

Dŵr Cymru Cyfyngedig

Regulatory accounts
for the year ended 31 March 2007

Registered Office:-
Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY

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Directors and advisors

Directors

Lord Burns	Chairman
Nigel Annett	Managing Director
Chris Jones	Finance Director
Peter Perry	Operations Director (appointed 1 August 2006)
Jim O'Sullivan	Operations Director (resigned 31 July 2006)
John Bryant	Non-Executive Director
Alison Carnwath	Non-Executive Director
Geraint Talfan Davies	Non-Executive Director
Dame Deidre Hine	Non-Executive Director
Tony Hobson	Non-Executive Director
James Strachan	Non-Executive Director (appointed 1 June 2007)

Company secretary

Richard Curtis

Auditors

PricewaterhouseCoopers LLP

Solicitors

Linklaters & Alliance
Edwards Geldard

Principal bankers

National Westminster Bank Plc

Directors' report

Introduction

Dŵr Cymru Cyfyngedig ('Welsh Water') is the company appointed by the Secretary of State for Wales as a water and sewerage undertaker under the Water Industry Act 1991 and is required to comply with the Conditions set out in the Instrument of Appointment (The Licence) issued thereunder.

The Regulatory Accounts are separate from the statutory financial statements of the Company, which are prepared under International Financial Reporting Standards (IFRS). There are differences between IFRS and the basis of preparation of information provided in the regulatory accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Appointed business

Welsh Water carried out both appointed and non-appointed businesses during the year ended 31 March 2007. The appointed business, as defined in condition A of the Instrument of Appointment, comprises those activities that are necessary in order for the Appointee to fulfil the functions and duties of a water and sewerage undertaker in accordance with the Water Industry Act 1991. The Non-Appointed Business comprises those functions and activities, which are not regulated under the Instrument of Appointment. In respect of the year ended 31 March 2007 the non-appointed business comprised the sale of non-appointed services to third parties including rechargeable works.

Financial results

Historic cost profit before tax for the financial year ended 31 March 2007 was £68.0 million (2006: £64.5 million). In 2006-07, customers received a 'customer dividend' of £25 million, or £19 per household served (£9.50 for water and £9.50 for wastewater services), by way of a reduction in bills below that allowed by the Ofwat price control. For the financial year 2007-08, for which water bills have been issued, the 'customer dividend' was increased to £20 per household (£10 for water and £10 for wastewater services) at a cost of £27 million.

Directors

The Directors are listed on page 1. With the exception of Jim O'Sullivan who resigned on 31 July 2006, Peter Perry who was appointed a director on 1 August 2006, and James Strachan who was appointed a director on 1 June 2007, all Directors served throughout the financial year. No Director has, or has had, a material interest, directly or indirectly, in any contract significant to the Company's business.

Employees

At 31 March 2007 Welsh Water employed 165 people.

Health and safety

We are committed to achieving high standards of health and safety, as there is nothing more important to us than the health and safety of the people who work for us, and those we affect through our work.

The process of health and safety management we adopt across our outsourced business structure, the performance of Welsh Water and its contract partners in 2006-07 and our current challenges and goals are set out in detail in our 2007 Health and Safety Report. A copy of this document is available on request or may be obtained from our website www.dwrcymru.com.

Research and development

The Company continues to monitor and selectively participate in water industry initiatives, most notably through membership of UK Water Industry Research Limited. Through this, and by continuing to benefit from a sharing of best practice from the R&D investment and initiatives by our outsourced contract partners, we aim to maintain our achievements in improving operational efficiency, and to ensure continued compliance with appropriate national and international standards for potable water, sewage effluent and sludge treatment.

Directors' report cont'd

Payment policy

Our policy is to agree payment terms at the start of a relationship with a supplier, which will only be changed by agreement. Payment will be made in accordance with agreed terms, save where we advise suppliers when an invoice is contested, which we will do without unreasonable delay. We will seek to remedy disputes as promptly as possible. Standard payment terms to suppliers of goods and services will be 30 days from date of receipt of a correct invoice for satisfactory goods or services which have been ordered or received, unless other terms are agreed in a contract.

In 2006-07, the average payment period was 43 days (2006: 61 days). Regulations require that in calculating this we include within trade creditors monies retained under contract in respect of capital investment projects. This level of retentions varies from year to year and adversely affects the average payment period for the year.

Dividends

During the year, the Company has not paid an ordinary dividend.

Donations

During the year, charitable donations amounted to £32,874 (2006: £33,395). Individual donations of above £200 were made to: WaterAid (£17,900), Keep Wales Tidy (£10,000), Mike Paines Bursary Memorial (2,278), Ty Hafan (£1,500) and Business in the Community (£1,000).

No donations are made to political parties. No payments or donations in kind have been made that are required to be disclosed under the Political Parties, Elections and Referendums Act 2000.

Welsh Language Scheme

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

Auditors

PricewaterhouseCoopers LLP acted as auditors to Dŵr Cymru Cyfyngedig for the accounts for the year ended 31 March 2007. As part of the audit process Directors have confirmed that as far as each Director is aware (a) there is no relevant audit information of which the Company's auditors are unaware, and (b) they have taken steps to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

PricewaterhouseCoopers LLP have expressed their willingness to continue as auditors and a resolution for their reappointment will be considered at the 2007 annual general meeting of Glas Cymru Cyfyngedig.

By order of the Board

R Curtis LLB ACIS
Company Secretary

8 June 2007

Our key performance at a glance

The Board has identified eight key performance indicators (KPI's) to monitor the success of the business, seven of which reflect our key financing and customer service strategies, i.e. reducing long term financing costs and improving customer service. The eighth addresses occupational health and safety and the fundamental right of all those who work on our behalf, or are affected by our undertaking, to return home safely at the end of each day.

Financial KPI's cover:

- (i) Bond credit rating;
- (ii) Gearing;
- (iii) Interest cover; and
- (iv) 'Customer dividend'.

[1](#) [2](#) [3](#) [4](#)

Customer service KPI's cover Ofwat's assessment of Overall Performance Assessment (OPA), customer satisfaction and overall bacteriological water quality. For occupational health and safety we monitor the Accident Incidence Rate (AIR). [5](#) [6](#) [7](#) [8](#)

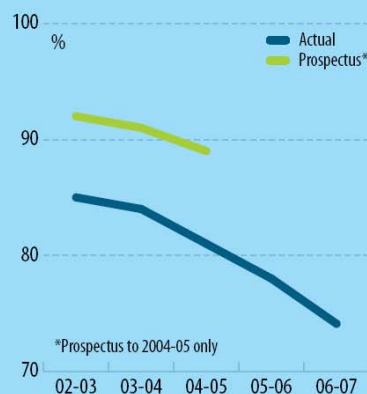
Further information regarding the definition, purpose and target for each of these KPI's can be found on page 30 of this report.

In addition to these KPI's we also report key performance measures for Welsh Water that we have published each year since Glas Cymru acquired Welsh Water in 2001. Further information regarding the definition of these indicators can also be found on page 30. [9](#)

1 Credit ratings of Glas Cymru bonds

	Standard & Poor's	Moody's	Fitch Ratings
Class A Bonds	AAA	Aaa	AAA
Class B Bonds	A-	A3	A
Class C Bonds	BBB	Baa2	BBB+

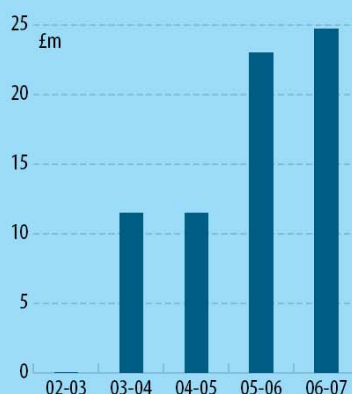
2 Gearing (net debt/RCV)



3 Interest cover

	2007 £m	2006 £m
Year to 31 March		
EBITDA (pre - 'customer dividend')	374	363
Interest payable (excluding indexation and amortisation of issue costs):		
Senior debt	115	114
Senior debt + class C bonds	125	127
Total debt	127	130
Interest cover (EBITDA/Net interest):		
Senior debt	3.3x	3.1x
Senior debt + class C bonds	3.0x	2.9x
Total debt	2.9x	2.8x

4 'Customer dividend'

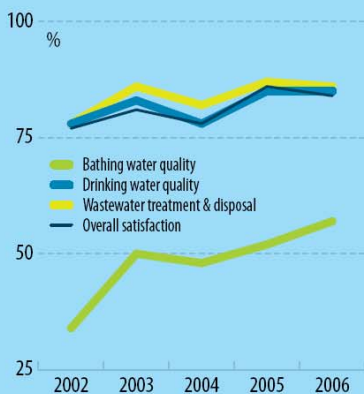


5 Overall Performance Assessment

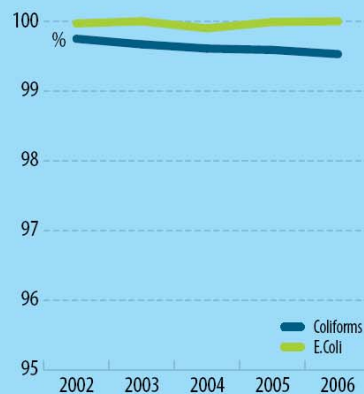


* OPA score and ranking in 2006-07 will be disclosed in Ofwat's Levels of Service Report published in Autumn 2007.

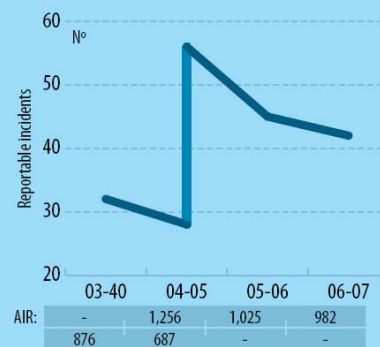
6 Customer satisfaction



7 Bacteriological compliance 'at the tap'



8 Health and safety



* 2003-04 includes directly employed contractors only. From 2005-05 tier-1 subcontractors have been fully engaged as part of the health and safety management system.

9 Key performance measures

Year to 31 March 2007	Monitoring Plan target ⁴	Previous performance 2005-06	Actual performance 2006-07	At or ahead of target	At or better than previous year
Customer service					
Properties 'at risk' of receiving low pressure	242	221	221	✓	✓
Unplanned water supply interruptions	1,080	454	313	✓	✓
Properties 'at risk' of sewer flooding	432	514	484	✗	✓
Properties flooded due to hydraulic overload	122	81	96	✓	✗
Properties flooded due to other causes	120	150	203	✗	✗
Billing enquiries answered within 5 days	100%	100%	100%	✓	✓
Written complaints answered within 10 days	99.9%	99.4%	99.7%	✗	✓
Number of written complaints received	n/a	9,948	10,348	n/a	✗
Customer meters read within year	99.9%	99.9%	99.9%	✓	✓
Telephone calls abandoned	1.3%	1.6%	1.7%	✗	✗
Telephone calls receiving engaged tone	0%	0.3%	0.4%	✗	✗
Call handling satisfaction ¹	n/a	4.6	4.6	n/a	✓
Water quality					
Overall water quality compliance 'at the tap' ^{2 C}	n/a	99.9%	99.9%	n/a	✓
Bacteriological compliance 'at the tap' ^C	n/a	99.6%	99.5%	n/a	✗
Iron compliance 'at the tap' ^C	98.9%	99.2%	99.1%	✓	✗
Operational Performance Index ^C	n/a	99.8%	99.8%	n/a	✓
Operational Performance Index (TIM) ^{3 C}	n/a	99.7%	99.7%	n/a	✓
Environment					
Leakage (m ³ /km/day)	7.7	8.2	7.7	✓	✓
Number of 'category 1 and 2' pollution incidents ^{5 C}	n/a	17	17	n/a	✓
Number of 'category 3' pollution incidents ^C	n/a	194	208	n/a	✗
Wastewater treatment works complying with (LUT) consents ^{6 C}	99.7%	99.6%	99.7%	✓	✓
Sewage sludge recycled satisfactorily ^C	100%	100%	100%	✓	✓
'Mandatory' coastal bathing water compliance at EU designated bathing beaches ^C	100%	100%	99%	✗	✗
'Guideline' coastal bathing water compliance at EU designated bathing beaches ^C	'Stable'	91%	89%	n/a	✗

¹ New measure introduced in 2005-06. Score out of maximum 5.

² This measure is now based on 'Mean Zonal Compliance'.

³ New measure introduced in 2005-06 which takes into account performance against turbidity, iron and manganese.

⁴ The Monitoring Plan sets out the targets agreed with regulators at the Regulatory Price Review in 2004 and covers the five year period to 31 March 2010.

⁵ 2 of these pollution incidents resulted from 'compliant discharges' (2005-06: 8).

⁶ 'Look up' table.

^C Calendar year 2006, all other figures are for the year ended 31 March 2007.

Definition, purpose and target for each KPI

Measure	Purpose	Source	Target	Progress to Target
Bond credit rating Strategy: Financing	A direct way of further reducing Welsh Water's financing cost is to improve the credit rating of the group's corporate bonds. Executive directors are incentivised to maintain bond ratings. Rating agencies apply their own definition and methodology in assessing bond credit rating.	Bond ratings as independently determined by three rating agencies: Standard & Poor's, Moody's and Fitch Lovell.	Corporate credit rating of 'A' grade.	✓
Gearing Strategy: Financing	The Glas Cymru business model aims to reduce Welsh Water's asset financing cost, the industry's single biggest cost. Improved credit quality is key to keeping Welsh Water cost of finance as low as possible. Gearing is the ratio of Net Debt to Regulatory Capital Value of Welsh Water.	Glas Cymru Investor Report	To reduce gearing to around 70%.	✓
Interest cover Strategy: Financing	The Glas Cymru business model aims to reduce Welsh Water's asset financing cost, the industry's single biggest cost. Meeting interest cover covenants is key to maintaining investor confidence and to keeping Welsh Water cost of finance as low as possible. Interest cover is the ratio of operating cashflow (before maintenance) to net interest (excluding indexation).	Glas Cymru Investor Report	To maintain interest cover consistent with target credit rating.	✓
Customer Dividend Strategy: Customer value	As well as improving credit quality, financing efficiency is used to build up reserves to insulate Welsh Water and its customers from unexpected costs and to have scope to return money to customers through sustained 'customer dividends'. Through the customer dividend, therefore, the customers of Welsh Water share in the success of the business.	Glas Cymru Audited Accounts	Progressive 'customer dividend' policy.	✓
Overall Performance Assessment (OPA) Strategy: Customer service	OPA is the measure published by Ofwat of each company's overall delivery of service to customers. It reflects a broad range of services provided to customers across key areas of water supply, sewerage service, security of supply, customer service and environmental impact.	Ofwat	Upper quartile performance relative to the ten water and sewerage companies in England and Wales.	✓*
Customer satisfaction Strategy: Customer service	Since 2001 the Board has monitored customer satisfaction with the services provided by Welsh Water via a six monthly customer opinion survey under taken by Beaufort Research. Although customer opinion can be influenced (often adversely) by media coverage of events elsewhere in the UK water industry, this is an important indicator of the company's progress.	Beaufort Research	To maintain consistent high levels of customer satisfaction.	✓
Overall bacteriological water quality Strategy: Customer service	An important measure of the quality of water supplied to customers is compliance with bacteriological standards. There is also a correlation between failures in bacteriological quality and unsatisfactory water supplied to customers. This measure is not a component of Ofwat's OPA index.	Drinking Water Inspectorate	100% of all assets compliant.	✓
Health and safety (Accident Incident Rate – AIR) Strategy: Occupational health and safety	AIR is a statistical index used by the Health and Safety Executive (HSE) to benchmark company and sector relative performance. It is the number of reportable incidents occurring in a reported period per 100,000 employees.	June Return	To have one of the best AIR of the UK's water and sewerage companies and to compare favourably with appropriate HSE benchmark for AIR.	✓

* Latest published data for the year ended 31 March 2006.

The service level indicators reported on page 3 derive from Welsh Water's annual regulatory report to Ofwat (the 'June Return') and are measures defined and monitored by Ofwat, the Drinking Water Inspectorate or the Environment Agency. An Overview of the latest June Return is available on request or from our website www.dwrcymru.com.

Operating and financial review

A single purpose

Glas Cymru is the single purpose company formed in 2000 to own, finance and manage Dwr Cymru Welsh Water ('Welsh Water'). It is a 'company limited by guarantee' and because it has no shareholders, any financial surpluses are retained for the benefit of Welsh Water's customers.

Under Glas Cymru's ownership, Welsh Water's assets and capital investment are financed by bonds, loans, leases and retained financial surpluses. All day-to-day activities are carried out by specialist contract partners employed by Welsh Water following a competitive procurement process. The Glas Cymru 'not-for-profit' business model aims to reduce Welsh Water's asset financing costs, the water industry's single biggest cost, and improve service delivery by employing the best companies for each distinct activity in the business.

Financing efficiency savings to date have largely been used to build up reserves to insulate Welsh Water and its customers from any unexpected costs and also to improve credit quality so that Welsh Water's cost of finance can be kept as low as possible in the years ahead. These savings have also funded additional discretionary investment in service improvements and the annual 'customer dividend', which since its introduction five years ago has returned nearly £100 million to customers.

To ensure that the interests of Glas Cymru and Welsh Water are fully aligned, the Directors of Glas Cymru are also Directors of Welsh Water.

Company structure and market

Welsh Water is wholly owned by Glas Cymru and is the sixth largest of the ten regulated water and sewerage companies in England and Wales, representing around 8% of the sector when measured by assets employed. It provides an essential public service to more than 3 million people living in Wales and some adjoining parts of England. Its primary responsibility is to operate, maintain and upgrade its assets so as to ensure a safe and reliable supply of drinking water and to deal effectively with wastewater so as to protect public health and the natural environment. Welsh Water was established in 1989, when the water industry in England and Wales was privatised, and is Glas Cymru's principal trading subsidiary.

In delivering these services Welsh Water operates one of the larger networks of infrastructure assets in the UK water industry. 71 impounding reservoirs and 91 water treatment works deliver a daily average of around 850 million litres of drinking water supplied through a network of 27,000 km of water mains, 532 pumping stations and 557 service reservoirs. Welsh Water also collects wastewater and surface water through a network of 19,000 km of sewers, incorporating 1,700 sewage-pumping stations and 3,300 combined sewer overflows. Treatment is carried out at 850 wastewater treatment works. Welsh Water also owns 35,000 hectares of land, much of which has a high value in terms of nature conservation and recreational use.

Household customers cannot currently choose which company provides their water or wastewater services, but non-household customers who use at least 50 million litres of water a year can take supply from any licensed water supplier. Welsh Water does not have a high concentration of non-household customers, with its 25 largest customers (by volume) accounting for less than 5% of revenue.

Welsh Water directly employs only 165 staff, but in total around 3,000 people are employed by contract partners in delivering water and sewerage services to its customers.

Financing

The group's bonds are listed on the Luxembourg Stock Exchange in the name Glas Cymru's wholly owned subsidiary, Dwr Cymru (Financing) Limited. Reporting of performance against the group's financial obligations to bondholders and other financial creditors is disclosed in a quarterly Investor Report available on our website: www.dwrcymru.com

Procurement

Under Glas Cymru's ownership, the primary objective of Welsh Water is to provide high quality water and sewerage services at least cost to its customers. To this end Welsh Water meets many of its obligations as

Operating and financial review cont'd

a regulated water and sewerage service provider through a portfolio of contracts with specialist contractors and service providers.

Welsh Water has appointed one contract partner to be responsible for clean water delivery 'from source to tap'. The operation of the waste water service is divided geographically, with one contractor responsible for north Wales, and one for south Wales and Herefordshire. Other functions such as capital investment and maintenance and support services, such as billing and income, IT, laboratories and sampling and network development services, are provided through 12 other partners. This outsourcing together covers around 85% of Welsh Water's annual operational and capital costs.

Welsh Water retains ultimate control of all activities carried out under contract and has the ability to exercise that control. Contracts are therefore designed to ensure Welsh Water is not locked-in to any one contract partner or set of working arrangements and that they operate on a transparent basis so that Welsh Water retains access to all staff, information and knowledge required to meet its legal and regulatory obligations. Welsh Water also determines asset strategy and retains final responsibility for decisions regarding key assets.

Contracts are specified and structured to enable contract partners to deliver the best possible combination of quality of service and cost efficiency and partners are incentivised to deliver sector-leading outcomes. They are also structured to achieve an efficient allocation of risk, with complementary provisions for incentive and reward between Welsh Water and its contract partners. This is built on the essential principles of openness and transparency which allows disclosure of trade offs between cost, risk and service performance, with the aim of securing the best interests of Welsh Water's customers.

Further information on our approach to competitive tendering can be found in Welsh Water's published Procurement Plan, available on our website: www.dwrcymru.com

Regulatory environment

Welsh Water operates within a regulatory framework prescribed by the Water Industry Act 1991. The economic regulator is The Water Services Regulation Authority (Ofwat), which is responsible for setting the limits on prices that Welsh Water can charge, and overseeing Welsh Water's overall performance. Ofwat also has a duty to protect the interests of customers, including by promoting competition.

The industry operates on a five-year asset management cycle, and 2006-07 was the second year of the current Asset Management Period (AMP4), which began in April 2005 and ends in March 2010. Welsh Water's settlement for AMP4 is based on a capital expenditure programme costing in total some £1.3 billion, similar to that of the previous five year period, and an assumption that the average Welsh Water customer's bill would increase by no more than 3.6% above retail price inflation each year during the review period, compared to a sector average of 4.3%. In 2005-06 and 2006-07 Welsh Water paid a 'customer dividend' of £19 and £20 respectively per customer (i.e. £9.50 and £10 respectively per service).

The regulator with responsibility for drinking water quality is the Drinking Water Inspectorate (DWI), which is part of the Department of the Environment, Food and Rural Affairs and also acts on behalf of the Welsh Assembly Government in respect of Welsh Water. Under DWI quality monitoring procedures more than 300,000 water supply tests are carried out each year. The results are reported to the DWI, who undertake a series of audits to verify the data provided. The Environment Agency oversees Welsh Water's environmental performance, specifically with regard to the way in which it abstracts water from rivers and reservoirs, and then disposes of wastewater after it has been treated.

All aspects of Welsh Water's water and wastewater operations are subject to extensive performance monitoring against targets set by regulators and Government. Each year these regulators publish reports commenting on and comparing the performance of water companies across a full range of measures, including cost efficiency, customer service, water quality and environmental quality, and each has powers that can be used in the event that Welsh Water's performance is not up to standard.

The Consumer Council for Water (CC Water) is the independent body established in 2005 to represent the general interests of customers of water companies. CC Water investigates individual concerns and complaints and seeks to influence company policy on issues that customers regard important.

The Welsh Assembly Government also has a role in determining water quality and environmental quality standards, as well as setting the framework for other public policy matters such as social considerations arising from water tariff structures.

Operating and financial review cont'd

WATER SUPPLY

Our biggest responsibility is to provide a safe and reliable drinking water supply, 24 hours a day - 365 days a year, while ensuring our water abstractions and water supply activities do not damage the environment.

In 2006 Welsh Water sustained a high level of performance with compliance on a number of key measures either being maintained at, or improved to, best-ever levels. This improved performance overall reflects continued investment in the distribution system as part of Welsh Water's capital investment programme and continuous improvement in operational practices.

Water resources and leakage

Despite summer rainfall being only 60% of the long-term average for Welsh Water's region, which created significant challenges in distribution in some of the more remote parts of the region, we were able to maintain water supplies to customers without imposing restrictions. In such circumstances minimising leakage is a priority and we promote awareness on water efficiency. Key to persuading our customers to use water wisely and avoid waste, is keeping leakage under control and dealing with reported leaks quickly.

In 2006-07 we achieved the leakage target agreed with Ofwat by reducing leakage to 209 mega litres a day (MI/d), 7% below the target we met for 2005-06 of 225MI/d. Our leakage performance is in line with the rest of the industry as measured by losses per km of water main. Ofwat is currently reviewing the economic level of leakage (ELL) for each company, i.e. the point at which it would cost more to reduce leakage further than to produce water from another source, which may lead to further reduction in regulatory leakage targets. Our current challenge is, by 2010, to reduce leakage to Ofwat's assessed ELL for Welsh Water of 195MI/d.

Around 95% of the water Welsh Water abstracts is taken from rivers and reservoirs, with the remaining 5% of water drawn from the ground through springs, wells and boreholes. As a result of cutting leakage and lower demand from large industrial users, Welsh Water now abstracts for public water supply 25% less water than 10 years ago.

Notwithstanding a relatively strong overall water resource position, there are a number of local areas where the balance between supply and demand continues to be tight and where there could be supply or distribution problems during drought conditions. Plans in place to improve the security of supply, especially in Ceredigion, parts of North Wales, and parts of rural Herefordshire and Mid Wales, are described in Welsh Water's published Water Resource Plan.

In April 2007 Welsh Water launched its Water Efficiency strategy having previously launched a campaign, Be Water Wise, to encourage customers to use water wisely.

Looking forward, water resource plans may need to be further modified as a result of the Environment Agency's ongoing review of licensed water abstractions in the context of meeting obligations imposed by the Water Framework Directive and the development of river basin management plans to achieve a healthy aquatic ecosystem.

Drinking water quality

Customers rely on Welsh Water to deliver a high quality and consistent supply of wholesome drinking water. How effective we are in this is measured against standards set down and monitored by the DWI. Last year, Welsh Water's quality monitoring procedures involved more than 300,000 individual tests of water quality, the results of which were reported to the DWI.

During 2006 Welsh Water sustained a high level of performance for drinking water compliance. In respect of samples taken at water treatment works there was 100% compliance with bacteriological standards for coliforms and E-coli (2005: 99.93%).

A key measure of overall water quality at customer taps is 'mean zonal compliance', which monitors overall compliance against 40 separate parameters, and in 2006 Welsh Water maintained its performance at

99.95% (2005: 99.95%). Performance against the 'distribution maintenance index', which takes into account

Operating and financial review cont'd

performance against turbidity, iron and manganese - the principal parameters for discolouration problems, was also maintained at 99.7% (2005: 99.7%).

One initiative we jointly launched in 2006 is the 'Water Health Partnership for Wales', which brings together relevant agencies to work more effectively to protect public health. This partnership includes the DWI, Welsh Assembly Government, local authority public and environmental health and emergency planning agencies, the Consumer Council for Water Wales and the National Public Health Agency Wales. Initial meetings have proved successful in providing opportunity for sharing best practice and benchmarking each organisations performance. Looking forward, the DWI has consulted on proposed changes to the Water Supply (Water Quality) Regulations. These set out the regulatory framework for ensuring the quality of water supplies in England and Wales by specifying requirements for the abstraction, treatment and testing of potable water. Proposed changes represent a further move away from reliance on 'end of pipe' testing to monitor water quality, to a risk based approach where the safety of drinking water is protected through a process of comprehensive risk assessment and management at all stages in the water supply chain.

Last year we reported that in November 2005 there was a higher than usual number of cases of illness caused by cryptosporidium in North West Wales which was linked to the tap water supplied by Cwellyn water treatment works. To date, the DWI has yet to publish its report into this incident.

Reliability of supply

A key measure of customer service is the number of instances where water supplies are cut off without warning because of a burst, third party damage or because we have over-run on planned works. In the last five years we have reduced the number of unplanned supply interruptions, lasting more than six hours by over 70%. In 2006-07, 313 properties were affected by these unplanned supply interruptions (2005-06: 454 properties), a best ever performance for Welsh Water.

We also monitor pressure in each water distribution zone, which allows us to identify possible problems and upgrade local water supply networks as necessary. Incidence of low pressure can change as new properties are connected to the water supply network and where we rationalise our assets. Last year we removed possible low pressure problems for 1,459 properties and at the end of the year there were 221 properties, or 0.02% of all connected properties, still at risk of having low pressure (2005-06: 221), maintaining high performance on this key measure.

Welsh Water's prioritised programme of work aimed at reducing the frequency of interruption to its worst served customers has helped maintain a reducing trend in burst rates on water mains both in real terms (2006: 167 bursts per 1,000km main; 2005: 171 bursts) and relative to other companies in the sector.

Capital investment

During the year we invested £132 million to improve or maintain our water assets. We refurbished over 390km of unlined water mains to improve water quality and iron compliance at customers' taps. A further 82km of water mains were replaced that were causing frequent supply interruptions to customers and 20km of mains were relined under maintenance programmes. Major improvement work was carried out at 55 water treatment works, 52 service reservoirs and 28 water-pumping stations.

During the year we passed an important milestone with 3,000km of unlined iron water mains refurbished under our 10 year programme, improving water quality and reducing the risk of discoloured water – a major cause of complaints. This investment of £264 million between 2000 and 2007 has also delivered a reduced likelihood of leaks and bursts, and associated interruptions to supply.

Quality management systems

Quality Management Systems (QMS) are essential to the effective management and operation of our daily activities. They provide reassurance that risk is minimised, ensure that customer service is prioritised, that

regulatory requirements are achieved and that everyone in the relevant organisations operate to the same exacting standards.

Operating and financial review cont'd

QMS systems play a major role across our business:

United Utilities Operating Services – Potable Water

United Utilities Operating Services – Waste Water (North Wales)

Kelda Water Wales – Waste Water (South Wales)

Thames Water – Customer Services

Severn Trent Laboratories – Sampling and Laboratory Services

All the above systems have been certified to the ISO 9001:2000 standard and are subject to routine audit and review. In addition, UUOS also operate an Environmental Management System (EMS) and currently hold certification to the ISO 14001:2004 standard for two of our wastewater treatment works. UUOS have a programme in place to extend this registration on a 'site-by-site' basis.

The monitoring of quality performance at Board level is led by the Quality and Environment Committee, which is chaired by Dame Deirdre Hine. This Committee meets monthly and reports directly to each Board meeting.

Further information about Welsh Water's water supply performance in 2006 can be found in the published report of the Quality and Environment Committee which, with the company's Water Resource Plan, is available on the website: www.dwrcymru.com

Operating and financial review cont'd

WASTE WATER

It is our responsibility to collect and treat customers' wastewater – together in many places with highway surface water that drains into the public sewer – in a way that safeguards public health and protects the environment. In 2006-07 we maintained our good standard of wastewater treatment works and bathing water compliance. However, the performance of our sewerage network is not yet satisfactory as the number of pollution incidents has remained at a similar level to 2005 and we have seen an increase in incidents of sewer flooding, particularly as a result of incidents caused other than by hydraulic overload.

Wastewater treatment

Notwithstanding that Welsh Water operates 850 wastewater treatment works, proportionately more than most companies in the sector, only three small works failed to meet the required standard of performance. This means that 99.97% of our customers (2005-06: 99.91%) are served by works that met the required consent standard, making last year the best for wastewater treatment works compliance under Glas Cymru ownership and only marginally short of our target of 100% compliance, which Welsh Water last achieved in 1997.

Coastal and river water quality

Welsh Water has one of the longest coastlines of any water and sewerage company in the sector – and since privatisation we have invested over £1 billion on upgrading or building new wastewater treatment works and improving the sewer network. This has led to a significant and substantial improvement in both coastal water and river water quality. Our role in delivering high quality coastal water quality is especially important for the Welsh tourism industry, which employs around 100,000 people and makes a significant contribution to the Welsh economy.

In 2006, 79 of the 80 EU designated bathing beaches around the coast of Wales achieved the mandatory bathing water standard required by legislation (2005:80). In addition a record 75 beaches (2005: 73) achieved much the higher 'guideline' standard. These results have secured 44 'Blue Flag' beach awards and five marina awards for the 2007 season (2006: 47 awards in total), which once again means that Wales has secured around one third of the UK's total Blue Flag awards.

Similarly the quality of rivers in Wales continues to be amongst the best in the UK. The last survey of river water quality published by the Environment Agency confirmed that over 98% of rivers in Wales were good or fair on the assessment of chemical quality and over 99% were good or fair on the assessment for biological quality. Notwithstanding this background, the required treatment standards continue to rise to meet obligations set by the Habitats and Water Framework Directives. Looking ahead, and working with its regulators, Welsh Water's challenge is to meet these rising standards in an environmentally sustainable way, where the cost of meeting new treatment standards do not outweigh the environmental benefits.

Reliability of sewer network

Maintaining high standards of environmental performance in the sewerage network is one of Welsh Water's major challenges - the average age of our 19,000km of sewer network is 60 years, with around a third being more than 100 years old. The network was also designed to carry away surface water as well as wastewater from households and businesses, which means that at times, and especially after heavy rainfall, the sewer network cannot cope and overloaded sewers can cause flooding at customers' properties.

We measure the risk of this happening and also report actual sewer flooding incidents caused by hydraulically overloaded sewers or other causes, such as blockages and sewer collapses. Despite significant investment and critical management focus on this key issue, our performance on sewer flooding deteriorated in 2006-07, when 335 properties experienced internal flooding by sewage (2005-06: 268). Of these 132 properties were flooded as a result of hydraulic overload of sewers following heavy rainfall and 203 properties were flooded by other causes, including blockages and sewer collapses. At the year-end 484 properties remained on the 'at risk register', a slight improvement on last year (2005-06: 514).

Operating and financial review cont'd

Reducing the risk of sewer flooding remains a top priority for Welsh Water, and we will continue to focus investment at properties where flooding has occurred most frequently. However, each year new incidents occur where flooding has not been experienced before. Re-examination of historical incident data in the light of changing weather patterns in the last few years has also identified some 300 locations at risk of a pollution incident, which we are now addressing in our investment programme.

Where we have 'hot-spot' flooding areas, we may provide a flood forum as a means of communicating Welsh Water's plan to the community affected, and to determine joint solutions to prevent repeat flooding problems with other authorities who have responsibilities for drainage.

Looking forward, we recognise the benefit of government proposals to transfer responsibility for private sewers and drains to statutory undertakers, however this brings with it a number of significant challenges as the number and current condition of these private sewers are as yet largely unknown. It will significantly increase the number of assets Welsh Water owns and we will need time to assess and deliver any investment necessary to bring these assets up and maintain them to regulatory standards. It is important therefore that private sewers are transferred in a way that does not increase customer bills disproportionately.

Intermittent discharges

Our investment to improve storm water overflows will reduce the amount of sewage and associated debris discharged to watercourses when, as a result of combined surface water and domestic wastewater, sewer capacity is exceeded during heavy rainfall. We have nearly 3,300 storm water overflows on Welsh Water's sewer network and by 2010 we will have improved around 460 unsatisfactory overflows under a prioritised programme agreed with the Environment Agency Wales. In 2006-07 we improved 87 storm overflows, bringing the AMP4 total to 155 during the first two years.

Notwithstanding this investment, the number of 'category 1' and 'category 2' pollution incidents in 2006-07 remained at the same level as 2005-06 with 17, and the number of 'category 3' incidents, which cause relatively minor environmental damage, rose slightly to 209 (2005-06: 194), although still remains more than 30% lower than in 2001.

Improving the performance of our sewerage network is both a priority and a challenge for the business. Following a zero-pollution pilot study in one poor performing catchments Welsh Water has approved a £5m programme to install additional telemetry alarm devices at key points of the network, and a prioritised programme of sewer desilting, cleaning and CCTV inspection. Together, these give Welsh Water a better understanding of the condition of its sewers and helps to direct investment appropriately, which will increasingly enable network operators to react quickly to potential problems before any sewer escape has any environmental impact.

Capital investment

During the year we invested £130 million to improve or maintain our wastewater assets. In all, we completed quality improvement schemes at over 188 different locations and significant maintenance schemes at 63 sites. In addition, 35km of new sewers were laid and 26km of sewers were refurbished.

New works opened in 2006-07 included Holyhead wastewater treatment works, following a six-year process of planning, consultation and construction. This scheme, which has improved services to customers and delivered environmental benefit to local bathing beaches, involved in addition to the new works, the construction of 16 new pumping stations and associated storm water storage facilities and a new 890 metre marine outfall.

Further information about Welsh Water's wastewater and sewerage performance in 2006-07 can be found in the published report of the Quality and Environment Committee of the Board which is available on our website: www.dwrcymru.com.

Operating and financial review cont'd

RESPONSIBLE BUSINESS

By delivering safe and reliable drinking water and wastewater services we provide an essential public service, but we also have a much wider responsibility. Our goal is to be recognised as a valued and trusted partner in the communities we serve.

Education

Since 2001 we have placed considerable emphasis on supporting education and have increased our facilities over this period from one classroom at one environmental education centre to five classrooms at four centres across Wales. In the last academic year almost 12,500 children attended one of Welsh Water's centres and received free curriculum-based lessons, and since our first centre opened in 1997 more than 70,000 children have received lessons designed and led by our seconded teachers. Our approach aims to teach the importance of diverse habitats and nature conservation and promote a better understanding of the importance of water in our everyday lives, as well as communicating key business messages on water conservation and efficiency and public safety.

In the last year we have redesigned our bilingual educational website and associated online interactive resources (www.livingandlearningwithwater.com), and added a new module on water efficiency to our interactive CDROM (Water-World Explorers), all of which are available free to schools in our region. These facilities complement a website developed with certain other water companies (www.waterintheschool.co.uk), which provides everything required to set up and run a water conservation project.

We also continue to work closely with organisations that have a similar approach to providing education, such as Eco-Schools and our education partners, who include the National Botanic Garden of Wales in Carmarthen, Techniquet in Cardiff, the Hereford Waterworks Museum and The Wildfowl and Wetlands Trust at its National Wetlands Centre at Llanelli. To improve the effectiveness of how we work with our education partners, and to make our education service more accessible to schools located too distant for a day visit to one of our centres, this year we have successfully trialled a new peripatetic teacher role, which will be rolled out in the next academic year.

Associated with our education strategy, for the last three years we have worked in a successful partnership with the Welsh Assembly Government to provide cooled tap water to children in schools across Wales. This recognises that water is beneficial to health (children should drink at least 3-4 glasses of water a day) and can improve concentration and academic performance. Over the same period we have issued more than 70,000 plastic water bottles, which are provided free of charge to children who visit our education centres and are made available for schools and other youth organisations in Welsh Water's region to purchase 'at cost'.

Sustainability and global citizenship are fairly new subjects in the national curriculum and in December 2006, 30 teachers received training at a workshop hosted by Welsh Water's teachers. Other participants were Oxfam Cymru, Christian Aid, British Telecom Volunteers, The Riverfront Theatre, Careers Wales and local education business partnerships.

Conservation, heritage and access

Welsh Water's region is rich in both biodiversity and heritage. To ensure our water and sewerage operations do not harm these national assets we continue to develop our conservation consultations database, which holds details of more than 1,100 sites of special scientific interest and more than 4,000 Scheduled Ancient Monuments or other sites of conservation or archaeological interest. This ensures our design teams are aware of such sensitivities at the earliest stage, and that appropriate consultation with conservation and heritage bodies can take place in a timely manner. This process is supported with an annual meeting of senior representatives of both our environmental and heritage stakeholders. We also continue to support the Hereford Waterworks Museum, which collects restores and displays artefacts associated with the history of water supply in Wales and the adjoining parts of England that we supply.

Healthy living

Welsh Water owns more than 35,000 hectares of land in Wales, much of it both scenic and environmentally sensitive. Access is encouraged at seventeen major reservoir sites, which provide valuable formal, and

informal, sporting recreational and leisure resources. Just under a million people visit one of these Welsh Water sites each year, which makes a valuable contribution to tourism and the local economy.

Operating and financial review cont'd

Public safety

Last year we revitalised our reservoir safety campaign with the launch, supported by the Welsh Assembly Government, of a multi-media campaign explaining the dangers of swimming in reservoirs. The campaign ('so you think reservoirs are cool?') targeted all schools in our region via; a pod-cast available on our website; posters and fact sheets.

We also work closely with various local community organisations, and for several years we have, in particular, worked with local police forces and other caring organisations to help combat 'distraction burglaries'. In areas where 'Beat the Burglar' partnerships are established the number of distraction burglaries has fallen.

Charity and community projects

Welsh Water is a member of Business in the Community and promotes a community investment scheme for employees who wish to become involved in charitable or other projects within their local communities. Many of our staff, and those of our contract partners, freely give their own time. In 2006-07, 12% of Welsh Water staff signed up to support local schools and participate in a 'World of Work' scheme coordinated by the Mid Glamorgan Education Business Partnership, which provides business mentoring and mock interview support for 15-16 year olds.

WaterAid is an international charity dedicated to extending access to safe domestic water, sanitation and hygiene education for some of the world's poorest communities. Re-launched in Wales in 2004, the support of our staff and customers means we are well on track to meet the goal of raising £1 million for WaterAid. This is achieved through year-round fund-raising activities, including an annual WaterAid Ball, fun events such as 'It's a Knockout Competitions', a monthly staff lottery and donations from Welsh Water customers.

Operating and financial review cont'd

OUR CUSTOMERS

We aim to deliver the best possible service to our customers, and we know that customer recognition of this will be judged on the standards and efficiency of the service our customers receive. So we aim to get things right first time, every time, and always deal with customers in a prompt, courteous and professional manner.

Improving customer service

Welsh Water has a strong track record of bringing innovation into the water sector to improve efficiency and performance for customers. To ensure this continues into the future, Welsh Water has commenced a £75 million four year programme of IT Enabled Change, which through improved IT systems and streamlined business processes will deliver improvements across our business. Our new Operational Activity Centre, which we opened this year alongside our Billing and Income Contact Centre in Cardiff, now receives and directs response to all customer contacts on matters of operational service or quality for both our water and sewerage services. This has already reduced unnecessary repeat and abortive calls and seen significantly more customer calls resolved on first contact.

We are also investing in new systems to manage our assets real-time and in the most effective manner, with enhanced capability to support remote diagnosis and operation of assets, and in systems to enhance our capability in terms of work scheduling and mobile working. Key to this is a system to capture information about the configuration and performance of over 500,000 assets, held in a single database, which essential information is available to Welsh Water and its contract partners as and when it is required. Only by improving our understanding how our assets perform, can we tailor capital investment and maintenance expenditure more effectively to deliver the best possible value for money for Welsh Water's customers.

Customer contact

The majority of customers prefer to contact us by telephone and last year we received 1.2 million calls to our customer billing or operational contact centres (up 9.4% from 2005-06). We also know that customers prefer not to have to deal with automated telephone response systems, which we use only where necessary, preferring the phone to be answered by a person straight away. In Ofwat's latest reported assessment for 2005-06 of call handling customer satisfaction Welsh Water was rated 4.57 out of a possible score of 5 (2006: 4.59).

In 2005-06 we reported the number of written complaints we received had risen due to the overall price increase at the start of the 2005-10 investment period, changes to our tariff structure, sewer flooding and especially the cryptosporidium outbreak in late 2005. This increase reversed a falling trend, which had seen complaints more than halved in five years. In 2006-07 the total number of complaints was 10,348 (2005-06: 9,691) but 80% of these related to disputed bills, charging policy or debt collection activity.

Supported by the Welsh Language Board and Welsh Assembly, we also recently launched an initiative 'Mae gen ti ddewis' (You have a choice) to draw customer attention to the fact that they have a choice over whether to use Welsh or English when they contact Welsh Water with an enquiry.

Keeping customers informed

Before starting any major investment scheme we liaise closely with the local communities that are affected. If water supplies are going to be interrupted, or if access to customer's premises will be required, then information is provided to those customers directly affected by the work and a 24 hour contact telephone number is provided. If required, customers can request a home visit to discuss how the works will impact on them, and we also keep the relevant local authority, community council and Assembly Member informed about major schemes of work.

A new initiative last year was the introduction of a 'Floodcare Plan' to improve communication with customers when they have experienced an incident of either internal or external sewer flooding. Under this new procedure we give a firm commitment to customers in relation to the immediate support we will provide and our longer-term investment plans to avoid reoccurrence of such events.

Operating and financial review cont'd

Additional services

We make extra effort to support our vulnerable, disabled and elderly customers, who at times need a little extra help. Among our additional services we offer large print or Braille bills, bottled water during emergencies, a password scheme for home visits and a 'knock and wait' service for customers who need a little more time to answer the door to callers. Over 3,000 customers are registered to receive one or more of these additional services.

Aided by the Citizens Advice Bureau, we also offer a Customer Assistance Fund which is designed to help customers who have fallen into arrears with their bill to return to paying current charges on a regular basis. Last year 1,080 customers benefited from this scheme (2005-06: 550).

Customer research

Every six months independent market research tracks customer views on a range of issues, including satisfaction with the service customers receive from Welsh Water, drinking water quality, river and coastal environmental quality and how customers perceive our service on value for money compared to other utilities. The latest research shows a relatively stable position following good improvement made in previous years.

In addition to this general research, independent surveys are undertaken, to monitor the views of customers who have contacted us. This shows that more than 70% of customers are very or fairly satisfied with our overall level of service. We also employ independent researchers as 'mystery shoppers' to assess the quality of our telephone contact service. Each of Welsh Water's contact centres continue to perform well, consistently beating industry benchmarks with satisfaction ratings in excess of 90%. This research is routinely shared with the Consumer Council for Water (Wales) and is used to inform an annual customer service improvement plan.

Operating and financial review cont'd

OUR IMPACT ON THE ENVIRONMENT

Our role in providing good quality and efficient drinking water and wastewater services means that, by the nature of our business, we are a major contributor to the quality of the environment in our region. We seek to operate in a sustainable way that minimises or, where an impact is unavoidable, mitigates any adverse environmental impact from our business activities. Our work programmes are designed to minimise the extent and duration of construction and, wherever possible, to achieve positive benefits for conservation and the wider community.

Climate change

We are addressing the longer-term environmental impacts associated with changing climate conditions, as greater variability in climate (wetter winters, drier summers) introduces new challenges for managing water resources and water quality, the sewer network and storm drainage. Welsh Water emits a significant quantity of greenhouse gases, and in the last three years we have worked in partnership with the Carbon Trust in Wales to develop our knowledge of our carbon footprint, and to identify sustainable opportunities to reduce our emissions. To date our focus has been on local schemes to increase renewable energy capacity and to improve energy efficiency.

We have identified that energy use is responsible for 60% of our carbon footprint, with our process emissions accounting for 35% and transport for the remaining 5%.

Since 2001 the footprint of Welsh Water has grown by some 30%, mainly due to a small number of large new works, including major new wastewater treatment works at Cardiff, Aberystwyth and more recently Holyhead. In 2006-07 our business generated some 284,000 tonnes of carbon emissions, which is broadly similar to the previous year (277,000 tonnes).

Our carbon management programme has helped mitigate the sharp increase in energy costs in the last two years, as well as highlighting the increased energy requirements likely to arise in future years from new quality standards. In particular, with the Carbon Trust, we are trialling a business tool that will reliably calculate the net carbon cost of alternative capital investment solutions required to meet increasing treatment and environmental standards.

Looking forward, work has commenced on a long-term plan for Welsh Water – looking 25 years ahead which is to be published during 2007-08. This will set out for consultation our ambition for Welsh Water in respect of its long term approach to climate change mitigation (what we will do to reduce our carbon emissions) and adaptation (how we need to adapt our operations and assets to ensure continued service to customers during more extreme adverse weather conditions). We are determined our proposals, which are still being developed, will deliver a significant reduction in our current level of carbon emissions.

Energy management

Welsh Water is one of the top ten energy users in Wales, so promoting energy efficiency and awareness is important for our business and for the environment. In 2006-07 we used almost 565Gwh of energy, which is 3% higher than the previous year primarily due to increased pumping across the water network during the dry summer months.

Looking forward, we are continuing to target key works and treatment processes to receive additional sub-meter monitoring to identify further opportunity for energy efficiency, as well as increased use of energy efficient electrical motors and initiatives to encourage staff to use energy wisely.

The generation of renewable energy from our resources and business processes is important for climate change mitigation. In 2006-07 combined heat and power (CHP) plants operated to capture and burn 'waste' methane gas generated from eight wastewater treatment sites. This included, as part of our expansion of self-generated electricity, two new CHP plants, at Kimmel Bay and Chester, and a refurbished plant at Penybont that were commissioned toward the end of last year. When fully operational these new works will have doubled renewable energy capacity on our sites, within two years.

In addition, in partnership with the Carbon Trust Wales, we are testing the robustness of various on site micro generation technologies, with promising results. Our goal is to set up more sites such as that at Eithinfynydd on the Cardigan Bay coast, which this year has started to generate more power than used at the works making it both energy and carbon neutral.

Operating and financial review cont'd

Our landholdings

We encourage conservation best practice and each of our major reservoir landholdings has a site-specific habitat and species plan. At locations such as Llandegfedd and Brenig Reservoirs we show how, by careful zoning, conservation can be managed alongside popular recreational activities such as fishing and sailing. We also encourage simple but effective measures, such as grassland management, that can make a difference to the conservation value of some of our operational sites. Our conservation manual and guidance on 'How to make the most of your site' is available to all staff and contract partners.

Working with the Environment Agency in Wales, at Llandegfedd Reservoir Welsh Water has created a system of ditches and reed beds that will ensure a constant area of standing water, even when water levels drop. This has established a new habitat for invertebrates, which are an important source of food for visiting birds, and shelter for nesting wildfowl.

Independent studies on the impact of climate change have reported, for example, that mountain heath land habitats and wildlife in Snowdonia are expected to be under serious threat by 2050, and similar studies report of threats to wetland habitats and species. In response we are re-evaluating the habitat value of Welsh Water's 'green corridor' of landholdings if, as expected over time, wildlife starts to migrate northwards.

Environmental procurement

When selecting contract partners we pay significant attention to an assessment of a prospective partner's environmental credentials and track record in showing environmental awareness, responsibility and best practice. Through the procurement chain we also seek, wherever possible, to procure energy and water efficient plant and machinery, thereby maximising environmental and financial benefit. We also pursue opportunities for resource optimisation and waste minimisation and to giving preference to efficient and sustainable waste management options, with landfill as the last option.

Operating and financial review cont'd

PEOPLE AND PARTNERS

Welsh Water has established an 'Asset Management Alliance' (AMA), comprising 3,000 people from 14 different organisations, who work together to look after the water industry in Welsh Water's region and to deliver a reliable and efficient high quality service to Welsh Water's 3 million customers. Our contract partners provide wide experience of best practice from some of the UK's leading utility, construction and infrastructure companies and share Welsh Water's commitment to progressive employee relations.

This alliance of Welsh Water and its contract partners operates on the basis of openness and transparency and aims to ensure a seamless approach to the delivery of all our services and programmes. Its ambition is to set new standards in partnership working. A Principals Leadership Team, comprising the heads of each contract partner in Wales, meets monthly to optimise the way we do business across the AMA.

Staff turnover in our business is only 4%, well below the national average. This has benefits for our business, from staff stability and knowledge of and commitment to the company, but it also provides some major challenges, particularly as regards succession planning and career development. Our HR team works closely with partner organisations in meeting these challenges and on such issues as organisational design, change management, and the optimisation of partnering and performance management.

All Welsh Water employees have a 'Personal Development Plan', which each year translates company objectives into personal objectives against which individual performance can be evaluated. In this way, a 'golden thread' is established through the business with the company business plan disseminated out into individual sets of objectives.

New initiatives in 2006-07 include the introduction of an assessment centre approach to aid recruitment of senior roles and the development, with the University of Wales Institute, Cardiff, of a knowledge transfer partnership which will provide technical graduates with high calibre placements, while also developing expert knowledge in the business for our programme of IT enabled change.

The views of our staff are important and these are independently tested through an annual employee satisfaction survey. Evidence from our latest survey (January 2007) shows a continuing high general level of satisfaction. The full results of the survey are shared with all employees, together with the resulting action plan that management considers appropriate.

Keeping staff informed on company performance and key business issues is important. We achieve this via monthly local team meetings, an annual staff forum, to which all Welsh Water are invited and a quarterly magazine - 'The Link'. We also provide regular opportunity for all staff, in small groups, to meet the Managing Director and ask questions directly. Emails and the employee intranet are also used to communicate immediate news and announcements, and working with staff the intranet has been redesigned this year, to improve its effectiveness and use.

Employee reward and recognition is closely aligned to business performance, with an annual cash bonus linked to Welsh Water's relative ranking in Ofwat's annual Overall Performance Assessment league table and financial performance. Compensation and Benefit packages are regularly benchmarked against the Welsh Employment market and the UK Industrial and Services market.

This year we offered all staff the opportunity to attend a pensions surgery with a qualified financial advisor and access to the company's pension scheme actuary, which some 20% of staff attended, and all staff received a 'total reward statement' for the first time.

Occupational health and safety

The health, safety and welfare of our employees and all those who work with us, is of the utmost importance, and we operate a proactive health and safety management system which applies to all contract partners and their first tier suppliers. In 2006-07 the number of health and safety reportable incidents fell by 6.7%, continuing the trend of the last five years. Regrettably suffered a fatal accident, which is still being investigated by the police and Health and Safety Executive.

During the year our partners implemented 172 risk based improvement plans, which were 96% complete during the year, focusing on improvements in occupational health as well as managing risks to safety. We

Operating and financial review cont'd

promote health and safety best practice and shared learning through an AMA steering group and a process of 'cross partner' audits, which we also verify through independent external audit.

During 2006-07 Welsh Water embarked on a review of occupational health and safety procedures with a view to securing certification to OHSAS 18001 by April 2008. We also enhanced our on-line reporting of health and safety performance and document management, and extended training initiatives to increase staff competency in investigating health and safety incidents.

In March 2007 Welsh Water also held its first Occupational Health and Safety Conference, sponsored by Mitsui Sumitomo Insurance, which brought together health and safety professionals from Welsh Water and its major partners. The conference also introduced a new award to recognise contract partners demonstrating best practice in the management of occupational health and safety.

Further details of our health and safety performance and approach are available in our 2007 Health and Safety Report which is available on request or via our website: www.dwrcymru.com.

Operating and financial review cont'd

FINANCIAL REVIEW

Welsh Water's financial strategy is to offer a secure, low risk investment to long-term investors. By strengthening our financial position, we intend to keep our future borrowing costs low, enabling us to finance future investment in the business efficiently, whilst having the scope to return money to our customers through sustained 'customer dividends'.

Financial results

Welsh Water's appointed business turnover in the year to 31 March 2007 was £569 million (2006: £545 million) – an increase of 4%. The increase primarily reflects the price increase of 6.4% in the year offset by a loss of revenue due to customers switching to metered charging and a reduction in consumption from metered, large user and trade effluent customers. The effect of 'customer dividends' in the year was that turnover was some £25 million (2006: £23 million) below the level that would have resulted from the full price control allowed by Ofwat. The rate of voluntary customer switching to metered charging in the year slowed somewhat to nearly 22,000 customers (2006: 27,000 customers), whilst some 9,000 new customers (2006: 10,000 customers) were added during the year, who are all metered.

The current cost depreciation charge was £134 million (2006: £122 million). The increase is due to additional charges arising on the £128 million of above ground capital expenditure during the year and a revision to the expected useful lives of certain assets.

The infrastructure renewals charge was £52 million (2006: £50 million). The charge reflects the medium to long-term maintenance needs of the infrastructure network and is based on expected maintenance expenditure over the period 2001 to 2015.

Net interest charges for the year were £153 million (2006: £151 million). Despite interest rate increases, the average cost of net debt during the period was 6.2% (2006: 6.4%), reflecting the benefit of refinancing undertaken during the year.

Current cost profit before tax was £84 million (2006: £63 million). This profit was made after funding the 'customer dividend' of £19 for customers receiving both water and wastewater services. The Board of Glas Cymru has decided to increase the 'customer dividend' for 2007-08 to £20.

The tax credit for the period was £13 million (2006: nil), comprising of £12 million deferred tax credit and a £1 million current tax credit.

Continued focus on cost control

Welsh Water's appointed business operating costs (excluding infrastructure renewals charge and depreciation) were £220 million (2006: £205 million), which represents an increase in real terms of some £8 million. This increase largely reflects substantial increases in energy costs, which were some £8 million (or 29%) higher than in the previous year, which in turn were some £9 million higher than the year before.

Around 70% of operating costs were incurred under outsourced service contracts, including the contract with United Utilities Operating Services (UUOS) for the operation of the water network and the wastewater network in North Wales and with Kelda Water Services, for the operation of the wastewater network in South Wales and Herefordshire. These contracts operate on a target cost basis which are designed to incentivise further improvements in operating efficiency in the period up to March 2010.

Customer debt recovery remains subject to very close attention by Welsh Water and by Thames Water, the billing and income services contract partner. Despite a difficult environment - water companies are not allowed to disconnect supplies to domestic customers due to non-payment - cash collection performance was on target. The bad debt charge for the year of £11 million (2006: £8 million) represents around 2% of annual turnover.

Capital expenditure by Welsh Water during the year (before capital grants and developer contributions and including infrastructure renewals expenditure) was £269 million (2006: £238 million), bringing the total expenditure over the first two years of the five-year AMP4 period to £507 million or some two fifths of the total programme. Welsh Water works with an alliance of capital investment partners (Laing Utilities, Morrison, AMEC, Costain, Imtech Process, MEICA, and Black and Veatch) with the aim of delivering the AMP4 investment programme at the best value for money for customers. A priority during the first two years of the programme has been to reappraise rigorously the design of certain key schemes with a view to achieving the reductions in unit costs assumed by Ofwat in the 2004 Price Review. Welsh Water is planning

Operating and financial review cont'd

to invest some £600 million over the next two years, a challenging target compared to historical levels. At this stage, it is expected that investment expenditure over the AMP4 period as a whole of some £1.3 billion will be broadly in line with the allowance made by Ofwat in the Final Determination.

Financing strategy and credit rating

The Board considers that it is in the best long-term interests of our customers to continue to reduce the level of gearing, with a view to achieving further reductions in its cost of finance.

Credit ratings are unchanged during the year.

To protect the Group's high credit quality, the Board has implemented prudent financial policies, covering the fixing of interest rates and the investment of cash balances. The Board considers that liabilities index linked to UK RPI inflation are particularly appropriate for the business, as its revenues and RCV are also linked to RPI through the regulatory system operated by Ofwat. As at 31 March 2007, approximately 57% of the group's gross debt was index linked via bonds and derivatives.

Future prospects

The objective of the Board will be to continue to improve the financial performance of the company during the period to 31 March 2010. The Board believes that its financial strategy will put the company in a strong position to raise the funding for the following five-year investment programme in the period to 2015 on efficient terms, which is an important part of the company's strategy to keep down customers' bills in the long-term.

The main risks to the achievement of this financial objective involve upward cost pressures. The unit costs of investment schemes are under upward pressure due to increasing materials costs and emerging resource shortages in the construction industry. Welsh Water continues to seek to mitigate these input cost increases by securing the resources for a long-term programme of work with its partners and by revisiting designs and working methods to secure offsetting efficiency improvements.

In addition, power costs have increased dramatically over the last two years and Welsh Water, like all water and sewerage companies, has a large energy requirement, notably for pumping and treatment processes. The increase in power prices can be only partially offset by improved working practices and investment in energy efficiency schemes. More recently, power prices have fallen back, which has enabled Welsh Water to purchase a large proportion of its power needs for the year to 31 March 2008 at a reduced cost. However, the risk of future volatility in power prices remains. Under the target cost arrangements, these upward cost pressures are shared only to an extent between Welsh Water and its relevant partners.

Welsh Water and its partner, Thames Water, also maintain a tight focus on customer cash collection in recognition of the continuing risk to cash collection posed by increasing water bills and the absence of a disconnection sanction.

The company does not expect to pay tax on its trading profits during the year to 31 March 2008, due to the availability of tax allowances on its investment programme. Future tax liabilities beyond that date will also be primarily influenced by this factor.

Disclaimer

This Report contains certain forward-looking statements with respect to the future business and taxation prospects and the strategies of the Glas Cymru Group. These statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

Operating and financial review cont'd

RISK

The assessment and mitigation of risk is a key priority for the business. The Board of Glas Cymru (the Board) has overall responsibility for the system of risk management and internal control.

As Glas Cymru cannot diversify into activities unrelated to those of a regulated water and sewerage business, this means that the nature and balance of risk to be managed by the group is different, and in many respects lower, than that of other companies in the UK utility sector.

The Quality and Environment Committee of the Board (QEC) is an important part of governance arrangements, providing critical focus on 'quality', 'service' and the management of risk in its monitoring of the performance of Welsh Water and its contract partners. The work of QEC is described in more detail in its annual report to the Board, which is available on our website or on request from the Company Secretary.

The principal risks faced by the group fall into the four broad categories of strategic risk: regulatory, operational, procurement and financial risks.

Regulatory risk

Regulatory risk can arise from Ofwat's price control determinations or from changes in the regulatory environment, such as proposals to increase competition in the water sector, which would affect all companies in the sector in the similar manner.

A price control determination generates risk in a number of ways, for example, if it were to provide an inadequate cost of capital allowance or be based on regulatory assumptions in respect of operating costs, required capital investment or revenue forecasts that prove unrealistic. Welsh Water's business plan seeks to meet and, where possible, exceed the assumptions made by Ofwat in its determination for the period 2005-10. However, at this early stage in the five-year regulatory period, this objective is subject to considerable uncertainty. The outcome of the next periodic review process in 2009 will also directly impact on future cashflow and profitability.

Welsh Water has to provide extensive data to the regulators each year on all aspects of its business. This responsibility is taken very seriously and processes are in place to review these data sets and to ensure that they are of appropriate accuracy and robustness.

Our Licence requires us to have strong governance arrangements, which ensure that the responsibility of Welsh Water for water quality, environmental quality and public health is not blurred.

Operational risk

Operational risk is varied and may include:

- The impact of major operational incidents on public health, environmental quality or customer service, whether arising from equipment failure, from natural events (e.g. acts of God, or contamination from naturally occurring compounds) or from third party interference with Welsh Water assets or equipment.
- Changes in environmental, consumer protection and public health and safety law and regulation, which typically require ever-higher standards of water quality, environmental and safety performance.
- The impact of more extreme weather conditions (i.e. climate change) on the availability of water resources during droughts and the ability of Welsh Water sewerage network to cope with severe rainfall events.
- Health and safety incidents arising from the operation of a large and complicated network of assets.
- Our ability to retain and develop key people within Welsh Water to ensure the business has the appropriate competencies and experience needed to ensure all obligations can be met in the long term.
- The impact of operational change associated with our five year £75 million programme of IT enabled change (ITEC), which will include the replacement of aging mainframe IT systems with new and more flexible systems. Accompanying the ITEC programme will be a phased review and simplification of business processes and the development of new tools to enable Welsh Water to become ever more efficient in its delivery of services to customers.

Policies and operational strategies exist to mitigate each of these risks that could create an adverse effect on the reputation, operating results and financial position of Welsh Water.

Operating and financial review cont'd

In the long term, Welsh Water needs to maintain its £14 billion asset base to deliver the high standards of water and wastewater services that customers expect. The rate at which assets can be maintained, refurbished or replaced is determined by the funding allowed by Ofwat through its five yearly price determination. At the rate of investment provided in the price determination for 2005-10, the average age of Welsh Water's assets will be greater at the end of the period than at the start, which may increase risk of future asset failure and poor serviceability.

The availability and terms of insurance as a tool to mitigate business risk is also relevant. Insurance policies cover property, business interruption, public liability, environmental pollution and employer's liability are generally multi-tiered, with the first tier of self insurance in the form of a deductible and the second, and often further tiers, of cover provided by external insurers in the market.

Financial risk

Like any business, Welsh Water is exposed to many financial risks, in particular between regulatory price reviews. Examples include:

- Revenue risk, in particular, changes in metered demand, the loss of large water business customers, and the introduction of competition into water supply.
- The collection of customer charges and non-recovery of customer debt, which is a particular risk following the prohibition in 1997 of disconnection of domestic water supply for non-payment.
- Failure by Welsh Water to achieve the challenging price determination targets set by Ofwat for operating and capital efficiency or to deliver the capital investment programme.
- External cost pressures, such as the impact of recent increase in power prices, which could also prevent the business from achieving Ofwat's operating and capital cost targets set at the last price review.

The overall financial risk is that the group may not be able to finance the operating and capital investment obligations of Welsh Water, which continue to be financed from cash flow from operations (i.e. customer bills) and debt financing.

Group policy is to ensure that the business has sufficient committed facilities available to meet at least twelve months anticipated net cash requirement. However, recognising favourable market conditions, financing risk has been significantly reduced during the first two years of AMP4 as a result of treasury activity, which has substantially completed Welsh Water's financing requirements for the period until 2010. The group's financial position at 31 March 2007 shows a significant balance of cash and undrawn borrowing facilities available, which gives the business a high degree of liquidity.

Rising pension costs due to factors outside's the Board control, such as rising pensioner longevity, is also a risk; however, with only 160 members the closed Welsh Water defined benefit pension scheme is small relative to the size of the business.

Procurement risk

Procurement risk is a particular risk for Welsh Water, with 85% of its annual operating and capital expenditure being undertaken by outsourced service providers. Our framework for competitive outsourcing is described in a published Procurement Plan which is available on Welsh Water's website or on request from the Company Secretary.

Initial outsourced operating contracts were generally let for a period of four years, which ended on 31 March 2005. New outsourced contract arrangements for water and wastewater services were put in place following a successful competitive re-tendering, which provide for contract partners to work with Welsh Water for up to 15 years (subject to price and performance reviews every five years). This was designed to encourage contract partners to view their involvement with Welsh Water on a longer term basis than was previously possible, thereby reducing the risk of short term conflict of interest and encouraging longer term investment in the resources, people and systems needed to continue to deliver high levels of service to Welsh Water customers.

Directors' pay and standards of performance

Welsh Water is the only trading company of the Glas Cymru Group. The Directors of Welsh Water are also directors of Glas Cymru. Directors' service contracts, pay and incentive arrangements are set by Glas Cymru's Remuneration Committee. The role of the Remuneration Committee is to approve, implement and keep under review the remuneration policy and practice.

Remuneration Policy

The aim of the remuneration policy is to ensure that, in a competitive market place, the business is well managed by high calibre executives who are incentivised to produce sector-leading performance for the benefit of Welsh Water's customers, investors and other key stakeholders. The policy is designed to align as closely as practicable the interests of the individual with the longer-term interests of the business, and, especially, the interests of the customers of Welsh Water. Accordingly, a high proportion of Directors' remuneration is dependent on performance.

The executive remuneration package comprises four elements: base salary and benefits, annual performance related bonus, a longer-term performance related incentive and pension.

The remuneration policy applies to the senior management team, as well as to Executive Directors, and has been founded on the following principles:

- overall, remuneration packages shall be broadly competitive when compared to the relevant market;
- the 'at-risk' performance related component of Directors' remuneration, which is non-pensionable, shall be above that typical in comparator companies for the achievement of stretching performance targets;
- customer service and financial performance are the key criteria by which the success of the business is judged and shall therefore be key determinants of performance related pay;
- only by an appropriate combination of annual and longer term incentivisation arrangements can the Committee ensure that individuals are motivated and that their interests are suitably aligned with the longer term objectives of Glas Cymru and the customers of Welsh Water; and
- the Remuneration Policy shall reflect the stated intention of the Board that Welsh Water should be one of the consistently best performing water companies in the sector, and that to earn bonuses Directors must outperform the level of customer service and financial performance expected by Welsh Water's regulators.

For 2006-07 the comparator companies comprised the water companies (AWG, Kelda plc, Pennon plc, Severn Trent plc and United Utilities plc), together with National Grid plc and Scottish Power plc. The appropriateness of the comparator group is reviewed on an annual basis.

Bonus Policy: Annual Performance Related Bonus

The maximum annual cash bonus payable is 80 percentage points of base salary ('PPBS'), with 50 PPBS (62.5% of the maximum) being payable for reaching 'target' level of performance. Maximum bonus is divided equally between customer service and financial performance components.

The customer service component is determined with reference to the 'Overall Performance Assessment' ('OPA') published by Ofwat, and can earn up to 40 PPBS for achieving 1st position in the OPA ranking of the ten water and sewerage companies of England and Wales ('OPA League Table'). 8 PPBS (20% of the maximum) will be payable for achieving median performance, being the average score of the 5th and 6th ranked companies, with ranking above this (but not below) rewarded on a linear scale.

The OPA includes non-financial performance measures for:

- water supply: e.g. interruptions to supply, restrictions on supply and drinking water compliance;
- sewerage measures: e.g. sewage flooding incidents and quality of effluent discharges to the environment; and
- customer service performance: e.g. speed of response to telephone and written billing enquiries and handling of written complaints.

At the discretion of the Committee, this bonus entitlement may be adjusted upward or downward by up to 10 PPBS to reflect identifiable and significant aspects of customer service performance not captured by OPA.

The financial component is based on net cash flow (before capital expenditure but after net interest payable) and can earn up to 40 PPBS. Performance will be rewarded on a linear scale from zero for meeting the annual cash flows in the regulatory settlement for 2005-10 announced by Ofwat in December

2004 (the 'Final Determination'), 25 PPBS (62.5% of maximum) and 40 PPBS for reaching the respective target and

Directors' pay and standards of performance cont'd

maximum levels approved by the Committee. To achieve target level bonus accordingly requires that Welsh Water outperform the Ofwat Final Determination, which is a key requirement if the business is to achieve the challenging objectives set by the Board.

The 2006-07 Accounts include a charge of £301,298 (equivalent to 43.5 basis points) reflecting the Committee's current estimate of Welsh Water's relative performance for the year ended 31 March 2007. The Committee will make its final assessment of bonus payable for 2006-07 in the Autumn 2007, following publication by Ofwat of its Levels of Service Report.

Bonus Policy: Rolling Long Term Incentive Scheme ('RLTIS')

The RLTIS is a longer-term incentive scheme introduced on 1 April 2005 on the basis of a rolling three-year period (except during the first two years). The maximum bonus payable under RLTIS will be 60 PPBS, with 30 PPBS (50% of the maximum) being payable for reaching 'target' performance. Maximum bonus is divided equally between customer service and financial performance components.

Payments under RLTIS will normally be made within six months of the end of the final year to which they relate, but payment may be deferred at the discretion of the Committee in the event that there is a significant deterioration in performance. Deferral may be for up to two years, or until the shortfall has been remedied, whichever is the earlier.

In addition, payment of up to 20 PPBS will be deferred in the event that any of the Company's bonds have been put on credit watch by any of the Rating Agencies, either until taken off credit watch or until they have been downgraded, in which case the 20 PPBS shall be forfeited.

The customer service component will be determined with reference to Welsh Water's position in an adjusted OPA League Table, compiled by aggregating OPA scores for each of the last three years up to and including the relevant year of assessment. Bonus will be payable on a sliding scale of 100% (30 PPBS) for achieving 1st position, 75% for 2nd, 50% for 3rd, 25% for 4th and zero for being ranked 5th or below of the ten comparator companies.

The financial performance component will be based on 'Financial Reserves' (Regulatory Capital Value less net debt) at the end of the relevant year, as defined for the purposes of the quarterly Investor Report routinely published by the Company. Growth in Financial Reserves is considered the best financial measure of customers' interest in the business, as it is from Financial Reserves that the 'customer dividend' and additional investment to deliver service improvements will be funded. Growth in Financial Reserves therefore captures the dynamics on which the objectives of Glas Cymru were founded and aligns the financial interests of Executive Directors in a direct and simple way with those of customers.

The Committee will normally confirm target ranges three years in advance. However, these ranges will be subject to revision by the Committee each year in certain circumstances. These include: (a) where there are differences between actual inflation and the assumptions originally made; (b) where the Board changes the 'customer dividend' after the original forecast was made; and (c) where there is any other material influence on Financial Reserves not originally foreseen and which the Committee determines to be outside the control of Executive Directors. Payment of bonus will be measured by reference to a lower limit, the Final Determination, at which no bonus will be earned, a target level at which 50% of maximum will be earned and an upper limit, set by the Committee, at which maximum bonus will be earned. Again, to achieve target level bonus accordingly requires that Welsh Water outperform the Final Determination.

The Committee may at its discretion adjust any bonus calculation, up or down, to reflect events or factors that are not captured by the bonus formulae described above, providing that justification for any such adjustment will be disclosed in the next annual report.

The 2006-07 Accounts include an accrual of £206,644 (equivalent to 39.1 basis points) reflecting the Committee's current estimate of Welsh Water's relative performance for the three year period ended 31 March 2007. The Committee will make its final assessment of bonus payable under the RLTIS for 2006-07 in the Autumn 2007 following publication by Ofwat of its Levels of Service Report.

Directors' pay and standards of performance cont'd

Bonuses paid

Annual performance related bonus

In Autumn 2006 Executive Directors received an annual incentive bonus for the year ended 31 March 2006 equivalent to 68.9% of salary, of which 28.9% related to performance against customer service targets and 40% to meeting financial targets. This compared to an accrual in the 2005-06 Accounts of 49.9%.

Rolling Long Term Incentive Scheme

In Autumn 2006 Executive Directors received a first payment under the RLTIS in respect of the period ended 31 March 2006 equivalent to 59.1% of salary, of which 30% related to performance against customer service targets and 29.1% to meeting financial targets. This compared to an accrual in the 2005-06 Accounts of 44.1%.

Licence condition F6A Certificate

Set out below is an extract from the minutes of a meeting of Directors of Dŵr Cymru Cyfyngedig held at Cardiff Wastewater Treatment Works on 8 June 2007.

Approval of the Regulatory Accounts for the year ended 31 March 2007

The Regulatory Accounts of the Company for the year ended 31 March 2007 were tabled and discussed. IT WAS RESOLVED that they be and are hereby approved.

The Secretary was asked to send to the Water Services Regulation Authority a certificate in accordance with Condition F Paragraph 6A.2A of the Instrument of Appointment (as amended) as follows:-

Directors' certificate on the protection of the appointed business

THAT in the opinion of the Directors, the Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next twelve months, the Regulated Activities (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment);

THAT in the opinion of the Directors, the Company will, for at least the next twelve months, have available to it management resources which are sufficient to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment):

THAT in the opinion of the Directors, the Company will, for at least the next twelve months, have available to it systems of planning and internal control which are sufficient to enable it to carry out its Regulated Activities (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment): and

THAT in the opinion of the Directors, all contracts entered into with any Associate Company include all the necessary provisions and requirements concerning the standards of services to be supplied by the Company, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

THAT in the opinion of Directors, the Company has sufficient rights and assets to comply with the requirements of paragraph 3.1 of Condition K of the Licence.

The following factors have been taken into account by Directors in giving this declaration:

- i. The financial strength of the Company and the management and other resources available to the Company as recorded in the Regulated Accounts for the year ended 31 March 2007;
- ii. The bond programme of financing implemented by Dŵr Cymru (Financing) Limited, an associate Company to, inter alia, provide future financing for the Company (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment);
- iii. The terms of contracts awarded by the Company to independent third parties for the provision of certain services and operations, issued in compliance with the Utilities Contract Regulations 1996 and other appropriate UK regulations and EC Directives for the procurement of such outsourced services;
- iv. The results from the ongoing monitoring of financial, operational and compliance controls and the risk management process reported to the board via four formal committees, the Audit Committee, the Remuneration Committee, the Nominations Committee and the Quality and Environment Committee. The group's outsourced internal audit function has carried out a programme of work, which incorporates a review of the control environment;
- v. The Board has reviewed the effectiveness of internal controls in compliance with the requirements of the Combined Code; and
- vi. The Undertaking that Glas Cymru Cyfyngedig ("Glas Cymru") has given following the acquisition of the Company, in which Glas Cymru confirms that it (and each of its subsidiaries other than the Company) will:-
 - a. Provide the Company with all such information as may be necessary to enable the Company to comply with the requirements of the conditions of Appointments, or such additional information as the Director may reasonably require about their activities and the financing of them;
 - b. Refrain from any action which would or may cause the Company to breach any of its obligations under the Act or conditions of Appointments;
 - c. Ensure that at all times the Board of the Company contains a majority of non-executive directors;

Licence condition F6A Certificate cont'd

- d. Comply with the Principles of Good Governance and Code of Best Practice (or any successor document having a similar purpose or intent) as may from time to time be appended to or approved for the purposes of the Listing Rules of the UK Listing Authority; and
- e. Not make any changes to their respective Memorandum and Articles of Association without the consent of the Director.

Disclosure of transactions with associates

There were no transactions with any associated companies except for:

- The directors of Dŵr Cymru Cyfyngedig are also directors of other companies within the Glas Cymru group. However, the emoluments of the Directors are paid in full by Dŵr Cymru Cyfyngedig as their activities are predominantly related to the regulated water and sewerage business. During the year the Directors emoluments amounted to £1,511,000 (2006: £1,194,000)
- Debtors include a loan to the Company's immediate parent company, Dŵr Cymru (Holdings) Limited, of £370.5million (2006: £370.5m). The interest rate on this loan is 12%. Loan interest of £44.6 million (2006: £44.6m) has been waived by the Company during the year. The interest waiver is a practical alternative to funding the interest otherwise receivable by the Company by means of an ordinary dividend.
- The proceeds of the group's bond programme have been on lent to Dŵr Cymru Cyfyngedig under an intercompany loan agreement. Under the terms of this agreement, the interest rates payable by the Company are based on the interest rates payable to the bondholders, after taking into account interest rate and currency swaps, plus a margin of 0.01%.

Certified a true copy

R Curtis LLB ACIS
Company Secretary

8 June 2007

Report on procurement activities

Under paragraph 9 of Condition F1 of the Welsh Water Licence, the Company is required to submit to Ofwat each year a written report on its procurement activities. This report should cover compliance with the Company's Procurement Plan and include details of the number and content of contracts let (or brought in-house) during the year.

Revision three of Welsh Water's Procurement Plan was submitted to Ofwat in August 2006 and audited by Ofwat's Reporter in January 2007. The Procurement Plan detailed the outcome of the competitive re-tendering process Welsh Water had undertaken for virtually all of Welsh Water's outsourced services including asset operation and maintenance, asset investment, income and billing, network development, ICT services and sampling and analysis. With the exception of the ICT services and sampling and analysis contracts the remainder all came into effect in 2005/2006 and were detailed in last year's report.

The period April 2006 to March 2007 has seen a consolidation of our procurement strategy. We have continued to develop the contractual relationships with our operations and investment service providers United Utilities Operational Services, Kelda Water Services Wales, Laing O'Rourke Utilities, Costain, AMEC, Morrison, Black and Veatch and Imtech (previously Meica); our Billing and Income provider Thames Water Services and network development consultant Hyder Consulting UK Ltd.

Through the Asset Management Alliance (AMA) established with our service delivery partners we continue to develop a programme of relationship management aimed at supporting integrated working and the efficient and effective delivery of service to our customers.

Information Technology

Following a detailed assessment process, Capgemini, LogicaCMG and Tata Consulting Services (TCS) were selected as preferred partners for ICT contracts in February 2006. A 7 year contract, with break points commencing after year 3, was awarded to each of the three companies. Contracts were concluded with Capgemini and Logica in June 2006 and with TCS shortly after.

The 6 lots were awarded as follows:

Capgemini

- Lot 1 Help Desk
- Lot 2 Desk side support and local area networks
- Lot 4 Applications development and management
- Lot 6 Commodity Services

LogicaCMG

- Lot 3 Data Centre
- Lot 4 Applications development and management
- Lot 5 Wide area network (data and voice)
- Lot 6 Commodity Services

TCS

- Lot 4 Applications development and management

Report on procurement activities cont'd

Sampling and Laboratory Analytical Services

The new Sampling and Analytical Services contract was awarded to Severn Trent Laboratories (STL) in December 2006 following a procurement process that commenced with the publication of an OJEU Notice inviting competition in May 2006.

The competition was structured around 6 service Lots being:

- Lot 1 Sampling Services (North)
- Lot 2 Sampling Services (South)
- Lot 3 Clean Water Analytical Services (North)
- Lot 4 Clean Water Analytical Services (South)
- Lot 5 Wastewater Analytical Services (North)
- Lot 6 Wastewater Analytical Services (South)

Tenders were received from a number of providers for all or some of the lots. Following detailed assessment Severn Trent were selected to provide services across all Lots. The contract was placed for an initial period of 5 years but may be extended for two further periods.

Other Procurement activities

In the normal course of business, Welsh Water has also carried out competitive procurement activity relating to the following services:

- Pension and actuarial services
- External audit services
- Office space planning and supply of furniture
- Customer research services
- Water resource planning consultants
- Health and safety auditors
- Legal pension services
- IT induction training
- Study for the reduction of flows in combined and foul sewers
- Strategic environmental assessment

Directors' responsibilities for the regulatory accounts

The Directors are required by the terms of the Instrument of Appointment to prepare regulatory accounts for each financial year in accordance with Condition F of the Instrument of Appointment and the Regulatory Accounting Guidelines. In preparing the regulatory accounts, the Directors ensure that appropriate accounting policies have been adopted and applied consistently, that applicable accounting standards have been followed and that reasonable and prudent judgements and estimates have been made.

It is the Directors' responsibility to maintain adequate accounting records and to institute and maintain systems and controls designed to safeguard the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board

R Curtis LLB ACIS
Company Secretary

8 June 2007

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Dŵr Cymru Cyfyngedig

We have audited the Regulatory Accounts of Dŵr Cymru Cyfyngedig ("the Company") on pages 34 to 79 which comprise:

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account and the regulatory historical cost balance sheet; and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes including the statement of accounting policies.

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

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company. There are differences between United Kingdom Generally Accepted Accounting Principles ("UK GAAP") and the basis of preparation of information provided in the Regulatory Accounts as the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the WSRA, the Directors and Auditors

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

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of Directors' responsibilities for regulatory information on page 30.

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Dŵr Cymru Cyfyngedig cont'd

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing issued by the Auditing Practices Board, except as stated in the "Basis of audit opinion", below and having regard to the guidance contained in Audit 05/03 "Reporting to Regulators of Regulated Entities".

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 66 to 79 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the performance review, the notes on regulatory information, and the additional information required by the Company's Regulatory Licence.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, 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 Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the WSR, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 34 to 65 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up in the Statutory Accounts under International Financial Reporting Standards and the Companies Act 1985 is given on pages 64 and 65.

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Dŵr Cymru Cyfyngedig cont'd

Opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2007 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 44 to 46 and 70 to 71, the state of the Company's affairs at 31 March 2007 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

In respect of this information we report that in our opinion:

- (a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;
- (b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
- (c) the regulatory historical cost accounting statements on pages 34 to 65 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
- (d) the regulatory current cost accounting statements on pages 66 to 79 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

13 July 2007

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

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

Historical cost financial statements and
accompanying notes for the year ended
31 March 2007

Historical cost profit and loss account for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Turnover	3	578.0	553.5
Net operating costs	4	(358.8)	(339.7)
Operating profit		219.2	213.8
Profit on disposal of fixed assets	6	-	0.8
Profit on ordinary activities before interest		219.2	214.6
Interest payable	7a	(158.5)	(159.5)
Interest receivable	7a	7.4	9.7
Other finance expense	7b	(0.1)	(0.3)
Profit on ordinary activities before taxation		68.0	64.5
Current tax	8	0.9	(3.7)
Deferred tax	8	12.5	3.6
Profit on ordinary activities after taxation		81.4	64.4
Dividends on ordinary shares	9	-	-
Retained profit for the year	22	81.4	64.4

All operations are continuing.

Historical cost statement of total recognised gains and losses for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Profit for the year		81.4	64.4
Actuarial (loss)/gain recognised in the pension scheme	28	(0.9)	1.5
Movement on the deferred tax asset relating to pension scheme	28	0.3	(0.5)
Total recognised gains for the year		80.8	65.4

Historical cost profit and loss account for the year ended 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2007

	Appointed Business 2007 £m	Non Appointed Business 2007 £m	Aggregated total 2007 £m
Turnover	569.2	8.8	578.0
Operating costs	(352.0)	(8.2)	(360.2)
Other operating income	-	-	-
Operating profit	217.2	0.6	217.8
Other income	1.4	-	1.4
Interest payable	(158.5)	-	(158.5)
Interest receivable	6.1	1.3	7.4
Other finance expense	(0.1)	-	(0.1)
Profit on ordinary activities before taxation	66.1	1.9	68.0
Current tax	0.9	-	0.9
Deferred tax	12.5	-	12.5
Retained profit for the year	79.5	1.9	81.4

Historical cost statement of total recognised gains and losses for the year ended 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2007

	Appointed Business 2007 £m	Non Appointed Business 2007 £m	Aggregated total 2007 £m
Profit for the year	79.5	1.9	81.4
Actuarial loss recognised in the pension scheme	(0.9)	-	(0.9)
Movement on the deferred tax asset relating to pension scheme	0.3	-	0.3
Total recognised gains for the year	78.9	1.9	80.8

Historical cost profit and loss account for the year ended 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2006

	Appointed Business 2006 £m	Non Appointed Business 2006 £m	Aggregated total 2006 £m
Turnover	544.8	8.7	553.5
Operating costs	(333.5)	(7.7)	(341.2)
Other operating income	0.8	-	0.8
Operating profit	212.1	1.0	213.1
Other income	1.5	-	1.5
Interest payable	(159.5)	-	(159.5)
Interest receivable	8.5	1.2	9.7
Other finance expense	(0.3)	-	(0.3)
Profit on ordinary activities before taxation	62.3	2.2	64.5
Current tax	(3.7)	-	(3.7)
Deferred tax	3.6	-	3.6
Retained profit for the year	62.2	2.2	64.4

Historical cost statement of total recognised gains and losses for the year ended 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2006

	Appointed Business 2006 £m	Non Appointed Business 2006 £m	Aggregated total 2006 £m
Profit for the year	62.2	2.2	64.4
Actuarial gain recognised in the pension scheme	1.5	-	1.5
Movement on the deferred tax asset relating to pension scheme	(0.5)	-	(0.5)
Total recognised gains for the year	63.2	2.2	65.4
Prior year adjustment – FRS 17	(5.5)	-	(5.5)
Prior year adjustment – reversal of discount of deferred tax provision	(240.1)	-	(240.1)
Total losses recognised since last annual report	(182.4)	2.2	(180.2)

Historical cost balance sheet at 31 March 2007

	Note	2007 £m	2006 £m
Fixed assets			
Tangible assets	10	2,949.8	2,840.3
Investments	11	0.1	0.1
		2,949.9	2,840.4
Current assets			
Debtors-due within one year	12(a)	94.0	86.8
Debtors-due after one year	12(b)	370.5	370.5
Current asset investments	13	153.6	10.1
Cash at bank and in hand		3.8	3.8
		621.9	471.2
Current liabilities			
Creditors: amounts falling due within one year	14(a)	(172.1)	(248.7)
Net current assets		449.8	222.5
Total assets less current liabilities		3,399.7	3,062.9
Creditors: amounts falling due after more than one year	14(b)	(2,520.0)	(2,247.2)
Retirement benefit obligations	28	(3.8)	(4.6)
Provisions for liabilities and charges	19	(312.1)	(326.7)
Deferred income	20	(30.7)	(32.1)
Net assets		533.1	452.3
Capital and reserves			
Called up share capital	21	309.9	309.9
Capital redemption reserve	22	166.2	166.2
Profit and loss account	22	57.0	(23.8)
Total shareholders' funds		533.1	452.3

The regulatory accounts on pages 34 to 79 were approved by the Board of Directors on 8 June 2007 and were signed on its behalf by:

NC Annett
Managing Director

CA Jones
Finance Director

Historical cost balance sheet as at 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2007.

	Appointed Business 2007 £m	Non- Appointed Business 2007 £m	Intra Segmental 2007 £m	Aggregated total 2007 £m
Fixed assets				
Tangible assets	2,949.8	-	-	2,949.8
Investments	0.1	-	-	0.1
	2,949.9	-	-	2,949.9
Current assets				
Infrastructure renewals prepayment	3.6	-	-	3.6
Debtors	460.9	-	-	460.9
Short term investments	125.2	-	28.4	153.6
Cash at bank and in hand	3.8	28.4	(28.4)	3.8
Total current assets	593.5	28.4	-	621.9
Creditors:				
amounts falling due within one year				
Borrowings	(67.6)	-	-	(67.6)
Other creditors	(104.5)	-	-	(104.5)
Total creditors	(172.1)	-	-	(172.1)
Net current assets	421.4	28.4	-	449.8
Total assets less current liabilities	3,371.3	28.4	-	3,399.7
Creditors:				
amounts falling due after more than one year				
Borrowings	(2,520.0)	-	-	(2,520.0)
Total creditors	(2,520.0)	-	-	(2,520.0)
Provision for deferred taxation	(296.3)	-	-	(296.3)
Other provisions for liabilities and charges	(15.8)	-	-	(15.8)
Retirement benefit obligations	(3.8)	-	-	(3.8)
Deferred income	(30.7)	-	-	(30.7)
Net assets employed	504.7	28.4	-	533.1
Capital and reserves				
Share capital	309.9	-	-	309.9
Reserves	28.6	28.4	-	57.0
Capital Redemption Reserve	166.2	-	-	166.2
Total shareholder's funds	504.7	28.4	-	533.1

Historical cost balance sheet as at 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2006.

	Appointed Business 2006 £m	Non- Appointed Business 2006 £m	Intra Segmental 2006 £m	Aggregated total 2006 £m
Fixed assets				
Tangible assets	2,840.3	-	-	2,840.3
Investments	0.1	-	-	0.1
	2,840.4	-	-	2,840.4
Current assets				
Debtors	457.3	-	-	457.3
Short term investments	(16.4)	-	26.5	10.1
Cash at bank and in hand	3.8	26.5	(26.5)	3.8
Total current assets	444.7	26.5	-	471.2
Creditors:				
amounts falling due within one year				
Borrowings	(4.0)	-	-	(4.0)
Infrastructure renewals accrual	(1.7)	-	-	(1.7)
Other creditors	(243.0)	-	-	(243.0)
Total creditors	(248.7)	-	-	(248.7)
Net current assets	196.0	26.5	-	222.5
Total assets less current liabilities	3,036.4	26.5	-	3,062.9
Creditors:				
amounts falling due after more than one year				
Borrowings	(2,228.5)	-	-	(2,228.5)
Other creditors	(18.7)	-	-	(18.7)
Total creditors	(2,247.2)	-	-	(2,247.2)
Provision for deferred taxation	(309.4)	-	-	(309.4)
Other provisions for liabilities and charges	(17.3)	-	-	(17.3)
Retirement benefit obligations	(4.6)	-	-	(4.6)
Deferred income	(32.1)	-	-	(32.1)
Net assets employed	425.8	26.5	-	452.3
Capital and reserves				
Share capital	309.9	-	-	309.9
Reserves	(50.3)	26.5	-	(23.8)
Capital Redemption Reserve	166.2	-	-	166.2
Total shareholder's funds	425.8	26.5	-	452.3

Historical cost cashflow statement for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Cash inflow from operating activities	24	330.2	307.9
Returns on investments and servicing of finance			
Interest received		7.0	10.1
Interest paid		(46.9)	(112.3)
Interest element of finance lease rental payments		(27.3)	(30.4)
		(67.2)	(132.6)
Taxation			
Group relief paid		-	(1.1)
		-	(1.1)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(208.2)	(178.0)
Sale of tangible fixed assets		-	0.8
Infrastructure renewals expenditure		(57.5)	(48.1)
Grants and contributions received		15.2	11.8
		(250.5)	(213.5)
Cash inflow/(outflow) before use of liquid resources and financing		12.5	(39.3)
Management of liquid resources			
Net (increase)/decrease in deposits		(143.5)	310.2
Cash (outflow)/inflow before financing		(131.0)	270.9
Financing			
Loan received from group undertaking		150.0	145.2
New finance leases received		32.2	113.8
Loan repaid to parent undertaking		(45.3)	(525.0)
Loan repaid to group undertaking		-	0.8
Other loan repayments		(0.4)	(0.5)
Capital element of finance repayments		(5.5)	(5.1)
		131.0	(270.8)
Increase in cash in the year	25	-	0.1

Historical cost cash flow statement for the year ended 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2007.

	Appointed Business 2007 £m	Non Appointed Business 2007 £m	Intra Segmental 2007 £m	Aggregated total 2007 £m
Cash flow from operating activities	329.6	0.6	-	330.2
Returns on investments and servicing of finance				
Interest received	5.7	1.3	-	7.0
Interest paid	(46.9)	-	-	(46.9)
Interest element of finance lease rental payments	(27.3)	-	-	(27.3)
	(68.5)	1.3	-	(67.2)
Taxation				
UK corporation tax paid	-	-	-	-
	-	-	-	-
Capital expenditure and financial investment				
Purchase of tangible fixed assets	(208.2)	-	-	(208.2)
Infrastructure renewals expenditure	(57.5)	-	-	(57.5)
Grants and contributions received	15.2	-	-	15.2
	(250.5)	-	-	(250.5)
Cash flow before use of liquid resources and financing	10.6	1.9	-	12.5
Management of liquid resources				
Net movement in deposits	(141.6)	-	(1.9)	(143.5)
Financing				
Long term loans received	32.2	-	-	32.2
Loan received from group undertaking	150.0	-	-	150.0
Loans repaid to parent undertaking	(45.3)	-	-	(45.3)
Loans repaid	(0.4)	-	-	(0.4)
Capital element of finance lease repayments	(5.5)	-	-	(5.5)
	131.0	-	-	131.0
Increase/(decrease) in cash in the year	-	1.9	(1.9)	-

Historical cost cash flow statement for the year ended 31 March 2007 cont'd

Analysis of historical cost financial information between appointed and non-appointed business for the year ended 31 March 2006.

	Appointed Business 2006 £m	Non Appointed Business 2006 £m	Intra Segmental 2006 £m	Aggregated total 2006 £m
Cash flow from operating activities	307.2	0.7	-	307.9
Returns on investments and servicing of finance				
Interest received	8.9	1.2	-	10.1
Interest paid	(112.3)	-	-	(112.3)
Interest element of finance lease rental payments	(30.4)	-	-	(30.4)
	(133.8)	1.2	-	(132.6)
Taxation				
UK corporation tax paid	(1.1)	-	-	(1.1)
	(1.1)	-	-	(1.1)
Capital expenditure and financial investment				
Purchase of tangible fixed assets	(178.0)	-	-	(178.0)
Infrastructure renewals expenditure	(48.1)	-	-	(48.1)
Sale of tangible fixed assets	0.8	-	-	0.8
Grants and contributions received	11.8	-	-	11.8
	(213.5)	-	-	(213.5)
Equity dividends paid	-	-	-	-
Cash flow before use of liquid resources and financing	(41.2)	1.9	-	(39.3)
Management of liquid resources				
Net movement in deposits	312.1	-	(1.9)	310.2
Financing				
Long term loans received	113.8	-	-	113.8
Loan received from group undertaking	145.2	-	-	145.2
Loans repaid to parent undertaking	(525.0)	-	-	(525.0)
Loans repaid	(0.5)	-	-	(0.5)
Loan repaid from subsidiary undertaking	0.8	-	-	0.8
Capital element of finance lease repayments	(5.1)	-	-	(5.1)
	(270.8)	-	-	(270.8)
Increase/(decrease) in cash in the year	0.1	1.9	(1.9)	0.1

Notes to the historical cost financial statements for the year ended 31 March 2007

1. Accounting policies

Basis of preparation

The financial statements are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK except for the dis-application of certain sections of FRS 12 and FRS 15 in relation to infrastructure renewals accounting as described below, and with the Companies Act 1985 except for the treatment of certain capital contributions. An explanation of this departure from the requirements of the Companies Act 1985 is given in the "Grants and customers contributions" section below and note 10(c).

Turnover

Turnover represents the income receivable in the ordinary course of business for services provided and excludes value added tax. Where services have been provided, but for which no invoice has been raised at the year-end, an estimate of the amounts are included in turnover.

Tangible fixed assets and depreciation

Tangible fixed assets comprise:

- (i) infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls); and
- (ii) other assets (including properties, aboveground operational structures and equipment and fixtures and fittings).

Tangible fixed assets are stated at cost of construction or purchase price and directly attributable costs. The carrying value of tangible fixed assets is reviewed for impairment if circumstances dictate that they may not be recoverable.

Infrastructure assets

Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity, enhancements or replacements of the network is treated as additions, which are included at cost after deducting grants and contributions.

The infrastructure renewals charge (IRC) is based on the estimated level of annual expenditure required to maintain the operating capability of the network over the medium to long-term.

The regulatory historical cost balance sheet has been prepared in accordance with RD15/99, with the relevant sections of FRS 12 and FRS 15 being dis-applied in relation to infrastructure renewals accounting. As a result, any cumulative difference between IRC and actual infrastructure renewals expenditure in the year is held as a prepayment or accrual in the balance sheet.

Other assets

Other assets are included at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated over their estimated useful economic lives, which are principally as follows:

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

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

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

Leased assets

Where assets are financed by leasing arrangements, which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor and the finance charges being written off to the profit and loss account over the period of the lease in reducing amounts in relation to the written down amount. The assets are depreciated over the shorter of their estimated useful life and the lease period. All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the profit and loss account in the year to which they relate.

Grants and customer contributions

Grants and customer contributions relating to infrastructure assets have been offset against fixed assets (see note 10(c)). Grants and customer contributions in respect of expenditure on other fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Capital expenditure programme incentive payments

The Company's agreement with its construction partners involved in delivering the capital expenditure programme incorporates incentive bonuses payable after completion of the programmes. The cost of fixed asset additions include an accrual for the proportion of incentive bonuses earned to date, relating to projects substantially completed at the year end, where the likelihood of making the incentive payment is considered probable. Amounts recoverable from contract partners, relating to targets not being achieved are only recognised on completed projects.

Target cost contracts

The Company maintains target cost contracts with its main operating partners. The group's policy in respect of pain/gain share payments/receivables arising from these contracts is to recognise when final agreement with the relevant service partner has been achieved.

Pension costs

The Company operates two pension schemes, a defined contribution and a defined benefit scheme.

In respect of the defined contribution scheme, the amount charged to the profit and loss account represents contributions payable to the independent investment managers, who operate the schemes, in funds separate from those of the Company.

The defined benefit scheme is funded by both employers' and employees' contributions. The assets are held by the Trustees, separately from the assets of the Company. The fund is valued every three years by a professionally qualified independent actuary. In the intervening years the actuary reviews the continuing appropriateness of the rates. The assets of the defined benefit scheme are measured using closing market rates. Pension scheme liabilities are measured using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent terms. The increase in the present value of the scheme expected to arise from employees service during the period is charged to operating profit. The expected return on scheme assets and the increase during the period in the present value of the scheme liabilities, arising from the passage of time, are included as an interest expense. Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

Debt and debt issue costs

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. Debt issue costs are recognised in the profit and loss account over the term of such instruments at a constant rate on the carrying amount.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

Investments

Long term investments held as fixed assets are stated at cost less amounts written off or provided to reflect permanent diminution in value. Those held as current assets are stated at the lower of cost and net realisable value.

Financial instruments

Derivative instruments utilised by the group are currency swaps, currency forward exchange contracts and interest rate swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the Company. Currency swap agreements and currency forward exchange contracts are translated at the rates ruling in the agreements and contracts.

Interest differentials, under swap arrangements used to manage interest rate exposure on borrowings and current asset investments, are recognised by adjusting interest payable or receivable as appropriate.

Research and development

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

Taxation

The charge for current taxation is based on the profit for the period as adjusted for disallowable and non-taxable items. In accordance with FRS19 "Deferred Tax" full provision is made for all deferred tax liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. Deferred tax assets are only recognised to the extent that they are considered recoverable. Recoverability is defined as when it can be regarded as more likely than not that there will be sufficient taxable profits from which future reversal of the timing differences can be deducted. Deferred tax is not discounted.

Provision for insurance liabilities

Provision is made for all known and estimated liabilities arising from uninsured claims against the Company where there is a present obligation and it is probable that a transfer of economic benefits will be required.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

2 Consolidated financial statements

The Company has taken advantage of Section 228 (1) of the Companies Act 1985 not to produce consolidated financial statements as it is a wholly owned subsidiary of Glas Cymru Cyfyngedig.

3 Segmental analysis by class of business

(a) Turnover

	2007 £m	2006 £m
Regulated water and sewerage activities	569.2	544.8
Non regulated activities	8.8	8.7
	578.0	553.5

(b) Profit on ordinary activities before taxation

	2007 £m	2006 £m
Regulated water and sewerage activities		
Operating profit	218.6	212.8
Profit on disposal of fixed assets	-	0.8
Net interest payable	(152.4)	(151.0)
Other finance expense - pension	(0.1)	(0.3)
	66.1	62.3
Non-regulated activities		
Operating profit	0.6	1.0
Interest receivable	1.3	1.2
	1.9	2.2

(c) Net assets

	2007 £m	2006 £m
Regulated water and sewerage activities	504.7	425.8
Non-regulated activities	28.4	26.5
	533.1	452.3

All turnover and profit before taxation, by origin and destination, was attributable to the UK.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

4 Net operating costs

	Note	2007 Total £m	2006 Total £m
Operating charges from outsourced activities:			
- Operating services agreements		115.9	107.7
- Customer services agreement		18.6	19.4
- Laboratories and analytical services		7.6	7.3
- Other contracts		14.2	11.7
		156.3	146.1
Staff costs	5(b)	11.0	10.1
Research and development		0.4	0.4
Charge for bad and doubtful debts		11.0	7.6
Rates		21.0	18.8
Environment Agency charges		13.5	13.0
Fees paid to auditors	4(a)	0.2	0.2
Own work capitalised		(8.5)	(7.3)
Net rents payable		-	0.5
Other operating charges		22.8	24.9
		227.7	214.3
Depreciation:			
- Own assets		51.9	50.5
- Assets held under finance leases		28.5	26.0
Amortisation of grants and contributions	19	(1.4)	(1.5)
Infrastructure renewal charge		52.3	50.4
		358.8	339.7

(a) Auditors' remuneration

Auditors during the period were PricewaterhouseCoopers LLP. They were used primarily for audit services, including regulatory audit services carried out to meet Ofwat reporting requirements.

	2007 £'000	2006 £'000
Audit services	61	78
Other services:		
- Regulatory audit services pursuant to legislation	49	32
- Tax advisory services	1	10
- Interim review	20	25
- Bond issue	24	-
- Grant applications	2	6
- Financial modelling	1	12
- IFRS transition	-	48
	158	211

Regulatory audit services includes work on the Regulatory Accounts, June Return and Principal Statement. In addition to the above services, PricewaterhouseCoopers LLP acted as auditor to the Welsh Water Pension Scheme. The appointment of auditors to the pension scheme and the fees paid in respect of the audit are agreed by the trustees of the scheme, who act independently from the management of the group. The fees paid in respect of audit services to the pension scheme during the year were £7,000 (2006: £7,000).

The Board has adopted a formal policy with respect to services received from external auditors. The external auditor will not be used for internal audit services and all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

5 Directors and employees

(a) Directors' emoluments

The combined emoluments of the Directors of Dŵr Cymru Cyfyngedig for their services as directors of the Company are set out below:

	2007 £'000	2006 Restated £'000
Salary (including benefits in kind)	920	805
Compensation for loss of office	179	-
Fees	412	389
	1,511	1,194
Long term incentive plan	207	214

Retirement benefits are accruing to three Directors (2006 – two) under defined benefit schemes. Benefits are accruing to no Directors (2006 – one) under a defined contribution scheme.

- i) The financial statements for the year ended 31 March 2007 include a provision of £301,298 (2006: £241,833) for bonus potentially payable to Executive Directors for performance in the financial year 2006/07. The final amount to be paid to each Director will be determined when Ofwat publishes its Overall Performance Assessment (OPA) results for 2006/07 in the Autumn of 2007 and could be higher or lower. An amount of £206,644 (2006: £213,844) has also been provided under the terms of the Executive Directors' Long Term Incentive Plan.
- ii) The comparatives have been restated to reflect the final performance bonus for 2005/06. The actual performance bonus in respect of 2005/06 was paid in October 2006 following the publication of Ofwat's OPA report for 2005/06, and amounted to £316,002 compared to the amount accrued at 31 March 2006 of £241,833. The aggregate emoluments of the highest paid Director increased by £41,839 to £373,511 and total emoluments increased by £74,169 to £1,193,900.

	2007 £'000	2006 Restated £'000
Highest paid Director: (NC Annett; 2006: NC Annett)		
Aggregate emoluments	332	374
Accrued pension under defined benefit scheme	73	51
Long term incentive plan	90	97

(b) Staff costs

	2007 £m	2006 £m
Severance programme and termination costs	0.2	-
Wages and salaries	8.0	7.2
Social security costs	0.9	0.7
Pension costs	1.9	2.2
	11.0	10.1

Of the above, £4.7m (2006 £3.7m) has been charged to capital. Other pension costs include £nil (2006: £0.4 m) in respect of the severance programme and termination costs. (note 28).

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

5 Directors and employees cont'd

(c) Average monthly number of employees during the year (including executive directors)

	2007 Number	2006 Number
Regulated water and sewerage activities	<u>159</u>	136

6 Profit on disposal of fixed assets

	2007 £m	2006 £m
Profit on disposal of fixed assets	<u>-</u>	0.8

The profit for disclosed above for the prior year relates to the disposal of land and buildings.

7 a) Net interest payable

	2007 £m	2006 £m
Interest receivable	<u>7.4</u>	9.7
Interest payable:		
On loans	(123.8)	(124.7)
On finance leases	(33.8)	(31.9)
Amortisation of bond issue costs	(0.9)	(2.9)
	<u>(158.5)</u>	(159.5)
Net interest payable	<u>(151.1)</u>	(149.8)

Included in loans are amounts payable to group undertakings of £114.7m (2006 £117.3m).

b) Other finance expense

	2007 £m	2006 £m
Other finance costs – pension scheme (note 28)	<u>(0.1)</u>	(0.3)

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

8 Taxation

	Note	2007 £m	2006 £m
(a) Analysis of (credit)/charge in period			
Current tax:			
Group relief payable		-	2.3
Adjustments in respect of previous periods		(0.9)	1.4
Total current tax (credit)/charge	8(b)	(0.9)	3.7
Deferred tax:			
Origination and reversal of timing differences – current period		0.1	11.6
Origination and reversal of timing differences – prior period		(12.6)	(15.2)
Total deferred tax		(12.5)	(3.6)
Tax (credit)/charge on profit on ordinary activities		(13.4)	0.1
		2007 £m	2006 £m

(b) Factors affecting current tax charge for period

Profit on ordinary activities before tax	68.0	64.5
Profit on ordinary activities multiplied by the corporation tax rate in the UK of 30%	20.4	19.3
Effects of:		
Expenses not deductible for tax purposes	3.8	(5.5)
Capital allowances in excess of depreciation	(31.9)	(9.7)
Other timing differences	(1.3)	(0.4)
Tax losses carried forward	9.0	(1.4)
Adjustments in respect of prior periods	(0.9)	1.4
Current tax (credit)/charge for period	(0.9)	3.7

9 Dividends

	2007 £m	2006 £m
Dividends on ordinary shares		
£1 ordinary shares	-	-

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

10 Tangible fixed assets

(a) Analysis by type

	Freehold land and buildings	Infrastructure assets	Operational structures	Vehicles, plant, equipment & computer hardware & software	Total
	£m	£m	£m	£m	£m
Cost					
At 1 April 2006	32.7	1,915.9	2,055.0	246.7	4,250.3
Additions	0.2	141.2	98.9	29.4	269.7
Grants and contributions	-	(19.4)	(3.1)	-	(22.5)
At 31 March 2007	32.9	2,037.7	2,150.8	276.1	4,497.5
Accumulated depreciation					
At 1 April 2006	15.6	540.3	654.5	199.6	1,410.0
Charge for the year	0.3	57.5	72.1	7.8	137.7
At 31 March 2007	15.9	597.8	726.6	207.4	1,547.7
Net book value					
At 31 March 2006	17.0	1,439.9	1,424.2	68.7	2,949.8
At 31 March 2006	17.1	1,375.6	1,400.5	47.1	2,840.3
Analysis of net book value at 31 March 2007					
Owned	17.0	913.1	980.6	68.7	1,979.4
Held under finance leases	-	526.8	443.6	-	970.4
	17.0	1,439.9	1,424.2	68.7	2,949.8

Tangible fixed assets at 31 March 2007 include £157.6m (2006 £99.9m) of assets in the course of construction, which are not depreciated until commissioned.

In accordance with RD 15/99, the infrastructure renewals charge reported in the profit and loss account was £52.3 million. The difference between the profit and loss account charge and the depreciation charge in respect of infrastructure assets shown above is included within prepayments and accrued income.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

10 Tangible fixed assets cont'd

(b) Analysis by service

	Water Services £m	Sewerage Services £m	General £m	Total £m
Cost				
At 1 April 2006	1,716.0	2,308.5	225.8	4,250.3
Additions	115.4	125.0	29.3	269.7
Grants and contributions	(6.6)	(15.9)	-	(22.5)
Disposals				
At 31 March 2007	1,824.8	2,417.6	255.1	4,497.5
Accumulated depreciation				
At 1 April 2006	603.2	620.0	186.8	1,410.0
Charge for the year	60.0	70.3	7.4	137.7
Eliminated on disposals				
At 31 March 2007	663.2	690.3	194.2	1,547.7
Net book value				
At 31 March 2007	1,161.6	1,727.3	60.9	2,949.8
At 31 March 2006	1,112.8	1,688.5	39.0	2,840.3
Analysis of net book value at 31 March 2007				
Owned	990.3	928.3	60.8	1,979.4
Held under finance leases	171.3	799.1	-	970.4
	1,161.6	1,727.4	60.8	2,949.8

- (c) The accounting treatment for grants and customer contributions in respect of infrastructure assets is described in the principal accounting policies in note 1. This treatment is not in accordance with Schedule 4 to the Companies Act 1985, which requires fixed assets to be shown at the purchase price or production cost and hence grants and contributions would be presented under the Act as deferred income. The treatment explained in note 1 has been adopted in accordance with section 227(6) of the Companies Act 1985 in order to show a true and fair view as, in the opinion of the Directors, it is not appropriate to treat grants and contributions on infrastructure assets as deferred income. The fixed assets to which they relate do not have determinable finite lives and therefore no basis exists for releasing any deferred income to the profit and loss account. As a consequence, the net book value of fixed assets and deferred income is £217.4m (2006: £194.9m) lower than they would have been the case had grants and contributions been treated as deferred income indefinitely.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

11 Fixed asset investments

At Cost and net book value	2007 £m	2006 £m
At 1 April and 31 March	0.1	0.1

The Company owns equity of less than 10% in the following unlisted company:-

	Nature of Business	Country of Incorporation	Description of Holding
Water Research Centre (1989) Plc	Water Research	Great Britain	"B" Ordinary Shares of £1

In addition, the Company holds 5% Convertible Unsecured Loan Stock 2014 at a cost of £23,326 in Water Research Centre (1989) Plc.

100% interest in the following subsidiary:

	Nature of Business	Country of Incorporation	Description of Holding
Welsh Water Utilities Finance Plc	Raising finance	Great Britain	Ordinary Shares of £1

12 Debtors

	2007 £m	2006 £m
(a) Amounts falling due within one year:		
Trade debtors	31.7	27.4
Amounts owed by group undertakings	0.1	0.1
Other debtors	5.2	9.8
Infrastructure renewals prepayment	3.6	-
Prepayments and accrued income	53.4	49.5
	94.0	86.8
(b) Amounts falling due after more than one year:		
Amounts owed by group undertakings	370.5	370.5
	370.5	370.5

Interest of £44.6m for the year (2006: £44.6m) has been waived by the Company on the amounts owed by group undertakings.

13 Current asset investments

Management of liquid resources

	2007 £m	2006 £m
Investments in:		
Fixed term and call deposits-due within one year	153.6	10.1
	153.6	10.1

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

13 Current asset investments cont'd

Cash generated from operating activities and from long-term borrowings in advance of future capital expenditure obligations is invested. These investments include long-term deposits, government securities and corporate bonds. It is group policy that investments are restricted to deposits and securities, which have a recognised investment grade credit rating.

Treasury activities are managed under policies, procedures and authorities approved by the Glas Cymru Cyfyngedig board.

14 Creditors

	Note	2007 £m	2006 £m
(a) Amounts falling due within one year:			
Loans:	15		
- owed to group undertakings		4.4	124.1
- external		0.3	0.4
Interest accruals:			
- owed to group undertakings		56.2	-
- external		1.9	0.3
Finance leases	16	4.7	3.7
Trade creditors		12.2	26.8
Capital creditors		42.0	45.3
Amounts owed to group undertakings		3.4	-
Taxation and social security		0.3	0.3
Infrastructure renewals accrual		-	1.7
Other creditors		46.7	46.1
		172.1	248.7
(b) Amounts falling due after more than one year			
Loans	15	2.9	3.3
Obligations under finance leases	16	762.1	736.4
Amounts owed to group undertakings	15	1,730.4	1,488.8
Interest accruals - between one and five years		24.6	18.7
		2,520.0	2,247.2

As part of the Glas group's bond programme a security package was granted by the Company for the benefit of holders of senior bonds, finance lessors and other senior financial creditors. The obligations of the Company are guaranteed by Glas Cymru Cyfyngedig, Glas Cymru (Securities) Limited and Dŵr Cymru (Holdings) Limited.

The main elements of the security package are:

- (i) a first fixed and floating security over all of the Company's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence;
- (ii) a fixed and floating security given by the guarantors referred to above which are secured on each of the Company's assets, including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in the Company.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

15 Loans due to group undertakings and other loans

	2007 £m	2006 £m
Repayable as follows:		
Within one year	4.7	124.5
Between one and two years	4.7	0.4
Between two and five years	29.0	1.1
After more than five years	1,699.6	1,490.6
	1,738.0	1,616.6
Repayable wholly within five years	125.0	126.4
Repayable wholly after five years	1,474.7	1,426.5
Repayable by instalments of which some repayments are after five years	138.3	63.7
	1,738.0	1,616.6
	2007	2006

Interest rates on these loans ranged as follows:

Index linked debt	1.40% to 5.06%	3.86% to 4.90%
Other debt	4.47% to 8.17%	4.74% to 8.17%

Costs directly attributable to the raising of debt are capitalised in accordance with FRS4 and are amortised to the profit and loss account over the term of the debt.

16 Finance leases

	2007 £m	2006 £m
Amounts due under finance leases within one year	4.7	3.7
Amounts due under finance leases between two and five years inclusive	30.7	25.6
Amounts due under finance leases after more than five years	731.3	710.8
Total	766.7	740.1

17 Capital commitments

The Company's business plan at 31 March 2007 shows net capital expenditure of £293m (2006: £280m) during the next financial year. While only a portion of this amount has been formally contracted for, the Company is effectively committed to the total as part of its overall capital expenditure programme approved by its Regulator.

18 Leasing commitments

	Land and buildings	
	2007 £m	2006 £m
At 31 March there were revenue commitments, in the ordinary course of business in the next year for the payment of rentals on non cancellable operating leases expiring:		
- after five years	-	0.4
	-	0.4

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

19 Provisions for liabilities and charges

	Note	2007 £m	2006 £m
Deferred taxation	(a)	296.3	309.4
Restructuring provision	(b)	1.1	5.3
Provision for uninsured losses	(c)	7.6	4.5
Provision for loss on swap closure	(d)	7.1	7.5
		312.1	326.7

(a) Deferred taxation

	2007 £m	2006 £m
Tax effect of timing differences		
Excess of tax allowances over depreciation	345.0	317.7
Other timing differences	(48.7)	(8.3)
Provision for deferred tax	296.3	309.4
Deferred tax asset – pension liability (note 28)	(1.7)	(2.0)
Net deferred tax position	294.6	307.4
Provision at start of year	307.4	310.5
Deferred tax credit for year in profit and loss	(12.5)	(3.6)
Deferred tax (credit)/charge for year in STRGL	(0.3)	0.5
Net deferred tax provision at end of year	294.6	307.4

The provision for deferred tax represents the tax effect of timing differences, which are expected to crystallise over periods up to 85 years.

(b) Restructuring provision

This provision at 31 March 2007 is in respect of payments to be made relating to estimated dilapidation costs, which will be utilised over the next three years.

	£m
At 1 April 2006	5.3
Released to profit and loss account	(3.9)
Utilised in the year	(0.3)
At 31 March 2007	1.1

(c) Provision for uninsured losses

This provision is in respect of uninsured losses and its utilisation period is uncertain due to the nature of insurance claims but is estimated to be five years.

	£m
At 1 April 2006	4.5
Charge to profit and loss account	4.3
Utilised in the year	(1.2)
At 31 March 2007	7.6

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

19 Provisions for liabilities and charges cont'd

(d) Provision for loss on swap closure

	£m
At 1 April 2006	7.5
Utilised in the year	(0.4)
At 31 March 2007	<u>7.1</u>

This provision is in respect of a liability that arose on the cancellation of certain interest rate swap contracts. These contracts were redeemed early and the loss arising on redemption was settled by setting a higher rate on another swap contract. This provision is being released to the profit and loss account over the life of the revised swap, which expires on 31 March 2031.

20 Deferred income

Deferred income relates to income received and receivable upon completion of assets under construction and will be credited to the profit and loss account over the lifetime of those assets.

	2007 £m	2006 £m
At 1 April	32.1	33.6
Released to profit and loss account	(1.4)	(1.5)
At 31 March	<u>30.7</u>	<u>32.1</u>

21 Called up share capital

	Ordinary share capital £m
2006 & 2007 Authorised: 501,050,000 ordinary shares of £1 each	<u>501.1</u> <u>501.1</u>
Allotted, called up and fully paid: 309,876,374 ordinary shares of £1 each	<u>309.9</u> <u>309.9</u>

22 Reserves

a) Profit and loss account

	Total £m
At 1 April 2006	(23.8)
Retained profit for the year	81.4
Actuarial loss on pension scheme	(0.9)
Movement on deferred tax relating to pension liability	0.3
At 31 March 2007	<u>57.0</u>

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

22 Reserves cont'd

b) Capital redemption reserve

	Capital Redemption Reserve £m
At 1 April 2006 and 31 March 2007	166.2

23 Reconciliation of movements in equity shareholders funds

	2007 £m	2006 £m
At 1 April	452.3	632.5
Prior year adjustment – FRS 17	-	(5.5)
Prior year adjustment – reversal of deferred tax discount	-	(240.1)
At 1 April as restated	452.3	386.9
Retained profit for the year	81.4	64.4
Actuarial (loss)/gain on pension scheme	(0.9)	1.5
Movement on deferred tax relating to pension liability	0.3	(0.5)
At 31 March	533.1	452.3

24 Cash inflow from operating activities

	2007 £m	2006 £m
Operating profit	219.2	213.8
Depreciation of tangible fixed assets	80.2	76.5
Infrastructure renewal charge	52.3	50.4
Amortisation of grants and contributions	(1.4)	(1.5)
Increase/(decrease) in provision for uninsured losses	2.2	(0.4)
Net increase in debtors	(3.3)	(17.8)
Net decrease in creditors	(14.8)	(13.5)
(Decrease)/increase in restructuring provisions	(4.2)	0.4
Cash inflow from operating activities	330.2	307.9

25 Reconciliation of net cash flow to movement in net debt

	2007 £m	2006 £m
Increase in cash in the year	-	0.1
Cash outflow/(inflow) from management of liquid resources	143.5	(310.2)
Cash (outflow)/inflow from movement in debt and lease financing	(131.1)	270.8
Non-cash flow items	(84.7)	(21.6)
Increase in net debt in the year	(72.3)	(60.9)
Net debt at start of year	(1,985.6)	(1,924.7)
Net debt at end of year	(2,057.9)	(1,985.6)

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

26 Analysis of net debt

	At 1 April 2006 £m	Cash Flow £m	Non- Cash Items £m	At 31 March 2007 £m
Net cash:				
Cash at bank and in hand	3.8	-	-	3.8
	<u>3.8</u>	<u>-</u>	<u>-</u>	<u>3.8</u>
Liquid resources:				
Current asset investments	10.1	143.5	-	153.6
	<u>10.1</u>	<u>143.5</u>	<u>-</u>	<u>153.6</u>
Group receivables:				
Debt owed by parent company after one year	370.5	-	-	370.5
	<u>370.5</u>	<u>-</u>	<u>-</u>	<u>370.5</u>
Debt:				
Finance leases	(740.1)	(26.7)	-	(766.8)
Debts falling due within one year	(120.6)	120.6	(4.7)	(4.7)
Bond issue costs	7.1	-	(0.7)	6.4
Indexation of inter-company loan	(66.1)	-	(23.0)	(89.1)
Accrued interest	(19.3)	-	(63.4)	(82.7)
Debts falling due after one year	(1,431.0)	(225.0)	5.4	(1,650.6)
	<u>(2,370.0)</u>	<u>(131.1)</u>	<u>(86.4)</u>	<u>(2,587.5)</u>
Net debt	<u>(1,985.6)</u>	<u>12.4</u>	<u>(84.7)</u>	<u>(2,059.6)</u>

27 Directors' and officers' loans and transactions

No loans or credit transactions with any Directors, officers or connected persons subsisted during the year or were outstanding at the year-end.

28 Pensions

Following the acquisition of Dŵr Cymru Cyfyngedig by Glas Cymru Cyfyngedig a new pension scheme for current employees was introduced on 1 December 2001.

An actuarial valuation of the scheme was undertaken as at 31 March 2006 by Quantum Advisory Limited, an independent, professionally qualified actuary using the attained age method.

A full actuarial valuation was carried out at 31 March 2006 and has been updated to 31 March 2007 by the qualified independent actuary. The major assumptions used by the actuary in the valuation of the scheme under FRS 17 are:

	2007	2006
Rate of increase in pensionable salaries	4.00%	3.75%
Rate of increase in pensions in payment	3.00%	2.75%
Discount rate	5.40%	5.10%
Inflation assumption	3.00%	2.75%

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

28 Pensions cont'd

The assets in the scheme and the expected rate of return were:

	Long term rate of return expected at 31 March 2007	Value at 31 March 2007 £'000	Long term rate of return expected at 31 March 2006	Value at 31 March 2006 £'000
Equities	7.0%	20,241	6.5%	16,684
Bonds	5.5%	12,779	5.0%	10,670
Other	4.5%	2,500	4.5%	3,207
		35,520		30,561

The following amounts at 31 March 2007 were measured in accordance with the requirements of FRS17 "Retirement Benefits".

	2007 £'000	2006 £'000
Total market value of assets	35,520	30,561
Present value of scheme liabilities	(41,009)	(37,197)
	(5,489)	(6,636)
Related deferred tax asset	1,647	1,991
Net pension liability	(3,842)	(4,645)

Analysis of amount charged to operating profit

	2007 £'000	2006 £'000
Current service	1,083	1,271
Past service cost	366	517
Settlements and curtailments	-	382
Total operating charge	1,449	2,170

Analysis of amount charged to other finance income

Expected return on pension scheme assets	1,858	1,502
Interest on pension scheme liabilities	(1,927)	(1,779)
Net charge	(69)	(277)

Analysis of amount recognised in statement of total recognised gains and losses

	2007 £'000	2006 £'000
Actual return less expected return on pension scheme assets	(229)	3,450
Experience gains and losses arising on the scheme liabilities	(1,961)	313
Changes in assumptions underlying present value of the scheme liabilities	1,269	(2,266)
Total (loss)/gain recognised	(921)	1,497

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

28 Pensions cont'd

Movement in deficit during the year	2007 £'000	2006 £'000
Deficit on scheme at 1 April	(6,636)	(7,769)
Movement in the year :		
- current service cost	(1,083)	(1,271)
- contributions	3,586	2,083
- past service cost	(366)	(899)
- other finance expense	(69)	(277)
- actuarial (loss)/gain	(921)	1,497
Deficit on scheme at 31 March	(5,489)	(6,636)

History of experience gains and losses	2007	2006	2005	2004
Difference between the actual and expected return on scheme assets :				
- Amount (£'000)	(229)	3,450	920	2,028
- Percentage of scheme assets	1%	11%	4%	11%
Experience gains/(losses) on scheme liabilities:				
- Amount (£'000)	(1,961)	313	(305)	12
- Percentage of present value of scheme liabilities	5%	1%	(1%)	0%
Total amount recognised in statement of total recognised gains and losses:				
- Amount (£'000)	(921)	1,497	6	1,941
- Percentage of present value of scheme liabilities	2%	4%	0%	7%

29 Elan Valley Trust Fund

In 1984 Welsh Water Authority entered into a conditional sale and purchase agreement with Severn Trent Water Authority for the sale of the aqueduct and associated works by which the bulk supply to Severn Trent reservoirs is conveyed.

The sum of £31.7m, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Welsh Water Authority, whilst preserving the capital value of the fund in real terms. Welsh Water Authority's interest in this fund was vested in Dŵr Cymru Cyfyngedig under the provisions of the Water Act 1989. The assets of the fund are not included in these financial statements.

Interest receivable includes £2.7m (2006: £2.1m) in respect of Elan Valley Trust Fund.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

30 Disclosure of transactions with associates

There were no transactions with any associated companies except for:

- The Directors of Dŵr Cymru Cyfyngedig are also directors of other companies within the Glas Cymru group. However, the emoluments of the Directors are paid in full by Dŵr Cymru Cyfyngedig as their activities are predominantly related to the regulated water and sewerage business. During the year the Directors emoluments amounted to £1,511,000 (2006: £1,194,000)
- Debtors include a loan to the Company's immediate parent company, Dŵr Cymru (Holdings) Limited, of £370.5million (2006: £370.5m). The interest rate on this loan is 12%. Loan interest of £44.6 million (2006: £44.6m) has been waived by the Company during the year. The interest waiver is a practical alternative to funding the interest otherwise receivable by the Company by means of an ordinary dividend.
- The proceeds of the group's bond programme have been on lent to Dŵr Cymru Cyfyngedig under an intercompany loan agreement. Under the terms of this agreement, the interest rates payable by the Company are based on the interest rates payable to the bondholders, after taking into account interest rate and currency swaps, plus a margin of 0.01%

31 Immediate and ultimate holding company

The Company's immediate parent company is Dŵr Cymru (Holdings) Limited, which is registered in England and Wales.

The smallest and largest group within which the results of this Company are consolidated is headed by Glas Cymru Cyfyngedig, whose consolidated financial statements can be obtained from the Company Secretary at Pentwyn Road, Nelson, Treharris, Caerphilly CF46 6LY.

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

32 Regulatory accounts to statutory accounts reconciliation

During the prior year, Welsh Water adopted International Financial Reporting Standards (IFRS) and this is reflected in its statutory accounts for the year ended 31 March 2007. However, the regulatory accounts are prepared on the basis of regulatory accounting guidelines and UK accounting standards. The principal differences between the Company's statutory accounts and its regulated accounts are set out below.

	2007 £m	2006 £m
Profit and loss account / income statement		
(a) Operating costs		
Per Regulatory Accounts	358.8	339.7
Difference in infrastructure accounting	31.8	(1.6)
Difference in depreciation	31.5	21.0
Staff costs difference – IAS 19/FRS17	0.7	(0.7)
Amortisation of grants and contributions	1.4	1.5
Other IFRS/UK GAAP differences	0.3	(0.4)
Per Statutory Accounts	<u>424.5</u>	<u>359.5</u>
(b) Net financing costs		
Per Regulatory Accounts	151.2	150.1
Pension finance expense per FRS 17	(0.1)	(0.3)
Fair value losses on financial instruments per IAS 39	(10.8)	3.5
Per Statutory Accounts	<u>140.3</u>	<u>153.3</u>
(c) Taxation credit /(charge)		
Per Regulatory Accounts	13.4	(0.1)
Deferred tax on rolled over capital gains	(9.1)	(15.1)
Deferred tax on differences between tax allowances and depreciation	-	(2.7)
Deferred tax on capital expenditure, tax deductible under IFRS	-	9.5
Deferred tax charge on retirement benefit obligations	-	(0.3)
Infrastructure renewals charge in excess of infrastructure renewals exp.	-	0.5
Prior year IFRS / UK GAAP adjustment	(11.8)	-
Fair value losses on derivative financial instruments	-	1.1
Other IFRS/UK GAAP differences	0.2	0.1
Per Statutory Accounts	<u>(7.3)</u>	<u>(7.0)</u>
Balance sheet		
(a) Fixed Assets		
Cost		
At 31 March per Regulatory Accounts	4,497.5	4,250.3
Adjustment to Opening Balance	(449.1)	(449.1)
Intangible assets separately identified under IFRS	(57.7)	(53.4)
Disposals per IFRS – Finance leases	(64.9)	-
Infrastructure Renewals Expenditure capitalised in previous years	(91.7)	(43.0)
Infrastructure Renewals Expenditure capitalised in the year	(52.2)	(48.7)
At 31 March per Statutory Accounts	<u>3,781.9</u>	<u>3,656.1</u>
Depreciation		
At 31 March per Regulatory Accounts	1,547.7	1,410.0
Adjustment to opening balance	(442.9)	(442.9)
Intangible assets separately identified under IFRS	(50.7)	(49.0)
Depreciation charge for Infrastructure assets (net of depreciation eliminated on disposals) – prior years	(97.2)	(48.5)
Depreciation charge for Infrastructure assets (net of depreciation eliminated on disposals) – current year	(57.5)	(48.9)
Eliminated on Disposals per IFRS – Finance leases	(35.6)	-
Infrastructure depreciation per IFRS – prior years	39.8	18.8
Infrastructure depreciation per IFRS – current year	31.4	21.0
At 31 March per Statutory Accounts	<u>935.0</u>	<u>860.5</u>

Notes to the historical cost financial statements for the year ended 31 March 2007 cont'd

32 Regulatory accounts to statutory account reconciliation cont'd

Balance sheet cont'd	2007 £m	2006 £m
(b) Derivative financial instruments – IAS 32		
At 31 March per Regulatory Accounts	-	-
Derivative non current financial assets	14.7	6.3
Derivative current financial liabilities	(2.3)	-
Derivative current financial assets	-	4.2
Derivative non current financial liabilities	(5.1)	(14.0)
At 31 March per Statutory Accounts	<u>7.3</u>	<u>(3.5)</u>
(c) Current asset investments / held to maturity investments		
At 31 March per Regulatory Accounts	153.6	10.1
Reclassified as cash & cash equivalents for IFRS	(153.6)	(10.1)
At 31 March per Statutory Accounts	<u>-</u>	<u>-</u>
(d) Cash at bank and in hand / cash and cash equivalents		
	3.8	3.8
Other difference	0.1	-
Reclassified from current asset investments for IFRS	153.6	10.1
At 31 March per Statutory Accounts	<u>157.5</u>	<u>13.9</u>
(e) Debtors due < 1year		
At 31 March per Regulatory Accounts	90.4	85.1
Other difference	0.1	-
Add back infrastructure renewals accrual	-	1.7
At 31 March per Statutory Accounts	<u>90.5</u>	<u>86.8</u>
(f) Retirement benefit obligations		
At 31 March per Regulatory Accounts	3.8	4.6
Add back related deferred tax asset	1.7	2.0
At 31 March per Statutory Accounts	<u>5.5</u>	<u>6.6</u>
(g) Deferred Income		
At 31 March per Regulatory Accounts	30.7	32.1
Write back of deferred income under IFRS	(30.7)	(32.1)
At 31 March per Statutory Accounts	<u>-</u>	<u>-</u>
(h) Deferred taxation provision		
At 31 March per Regulatory Accounts	296.3	309.4
Deferred tax on rolled over capital gains	25.2	16.0
Deferred tax on differences between tax allowances and depreciation	-	(1.1)
Deferred tax on capital expenditure, tax deductible under IFRS	-	(9.5)
Deferred tax on retirement benefit obligations	(1.7)	(2.0)
Infrastructure renewals charge in excess of infrastructure renewals expenditure	-	(0.5)
Fair value losses on derivative financial instruments	-	(1.0)
Other IFRS/UK GAAP tax differences	-	0.3
At 31 March per Statutory Accounts	<u>319.8</u>	<u>311.6</u>

Current cost financial statements for the appointed business and accompanying notes for the year ended 31 March 2007

Current cost profit and loss account for the appointed business for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Turnover	2	569.2	544.8
Current cost operating costs		(406.5)	(377.7)
Other operating income	2	-	0.8
		162.7	167.9
Working capital adjustment	2	1.6	1.4
Current cost operating profit		164.3	169.3
Other income		1.4	1.5
Interest payable		(158.6)	(159.8)
Interest receivable		6.1	8.5
Financing adjustment		70.8	43.5
Current cost profit before taxation		84.0	63.0
Current tax		0.9	(3.7)
Deferred tax		12.5	3.6
Profit on ordinary activities after taxation		97.4	62.9
Dividends on ordinary shares		-	-
Retained profit for the year	5(a)	97.4	62.9

Current cost balance sheet for the appointed business at 31 March 2007

	Note	2007 £m	2006 £m
Fixed assets			
Tangible fixed assets	3 (c)	16,210.4	15,401.0
Grants and contributions		(211.3)	(189.1)
		15,999.1	15,211.9
Working capital			
Cash	4	(11.3)	(31.9)
Short term deposits		3.8	3.8
Infrastructure renewals prepayment/(accrual)		125.2	-
		3.6	(1.7)
Net operating assets		16,120.4	15,182.1
Non-operating assets and liabilities			
Borrowings		(67.6)	(20.4)
Non-trade debtors		371.0	370.7
Non-trade creditors due within one year		(3.3)	(124.5)
Investment - other		0.1	0.1
		300.2	225.9
Creditors: amounts falling due after more than one year			
Borrowings		(2,520.0)	(2,226.2)
Other creditors		-	(21.0)
		(2,520.0)	(2,247.2)
Provisions for liabilities and charges			
Deferred taxation		(296.3)	(309.7)
Post employment liabilities		(3.8)	(4.6)
Provisions for liabilities and charges		(15.8)	(17.0)
		(315.9)	(331.3)
Net assets employed		13,584.7	12,829.5
Capital and reserves			
Share capital		309.9	309.9
Current cost reserve	5 (b)	13,691.8	13,034.0
Profit and loss account	5 (a)	(583.2)	(680.6)
Capital redemption reserve		166.2	166.2
Equity shareholder's funds		13,584.7	12,829.5
Total capital and reserves		13,584.7	12,829.5

Current cost cash flow statement for the appointed business for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Cash flow from operating activities	6	329.5	307.2
Returns on investments and servicing of finance			
Interest received		5.7	8.9
Interest paid		(46.9)	(112.3)
Preference dividend paid			-
Interest element of finance lease rental payments		(27.3)	(30.4)
		(68.5)	(133.8)
Taxation:			
UK corporation tax paid		-	(1.1)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(208.2)	(178.0)
Sale of tangible fixed assets		-	0.8
Infrastructure renewals expenditure		(57.5)	(48.1)
Grants and contributions received		15.3	11.8
		(250.4)	(213.5)
Cash inflow/(outflow) before use of liquid resources and financing		10.6	(41.2)
Management of liquid resources			
Net movement in deposits		(141.5)	312.1
Financing			
Finance leases received		32.2	113.8
Loan repaid from parent undertaking		-	0.8
Loan received from group undertaking		225.0	145.2
Loan repaid to group undertaking		(120.3)	(525.0)
Loans and leases repaid		(6.0)	(5.6)
		131.0	(270.8)
Increase in cash in the year	7	-	0.1

Current cost notes to the financial statements for the year ended 31 March 2007

1 Accounting policies

The accounting policies used are the same as those adopted in the historical cost financial statements, except as set out below.

Basis of preparation

These accounts have been prepared for the Appointed Business of Dŵr Cymru Cyfyngedig in accordance with guidance issued by the Director General of Water Services for modified real terms financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of assets, which are valued at their current cost value to the business.

Real financial capital maintenance adjustments

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

Depreciation adjustment - this is the difference between depreciation based on the current cost value of assets in these accounts and depreciation charged in arriving at historical cost profit.

Working capital adjustment - this is calculated by applying the change in Retail Price Index (RPI) over the year to the opening total of working capital. (See Note 4)

Financing adjustment - this is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital, and liabilities that are already indexed linked through the historical cost profit and loss account.

Valuation bases for determining depreciation and disposal adjustment

(i) Tangible fixed assets

Assets acquired prior to 31 March 1990 and in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for possible funding of future replacements of pre 31 March 1990 assets by contributions from third parties and, to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amounts.

(ii) Land and buildings

Non-specialised operational properties were valued on the basis of open market value for existing use at 1 September 1989 and have been expressed in real terms by indexing using the RPI.

Specialised operational properties are valued at replacement cost, determined principally on the basis of data provided by the Asset Management Plan (AMP). The unamortised portion of third party contributions received since 1st April 1990 is deducted in arriving at net operating assets (as described below).

(iii) Infrastructure assets

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

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

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

1 Accounting policies cont'd

(iv) Other fixed assets

All other fixed assets are valued periodically at depreciated replacement cost.

(v) Surplus land

Surplus land is valued at recoverable amount, taking into account that part of any proceeds to be passed on to customers under Condition B of the Licence.

(vi) Valuation basis for determining grants and other third party contributions adjustments

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

Analysis of operating costs

Condition F of the Licence and Regulatory Accounting Guideline 4 (RAG 4) requires operating costs to be analysed by the service and business activities undertaken by the appointed business.

Operating costs are classified as Direct Costs, General & Support and Service Costs. Direct Costs are the costs directly attributable to each of the individual activities and, where necessary by operational considerations, include apportionments. General & Support include all centrally provided services such as administration and management services. Certain costs cannot be attributed to individual activities and are apportioned by service only i.e. Service Costs. These include local authority rates (including cumulo rates for water supply), charges for bad and doubtful debts, amortisation of intangible fixed assets and other exceptional items.

Where apportionments are required to allocate operating costs to the appropriate activity, the apportionment is based on the usage of that service by each activity. The apportionment bases used include employment costs for expenditure incurred on people & resources, energy usage for power related expenditure and in many instances where there is no clear cost driver, local managers' assessments. In the absence of any causal links, General & Support Costs are apportioned on the basis of Direct Costs.

Direct Costs are further analysed into subjective categories such as employment costs, power and hired and contracted services. The vast majority of operating costs incurred by the Company relate to outsourced service contracts for the operation of the water and wastewater services. In the interest of transparency and comparability, these outsourced service costs are also analysed into the underlying subjective categories rather than reported as Hired and Contracted Services.

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

2 Analysis of turnover and operating income for the appointed business

	Water Services 2007 £m	Sewerage Services 2007 £m	Appointed Business 2007 £m	Water Services 2006 £m	Sewerage Services 2006 £m	Appointed Business 2006 £m
Turnover						
Measured	96.7	89.7	186.4	91.3	80.4	171.7
Unmeasured	146.7	195.6	342.3	141.9	187.4	329.3
Large Users & special agreements	9.0	7.0	16.0	14.8	7.4	22.2
Trade Effluent	-	8.3	8.3	-	9.2	9.2
Third party (exc. Non potable water)	10.7	-	10.7	6.8	0.1	6.9
Other sources	5.5	-	5.5	5.5	-	5.5
Total turnover	268.6	300.6	569.2	260.3	284.5	544.8

The value for large user revenues has been based on potable supplies 250 MI per year and above, which are excluded from the tariff basket. Ofwat have defined "large users" as those using 100MI per year. However, this level has not been agreed within Wales and consequently 250 MI per year has been used.

Other operating income

Current cost profit on disposal of fixed assets	-	-	-	0.8	-	0.8
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Working capital adjustment

Working capital adjustment	0.8	0.8	1.6	0.7	0.7	1.4
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Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

3(a) Current cost analysis of tangible fixed assets by asset type - Water Services

	Specialised operational properties £m	Non- specialised operational properties £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2006	1,533.0	21.5	5,534.2	136.5	7,225.2
RPI adjustment	73.6	1.0	265.6	6.6	346.8
Additions	37.2	-	38.8	18.6	94.6
At 31 March 2007	1,643.8	22.5	5,838.6	161.7	7,666.6
Depreciation					
At 1 April 2006	605.0	11.9	-	100.0	717.1
RPI adjustment	29.1	0.6	-	4.8	34.5
Provision for the year	66.8	0.9	-	7.0	74.7
At 31 March 2007	701.1	13.4	-	111.8	826.3
Net book value					
At 31 March 2007	942.7	9.1	5,838.6	49.9	6,840.3
At 31 March 2006	927.8	9.6	5,534.2	36.5	6,508.1

3(b) Current cost analysis of tangible fixed assets by asset type - Sewerage Services

	Specialised operational properties £m	Non- specialised operational properties £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2006	1,793.6	14.4	7,654.2	88.7	9,550.9
RPI adjustment	86.1	0.7	367.4	4.3	458.5
Additions	61.6	0.2	37.4	10.7	109.9
At 31 March 2007	1,941.3	15.3	8,059.0	103.7	10,119.3
Depreciation					
At 1 April 2006	570.0	7.9	-	80.2	658.1
RPI adjustment	27.3	0.4	-	3.9	31.6
Provision for the year	53.9	-	-	5.6	59.5
At 31 March 2007	651.2	8.3	-	89.7	749.2
Net book value					
At 31 March 2007	1,290.1	7.0	8,059.0	14.0	9,370.1
At 31 March 2006	1,223.6	6.5	7,654.2	8.5	8,892.8

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

3(c) Current cost analysis of tangible fixed assets by asset type - Total Services

	Specialised operational properties £m	Non- specialised operational properties £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2006	3,326.6	35.9	13,188.4	225.2	16,776.1
RPI adjustment	159.7	1.7	633.0	10.9	805.3
Disposals					
Additions	98.8	0.2	76.2	29.3	204.5
At 31 March 2007	3,585.1	37.8	13,897.6	265.4	17,785.9
Depreciation					
At 1 April 2006	1,175.2	19.8	-	180.2	1,375.2
RPI adjustment	56.4	1.0	-	8.7	66.1
Disposals					
Provision for the year	120.7	0.9		12.6	134.2
At 31 March 2007	1,352.3	21.7	-	201.5	1,575.5
Net book value					
At 31 March 2007	2,232.8	16.1	13,897.6	63.9	16,210.4
At 31 March 2006	2,151.4	16.1	13,188.4	45.0	15,400.9

4 Working capital

	2007 £m	2006 £m
Trade debtors		
- Measured household	7.0	6.2
- Unmeasured household	16.6	13.7
- Measured non-household	6.6	5.2
- Unmeasured non-household	1.4	0.9
- Other	5.1	11.0
Measured income accrual	46.7	43.7
Prepayments and other debtors	6.4	5.8
Trade creditors	(26.2)	(41.2)
Deferred income – customer advance receipts	(32.6)	(31.7)
Short term capital creditors	(42.0)	(45.3)
Accruals and other creditors	(0.3)	(0.2)
	(11.3)	(31.9)

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

5 Movement on reserves of the appointed business

	2007 £m	2006 £m
(a) Profit and loss account		
At 1 April	(680.6)	(743.5)
Current cost profit retained	97.4	62.9
At 31 March	<u>(583.2)</u>	<u>(680.6)</u>
(b) Current cost reserve		
At 1 April	13,034.0	12,969.1
Prior year adjustment – FRS17 / Reversal of Deferred tax discount	-	(245.6)
At 1 April as restated	13,034.0	12,723.5
RPI adjustments:		
- Fixed assets	739.4	359.5
- Working capital	(1.6)	(1.4)
- Financing	(70.8)	(43.5)
- Grants and contributions	(9.2)	(4.1)
At 31 March	<u>13,691.8</u>	<u>13,034.0</u>

6 Reconciliation of current cost operating profit to net cash flow from operating activities for the appointed business

	2007 £m	2006 £m
Current cost operating profit	164.3	169.3
Current cost depreciation	134.2	120.6
Infrastructure renewals charge	52.3	50.4
Profit on disposal of assets	-	(0.8)
Movement in working capital	(20.6)	(26.9)
Other non-cash profit and loss items	0.9	(4.0)
Working capital adjustment	(1.6)	(1.4)
Cash flow from operating activities	<u>329.5</u>	<u>307.2</u>

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

7 Analysis of net debt

	At 1 April 2006 £m	Cash Flow £m	Non- cash items £m	At 31 March 2007 £m
Net cash:				
Cash at bank and in hand	3.8	-	-	3.8
Liquid reserves:				
Current asset investments	(16.4)	141.7	-	125.3
Group receivables:				
Debt owed to Dŵr Cymru Cyfyngedig after one year	370.5	-	-	370.5
Debt:				
Loans due within one year	(120.6)	120.6	(4.7)	(4.7)
Loans due after one year	(1,431.0)	(225.0)	5.4	(1,650.6)
Unamortised bond costs	7.1	-	(0.7)	6.4
Indexation of long term loan	(66.1)	-	(23.0)	(89.1)
Accrued interest	(19.3)	-	(63.4)	(82.7)
Finance leases due within one year	(3.7)	(1.0)	-	(4.7)
Finance leases due after one year	(736.4)	(25.7)	-	(762.1)
Net debt	(2,012.1)	10.6	(86.4)	(2,087.9)

Maturity profile	Interest rate risk profile			Total
	Fixed Rate	Floating Rate	Index Linked	
Less than one year	(57.3)	(6.3)	(3.9)	(67.5)
Between one and two years	-	(6.8)	(3.7)	(10.5)
Between two and five years	(125.0)	(37.9)	(16.1)	(179.0)
Between five and twenty years	-	(214.0)	(472.7)	(686.7)
In more than twenty years	(350.0)	-	(1,293.8)	(1,643.8)
Borrowings	(532.3)	(265.0)	(1790.2)	(2,587.5)
Debt owed by group company				370.5
Short term deposits				125.3
Cash at bank and in hand				3.8
Net debt				(2,087.9)

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

8 Regulatory capital value

The table below shows the regulatory capital value used by Ofwat in 2004 in setting the price limits for 2006/07 at 2006/07 prices. Differences between the figures shown below and actual expenditure/charges for the year will not affect the price limits in the current regulatory period.

	£m
Closing RCV at 31 March 2006	3,042
Indexation (<i>inflating from 2005/06 prices to 2006/07 prices</i>)	153
Opening RCV at 1 April 2006	3,195
Capital expenditure	250
Infrastructure renewals expenditure	49
Grants and contributions	(7)
Current cost depreciation	(102)
Infrastructure renewals charge	(54)
Out-performance of regulatory assumptions	(21)
At 31 March 2007	3,310
Average regulatory capital value during the year	3,218

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

9 Operating cost activity table – 2006/07

	Service Analysis						
	Water Supply			Sewerage Services			
	Water Resources & Treatment 2006/07 £'000	Water Distribution 2006/07 £'000	Water Supply sub total 2006/07 £'000	Sewerage 2006/07 £'000	Sewage Treatment 2006/07 £'000	Sludge Treatment 2006/07 £'000	Sewerage Service Total 2006/07 £'000
Direct Costs							
Employment Costs	5,272	7,777	13,049	3,162	6,281	1,669	11,112
Power	10,286	3,375	13,661	3,792	13,384	3,060	20,236
Agencies	-	-	-	-	-	-	-
Hired & Contracted Services	4,159	5,195	9,354	6,695	4,696	6,637	18,028
Associated Companies	-	-	-	-	-	-	-
Materials & Consumables	4,032	260	4,292	213	1,223	1,986	3,422
Service Charges	8,781	-	8,781	1,474	3,245	-	4,719
Total Direct Costs	33,093	16,607	49,700	15,336	28,829	13,352	57,517
General & Support Expenditure	9,966	10,360	20,326	3,509	9,560	3,627	16,696
Total Functional Expenditure	43,059	26,967	70,026	18,845	38,389	16,979	74,213
Business Activities							
Customer Services			10,757				14,005
Scientific Services			7,556				1,858
Other Business Activities			643				838
Total Business Activities			18,956				16,701
Rates			13,636				7,389
Doubtful Debts			4,789				6,235
Exceptional Items			-				-
Total Opex costs less third party services			107,407				104,538
Third Party Services -Opex			8,050				-
Total Opex			115,457				104,538
Capital Maintenance							
Infrastructure Renewals Charge	1,949	27,870	29,819	22,100			22,100
Current Cost Depreciation	45,519	28,215	73,734	9,020	49,680	771	59,471
Capital Maintenance (exc. Third party services)			103,553				81,571
Third Party Services - CCD			999				-
Third Party Services - IRC			381				-
Total Capital Maintenance			104,933				81,571
CCA (MEA) Values							
Service Activities	2,007,040	5,448,179	7,455,219	8,186,981	1,329,437	485,752	10,002,170
Business Activities			182,955				117,100
Service totals			7,638,174				10,002,170
Services for third parties			28,473				-
Total			7,666,647				10,119,270

Current cost notes to the financial statements for the year ended 31 March 2007 cont'd

9 Operating cost activity table cont'd

	Service Analysis								Business Analysis		
	Water Supply			Sewerage Services					Customer Services	Scientific Services	Cost of Regulation
	Water Resources & Treatment	Water Distribution	Water Supply sub total	Sewerage	Sewage Treatment	Sludge Treatment	Sewage Treatment & Disposal sub-total	Sewerage Total			
2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	2005/06 £'000	
Direct Costs											
Employment Costs	7,070	8,754	15,824	2,389	6,662	1,522	8,184	10,573			
Power	7,822	2,167	9,989	2,768	10,278	3,376	13,654	16,423			
Agencies	-	-	-	-	-	-	-	-			
Hired & Contracted Services	4,296	4,851	9,147	7,415	3,674	6,289	9,963	17,378			
Associated Companies	-	-	-	-	-	-	-	-			
Materials & Consumables	3,653	307	3,960	178	881	1,800	2,681	2,859			
Service Charges	8,239	-	8,239	1,441	3,282	-	3,282	4,723			
Total Direct Costs	31,080	16,079	47,159	14,191	24,777	12,987	37,764	51,955			
General & Support Expenditure	9,201	10,061	19,262	3,494	9,213	3,869	13,082	16,576			
Functional Expenditure	40,281	26,140	66,421	17,686	33,990	16,856	50,846	68,532	25,984	9,292	1,944
Capital Costs											
Current Cost											
Depreciation	42,038	25,077	67,115	8,694	44,052	699	44,751	53,445			
Infrastructure Renewals	691	30,450	31,141	16,974	-	-	-	16,974			
Infrastructure Expenditure											
Infrastructure Renewal Accrual/ (Prepayment)	-	(2,733)	(2,733)	4,328	-	-	-	4,328			
Third Party Services - Capital Maintenance	-	-	2,184								
Functional Cost	83,010	78,934	164,127	47,682	78,042	17,555	95,597	143,279			
Total Business Activities			18,821					18,100			
Rates			13,338					5,569			
Doubtful Debts			3,341					4,253			
Exceptional Items			-					-			
Total Opex costs less third party services			199,627					171,201			
Third Party Services -Opex			6,816					0			
Total			206,443					171,201			
CCA (MEA) Values											
Service Activities	1,888,877	5,151,448	7,040,325	7,733,986	1,255,878	458,874	1,714,752	9,448,738			
Business Activities			157,763	83,618			18,450	102,158			
Service totals			7,198,088	7,836,144			1,733,202	9,550,896			
Services for third parties			27,169					-			
Total			7,225,257					9,550,896			