

**SOUTHERN WATER CAPITAL LIMITED**

**DIRECTORS' REPORT  
AND ACCOUNTS FOR THE YEAR ENDED  
31 MARCH 2006  
Registered Number 04608528**



**SOUTHERN WATER CAPITAL LIMITED**

**Directors' Report and Accounts for the year ended**

**31 March 2006**

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# SOUTHERN WATER CAPITAL LIMITED

## REPORT OF THE DIRECTORS

The directors present their report and the audited accounts for the year ended 31 March 2006.

## GROUP

The company acquired 80.1% of Southern Water Investments Limited ("SWIL") on the 7 May 2003, the remaining 19.9% being held by Veolia Water Investments Limited ("VWIL"). On 21 November 2005 the Company sold 510,000 Ordinary Shares of £1 of SWIL, representing 5.1 % of its shareholding, to VWIL reducing its shareholding to 75% of the issued share capital. Subsequently on 10 April 2006 the company acquired VWIL's entire shareholding. The major subsidiaries included within the Group are shown in note 27.

## PRINCIPAL ACTIVITIES OF THE COMPANY

The Company's principal activity is that of a holding company for SWIL and its subsidiaries.

## PRINCIPAL ACTIVITIES OF THE GROUP

The principal activities of the Group are the provision of water supply and wastewater services in the south-east of England.

The trading results reflect the performance of the major trading subsidiary Southern Water Services Limited (SWS).

## ISSUES AFFECTING THE BUSINESS

### *Drought*

The south of England is currently experiencing the worst drought since the 1930's. Two consecutive dry winters have left resources significantly below normal levels and hosepipe and sprinkler bans have been put in place to conserve supplies. SWS has taken steps to move water around its regional supply grid, from areas of surplus to areas of drought, and has developed additional resources in its Sussex and Kent water resource zones. *In addition SWS has continued to drive leakage levels down and has run an extensive media campaign highlighting the severity of the drought.* There are a number of further actions that are being taken. These include applications to the Environment Agency for Drought Permits, which allow SWS to temporarily extract more water from elsewhere in the environment, and an application for a Drought Order, to enable the restriction of the use of water for certain activities such as watering golf courses, sports fields and parks. The Drought Order was issued by DEFRA on 25 May 2006, however SWS has currently not enforced the order due to benefits of the rainfall received at the end of the Spring period, the additional resources brought on line, the reduction of leakage and the positive response from our customers, which has resulted in demand being some 5% to 10% down from prior forecasts. The water resource situation is under constant review and further restrictions on usage may still be required.

### *Brighton and Hove Area Wastewater Scheme*

To comply with the Urban Wastewater Treatment Directive, SWS is required to deliver improved wastewater treatment to the Brighton, Hove and Peacehaven area by constructing a new wastewater treatment works. This project has an estimated cost of £225m.

Following an extensive consultation and selection process, a planning application was submitted to build the wastewater treatment works at Peacehaven. East Sussex County Council and Brighton & Hove City Council were unable to determine this planning application locally, and SWS lodged an appeal to the Secretary of State. A public enquiry commenced on 21 June 2006 and concluded on 28 July 2006. SWS has been notified by the Planning Inspectorate that the decision of the Secretary of State is expected on or before 12 April 2007.

# SOUTHERN WATER CAPITAL LIMITED

## ISSUES AFFECTING THE BUSINESS (continued)

### *General Levels of Service*

During the period SWS brought to the attention of Ofwat certain inconsistencies relating to the reporting of response levels to, and handling of, customer enquiries and complaints discovered in the course of a project to install a new customer billing system. These inconsistencies have meant that some customers did not receive compensation they were due under a Guaranteed Standards Scheme (GSS) where SWS is obliged to make payments if it does not respond to letters within certain timescales. A specialist team was appointed to investigate these inconsistencies and work was also instigated to make the payments due under the GSS. At 31 March 2005 a provision of £5.7m was established. In this years accounts the costs of the investigation, together with the costs of identifying and making the GSS payments is shown in the Accounts as an exceptional item of £8.4m (2005:£5.7m).

The Serious Fraud Office (SFO) has been kept informed about the investigations and has announced it is to undertake its own investigation.

On 31 March 2006, SWS was notified by the regulator that it will be fined for its failure to achieve customer service performance standards under the GSS. Although no penalty has yet been fixed, SWS could be fined up to a maximum of 10% of its annual turnover, as referred to in note 23

### *Capital Programme delivery*

During April 2005, a contract was awarded to a consortium comprising United Utilities, Costain, and Montgomery Watson Harza to deliver a major part of the capital programme. Called 4Delivery Limited (4D), the consortium will project manage, design and deliver more than 250 schemes in the investment programme. Approximately 120 staff were transferred from Southern Water to 4D. The contract has successfully delivered in line with expectations during the year ended 31 March 2006.

## PROFIT AND LOSS ACCOUNT

Turnover in 2005/06 increased by 14.0% to £541.5m (2004/05 £475.0m). This was principally due to an increase in the K factor (the annual price movement as set by Ofwat) which was required to secure and service the ongoing finance for the capital investment programme.

Cost of sales increased by 7.6% to £287.7m (2004/05 £267.3m), and administration expenses, before exceptional items, increased by 8.5% to £28.1m (2004/05 £25.9m). The increase in costs resulted mainly from additional depreciation, higher electricity prices, and the effects of inflation, offset by operating efficiencies.

As previously stated, the costs of the customer service investigation, together with the costs of identifying and making GSS payments due is shown as an exceptional item of £8.4m (2004/5 £5.7m) .

Operating profit increased to £219.8m in 2005/06 compared with £178.1m in 2004/05.

Net interest increased to £173.2m from £164.9m in 2004/5 and the tax on profit on ordinary activities increased to £20.4m from £0.7m.

Profit after taxation for the financial year was £34.8m (2005: £15.5m). The directors recommend a final dividend of £nil per ordinary share (2005: £nil) which together with an interim dividend totalling £0.25 per ordinary share (2005: £nil) gives a total dividend of £0.25 per ordinary share for the year (2005: £nil). The retained profit for the year of £16.4 m (2005:£11.4m) has been transferred to reserves.

# SOUTHERN WATER CAPITAL LIMITED

## CASHFLOW

Net cash inflow from operating activities increased to £335.6m for 2005/06 from £300.0m in 2004/05, mainly due to the increased turnover. The net cash outflow from returns on investment and servicing of finance increased to £167.3m for 2005/06 from £154.3m in 2004/05, largely due to costs associated with a bond refinancing. There was an outflow of cash relating to the purchase of tangible fixed assets of £272.5m (2004/05 £189.5m) and a net cash outflow before financing in 2005/06 of £90.6m (2004/05 £26.5m).

The refinancing was carried out during May to July 2005. This comprised a bond issue of £500m and the repayment of £420m of bonds in issue at March 2005, together with putting in place an additional undrawn revolving credit facility of £120m. This resulted in a net cash inflow from financing during 2005/06 of £79.5m.

## BALANCE SHEET

At the end of the period to 31 March 2006, the Company had fixed assets of £3,144.1m (2005: £2,978.5m) an increase of £165.6m. This increase results from the capital investment programme. As a result of a bond refinancing creditors falling due after more than one year increased to £2,796.9m from £2,711.9m at March 2005. During the year FRS 17 'Retirement benefits' was fully implemented and the pension deficit of £96.6m (2005: £98.0m) was recognised on the balance sheet. Overall net assets before the pension deficit increased to £115.1m from £94.3m.

## KEY PERFORMANCE INDICATORS

Under the terms of its financing, SWS is required to operate within key financial ratios. These can be summarised as Regulatory Asset Ratios (the proportion of borrowing to its Regulated Capital Value) and Interest Cover Ratios. SWS has operated within the required levels throughout the period.

SWS is required to provide information to Ofwat on its performance against various aspects of service, these are published in Ofwat's annual 'Level of Service' report. The operational indicators have been submitted in the annual return to Ofwat for the year 2005/06. SWS has put in place plans to improve customer service performance as this does not currently meet the required standard.

## FUTURE DEVELOPMENTS

The Directors anticipate that the Company will continue to act as a holding company to the Southern Water Group of companies.

The year to 31 March 2006 is the second of the five-year regulatory period. During this regulatory period, the Group will continue to focus on delivering its large investment programme, and continuing to achieve operational performance targets as detailed in its Monitoring Plan to Ofwat, which is available on the SWS website.

SWS will also focus on dealing with the key risks and uncertainties that have been highlighted by the customer services issues, the drought and the Brighton and Hove wastewater treatment works.

## DIRECTORS AND THEIR INTERESTS

The directors during the period were:-

S Dance  
D Workman  
R Thian

Robert Thian has 50,000 A shares of £1 each in Southern Water Capital Limited held in a trust fund of which he is the beneficial holder, these were acquired on 11 August 2005. None of the other directors has any disclosable interests in the shares of any company within the group.

# SOUTHERN WATER CAPITAL LIMITED

## RESEARCH AND DEVELOPMENT

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the Group's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.4m (2005: £1.5m).

## EMPLOYEES

### *Employee involvement*

The Group recognises the importance of its employees and is committed to effective two-way communication and consultation.

The Group has established Business Involvement Groups to facilitate meaningful consultation between Group Management and employees through elected Employee Representatives. The Groups meet regularly at both functional and company-wide levels.

The Group also recognises the rights of every employee to join a trade union and participate in its activities. SWS has a single union agreement with Unison.

The Group publishes its own in-house newspaper, 'Southern Water News' on a regular basis. General information is posted on the Group Intranet and regular team briefing sessions are also held.

### *Equal opportunity*

The Group's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The Group is a member of the Employers' Forum on Disability, which supports the efforts to meet the needs of the disabled for employment and access to the Company and its buildings.

### *Health and safety*

The Group recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition there is a health and safety management review group which ensures that there is an adequate system for meeting the Group's responsibilities for health and safety to its staff, customers and members of the public.

The Group provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

## CREDITOR PAYMENT POLICY AND PRACTICE

The Group's policy and practice is to agree terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in accordance with its contractual and legal obligations. The Group's trade creditor days at 31 March 2006 were 22 days (2005: 36 days).

# SOUTHERN WATER CAPITAL LIMITED

## **ENVIRONMENTAL ISSUES**

The Group is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice, and aims to contain the environmental impact of its activities to a practicable minimum.

The Group's environmental performance is reported in its annual Sustainability Report, which is available on our website. The Group recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

## **CHARITABLE DONATIONS**

The Group made donations of £21,000 (2005: £53,000) to a variety of charities over the year.

No political donations were made.

## **LAND AND BUILDINGS**

In the opinion of the directors, the market value of land is significantly more than its book value, and it would not be practicable to quantify the value of land.

## **FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES**

The Group intends to at least maintain its present risk profile, as measured by its investment grade credit rating. The Group does not enter into treasury transactions for the purpose of speculation, but only to manage risk inherent in the business or funding on a prudent basis.

**Currency Risk** - The Group uses derivatives to ensure that no currency risk is borne in respect of any foreign currency denominated debt instrument, or in respect of any significant foreign currency purchases (including Financial Guarantee Fees, payable in respect of any foreign currency denominated Authorised Credit Facility and excluding any related fees).

**Interest Rate Risk** - The Group hedges its exposure to interest rate risk on at least 85% of its total outstanding debt liabilities in respect of Class A Debt and Class B Debt for the current period to the next Periodic Review and at least 70% in the next period to the subsequent Periodic Review (on a rolling basis) into either index-linked obligations or fixed rate obligations.

**Inflation Risk** - The regulatory framework, under which revenues and the RCV (Regulatory Capital Value) are indexed, exposes the Group to inflation risk. The Group manages this risk through the use of index-linked instruments within its overall debt portfolio.

**Liquidity risk** – The Group raises additional funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business for at least the next twelve months.

**Cash management risk** – The Group sets exposure limits for, and deposits cash balances with, organisations whose credit ratings are rated a minimum of Moody's P1, Standard & Poors A1 or Fitch F1.

# SOUTHERN WATER CAPITAL LIMITED

## DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare Accounts for each financial period which give a true and fair view of the state of affairs of the Group as at the end of the financial period and of the profit or loss of the Group for that period.

Having assessed the future funding requirements of the Group, the directors are of the opinion that it is appropriate for the Accounts to be prepared on a going concern basis.

The directors confirm that suitable accounting policies have been used and applied consistently except where detailed in note 1 to the Accounts (Accounting policies). They also confirm that reasonable and prudent judgements and estimates have been made in preparing the Accounts for the year ended 31 March 2006 and that applicable accounting standards have been followed, subject to any material departures disclosed and explained.

The directors are responsible for ensuring that the Accounts are published, and where they are published on the Internet, for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded, as information published on the Internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of Accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Accounts comply with the Companies Act 1985. More broadly, they owe a fiduciary duty to the Group and are responsible for safeguarding its assets.

## PROVISION OF INFORMATION TO AUDITORS

So far as the directors are aware, there is no relevant information of which the Group's auditors are unaware. The directors have taken all the steps, (such as making enquiries of other directors and the auditors and any other steps required by the director's duty to exercise due care, skill and diligence), that they ought to have taken in their duty as a director in order to make themselves aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

## AUDITORS

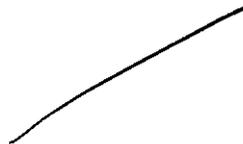
The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution that they be re-appointed will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board.



D Workman  
Director

18 October 2006.



# SOUTHERN WATER CAPITAL LIMITED

## CONSOLIDATED PROFIT AND LOSS ACCOUNT

for the year ended 31 March 2006

	Notes	31 March 2006 £m	31 March 2006 £m	31 March 2005 (restated) £m	31 March 2005 (restated) £m
<b>Turnover</b>	1,2,3		<b>541.5</b>		475.0
Cost of sales	3		<b>(287.7)</b>		(267.3)
<b>Gross profit</b>			<b>253.8</b>		207.7
Administrative expenses	3				
- before exceptional items		<b>(28.1)</b>		(25.9)	
- exceptional items		<b>(8.4)</b>		(5.7)	
Administrative expenses			<b>(36.5)</b>		(31.6)
Other operating income	3		<b>2.5</b>		2.0
<b>Operating profit and profit on ordinary activities before interest and taxation</b>	4		<b>219.8</b>		178.1
Profit on disposal of fixed assets			<b>8.6</b>		3.0
Net interest and similar charges	7		<b>(173.2)</b>		(164.9)
<b>Profit on ordinary activities before taxation</b>			<b>55.2</b>		16.2
Tax on profit on ordinary activities	8		<b>(20.4)</b>		(0.7)
<b>Profit on ordinary activities after taxation</b>			<b>34.8</b>		15.5
Equity Minority Interests			<b>(8.4)</b>		(4.1)
Dividends	9		<b>(10.0)</b>		-
<b>Retained profit for the financial year</b>	20		<b>16.4</b>		11.4

The above results relate entirely to continuing operations.

There was no difference between the profit on ordinary activities before taxation and the retained profit for the financial year stated above, and their historical cost equivalent.  
The Notes on pages 11 to 38 form part of these accounts.

# SOUTHERN WATER CAPITAL LIMITED

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 March 2006

	Notes	2006 £m	2005 (restated) £m
<b>Profit on ordinary activities after taxation</b>		<b>34.8</b>	15.5
Actuarial (loss)/gain recognised in the pension fund	22	(1.6)	10.6
Movement on deferred tax relating to pension deficit		0.5	(3.1)
Minority interest		(0.3)	1.7
<b>Total recognised gains for the year</b>		<b>33.4</b>	24.7
Prior year adjustment	20	(57.1)	
Minority Interest		(14.2)	
<b>Total losses recognised since last annual report</b>		<b>(37.9)</b>	
<b>Attributable to:</b>			
Equity shareholders		(31.8)	18.9
Minority interests		(6.1)	5.8
		<b>(37.9)</b>	24.7

There is no difference between the profit on ordinary activities before taxation and the retained loss for the year stated above and their historical cost equivalents.

# SOUTHERN WATER CAPITAL LIMITED

## CONSOLIDATED BALANCE SHEET

as at 31 March 2006

	Notes	Group 2006 £m	Company 2006 £m	Group 2005 (restated) £m	Company 2005 (restated) £m
<b>Fixed Assets</b>					
Tangible assets	10	3,144.1	-	2,978.5	-
Investments	11,26	7.0	37.5	7.0	40.1
		<u>3,151.1</u>	<u>37.5</u>	<u>2,985.5</u>	<u>40.1</u>
<b>Current assets</b>					
Stocks	12	1.1	-	1.0	-
Debtors: amounts falling due within one year	13	118.8	0.5	105.9	-
Cash at bank and in hand	17	247.3	3.4	246.2	4.2
		<u>367.2</u>	<u>3.9</u>	<u>353.1</u>	<u>4.2</u>
<b>Creditors: amounts falling due within one year</b>	14	<u>(217.4)</u>	<u>(0.2)</u>	<u>(159.3)</u>	<u>(0.1)</u>
<b>Net current assets</b>		<u>149.8</u>	<u>3.7</u>	<u>193.8</u>	<u>4.1</u>
<b>Total assets less current liabilities</b>		<u>3,300.9</u>	<u>41.2</u>	<u>3,179.3</u>	<u>44.2</u>
<b>Creditors: amounts falling due after one year</b>	15	(2,796.9)	-	(2,711.9)	-
<b>Provision for liabilities and charges</b>	16	(342.7)	-	(329.4)	-
<b>Grants and contributions</b>	18	(46.2)	-	(43.7)	-
<b>Net assets excluding pension deficit</b>		<u>115.1</u>	<u>41.2</u>	<u>94.3</u>	<u>44.2</u>
<b>Pension deficit</b>		(96.6)	-	(98.0)	-
<b>Net assets including pension deficit</b>		<u>18.5</u>	<u>41.2</u>	<u>(3.7)</u>	<u>44.2</u>
<b>Capital and reserves</b>					
Called up share capital	19	40.1	40.1	40.1	40.1
Profit and loss account	20	(28.0)	1.1	(43.3)	4.1
<b>Total shareholder's funds (including non-equity interests)</b>		<u>12.1</u>	<u>41.2</u>	<u>(3.2)</u>	<u>44.2</u>
<b>Equity minority interests</b>		<u>6.4</u>	<u>-</u>	<u>(0.5)</u>	<u>-</u>
<b>Capital employed</b>		<u>18.5</u>	<u>41.2</u>	<u>(3.7)</u>	<u>44.2</u>

The accounts on pages 7 to 38 were approved by the Board on 18 October 2006 and signed on its behalf by:



D Workman  
Director

SOUTHERN WATER CAPITAL LIMITED

**CONSOLIDATED CASH FLOW STATEMENT**

for the year ended 31 March 2006

	Notes	March 2006 £m	March 2005 (restated) £m
<b>Net cash inflow from operating activities</b>	21	<b>335.6</b>	300.0
<b>Returns on investments and servicing of finance</b>			
Issue costs of new loans		(8.6)	(0.7)
Interest paid		(162.3)	(152.5)
Interest received		18.9	13.6
Preference share dividends		(13.7)	(13.7)
Dividends paid to minority interests		(1.6)	(1.0)
<b>Net cash outflow from returns on investments and servicing of finance</b>		<b>(167.3)</b>	(154.3)
<b>Taxation</b>		<b>(0.0)</b>	2.8
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets		(272.5)	(189.5)
Sale of tangible fixed assets		9.8	4.5
Receipt of grants and contributions		13.8	10.0
<b>Net cash outflow for capital expenditure and financial investment</b>		<b>(248.9)</b>	(175.0)
<b>Equity dividends paid to shareholders</b>		<b>(10.0)</b>	-
<b>Net cash (outflow) before financing</b>		<b>(90.6)</b>	(26.5)
<b>Financing</b>			
Premium arising on new loans		-	18.5
Repayment of short term loan		420.0	-
Issue of long term loans		499.5	156.6
<b>Net cash inflow from financing</b>		<b>79.5</b>	175.1
<b>(Decrease)/Increase in net cash</b>		<b>(11.1)</b>	148.6
<b>Reconciliation to net debt</b>			
Net debt at beginning of year		(2,474.3)	(2,494.4)
(Decrease)/Increase in net cash		(11.1)	148.6
Movement in borrowings		(79.5)	(156.6)
Bond Premium		-	(18.5)
Debt issue costs		8.6	0.6
Non-cash items		(14.2)	46.0
<b>Net debt at end of year</b>	21	<b>(2,570.5)</b>	(2,474.3)

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 1 Accounting policies

#### **Basis of accounting**

The accounts have been prepared under the historical cost convention as modified by the revaluation of freehold land and buildings and infrastructure assets and in accordance with applicable accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 1985.

#### **Basis of consolidation**

The Group accounts include the accounts of the Company and all of its subsidiary undertakings. The results of the subsidiaries are included in the Profit and Loss Account from the date of acquisition. Intra group sales and profits are eliminated fully on consolidation. The acquisition method of accounting has been used to consolidate the subsidiaries.

#### **Changes in accounting policies**

During the year the Group has completed the final stage of the implementation of FRS 17 'retirement benefits', FRS 21 'events after the balance sheet date' and FRS 25 'disclosure of financial instruments'. The adoption of each of these standards represents a change in accounting policy and the comparative figures have been restated accordingly. Due to the Group already adopting FRS 4, FRS 25 has had no impact on the disclosure of the preference shares. Details of the effect of the prior year adjustments are given in note 20.

#### **Turnover**

Turnover represents the income receivable (excluding value added tax) in the ordinary course of the business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured and unmeasured income.

Measured income arises from customers who have meters fitted at their premises. Therefore amounts billed are based on actual water consumption. Unmeasured income bills are based on the rateable value of properties. The income accrual is an estimation of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average tariffs and historical billing and consumption information.

#### **Bad debts**

The bad debt provision is calculated by applying recovery rates to an aged debt profile to ensure that the age of debt not covered by the provision is an accurate reflection of the recoverability of debt.

#### **Research and development**

Expenditure on research and development is charged to the profit and loss account as it is incurred.

#### **Capital instruments**

The issue costs of capital instruments have been amortised over the life of the financial instrument to which they relate.

Premiums received on issue of debt instruments are credited to the profit and loss account over the term of the debt at a constant rate on the carrying amount.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the profit and loss account in the year in which it arises.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 1 Accounting policies (continued)

#### Preference shares

The Group has adopted the provisions of FRS 25 'Financial instruments: disclosure and presentation' and since the Group had already classified the preference shares as loans in accordance with FRS 4 this has had no impact on disclosure. The preference shares are redeemable on a specific date or at the Group's option anytime earlier. Dividends on preference shares classified as debt are recognised in the profit and loss account through interest payable. The value of the debt has been based on the original nominal value and share premium on issue of the shares as detailed in note 15.

#### Foreign currencies

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

#### Tangible fixed assets

- i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of systems.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs represent those costs directly related to the construction of a specific infrastructure asset and are capitalised as part of infrastructure assets on the basis of the amount of time spent by individuals on capital projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

- ii) Other assets (including overground assets, plant and equipment) are stated at cost less accumulated depreciation. Other assets are depreciated on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 - 60
Operational structures	15 - 80
Fixed plant	10 - 40
Vehicles, computers and mobile plant	3 - 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

- iii) Freehold land is not depreciated.

Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 1 Accounting policies (continued)

#### Grants and contributions

Capital grants and customer contributions in respect of additions to non-infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 of the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions, hence these would have been accounted for as deferred income.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the accounts to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

#### Leased assets

Fixed assets leased to the Group under finance leases are capitalised and depreciated in line with the Group's depreciation policy. The interest element of finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rentals payable under operating leases are charged to profit and loss account as incurred.

#### Fixed asset investments

Investments held as fixed assets are stated at cost, less provision, if appropriate, for any impairment in value other than a temporary impairment in value. The carrying values of fixed asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

#### Stocks

Stocks are valued at the lower of cost and net realisable value.

#### Taxation

The taxation charge in the profit and loss account is based on the profit for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with Financial Reporting Standard 19 "Deferred Tax". ("FRS 19") Deferred taxation balances are not discounted. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 2006

### 1 Accounting policies (continued)

#### Pensions

The Group operates pension schemes which cover the majority of the employees. An independent actuary normally conducts a valuation of the defined benefits pension scheme every three years. The Group has completed the final stage of the implementation of FRS 17 "Retirement Benefits" during the year.

In accordance with FRS 17 the pension deficit has been recognised on the balance sheet and operating and financing costs of pension and post-retirement schemes are recognised separately in the profit and loss account. Service costs are systematically spread over the service lives of the employees and financing costs are recognised in the period in which they arise. The costs of past service benefit enhancements, settlements and curtailments are also recognised in the period in which they arise.

The differences between actual and expected returns on assets and liabilities during the year, including changes in actuarial assumptions, are recognised in the statement of total recognised gains and losses.

#### Financial instruments

Derivative transactions include interest rate, currency and index-linked swaps that are only used for non trading purposes. These derivatives are entered into for the purpose of matching or eliminating risk from potential movements in interest and currency rates and RPI associated with the long term borrowing requirements of the Group (see note 17). All non trading derivatives are accounted for on an accruals basis.

Provisions are made for losses, if appropriate, in the event that it is expected that any portion of a financial instrument will not be a hedge of the long term borrowing requirements of the Group.

Interest rate and currency swaps are used to manage interest rate profiles and mitigate exchange risks. When matched with primary financial instruments, the net position is measured at the hedge rate and presented within creditors on the balance sheet. Income, costs, gains, losses and expenses are recognised within net interest payable in the profit and loss account over the life of the instruments.

#### Provisions

An environmental provision is made in accordance with FRS12 for the costs relating to the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted.

### 2 Segmental analysis

The directors believe that the whole of the Group's activities constitute a single class of business. The Group's turnover is generated wholly from within the UK.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 2006

### 3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income relates to rents receivable.

### 4 Profit on ordinary activities before taxation

	<b>March 2006 £m</b>	March 2005 £m
Profit on ordinary activities before taxation is stated after charging/(crediting):		
Staff costs (note 6a)	<b>47.6</b>	45.6
Depreciation on		
- owned assets	<b>141.6</b>	121.2
- assets held under finance leases	<b>0.4</b>	0.3
	<b><u>142.0</u></b>	<u>121.5</u>
Rentals under operating leases – other	<b>3.7</b>	4.1
Research and development expenditure	<b>1.4</b>	1.5
Release of grants and contributions (note 18)	<b>(2.2)</b>	(2.1)
Exceptional item (See note (i) below)	<b>8.4</b>	5.7
Auditors' remuneration for audit work	<b>0.3</b>	0.2
Auditors' remuneration for non-audit services to the group (included in exceptional item above)	<b>1.7</b>	0.1

#### Note (i)

During the period SWS brought to the attention of Ofwat certain inconsistencies relating to the reporting of response levels to, and handling of, customer enquiries and complaints discovered in the course of a project to install a new customer billing system. These inconsistencies have meant that some customers did not receive compensation they were due under a Guaranteed Standards Scheme (GSS) where the Company is obliged to make payments if it does not respond to letters within certain timescales. A specialist team was appointed to investigate these inconsistencies and work was also instigated to make the payments due under the GSS. The costs of the investigation, together with the costs of identifying and making the GSS payments is shown in the Accounts as an exceptional item of £8.4m (2005:£5.7m).

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 5 Profit of Parent Company

The company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The loss for the financial year dealt with in the financial statements of the parent company is £3.0m (March 2005: Profit £0.2m).

### 6 Employee information

	<b>March 2006 £m</b>	March 2005 (restated) £m
<b>(a) Employee costs (including directors' emoluments):</b>		
Wages and salaries	49.1	52.7
Social security costs	3.9	4.2
Pension costs	7.6	10.3
	60.6	67.2
Total employee costs		
Less: charged as capital expenditure	(13.0)	(16.7)
Charged to the profit and loss account	47.6	50.5
	<b>March 2006 No.</b>	March 2005 (restated) No.
<b>(b) Average number of persons employed</b>		
Operations	1,234	1,369
Project Delivery	-	58
Customer Services	279	263
Corporate Centre	388	372
	1,901	2,062

The prior year numbers have been restated in order to be consistent with the current year's disclosures. The total numbers have not changed.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 2006

### 7 Net interest and similar charges

	<b>March 2006</b>	March 2005 (restated)
	£m	£m
<b>Interest payable</b>		
Interest payable on other loans	159.5	145.3
Interest rate swap payments	2.0	5.3
Indexation	19.8	19.0
Other finance expense (note 22)	2.6	4.0
Amortisation of issue costs	4.4	2.5
Preference share appropriation	-	(2.9)
Amortisation of bond premium	(9.9)	(8.4)
Interest on preference shares	13.7	13.7
Total interest payable	<b>192.1</b>	178.5
 <b>Interest receivable</b>		
Other interest receivable	18.9	13.6
	<b>18.9</b>	13.6
 <b>Net interest charge</b>	<b>173.2</b>	164.9

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 8 Tax on profit on ordinary activities

	Year to 31 March 2006 £m	Period to 31 March 2005 £m
Current tax:		
UK corporation tax on profits of the period	-	-
Adjustment in respect of prior years	-	(10.1)
	-	(10.1)
Deferred tax:		
Origination and reversal of timing differences	19.2	10.8
Pension cost relief in excess of pension cost charge	1.2	-
Total deferred tax	20.4	10.8
Total tax on profit on ordinary activities	20.4	0.7

The rate of current tax charge on profit on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2006 £m	2005 £m
Current tax:		
UK corporation tax rate at 30% on profit for the period	16.5	6.0
Adjustment in respect of prior years	-	(10.1)
Other differences	0.7	0.7
Permanent differences	3.2	3.7
<b>Tax charge on ordinary activities</b>	<b>20.4</b>	<b>0.3</b>
Effect of deferred tax	(20.4)	(10.4)
<b>Current tax charge for period</b>	<b>-</b>	<b>(10.1)</b>

### 9 Dividends per share

	2006 £ per ordinary share	2005 £ per ordinary share	2006 £m	2005 £m
<b>Ordinary shares</b>				
Interim dividend – 27 March 2006	0.25	-	10.0	-
<b>Total ordinary dividend</b>	<b>0.25</b>	-	<b>10.0</b>	-

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 10 Fixed assets and capital commitments

The Group tangible assets are shown below. The Company has no tangible assets.

#### (a) Group tangible assets

	Freehold land & buildings £m	Plant & Machinery £m	Infra- structure assets £m	Assets in the course of const- ruction £m	Other £m	Total £m
<b>Cost:</b>						
At 1 April 2005	863.8	775.8	1,163.8	215.1	158.5	3,177.0
Additions	15.6	14.2	14.4	271.2	1.9	317.3
Transfers	29.5	75.4	61.8	(165.1)	(1.6)	-
Grants & contributions			(9.1)			(9.1)
Disposals	(0.6)	(0.1)	(1.6)			(2.3)
<b>At 31 March 2006</b>	<b>908.3</b>	<b>865.3</b>	<b>1,229.3</b>	<b>321.2</b>	<b>158.8</b>	<b>3,482.9</b>
<b>Depreciation:</b>						
At 1 April 2005	51.1	70.3	51.5	-	25.6	198.5
Charge for the period	32.8	51.2	39.4	-	18.6	142.0
Disposals		(0.1)	(1.6)	-		(1.7)
<b>At 31 March 2006</b>	<b>83.9</b>	<b>121.4</b>	<b>89.3</b>	<b>-</b>	<b>44.2</b>	<b>338.8</b>
<b>Net book value:</b>						
<b>At 31 March 2006</b>	<b>824.4</b>	<b>743.9</b>	<b>1,140.0</b>	<b>321.2</b>	<b>114.6</b>	<b>3,144.1</b>
At 31 March 2005	812.7	705.5	1,112.3	215.1	132.9	2,978.5

Of the additions to infrastructure assets, the amount spent on infrastructure renewals during the year ended 31 March 2006 was £45.9m (2005: £21.2m). Of the grants and contributions set against infrastructure assets during the year ended 31 March 2006, £5.1m (2005: £3.0m) relates to infrastructure renewals.

For the year ended 31 March 2006, the net book value of infrastructure assets is stated after deducting grants and contributions of £148.1m (2005: £139.0m).

Freehold land is stated at a cost of £68.4m (2005: £63.7m) at 31 March 2006, and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices.

Assets held under finance leases are capitalised and included in plant and machinery:

	Group 2006 £m	Group 2005 £m
Cost	11.7	11.7
Aggregate depreciation	(8.2)	(7.8)
Net book amount	<u>3.5</u>	<u>3.9</u>
<b>(b) Group Capital Commitments</b>	<b>2006</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>
In respect of contracts placed	<u>741.0</u>	<u>69.1</u>

The company has no capital commitments

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 11 Fixed asset investments

	<b>Group 2006 £m</b>	<b>Company 2006 £m</b>	<b>Group 2005 £m</b>	<b>Company 2005 £m</b>
SWIL				
At 1 April	-	40.1	-	40.1
Disposal in year	-	(2.6)	-	-
At 31 March	-	37.5	-	40.1
Other external investments (see below)	7.0	-	7.0	-
	<u>7.0</u>	<u>37.5</u>	<u>7.0</u>	<u>40.1</u>

Other Group external investments are stated below.

Company	Class of share capital	Proportion of shares held	Activity
Folkestone & Dover Water Services Ltd	Ordinary	25.1%	Water treatment and supply
	Preference	21.8%	
	Deferred	12.2%	

The undertaking operates in its country of incorporation (the UK). The investment is held by a subsidiary of Southern Water Capital Limited. Folkestone & Dover Water Services Ltd had retained losses of £1.2m for the year ended 31 December 2005 (2004: Profit £0.6m restated) and net assets of £18.5m at 31 December 2005 (2005: £19.4m restated).

The Company acquired on 7 May 2003 8,010,000 Ordinary Shares of £1 of SWIL (being 80.1% of its issued capital), a company incorporated in the United Kingdom. On 21 November 2005 the Company sold 510,000 Ordinary Shares of £1 of SWIL, 5.1 % of its shareholding, to VWIL reducing its shareholding to 7,500,000 Ordinary Shares of £1, 75% of the issued share capital. The Company acquired VWIL's shareholding on the 10 April 2006, please see note 28 for further details.

SWIL itself owns the entire issued capital of Southern Water Services Group Limited and Southern Water NR Holdings Limited. A full list of the company subsidiaries is shown in note 27.

### 12 Stocks

	<b>Group 2006 £m</b>	<b>Group 2005 £m</b>
Raw materials	0.8	0.7
Work in progress	0.3	0.3
	<u>1.1</u>	<u>1.0</u>

The Company does not hold any stock.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 13 Debtors: amounts falling due within one year

	<b>Group</b>	<b>Company</b>	<b>Group</b>	<b>Company</b>
	<b>2006</b>	<b>2006</b>	<b>2005</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Trade debtors	62.3	-	56.9	-
Unbilled income	40.6	-	37.2	-
Prepayments	2.9	-	2.0	-
Other debtors	13.0	-	9.8	-
Amounts owed by other Southern Water group undertakings	-	0.5	-	-
	<b>118.8</b>	<b>0.5</b>	<b>105.9</b>	<b>-</b>

### 14 Creditors: amounts falling due within one year

	<b>Group</b>	<b>Company</b>	<b>Group</b>	<b>Company</b>
	<b>2006</b>	<b>2006</b>	<b>2005</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>	<b>(restated)</b>	<b>£m</b>
Bank overdraft	13.3	-	1.1	-
Trade creditors	16.0	-	11.0	-
Capital creditors and capital accruals	114.0	-	69.2	-
Corporation tax	-	-	-	-
Other taxation and social security	1.4	-	1.4	-
Other accruals and deferred revenue	65.2	0.2	69.1	0.1
Bond premium deferred	9.9	-	10.0	-
Debt issue costs	(2.4)	-	(2.5)	-
	<b>217.4</b>	<b>0.2</b>	<b>159.3</b>	<b>0.1</b>

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED MARCH 2006

### 15 Creditors: amounts falling due after one year

	Group 2006	Company 2006	Group 2005 (restated)	Company 2005
	£m	£m	£m	£m
Long term borrowings	2,646.7	-	2,547.5	-
Debt issue costs	(52.0)	-	(47.7)	-
Bond premium deferred	202.2	-	212.1	-
	<u>2,796.9</u>	<u>-</u>	<u>2,711.9</u>	<u>-</u>

	2006 £m	2005 (restated) £m
<b>Repayments fall due as follows:</b>		
Between two and five years	-	300.0
After five years not by instalments	<u>2,796.9</u>	<u>2,411.9</u>
	<u>2,796.9</u>	<u>2,711.9</u>

An analysis of the external loans is shown below: -

<b>Loans</b>	Group 2006 £m	Group 2005 £m
Class A £350m 6.192% fixed rate 2029	350.0	350.0
Class A £150m 3.706% index linked 2034	161.8	157.2
Class A £35m 3.706% index linked 2034	37.7	36.7
Class A \$483m USD LIBOR plus 0.40% floating rate 2007	-	300.0
Class A £350m 6.640% fixed rate 2026	350.0	350.0
Class A £150m 3.816% index linked 2023	161.8	157.3
Class A £120m 6.925% fixed rate 2013	-	120.0
Class A £350m 5.01% fixed rate 2021	349.9	
Class A £150m 2.295% index linked 2041 (note (iv) below)	149.6	
Class B £250m 7.869% fixed rate 2038 - (note (i) below)	250.0	250.0
Artesian £165m 4.076% index linked 2033	178.0	173.0
Artesian £156.5m 3.635% index linked 2032	164.7	160.1
Senior mezzanine £127.2m 11.96% fixed rate 2038 - (note (ii) below)	127.2	127.2
Junior mezzanine £106m 16.0% fixed rate 2038	106.0	106.0
Debt issue costs (note iii below)	(52.0)	(47.7)
Premium on issue	202.2	212.1
Class A1 Preference shares -(note (v) below)	150.0	150.0
Class B Preference shares -(note (v) below)	110.0	110.0
Class A2 Preference shares-(notes (v) & (vi) below)	-	-
	<u>2,796.9</u>	<u>2,711.9</u>

In 2005 SWSF raised £500m in the financial markets which included a discount of £0.5m and repaid loans of £420m. The debt has then been on-lent to SWS. The net proceeds were advanced by SWSF to SWS. Issue costs of £8.0m were paid by SWSF and recharged to SWS. Floating interest rates have been hedged to fixed and US dollar currency have been hedged to sterling.

These loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited, SWS Holdings Limited, and SWS Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and Licence.

## SOUTHERN WATER CAPITAL LIMITED

### NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED MARCH 2006

#### 15 Creditors: amounts falling due after one year (continued)

Notes :

- (i) The interest rate on the class B £250m is fixed at 7.869% until March 2014 when it steps up to LIBOR plus 4.75%.
- (ii) The interest rate on the senior mezzanine £125m loan is fixed at 11.96% until March 2022 when it reverts to LIBOR plus 6.25%. For the remaining senior mezzanine loan of £2.2m the interest rate is LIBOR plus 6.25%.
- (iii) Debt issue costs represent issue fees paid to SWSF. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loan advances noted above. As at 31 March 2006 debt issue costs amounted to £54.4m of which £2.4m represents the short-term amount which is disclosed separately in note 14.
- (iv) The company has entered into a swap agreement that has converted its Class A £150m from a fixed rate of 5.0% to an index linked bond with an interest rate of 2.295% plus RPI.
- (v) The preference shares issued by subsidiaries have been classified as loans in the consolidated financial statements as stated in FRS 25, since the Group taken as a whole has an obligation to transfer economic benefits in connection with the shares. All shares are redeemable at the company's option at any time.

The Class A1 and B shares preference shares, which do not carry voting rights, were issued on the 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0m for both classes of shares. Class A2 were issued for £0.01 per share on the 7 May 2003 and the amount received totalled £1,500 and are redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows: -

Class A1

- £40 per share

Class A2

- the base value dividend plus an amount for company outperformance and any savings arising from any refinancing of the mezzanine debt. The base value is £nil per share increasing by £15 every five years. (Outperformance from 1 April 2005 onwards is the difference between Southern Water Services Limited's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by OFWAT in the periodic review. Outperformance for the previous year is measured against numbers agreed as part of the refinancing).

Class B

- £70 per share

These dividends are payable on the 31 March and 30 September each year. On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

- (vi) The class A2 preference shares have been included in the balance sheet at their fair value on acquisition at the 7 May 2003. The valuation is based on the present value of the total expected payments up to the first possible redemption date. Since the shares are redeemable at any time at the option of the company, they are reflected at the nominal value of £1,500.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 16 Provision for liabilities and charges

	<b>Group 2006</b>	Group 2005 (restated)
	<b>£m</b>	£m
<b>(a) Environmental obligations</b>		
Provision brought forward	2.3	3.9
Written back in year	-	(1.2)
Utilised in year	<u>(0.2)</u>	<u>(0.4)</u>
Provision at 31 March	<u>2.1</u>	<u>2.3</u>
<b>(b) Deferred taxation</b>		
Accelerated capital allowances	420.2	392.7
Other timing differences	<u>(79.6)</u>	<u>(71.3)</u>
<b>Deferred taxation</b>	<u>340.6</u>	<u>321.4</u>
<b>(c) Provision for guaranteed standard scheme payments</b>		
Provision brought forward	5.7	-
Provision made in year	-	5.7
Written back in year	<u>(5.7)</u>	<u>-</u>
Provision at 31 March	<u>-</u>	<u>5.7</u>
<b>Total</b>	<u><u>342.7</u></u>	<u><u>329.4</u></u>

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. As the period over which the provision will be utilised cannot be determined the provision is not discounted.

The provision for guaranteed standard scheme payments related to the ongoing investigation into the companies reporting and handling of customer enquiries. SWS is obliged to make payments to customers if it does not reply to letters within certain timescales and the company has now largely completed the process of identifying anyone who should have been paid and has not. The amounts to be paid of £0.5m have been reclassified and included within 'other accruals and deferred revenue' detailed in note 14.

	<b>Group 2006</b>	Group 2005 (restated)
	<b>£m</b>	£m
<b>Movement in deferred tax provision:</b>		
Deferred tax provision brought forward	321.4	308.9
Prior year adjustment	-	2.1
Deferred tax charge in Profit and Loss Account	19.2	10.4
<b>Deferred tax provided at 31 March</b>	<u>340.6</u>	<u>321.4</u>

The Company has no provisions for liabilities and charges.

No provision has been made for potential deferred tax liability on fair value adjustments to the fixed assets recognised. Such tax would only become payable if a contract was entered into to sell the related assets.

The total amount unprovided is £77.5m. At present it is not envisaged that any such tax will become payable in the foreseeable future.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 17 Financial instruments

Derivative activity is undertaken by a subsidiary in the Group, SWSF as determined by the Board, which considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. No derivatives are undertaken for trading purposes, or to benefit from price fluctuations.

The SWSF business consists of lending to other group Companies and raising external finance. In the opinion of the Directors, the fair values of the financial assets and liabilities of the Group (apart from the specific financing loans and hedging instruments shown in the fair value table below) are not materially different from the book values and are not separately disclosed.

All fair values are based on arms length transactions in normal market conditions. Where available market values have been used to determine fair values.

The fair value of the Group's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

For foreign currency and interest rate swap agreements the fair value has been estimated based on market valuations at the balance sheet dates.

The Group has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

The table below describes the main activities and risks which lead to the use of derivatives.

Activity	Risk	Type of hedge in place
Floating rate borrowing / financing	Increased interest expense due to increases in interest rates	Interest rate swaps which fix the amount of interest payable.
Currency rate borrowing / financing	Increased currency losses due to increases in exchange rates	Currency rate swaps which fix the exchange rates.
Indexation	The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk	Index-linked instruments

On 23 July 2003, the Group carried out a refinancing transaction and entered in to a series of derivative transactions for the purpose of hedging risk associated with the long term borrowing requirements of the Southern Water Capital Group.

For the purposes of the notes below, short term debtors and creditors have been excluded.

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED

# SOUTHERN WATER CAPITAL LIMITED

31 MARCH 2006

17 Financial instruments (continued)

## Interest Rate Risk profile of financial liabilities

Currency	Total	Index Linked financial liabilities	Fixed rate financial liabilities	Variable rate financial liabilities	Non equity fixed rate preference shares
	£m	£m	£m	£m	£m
GBP	2,547.5	684.3	1,601.0	2.2	260.0
<b>At 31 March 2005</b>	<b>2,547.5</b>	<b>684.3</b>	<b>1,601.0</b>	<b>2.2</b>	<b>260.0</b>
GBP	2,646.7	853.6	1,530.9	2.2	260.0
<b>At 31 March 2006</b>	<b>2,646.7</b>	<b>853.6</b>	<b>1,530.9</b>	<b>2.2</b>	<b>260.0</b>

The balance above includes the debt raised in external finance markets (described further in note 15).

## Fixed rate financial liabilities

Currency	Weighted average interest rate %	Weighted average time for which rate is fixed Years
GBP		
<b>31 March 2005</b>	<b>7.7</b>	<b>15.4</b>
GBP		
<b>31 March 2006</b>	<b>7.5</b>	<b>18.1</b>

The Group held the following financial assets, as part of the financing arrangements at 31 March 2005.

	31 March 2006	31 March 2005
	£m	£m
GBP Cash	246.1	245.7
GBP Restricted cash	1.2	0.5
	<b>247.3</b>	<b>246.2</b>

Restricted cash of £1.2m is held in a designated bank account in order to meet the interest requirements on the loan finance.

The above financial assets attract interest at floating rates.

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED

# SOUTHERN WATER CAPITAL LIMITED

31 MARCH 2006

## 17 Financial instruments (continued)

### Fair values of financial assets and financial liabilities

The following table provides a comparison by category of the carrying amounts and the fair values of the Group's financial assets and financial liabilities at 31 March 2006. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. Where available, market values have been used to determine fair values.

	<b>Book value</b>	<b>Fair value</b>	Book value	Fair value
	<b>2006</b>	<b>2006</b>	2005	2005
	<b>£m</b>	<b>£m</b>	£m	£m
Long term borrowings	(2,646.7)	(3,072.0)	(2,547.5)	(2,765.8)
Restricted Cash	1.2	1.2	0.5	0.5
Cash at Bank and in Hand	246.1	246.1	245.7	245.7
Overdraft (note 14)	(13.3)	(13.3)	(1.1)	(1.1)
<b>Derivative financial instruments held to manage interest rate and currency profile</b>				
Interest Rate Swaps	-	(55.1)	-	(18.5)
Currency Rate Swaps	-	-	-	(44.9)

### HEDGES

The table below shows the extent to which the Group has off-balance sheet (unrecognised) and on-balance sheet (deferred) gains and losses in respect of financial instruments used as hedges at the beginning and end of the year. It also shows the amount of such gains and losses which have been included in the profit and loss account for the year and those gains and losses which are expected to be included in next year's or later profit and loss accounts.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 17 Financial instruments (continued)

All the gains and losses on the hedging instruments are expected to be matched by losses and gains on the hedged transactions or positions.

	<b>Unrecognised Losses £m</b>
Losses on hedges at 1 April 2005	(63.4)
Disposals in current year	52.4
Losses not realised 2006	(36.0)
<b>Losses on hedges at 31 March 2006</b>	<b>(47.0)</b>
Of which:	
Gains and losses expected to be recognised within 2007 income	-
Gains and losses expected to be recognised within 2008 income or later	(47.0)

In 2003 derivatives were put into place to hedge the anticipated bond issue. The bonds were issued at the hedged rate on the 23 July 2003. The premium proceeds on the bond issue were used to finance the payment of the swap break costs on the same date.

The losses of £36.0m for the current period relate to instruments which will continue to hedge the Group's exposure to movements in interest and currency rates.

### 18 Grants and contributions

	<b>Group £m</b>
At 1 April 2005	43.7
Receivable in year	4.7
Released to profit and loss account	(2.2)
<b>At 31 March 2006</b>	<b>46.2</b>

Grants and Contributions relate to non-infrastructure assets.

### 19 Share capital

	<b>Group and Company 2006 £m</b>	<b>Group and Company 2005 £m</b>
Authorised		
5,000,000 ordinary A shares of £1 each	5.0	5.0
195,000,000 ordinary B shares of £1 each	195.0	195.0
	<b>200.0</b>	<b>200.0</b>
Allotted, called up and fully paid		
5,000,000 ordinary A shares of £1 each	5.0	5.0
35,050,000 ordinary B shares of £1 each	35.1	35.1
	<b>40.1</b>	<b>40.1</b>

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 19 Share capital (continued)

The share capital of the Company was increased from £100 to £200,000,000 by a written resolution dated 6 May 2003 by the creation of 99,999,900 ordinary shares of £1 each and 100,000,000 redeemable shares of £1 each. By written resolution dated 14 October 2003 the share capital was redesignated into 5,000,000 A shares of £1 each and 195,000,000 B shares of £1 each. Class A shares only carry voting rights, in all respects the A and B shares rank pari passu as regards rights to income and capital.

On 7 May 2003 5,000,000 ordinary A shares were issued at £1 per share and £35,050,000 ordinary B shares were issued at £1 per share, the amounts received totalled £40.1m for both classes of shares.

### 20 Reconciliation of movement in shareholder's funds

#### Group

	Called up share capital £m	Profit and loss account £m	Total £m
At 1 April 2004	40.1	(5.1)	35.0
Prior year adjustment FRS 17		(58.1)	(58.1)
FRS 21		1.0	1.0
At 1 April 2004 restated	<u>40.1</u>	<u>(62.2)</u>	<u>(22.1)</u>
Profit for the year	-	11.4	11.4
Actuarial gain on pension scheme	-	10.6	10.6
Movement on deferred tax relating to pension asset	-	(3.1)	(3.1)
<b>At 31 March 2005</b>	<u>40.1</u>	<u>(43.3)</u>	<u>(3.2)</u>
At 1 April 2005	40.1	(43.3)	(3.2)
Profit for the year	-	16.4	16.4
Actuarial loss on pension scheme		(1.6)	(1.6)
Movement on deferred tax relating to pension asset		0.5	0.5
<b>At 31 March 2006</b>	<u>40.1</u>	<u>(28.0)</u>	<u>12.1</u>

#### Prior year adjustments arising from the implementation of new standards

The prior year adjustments relate to the implementation of FRS 17 'retirement benefits' and FRS 21 'events after the balance sheet date'.

The adoption of FRS 21 has resulted in an increase in shareholders funds of £1.0m at 1 April 2005 (2004: £1.0m) due to the write back of the dividend proposed at 31 March 2005, which can now only be recognised once approved by the Board.

The adoption of FRS 17 has resulted in a decrease in operating costs by £6.6m (2005 £1.4m), an increase in interest of £2.6m (2005 £4.0m), and an increase in tax of £1.0m (reduction 2005 £0.8m), together with the recognition of the pension deficit on the balance sheet £96.6m (2005 £98.0m). The actuarial loss of £2.0m (2005: profit £13.1m) in the pension fund has been disclosed in the Statement of Total Recognised Gains and Losses.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 20 Reconciliation of movement in shareholders' funds

#### Company

	Called up share capital £m	Profit and loss account £m	Total £m
At 1 April 2004	40.1	3.9	44.0
Prior year adjustment – FRS21		(4.0)	(4.0)
Profit for the year	-	4.2	4.2
<b>At 31 March 2005</b>	<b>40.1</b>	<b>4.1</b>	<b>44.2</b>
At 1 April 2005	40.1	4.1	44.2
Loss for the year	-	(3.0)	(3.3)
<b>At 31 March 2006</b>	<b>40.1</b>	<b>1.1</b>	<b>40.9</b>

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 21 Notes to the cash flow statement

Cash flow from operating activities	2006	2005 (restated)
	£m	£m
<b>Continuing operations</b>		
Operating profit and profit on ordinary activities before interest and taxation.	219.5	181.0
(Decrease) / Increase in provisions	(5.4)	4.1
Decrease in pension deficit	(6.6)	(0.1)
Depreciation charge	142.0	121.5
Depreciation of grants & contributions	(2.2)	(2.1)
(Increase) / decrease in stocks	(0.1)	0.4
Increase in debtors	(12.5)	-
Increase / (decrease) in creditors	0.9	(4.8)
<b>Total net cash inflow from operating activities</b>	<b>335.6</b>	<b>300.0</b>

#### Analysis of Net Debt:

	At 1 April 2005	Cash flows	Other non-cash	31 March 06
	£m	£m	£m	£m
Cash	246.2	1.1	-	247.3
Bank overdraft	(1.1)	(12.2)	-	(13.3)
	245.1	(11.1)	-	234.0
Debt due within one year	(7.5)	-	-	(7.5)
Debt due after one year	(2,711.9)	(70.9)	(14.2)	(2,797.0)
<b>Net Debt</b>	<b>(2,474.3)</b>	<b>(82.0)</b>	<b>(14.2)</b>	<b>(2,570.5)</b>

### 22 Pensions

The Group accounted for pension costs during the year under FRS17. These disclosures show a net FRS 17 deficit (after deferred tax) of £96.6 million (2005 deficit: £98.0m). The deficit has arisen mainly as a result of lower expected future returns on investments and turbulence in the stock market.

#### Pension schemes operated

At 1 April 2005 the Group principally operated two schemes, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, which was closed to new members in 31 December 1998 but re-opened in July 2003 and finally closed to new entrants on 1 April 2005. This scheme has nine trustee directors.
2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

The assets of the schemes are held separately from those of the Group. State Street Bank and Trust Company acts as custodian for the defined benefit schemes and asset management is delegated to external fund managers.

Members of all schemes receive an annual statement of their accrued benefits.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 22 Pensions (continued)

#### Pension schemes operated

The latest actuarial valuations of the Southern Water Pension Scheme (SWPS) and Southern Water Services Executive Pension (SWEPS) schemes were carried out as at 31 March 2004 using the projected unit method. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, the rate of future pensionable salary increases and the level of pension increases.

For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement.

The principal assumptions made by the actuary in the valuation were as follows:

	2004 SWPS	2004 SWEPS
	% pa	% pa
Return on investments	6.3	5.6
Salary growth	4.3	4.3
Pension increases on the excess over guaranteed minimum pensions	2.8	2.8

The assets of the scheme had a market value of £270.4m for the SWPS and £21.9m for the SWEPS at 31 March 2004. This was sufficient to cover 78% and 82% of the benefits of SWPS and SWEPS respectively, that had accrued to members at that date, after allowing for expected future increases in earnings.

#### FRS 17 - assumptions, asset, liability and reserves disclosures

Formal actuarial funding valuations of the two principal defined benefit schemes in the UK were carried out at 1 April 2004 and updated to 31 March 2006 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below.

	2006 % pa	2005 % pa	2004 % pa
Price inflation	3.0	2.9	2.9
Rate of increase in salaries (plus an age- related promotional scale)	4.3	4.4	4.4
Rate of increase of pensions in payment	3.0	2.9	2.9
Rate of increase for deferred pensions	3.0	2.9	2.9
Discount rate	5.0	5.5	5.6
Expected return on assets	6.8	7.0	7.2

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 22 Pensions (continued)

FRS 17 - assumptions, asset, liability and reserves disclosures

The assets and liabilities in the schemes and the expected rates of return at 31 March 2006, 31 March 2005 and 31 March 2004 were:

	Rate of return 2006 %	Rate of return 2005 %	Rate of return 2004 %	Value at 2006 £m	Value at 2005 £m	Value at 2004 £m
Equities	7.9%	8.1%	8.4%	273.3	223.5	192.6
Bonds	4.2%	4.7%	4.8%	108.7	94.1	87.9
Cash	4.0%	3.9%	3.9%	5.5	7.5	4.9
Total market value of Plan assets				<u>387.5</u>	325.1	285.4
Total value of Plan liabilities				<u>(525.5)</u>	(465.1)	(434.6)
Accrued deficit in the Plan				<u>(138.0)</u>	(140.0)	(149.2)
Related deferred tax asset				41.4	42.0	44.7
Net pension liability				<u>(96.6)</u>	(98.0)	(104.5)

#### Analysis of amounts charged to operating profit:

	2006 £m	2005 £m
Employer's current service cost	7.1	10.0
Employer's past service costs	0.5	0.3
Total charged to operating profit	<u>7.6</u>	<u>10.3</u>

#### Analysis of other amounts credited to operating profit:

	2006 £m	2005 £m
Gain on curtailment	(2.5)	-
Net gain credited to operating profit	<u>(2.5)</u>	<u>-</u>

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 22 Pensions (continued)

#### Analysis of the amount charged to other finance expense:

	2006	2005
	£m	£m
Interest on pension scheme liabilities	25.5	24.3
Expected return on pension scheme assets	(22.9)	(20.3)
Net charge to other finance expense	2.6	4.0
Total charge before tax	7.7	14.3

#### Analysis of the amounts recognised in STRGL:

	2006	2005
	£m	£m
Actuarial return less expected return on pension scheme assets	39.7	19.2
Experience gain/(loss) arising on scheme liabilities	4.6	1.8
Loss on change of assumptions (financial and demographic)	(46.3)	(7.9)
Total gain/(loss) recognised in STRGL before adjustment for tax	(2.0)	13.1

#### Analysis of the movement in the schemes' deficits during the year

	2006	2005
	£m	£m
Deficit in the scheme at 1 April	(140.0)	(149.2)
Employer's contributions	11.7	10.4
Employer's current service cost	(7.1)	(10.0)
Employer's past service cost	(0.5)	(0.3)
Curtailment gain	2.5	-
Other finance income	(2.6)	(4.0)
Actuarial (loss)/gain	(2.0)	13.1
Deficit in the scheme at end of year	(138.0)	(140.0)

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 22 Pensions (continued)

Details of experience gains and losses for the year to 31 March 2006 are as follows:

	2006	2005	2004	2003
a. Actuarial (gain)/loss on scheme assets				
Amount (£m)	(39.7)	(19.2)	(34.0)	77.6
Percentage of the scheme assets	10.2%	5.9%	11.9%	32.8%
b. Experience (gain)/loss on scheme liabilities				
Amount (£m)	(4.6)	(1.8)	6.8	3.0
Percentage of the present value of the scheme liabilities	0.9%	0.4%	1.6%	0.8%
c. Total actuarial loss/(gain) recognised in STRGL				
Amount (£m)	2.0	(13.1)	0.3	100.0
Percentage of the present value of the scheme liabilities	0.4%	2.9%	0.1%	26.4%

### 23 Contingent liabilities

	Group 2006 £m	Group 2005 £m
Contractors' claims	1.9	8.7

Contractors submit claims to SWS for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and SWS's valuation.

On 31 March 2006 SWS was notified by its regulator, Ofwat, that it will be fined for failing to meet customer service standards. Although no penalty has been fixed yet, the company could be fined up to a maximum of 10% of its annual turnover.

### 24 Financial commitments

	Group 2006 £m	Group 2005 £m
Annual commitments under other operating leases:		
Expiring within one year	0.4	0.4
Expiring between two and five years	2.7	2.7
	<u>3.1</u>	<u>3.1</u>

Operating leases are charged to the Profit and Loss Account over the lease term.

The Company has no such commitments.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### 25 Directors' emoluments

	2006	2005
	£000	£000
Aggregate emoluments (including benefits in kind)	203.7	254.1

Directors' emoluments relate to amounts paid by Southern Water Services Limited for their services to that company.

No payments were made to the directors of Southern Water Capital Limited by the company as they are deemed to be of a non-executive nature.

### 26 Related party transactions and ultimate controlling party

The major shareholders in Southern Water Capital Limited at 31 March 2006 are Royal Bank Investments Limited and PPI Investments SP, Inc. Southern Water Capital owns 75.0% of the share capital of Southern Water Investments Limited. The remaining 25.0% is owned by Veolia Water Investment Limited. The Company acquired VWIL's shareholding on the 10 April 2006, please see note 28 for further details.

The transactions and balances with the Group's related parties, as defined by Financial Reporting Standard 8 and the extent of the transactions with them are summarised below.

	2006	2005
	£m	£m
<b>Turnover</b>		
Recharges for consultancy to Veolia Water UK plc	0.1	-
<b>Costs</b>		
Royal Bank Investments Limited		
- fees in respect of the debt issued	2.5	0.9
Veolia Water UK plc		
- preference dividends paid	1.6	1.6
- ordinary dividends paid	1.0	1.0
Renex Limited		
- consultancy fees for R Thian	0.1	0.1
<b>Creditors</b>		
Management charges payable to Veolia Water Investment Limited and Royal Bank Investments Limited	0.2	0.5
<b>Loans greater than one year</b>		
Loan from Royal Bank Investments Limited (mezzanine debt)	233.2	233.2

## SOUTHERN WATER CAPITAL LIMITED

### NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

#### 27 Principal subsidiaries

As of 31 March 2006 the Company held 75% of the ordinary share capital of Southern Water Investments Limited. Southern Water Investments Limited principal subsidiaries are listed below.

Company	Class of share capital	Proportion of shares held	Activity
Southern Water( NR) Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water( NR) Limited (formerly Aspen 4 Limited)	Ordinary	100%	Non-trading activities
SWS Group Holdings Limited	Ordinary	100%	Non-trading activities
SWS Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water Limited (formerly Southern Water plc)	Ordinary	100%	Intermediate parent company for Southern Water(NR) Group
Southern Water Services Limited	Ordinary	100%	Supply of Water and Wastewater Services
Southern Water Services Finance Limited	Ordinary	100%	To raise debt finance
Southern Water Services Group Limited	Ordinary	100%	Non-trading activities
Southern Water Industries Limited	Ordinary	100%	Commercial Services
Southern Water Services Finance plc	Ordinary	100%	Financial Services
Bowsprit Holdings Limited	Ordinary	100%	Property Investment
Monk Rawling Limited	Ordinary	100%	Estate Management
Bowsprit Property Development Limited	Ordinary	100%	Property Development
James Leppard & Sons Limited	Ordinary	100%	Landfill Operator
Taylor Plant & Haulage Limited	Ordinary	100%	Landfill Operator
EcoClear Limited	Ordinary	100%	Dormant
Southern Water Executive Pension Scheme Trustees Limited	Ordinary	100%	Corporate Trustee of Executive Pension Scheme
Southern Water Pension Trustees Limited	Ordinary	100%	Corporate Trustee of Company Pension Scheme

All subsidiaries have been included in Southern Water Capital Limited's consolidated accounts.

#### Associate Company

Coastal Wastewater Consultants Limited	Ordinary	50%	Marine treatment, engineering design and consultancy
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This company has not been consolidated in the financial statements due to immateriality.

# SOUTHERN WATER CAPITAL LIMITED

## NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### **28 Post Balance sheet events**

On 10 April 2006 Veolia Water Investment limited sold its entire shareholding in Southern Water Investments Limited to SWC.

## SOUTHERN WATER CAPITAL LIMITED

### **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHERN WATER CAPITAL LIMITED**

We have audited the Group and Company financial statements (the "financial statements") for the year ended 31 March 2006 which comprise the Group Profit and Loss Account, the Group and Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

#### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

# SOUTHERN WATER CAPITAL LIMITED

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHERN WATER CAPITAL LIMITED

### Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group and Company's affairs as at 31 March 2006 and of its Group profit and Group cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

*PricewaterhouseCoopers LLP*  
PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Gatwick

*12 October 2006*