

REGISTRATION NO. 2366620

SOUTHERN WATER PLC

**DIRECTORS' REPORT
AND ACCOUNTS 1996-97**



SOUTHERN WATER PLC

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REPORT OF THE DIRECTORS

The Directors present their report and the audited accounts for the year ended 31 March 1997.

RESULTS AND DIVIDEND

The loss for the financial year after the charge for exceptional items amounted to £18.0 million. The directors recommend a dividend of 37.2p per ordinary share be paid. The subsequent loss of £42.1 million has been transferred from reserves.

ACTIVITIES AND REVIEW

The Company's principal activity, which is not expected to change, is to act as parent company of the subsidiary undertakings in the Southern Water group of companies and in this role to oversee the management and co-ordination of their activities.

Scottish Power plc acquired the Company on 6 August 1996.

DIRECTORS AND THEIR INTERESTS

The directors who held office during the year were as follows:

W J W Courtney	(Resigned: 7 August 1996)
M R Webster	(Resigned: 10 October 1996)
R King	(Resigned: 7 August 1996)
K Tozzi	(Resigned: 30 November 1996)
J Cullen	(Appointed: 1 April, resigned: 7 August 1996)
A M Fry	(Resigned: 7 August 1996)
V E Thomas	(Resigned: 9 May 1996)
J M Westhead	(Resigned: 7 August 1996)
T Blackler	(Appointed: 1 June 1996, resigned: 7 August 1996)
I Robinson	(Appointed: 7 August 1996)
D Whyte	(Appointed; 7 August 1996)
I S M Russell	(Appointed: 7 August 1996)
M J Kinski	(Appointed: 7 August 1996)
W G McAloon	(Appointed; 7 August 1996)
S Derwent	(Appointed: 10 October 1996)

None of the directors who held office at the end of the financial year had any disclosable interests in the shares of the Company.

Messrs Robinson, Whyte, Russell and Kinski are directors of Scottish Power plc and their interests in the shares of that company are shown in its Annual Report and Accounts. Prior to the acquisition they had no interest in the share capital of Southern Water plc.

The interests of Messrs McAloon and Derwent, the other serving directors at the end of the financial year, in the shares of Scottish Power plc at 31 March 1997 and the date of their appointment, together with the interests of Mr Derwent in the shares of Southern Water plc prior to the acquisition, Mr McAloon having none, are shown below.

REPORT OF THE DIRECTORS

Southern Water plc

	Ordinary Shares Held		Share Options				Sharesave Scheme			
	1/4/96		Executive Scheme		6/8/96		1/4/96		6/8/96	
			Granted	Exercised			Granted	Exercised		
S Derwent	11,148	33,000	-	25,000	8,000	5,293	-	-	5,293	

Scottish Power plc

	Ordinary Shares Held		Share Options				Sharesave Scheme			
	31/3/97		Executive Scheme		31/3/97		31/3/97		31/3/97	
	Appt.		Appt.	Granted	Exercised		Appt.	Granted	Exercised	
S Derwent	16,127	16,127	-	-	-	-	17,737	-	-	17,737
W G McAloon	-	-	13,889	305	-	14,194	6,436	145	-	6,581

In addition Mr McAloon has been allocated 5,048 shares under the ScottishPower long term incentive plan.

On acquisition by Scottish Power plc, options over Southern Water shares became exercisable at their pre-determined exercise price. Individuals participating in the Sharesave scheme had the additional option of converting their holdings into ScottishPower options. The options exercised or converted by the executive directors serving at the time of the acquisition are shown below. Messrs Fry, Blackler, Westhead and Thomas were non - executive directors and had no options over Southern Water plc shares.

	Executive share option scheme		Sharesave scheme	
	No. exercised	Exercise price(£)	No. exercised	Exercise price(£)
Mr W J W Courtney	40,000	6.39	2,496	2.48
	25,000	5.25	640	4.56
	29,500	6.68		
Mr M R Webster	35,000	6.39	3,024*	2.48
	25,000	5.25	195	5.37
Mr R King	21,000	4.66	3,170	3.72
	25,000	6.39		
	11,500	5.25		
Mr K Tozzi	25,000	6.39	2,496	2.48
	20,000	5.25	1,268	3.72
			1,280	4.56
Mr J Cullen	4,000	6.39	3,024*	2.48
	10,000	5.25	2,269*	4.56

* Denotes options converted.

The Scottish Power plc offer price at 6 August 1996 was 1050p.

REPORT OF THE DIRECTORS

On acquisition by Scottish Power plc, shares in Southern Water plc, held in trust under the Southern Water plc Long Term Incentive Scheme and originally eligible for award in July 1998, were released to the following directors:

	<u>Shares</u>
M R Webster	7,000
R King	5,000
K Tozzi	5,000
J Cullen	3,000

DIRECTORS' RESPONSIBILITIES

The directors are required by UK company law to prepare financial statements that give a true and fair view of the state of affairs of the Company as at the end of the financial period and of the profit or loss of the Company for that period.

The directors confirm that suitable accounting policies have been used and applied consistently and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the period ended 31 March 1997. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis.

The directors are responsible for keeping proper accounting records, for taking reasonable steps to safeguard assets of the Company and to prevent fraud and other irregularities.

DIRECTORS AND OFFICERS LIABILITY INSURANCE

The Company maintains liability insurance covering the directors and other officers of the Company.

EMPLOYMENT POLICIES

The Company is an equal opportunities employer and has a policy of non-discrimination in all forms of employment. Selection and promotion are based solely on merit and ability, and no job applicant or employee receives less favourable treatment. Disabled persons are considered for all types of work and modifications to jobs and equipment are made to enable them to be employed. Employees who become disabled are offered alternative work within the Company wherever possible.

With the future prosperity of the Company depending on the skills of its employees, we are committed to ensuring that the training required to fulfil career potential is provided. Training programmes are designed to meet specific needs, and include a range of in-house courses, beginning with an induction programme which introduces new employees to the fundamentals of customer service, teamwork and quality standards. The Open Learning programme of ScottishPower has been successfully implemented in Southern Water.

The Company places strong emphasis on effective employee communications and operates a number of formal and informal mechanisms, ranging from employee briefings to publications such as the corporate newspaper "Southern Water News". All employees are made aware of the objectives of the business and the contribution they themselves can make. Pay is related to company and individual performance and employees are encouraged to participate in the Employee Sharesave Scheme.

REPORT OF THE DIRECTORS

The health and safety of employees is of paramount concern and every effort is made to ensure safe working conditions and appropriate safety training. Additionally, all employees have the opportunity to undertake health and lifestyle checks at the Company's expense.

PAYMENT OF CREDITORS

The Company's current policy concerning the payment of the majority of its trade creditors is to follow the CBI's Prompt Payers Code. For other suppliers, the Company's policy is to

- (i) settle terms of payments with suppliers when agreeing the terms of transactions,
- (ii) ensure that suppliers are made aware of the terms of payment, and
- (iii) to comply with those contractual arrangements.

The Company's "creditor days" as defined in the Statement of Payment Practice Regulations of the Companies Act 1985 (as amended) were 30 days for the financial year ended 31 March 1997.

AUDITORS

A resolution to reappoint the auditors, Coopers & Lybrand, will be proposed at the Annual General Meeting.

By Order of the Board.



Andrew Mitchell
Secretary
12th May 1997

REGISTERED OFFICE

Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX

ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared under the historical cost convention and in accordance with the requirements of the Companies Act 1985 and applicable accounting standards in the United Kingdom.

Basis of preparation

The financial statements contain information about Southern Water plc as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The Company is exempt under section 228 of the Companies Act 1985 from the requirement to prepare consolidated financial statements as it and its subsidiaries are included by full consolidation in the consolidated financial statements of the ultimate holding company Scottish Power plc, a company registered in Scotland.

Statement of cash flows

The company is exempt from including a Statement of Cash Flows in its accounts as it is a wholly owned subsidiary of a company incorporated in the United Kingdom which has included a consolidated Statement of Cash Flows in its consolidated accounts.

Turnover

Turnover represents the invoiced value of goods and services provided, excluding value added tax.

Tangible fixed assets

Fixed assets are stated at cost and depreciated on the straight-line method over their estimated operational lives. The main depreciation periods used by the company are set out below:

	<u>years</u>
Fixtures and fittings	3-10
Plant, machinery and vehicles	3-10

Leased assets

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

Investments

Investments held as fixed assets are stated at cost less provision for any permanent diminution in value.

Current asset investments

Current asset investments are stated in the balance sheet at market value. Realised and unrealised gains and losses arising in the year are recognised in the profit and loss account.

ACCOUNTING POLICIES

Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of transaction or at the forward cover rate where forward cover arrangements exist. Foreign currency balances are translated at the rate ruling at the balance sheet date or, where applicable, at the contracted rate. All foreign currency gains and losses are taken to the profit and loss account.

Taxation

Advance corporation tax in respect of dividends payable for the year is written off in the profit and loss account unless it can be recovered against mainstream corporation tax.

Provision is made for deferred taxation, using the liability method, in respect of timing differences to the extent that it is probable that a liability will crystallise in the foreseeable future. Such timing differences arise primarily from the different treatment for taxation and accounting purposes of provisions and the depreciation of fixed assets.

Pensions

The company operates defined benefit and defined contribution pension schemes. A revaluation of the pension schemes is normally conducted by an independent actuary every three years. The regular cost of providing pensions and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Payments to defined contribution schemes are charged against profit as incurred.

BALANCE SHEET

As at 31 March 1997

Notes	1997		1996	
	£m	£m	£m	£m
	Fixed assets			
8	Tangible assets	1.4		1.2
9	Investments	467.9		504.0
		<u> </u>		<u> </u>
		469.3		505.2
	Current assets			
10	Debtors	142.2		176.7
11	Current asset investments	-		50.7
	Short term bank and other deposits	118.1		17.2
		<u> </u>		<u> </u>
		260.3		244.6
	Creditors			
12	Amounts falling due within one year	(160.7)		(135.7)
		<u> </u>		<u> </u>
	Net current assets		99.6	108.9
			<u> </u>	<u> </u>
	Total assets less current liabilities		568.9	614.1
	Creditors			
12	Amounts falling due after more than one year		(146.4)	(155.1)
			<u> </u>	<u> </u>
	Net assets		422.5	459.0
			<u> </u>	<u> </u>
13	Called up share capital		156.6	155.4
14	Capital redemption reserve		16.9	16.9
14	Share premium		14.4	11.8
14	Profit and loss account		234.6	274.9
			<u> </u>	<u> </u>
	Equity shareholders' funds		422.5	459.0
			<u> </u>	<u> </u>

The accounting policies on pages 6 and 7 together with the notes on pages 10 to 19, form part of these accounts.

Approved by the Board on 12th May 1997 and signed on its behalf by:



W G McAloon
Finance Director

NOTES TO THE ACCOUNTS

1 Classification of revenue costs

Administrative expenses relate to the costs incurred as part of the management and coordination of the group's activities. Other operating income includes recharges of costs and dividends receivable from subsidiary companies.

2 Operating profit

	1997	1996
	£m	£m
Operating (loss)/profit is stated after charging:		
Depreciation on own fixed assets	0.5	0.5
Rentals under operating leases:		
- motor vehicles	0.2	0.2
	<u>£000</u>	<u>£000</u>
Auditors' remuneration for audit	40	40
Auditors' remuneration for non-audit services to the company	50	105
	<u> </u>	<u> </u>
Exceptional operating expenses:		

Following the acquisition of the Company by Scottish Power plc on 6 August 1996, a detailed review of assets and liabilities was carried out in accordance with the fair value principles set out in Financial Reporting Standard Number 7. Following this exercise, accruals totalling £64.5 million were set up to recognise environmental (£20.6 million) and capital and other liabilities (£43.9 million) across the group.

3 Employee information

	1997	1996
	£m	£m
(a) Staff costs (including directors' emoluments)		
Wages and salaries	3.6	4.0
Social security costs	0.4	0.3
Pension contributions	0.7	0.8
	<u>4.7</u>	<u>5.1</u>
	<u> </u>	<u> </u>
	1997	1996
	Number	Number
(b) The average number of employees (full time and part time) employed by the Company, including executive directors was	134	140
	<u> </u>	<u> </u>

NOTES TO THE ACCOUNTS

4 Net interest receivable	1997	1996
	£m	£m
Interest payable on bank loans, overdrafts and other loans:		
Repayable wholly within 5 years	(2.1)	(5.5)
Not wholly repayable within 5 years	(15.8)	(10.2)
	<u>(17.9)</u>	<u>(15.7)</u>
Total interest payable		
Interest receivable	51.6	55.5
	<u>33.7</u>	<u>39.8</u>

Interest receivable of £45.6m was receivable from Southern Water group companies.

5 Exceptional items	1997	1996
	£m	£m
Costs of defending takeover bids	16.0	-
Reorganisation costs	7.2	-
	<u>23.2</u>	<u>-</u>

The costs associated with defending the takeover bids during 1996/7 have been charged as a non-operating exceptional item as in the opinion of the directors such costs are unrelated to the Company's operations. Included in the costs of defending the takeover bids is an amount of £100,000 paid to the Company's auditors. Reorganisation costs relate to the fundamental restructuring of the Southern Water group following the acquisition by Scottish Power plc.

6 Taxation	1997	1996
	£m	£m
United Kingdom taxation at 33% (1996: 33%):		
Corporation tax in respect of the current year	29.7	-
Corporation tax provision in respect of prior years no longer required	-	(0.5)
	<u>29.7</u>	<u>(0.5)</u>
Advance corporation tax in respect of prior years no longer required	-	0.3
Advance corporation tax previously written off now utilised	(18.1)	-
Advance corporation tax on dividends for the year	-	10.6
	<u>11.6</u>	<u>10.4</u>

The corporation tax charge for the year of £29.7m has been reduced by £1.4m in respect of the excess of tax allowances over depreciation and other timing differences.

NOTES TO THE ACCOUNTS

7 Dividend per ordinary share

	1997 pence per ordinary share	1996 pence per ordinary share	1997 £m	1996 £m
Interim dividend	-	9.8	-	15.0
1997 Proposed final dividend	37.2	-	58.3	-
1996 final dividend	-	21.8	(34.2)	34.0
	<u>37.2</u>	<u>31.6</u>	<u>24.1</u>	<u>49.0</u>

On the acquisition of the Company, the purchase consideration paid by Scottish Power plc included a dividend of 21.8p (net) per share totalling £34.2 million, which was paid in substitution for the final 1996 dividend.

8 Fixed assets and capital commitments

(a) Tangible assets	Plant machinery and vehicles £m	Fixtures, fittings and other £m	Total £m
Cost :			
At 1 April 1996	0.5	2.3	2.8
Additions	-	0.7	0.7
Disposals	(0.2)	-	(0.2)
At 31 March 1997	<u>0.3</u>	<u>3.0</u>	<u>3.3</u>
Depreciation :			
At 1 April 1996	0.3	1.3	1.6
Charge for the year	0.1	0.4	0.5
Disposals	(0.2)	-	(0.2)
At 31 March 1997	<u>0.2</u>	<u>1.7</u>	<u>1.9</u>
Net book value :			
At 31 March 1997	<u>0.1</u>	<u>1.3</u>	<u>1.4</u>
At 31 March 1996	<u>0.2</u>	<u>1.0</u>	<u>1.2</u>

(b) There were no capital commitments as at 31 March 1997 and 31 March 1996.

NOTES TO THE ACCOUNTS

9 Fixed asset investments

	Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Other investments £m	Total £m
Cost:				
At 1 April 1996	85.2	424.6	1.4	511.2
Additions/net loans (repaid)	0.3	(30.3)	-	(30.0)
At 31 March 1997	85.5	394.3	1.4	481.2
Amounts written off:				
At 1 April 1996	(4.3)	(2.9)	-	(7.2)
Movement in the year	0.3	(6.4)	-	(6.1)
At 31 March 1997	(4.0)	(9.3)	-	(13.3)
Net book value :				
At 31 March 1997	81.5	385.0	1.4	467.9
At 31 March 1996	80.9	421.7	1.4	504.0

Subsidiary undertakings

The Company's principal subsidiary undertakings at 31 March 1997 are listed below.

Company	Class of capital	Proportion of class held	Nature of business
Southern Water Services Limited	Ordinary	100%	Provision of water supply and wastewater services
Pipeworks Limited	Ordinary	100%	Pipework, mainlaying, plumbing, heating and ventilation services
Nationwide Maintenance Limited*	Ordinary	100%	Facilities management services
Southern Water Industries Limited	Ordinary	100%	Industrial and commercial services
McDowells Limited*	Ordinary	100%	Civil and structural engineering design and consultancy
IT Southern Limited*	Ordinary	100%	Information technology services
Paperstream Limited*	Ordinary	100%	Mailing, remittance processing and printing services
Tynemarch Systems Engineering Limited	Ordinary	100%	Process control and engineering software services

NOTES TO THE ACCOUNTS

Subsidiary undertakings continued

Company	Class of capital	Proportion of class held	Nature of business
Sectron Systems Limited*	Ordinary	100%	Security services
Southern Science Limited*	Ordinary	100%	Laboratory analysis and environmental assessment
GMSS Limited	Ordinary	75%	Laboratory services
Aquaclear Limited*	Ordinary	100%	Commercial water systems consultancy
Eco-clear Limited	Ordinary	100%	Liquid waste management
Taylor Plant & Haulage Limited	Ordinary	100%	Waste disposal services
James Leppard & Son Limited	Ordinary	100%	Landfill operation
ERG Environmental Resource Group plc	Ordinary	100%	Effluent and odour treatment services
Greenhill Enterprises Limited	Ordinary	100%	Waste management
Clinical Waste Limited	Ordinary	55%	Clinical waste management
Topmark Vehicle Contracts Limited*	Ordinary	100%	Vehicle contract hire sales and rentals
Vehicle Contract Hire & Leasing*	Ordinary	100%	Vehicle contract hire, sales and rentals
Pipestock Plus Limited	Ordinary	100%	Materials, purchasing and distribution
Hazeley Down Mineral Water Company Limited*	Ordinary	100%	Bottled mineral water
Bowsprit Holdings Limited	Ordinary	100%	Property investment
Monk Rawling Limited	Ordinary	100%	Estates management and property consultancy
Bowsprit Property Development Ltd	Ordinary	100%	Property development
Moreton & Padmore Limited *	Ordinary	100%	Quantity surveying
Waterline Insurance Company Ltd**	Ordinary	100%	Insurance
Southern Water Technologies Ltd*	Ordinary	100%	Technology marketing services
Southern Water Global Limited*	Ordinary	100%	Overseas engineering and environmental consultancy and operations

* These companies act as agents of Southern Water Industries Limited.

** Registered in the Isle of Man

NOTES TO THE ACCOUNTS

Investments in other companies

Company	Class of capital	Proportion of class held	Nature of business	Total capital and reserves £m	Profit for the period £m
Associated undertaking					
Coastal Wastewater Consultants Limited	Ordinary	50.0%	Marine treatment engineering design and consultancy	-	-
Other investments					
Folkestone & Dover Water Services Ltd	Ordinary Preference Deferred	25.1% 21.8% 12.2%	Water supply	10.9	3.9

10 Debtors

	1997 £m	1996 £m
Amounts owed by parent company and fellow subsidiary undertakings	72.7	-
Amounts owed by subsidiary undertakings	67.4	174.4
Other debtors	0.3	0.3
Prepayments	1.8	2.0
	<u>142.2</u>	<u>176.7</u>

11 Current asset investments

	1997 £m	1996 £m
Current asset investments at market value	-	47.9
Own shares held, at cost	-	2.8
	<u>-</u>	<u>50.7</u>

NOTES TO THE ACCOUNTS

12 Creditors

	1997	1996
	£m	£m
(a) Amounts falling due within one year:		
Bank loans and overdrafts	-	56.1
Long term borrowings repayable within 12 months	8.7	3.9
Trade creditors	0.2	0.2
Amounts owed to parent company and fellow subsidiary undertakings	1.4	-
Amounts owed to subsidiary undertakings	4.1	3.3
Corporation tax	11.6	11.9
Other taxes and social security	0.1	0.2
Accrued expenses and deferred income (see note 2)	76.3	10.8
Proposed dividend	58.3	49.3
	<u>160.7</u>	<u>135.7</u>
(b) Amounts falling due after more than one year :		
Bank loans	155.1	159.0
Less amounts repayable within 12 months	(8.7)	(3.9)
	<u>146.4</u>	<u>155.1</u>
Repayable as follows:		
Between one and two years	10.0	8.7
Between two and five years	37.2	32.8
After five years	99.2	113.6
	<u>146.4</u>	<u>155.1</u>

Bank loans are unsecured and repayable by instalments for periods up to 15 years. The rates of interest payable on loans range from 7.1% to 11.05%.

13 Share capital

	1997	1996
	£m	£m
Authorised :		
225,000,000 ordinary shares of £1 each	225.0	225.0
1 special rights non-voting redeemable preference share	-	-
	<u>225.0</u>	<u>225.0</u>
Allotted, called up and fully paid ordinary shares of £1 each:		
At 1 April	155.4	169.3
Allotments during the year	1.2	3.0
Share repurchase	-	(16.9)
	<u>156.6</u>	<u>155.4</u>
At 31 March		

NOTES TO THE ACCOUNTS

Allotments in the year were in respect of scrip dividends 0.2m, executive share options exercised 0.5m, and sharesave scheme 0.5m. Cash received in respect of shares allotted amounted to £3.9m.

On 6 August 1996 the Company was acquired by Scottish Power plc and was a wholly owned subsidiary of Scottish Power plc at 31 March 1997.

14 Reconciliation of movements in shareholders' funds

	Called up share redemption capital £m	Capital reserve £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 1996	155.4	16.9	11.8	274.9	459.0
Loss retained	-	-	-	(42.1)	(42.1)
Allotment of shares	1.2	-	4.4	-	5.6
Scrip adjustment	-	-	(1.8)	1.8	-
At 31 March 1997	<u>156.6</u>	<u>16.9</u>	<u>14.4</u>	<u>234.6</u>	<u>422.5</u>

15 Acquisitions

On 31 July 1996 Southern Water plc acquired the entire issued share capital of Falcon Mechanical Services Limited, a company specialising in facilities management services, for a total consideration of £198,000 in cash.

16 Pensions

The company operates a number of pension schemes on behalf of the Southern Water group of companies. The principal defined benefit scheme, which covers over 70% of the group's employees has eight Trustee Directors - Mr M J Kinski and Mr W G McAloon and six other members who are not Directors of the company. The power of appointment of new Trustee Directors is vested in Southern Water plc.

The assets of the schemes are held separately from those of the company. The Bank of Scotland acts as custodian trustee for the defined benefit schemes and asset management is delegated to an external fund manager.

Members of the schemes receive an annual statement of their accrued benefits and a copy of the trustees' annual report. The accounts of all schemes are audited annually by Coopers & Lybrand.

The defined benefit schemes are valued by independent consulting actuaries using either the 'projected' unit method or the 'attained age' method. The last completed actuarial valuation of the principal scheme was carried out as at 31 March 1995. At that date, the market value of the scheme's assets was £148.3m, and the actuarial value of these assets represented approximately 102% of the benefits accrued to members, after allowing for expected increases in earnings. The employers' average contribution is 12.7% of pensionable pay with members paying standard contributions of 6%, 5% or 3%.

NOTES TO THE ACCOUNTS

The most recent actuarial valuations of the other defined benefit schemes indicated that the market values of their assets covered the estimated value of members' accrued benefits, after allowing for a special contribution paid into one of the schemes. On 1 April 1996 one of these defined benefit schemes was merged with the principal scheme.

The principal assumptions used in all actuarial valuations are those related to the differentials between the rates of return on investments and the rates of increases in earnings and pensions. In the main scheme, it has been assumed that the investment return per annum will be 2% higher than wage and salary increases and 3.5% higher than pension increases (4% higher where limited price indexation applies).

Pension costs of the company for the year were £0.7m (1996: £0.8m).

17 Financial commitments

	1997	1996
	£m	£m
Annual commitments under operating leases:		
Expiring between two and five years	0.2	0.2
	—	—

18 Windfall levy

On May 2 1997, the Labour Party was invited to form the Government of the United Kingdom. The Labour Party's election manifesto contained proposals for a "windfall levy" of unspecified amount to be imposed on United Kingdom utility companies. It is probable that the windfall levy will be reflected in the Government's legislative proposals for 1997-98. However, details of the application of the proposed levy and its basis of calculation have not been published. Therefore it is not possible for the company to ascertain whether or not it will be liable to a levy, and if it were, the amount that would be charged. Provision for the company's liability, if any, in respect of any such levy will therefore be charged in arriving at the results for the company once the details of the levy and its application have been determined.

19 Contingent liabilities

Other than the windfall levy discussed in note 18, there were no contingent liabilities at 31 March 1997 and 31 March 1996.

The Company is party to mutual cross guarantees for any monies owed by Southern Water group companies to National Westminster Bank plc.

NOTES TO THE ACCOUNTS

20 Directors' emoluments and interests

	1997 £000	1996 £000
Aggregate emoluments (including bonuses and benefits in kind)	606	702
Compensation for loss of office	367	-
	<hr/>	<hr/>
	973	702
	<hr/>	<hr/>
Highest paid director: aggregate emoluments and benefits (excluding gains made on exercise of share options and value of shares received under long-term incentive schemes)	161	203
	<hr/>	<hr/>

Defined benefit pension scheme : the highest paid director, who retired during the year, commuted some of his pension to provide a lump sum of £98,000 and an annual pension of £40,919.

Six of the directors exercised share options during the year, as set out on pages 2 to 4 of the Directors' Report. No directors became entitled to receive shares under the Southern Water long-term incentive scheme. Retirement benefits are accruing to one director under a Southern Water defined benefit scheme.

Messrs Robinson, Whyte, Russell and Kinski are directors of the ultimate holding company, Scottish Power plc, and full details of their remuneration for 1997 and 1996 are contained in that company's financial statements.

21 Related party transactions

As a wholly owned subsidiary, the Company is exempt from the requirement to disclose related party transactions with other Southern Water and ScottishPower group undertakings under Financial Reporting Standard Number 8.

22 Ultimate holding company

The company is a wholly owned subsidiary of Scottish Power plc.

(Copies of Scottish Power plc's consolidated financial statements may be obtained from the Company Secretary at 1 Atlantic Quay, Glasgow G2 8SP).

REPORT OF THE AUDITORS

To the members of Southern Water plc.

We have audited the financial statements on pages 6 to 19.

Respective responsibilities of directors and auditors

As described on page 4, the Company's Directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards 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 judgements 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.

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs at 31 March 1997 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers & Lybrand

Coopers & Lybrand
Chartered Accountants and Registered Auditors
London
12th May 1997