investment Disclosure and is satisfied that neither the executive directors' annual bonus targets nor the LTIP performance conditions are likely, inadvertently, to motivate irresponsible behaviour.

Non-executive directors' fees

The Company's remuneration policy is that the Chairman and the non-executive directors should receive a fixed fee for their normal duties. Reflecting the added responsibilities and time commitment, chairing the Remuneration and Audit Committees attracts an additional fee over the non-executive directors' standard base fee.

Fees payable during 2010/11 and the Company's policy from 1 April 2011 (in line with the approach taken in respect of the salaries of NWG executives) are

	2011/12 £	2010/11 £
Chairman	165,434	159,516
Non-executive director base fee	38,601	37,220
Audit Committee chairing fee	11,029	10,634
Remuneration Committee chairing fee	5,514	5,317

The Chairman and the non-executive directors do not receive benefits in kind and do not participate in bonus, pension or share schemes operated by the Company. Further details of non-executive directors' remuneration are set out in table 1.

Directors' interests in LTIP awards

The directors' conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP as at 31 March 2011, are set out in table 3.

Directors' remuneration report continued

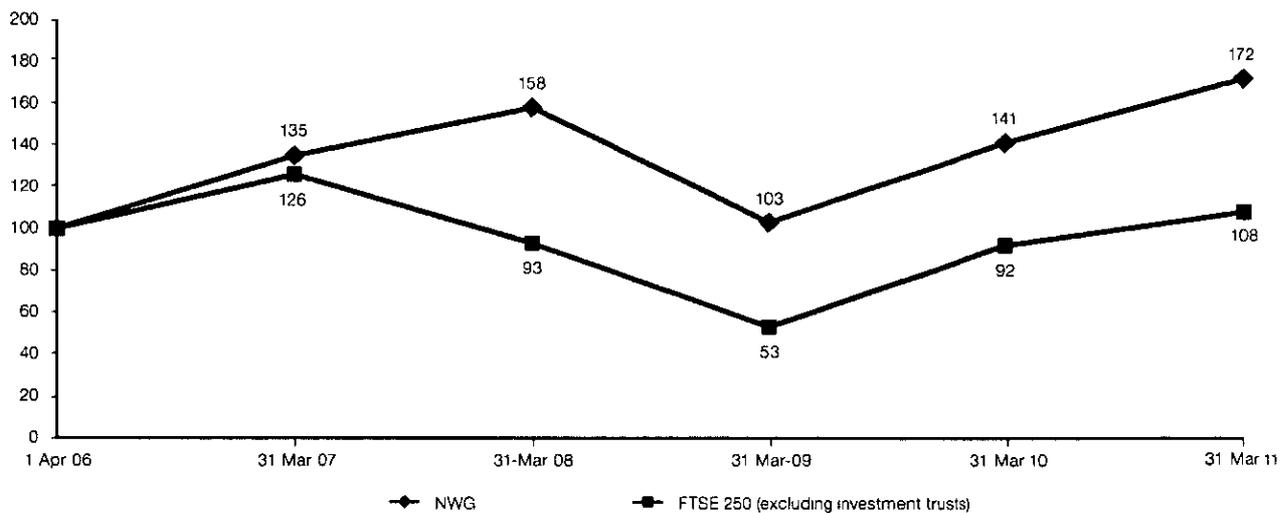
Ordinary 10 pence shares required to fulfil LTIP awards which have vested may be provided by the Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited. The Trustees are Sir Patrick Brown, Martin Negre and Kate Alsop. Anita Frew and Alastair Balls stood down as Trustees when they retired as non-executive directors of NWL on 31 March 2011. At that date, the Trust held a total of 765,962 ordinary 10 pence shares. This represents 0.1% of the Company's total issued share capital, so is substantially less than the 5% limit on shares that can be held in trust. In line with the ABI Guidelines, dividends are waived on these shares and the voting rights attached to these shares will not be exercised at the AGM.

Share dilution

The Company's share plans contain dilution limits that comply with the ABI Guidelines. Shares for both the LTIP and SIP schemes are provided by purchase on the market. There has, therefore, been no dilution to date and there is no commitment to issue new shares in relation to either scheme.

Performance graph

The graph below shows a comparison between the TSR for the Company's shares for the five year period to 31 March 2011, and the TSR for the companies comprising the FTSE 250 Index (excluding investment trusts) over the same period. This index has been selected as the Company is a constituent of the FTSE 250.



Note

This graph shows the value by 31 March 2011 of £100 invested in NWG on 1 April 2006 compared with the value of £100 invested in the FTSE 250 Index (excluding investment trusts) over the same period.

Source: Thomson DataStream.

Service contracts

All non-executive directors are appointed for a term of 12 months with a six month notice period for the Company and the director. The executive directors have service contracts with 12 months notice periods and which expire when the directors reach normal retirement age. No special arrangements apply if there is a change of control. The contracts do not contain any liquidated damages clauses or provide explicitly for termination payments. If a contract is to be terminated, the Committee will determine the compensation to be paid. There is no automatic entitlement to bonus payments and LTIP vesting is at the discretion of the Committee. The Committee will apply such mitigation to any contractual obligations as it considers fair and reasonable, taking into account the best practice provisions of the Code. Details of the contracts of the executive and non-executive directors who served during the year are shown in table 4.

Terms and conditions of appointment of non-executive directors are available for inspection at the Company's registered office during normal business hours and at the AGM. The terms of appointment set out the expected time commitment for each non-executive director.

External appointments of executive directors

The Board's position on external appointments is described in full in the corporate governance statement but, in summary, the Board has agreed that executive directors of the Company who are appointed to non-executive directorships which pay a fee may retain the fees, subject to obtaining the Chairman's consent before an appointment is accepted. Only one such external appointment per director will generally be permitted. Heidi Mottram is a Board member of Yorkshire Forward for which she is paid and retains an annual fee of £8,666.

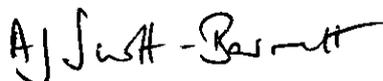
Directors' interests in shares

The directors' beneficial interests in the ordinary 10 pence shares of the Company, as at 31 March 2011, are set out in table 6.

Directors' interests in shares under the SIP

The Company SIP is open to UK employees with more than three months service. Further details of the SIP are set out in the directors' report – business review. During the year, the executive directors had the opportunity to participate in the SIP and their interests in the ordinary 10 pence shares of the Company, purchased and held in accordance with the terms of the SIP, are set out in table 7.

This directors' remuneration report has been produced in accordance with the Companies Act 2006 and Schedule 8 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008. It was approved by the Board and signed on its behalf by the Chairman of the Remuneration Committee. It will be put to the shareholders for approval at the Company's AGM.



Alex Scott-Barrett

Chairman of Remuneration Committee

31 May 2011

Directors' remuneration report

continued

These tables form the part of the directors' remuneration report which are audited (except for tables 2 and 4 which do not require auditing)

Table 1

Directors' emoluments (audited)

The emoluments of the directors of the Company for their services as directors of the Company and (where relevant) its subsidiaries, are set out below, rounded to the nearest thousand pounds

	Fees £000	Basic salary £000	Benefits ¹ £000	Bonus ² £000	Total for the year ended 31 3 2011 £000	Total for the year ended 31 3 2010 £000
Executive directors						
John Cuthbert	-	-	-	-	-	429
Heidi Mottram	-	320	11	195	526	38
Chris Green	-	228	12	139	379	323
Non-executive directors						
Sir Derek Wanless	160	-	-	-	160	158
Sir Patrick Brown ³	48	-	-	-	48	47
Margaret Fay	31	-	-	-	31	-
Claude Lamoureux	37	-	-	-	37	37
Martin Negre	37	-	-	-	37	42
Alex Scott-Barrett ⁴	43	-	-	-	43	37
Paul Rew	19	-	-	-	19	-
Jenny Williams	12	-	-	-	12	37
Total remuneration	387	548	23	334	1,292	1,148

Notes

- 1 The remuneration of each executive director includes non-cash benefits comprising the provision of car allowances and healthcare
- 2 The annual bonus is payable in June 2011 for performance during the year ended 31 March 2011
- 3 Includes additional fee paid as Chairman of the Audit Committee
- 4 Includes additional fee paid as Chairman of the Remuneration Committee

Table 2
Summary of LTIP performance conditions (unaudited)

LTIP award made 13 December 2007 and 15 December 2008

Maximum award	100% of salary permitted and actual grants to executive directors related to shares worth 100% of salary
Performance conditions	(1) 50% of award depends on NWL's return on capital employed relative to that of the other water and sewerage companies of England and Wales (2) 50% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts
Vesting schedules	(1) 30% vests at median performance. At upper quartile or above, all of this element of the award will vest. Between median and upper quartile, straight line pro-rating will apply. Where the return on capital employed performance is below the median, none of this element of the award will vest. (2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where the Company's TSR performance is below the median, none of this element of the award will vest.

LTIP award made 4 January 2010 and 8 December 2010

Maximum award	100% of salary permitted and actual grants to executive directors related to shares worth 100% of salary
Performance conditions and vesting schedules	Please refer back to the remuneration report for performance conditions

Directors' remuneration report

continued

Table 3

Directors' interests in LTIP awards (audited)

As at 31 March 2011, the directors had the following conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP

	Award date	Awards held at the start of the year	Awards awarded during the year	Awards lapsed during the year	Awards vested during the year	Awards held as at 31 3 2011
Heidi Mottram	8 12 2010 ⁵	–	96,212	–	–	96,212
Totals		–	96,212	–	–	96,212
Chris Green	13 12 2007 ¹	61,620	–	31,525	30,095 ²	–
	15 12 2008 ³	78,650	–	–	–	78,650
	4 1 2010 ⁴	83,240	–	–	–	83,240
	8 12 2010 ⁵	–	68,551	–	–	68,551
Totals		223,510	68,551	31,525	30,095	230,441

Notes

- The market value of the shares on the date of the award was 334 0 pence per share. The three year performance period ran from 1 October 2007 to 30 September 2010.
- Shares vested on 13 December 2010 and the closing price on that date was 332 0 pence per share.
- The market value of the shares on the date of the award was 251 5 pence per share. The three year performance period runs from 1 October 2008 to 30 September 2011.
- The market value of the shares on the date of the award was 272 5 pence per share. The three year performance period runs from 1 October 2009 to 30 September 2012.
- The market value of the shares on the date of the award was 328 7 pence per share. The three year performance period runs from 1 October 2010 to 30 September 2013.
- The cost of conditional awards is charged to the income statement over the three year performance period to which they relate after taking account of the probability of performance criteria being met. In the year £0 1 million was charged to the income statement (2010 £0 4 million).
- Details of the performance conditions are shown at table 2.
- The market price of the shares on 31 March 2011 was 332 2 pence per share. During the year the highest market price was 364 0 pence per share and the lowest market price was 245 1 pence per share.
- Aggregate gross gains made by directors on exercise of awards at date of vesting was £99 915 (2010 £103 955).

Table 4

Directors' service contracts (unaudited)

Details, as at 31 May 2011, of the contracts of the directors who served during the year are shown below

	Initial appointment	Contract start date	Unexpired term ¹	Notice period by either party	Current contract end date
Executive directors²					
Heidi Mottram	1 3 2010	1 3 2010	Not fixed term	12 months	Normal retirement age (65)
Chris Green	23 5 2003	23 5 2003	Not fixed term	12 months	Normal retirement age (65)
Non-executive directors³					
Sir Derek Wanless	1 12 2003	1 12 2010	6 months	6 months	30 11 2011
Sir Patrick Brown	12 5 2003	12 5 2011	11 months	6 months	11 5 2012
Margaret Fay	1 6 2010	1 6 2010	–	6 months	31 5 2011
Claude Lamoureux	1 12 2006	1 12 2010	2 months	6 months	28 7 2011
Martin Negre	12 5 2003	12 5 2011	11 months	6 months	11 5 2012
Alex Scott-Barrett	26 9 2006	26 9 2010	4 months	6 months	25 9 2011
Paul Rew	1 10 2010	1 10 2010	4 months	6 months	30 9 2011

Notes

- Calculated as at 31 May 2011 and rounded to nearest whole month.
- The service contracts of the executive directors do not contain provisions relating to compensation for termination. In the event of termination by the Company the Remuneration Committee would make recommendations to the Board on what payments, if any, should be made to the director, depending on the circumstances of the termination, taking into account the Code which discourages payment for failure. The Company would also expect directors to seek to mitigate their loss.
- Contracts do not provide for compensation for loss of office in excess of fees accrued.

Table 5
Directors' pensions and pension benefits (audited)

The accrued defined benefit pensions and corresponding transfer values for the executive directors are set out below

Defined contribution scheme

	Employee contributions during the year £000	Employer contributions during the year £000
Heidi Mottram	– ¹	43.6

Defined benefit scheme

	Accrued pension at 31 3 2010 £000	Accrued pension at 31 3 2011 £000	Increase in accrued pension £000	Increase in accrued pension net of inflation £000	Transfer value of net increase in accrued pension less directors' contributions £000	Transfer value of accrued pension at 1 4 2010 £000	Transfer value of accrued pension at 31 3 2011 £000	Total change in transfer value less directors' contributions £000
Chris Green	104.3	110.7	6.4	0.9	18.9	2,111.4	2,281.3	169.9

Notes

- The directors participate in a salary sacrifice arrangement and, therefore, paid no contributions to the schemes during the year
- Accrued pensions shown are the amounts that would be paid annually at the normal retirement age based on service to the end of the year
- Voluntary contributions paid by the directors and resulting benefits are not shown
- The change in transfer value reflects fluctuations in the transfer value due to factors beyond the control of the Company and directors, such as changes in stock market conditions
- The transfer values have been calculated in line with the relevant legislation and using actuarial assumptions agreed by the Trustee

Table 6
Directors' interests in shares (audited)

The directors had the following beneficial or family interests in the ordinary 10 pence shares of the Company as at 31 March 2011

	Number of shares held at the start of the year	Number of shares held as at 31 3 2011	Number of shares held as at 31 5 2011
Sir Derek Wanless	65,000	65,000	65,000
Chris Green	169,339 ¹	199,434 ²	199,434
Sir Patrick Brown	43,000	43,000 ³	43,000
Claude Lamoureux	25,000	25,000	25,000
Martin Nègre	70,000	20,000	20,000
Alex Scott-Barrett	20,000	20,000	20,000
Jenny Williams ⁴	6,000	–	–

Notes

- At 1 April 2010, 139,339 of these shares were beneficially owned by Mrs G Green and 10,000 were beneficially owned by each of Miss P J Green, Mr M F Green and Mr J M Green
- At 31 March 2011, 139,434 of these shares were beneficially owned by Mrs G Green and 20,000 were beneficially owned by each of Miss P J Green, Mr M F Green and Mr J M Green
- At 31 March 2011, the 43,000 shares were beneficially owned by Lady Brown
- Jenny Williams retired from the Board on 29 July 2010

Directors' remuneration report

continued

Table 7

Directors' interests in shares under the SIP (audited)

The directors who held office as at 31 March 2011 had the following interests in the ordinary 10 pence shares of the Company, purchased and held in accordance with the terms of the SIP

	Number of SIP shares held at the start of the year ¹	Number of SIP shares held as at 31.3.2011 ¹	Number of SIP shares held as at 31.5.2011 ¹
Heidi Mottram	–	606	606
Chris Green	5,653	6,372	6,936

Notes

- 1 These figures include the shares paid for by the participant and the free shares granted by the Company
- 2 A summary of the SIP can be found in the directors' report – business review

Statement of directors' responsibilities in relation to the Group financial statements

The directors are responsible for preparing the annual report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards (IFRSs) as adopted by the European Union

The directors are required to prepare Group financial statements for each financial year. Under Company Law, the directors must not approve the financial statements unless they are satisfied that they present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group financial statements the directors are required to

- select suitable accounting policies in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,
- provide additional disclosures when compliance with specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance,
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements, and
- make judgements and estimates that are reasonable and prudent

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and, hence, for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Responsibility statements

We confirm that to the best of our knowledge

- the financial statements, prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the undertakings included in the consolidation taken as a whole, and
- the directors' report and business review includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face

By order of the Board


Sir Derek Wanless
Chairman


Heidi Mottram
Chief Executive Officer

Report of the auditors on the Group financial statements

Independent auditors' report to the members of Northumbrian Water Group plc

We have audited the Group financial statements of Northumbrian Water Group plc for the year ended 31 March 2011 which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated balance sheet, consolidated cash flow and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report 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 Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 85, the directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group 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.

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 Group'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 Group financial statements

- give a true and fair view of the state of the Group's affairs as at 31 March 2011 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matters 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 Group financial statements, and
- the information given in the corporate governance statement set out on pages 58 to 70 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following

Under the Companies Act 2006 we are required to report to you if, in our opinion

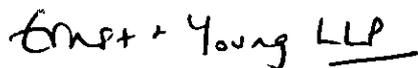
- certain disclosures of directors' remuneration specified by law are not made,
- we have not received all the information and explanations we require for our audit, or
- a corporate governance statement has not been prepared by the Company

Under the Listing Rules we are required to review

- the directors' statement, set out on page 57, in relation to going concern, and
- the part of the corporate governance statement on pages 58 to 70 relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review

Other matter

We have reported separately on the parent Company financial statements of Northumbrian Water Group plc for the year ended 31 March 2011 and on the information in the Directors' Remuneration Report that is described as having been audited



Debbie O'Hanlon (Senior statutory auditor)

For and on behalf of Ernst & Young LLP

Statutory Auditor

Newcastle upon Tyne

31 May 2011

Consolidated income statement

For the year ended 31 March 2011

	Notes	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Continuing operations			
Revenue	2	738.1	704.7
Operating costs	3	(433.9)	(428.9)
Profit on ordinary activities before interest	2	304.2	275.8
Finance costs payable	6	(178.8)	(143.7)
Finance income receivable	6	54.9	37.2
Share of profit after tax of jointly controlled entities		0.7	0.9
Profit on ordinary activities before taxation	2	181.0	170.2
– current taxation	7	(33.1)	(37.8)
– deferred taxation	7	30.5	(9.5)
Profit for the year		178.4	122.9
Attributable to			
Equity shareholders of the parent Company		178.3	122.5
Non-controlling interests		0.1	0.4
		178.4	122.9
Basic earnings per share attributable to ordinary equity holders of the parent Company	8	34.44p	23.67p
Diluted earnings per share attributable to ordinary equity holders of the parent Company	8	34.38p	23.62p
Adjusted earnings per share attributable to ordinary equity holders of the parent Company	8	25.50p	23.67p
Adjusted diluted earnings per share attributable to ordinary equity holders of the parent Company	8	25.45p	23.62p
Ordinary final dividend proposed per share	9	9.57p	8.85p
Dividend paid per share	9	13.57p	12.89p

Consolidated statement of comprehensive income

For the year ended 31 March 2011

	Notes	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Profit for the year		178.4	122.9
Other comprehensive income			
Actuarial gains	24	74.0	1.1
Gains/(losses) on cash flow hedges taken to equity		2.6	(0.8)
Translation differences		0.2	(0.3)
Tax on items charged or credited to equity		(23.1)	(0.1)
Total other comprehensive gain/(loss)		53.7	(0.1)
Total comprehensive income for the year		232.1	122.8
Attributable to			
Equity shareholders of the parent Company		232.0	122.4
Non-controlling interests		0.1	0.4
		232.1	122.8

Consolidated statement of changes in equity

For the year ended 31 March 2011

	Equity share capital £m	Share premium reserve £m	Cash flow hedge reserve £m	Treasury shares £m	Currency translation £m	Retained earnings £m	Total equity £m	Non-controlling interests £m	Total £m
At 1 April 2009	51.9	446.5	(7.6)	(2.3)	1.0	(234.5)	255.0	2.4	257.4
Profit for the year	-	-	-	-	-	122.5	122.5	0.4	122.9
Other comprehensive income	-	-	(0.6)	-	(0.3)	0.8	(0.1)	-	(0.1)
Total comprehensive income and expense for the year	-	-	(0.6)	-	(0.3)	123.3	122.4	0.4	122.8
Share-based payment	-	-	-	-	-	0.4	0.4	-	0.4
Exercise of LTIP awards	-	-	-	0.3	-	(0.3)	-	-	-
Equity dividends paid	-	-	-	-	-	(66.7)	(66.7)	-	(66.7)
At 1 April 2010	51.9	446.5	(8.2)	(2.0)	0.7	(177.8)	311.1	2.8	313.9
Profit for the year	-	-	-	-	-	178.3	178.3	0.1	178.4
Other comprehensive income	-	-	1.6	-	0.2	51.9	53.7	-	53.7
Total comprehensive income and expense for the year	-	-	1.6	-	0.2	230.2	232.0	0.1	232.1
Share-based payment	-	-	-	-	-	0.1	0.1	-	0.1
Exercise of LTIP awards	-	-	-	0.3	-	(0.3)	-	-	-
Deferred tax related to share-based payment	-	-	-	-	-	0.1	0.1	-	0.1
Acquisition of non-controlling interest in subsidiaries	-	-	-	-	-	0.6	0.6	(0.6)	-
Equity dividends paid	-	-	-	-	-	(70.3)	(70.3)	-	(70.3)
At 31 March 2011	51.9	446.5	(6.6)	(1.7)	0.9	(17.4)	473.6	2.3	475.9

Consolidated balance sheet

As at 31 March 2011

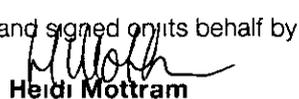
	Notes	Year to 31 3 2011 £m	Year to 31 3 2010 restated ¹ £m
Non-current assets			
Goodwill	10	3.6	3.6
Other intangible assets	10	64.2	64.2
Property, plant and equipment	11	3,626.8	3,518.9
Investments in jointly controlled entities	12	4.0	4.1
Financial assets		12.0	12.9
Amounts receivable relating to consortium relief		1.7	1.7
		3,712.3	3,605.4
Current assets			
Inventories	13	3.3	3.3
Trade and other receivables	14	153.9	136.4
Short term cash deposits	15	1.4	15.8
Cash and cash equivalents	15	141.7	174.8
		300.3	330.3
Total assets		4,012.6	3,935.7
Non-current liabilities			
Interest bearing loans and borrowings	17	2,295.8	2,433.9
Provisions	19	2.4	2.2
Deferred income tax liabilities	7	598.7	606.1
Pension liability	24	46.0	133.1
Other payables		6.8	7.8
Grants and deferred income		255.1	233.5
		3,204.8	3,416.6
Current liabilities			
Interest bearing loans and borrowings	17	163.7	33.1
Provisions	19	0.2	0.2
Trade and other payables	16	155.6	151.2
Interest rate swaps	20	9.8	12.5
Income tax payable		2.6	8.2
		331.9	205.2
Total liabilities		3,536.7	3,621.8
Net assets		475.9	313.9
Capital and reserves			
Issued capital	21	51.9	51.9
Share premium reserve		446.5	446.5
Cash flow hedge reserve		(6.6)	(8.2)
Treasury shares		(1.7)	(2.0)
Currency translation		0.9	0.7
Retained earnings		(17.4)	(177.8)
Equity shareholders' funds		473.6	311.1
Non-controlling interests		2.3	2.8
Total capital and reserves		475.9	313.9

Note

1 The prior year balance sheet has been restated to reflect the impact of IFRIC 18 Transfers of Assets from Customers

Approved by the Board on 31 May 2011 and signed on its behalf by


Sir Derek Wanless
Chairman


Heidi Mottram
Chief Executive Officer

Consolidated cash flow statement

For the year ended 31 March 2011

	Notes	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Operating activities			
Reconciliation of profit before interest to net cash flows from operating activities			
Profit on ordinary activities before interest		304.2	275.8
Depreciation		111.6	105.5
Other non-cash charges and credits		(8.9)	(5.7)
Net credit for provisions, less payments		0.2	(0.3)
Difference between pension contributions paid and amounts recognised in the income statement		11.5	10.3
Increase in inventories		-	(0.1)
Increase in trade and other receivables		(14.7)	(5.0)
Increase in trade and other payables		5.2	0.4
Cash generated from operations		409.1	380.9
Advanced contributions in respect of retirement benefits		(22.4)	-
Interest paid		(116.1)	(114.8)
Income taxes paid		(38.7)	(35.7)
Net cash flows from operating activities		231.9	230.4
Investing activities			
Interest received		4.7	8.8
Capital grants received		13.2	10.1
Proceeds on disposal of property, plant and equipment		1.3	0.3
Dividends received from jointly controlled entities		0.8	0.6
Short term cash deposits		14.4	144.8
Maturity of investments		1.1	1.4
Purchase of property, plant and equipment		(202.9)	(220.6)
Net cash flows from investing activities		(167.4)	(54.6)
Financing activities			
Dividends paid to equity shareholders		(70.3)	(66.7)
Repayment of borrowings		(19.5)	(20.9)
Payment of principal under hire purchase contracts and finance leases		(7.3)	(7.2)
Acquisition of externally held loan stock issued by a subsidiary		(0.4)	-
Net cash flows from financing activities		(97.5)	(94.8)
(Decrease)/increase in cash and cash equivalents		(33.0)	81.0
Cash and cash equivalents at start of year	15	173.3	92.3
Cash and cash equivalents at end of year	15	140.3	173.3
Cash and cash equivalents at end of year	15	140.3	173.3
Short term cash deposits	15	1.4	15.8
Total cash, cash equivalents and short term cash deposits		141.7	189.1

Notes to the consolidated financial statements

1. Accounting policies

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union as it applies to the financial statements of the Group for the year ended 31 March 2011 and in accordance with the Companies Act 2006

The financial statements have been prepared on a going concern basis which assumes that the Group will have adequate funding to meet its liabilities as they fall due in the foreseeable future. As at 31 March 2011 the Group had net current liabilities of £31.6 million (2010 net current assets of £125.1 million). The directors have reviewed cash flow requirements and are confident that they will be able to meet these from funds available and new financing facilities. Accordingly, the directors believe it is appropriate to prepare the financial statements on a going concern basis.

The directors consider the following accounting policies to be relevant in relation to the Group's financial statements. The financial statements of the Group for the year ended 31 March 2011 were authorised for issue by the Board of directors on 31 May 2011 and the balance sheet was signed on the Board's behalf by Sir Derek Wanless (Chairman) and Heidi Mottram (Chief Executive Officer).

The Group has adopted the following standards and interpretations during the year:

- IFRS 3 Business Combinations (Revised)
- IAS 27 Consolidated and Separate Financial Statements (Amendment)
- IAS 32 Financial Instruments: Classification of Rights Issues (Amendment)
- IAS 39 Financial Instruments: Recognition and Measurement – Eligible hedged items (Amendment)
- IFRIC 17 Distributions of Non-cash Assets to Owners
- IFRIC 18 Transfers of Assets from Customers
- Improvements to IFRS 2009

The adoption of IAS 27 Consolidated and Separate Financial Statements (Amendment) has required the reclassification of minority interests as non-controlling interests. Also, any transactions with non-controlling interests that do not result in gaining or losing control will be accounted for as equity transactions.

IFRIC 18 Transfers of Assets from Customers was adopted in the period. IFRIC 18 is effective for accounting periods beginning on or after 31 October 2009, applicable to transactions effected on or after 1 July 2009. This has required the prior year balance sheet to be restated resulting in the balances of property, plant and equipment, and grants and deferred income, each increasing by £14.0 million at 31 March 2010. The impact on profit for both the current period and prior periods is £nil.

The adoption of the other standards and interpretations listed above do not have a material impact on the Group.

The guidance provided in the Urgent Issues Task Force Draft Abstract Accounting Implications of the Replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits has also been applied in the period.

Northumbrian Water Group plc is a public limited company incorporated and domiciled in England and Wales. The Company's ordinary shares are traded on the London Stock Exchange.

The Group financial statements are presented in sterling and all values are rounded to the nearest one hundred thousand pounds (£0.1 million) except where otherwise indicated.

Notes to the consolidated financial statements

continued

1. Accounting policies continued

(b) Basis of consolidation

The consolidated financial statements include the Company and its subsidiary undertakings. The results of subsidiaries acquired during the period are included from the date of their acquisition. The results of subsidiaries disposed of during the period are included to the date of their disposal. Inter-segment sales and profits are eliminated fully on consolidation. Where, for commercial reasons, the accounting reference date of a subsidiary is a date other than that of the Company, management accounts made up to the Company's accounting reference date have been used. In accordance with SIC 12 'Consolidation – Special Purpose Entities', the financial statements of two companies are consolidated as special purpose entities, with effect from 12 May 2004, the date of the transaction which utilised these entities.

Where necessary, adjustments are made to bring the accounting policies used under relevant local GAAP in the individual financial statements of the Company, subsidiaries and jointly controlled entities into line with those used by the Group under IFRS.

Non-controlling interests represent the portion of profit or loss and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separately from parent shareholders' equity.

(c) Associates and jointly controlled entities

Investments in associates and jointly controlled entities in the Group financial statements are accounted for using the equity method of accounting where the Group exercises significant influence over the associate. Significant influence is generally presumed to exist where the Group's effective ownership is 20% or more. The Group's share of the post tax profits less losses of associates and jointly controlled entities is included in the consolidated income statement and the carrying value in the balance sheet comprises the Group's share of their net assets/liabilities less distributions received and any impairment losses. Goodwill arising on the acquisition of associates and jointly controlled entities, representing the excess of the cost of investment compared to the Group's share of net fair value of the associate's identifiable assets, liabilities and contingent liabilities, is included in the carrying amount of the associate and is not amortised. Financial statements of jointly controlled entities and associates are prepared for the same reporting period as the Group. Where necessary, adjustments are made to bring the accounting policies used into line with those of the Group to take into account fair values assigned at the date of acquisition and to reflect impairment losses where appropriate. Adjustments are also made to the Group's financial statements to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its jointly controlled entities and associates.

(d) Goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses represents the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Prior to 1 April 2004, goodwill was amortised over its estimated useful life, such amortisation ceased on 31 March 2004. Goodwill relating to acquisitions since 1 April 2004 is not amortised. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. For the purposes of impairment testing, goodwill is allocated to the related cash-generating units monitored by management. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement. The carrying amount of goodwill allocated to a cash-generating unit is taken into account when determining the gain or loss on disposal of the unit, or of an operation within it.

1. Accounting policies continued

(e) Intangible assets other than goodwill

Other intangible fixed assets represent the right to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme. The value of this intangible asset has been assessed with reference to the net monies raised in accordance with the Kielder securitisation on 12 May 2004. The term of the operating agreement is in perpetuity and, accordingly, no amortisation is provided. The value of this intangible is assessed for impairment on an annual basis in accordance with IAS 36 'Impairment of Assets'.

Expenditure on internally developed intangible assets, excluding development costs, is taken to the income statement in the year in which it is incurred. Intangible assets acquired separately from a business are carried initially at cost. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably. Development expenditure is recognised as an intangible asset only after its technical feasibility and commercial viability can be demonstrated, the availability of adequate technical and financial resources and an intention to complete the project have been confirmed and the correlation between development costs and future revenues has been established.

(f) Property, plant and equipment

Property, plant and equipment and depreciation

Property, plant and equipment, including assets in the course of construction, comprise infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, overground plant and equipment).

Property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment. Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended.

Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows: freehold buildings, 30-60 years, operational structures, plant and machinery, 4-92 years, infrastructure assets 13-200 years (see below), and fixtures, fittings, tools and equipment, 4-10 years.

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and, where adjustments are required, these are made prospectively.

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

Infrastructure assets

In the regulated water services business, infrastructure assets comprise a network of systems being mains and sewers, reservoirs, dams and sea outfalls.

Infrastructure assets were measured at a date prior to transition to IFRS (23 May 2003) at their fair value, which was adopted as deemed historical cost on transition to IFRS. The assets and liabilities were measured at fair value as a result of the acquisition on 23 May 2003.

Expenditure on infrastructure assets which enhances the asset base is treated as fixed asset additions while maintenance expenditure which does not enhance the asset base is charged as an operating cost.

Notes to the consolidated financial statements

continued

1. Accounting policies continued

Infrastructure assets are depreciated evenly to their estimated residual values over their estimated economic lives, which are principally as follows

Dams and impounding reservoirs	150 years
Water mains	100 years
Sea outfalls	60 years
Sewers	200 years
Dedicated pipelines	4-20 years

(g) Financial assets

Financial assets comprise loans to third parties recoverable in more than one year and include cash held on long term deposit as a guaranteed investment contract relating to the Kielder securitisation. These assets are recognised at cost and are measured annually based on the ability of the borrower to repay. Any impairment is taken to the income statement in the period in which it arises. Loans and receivables are measured at amortised cost using the effective interest rate method. The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

(h) Foreign currencies and foreign currency transactions

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated at the functional currency rate of exchange ruling at the balance sheet date. The functional and presentational currency of Northumbrian Water Group plc is United Kingdom sterling (£). Assets and liabilities of subsidiaries and jointly controlled entities in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial period and the results of foreign subsidiaries are translated at the average rate of exchange for the period. Differences on exchange arising from the re-translation of the opening net investment in subsidiary companies and jointly controlled entities, and from the translation of the results of those companies at average rate, are taken to equity. All other foreign exchange differences are taken to the income statement in the period in which they arise.

Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities, where material, and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

(i) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs, as well as an element of overheads that have been incurred in bringing the inventories to their present locations and condition.

(j) Revenues

Provision of services

Revenue, which excludes value added tax, represents the fair value of the income receivable in the ordinary course of business for services provided. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

1. Accounting policies continued

Revenue is not recognised until the services have been provided to the customer. Revenue for services relates to the year, excluding any amounts paid in advance. Revenue for measured water and waste 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.

Dividends

Revenue is recognised when the shareholders' right to receive the revenue is established.

(k) Grants and contributions

Grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Revenue grants are credited to the income statement in the period to which they relate. Capital grants and contributions relating to property, plant and equipment are treated as deferred income and amortised to the income statement over the expected useful economic lives of the related assets. Deferred income relating to assets adopted from customers, recognised in accordance with IFRIC 18, is amortised to the income statement over the expected useful economic lives of the related assets.

(l) Leases

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the Group, the assets are treated as if they had been purchased at their fair value or, if lower, at the present value of the minimum lease payments. Rentals or leasing payments are treated as consisting of a capital element and finance charges, the capital element reducing the outstanding liability and the finance charges being charged to the income statement over the period of the leasing contract at a constant rate on the reducing outstanding liability.

Rentals under operating leases (where the lessor retains a significant proportion of the risks and rewards of ownership) are expensed in the income statement on a straight line basis over the lease term.

(m) Pensions and other post-employment benefits**Defined benefit scheme**

The cost of providing benefits under the defined benefit scheme is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight line basis over the vesting period or immediately if the benefits have vested. When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs, the obligation and related plan assets are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year.

The service cost is disclosed in employment costs and the expected interest income and interest cost on obligations are disclosed within finance costs payable/(income receivable).

Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the consolidated statement of comprehensive income.

Notes to the consolidated financial statements

continued

1. Accounting policies continued

Defined contribution scheme

The Group also operates a defined contribution scheme. Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

(n) Share-based payments

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by an external valuer using the Monte-Carlo simulation model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions) or those not related to performance or service (non-vesting conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market or non-vesting condition, which are treated as vesting irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired, management's best estimate of the achievement or otherwise of vesting conditions and the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market or non-vesting condition, be treated as vesting as described above. This includes any award where non-vesting conditions within the control of the Group or the employee are not met. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

(o) Taxes

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

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

Deferred tax liabilities are recognised for all taxable temporary differences except

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss, and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in jointly controlled entities, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

1. Accounting policies continued

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss, and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in jointly controlled entities, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

Deferred tax is recognised in the income statement unless it relates to items accounted for outside profit or loss, in which case it is recognised in correlation with the underlying transaction either in other comprehensive income or directly in equity.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax except

- where the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable, and
- receivables and payables

The net amount of value added tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

(p) Derivative financial instruments

The Group utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Group in line with the Group's risk management policies. Interest rate swap agreements are used to manage interest rate exposures. Derivative financial instruments are stated at their fair value.

Notes to the consolidated financial statements

continued

1. Accounting policies continued

Under IAS 39, derivative financial instruments are always measured at fair value, with hedge accounting employed in respect of those derivatives fulfilling the stringent requirements for hedge accounting as prescribed under IAS 39. In summary, these criteria relate to initial designation and documentation of the hedge relationship, prospective testing of the relationship to demonstrate the expectation that the hedge will be highly effective throughout its life and subsequent retrospective testing of the hedge to verify effectiveness.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swaps is determined by reference to market values for similar instruments.

Hedging transactions undertaken by the Company are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cash flow hedges where they hedge exposure to variability in currency cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in profit or loss. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement. Where the adjustment is to the carrying amount of a hedged interest bearing financial instrument, the adjustment is amortised to the net profit and loss such that it is fully amortised by maturity.

In relation to cash flow hedges to hedge firm currency commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or a non-financial liability then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same periods in which the hedged firm commitment affects the net profit and loss.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

(q) Interest bearing loans and borrowings

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period. The carrying amount of index linked borrowings increases annually in line with the July RPI, with the accretion being charged to the income statement as finance costs payable. Other borrowing costs are recognised as an expense when incurred.

1. Accounting policies continued

Loans and borrowings acquired at acquisition are restated to fair value. The adjustment arising on acquisition is amortised to the income statement on the basis of the maturity profile of each instrument. Realised gains and losses that occur from the early termination of loans and borrowings are taken to the income statement in that period.

Net debt is the sum of all current and non-current liabilities less cash and cash equivalents, short term cash deposits, financial investments and loans receivable.

(r) Borrowing costs

Borrowing costs are generally expensed as incurred. Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial time to prepare for its intended use are capitalised while the asset is being constructed as part of the cost of that asset.

Capitalisation ceases when the asset is substantially ready for its intended use or sale. If active development is interrupted for an extended period, capitalisation is suspended. When construction occurs piecemeal and use of each part ceases upon substantial completion of that part, a weighted average cost of borrowings is used.

The Group capitalises borrowing costs for all eligible assets when construction commenced on or after 1 April 2009, and continues to expense borrowing costs relating to construction projects that commenced prior to that date.

(s) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available for sale. Gains and losses are recognised in income when the investments are de-recognised or impaired, as well as through the amortisation process.

(t) Cash and cash equivalents and short term cash deposits

Cash and cash equivalents disclosed in the balance sheet comprise cash at bank and in hand and short term deposits with a maturity on acquisition of three months or less, which are held for the purpose of meeting short term cash commitments rather than for investment or other purposes. Cash equivalents are readily convertible to a known amount of cash and subject to an insignificant risk of changes in value.

Short term cash deposits disclosed in the balance sheet comprise cash deposited with a maturity of greater than three months on acquisition, a fixed interest rate and which do not constitute cash equivalents under IAS 7 'Statement of Cash Flows'.

For the purpose of the consolidated cash flow statement, cash and cash equivalents are as defined above, net of outstanding bank overdrafts.

(u) Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. Invoices for unmeasured water and waste water charges are due on fixed dates, other receivables generally have 30 day payment terms. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified. Trade and other receivables do not carry any interest.

Notes to the consolidated financial statements

continued

1. Accounting policies continued

(v) Investments

Investments are initially recorded at the fair value of the consideration given including the acquisition charges associated with the investment. Subsequent to initial recognition, they are valued at original cost less any impairment.

(w) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required and a reliable estimate can be made of the amount of the obligation.

(x) Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses on continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(y) De-recognition of financial assets and liabilities

A financial asset or liability is generally de-recognised when the contract that gives rise to it is settled, sold, cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the income statement.

1. Accounting policies continued**(z) Accounting standards**

During the year, the International Accounting Standards Board and International Financial Reporting Interpretation Committee (IFRIC) have issued the following standards and interpretations with an effective date after the date of these financial statements

International Accounting Standards (IAS/IFRS)	Effective for accounting periods beginning on or after
IFRS 1 Amendment to IFRS 1 – Limited Exemption from Comparative IFRS 7 Disclosures	1 7 2010
IFRS 7 Amendment to IFRS 7 – Financial Instrument Disclosures	1 7 2011
IFRS 9 Financial Instruments Classification and Measurement	1 1 2013
IFRS10 Consolidated Financial Statements	1 1 2013
IFRS11 Joint Arrangements	1 1 2013
IFRS12 Disclosure of Interests in Other Entities	1 1 2013
IFRS13 Fair Value Measurement	1 1 2013
IAS 24 Related Party Disclosures (Revised)	1 1 2011
Improvements to IFRS 2010	1 7 2010, 1 7 2011

IFRIC	Effective for accounting periods beginning on or after
IFRIC 14 Amendment Prepayments of a Minimum Funding Requirement	1 1 2011
IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments	1 7 2010

Given the recent publication of IFRS 10,11,12 and 13, the directors are still evaluating the impact of these standards on the Group's financial statements in the period of initial application

(aa) Key assumptions

The directors consider that the key assumptions applied at the balance sheet date, which may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are

- those assumptions used in arriving at the pension asset/liability under IAS 19. These key assumptions and their possible impact are disclosed in note 24, 'Pensions and other post-retirement benefits';
- the bad debt provision which is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied, and
- the asset lives assigned to property, plant and equipment, details of which can be found in note 1(f)

Notes to the consolidated financial statements

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2. Segmental analysis

For management purposes, the Group is organised into business units according to the nature of its products and services and has three reportable operating segments. The trading of the business is principally carried out within the UK. Profit is measured at profit on ordinary activities before interest.

Northumbrian Water Limited

NWL is one of the ten regulated water and sewerage businesses in England and Wales. NWL operates in the north east of England, where it trades as Northumbrian Water, and in the south east of England, where it trades as Essex & Suffolk Water. NWL also has non-regulated activities closely related to its principal regulated activity.

Water and waste water contracts

NWG owns a number of special purpose companies for specific water and waste water contracts in Scotland, Ireland and Gibraltar.

Other

Agree provides overseas aid funded project work in developing countries through a number of funding agencies. Central unallocated costs and provisions are also included in this segment.

Transfer prices between business segments are set on an arm's length basis in a manner similar to transactions with third parties. Segment revenue, segment expense and segment result include transfers between business segments. Those transfers are eliminated on consolidation.

Revenue

	Northumbrian Water Limited £m	Water and waste water contracts £m	Other £m	Total £m
Year ended 31 March 2011				
Segment revenue	689.4	40.0	14.1	743.5
Inter-segment revenue	-	-	(5.4)	(5.4)
Revenue from external customers	689.4	40.0	8.7	738.1
Year ended 31 March 2010				
Segment revenue	657.8	38.3	14.8	710.9
Inter-segment revenue	-	-	(6.2)	(6.2)
Revenue from external customers	657.8	38.3	8.6	704.7

2. Segmental analysis continued

Profit on ordinary activities before interest

	Northumbrian Water Limited £m	Water and waste water contracts £m	Other £m	Total £m
Year ended 31 March 2011				
Segment profit on ordinary activities before interest	297.6	9.5	(2.9)	304.2
Net finance costs				(123.9)
Share of profit from jointly controlled entities				0.7
Profit on ordinary activities before taxation				181.0
Taxation				(2.6)
Profit for the year from continuing operations				178.4
Year ended 31 March 2010				
Segment profit on ordinary activities before interest	268.9	10.2	(3.3)	275.8
Net finance costs				(106.5)
Share of profit from jointly controlled entities				0.9
Profit on ordinary activities before taxation				170.2
Taxation				(47.3)
Profit for the year from continuing operations				122.9

Assets and liabilities

	Northumbrian Water Limited		Water and waste water contracts		Other		Total	
	31 3 2011 £m	31 3 2010 restated £m	31 3 2011 £m	31 3 2010 £m	31 3 2011 £m	31 3 2010 £m	31 3 2011 £m	31 3 2010 restated £m
Segment assets	3,709.6	3,517.6	123.6	130.6	179.4	287.5	4,012.6	3,935.7
Segment liabilities	422.3	458.5	18.0	22.9	3,096.4	3,140.4	3,536.7	3,621.8

Other comprises taxation, interest and net debt

	Northumbrian Water Limited		Water and waste water contracts		Total	
	31 3 2011 £m	31 3 2010 restated £m	31 3 2011 £m	31 3 2010 £m	31 3 2011 £m	31 3 2010 restated £m
Property, plant and equipment additions	219.6	230.9	0.3	5.4	219.9	236.3
Depreciation	105.8	99.5	5.8	6.0	111.6	105.5

IFRIC 18 Transfers of Assets from Customers was adopted in the period. This has required the prior year segment assets and property, plant and equipment additions to be restated by £14.0 million for transactions effected on or after 1 July 2009.

Geographical information

Revenue from external customers from the UK was £714.8 million (2010: £680.0 million). Revenue from other countries was £23.3 million (2010: £24.7 million).

Non-current assets for operations in the UK were £3,700.7 million (2010: £3,592.1 million). Non-current assets for operations in other countries were £11.6 million (2010: £13.3 million).

Notes to the consolidated financial statements

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3. Operating costs

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Materials and consumables	25.6	23.7
Manpower costs (see note 5)	110.6	111.4
Own work capitalised	(28.7)	(27.0)
Depreciation of property, plant and equipment	111.6	105.5
Profit on disposal of property, plant and equipment	(0.9)	(0.2)
Amortisation of capital grants	(4.6)	(5.0)
Costs of research and development	2.3	2.1
Operating lease payments	1.2	1.2
Bad debt charge	17.8	19.6
Other operating costs	199.0	197.6
Operating costs	433.9	428.9

4 Auditors' remuneration

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Audit of the financial statements ¹	0.3	0.3
Other fees to auditors		
Other services	0.1	-

Note

1 £97,000 of this relates to the Company (2010 £95,000)

5. Employee information

The total employment costs of all employees (including directors) of the Group were

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Wages and salaries	87.6	87.1
Restructuring cost – wages and salaries	-	0.9
Restructuring cost – defined benefit pension service cost (see note 24)	-	4.8
Social security costs	7.3	7.3
Defined benefit pension service cost (see note 24)	13.9	9.7
Other pension costs	1.8	1.6
Total employment costs	110.6	111.4
Total employment costs were charged as follows		
Capital schemes and infrastructure renewals	25.4	23.1
Manpower costs	85.2	88.3
	110.6	111.4

Included in wages and salaries is a total expense of share-based payments of £0.4 million (2010 £0.7 million) which arises from transactions accounted for as equity-settled share-based payments

5. Employee information continued

The average monthly number of employees of the Group during the year was

	Year to 31 3 2011 Number	Year to 31 3 2010 Number
Northumbrian Water Limited	2,875	2,930
Water and waste water contracts	132	151
Other	24	24
	3,031	3,105

The information required by Schedule 5 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 is contained in the directors' remuneration report under directors' emoluments, directors' pensions and benefits, directors' interests in shares and debentures, directors' interests in LTIP awards and directors' interests in shares under the Share Incentive Plan

6 Finance costs payable/(income receivable)

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Finance costs payable on debentures, bank and other loans and overdrafts	112.9	114.7
Amortisation of discount, fees, loan issue costs and other financing items	(4.4)	(4.5)
Accretion on index linked bonds	21.9	(6.6)
Interest cost on pension plan obligations	43.3	36.1
Finance costs payable on hire purchase contracts and finance leases	5.1	4.0
Total finance costs payable	178.8	143.7
Expected return on pension plan assets	(45.5)	(31.6)
Finance income receivable	(1.9)	(5.6)
Acquisition of CES loan stock	(4.6)	-
Finance lease termination discount	(2.9)	-
Net finance costs payable	123.9	106.5

During the period, the Group acquired the subordinated loan stock issued by CES from an external party. This was acquired at below book value leading to a gain of £4.6 million. In addition, the Group transferred a finance lease to a new counterparty with a termination discount valued at £2.9 million.

Notes to the consolidated financial statements

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7. Taxation

(a) Tax on profit on ordinary activities

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Current tax		
Current income tax charge at 28%	42.3	38.9
Income tax recycled from equity on cash flow hedges	0.1	–
Adjustment in respect of prior periods	(9.5)	(1.3)
UK corporation tax	32.9	37.6
Overseas tax	0.2	0.2
Total current tax	33.1	37.8
Deferred tax		
Origination and reversal of temporary differences in the year at 26% (2010: 28%)	9.0	9.2
Effect of changes in tax rates and laws		
– Impact of reduction in rate of UK corporation tax	(46.3)	–
Adjustment in respect of prior periods	6.8	0.3
Total deferred tax (credit)/charge	(30.5)	9.5
Tax charge in the income statement	2.6	47.3

The rate of UK corporation tax was reduced from 28% to 27% by the Finance (No. 2) Act 2010 with effect from 1 April 2011. The rate was further reduced to 26%, with effect from the same date, on the passing of a resolution under the Provisional Collection of Taxes Act 1968 on 23 March 2011 at which point the new rate was substantively enacted. As a result, deferred tax was re-measured at the rate at which timing differences are expected to reverse. Adjustments in respect of prior periods arise from revisions to UK tax returns.

(b) Tax relating to items charged or credited outside of profit or loss

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Current tax		
Current tax recycled to income statement on cash flow hedges	(0.1)	–
Deferred tax		
Actuarial gains and losses on pension schemes	19.4	0.3
Interest rate swaps	0.7	(0.2)
Impact of reduction in rate of UK corporation tax	3.1	–
Tax charge in the statement of comprehensive income	23.1	0.1
Deferred tax		
Share based payment	(0.1)	–
Tax credit in the statement of changes in equity	(0.1)	–

7. Taxation continued

(c) Reconciliation of the total tax charge

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Accounting profit before tax	181.0	170.2
Accounting profit multiplied by standard rate of corporation tax (28%)	50.7	47.7
Effects of		
Expenses not deductible for tax purposes	2.1	1.8
Depreciation in respect of non-qualifying items	1.1	0.9
Non-taxable income and enhanced tax reliefs	–	(0.5)
Non-taxable amortisation of financing items	(1.4)	(1.5)
Adjustment to tax charge in respect of prior periods	(2.7)	(1.0)
Other	(0.2)	(0.1)
	49.6	47.3
Effect of changes in tax rates and laws		
– Impact of rate reduction on opening deferred tax	(46.3)	–
– Impact of rate reduction on movement in deferred tax	(0.7)	–
Total tax expense reported in the income statement	2.6	47.3

The effective tax rate for the year to 31 March 2011 was 1.4% (2010 27.8%). The decrease of 26.4% is mainly due to the impacts of the reduction in the rate of UK corporation tax and prior year items. In the absence of the rate change and prior year items, the effective rate would have been 28.5%.

(d) Deferred tax

The movements in deferred tax liabilities/(assets) are as follows

	Accelerated tax depreciation £m	Deferred income £m	Tax losses £m	Retirement benefit obligations £m	Fair values interest rate swaps £m	Business combinations £m	Other £m	Total £m
At 1 April 2009	671.4	(58.9)	(5.1)	(34.2)	(3.3)	11.3	15.3	596.5
Charge/(credit) in the income statement	15.5	(1.3)	(0.6)	(4.2)	–	(0.4)	0.5	9.5
Charge/(credit) in other comprehensive income	–	–	–	0.3	(0.2)	–	–	0.1
At 1 April 2010	686.9	(60.2)	(5.7)	(38.1)	(3.5)	10.9	15.8	606.1
Charge/(credit) in the income statement	(43.5)	13.8	0.2	(0.4)	–	(1.0)	0.4	(30.5)
Charge in other comprehensive income	–	–	–	22.1	1.0	–	0.1	23.2
Reported in equity on share-based payment	–	–	–	–	–	–	(0.1)	(0.1)
At 31 March 2011	643.4	(46.4)	(5.5)	(16.4)	(2.5)	9.9	16.2	598.7

The Group has tax losses of £7.0 million (2010 £7.1 million) which have arisen in its Gibraltar subsidiary for which a deferred tax asset has not been recognised as they may not be used to offset taxable profits elsewhere in the Group and it is not expected that the subsidiary will utilise significant amounts in the foreseeable future. The losses are, however, available for offset against future taxable profits arising in the subsidiary without time limit.

Notes to the consolidated financial statements

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7. Taxation continued

(e) Factors that may affect future tax charges

The Government has stated its intention to reduce the UK rate of corporation tax to 23% by 1 April 2014. Had that rate applied in 2010/11 the closing deferred tax liability would have been reduced by £69.1 million to £529.6 million and the current year's corporation tax charge would have been reduced by £7.6 million to £34.7 million.

The Group expects to continue to incur high levels of capital expenditure during NWL's 2010-15 regulatory period and be able to claim tax reliefs in excess of depreciation. However, it is expected that capital allowances will be claimed at a slower rate in future because Finance (No 3) Bill 2011 contains clauses to reduce rates from 20% to 18% (general plant pool) and from 10% to 8% (special rate pool) with effect from 1 April 2012.

8 Earnings per share

Basic EPS is calculated by dividing the profit attributable to ordinary equity holders of the parent Company by the weighted average number of ordinary shares in issue during the year. Treasury shares held are excluded from the weighted average number of shares for basic EPS.

The weighted average number of shares for diluted EPS is calculated by adding the weighted average number of ordinary shares in issue during the year and the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

	Profit 31 3 2011 £m	Weighted average number of shares 31 3 2011 million	Earnings per share 31 3 2011 pence	Profit 31 3 2010 £m	Weighted average number of shares 31 3 2010 million	Earnings per share 31 3 2010 pence
Basic EPS	178.3	517.8	34.44	122.5	517.6	23.67
Diluted EPS	178.3	518.6	34.38	122.5	518.6	23.62

The directors consider that EPS adjusted for the volatility inherent in some deferred tax items gives a better indication of the Group's underlying performance. In previous years, an adjustment had been made for total deferred tax. However, the directors have concluded that the ongoing deferred tax charge forms part of underlying performance and it is more appropriate to only adjust for significant non-recurring deferred tax items. For the current period, the deferred tax credit relating to the corporation tax rate reduction has been adjusted and the prior year adjusted EPS has been restated with no element of deferred tax removed. The deferred tax charge now included in adjusted EPS for the current period is £15.8 million (2010: £9.5 million) and has an impact on the adjusted EPS of 2.80 pence (2010: 1.84 pence per share).

	Profit 31 3 2011 £m	Weighted average number of shares 31 3 2011 million	Earnings per share 31 3 2011 pence	Profit 31 3 2010 restated £m	Weighted average number of shares 31 3 2010 million	Earnings per share 31 3 2010 restated pence
Basic EPS	178.3	517.8	34.44	122.5	517.6	23.67
Deferred tax – effect of changes in tax rates	(46.3)		(8.94)	–		–
Adjusted EPS	132.0	517.8	25.50	122.5	517.6	23.67
Diluted adjusted EPS	132.0	518.6	25.45	122.5	518.6	23.62

9. Dividends paid and proposed

	Year to 31 3 2011 £m	Year to 31 3 2010 £m
Declared and paid during the year		
Equity dividends on ordinary shares		
Final dividend for 2009/10 8.85 pence (2008/09 8.50 pence)	45.8	44.0
Interim dividend for 2010/11 4.72 pence (2009/10 4.39 pence)	24.5	22.7
Dividends paid	70.3	66.7
Proposed for approval by shareholders at the AGM		
Final dividend for 2010/11 9.57 pence (2009/10 8.85 pence)	49.6	45.8

10. Intangible assets

	Goodwill £m	Other £m	Total £m
Cost			
At 1 April 2009, 1 April 2010 and 31 March 2011	3.8	64.2	68.0
Impairment			
At 1 April 2009, 1 April 2010 and 31 March 2011	(0.2)	-	(0.2)
Net book value at 31 March 2011	3.6	64.2	67.8
Net book value at 1 April 2009 and 31 March 2010	3.6	64.2	67.8

As from 1 April 2004, the date of transition to IFRS, goodwill is no longer amortised but is now subject to an annual impairment review.

Goodwill has been allocated to the water and waste water cash-generating unit and the other intangible asset has been allocated to the Northumbrian Water Limited cash-generating unit, which are also the operating segments.

The other intangible asset represents the right in perpetuity to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme and, therefore, the directors consider the asset has an indefinite life. Accordingly, future cash flows, which increase in line with inflation, have been discounted at a rate of 6.44% in perpetuity. This represents a long term nominal gilt yield and an assumed credit spread. This calculation satisfied the Group that the carrying value at 31 March 2011 had not been impaired. Furthermore, it is improbable that the discount rate would increase to such a level that the carrying value would be impaired.

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11. Property, plant and equipment

	Freehold land and buildings £m	Infrastructure assets £m	Operational structures plant and machinery £m	Fixtures fittings tools and equipment £m	Assets in the course of construction £m	Total £m
Cost						
At 1 April 2009	95.3	1,702.9	2,125.0	180.9	170.5	4,274.6
Additions (restated)	-	18.7	1.6	0.3	215.7	236.3
Schemes commissioned	6.9	96.7	132.9	38.3	(274.8)	-
Reclassifications	13.4	-	(2.0)	(11.4)	-	-
Disposals	-	(6.6)	(3.2)	-	-	(9.8)
At 1 April 2010 (restated)	115.6	1,811.7	2,254.3	208.1	111.4	4,501.1
Additions	-	14.5	1.2	0.4	203.8	219.9
Schemes commissioned	3.7	76.3	73.7	13.1	(166.8)	-
Reclassifications	2.8	-	(2.5)	(0.3)	-	-
Disposals	(0.5)	(6.8)	(2.4)	-	-	(9.7)
At 31 March 2011	121.6	1,895.7	2,324.3	221.3	148.4	4,711.3
Depreciation						
At 1 April 2009	34.0	83.7	640.7	128.0	-	886.4
Charge for the year	1.9	22.8	71.8	9.0	-	105.5
Reclassifications	0.1	-	-	(0.1)	-	-
Disposals	-	(6.6)	(3.1)	-	-	(9.7)
At 1 April 2010	36.0	99.9	709.4	136.9	-	982.2
Charge for the year	2.2	25.2	72.8	11.4	-	111.6
Reclassifications	-	-	(0.3)	0.3	-	-
Disposals	-	(6.8)	(2.5)	-	-	(9.3)
At 31 March 2011	38.2	118.3	779.4	148.6	-	1,084.5
Net book value at 31 March 2011	83.4	1,777.4	1,544.9	72.7	148.4	3,626.8
Net book value at 31 March 2010 (restated)	79.6	1,711.8	1,544.9	71.2	111.4	3,518.9
Net book value at 1 April 2009	61.3	1,619.2	1,484.3	52.9	170.5	3,388.2

Operational structures, plant and machinery include an element of land and buildings dedicated to those assets. The Group has applied IAS 23 Borrowing Costs (Revised) in the year and has capitalised £1.9 million for the year to 31 March 2011 (2010: £1.2 million). The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation was 5.96% (2010: 5.96%). IFRIC 18 Transfers of Assets from Customers was adopted in the period. This has required prior year additions to be restated by £14.0 million for transactions effected on or after 1 July 2009.

The net book value of property, plant and equipment held under hire purchase contracts and finance leases was as follows:

	31.3.2011 £m	31.3.2010 £m
Infrastructure assets	47.3	47.8
Operational structures, plant and machinery	22.0	23.6
	69.3	71.4

12. Investments

	31 3 2011 £m	31 3 2010 £m
Investments in jointly controlled entities	4.0	4.1

(a) Investments in jointly controlled entities

The Group, through Northumbrian Services Limited, holds 50% of the nominal value of issued ordinary £1 shares in Vehicle Lease and Service Limited (VLS), the Group's principal jointly controlled entity. VLS was incorporated in England and Wales and undertakes the business of hiring, leasing and servicing of vehicles and plant.

The Group, through Agrer, also holds a 50% interest in Agreco, a jointly controlled entity incorporated in Belgium.

	VLS 31 3 2011 £m	Agreco 31 3 2011 £m	VLS 31 3 2010 £m	Agreco 31 3 2010 £m
Revenue	6.7	3.2	6.9	3.1
Operating costs	(5.7)	(2.9)	(5.9)	(2.5)
Profit on ordinary activities before interest	1.0	0.3	1.0	0.6
Finance costs payable	(0.5)	-	(0.6)	-
Profit on ordinary activities before taxation	0.5	0.3	0.4	0.6
Current taxation	(0.1)	-	(0.1)	-
Profit for the year	0.4	0.3	0.3	0.6
Non-current assets	8.4	-	7.9	-
Current assets	7.7	1.4	7.9	3.6
Share of gross assets	16.1	1.4	15.8	3.6
Current liabilities	(4.9)	(0.8)	(4.6)	(2.8)
Non-current liabilities	(7.8)	-	(7.9)	-
Share of gross liabilities	(12.7)	(0.8)	(12.5)	(2.8)
Share of net assets	3.4	0.6	3.3	0.8

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12. Investments continued

(b) The Group's interests in principal subsidiaries at 31 March 2011 were as follows:

Name of undertaking	Country of incorporation or registration and operation	Description of shares held	Proportion of nominal value of issued shares held by Group (%)	Business activity
Northumbrian Services Limited	England and Wales	Ordinary shares of £1	100	Holding of investments and loans
Northumbrian Water Limited	England and Wales	Ordinary shares of £1	100	Water and sewerage services
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Caledonian Environmental Services plc	Scotland	Ordinary shares of £1	100	Waste water services
Caledonian Environmental Levenmouth Treatment Services Limited	Scotland	Ordinary shares of £1	100	Waste water services
Ayr Environmental Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Operations Limited	Scotland	Ordinary shares of £1	100	Waste water services
AquaGib Limited	Gibraltar	Ordinary shares of £1	67	Water and sewerage services
Northumbrian Water Projects Limited	England and Wales	Ordinary shares of £1	100	Waste water services
SA Agrer NV	Belgium	Ordinary shares of £1	100	Aid funded project work

In 2010/11 the Group increased its shareholding in both Caledonian Environmental Services plc and Caledonian Environmental Levenmouth Treatment Services Limited from 75% to 100%

All subsidiaries listed above are indirectly held. The directors consider that to give full particulars of all subsidiary and associated undertakings would lead to a statement of excessive length. The above information relates to those subsidiary and associated undertakings or groups of undertakings whose results or financial position, in the opinion of the directors, principally affect the figures of the Group. A full list of the Company's subsidiaries is attached to the Company's latest annual return filed at Companies House.

13. Inventories

	31 3 2011 £m	31 3 2010 £m
Stores	33	33

14 Trade and other receivables

	31 3 2011 £m	31 3 2010 £m
Trade receivables	78.2	72.2
Amounts owed by jointly controlled entities	0.6	0.5
Prepayments and accrued income	60.3	53.4
Financial assets	3.8	1.1
Other receivables	11.0	9.2
	153.9	136.4

As at 31 March 2011, trade receivables at nominal value of £44.5 million (2010: £37.1 million) were impaired. Movements in the provision for impairment of trade receivables were as follows:

	£m
At 1 April 2009	31.7
Charge for the year	19.6
Utilised	(14.2)
At 1 April 2010	37.1
Charge for the year	17.8
Utilised	(10.4)
At 31 March 2011	44.5

At 31 March, the analysis of trade receivables overdue but not impaired is as follows:

	0-3 months £m	3-12 months £m	12-24 months £m	24-36 months £m	36-48 months £m	>48 months £m	Total £m
2011	0.6	26.8	12.4	6.4	2.5	-	48.7
2010	0.5	24.9	11.8	5.8	2.7	0.6	46.3

15. Cash and cash equivalents and short term deposits

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise the following at 31 March:

	31 3 2011 £m	31 3 2010 £m
Cash at bank and in hand	76.7	66.1
Cash equivalent deposits	65.0	108.7
	141.7	174.8
Bank overdrafts	(1.4)	(1.5)
Cash and cash equivalents	140.3	173.3
	31 3 2011 £m	31 3 2010 £m
Short term cash deposits >3 months	1.4	1.1
Short term cash deposits <3 months	-	14.7
Short term cash deposits	1.4	15.8

Short term cash deposits of £nil (2010: £14.7 million), with a maturity of less than three months, represent amounts on deposit at fixed rates with the Northumbrian Water Pension Scheme.

Notes to the consolidated financial statements

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16. Trade and other payables

	31 3 2011 £m	31 3 2010 £m
Trade payables	16.5	11.0
Other payables	17.8	19.4
Interest payable	39.1	39.7
Accruals and deferred income	82.2	81.1
	155.6	151.2

17. Interest bearing loans and borrowings

	31 3 2011 £m	31 3 2010 £m
Current		
Bank overdrafts	1.4	1.5
Current instalments due on borrowings (principal £150.4 million, 2010 £19.7 million)	155.1	24.6
Current obligations under finance leases and hire purchase contracts (see note 18)	7.2	7.0
	163.7	33.1
Non-current		
Non-current obligations under finance leases and hire purchase contracts (principal £103.5 million, 2010 £104.1 million) (see note 18)	103.5	104.1
Non-current instalments on borrowings (principal £2,166.9 million, 2010 £2,300.2 million)	2,192.3	2,329.8
	2,295.8	2,433.9
Borrowings comprise the following		
Loans (principal £527.1 million, 2010 £546.6 million)	530.0	550.5
Subordinated loan stock (principal £1.9 million, 2010 £6.8 million)	1.9	6.8
Eurobonds – due 11 October 2017 bearing interest rate of 6.0% (principal £300.0 million, 2010 £300.0 million)	307.5	308.6
Eurobonds – due 6 February 2023 bearing interest rate of 6.875% (principal £350.0 million, 2010 £350.0 million)	384.0	386.8
Eurobonds – due 29 April 2033 bearing interest rate of 5.625% (principal £350.0 million, 2010 £350.0 million)	346.4	346.3
Eurobonds – due 23 January 2034 bearing interest rate of 5.87526% (principal £248.0 million, 2010 £248.0 million)	241.4	241.1
Eurobonds – due 31 March 2037 bearing interest rate of 6.627% (principal £61.5 million, 2010 £61.6 million)	58.9	58.9
Index linked Eurobonds – due 15 July 2036 bearing interest rate of 2.033% (principal £177.6 million, 2010 £169.5 million)	176.6	168.5
Index linked Eurobonds – due 30 January 2041 bearing interest rate of 1.6274% (principal £69.8 million, 2010 £66.6 million)	69.7	66.5
Index linked Eurobonds – due 16 July 2049 bearing interest rate of 1.7118% (principal £115.7 million, 2010 £110.4 million)	115.5	110.2
Index linked Eurobonds – due 16 July 2053 bearing interest rate of 1.7484% (principal £115.7 million, 2010 £110.4 million)	115.5	110.2
	2,347.4	2,354.4
Less current instalments due on bank loans (principal £150.4 million, 2010 £19.7 million)	(155.1)	(24.6)
	2,192.3	2,329.8

17. Interest bearing loans and borrowings continued

The difference between the principal value of £2,166.9 million (2010 £2,300.2 million) and the carrying value of £2,192.3 million (2010 £2,329.8 million) are unamortised issue costs of £14.1 million (2010 £14.7 million) and a credit of £39.5 million (2010 £44.3 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003

The Eurobonds – due 23 January 2034 are secured on the income receivable under the Kielder Water transfer scheme for the period to 23 January 2034

The value of the capital and interest elements of the index linked Eurobonds are linked to movements in the UK RPI (see note 1(q))

18. Obligations under hire purchase contracts and finance leases

	31 3 2011 £m	31 3 2010 £m
Amounts due		
Not later than one year	7.2	7.0
After one year but not more than five years	23.5	23.5
Later than five years	151.6	154.6
	182.3	185.1
Less finance charges allocated to future periods	(71.6)	(74.0)
Present value of minimum lease payments	110.7	111.1
Disclosed as due		
Not later than one year	7.2	7.0
After more than one year	103.5	104.1
	110.7	111.1

Lease commitments

The Group has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The future minimum rentals payable under non-cancellable operating leases are as follows

	31 3 2011 £m	31 3 2010 £m
Not later than one year	0.7	0.8
After one year but not more than five years	2.4	2.6
After five years	26.6	26.7
	29.7	30.1

Notes to the consolidated financial statements

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19. Provisions

	£m
At 1 April 2010	
Current	0.2
Non-current	2.2
At 1 April 2010	2.4
Arising during the year	0.4
Utilised	(0.2)
At 31 March 2011	2.6
Analysed as	
Current	0.2
Non-current	2.4
	2.6

The provision represents outstanding discretionary pension liabilities. The discretionary pension liabilities have been calculated by an independent actuary, using the same actuarial assumptions as applied to the defined benefit pension scheme (see note 24), and are expected to be paid over the remaining lives, which is approximately 11 years.

20 Financial instruments

(a) Group strategy

The level of capital expenditure which the Group is obliged to incur is such that it cannot be wholly financed by internally generated sources. As a result, the Group must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required in its regulated business. The Group's strategy is to finance such investment by raising medium to long term debt, to provide a balance sheet match with long term assets and to fix a major proportion of interest rates.

(b) Treasury operations

The main purpose of the Group's treasury function is to assess the Group's ongoing capital requirement and to raise funding on a timely basis, taking advantage of any favourable market opportunities. It also invests any surplus funds the Group may have, based upon its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process but the Group's policies prohibit their use for speculation.

(c) Risks arising from the Group's financial instruments

The main risks arising from the Group's financial instruments are liquidity risk, interest rate risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. All treasury activities are conducted in accordance with these policies.

(d) Liquidity risk

As regards day to day liquidity, the Group's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0 million and with a bank agreement availability period of no less than three months. At 31 March 2011, the Group had £35.0 million of undrawn committed bank facilities (2010: £75.0 million). A further £70.0 million of committed bank facilities were entered into on 7 April 2011.

20. Financial instruments continued**(e) Interest rate risk**

The Group finances its operations through a mixture of retained profits and bank borrowings. It borrows at both fixed and floating rates of interest and, accordingly, uses interest rate swaps to generate the desired interest profile and to manage the Group's exposure to interest rate fluctuations. The Group's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2011, 74% (2010: 75%) of the Group's borrowings were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

(f) Foreign currency risk

The Group's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3.0 million sterling equivalent of a translation nature, should be covered immediately on identification. Any exposures are covered through the use of forward foreign exchange contracts.

(g) Market price risk

The Group's exposure to market price risk principally comprises interest rate exposures. The Group's policy is to accept a degree of interest rate risk. The following table shows the impact on profit and equity of an increase in the variable cost of borrowing. The range is considered reasonable based on the forecast variable rates of borrowing and all other elements being consistent for the next 12 months and highlights this is not material to the Group.

Increase in basis points	Effect on profit/equity £m
2011	
+50	1.3
+100	2.5
+150	3.8
2010	
+50	0.9
+100	1.9
+150	2.8

(h) Credit risk

There are no significant concentrations of credit risk within the Group. Management's assessment of the maximum credit risk exposure relating to financial assets is represented by their carrying value as at the balance sheet date (see (o)). A significant proportion of the trade debtor balances are with domestic customers who are unlikely to have a published credit rating.

(i) Counterparty risk

The treasury strategy, which is approved by the Board, requires that investments are limited to certain money market and treasury instruments, and that the Group's exposure to any single bank, building society or market is controlled, with maximum deposits allowed with any single counterparty. The investment criteria cover credit rating and asset size, including sovereign and political risk. Current market conditions have resulted in closer monitoring of counterparties and cancellation or suspension of deposits.

(j) Capital risk

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value.

The Group monitors capital using gearing ratios for the Group and NWL. For NWL, this is net debt divided by the RCV as determined and published by Ofwat, and for the Group, RCV plus a pro forma RCV for the Kielder securitisation and the PFI contracts (at the level of associated debt included in the Group's net debt relating to those assets). The Group's policy is to keep the gearing ratio less than 75% and 70% for the Group and NWL, respectively.

Notes to the consolidated financial statements

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20. Financial instruments continued

For the Group, the pro forma RCV at 31 March 2011 was £3,643.1 million. For NWL, the RCV at 31 March 2011 was £3,318.4 million. On this basis, the gearing ratios were 63% for the Group and 56% for NWL.

(k) Contractual maturity of financial liabilities (principal and future interest payments)

The table below summarises the maturity profile of the Group's financial liabilities at 31 March based on contractual undiscounted payments.

Year ended 31 March 2011

	On demand £m	Less than 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Interest bearing loans and borrowings	1.4	162.4	124.6	704.5	4,381.8	5,374.7
Trade and other payables	-	82.3	48.7	-	-	131.0
	1.4	244.7	173.3	704.5	4,381.8	5,505.7

Year ended 31 March 2010

	On demand £m	Less than 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Interest bearing loans and borrowings	1.5	40.3	118.0	824.4	4,381.8	5,366.0
Trade and other payables	0.1	31.3	20.0	-	-	51.4
	1.6	71.6	138.0	824.4	4,381.8	5,417.4

(l) Maturity profile of financial assets and liabilities (carrying value)

Year ended 31 March 2011

	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	Total £m
Fixed rate							
Eurobonds	(4.2)	(4.1)	(4.2)	(4.2)	(4.3)	(1,317.2)	(1,338.2)
Subordinated loan stock	-	-	-	-	-	(1.9)	(1.9)
Bank loans	(24.3)	(21.2)	(21.1)	(21.3)	(22.1)	(145.9)	(255.9)
Obligations under finance leases and hire purchase contracts	(2.8)	(2.0)	(1.5)	(1.0)	(0.5)	(0.4)	(8.2)
Other loans	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(0.9)	(2.4)
Fixed rate at 31 March 2011	(31.6)	(27.6)	(27.1)	(26.8)	(27.2)	(1,466.3)	(1,606.6)
Variable rate							
Cash and cash equivalents	143.1	-	-	-	-	-	143.1
Financial investments	0.9	0.5	0.2	-	-	11.3	12.9
Eurobonds	-	-	-	-	-	(477.3)	(477.3)
Bank loans	(126.3)	(55.4)	(10.0)	(10.0)	(10.0)	(60.0)	(271.7)
Overdrafts	(1.4)	-	-	-	-	-	(1.4)
Obligations under finance leases and hire purchase contracts	(4.4)	(4.4)	(4.5)	(4.5)	(4.5)	(80.2)	(102.5)
Variable rate at 31 March 2011	11.9	(59.3)	(14.3)	(14.5)	(14.5)	(606.2)	(696.9)
Net borrowings at 31 March 2011							(2,303.5)

20 Financial instruments continued

Year ended 31 March 2010

	Within 1 year £m	1 2 years £m	2 3 years £m	3 4 years £m	4 5 years £m	More than 5 years £m	Total £m
Fixed rate							
Eurobonds	(4 0)	(4 1)	(4 2)	(4 1)	(4 3)	(1,321 0)	(1,341 7)
Subordinated loan stock	–	–	–	–	–	(6 8)	(6 8)
Bank loans	(17 7)	(24 5)	(21 1)	(21 2)	(21 2)	(168 0)	(273 7)
Obligations under finance leases and hire purchase contracts	(2 7)	(2 3)	(1 7)	(1 1)	(0 5)	(0 4)	(8 7)
Other loans	(0 4)	(0 3)	(0 3)	(0 3)	(0 3)	(1 0)	(2 6)
Fixed rate at 31 March 2010	(24 8)	(31 2)	(27 3)	(26 7)	(26 3)	(1,497 2)	(1,633 5)
Variable rate							
Cash and cash equivalents	174 8	–	–	–	–	–	174 8
Short term cash deposits	15 8	–	–	–	–	–	15 8
Financial investments	1 1	0 9	0 5	0 2	–	11 3	14 0
Eurobonds	–	–	–	–	–	(455 4)	(455 4)
Bank loans	(2 5)	(171 7)	(10 0)	(10 0)	(10 0)	(70 0)	(274 2)
Overdrafts	(1 5)	–	–	–	–	–	(1 5)
Obligations under finance leases and hire purchase contracts	(4 3)	(4 4)	(4 5)	(4 5)	(4 5)	(80 2)	(102 4)
Variable rate at 31 March 2010	183 4	(175 2)	(14 0)	(14 3)	(14 5)	(594 3)	(628 9)
Net borrowings at 31 March 2010							(2,262 4)

The variable rate net borrowings comprise sterling denominated bank borrowings and deposits that bear interest at rates based upon up to 12 months LIBOR

(m) Currency exposures

At 31 March 2011, after taking into account the effects of forward foreign exchange contracts, the Group had no currency exposures (2010 £nil)

(n) Borrowing facilities

The Group has various undrawn committed borrowing facilities. The facilities available at 31 March, in respect of which all conditions precedent have been met, are as follows

	31 3 2011 £m	31 3 2010 £m
Expiring in less than one year	35.0	75 0

Notes to the consolidated financial statements

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20. Financial instruments continued

(o) Fair values of financial assets and financial liabilities

A comparison by category of book values, which are all recognised at amortised cost, and fair values of the Group's financial assets and liabilities as at 31 March is set out below

	Book value		Fair value	
	31 3 2011 £m	31 3 2010 £m	31 3 2011 £m	31 3 2010 £m
Financial assets				
Cash and cash equivalents	143.1	174.8	143.1	174.8
Short term cash deposits	–	15.8	–	15.8
Financial investments	12.9	14.0	12.9	14.0
Trade and other receivables	153.9	136.4	153.9	136.4
Financial liabilities				
Overdraft	(1.4)	(1.5)	(1.4)	(1.5)
Bank loans (principal of £527.1 million, 2010 £546.6 million)	(530.0)	(550.5)	(541.3)	(559.5)
Subordinated loan stock (principal of £1.9 million, 2010 £6.8 million)	(1.9)	(6.8)	(1.9)	(6.8)
Eurobonds (principal of £1,788.3 million, 2010 £1,766.4 million)	(1,815.5)	(1,797.1)	(1,899.2)	(1,804.0)
Obligations under finance leases and hire purchase contracts (principal of £110.7 million, 2010 £111.1 million)	(110.7)	(111.1)	(110.7)	(111.1)
Interest rate swaps	(9.8)	(12.5)	(9.8)	(12.5)
Trade and other payables	(155.5)	(151.2)	(155.5)	(151.2)
	(2,314.9)	(2,289.7)	(2,409.9)	(2,305.6)

The fair values of the interest rate swaps and sterling denominated long term fixed rate and index linked debt with a book value of £1,815.5 million (2010 £1,797.1 million), have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

In the absence of an openly traded market value for the index linked bonds with a book value of £477.3 million (2010 £455.4 million), the fair value at the balance sheet date has been calculated by considering the remaining debt maturity, the relevant UK index linked gilt rate and an appropriate credit spread by reference to market evidence for conventional bonds.

The difference between the principal value of £2,428.0 million (2010 £2,430.9 million) and the carrying value of £2,458.1 million (2010 £2,465.5 million) are unamortised issue costs of £14.3 million (2010 £14.7 million) and a credit of £44.4 million (2010 £49.3 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

(p) Hedges

Cash flow hedges – currency forward contracts

At 31 March 2011, the Group held no forward exchange contracts (2010 nil)

20. Financial instruments continued

Cash flow hedges – interest rate swap

At 31 March 2011, the Group held three interest rate swaps, designated as a hedge of future interest cash flows, for which the Group has firm commitments. The swaps were used to convert variable rate interest payments to a fixed rate basis. The terms of these swaps were as follows:

Notional amount	Start date	Termination date	Fixed rate %
GBP 100.0 million	15.9.2008	15.3.2022	4.79
GBP 62.5 million	29.1.2009	31.5.2011	2.345
GBP 62.5 million	29.1.2009	31.5.2011	2.435

The £100.0 million swap was designated as highly effective. The two £62.5 million swaps were not effective.

At 31 March 2010, the Group held three interest rate swaps, designated as a hedge of future interest cash flows, for which the Group had firm commitments. The swaps were used to convert variable rate interest payments to a fixed rate basis. The terms of these swaps were as follows:

Notional amount	Start date	Termination date	Fixed rate %
GBP 100.0 million	15.9.2008	15.3.2022	4.79
GBP 62.5 million	29.1.2009	31.5.2011	2.345
GBP 62.5 million	29.1.2009	31.5.2011	2.435

These hedges were designated as highly effective.

(q) Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities,
- level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly, and
- level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

All other financial assets and liabilities are carried at amortised cost.

Liabilities measured at fair value

Year ended 31 March 2011

	31.3.2011 £m	Level 1 £m	Level 2 £m	Level 3 £m
Interest rate swap	(9.8)	–	(9.8)	–

Year ended 31 March 2010

	31.3.2010 £m	Level 1 £m	Level 2 £m	Level 3 £m
Interest rate swap	(12.5)	–	(12.5)	–

During the year to 31 March 2011, there were no transfers between level 1 and level 2 fair value measurements, and no transfers into and out of level 3 fair value measurements.

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21. Authorised and issued share capital

	31 3 2011 £m	31 3 2010 £m
Authorised 700 million ordinary shares of 10 pence each	70 0	70 0
Allotted, called up and fully paid 518.6 million ordinary shares of 10 pence each	51 9	51 9

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, currently holds 765,962 (2010 914,518) ordinary 10 pence shares in the Company for use under the Company's LTIP. All of these shares have been conditionally awarded under the LTIP. Details of the main features of the LTIP and the conditions for vesting can be found in the directors' remuneration report on pages 71 to 84. As at 31 March 2011, the share price of the ordinary 10 pence shares in the Company was 332.2 pence (2010 283.1 pence).

22. Additional cash flow information

Analysis of net debt as at 31 March 2011

	As at 14 2010 £m	Cash flow £m	Other non-cash movements £m	As at 31 3 2011 £m
Cash and cash equivalents	173.3	(33.0)	–	140.3
Short term cash deposits	15.8	(14.4)	–	1.4
Financial investments	14.0	(1.1)	–	12.9
Loans (principal of £2,317.3 million, 2010 £2,319.8 million)	(2,354.4)	19.9	(12.9)	(2,347.4)
Finance leases (principal of £110.7 million, 2010 £111.1 million)	(111.1)	7.3	(6.9)	(110.7)
	(2,262.4)	(21.3)	(19.8)	(2,303.5)

The difference between the principal value of £2,428.0 million (2010 £2,430.9 million) and the carrying value of £2,458.1 million (2010 £2,465.5 million) are unamortised issue costs of £14.3 million (2010 £14.7 million) and a credit of £44.4 million (2010 £49.3 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

Non-cash movements on loans relate to the principal uplift on index linked borrowings and amortisation of loan issue costs offset by the amortisation of debt fair value for the year. Non-cash movements on finance leases relate to the inception of new finance leases on the acquisition of plant and machinery during the year.

Analysis of net debt as at 31 March 2010

	As at 14 2009 £m	Cash flow £m	Other non-cash movements £m	As at 31 3 2010 £m
Cash and cash equivalents	92.3	81.0	–	173.3
Short term cash deposits	160.6	(144.8)	–	15.8
Financial investments	15.4	(1.4)	–	14.0
Loans (principal of £2,319.8 million, 2009 £2,347.2 million)	(2,386.3)	20.9	11.0	(2,354.4)
Finance leases (principal of £111.1 million, 2009 £111.6 million)	(111.7)	7.2	(6.6)	(111.1)
	(2,229.7)	(37.1)	4.4	(2,262.4)

22. Additional cash flow information continued

The difference between the principal value of £2,430.9 million (2009 £2,458.8 million) and the carrying value of £2,465.5 million (2009 £2,498.0 million) are unamortised issue costs of £14.7 million (2009 £15.4 million) and a credit of £49.3 million (2009 £54.6 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

Non-cash movements on loans relate to the principal uplift on index linked borrowings and amortisation of loan issue costs offset by the amortisation of debt fair value for the year. Non-cash movements on finance leases relate to the inception of new finance leases on the acquisition of plant and machinery during the year.

23 Financial commitments

	31.3.2011 £m	31.3.2010 £m
Expenditure contracted for	222.3	85.3

In addition to these commitments, the Group has longer term expenditure plans, which include investment to meet shortfalls in performance and condition, and to provide for new demand and growth within the water and sewerage business.

24. Pensions and other post-retirement benefits

The Group operates a defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 1,908 active members at 31 March 2011 (2010 2,033).

The assets of the NWPS are held separately from those of the Group in independently administered funds.

The most recent actuarial valuation of the scheme was at 31 December 2007. At that date the value of assets amounted to £732.3 million and the funding level was 106.1%.

The future service contribution rate jointly payable by members and the employers from 31 December 2007 was 22.6% of pensionable salaries. Members' contributions are 7.3% on average with the employers paying 15.3%.

The employer contribution rate was assessed using the projected unit method and the following actuarial assumptions:

	%
Pre-retirement	6.1
Post-retirement	5.2
Pay increases	3.7
Pension increases	3.4
Price inflation	3.4

Following the 2004 actuarial valuation the employers had prepaid contributions to the scheme up to 31 December 2010. The scheme actuary recommended that regular contributions should recommence from 1 January 2011. However, the Group made an alternative proposal, which was accepted by the NWPS Trustees, to make new capital injections of £70.0 million to cover the period 1 January 2011 to 31 March 2015. These payments comprise employers' contributions and the deficit recovery funding assumed in the final determination. Amounts totalling £22.9 million have been paid in the period, of which £0.5 million was paid by a jointly controlled entity. The remaining £47.1 million was paid in April 2011 which, along with other payments of an estimated £1.9 million relating to early retirements, will bring total contributions to the scheme next year to £49.0 million. A full actuarial valuation of the scheme as at 31 December 2010 has commenced.

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24. Pensions and other post-retirement benefits continued

The scheme also has a defined contribution section which had 460 active members at 31 March 2011 (2010 389). Members can choose to contribute either 3%, 4% or 5% of salary, with employers contributing at either 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Group in the year totalled £0.8 million (2010 £0.6 million).

The additional disclosures regarding the Group's defined benefit scheme as required under IAS 19 Employee Benefits, and the relevant impact on the Group's financial statements are set out below.

A qualified actuary, using revised assumptions that are consistent with the requirements of IAS 19, has updated the actuarial valuation described above as at 31 March 2011. Investments have been valued, for this purpose, at fair value.

	31 3 2011	31 3 2010
Pay increases ¹	4.5%	4.7%
RPI inflation	3.5%	3.7%
CPI inflation	2.8%	n/a
Pension increases linked to RPI	3.5%	3.7%
Pension increases linked to CPI	2.8%	n/a
Discount rate	5.5%	5.5%
Mortality assumptions ²	PCMA/PCFA00	PCMA/PCFA00
– Life expectancy for a member aged 65 – female (years)	23.0	23.0
– Life expectancy for a member aged 65 – male (years)	20.7	20.7

Notes

1 Including promotional salary scale

2 115% of PCMA00/PCFA00 (year of birth with medium cohort improvements)

The fair value of the assets in the NWPS, the present value of the liabilities in the scheme and the long term expected rate of return at 31 March were:

	Long term expected rate of return 31 3 2011 %	31 3 2011 £m	Long term expected rate of return 31 3 2010 %	31 3 2010 £m
Equities	7.3	511.8	7.5	499.3
Corporate bonds	5.5	62.1	5.5	70.7
Government bonds	4.3	63.9	4.5	27.2
Property	5.8	71.6	6.0	66.6
Cash	3.8	3.9	3.9	14.3
Loan to scheme from Company	–	–	0.5	(14.7)
Total fair value of assets		713.3		663.4
Present value of liabilities		(759.3)		(796.5)
Deficit		(46.0)		(133.1)

The discount rate at 31 March 2011 has been set by reference to the yield on AA corporate bonds (AA over 15 years) at that date, extrapolated forward to a duration of 18 years which reflect the duration of the expected benefit payments. The expected rate of return on equities represents a 3% premium of the yield on long term Government bonds at 31 March 2011. The gross redemption yield on index linked UK Government stocks was 0.7%. The long term inflation rate implied by these yields is 3.6% which has been reduced by 0.1% to allow for an inflation risk premium. Mortality rates have been based on the PA00 tables, applying medium cohort adjustment of 115% loading to mortality rates based on the year of birth of the membership.

24. Pensions and other post-retirement benefits continued

The valuation of the scheme liabilities has taken account of legislative changes which mean that future statutory deferred revaluations and pension increases will be linked to CPI. As a consequence, CPI increases have been applied for deferred pensions in all sections of the scheme and to those sections where the scheme rules link increases to the Government's pension increase orders. This has given rise to a reduction in the actuarial valuation of the liabilities of around £36.0 million.

The amounts recognised in the income statement and in the statement of comprehensive income for the year are analysed as follows:

	31 3 2011 £m	31 3 2010 £m
Recognised in the income statement		
Current service cost	13.5	9.9
Past service cost	0.4	4.6
Recognised in operating costs in arriving at profit on ordinary activities before interest	13.9	14.5
Interest cost on plan obligations	43.3	36.1
Expected return on plan assets	(45.5)	(31.6)
Recognised in (income receivable)/finance costs payable	(2.2)	4.5
Recognised in the statement of comprehensive income		
Actual return on scheme assets	56.2	209.0
Less expected return on scheme assets	(45.5)	(31.6)
	10.7	177.4
Other actuarial gains and losses	63.3	(176.3)
Net actuarial gains	74.0	1.1
Cumulative amounts recognised since adopting the standard	(6.5)	(80.5)

History of experience gains and losses

	31 3 2011 £m	31 3 2010 £m	31 3 2009 £m	31 3 2008 £m	31 3 2007 £m
Fair value of assets	713.3	663.4	478.6	666.7	710.8
Present value of defined benefit obligation	(759.3)	(796.5)	(598.0)	(576.2)	(668.1)
(Deficit)/surplus	(46.0)	(133.1)	(119.4)	90.5	42.7
Experience adjustments arising on plan assets	10.7	177.4	(205.3)	(93.4)	0.6
Experience adjustments arising on plan liabilities	-	-	18.7	0.6	1.7

Changes in the present value of the defined benefit pension obligations are analysed as follows:

	31 3 2011 £m	31 3 2010 £m
At 1 April	796.5	598.0
Current service cost	13.5	9.9
Past service cost	0.4	4.6
Interest cost on plan obligations	43.3	36.1
Contributions by plan participants	0.1	0.1
Actuarial (gain)/loss on obligations	(63.3)	176.3
Benefits paid	(31.2)	(28.5)
At 31 March	759.3	796.5
Present value of funded defined benefit obligations	759.3	796.5

Notes to the consolidated financial statements

continued

24. Pensions and other post-retirement benefits continued

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

	31 3 2011 £m	31 3 2010 £m
At 1 April	663.4	478.6
Expected return on plan assets	45.5	31.6
Actuarial gain on plan assets	10.7	177.4
Contributions by employer	24.8	4.2
Contributions by plan participants	0.1	0.1
Benefits paid	(31.2)	(28.5)
At 31 March	713.3	663.4

The Group through its subsidiary, AquaGib, also operates a non-contributory defined benefit scheme. The deficit at 31 March 2011, under local GAAP, was £2.1 million (2010: £2.8 million). The Group made contributions amounting to £1.0 million (2010: £0.8 million) to the defined benefit pension scheme.

Sensitivity to key assumptions

IAS 19 requires disclosure of the sensitivity of the results to the methods and assumptions used.

The costs of a pension arrangement require estimates regarding future experience. The financial assumptions used for IAS 19 reporting are the responsibility of the directors of the Company. These assumptions reflect market conditions at the balance sheet date. Changes in market conditions which result in changes in the net discount rate (essentially the difference between the discount rate and the assumed rates of increases of salaries, deferred pension revaluation or pensions in payment), can have a significant effect on the value of the liabilities reported.

A reduction in the net discount rate will increase the assessed value of liabilities, as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have an opposite effect of similar magnitude. The overall effect of a change in the net discount rate of 0.1% would change the liabilities by around £14.8 million.

There is also uncertainty around life expectancy for the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

The disclosures have been prepared using the mortality assumptions adopted for the 2007 formal valuation – namely the PCMA/PCFA00 tables, applying a medium cohort adjustment with a 115% loading to mortality rates based on the year of birth of the membership. These assumptions imply an assumed life expectancy for a member aged 65 at 31 March 2011 of 20.7 years (2010: 20.7 years) for males and 23.0 years (2010: 23.0 years) for females.

The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around 2.8%.

25. Long Term Incentive Plan

Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Company. Further details of the LTIP can be found in the directors' remuneration report.

The following table illustrates the movements in conditional share awards during the year.

	31 3 2011 Number	31 3 2010 Number
Outstanding at 1 April	1,242,293	1,190,034
Granted during the year	378,503	414,679
Forfeited/lapsed during the year	(351,299)	(238,686)
Exercised	(148,556)	(123,734)
Outstanding at 31 March	1,120,941	1,242,293
Exercisable at 31 March	4,649	4,724

The weighted average exercise price throughout the year was £nil (2010: £nil). The fair value of conditional share awards granted during the year was £nil (2010: £0.1 million).

The weighted average share price at the date of exercise for the conditional share awards is 324.79 pence (2010: 268.71 pence).

For the conditional awards outstanding as at 31 March 2011, the weighted average remaining contractual life is 1.7 years (2010: 1.8 years).

The fair value of conditional share awards granted was estimated using the Monte-Carlo model. The significant inputs to the model were as follows:

	31 3 2011	31 3 2010
Dividend yield	4.0%	4.7%
Expected share price volatility	28%	29%
Share price at award	328.70p	272.50p
Expected FTSE 250 Index volatility	21%	24%
Risk free interest rate	1.5%	2.1%
Expected life of option (years)	3	3

The expected life of these options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

Notes to the consolidated financial statements

continued

25. Long Term Incentive Plan continued

Share Incentive Plan

The SIP scheme provides one free matching share for every three shares purchased by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants.

The following table illustrates the movements in conditional share awards during the year

	31 3 2011 Number	31 3 2010 Number
Outstanding at 1 April	143,201	117,687
Granted during the year	115,519	134,397
Forfeited during the year	(3,383)	(1,805)
Exercised	(95,155)	(107,078)
Outstanding at 31 March	160,182	143,201

26. Special purpose entities

As noted under accounting policy 1(b), under SIC 12, two companies are consolidated as special purpose entities. The principal special purpose entity is Bakethin Holdings Limited, the shares in which are owned by Bakethin Charitable Trust. The other special purpose entity is Bakethin Finance plc, which is a wholly owned subsidiary of Bakethin Holdings Limited.

Bakethin Finance plc was established for the purpose of issuing guaranteed secured Eurobonds. On 12 May 2004, Bakethin Finance plc issued £248.0 million of guaranteed secured bonds maturing January 2034. Bakethin Finance plc used the proceeds of the bond issue to make a loan to Reiver Finance Limited to fund the consideration given by that company to Northumbrian Water Limited for the securitisation of the cash flows receivable from the EA under the Water Resources Operating Agreement relating to Kielder Water transfer scheme. The assignment is for a period of 30 years.

The summarised combined financial statements of the special purpose entities are as follows

	31 3 2011 £m	31 3 2010 £m
Income statement		
Finance costs receivable	14.9	14.9
Finance costs payable	(14.9)	(14.9)
Balance sheet		
Investments	241.4	241.0
Current assets	4.7	4.7
Non-current liabilities	(243.2)	(242.9)
Current liabilities	(2.7)	(2.7)
Net assets	0.2	0.1

27. Related parties

During the year, the Group entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into and trading balances outstanding at 31 March between the Group and its associates and joint ventures, are as follows

Trading transactions

	Sales to related party £m	Purchases from related party £m	Amounts owed by related party £m	Amounts owed to related party £m
Related party				
Jointly controlled entities				
2011	0.1	9.6	0.6	8.2
2010	0.1	10.2	0.5	8.7

Purchases from jointly controlled entities include £2.5 million (2010: £3.3 million) in respect of capital purchases under finance leases, £0.1 million (2010: £0.1 million) in respect of operating leases, £6.3 million (2010: £6.2 million) in respect of costs payable under finance leases and £0.7 million (2010: £0.6 million) in respect of other purchases.

At 31 March 2011, the Group had a short term cash deposit with the Northumbrian Water Pension Scheme of £nil (2010: £14.7 million).

Outstanding balances due from related parties are expected to be settled within 60 days and amounts due to related parties are in respect of leasing arrangements, where the amounts owed will relate specifically to the terms of the lease.

Remuneration of key management personnel

The remuneration of the directors is included within the amounts disclosed below. Further information about the remuneration of individual directors is provided in the audited part of the directors' remuneration report on pages 80 to 84.

	31.3.2011 £m	31.3.2010 £m
Short term employee benefits	1.4	1.2
Post employment benefits	0.2	0.2
Share based payments	0.5	0.2
	2.1	1.6

28. Post balance sheet event

On 14 April 2011, the Group borrowed £100.0 million through a US private placement facility with a 10 year maturity at a coupon of 5.82%. On the same date, two £62.5 million loans to Northumbrian Services Limited, maturing in May 2011, were repaid.

Statement of directors' responsibilities in relation to the parent Company financial statements

The directors are responsible for preparing the annual 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 elected to prepare 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 those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable United Kingdom 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 to 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.

Report of the auditors on the Company financial statements

Independent auditors' report to the members of Northumbrian Water Group plc

We have audited the parent Company financial statements of Northumbrian Water Group plc for the year ended 31 March 2011 which comprise the parent Company balance sheet and the related notes 1 to 10. 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).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report 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 Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of directors' responsibilities set out on page 132, the directors are responsible for the preparation of the parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent Company 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.

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 parent Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the parent Company financial statements

- give a true and fair view of the state of the Company's affairs as at 31 March 2011,
- 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 matters prescribed by the Companies Act 2006

In our opinion

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Directors' report and business review for the financial year for which the financial statements are prepared is consistent with the parent Company financial statements.

Report of the auditors on the Company financial statements continued

Matters on which we are required to report by exception

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

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

Other matters

We have reported separately on the Group financial statements of Northumbrian Water Group plc for the year ended 31 March 2011

Ernst & Young LLP

Debbie O'Hanlon (Senior statutory auditor)

For and on behalf of Ernst & Young LLP

Statutory Auditor

Newcastle upon Tyne

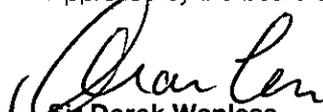
31 May 2011

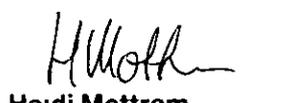
Company balance sheet

As at 31 March 2011

	Notes	31 3 2011 £m	31 3 2010 £m
Fixed assets			
Investments in subsidiary undertakings	4	1,101.4	1,022.6
		1,101.4	1,022.6
Current assets			
Debtors receivable within one year	5	3.5	4.3
Cash at bank		59.1	12.0
		62.6	16.3
Creditors' amounts falling due within one year	6	(93.2)	(2.8)
Net current (liabilities)/assets		(30.6)	13.5
Total assets less current liabilities		1,070.8	1,036.1
Creditors: amounts falling due after more than one year	7	(490.0)	(491.9)
Net assets		580.8	544.2
Capital and reserves			
Called up share capital	8	51.9	51.9
Share premium account	9	446.5	446.5
Treasury shares	9	(1.7)	(2.0)
Profit and loss account	9	84.1	47.8
Equity shareholders' funds		580.8	544.2

Approved by the Board on 31 May 2011 and signed on its behalf by


Sir Derek Wanless
Chairman


Heidi Mottram
Chief Executive Officer

Notes to the Company financial statements

1. Accounting policies

(a) Basis of accounting

The financial statements have been prepared in accordance with applicable United Kingdom law and accounting standards. The accounting policies have been reviewed in accordance with the requirements of FRS 18 Accounting Policies. The directors consider the following accounting policies to be relevant in relation to the Company's financial statements. The Company's financial statements are included in the consolidated financial statements of Northumbrian Water Group plc. Accordingly, the Company has taken advantage of the exemption from publishing a profit and loss account and cash flow statement and from disclosing related party transactions with its wholly-owned subsidiaries. The Company is also exempt from disclosing the information otherwise required by FRS 29 Financial Instruments Disclosures, as the consolidated financial statements, in which the Company is included, provide equivalent disclosures for the Group under IFRS 7 Financial Instruments Disclosures.

The financial statements have been prepared on a going concern basis which assumes that the Company will have adequate funding to meet its liabilities as they fall due in the foreseeable future. As at 31 March 2011 the Company had net current liabilities of £30.6 million (2010 net current assets of £13.5 million). The directors have reviewed cash flow requirements and are confident that they will be able to meet these from funds available. Accordingly, the directors believe it is appropriate to prepare the financial statements on a going concern basis.

(b) Fixed asset investments

Fixed asset investments are stated at their purchase cost, less any provision for impairment.

(c) Taxation

Corporation tax is based on the profit for the year as adjusted for taxation purposes using the rates of tax enacted at the balance sheet date. Provision is made for deferred tax in respect of all timing differences that have originated but not reversed at the balance sheet date that will result in an obligation to pay more, or a right to pay less, tax in future periods. Deferred tax is calculated at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date. 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.

(d) Interest bearing loans and borrowings

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period.

2. Auditors' remuneration

Auditors' remuneration for the year ended 31 March 2011 was £97,000 (2010 £95,000).

Fees paid to Ernst & Young LLP for non-audit services to the Company itself are not disclosed in the individual financial statements of the Company because Group financial statements are prepared which are required to disclose such fees on a consolidated basis.

3. Profit attributable to members of the parent Company

The profit dealt with in the financial statements of the parent Company is £106.9 million (2010 £67.7 million).

4 Investments in subsidiary undertakings

	£m
At 1 April 2010	1,022.6
Additions	78.8
At 31 March 2011	1,101.4

Additions in the year represent the acquisition of shares in a subsidiary company, Atlantic Water Ltd, from a subsidiary company, Three Rivers Finance Ltd

During the year, the Company increased its shareholding in both Caledonian Environmental Services plc and Caledonian Environmental Levenmouth Treatment Services Limited from 75% to 100% at a nominal cost

Name of undertaking	Country of incorporation or registration and operation	Description of shares held	Proportion of nominal value of issued shares held by Group (%)	Business activity
Northumbrian Services Limited	England and Wales	Ordinary shares of £1	100	Holding of investments and loans
Northumbrian Water Limited	England and Wales	Ordinary shares of £1	100	Water and sewerage services
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Caledonian Environmental Services plc	Scotland	Ordinary shares of £1	100	Waste water services
Caledonian Environmental Levenmouth Treatment Services Limited	Scotland	Ordinary shares of £1	100	Waste water services
Ayr Environmental Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Operations Limited	Scotland	Ordinary shares of £1	100	Waste water services
AquaGib Limited	Gibraltar	Ordinary shares of £1	67	Water and sewerage services
Northumbrian Water Projects Limited	England and Wales	Ordinary shares of £1	100	Waste water services
SA Agrer NV	Belgium	Ordinary shares of £1	100	Aid funded project work

All subsidiaries listed above are indirectly held. The directors consider that to give full particulars of all subsidiary and associated undertakings would lead to a statement of excessive length. A full list of the Company's subsidiaries is attached to the Company's latest annual return filed at Companies House.

5. Debtors

	31 3 2011 £m	31 3 2010 £m
Amounts owed by subsidiary undertakings	3.3	4.0
Other	0.2	0.3
	3.5	4.3

Amounts owed by subsidiary undertakings include amounts receivable for the provisional surrender of tax losses amounting to £1.6 million (2010: £2.3 million)

Notes to the Company financial statements

continued

6. Creditors: amounts falling due within one year

	31 3 2011 £m	31 3 2010 £m
Trade creditors	0.1	–
Amounts owed to subsidiary undertakings	93.0	2.6
Accruals and deferred income	0.1	0.2
	93.2	2.8

7. Creditors: amounts falling due after more than one year

	31 3 2011 £m	31 3 2010 £m
Amounts owed to subsidiary undertakings	490.0	491.9
	490.0	491.9

	31 3 2011 £m	31 3 2010 £m
Loans are repayable as follows		
Not wholly repayable within five years	490.0	491.9

The loan bears a rate of interest linked to LIBOR. The loan will continue until such time as terminated by mutual agreement.

8. Authorised and issued share capital

	31 3 2011 £m	31 3 2010 £m
Authorised		
700 million ordinary shares of 10 pence	70.0	70.0
Allotted, called up and fully paid		
518.6 million ordinary shares of 10 pence	51.9	51.9

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, currently holds 765,962 (2010: 914,518) ordinary 10 pence shares in the Company for use under the Company's LTIP. All of these shares have been conditionally awarded under the LTIP. Details of the main features of the LTIP and the conditions for vesting can be found in the directors' remuneration report on pages 71 to 84. As at 31 March 2011, the share price of the ordinary 10 pence shares in the Company was 332.2 pence (2010: 283.1 pence).

9. Reserves

	Treasury shares £m	Share premium account £m	Profit and loss account £m
At 1 April 2009	(2.3)	446.5	47.0
Profit for the year	-	-	67.7
Share-based payment	-	-	0.1
Exercise of LTIP awards	0.3	-	(0.3)
Dividends paid	-	-	(66.7)
At 31 March 2010	(2.0)	446.5	47.8
Profit for the year	-	-	106.9
Exercise of LTIP awards	0.3	-	(0.3)
Dividends paid	-	-	(70.3)
At 31 March 2011	(1.7)	446.5	84.1

10. Commitments

The Company has issued letters of continuing support to subsidiary companies with net liabilities amounting to £11.9 million (2010: £8.3 million) and net current liabilities of £nil (2010: £nil). These subsidiary companies are expected to meet their working capital requirements from operating cash flows.

The Company is guarantor to the EIB in respect of borrowings by Northumbrian Water Limited. The loan principal outstanding at 31 March 2011 amounted to £344.7 million (2010: £362.4 million).

The Company is party to a cross guarantee arrangement with other Group companies in respect of bank facilities. Overdrafts outstanding at 31 March 2011 in respect of the arrangement amounted to £27.2 million (2010: £0.9 million). The directors do not expect any loss to arise as a result of this arrangement.

Shareholder information

Financial calendar

2011

July

28 July	AGM
28 July	Interim Management Statement

August

10 August	Ex-dividend date
12 August	Record date

September

09 September	Final dividend payment
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November

30 November	Half-yearly announcement
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December

14 December	Ex-dividend date
16 December	Record date

2012

January

27 January	Interim dividend payment
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Share portal (www.capitashareportal.com)

You can manage your shareholding online, through the website of our registrar, Capita Registrars, by registering for the share portal. This provides free, secure, online access to your shareholding. Facilities include:

Electronic communications

This allows you to register your email address to enable you to receive shareholder communications such as annual reports via the internet rather than by post

Account enquiry

You can access your personal shareholding, including share transaction history, dividend payment history and to obtain an up-to-date shareholding valuation

Amendment of standing data

This allows you to change your registered postal address and add, change or delete dividend mandate instructions

You can also download from this site forms such as change of address, stock transfer and dividend mandates and buy and sell shares in the Company

To use any of these facilities, please log on to Capita Registrars' website at www.capitashareportal.com

If you have any queries about the above facilities, please contact the Capita share portal helpline on 0871 664 0391 (calls cost 10 pence per minute plus network extras) overseas +44 (0)20 8639 3367, or by email at shareportal@capita.co.uk

Capita share dealing services

Capita Registrars provides a low cost share dealing service. Further information is available at www.capitadeal.com, or by telephoning 0871 664 0445 (calls cost up to 10 pence per minute plus network extras). This enables you to deal in the shares of the Company and other companies for which Capita acts as registrar, provided you are already a shareholder in the relevant company, and it offers the share deal facility to its shareholders.

International payment services

Capita Registrars has partnered with Travelex, the world's largest specialist provider of commercial international payment services, to provide a service that will convert your sterling dividends into your local currency at a competitive rate. They can either arrange for these funds to be sent to you by currency draft or can pay them direct into your bank account. For further information telephone +44 (0)20 8639 3405 (from outside the UK) or 0871 664 0385 (from within the UK) between 9.00am and 5.30pm in the UK. Calls cost 10 pence per minute plus network extras.

ShareGift

You may donate your shares to charity free of charge through ShareGift. Further details are available at www.sharegift.org.uk or by telephoning +44 (0)20 7930 3737.

Dividend re-investment plan

The Company receives occasional requests from shareholders wishing to receive their dividends in the form of shares instead of cash. There are costs involved in providing this service, and at present it would not be cost effective. This issue is kept under regular review.

Beneficial owners of shares with 'information rights'

Please note that beneficial owners of shares who have been nominated by the registered holder of those shares to receive information rights under section 146 of the Companies Act 2006 are required to direct all communications to the registered holder of their shares rather than to the Company's registrar, Capita Registrars, or the Company.

Shareholder analysis

Disability Discrimination Act

If you wish to receive a copy of our report on audio tape, in braille or in a large text version, please telephone us on +44 (0)191 301 6701, or email us at shareholders@nwl.co.uk.

For general queries about your shares, please contact Capita Registrars.

The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU
Tel 0871 664 0300 (calls cost 10 pence per minute plus network extras)
From overseas +44 (0)20 8639 3399
Fax +44 (0)1484 600 911
Email ssd@capitaregistrars.com
Web www.capitaregistrars.com

Shareholder information continued

For general shareholder queries please contact Secretariat:

Tel +44 (0)191 301 6701
Fax +44 (0)191 301 6705
Email shareholders@nwl.co.uk

To request financial statements and other Company literature please contact Communications:

Tel +44 (0)191 301 6734
Email shareholders@nwl.co.uk

Annual General Meeting

The Notice of Meeting, information about the AGM to be held on 28 July 2011 and the proxy voting card are enclosed with these financial statements. Shareholder questions and special needs requests should be addressed to Secretariat at our registered office address, raised by telephone on +44 (0)191 301 6701, or sent by email to shareholders@nwl.co.uk

Warning to shareholders – boiler room scams

In recent years, many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who target UK shareholders, offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. These operations are commonly known as 'boiler rooms'. These 'brokers' can be very persistent and extremely persuasive, and a 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors is around £20,000.

It is not just the novice investor that has been duped in this way, many of the victims had been successfully investing for several years. Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports. If you receive any unsolicited investment advice:

- make sure you get the correct name of the person and organisation,
- check that they are properly authorised by the FSA before getting involved by visiting www.fsa.gov.uk/register/ and contacting the firm using the details on the register,
- report the matter to the FSA either by calling 0845 606 1234 or visiting www.fsa.gov.uk/pages/consumerinformation, and
- if the calls persist, hang up

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at <http://www.fsa.gov.uk/Pages/Doing/Regulated/Law/Alerts/form.sthtml>

Details of any share dealing facilities that the Company endorses will be included in company mailings.

More detailed information on this or similar activity can be found on our Consumer Information section at www.fsa.gov.uk/pages/consumerinformation

General Counsel and Company Secretary Martin Parker

Registered office

Northumbrian Water Group plc
Northumbria House
Abbey Road
Pity Me
Durham, DH1 5FJ
Tel 0845 604 7468

Group websites

www.nwg.co.uk
www.nwl.co.uk
www.eswater.co.uk
www.nw-ss.co.uk
www.nwpropertyolutions.co.uk
www.visitkielder.com
www.agrer.com

Northumbrian Water main switchboard Tel 0845 604 7468

Northumbrian Water customer queries Customer services 0845 717 1100 Customer accounts 0845 733 5566

Essex & Suffolk Water customer queries Customer services 0845 782 0999 Customer accounts 0845 782 0111

Notes

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www.nwg.co.uk

Northumbrian Water Group plc

Northumbria House
Abbey Road
Pity Me
Durham DH1 5FJ

Tel 0845 604 7468
Fax 0191 301 6202

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