NORTHUMBRIAN WATER LIMITED

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2012

Registered no: 2366703

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FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 March 2012

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DIRECTORS' REPORT and OPERATING AND FINANCIAL REVIEW (OFR) for the year ended 31 March 2012

The directors present their annual report and operating and financial review and the audited financial statements for the year ended 31 March 2012.

Cautionary statement

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

Change of controlling party

On 14 October 2011, Northumbrian Water Group plc (NWG), the Company's controlling party at the time, was acquired by UK Water (2011) Limited (UKW). Shares in NWG were delisted from the London Stock Exchange on the same date and it was re-registered as a private limited company under the name Northumbrian Water Group Limited (NWGL or the Group). UKW is indirectly wholly owned by a consortium comprising Cheung Kong Infrastructure Holdings Limited, Cheung Kong (Holdings) Limited and Li Ka Shing Foundation Limited.

Principal activities

The principal activities of the business comprise the supply of potable water in both the northern and southern regions and the collection, treatment and disposal of sewage and sewage sludge throughout the north east of England.

Directors

The directors who served during the year were as follows:

A J Hunter	Non-Executive Chairman (appointed 14/10/11)
H Mottram OBE	Chief Executive Officer
C M Green	Finance Director
G Neave	Operations Director
A C Jones	Regulation and Scientific Services Director
M Fay CBE	Independent Non-Executive Director
Dr S Lyster	Independent Non-Executive Director
L S Chan	Alternate Director (appointed 14/10/11)
F R Frame	Non-Executive Director (appointed 4/11/11)
T C E Ip	Non-Executive Director (appointed 14/10/11)
H L Kam	Non-Executive Director (appointed 14/10/11)
S H Luk	Alternate Director (appointed 14/10/11)
D N Macrae	Non-Executive Director (appointed 14/10/11)
M A B Nègre	Non-Executive Director
P Rew	Independent Non-Executive Director
Sir D Wanless	Non-Executive Chairman (resigned 14/10/11)
A J Scott-Barrett	Independent Non-Executive Director (resigned 14/10/11)
Sir A P Brown	Non-Executive Director (resigned 20/10/11)
C R Lamoureux	Non-Executive Director (resigned 28/7/11)

Directors (continued)
Sir Derek Wanless
The Board is very sorry to report the untimely death of Sir Derek Wanless, who died on 22 May 2012, after a short illness. Sir Derek joined the board of NWG in December 2003 and chaired its board, and that of the Company, between July 2006 and October 2011. The Board wishes to express its thanks for Sir Derek's tremendous contribution during a time of significant change.

BUSINESS OVERVIEW

Our market
NWL is one of the ten regulated water and sewerage businesses in England and Wales, operating in the north east of England, trading as Northumbrian Water, and in the south east of England, trading as Essex & Suffolk Water. The Company's ultimate parent undertaking and controlling party is UKW.

In the north east, serving 2.7m people, the business comprises the supply of both potable and raw water and the collection, treatment and disposal of sewage and sewage sludge. In this region, there has been a gradual fall in overall water demand in recent decades as a consequence of a reduction in industrial demand for water and this trend is expected to continue. The north east compares well to the rest of the country as far as water resources are concerned and our major regional rivers can all be supported by Kielder Water. This provides very high security of supply for our customers. We also provide the highest levels of compliance for waste water across this area ensuring that we can return the water and sewage sludge to the environment satisfactorily whilst meeting the demands of all customers. Bran Sands is particularly important in this respect as it supports the heavily industrialised area within Teesside by treating its waste. The advanced anaerobic digestion (AAD) plant there is now operating effectively and helping us to build our use of renewable energy. A second AAD plant at Howdon in Tyneside will come into operation in 2012.

In the south, the business supplies potable water to 1.8m people. This is a water scarce region that is forecast to experience further economic and population growth in the medium term. This area has also seen a reduction in demand from heavy industry, but there has been an increase in population with further increases forecast. Supplies are currently not secure in a severe drought but the project to increase the capacity of Abberton reservoir, near Colchester, coupled with ongoing demand management measures, will secure supplies to the Essex area for the foreseeable future. The Abberton scheme will be complete in 2013 and the additional capacity available for supply the following year.

Key facts
NWL operates with an extensive asset base, which includes:

44	impounding reservoirs
57	water treatment works
344	water pumping stations
338	water service reservoirs
25,545km	water mains
418	sewage treatment works
765	sewage pumping stations
29,724km	sewers (including the transfer of 13,510km of private drains and sewers on 1 October 2011)

NWL currently supplies over 1,150 megalitres of drinking quality water per day. This water is drawn from reservoirs, where it is collected and stored, rivers and groundwater sources. It is treated at our works before it is delivered by a network of pipes to homes and businesses.

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

Key facts (continued)
Our water and sewerage services in the north east will cost, in 2012/13 prices, an average householder 96 pence per day and, in Essex and Suffolk areas, 60 pence for water only.

The Water Services Regulation Authority (Ofwat), as the economic regulator, sets price limits for companies in England and Wales every five years: 2011/12 was the second year in the current five year investment plan. This regulation is performance based and companies are measured in terms of efficiencies related to operating costs, capital programmes and financing as well as their general operations. The regulated revenue of the Company is set by reference to the rate of inflation, measured by the Retail Price Index (RPI), as well as an adjustment factor referred to as 'k'. The profile of 'k' for the current five year period is shown below:

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

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

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

We aim to maintain good working relationships with our regulators and with regional organisations, such as local authorities, which have an interest in the services we provide and can influence our business. This is particularly important following Government reviews of the regulators, changes in regulatory reporting and proposals to legislate in the sector following the publication of a White Paper during the period.

We are an active member of Water UK, the industry association which represents all UK water and waste water service suppliers at national and European level. It provides a very effective framework for the industry to engage with Government, regulators, stakeholder organisations and the public and helps to develop policy and improve understanding of the industry. We also meet regularly with national, regional and local authorities and other appropriate organisations to explain our activities and related issues.

2011/12
The Company was successful in meeting many of the targets in its detailed balanced scorecard during the year. We improved in 26 of our 28 targets and achieved or exceeded 19 of them. Most notable were the improvements in our Service Incentive Mechanism (SIM) score for customer service, the reduction in the number of interruptions to supply and our position on leakage. We were also very pleased to remain amongst the industry leaders in sewage treatment performance.

This report will focus on many highlights throughout the year but the development of our work to extend Abberton reservoir and the construction of our second AAD plant at Howdon, after the successful operation at Bran Sands, are particularly notable.

We also continued to receive external recognition for our activities. For the second year running, the Ethisphere Institute listed NWGL as one of the most ethical companies in the world, one of only seven UK only companies chosen and the only water utility selected worldwide. This recognises the impact we have on underpinning the communities in which we operate and also recognises the longstanding relationships with key industrial and commercial customers.

2011/12 (continued)
We continue to be actively involved in the business community in all operating areas through direct membership and involvement in the councils/boards of the Confederation of British Industry (CBI), Chambers of Commerce and other similar organisations. Our Chief Executive Officer (CEO), Heidi Mottram, is involved in a number of organisations which we believe can influence the future of the Company and locally, she is Deputy Chair of the CBI Council and a member of its national Infrastructure Board. Heidi has also joined the Government's Green Economy Council as the water industry representative and we hope that the Council can bring a real influence to the development of policy relating to a low carbon economy.

This year, industrial demand has deteriorated, with some prolonged shutdowns as a result of the economic situation and lower volumes at many of our smaller commercial customers. Domestic demand has also started to reduce in some areas, as customers have become aware of the restrictions in other parts of the country and the importance of using water wisely. We continue to monitor the situation and work closely with our key industrial customers. The collection of income remains a key focus for us, particularly in a difficult economic climate.

Transferred drains and sewers
Water and sewerage companies were required to adopt certain drains and sewers on 1 October 2011, which were previously in private ownership. The estimated length of adopted assets is 13,510km, nearly doubling the length of sewers to be operated and maintained by the Company. Whilst the transfer took place smoothly, this generated a major increase in activity for the business which, in turn, increased operating costs. Although customer contact and job volumes were initially lower than anticipated, they have been gradually increasing month on month. Positive feedback has been received from our customers via our customer feedback surveys. We are continuing to work closely with other water companies to share information and experiences to ensure we deliver the most practical and cost effective solutions for customers. The transfer was valued at a nil fair value, as the net present value of the incremental cash flows arising as a result of the adoption were considered insignificant.

Legislative changes
We broadly support the Government's policy intention for the water industry, as laid out in the Water White Paper – 'Water for life'. We welcome the desire to build on the strengths of the current industry structure and strongly agree that a stable business and regulatory environment is vital if investor confidence is to be retained, so that the investment required over the coming decades can continue to be financed at a cost our customers can afford.

NWL is very keen to work closely with Defra and the industry regulators to ensure the Government's policies are implemented successfully.

We are pleased to have had the opportunity to contribute to the consultation on draft regulation from Defra to introduce a duty on landlords to provide water companies with relevant details so that accurate bills can be issued to tenants. Applying section 45 of the Flood and Water Management Act 2010 should assist in collecting income from the private rented sector where bad debts have been relatively high.

Regulatory reform
NWL strongly supports Ofwat's newly introduced proportionate and risk-based approach to regulation. The decision to end the requirement for water companies to submit a lengthy annual report to Ofwat (the 'June Return'), and replace this with a Regulatory Risk and Compliance Statement (RRCS) and a set of high level key performance indicators (KPIs), will significantly reduce the burden of regulatory reporting whilst enhancing companies' accountability.

This set of high level KPIs will be published along with the RRCS on the Company's website. To deliver the Company's vision of being 'the national leader in water and waste water services', we have incorporated these targets within our own internal targets. Details of these can be found in the 'our performance measures' section of this report.

Regulatory reform (continued)
Ofwat has recently published its 'Future price limits - statement of principles' document setting out the high level principles it intends to use to set price limits in the future. We welcome the six key principles: targeted price controls; proportionate price setting; effective incentives; ownership, accountability and innovation; flexibility and responsiveness; transparency and predictability. Establishing these principles should help to provide stable and predictable regulation in the longer term.

NWL particularly welcomes the continued commitment to the Regulatory Capital Value for the long term and confirmation that RPI remains the most appropriate index to use for tariff setting and strongly supports the focus on outcome based regulation and the increased role for customers at price reviews. We support the introduction of separate wholesale and retail price controls in line with the White Paper.

Some of Ofwat's more detailed proposals, including a water service network plus non-binding price control, require further justification. The additional incentive mechanisms proposed, including the totex mechanism, add substantial complexity and a lot of work is required to develop these concepts into a workable methodology. We have signalled our willingness to work constructively with Ofwat and offer any assistance we can in developing a practical and robust price review methodology that will deliver the right outcome for customers.

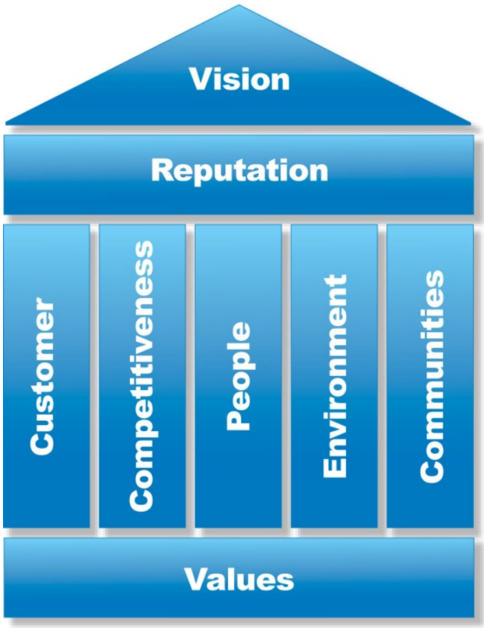
BUSINESS STRATEGY AND OBJECTIVES

Our vision
The Group's vision is to be the national leader in the provision of sustainable water and waste water services, and this is shared by NWL.

Strategic direction
We want to continue to deliver value to customers and other stakeholders by focusing on our core competencies of water and waste water management. We underpin our drive to be the best with five strategic themes containing goals and targets that, when reached, will see our vision and our values delivered. 'Our Vision Our Values Our Way' has been shared with all our employees during a series of annual interactive roadshows and, as a result, there is clarity and energy throughout the Company which is driving the business forward.

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

Strategic direction (continued)



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

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

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

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

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

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

We believe that clear direction and goals are key to success, but just as important is a clear sense of values, and how we do things 'around here'. We have made a clear commitment to five core values.

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

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

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

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

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

OUR PERFORMANCE MEASURES

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

In order to measure delivery of the Company business plan and goals, a balanced scorecard of KPIs is used. These indicators are spread across the themes of customer, competitiveness, people, environment and communities and targets have been set on a trajectory to deliver the Company vision of being 'the national leader in water and waste water services'.

In order to ensure alignment of the management team, this balanced scorecard now represents 90% of the criteria contributing to their annual bonus, with a further 10% available for the achievement of bespoke personal targets. Further details can be found in note 11 of the regulatory accounts, 'statement on directors' pay and standards of performance', which is incorporated by reference into these statutory financial statements.

The table below details the KPIs referred to above and the targets set for 2012/13. For our competitiveness theme, the Company has targets in respect of earnings before interest and cash available for distribution in respect of UKW. A full explanation of each target is set out on pages 29 and 30.

Strategic theme	Scorecard measure	Proposed target
Customer	Customer satisfaction	
	- SIM quantitative score	84
	- SIM qualitative score	4.5
	Unplanned interruptions >6 hours (combined)	1,500
	Coliform incidents (no.)	7
People	Employee engagement score	1* Best Companies
	Lost time reportable accidents (no.)	10
Environment	Leakage (Mld)	
	- north	147
	- south	66
	STW failing LUT consent (%)	0
	Pollution incidents (categories 1 & 2)	3
Communities	BITC Platinum Plus	Retain status
	Just an Hour	50%
Personal targets	Bespoke	Bespoke

OUR FINANCIAL PERFORMANCE

We use a range of indicators to monitor performance. A detailed explanation of each KPI is shown on page 29. Performance against the financial KPIs is set out below:

KPI	Target	Performance	
		Current year	Previous year
Gearing to RCV – NWL group (see note 11) (%)	<70	64	56
Gearing to RCV – Appointed business only (%)	<65	63	56
Cash interest cover (times)	>3.0	4.2	4.0
Cash flow to net debt (%)	>13	18	20

All financial KPIs remained better than the target for the year. Gearing for the Company and for the regulated business, has increased to 64% and 63%, respectively. This is principally due to the delay in 2010/11 dividend payments until after the previous year end (paid 7 April 2011) and a special dividend of £232.0m which was paid during the year, following the change of control.

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

Financial results and dividends

The Company's profit and loss account and balance sheet are set out on pages 31 and 32. The statutory financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. The key accounting policies are summarised in note 1 to the statutory financial statements on pages 33 to 36 and these have been applied consistently throughout the current and preceding periods.

Turnover was £730.6m for the year ended 31 March 2012 (2011: £682.8m). The increase is mainly due to the application of the Ofwat price review in 2009 (final determination) of 3.8% plus 4.7% in respect of RPI, on water and sewerage charges, which has been partially offset with lower demand from industrial customers.

Operating costs, excluding capital maintenance costs, have increased from £280.5m in 2010/11 to £286.9m in 2011/12, principally reflecting the impact of increases in manpower costs, including some restructuring costs, rates, carbon reduction commitment charges and general inflationary increases. These upward pressures have been partially offset by lower commodity prices and lower usage of energy coupled with the benefits of the efficiency programme.

Capital maintenance costs have increased from £120.7m in 2010/11 to £123.3m in 2011/12, reflecting increased depreciation arising from the commissioning of new assets.

Net interest payable increased from £102.0m in 2010/11 to £106.1m in 2011/12, an increase of £4.1m within which net cash interest charges increased by £7.7m. The non-cash elements principally reflects an increase in inflation of the principal on the index linked bonds (£1.9m), partially offset by better than expected returns on pension assets (£3.8m) and a decrease in the interest cost of pension plan obligations (£2.0m).

Financial results and dividends (continued)
Profit on ordinary activities before taxation for the year was £214.3m (2011: £179.6m). The current tax charge of £37.3m (2011: £35.6m) principally reflects increased profitability, offset by a reduction in the rate of corporation tax and tax relief for lump sum contributions to the pension scheme. The deferred tax charge of £33.9m (2011: credit of £8.7m) reflects a decrease in the deferred tax liability following the enactment of a reduction in the UK corporation tax rate from 26.0% to 24.0% with effect from 1 April 2011, more than offset by a reduction in discount as a result of decreases in the post-tax yields on Government gilts and movements arising from lump sum pension contributions.

Profit for the financial year was £143.1m (2011: £152.7m).

The directors recommend a final ordinary dividend of £nil (2011: £46.7m). Following the change of control, a special dividend was paid reflecting the Company's past outperformance. The interim dividend proposed of £98.9m (2011: £46.3m) along with the special dividend paid of £232.0m (2011: £nil), makes a total for the year of £330.9m (2011: £93.0m). Excluding the special dividend, this applies the stated dividend policy for the appointed business of 2.1% real annual growth (see note 9 to the statutory financial statements). The Board has proposed a dividend policy consistent with the underlying growth assumptions adopted by Ofwat at its price review in 2009.

The focus continues on our efficiency programme, identifying and implementing sustainable operating cost efficiencies in order to achieve our medium term goal of being in the top efficiency band for both water and sewerage, as measured by Ofwat, by 2013/14. This programme has progressed well and, as a result, we continue to be ahead of our final determination profile. Further information on this programme is provided on page 12.

Capital investment
Capital investment in the regulated business for the period was £292.0m, under regulatory accounting guidelines (2011: £221.5m). This is slightly higher than the final determination profile deflated by the Construction Industry Price Index (COPI), as a result of increased maintenance investment and a recovery from the severe winter weather experienced the previous year. It is difficult to assess any potential outperformance over the AMP5 period at this time, given the volatile nature of COPI, but we remain focused on delivering our regulatory programme.

The construction works for the £150.0m Abberton scheme, commenced in 2010 to help secure water supply to 1.5m customers in Essex, continues to make good progress and is ahead of schedule. The capacity of the reservoir, near Colchester, has been enlarged by 58% and its top water level footprint extended by 40%. The construction of the twin 1.2 metre diameter, 16 kilometre long, steel raw water pipelines to transfer water from the River Stour at Wormingford to Abberton reservoir has been completed ahead of schedule. The reconstruction of the Abberton Reservoir Raw Water Pumping Station, and the construction of the Wormingford Intake Pumping Station, are well underway with works currently on schedule for completion in 2012/13.

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

The Company agreed a new £150.0m facility from the European Investment Bank (EIB) in June 2011 and the first £50.0m tranche was drawn on a variable rate basis in November 2011. The Company has cash resources and substantial undrawn committed five year bank facilities available to maintain general liquidity. The undrawn bank committed facilities amounted to £450.0m at 31 March 2012.

The Company, through its finance subsidiary, Northumbrian Water Finance plc (NWF), issued £360.0m Guaranteed Eurobonds in January 2012, maturing January 2042, with an annual coupon of 5.125%. The issue was guaranteed by the Company, which received the issue proceeds by way of an inter-company loan.

Credit rating
The credit rating for NWL has remained consistent throughout the year at BBB+ stable (Fitch and Standard & Poors) and Baa1 stable (Moody's).

Treasury policies
The Board is responsible for the financing strategy of the Company which is determined within treasury policies set by NWGL. The Group's treasury function carries out treasury operations on behalf of the Company and its main purposes are to assess the ongoing capital requirement, to maintain short term liquidity, ensuring access to medium term committed back up facilities, and to raise funding, taking advantage of any favourable market opportunities.

It also invests any surplus funds the Company may have, based on its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process, but the treasury policy prohibits their use for speculation.

OUR OPERATING PERFORMANCE

We use a range of KPIs to measure non-financial performance in the business and these indicators are reviewed by the management team each month. Performance for the year is reported in this section. A full explanation of each target is disclosed on pages 29 and 30.

The Board undertook a review of these measures during the year, and as a consequence, a small number of the KPIs have been revised for 2012/13, as outlined in 'our performance measures' on page 7.

Customer

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

Customer satisfaction

	Target 2011/12	Performance 2011/12
SIM quantitative score	174	162
SIM qualitative score	4.40	4.33

Ofwat introduced the Service Incentive Mechanism (SIM) in 2010/11, which monitors both quantitative and qualitative aspects of customer service. This new mechanism financially incentivises the best performing companies and penalises the worst, endeavouring to simulate competition and encourage excellent service throughout the industry. Our aim is to be the leading company for SIM.

The quantitative aspect of SIM includes metrics for all lines busy and abandoned calls, unwanted calls, written complaints and CCWater investigations, each of which attract a number of penalty points depending upon the severity. Results across all metrics improved during the year, customer complaints continue to reduce and our quantitative SIM contact levels score for 2011/12 was 162, a significant improvement compared to 2010/11 when our score was 212.

The qualitative aspect of SIM takes the form of a survey, which is conducted each quarter across every water company and asks customers who have made contact with us about their experience. Our cumulative score for the four quarterly surveys was 4.33 out of 5, an improvement on the previous year's score of 4.14.

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

Customer service
The performance against standards of service is shown below:

	North (N) South (S)	Target 2011/12	Performance 2011/12
Unplanned interruptions >6 hours	N	900	445
	S	600	161
Coliform incidents (no.)		15	21

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

Overall, a sustained level of compliance has been achieved with fewer failures at customer taps and a reduction in the number of health-related failures at water treatment works and service reservoirs. Asset integrity continues to be a major focus, with enhanced maintenance and inspection programmes at service reservoirs retained to support internal medium term targets of performance and so minimise microbiological risk.

Significant improvements have been seen in iron and manganese compliance in 2011. In addition, there has been a further reduction in customer contacts relating to discoloured water. This has been helped by the cleaning of 150km of large diameter water mains in Tyneside and South East Northumberland, which was completed in June 2011. A similar three year programme of work was started in 2012, this time targeting larger mains in Gateshead and Newcastle as part of an ongoing strategy to improve the acceptability of water to consumers.

Business customers
The economic situation has had a significant impact on some business sectors in our operating regions and we have been working closely with major customers to mitigate the impact where possible. Due to the challenging economic conditions a number of large industrial customers temporarily ceased production for periods during the year whilst a number of other smaller commercial customers have ceased trading altogether. This has led to a downturn in water demand from industrial and commercial customers. However, this should be partially offset in 2012/13 largely due to SSI UK restarting steel production on Teesside.

We are active in the business communities where we are a member of the CBI, Chambers of Commerce and North East of England Process Industry Cluster (NEPIC). By supporting these and other smaller groups, NWL can help business growth and development in the areas we serve as well as retaining contact with organisations which represent customers. Business customer satisfaction is tracked on a regular basis and levels of satisfaction are high.

Leisure customers
We have further developed our leisure infrastructure, by improving the quality of car parks, footpaths and toilet facilities. This has improved customer satisfaction scores and increased visitor numbers to our strategic sites. The development of new added value services at Kielder has enabled us to maintain our position within the market place and achieve our predicted growth targets. We continue to work in partnership with the local community and regional and national organisations to ensure that our sites support the use of recreational activities to increase the awareness of the environment, promote healthy living and improve education.

Working in partnership
We always aim to exceed the expectations of our customers by taking personal responsibility for delivering and communicating a good service and keeping promises. We aim to work in partnership with our major business customers as we understand the importance of the reliability and security of our services.

Competitiveness

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

Efficiency programme
The efficiency programme identified around 100 projects and initiatives from across the whole business, ranging from large scale strategic reviews to smaller improvements at a local level. These efficiencies are in addition to the benefits already secured through buying our full energy requirements to March 2015 in advance. Delivery of the programme continues to be on schedule and, as a result, we are ahead of the final determination profile.

Other aspects of performance in relation to our competitiveness theme are included in 'our financial performance' on page 8.

Research and development
We invest in a programme of research and development to ensure we can meet the needs of our customers and to support the sustainable and cost effective operation of our business, now and into the future. Our research and innovation activities include the development of technical solutions for water and waste water management, collaborative research within the sector and partnerships with suppliers, universities and research organisations. This has supported the invention, development, trial and/or implementation of:

- advanced automatic control systems for water and waste water treatment processes;
- devices and systems for reducing flooding and pollution from our sewers;
- microbial fuel cells and electrochemical cells, which, respectively, generate electricity or hydrogen from waste water;
- novel instruments for monitoring the quality of waste water effluent;
- beneficial re-uses for water treatment sludge;
- low power de-watering and thickening of water treatment sludge using reed beds;
- internal inspection and condition assessment of water distribution pipes while in service;
- lining systems for extending the life expectancy of water distribution pipes;
- novel processes for drinking water production and waste water treatment;
- regeneration of brownfield land using water treatment by-products; and
- novel cleaning techniques for water mains to reduce occurrences of discoloured water.

During the year, the Company invested £1.1m (2011: £2.3m) in research and development, reflecting the stages of the projects above.

People

Key People Indicators

	Target 2011/12	Performance 2011/12
Engagement and satisfaction index (%)	81	78
Lost time reportable accidents (no.)	11	8

People strategy and policy

Our approach to strategy development focuses on achieving the medium term goals and specific business objectives in all parts of the Company. Our policies aim to nurture a mindset where our people will consistently choose to go the extra mile in delivering great service to customers every day. People are clear about our vision and values and the NWGL Code of Conduct sets out our approach to doing business. The CEO has responsibility at Board level for the People strategy and policy.

We aim to recruit and retain the best people, with a diverse range of skills, experience and backgrounds, who are committed to our vision and values. In return, we aim to provide opportunities for people to develop their skills and capabilities and fulfilling and challenging work in a supportive culture which recognises, celebrates and rewards the contribution made by both teams and individuals.

Our target is to achieve and sustain an Employee Satisfaction Index (ESI) of 81%. This is a key measure in our annual employee survey which helps us to understand how people feel about working for the Company. Although we missed the target in 2011/12, we did achieve our highest ever annual score of 78% and are confident that we will achieve this medium term goal by 2015.

Valuing diversity

We understand that having a diverse workforce enhances our performance, fostering innovation and creativity and helping us better understand how to serve the needs of our customers. Our equal opportunity policy seeks to ensure that all our current employees and potential employees are treated with respect.

We welcome job applications from all parts of the community. It is our intention that all job applicants and employees are treated equally, regardless of their age, ability, marital or partnership status, race, religion or belief, sex or sexual orientation. We monitor our workforce profile against census and sector data and aim to be recognised as an employer of choice within the diverse communities we serve, ensuring we take full advantage of the wide range of backgrounds and abilities of current and potential employees.

Engaging leadership and management

We fully recognise the importance of an inclusive and engaging leadership and management style. In 2011 we continued to build on our award-winning approach by engaging with our people through over 120 departmental workshops facilitated by senior managers and over 50 participative roadshows facilitated by the CEO and directors. The roadshows were focused on our vision and values and enabled people to celebrate their successes and discuss possible improvements to efficient working practices, customer service, the environment and our future strategy. Our bi-annual leadership events focus on engaging our most senior managers in the continuous development of plans to achieve our vision to be the national leader. Throughout the year we share key information through TeamTalk, the CEO's bi-monthly briefing which is cascaded through the business, with a wide range of newsletters and briefings also keeping people informed of more local news.

Our constructive employee relations have been further enhanced through collaborative working, establishing a change management framework which was developed jointly with our trade union representatives, describing how we involve and engage people affected by change. This has enabled early involvement of trade union and employee representatives in shaping proposals and communication plans, even where formal collective consultation is not a requirement. Our approach to communicating change is continually improving and, during the year, a number of change projects were smoothly implemented, using a supportive approach to alleviate the impact on individuals.

Committed team of people
Actively involving and engaging our people is a fundamental building block to delivering strong results and improving our performance. Every year we seek their views through an annual employee engagement survey. This year's survey had the largest response rate ever, with 78% of people taking part. The survey covered working life, training, communications, managers and the Company. All employees were invited to workshops where the results were shared and invited to jointly identify areas for improvement. The feedback from each team contributed to the development of departmental action plans.

Overall, 83% of respondents told us they are proud to work for the Company, 85% would recommend working for the Company and 80% believe that NWL is a great organisation to work for. This commitment is borne out by low employee turnover which, at 4.56% last year, was well below the UK average of 16% (CIPD 2011).

To recognise the contribution of our people, who bring our values to life every day in the way they do their jobs, we have launched our Vision and Values awards, known as the ViVa Awards. In the first year over 240 people and teams have been nominated by colleagues in the business to celebrate great ViVa performance against one or more of our five Values.

Supporting wellbeing
It is clear to us that when people are feeling at their best they will give of their best to customers and colleagues. In 2011, we signed up to the Public Health Responsibility Deal and have further developed our Wellbeing strategy to promote all aspects of working well.

We actively encourage our people to take care of their health and wellbeing by providing a wide range of health services, support and resources. The Group's medical advisor provides comprehensive occupational health services, general health promotion and stress management. Our people have access to specialist advice and treatment to support recovery from musculoskeletal disorders (MSD). Since 2008 we have reduced sickness absence due to MSD by 22%. In 2010, we introduced NWL Support, which gives our people access to face to face or telephone counselling on a range of personal concerns, as well as providing a telephone based case management service for employees with stress related or mental health conditions.

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

Where employees develop a disability which affects their work we support them to remain in employment, wherever practicable, by providing appropriate adjustments to their roles and/or effective redeployment. Occupational health physicians assist this process with professional medical advice.

Our current level of sickness absence is 3.0%, continuing on a downward trend from 3.2% in 2010 and 3.1% in 2011.

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

Annual appraisals are given high priority, along with the identification of training needs, recognising how important technical and personal skills are in seeking to achieve the Company's vision and values. We have introduced a 360° feedback process for all our senior managers, which is the focus of a developmental discussion about living and role modelling our values as part of the annual appraisal.

Encouraging personal growth (continued)

We continue to implement our Management Development Framework which is structured to cover the training needs of those who show the potential for management right through to development at director level. As part of this framework, we are working in partnership with Newcastle Business School to provide qualifications, from a Diploma to a Masters degree, in leadership and management. In 2011, we introduced our LEADer programme, the next step in our Management Development Framework, supporting our operational departments. To date, around 150 people have taken part in the LEADer programme, which is aimed at supervisors, team leaders and works managers. It includes assessment to National Qualification Framework (NQF) Levels 2, 3 and 5 management standards, supported by formal development and coaching.

Currently, 75% of our line managers are qualified to at least NQF Level 3. Overall, around 2,600 of our people, 90% of the workforce, are qualified to at least NQF Level 2 – the equivalent of five GCSEs at grades A to C. Our commitment to skills is delivered through a series of NVQ programmes, working in partnership with leading providers.

Growing new talent is key to our continued success and, last year, four people were participating in our graduate development programme, with 18 in our apprentice programme, and plans are being formulated to increase our development programmes for 2012.

To recognise the academic achievements of people at all levels in the Company we held the sixth annual skills awards. Celebrating everything from apprenticeships to Masters Degrees, guest speaker Kriss Akabusi ensured a motivational and memorable evening for all our successful students.

A fair deal

We aim for our terms and conditions to both attract and retain the best people in the areas we serve. In addition to competitive pay and benefits we also offer a scheme providing a wide range of lifestyle benefits through salary sacrifice, such as childcare vouchers, water services, cars for personal use and discounted store vouchers. Around 80% of our people chose to take advantage of the scheme during the year, up from 73% last year.

Communication

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

Disclosure (Whistleblowing)

We encourage open feedback and are committed to protecting employees who wish to voice concerns about behaviour or decisions that they believe to be illegal or unethical. The Audit Committee regularly reviews the disclosure policy. There were no concerns raised by the Audit Committee during the year.

Health and safety

We place great emphasis on health and safety and a safe working environment. Employees are actively encouraged to be involved in identifying and eliminating hazards in the workplace. This has resulted in a significant reduction in accidents over recent years and, this year, there were only eight lost time reportable accidents, which continues the improving trend.

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

Health and safety (continued)

Safety information, communication and awareness are critical to creating a positive safety culture. In 2010, we reviewed the consultation process and, this year, introduced a new health and safety committee structure and a new Company health and safety forum chaired by the CEO. We are already seeing the benefits from involving the safety representatives in reviewing and consulting on safety policies and procedures and in championing the importance of health and safety in the workplace.

Employee Share Incentive Plan (SIP)

Prior to the change of control, NWG operated a Share Incentive Plan (the Plan) that provided one free matching share for every three shares purchased by an employee. The Plan closed in October 2011 following the change of control of NWG.

Environment

	North (N) South (S)	Target 2011/12	Performance 2011/12
Leakage	N	147	130
	S	66	59
Sewage treatment works compliance (%)		100	99.4
Pollution incidents (categories 1 & 2)		3	11

Water resources

We continue to make excellent progress with the Abberton Scheme. This increases the capacity of Abberton reservoir by 58% and also includes the construction of two pipelines and a pumping station, all of which remain on programme. The Denver and Blackdyke licences have also now been varied, which increases the availability of water for transfer, should it be required, during November and December. Once this scheme is operating, in 2014, we do not expect to have to develop further major resources in Essex for the next 25 years.

In addition to improving the supply of water, we believe it is important to manage the demand for water so that it does not exceed levels that can be supplied in a sustainable way. Metering has an important role to play in this regard. For several years we have been installing water meters upon change of occupier in properties in Essex. This is in addition to the optional metering scheme available to all customers. Around 50% of domestic households in Essex and 61% in Suffolk are now metered. In the north east, where supplies are more plentiful, 26% of households are metered.

Water efficiency targets were introduced in 2010/11 to reduce consumption of water by the Company's customers by one litre per property per day. These targets apply in all areas served and the award-winning work previously carried out in Essex and Suffolk was extended to the rest of the Company. New initiatives have been developed, including an innovative theatre production called 'Little Green Riding Hood', with Fame Factory Spotlight, which has delivered water efficiency messages to over 72,000 school children since it was launched in 2010. We have consistently met our water efficiency targets year on year.

The reporting year was very dry in Essex and Suffolk, where only 83% of the long term average rainfall was recorded. However, through careful abstraction management, we were on track to fill our reservoirs to target levels by the end of April and have avoided the need to impose a Temporary Use Ban (previously known as a hosepipe ban). In the north east, for the majority of the year, our storage position was at or above average. The annual rainfall total was 88% of the long term average. In spite of a dry autumn and very dry early winter, our impounding reservoirs held up well with overall storage at the end of the reporting period only some 10% below average and there were no issues with our ability to meet demand. There are no plans for restrictions during 2012/13, although the Company will continue to encourage customers to use water wisely and control demand in dry periods.

Water resources (continued)

By March 2011, we had recovered from the previous year's extremely severe winter which caused our northern operating area to miss its annual leakage target. Changes had already been made to the leakage operations management and the underlying structure in February, which we demonstrated at the 2011 regulatory June Return. NWL agreed to send Ofwat regular updates of progress against the target and, throughout the year, we have provided reports summarising leakage management performance in our northern operating area, along with forecasts of the expected position at the end of March 2012.

Throughout 2011/12, distribution input and leakage levels have been at their lowest ever. The winter season began with a significantly different profile from that of 2010/11, and continued well below the typical average year. The cold period expected towards the end of January 2012 did not fully materialise. Our reaction to any increase in leakage was quick, thorough and efficient, to ensure that we achieved the 2011/12 leakage target regardless of the weather. Our final reported leakage figure has met our target comfortably.

Waste water

Our exceptional performance for sewage treatment works continued for a fourth year. All numerically consented works remained compliant for the year on the basis of routine Operator Self Monitoring (OSM) samples. One works, Bowburn, was non-compliant based on an additional sample taken following the self reporting of a process issue to the EA.

Industrial treatment streams at Bran Sands have performed exceptionally well, in line with the sewage treatment performance and with reduced energy requirements through optimising liquid waste streams and processes such as the anaerobic digesters treating Lotte UK's waste.

The advanced anaerobic digestion plant at Bran Sands has performed well over the last 12 months. The waste water team successfully planned and executed some major statutory inspections on the AAD plant, which not only affected AAD throughput but impacted on the rest of the region's sludge management. This was carried out in record time, minimising downtime and maximising energy production. Further enhancements to the site are planned in 2012/13 to increase energy production again. A second manning review at Bran Sands has been completed and this has allowed us to operate with reduced numbers and management positions.

Construction of the Howdon plant, on Tyneside, to process the remainder of NWL's sludge has gone well and should be ready to start commissioning in June 2012.

The number of properties experiencing internal flooding due to hydraulic overloading reduced significantly for the second year in 2011/12. This can be attributed to a combination of less frequent and intense summer storms in 2011 and the cumulative effect of our sewer flooding investment programme. Enhanced resolution rain radar has now been in place in the north east since 2009, allowing us to identify severe weather across the region.

During 2011/12, we invested over £22.0m in conventional sewer flood relief projects, resulting in the removal of 224 properties from our flooding registers. Planning to identify schemes for coming years forms a key part of our investment programme and is well advanced, with a further 137 properties to be addressed in 2012/13. Additionally, in line with our serviceability action plan for sewer flooding, we have embarked on a programme of increased mitigation. This covers not only properties where a scheme is not cost beneficial, but also properties where a solution may not be implemented quickly. In 2011/12, we have invested £621k in our programme of mitigation measures to 268 properties that have previously been flooded from overloaded sewers. These measures include installation of non-return valves, flood doors, "smart" air brick covers, and re-profiling of land. Whilst not providing an immediate engineering solution we have reduced flood risk to these properties and provided some reassurance to our customers.

Waste water (continued)
The number of properties flooded due to other causes has increased in 2011/12. A serviceability action plan has been put in place to reduce flooding due to other causes. This includes new and additional programmes of sewer cleansing, sewer inspection, and sewer rehabilitation. These programmes form part of our long term policy to prevent unmanaged escapes from the sewer network.

The total number of pollution incidents showed a slight reduction from 2010, however, there was a significant increase in those classified as serious (categories 1 & 2). While there was no single cause for these serious events, the programme of installing overflow and sewer level monitoring (Hawkeye) is continuing. Furthermore, the monitoring has been brought in-house for quicker detection and a rapid response to warning level alarms, to solve problems before any overflow occurs.

All of the 34 bathing waters in the north east passed the required mandatory standard and 31 met the more demanding guideline standard.

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

We have published our carbon management plan to meet the target of a 35% reduction in operational emissions by 2020, from a 2008 base.

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

- our £33.0m investment in thermal hydrolysis advanced anaerobic digestion at Bran Sands, which provides 50% (c.4.7 MW) of the energy requirements of the site. This enables waste water sludge to generate methane to fuel gas engines and produce green electricity. A similar plant is being constructed at Howdon on Tyneside, and this will come on line in the next few months. Together, these plants will help meet our target of generating 20% of our energy needs from renewable energy, as well as reducing our overall energy demand;
- hydroelectric installations at five reservoirs, including the UK's largest man-made reservoir, Kielder Water. Recently commissioned hydroelectric plants at our Selset reservoir and Mosswood water treatment works will together generate over 900 kilowatts of electricity – 5,400 megawatt hours a year. Renewable energy is also being generated with hydroelectric plants at Lartington and Wear Valley water treatment works and Derwent reservoir and we are planning to develop further opportunities at other reservoir sites;
- we have extended and improved our metering of electricity so that we have a clearer understanding of our energy use and can improve our energy efficiency through site energy management plans;
- limiting tertiary ultraviolet disinfection outside the bathing water season at five major works reduces energy consumption and carbon emissions with no detrimental effect on the marine environment; and
- encouraging customers, through our 'using water wisely' campaign, to recognise that wasting water is closely linked to wasting energy (information and tools are available for customers on our websites).

Through these projects, and by reviewing the efficiency of our pumps across the business, we have progressively reduced the amount of energy used over recent years despite upward pressures as a consequence of tighter environmental standards.

Carbon management plan (continued)
We have been awarded, for the second time, the Carbon Trust Standard for our efforts in reducing greenhouse gas emissions. The standard provides an objective benchmark against which our commitment and success in addressing our climate change impact was assessed and is significant as it demonstrates progress against our ambitious carbon management plan.

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

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

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

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

Quality
We have maintained our certification to the international standards for quality (ISO 9001:2008), environment (ISO 14001:2004) and occupational health and safety (OHSAS 18001:2007) across all areas of the business, including operational sites and office based teams.

Communities

We support the communities we serve in a number of different ways. We have been widely recognised as leaders in our support for projects that make the areas we serve better places in which to live, work or invest. This year, the Company has been re-accredited by FTSE4Good though, following our delisting in the autumn, we will not be eligible for this index in future years. We have also received re-accreditation as a Platinum Plus company by Business in the Community. The Queen's Award for Industry is still in place as it was awarded in 2009 for a five year period. For the second year running, the Company was also recognised by Ethisphere, an American-based international think-tank, as one of the most ethical companies in the world and was one of only seven UK only based companies and the only water utility worldwide to make the list of 145 companies.

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

DIRECTORS' REPORT and OFR (continued)

<u>Communities</u> (continued)

This year, the Group made charitable donations totalling £155,000. In addition, and in line with previous years, we have contributed resources with a value equivalent to at least 1% of our annual pre-tax profits (through cash, employee time and expertise, or use of our facilities) to projects which benefit the communities we serve. Our employees raised £43,667 for charities this year.

The 'Care for safety' scheme, which encourages employees to reduce accidents and associated lost time, has triggered payments of over £28,190 for charities nominated by employees (Crawford House, North East Air Ambulance, Little Havens Children's Hospice, Open Door and the Prince's Trust Million Makers). Since it began in 2004, over £354,470 has been raised for charity.

Investment in our communities

Community Foundations covering our areas of supply hold endowment funds totalling nearly £1.0m contributed by NWL over the last 20 years. These are long term investments with the income from the funds used to support community and environmental initiatives. Community groups are chosen by committees of our own employees (34 recipients this year).

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

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

This is the first full operating year for the newly formed Kielder Water & Forest Park (KW&FP) Development Trust, a registered charity which formalised the original Kielder Partnership founded in 1994. This year, activity has focused on refining the vision, mission and goals of the Trust as well as ensuring the appropriate governance and financial systems are in place, but this has not stopped the continued delivery of the 25 year investment plan for the area.

A £10.0m development scheme for the Calvert Trust Kielder site has gained planning permission which will increase the activity provision and accommodation within the Park.

Encouraging and enabling sustainable development has been a high priority and the development of the local business forum has been a key facet. Kielder petrol station was re-opened after a four year battle to secure funding and we have helped the Kielder Observatory secure funding leading to a significant uplift in observing sessions and visitors. A great deal of work was undertaken on progressing towards, and application for, Dark Skies Park Status which is an independent international award for the quality of the dark skies at Kielder and the delivery of excellent programmes for the public to explore and learn about the starscape. Events and activities have also grown with the successful delivery of the second Kielder marathon, dubbed 'Britain's Most Beautiful', and the Kielder 100 – the 100 mile mountain bike race using the new trails across Kielder Forest.

Investment in our communities (continued)
Funding has been secured to continue the Art & Architecture programme and increase audience enjoyment. The independent evaluation carried out during the year confirmed that KW&FP is now one of the most significant destinations for mountain bikers in England attracting competitors to international events. The projects delivered over the last five years, significantly raise the future potential of KW&FP to attract visitors and to contribute to the development of tourism in Northumberland. They have also contributed to the formation of new businesses with over half of businesses interviewed having increased their turnover and each of the projects was considered to have had a positive effect on turnover. Fifty six per cent of businesses located within KW&FP expanded their turnover, as did 50% of those located outside KW&FP. The website www.visitkielder.com provides further details of all facilities.

Participation in our communities
As part of NWL's in-kind giving, we encourage employees to volunteer their time, skills and expertise through our 'Just an hour' volunteering scheme. We support our people to participate in their local communities by giving them work time to volunteer in projects of their choice.

During the year, our people have helped hundreds of community projects to undertake tasks as varied as painting, giving blood, litter picking, transforming gardens, ironing for a hospice, teaching scuba diving to disadvantaged young people, teaching children to read, cleaning out streams, laying paving and much more. In the last year, we have carried out 740 different 'Just an hour' projects and employees have volunteered 15,204 hours in their communities. In 2011/12, 48% of our employees participated in the 'Just an hour' volunteering scheme (up from 27% in the previous year) and 1,417 different organisations were given financial and in-kind support.

We have continued our support for Castle View Enterprise Academy, in Sunderland, for which NWL is lead sponsor. The school has now completed its second year of operations after opening its doors in 2009. The school was built to replace a failing school in a deprived local community, largely of third generation unemployed families, to provide their young people with a caring and supportive learning environment, relevant qualifications, opportunity and hope.

Two academic years on, our ambition to create a centre of excellence with a clear focus on raising standards of academic performance to enable every student to achieve their personal best in all areas of academy life within a safe, secure and stable environment, is coming to fruition.

The pass rate for students in GCSEs including English and Maths has improved considerably:

	Old school	Academy year 1	Academy year 2
A*-Cs including English and Maths	26%	43%	54%

The percentage of pupils achieving A*-C overall has also risen.

	Old school	Academy year 1	Academy year 2
A*-C overall	63%	86%	94%

Educating our communities about their environment
Key partnerships have been developed by NWL to help the conservation of biodiversity on our sites, to facilitate public access and to develop conservation education. Our contribution includes funding project officers and providing expertise to the organisations. Our current partnerships include:
- Northumberland Wildlife Trust (Kielder and Bakethin);
- Durham Wildlife Trust;
- Essex Wildlife Trust (Hanningfield);
- Broads Authority (Lound and Trinity Broads); and
- Davy Down Trust (North Stifford, Essex).

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

Supporting healthy communities
We continue to promote the health benefits of drinking tap water and our 'Water for health' campaign aims to encourage people to lead a healthy lifestyle. To date, almost £376,000 has been provided to fund free mains-fed water coolers in schools and around 800 have been supplied in nearly 465 schools and community groups. We also continue to promote bottle-free water coolers as a sustainable alternative to bottle-fed coolers. Similarly, we use our 'tap into' initiative to donate bottled tap water to community sporting events in order to promote the importance of rehydration during exercise. This year we donated 143,200 bottles of tap water to events.

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

Through our partnerships we have reached 104,000 children and adults. We provide:
- links and networks to enable sporting partners to get together to share ideas and resources;
- financial support of approximately £65,000 per annum which then levered over £140,000 from other sources;
- advice and marketing support on programme development;
- bottled tap water, sports bottles, water jugs or mains-fed bottle-free coolers to reinforce the importance of drinking tap water to rehydrate during sporting activities; and
- help with fundraising and raising the profile of the partnerships to attract additional investment.

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

We are represented on the steering group for Healthworks and provide research, marketing and communications support. We believe this is the only project of its kind in the country and shows how much can be achieved by working in partnership. The centre received 27,500 visits during the year and now provides over 70 health and community support services including a GP led walk-in health centre open from 8am to 8pm 365 days a year. It acts as a community focal point where service providers and community groups can come together to address issues that affect the quality of life in their local community. In January 2012, we also organized and supported the first Healthworks recognition awards to honour those who have taken steps to improve their health and wellbeing or give up their time to volunteer at the centre.

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

Supporting developing communities through WaterAid (continued)
The employee fundraising committee has raised more than £5.0m, since 1997, with the help of the Company and last year focused its fundraising support on specific projects in Ghana and Tanzania. We support our employees to become ambassadors for the charity and encourage annual supporter trips to see WaterAid projects. This year, Technical Support Team Leader Lee Edwards visited Zambia and saw firsthand how our adopted international charity saves lives.

OUR RISKS AND UNCERTAINTIES

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

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

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

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

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

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

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

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

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

An assurance map forms a permanent part of the process and, for each risk, highlights who provides assurance that the control activities are in place and operating effectively.

Risk description	Mitigation measures
Funding and liquidity risk	The financial ratios, financial results, liquidity position and credit ratings are described in the financial performance section on pages 8 to 10. See below for details on the Company's strategy and treasury operations for managing its capital; its exposures to liquidity risk, interest rate risk and foreign currency risk. The Group reviews the treasury strategy periodically and approves specific proposals.
Unfavourable changes to the regulatory structure, as a result of the Water White Paper	We play a leading role in the policy debate, through Water UK, direct lobbying and forging positive relationships with relevant parties. We respond positively to consultation papers.
Unfavourable changes to the regulatory structure or price setting mechanism by Ofwat	We play a leading role in consultation groups with Ofwat and other stakeholders. We respond positively to consultation papers.
Impact of the transfer of private drains and sewers is greater than anticipated	An internal project team was established to understand and prepare the business for the transfer. We maintain sound financial documentation to support a possible future claim for tariff increases in order to recover additional costs borne. We maintain close liaison with the rest of the industry and have had constructive dialogue with Ofwat regarding the process.
Unexpected shift in climate change impact	We have processes in place to anticipate and plan for the impact of climate change. While these have long time horizons, they are reviewed regularly to ensure that any changes are identified early.
Loss of supply due to failure of strategic water main. This covers catastrophic failure that is greater than the response capability of the Company	In most cases, duplicate mains and diversion of supplies would limit supply consequences. Comprehensive plans exist to provide a minimum emergency service to customers until repairs are completed, including mutual aid arrangements with other water companies. A proactive inspection regime is in place along with longer term reviews of network resilience.
Sewer flooding failures	A sewer flooding group, comprising stakeholders from various teams, is responsible for managing the process, flood reporting, network capacity studies and prioritisation of investment to reduce risk. Significant additional capital expenditure has been invested to address affected properties. The recently constructed rain radar station for the region is now operational and provides improved data. However, controls are not yet sophisticated enough to predict or prevent consequences of severe rainfall.
Pesticides lead to prescribed concentration or value failure and possible enforcement action	Undertakings have been agreed with the DWI to carry out certain actions to mitigate pesticide issues (metaldehyde and clopyralid). While specific treatment processes, such as carbon filters, are undertaken at treatment works, proactive catchment management is also being carried out. This involves working with farmers, regulators and other stakeholders to advise on improved storage and application techniques for such pesticides. This is a more sustainable solution than the alternative of constructing major new treatment processes.
Loss of income through closure of large customers or lower industrial volumes	It is not possible to directly influence industrial volumes; however, our account managers liaise closely with significant customers to provide support where possible.
Incident at Bran Sands waste water treatment works causes business interruption	We have a number of contracts to treat industrial waste streams at our Bran Sands works. The liability under each contract is capped except, in certain cases, where NWL is in wilful breach. A site-specific management regime is in place incorporating additional monitoring and a greater amount of standby assets.
Risk of increasing pension contributions resulting from increasing longevity and the impact of economic conditions on investment returns	The defined benefit scheme was closed to new entrants, benefits restructured and employee contributions increased in 2008. Advance contributions have been made to the scheme, including deficit funding allowed at the last price review. The scheme Trustee determines investment policy and monitors performance of investment managers. Triennial actuarial valuations of the scheme are carried out, with the latest completed in January 2011.
Health and safety prosecution	Our health and safety policy and safety management system define clear arrangements and responsibilities for implementation and management throughout the Company. This is audited as part of our quality and environmental management system. Visible high level support for health and safety is provided by the Board and management team. Long term plans and targets are set to promote continuous improvement.

OUR RISKS AND UNCERTAINTIES (continued)

Risks arising from the Company's financial instruments

The main risks arising from the Company's financial instruments are liquidity risk and interest rate risk. As noted above, the Company's financing strategy is developed in accordance with the treasury policies of NWGL, whose board reviews and agrees policies for managing each of these risks. These are summarised below. The treasury activities of the Company are conducted in accordance with these policies.

Liquidity risk

The Company is responsible for cash management. The Group's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0m and with a bank agreement availability period of no less than 3 months. At 31 March 2012, NWL had £450.0m (2011: £35.0m).

Interest rate risk

The Company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and floating rates of interest and, as noted above, on occasion uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. The Company's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2012, 73% (2011: 70%) of the borrowings of the Company were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

Foreign currency risk

The Group's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered immediately on recognition. At 31 March 2012, the Company had no currency exposures (2011: nil).

Market price risk

The Company's exposure to market price risk principally comprises interest rate exposure. The Company's policy is to accept a degree of interest rate risk. On the basis of the Company's analysis, it is estimated that a 1% rise in interest rates would not have a material effect.

OUR CORPORATE RESPONSIBILITY

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

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

We believe that sustainability helps to improve the performance of the Company and to achieve our business strategy and objectives. This is reflected in our business plan where our sustainability objectives are woven into our core business strategy. Our credentials for our work have been recognised and these are outlined on page 19. Our customer research also highlights that customers value the work of the Company in the community and for the environment and it helps to build their trust in our work. Each aspect of the highlighted work in this report has a direct benefit to the Company, its community and its environment, such as cost saving, carbon reduction, environmental impact, skills development or leverage.

OUR CORPORATE RESPONSIBILITY (continued)

To ensure that sustainability runs throughout the business, we ensure that all parts of the Company are involved from the Board through to all employees.

Up to the point of the change of control, governance of our sustainability activity was led by our Corporate Responsibility Committee (CRC), a subcommittee of the NWL Board. From October 2011, governance was led by our Corporate Responsibility Management Group (CRMG) a sub-committee of the NWL Management Team. The CRMG will meet four times a year and non-executive directors and the CEO (who is directly accountable to the NWL and NWGL boards for both the environment and sustainable development policies) will attend at least once to develop strategy and to inform the Board.

In addition, two CR Advisory Groups (CRAG) (one for each of Northumbrian and Essex & Suffolk Regions) act as 'critical friend', helping to validate, guide and challenge NWL's sustainability strategy and activities. The CRAGs are made up of senior representatives from key stakeholder organisations to reflect the main areas of our environment and communities' strategy

OTHER DISCLOSURES

Political

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

We do not support any political party and we do not, directly or through any subsidiary, make what are commonly regarded as donations to any political party or other political organisation. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the Group and political parties and political organisations. These activities include attending party conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. The costs associated with these activities during 2011/12 were as follows:

Name of political party	£
Conservative	3,750
Labour	6,531
Liberal Democrats	1,860
Total	**12,141**

Company payment policy

The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. The Company's policy is to make payment not more than 30 days after receipt of a valid invoice, except as otherwise agreed. The ratio, expressed in days, between the amount invoiced by its suppliers during the year and the amount owed to its trade creditors at 31 March 2012, was 15 days (2011: 21 days).

Fixed assets

Freehold land and buildings are carried in the financial statements at historical cost with a net book value of £81.1m (2011: £82.9m). In the opinion of the directors, at 31 March 2012, there is no significant difference between the net book value and market value of property capable of disposal within the foreseeable future. Note 10 gives more details of the fixed asset movements during the year.

Pensions
The Group operates both a defined benefit pension scheme, of which the Company is the principal member, which is closed to new entrants, and an occupational defined contribution scheme.

The deficit (under FRS 17) of the defined benefit scheme has increased from £46.0m, at 31 March 2011, to £84.1m at 31 March 2012. This is due to an increase in the liabilities of the scheme (£63.1m), partially offset by an increase in the value of scheme assets (£25.0m). The increase in the valuation of the scheme liabilities is principally due to the decrease in the discount rate applied from 5.5% to 4.8%, the increase in valuation of the scheme assets is principally due to the advance contributions paid during the year.

In place of recommencing regular contributions from 1 January 2011, the Group agreed to pay further advance contributions to the scheme totalling £70.0m for the period to 31 March 2015. Amounts totalling £22.9m were paid in the period to 31 March 2011 and a further £47.1m was paid in April 2011. These payments comprise employers' contributions, the deficit recovery funding assumed in the final determination and employees' contributions under a salary sacrifice arrangement.

Further information about the pension schemes in which the Company participates is contained in note 26 to the financial statements.

Directors' remuneration
Information about directors' remuneration is contained in note 5 to the financial statements.

Indemnification of directors
UK Water (2011) Limited has in place directors' and officers' insurance and, on 28 November 2005, Northumbrian Water Group Limited entered into a deed of indemnity to grant the directors of the Group and its subsidiaries further protection against liability to third parties.

Directors' declaration
As required under section 418 of the Companies Act 2006, so far as each current director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors
Deloitte LLP was appointed auditor in the current year, following the resignation of Ernst & Young LLP. Deloitte LLP has expressed its willingness to continue in office for the ensuing year.

DIRECTORS' REPORT and OFR (continued)

Financial statements preparation and going concern
The directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

In arriving at their decision, the Directors have taken into account:
- the acceptance of the 2009 Final Determination by the Board;
- the financial strength of the Company at the balance sheet date and performance during 2011/12;
- the key financial ratios over the planning horizon of the Company's one year budget and medium term plan to 2015 as reflected in strong investment grade credit ratings;
- the fact that the Company has arranged £450.0m of five year committed bank facilities as back up liquidity (maturing in 2016), and that these remained undrawn at 31 March 2012;
- its contractual arrangements with suppliers for key materials and support services and its capital framework arrangements;
- its robust People Plan for 2010-15 which underpins the employment resources to fulfil all operational requirements; and,
- the Company's formal risk and governance arrangements which are monitored by the Audit Committee and Board.

Statement of Directors' responsibilities
The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:
- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

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

By order of the Board

M Parker
Company Secretary
11 July 2012

APPENDIX TO THE DIRECTORS' REPORT and OFR

DEFINITION OF KEY PERFORMANCE INDICATORS

Financial KPIs

Measure	Definition of measure
Gearing to RCV	The ratio of net debt (total borrowings net of loans to other Group companies, cash and short term deposits) to Regulatory Capital Value (RCV). The RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews based on its view of the cost of capital. The RCV generates most of the revenue stream of the Company and regulatory gearing is an important factor in credit ratings. The RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to the end of the current price review period, based on its last price determination. Net debt is calculated from the balance sheet in the audited financial statements.
Regulatory gearing	The ratio of NWL appointed business net debt to RCV. The RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews based on its view of the cost of capital. The RCV generates most of the revenue stream of the Company and regulatory gearing is an important factor in credit ratings. The RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to the end of the current price review period, based on its last price determination. Net debt is disclosed in the audited regulatory accounts.
Cash interest cover	The ratio of cash generated from operations less tax divided by net interest paid. This measures the ability of the Company to service its debt. Cash interest cover is calculated from the audited financial statements.
Cash flow to net debt	The ratio of cash generated from operations less tax paid divided by net debt. This indicates the Company's ability to reduce debt in the absence of need for additional investment, without resorting to asset disposal. Cash flow to net debt is calculated from the audited financial statements.

Non-financial KPIs

All targets are for 2012/13 unless stated otherwise.

Measure	Definition of measure
Customer	
Customer satisfaction – SIM quantitative score	SIM quantitative measure, based on customer contacts. Contacts are normalised per thousand connected properties and multiplied by a weighting factor for each 'unwanted' category. Categories include unwanted customer calls, abandoned calls, first stage written complaints, second stage written complaints and CCWater investigations. The lower the score the higher the customer satisfaction.
Customer satisfaction – SIM qualitative score	SIM qualitative measure, assessing satisfaction of consumers across their experience from first correspondence (calls or written) to final resolution, through independent surveys. Surveys are carried out four times a year for water, waste water and billing contacts and the average score taken. A score of 5 indicates maximum satisfaction.
Unplanned interruptions >6 hours	A weighted scoring of the number of properties affected by interruptions to supply of more than six hours duration which are unplanned or unwarned (excluding overruns of planned and warned interruptions) except for those caused directly by third parties. It includes interruptions for which customers are notified less than 48 hours in advance. The scoring weights interruptions which exceed 12 hours, and heavily weights those which exceed 24 hours.
Coliform incidents	Total number of coliform failures in regulatory samples at water treatment works and service reservoirs. One coliform or more is a failing sample.

APPENDIX TO THE DIRECTORS' REPORT and OFR (continued)

DEFINITION OF KEY PERFORMANCE INDICATORS (continued)

Measure	Definition of measure
Competitiveness (2011/12)	
Profit before tax	Actual profit before tax compared to the budget approved by the Board, adjusted for the impact of variances related to indexation on index linked bonds, which depends on the July RPI. Profit before tax has been chosen because it is a primary financial measure for the Group for which the executive directors are accountable.
Capital efficiency	An assessment of the efficiency of the NWL capital investment programme undertaken annually by the Board.
Competitiveness	
UKW EBIT	Actual earnings before interest and tax (EBIT) compared to the budget approved by the board. EBIT has been chosen because it is a primary financial measure for which the executive directors are accountable.
Cash available for distributions	Cash available for distributions in the period at UKW, compared to the budget approved by the board.
People	
Employee engagement score	The Engagement and Satisfaction Index is calculated from scores for 13 items selected from the employee survey. These items align to the Sunday Times Best Companies survey and give a measure of employee satisfaction. The employee survey and Sunday Times Best Companies survey alternate annually.
Lost time reportable accidents (no.)	Accidents reportable to the Health and Safety Executive resulting in more than three days lost from work.
Environment	
Leakage (Mld)	Water network leakage for the financial year, as reported to Ofwat.
Sewage treatment works compliance (%)	Percentage of population equivalent served by sewage treatment works compliant with Environment Agency (EA) look-up table (LUT) consents.
Pollution incidents (categories 1 & 2)	Number of category 1 and 2 pollution incidents in the calendar year, as defined by the EA. Category 1 is a major water pollution incident and category 2 is a significant water pollution incident.
Communities	
FTSE4Good accreditation (2011/12)	Accreditation by FTSE4Good index series, which has been designed to objectively measure the performance of companies that meet globally recognised corporate responsibility standards.
BITC Platinum Plus accreditation	Accreditation by Business In The Community (BITC) at Platinum Plus level, the highest level in their corporate responsibility index. BITC is a national business-led charity which advises, challenges and supports its members to create a sustainable future for people and the planet and to improve business performance.
Just an Hour	The percentage of employees actively volunteering in their communities.

PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2012

	Note	2012	2011
		£'m	£'m
Turnover	2	730.6	682.8
Operating costs	3(a)	(286.9)	(280.5)
Capital maintenance costs	3(b)	(123.3)	(120.7)
Total operating costs		(410.2)	(401.2)
OPERATING PROFIT		320.4	281.6
Net interest payable	4	(106.1)	(102.0)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		214.3	179.6
Taxation	8(a)	(71.2)	(26.9)
PROFIT FOR THE FINANCIAL YEAR	24	143.1	152.7

All results are from continuing operations in the United Kingdom.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2012

	Note	2012	2011
		£'m	£'m
Profit for the financial year		143.1	152.7
Pension liability actuarial (loss) / gain in the year	26	(83.5)	74.4
Deferred tax related to pension adjustments	26	18.8	(22.1)
Total recognised gains and losses relating to the year		78.4	205.0

BALANCE SHEET
at 31 March 2012

	Note	2012	2011
		£'m	£'m
FIXED ASSETS			
Tangible assets	10	3,630.3	3,466.5
Investments	11	160.9	160.9
		3,791.2	3,627.4
CURRENT ASSETS			
Stocks	12	2.7	2.8
Debtors due in less than one year	13	162.6	138.4
Debtors due in more than one year	14	4.9	3.1
Investments	15	80.0	116.9
Cash at bank and in hand		25.5	6.3
		275.7	267.5
CREDITORS			
Amounts falling due within one year	16	(252.8)	(181.4)
NET CURRENT ASSETS		22.9	86.1
TOTAL ASSETS LESS CURRENT LIABILITIES		3,814.1	3,713.5
CREDITORS: Amounts falling due after more than one year	17	(2,239.1)	(1,899.1)
PROVISIONS FOR LIABILITIES AND CHARGES	21	(230.5)	(207.4)
ACCRUALS AND DEFERRED INCOME	22	(384.1)	(386.1)
		(2,853.7)	(2,492.6)
NET ASSETS EXCLUDING PENSION LIABILITY		960.4	1,220.9
Pension liability	26	(63.9)	(34.0)
NET ASSETS INCLUDING PENSION LIABILITY		896.5	1,186.9
CAPITAL AND RESERVES			
Called up share capital	23	122.7	122.7
Profit and loss account	24	773.8	1,064.2
EQUITY SHAREHOLDERS' FUNDS	24	896.5	1,186.9

Approved by the Board and signed on their behalf by:

H Mottram G Neave
11 July 2012

NOTES TO THE STATUTORY FINANCIAL STATEMENTS
for the year ended 31 March 2012

1. STATEMENT OF ACCOUNTING POLICIES

These financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the principal accounting policies is set out below. These have been applied consistently throughout the current and preceding periods.

(a) Basis of accounting

The financial statements have been prepared under the historical cost convention on a going concern basis (see page 28 of the Directors' report and OFR). The Company is exempt by virtue of section 400 of the Companies Act 2006 from the requirement to prepare group financial statements, as it is included in the group financial statements of UK Water (2011) Ltd. These financial statements therefore present information about the individual company and not about its group.

(b) Turnover

Turnover, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom. All water and sewerage charges billed to customers are recognised pro-rata over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

(c) Cash flow statement

The directors have taken advantage of the exemption in FRS 1 (revised) and have not included a cash flow statement on the grounds that the Company is wholly owned and its ultimate parent undertaking and controlling party publishes a consolidated cash flow statement.

(d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

(i) Infrastructure assets

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

Expenditure on infrastructure assets relating to increases in capacity, or enhancements of the network, and on maintaining the operational capability of the network, in accordance with defined standards of service, is treated as additions which are included at cost. Costs include external and internal costs to bring the asset into use.

The depreciation charge for infrastructure assets is based on the Company's independently certified asset management plan which has estimated the level of expenditure required to 2020 to maintain the operating capability of the network. This is adjusted if the forecast expenditure is expected to differ significantly from the amounts included in the original plan.

(ii) Non-infrastructure assets

Other assets are included at cost less accumulated depreciation and, where required, provision for impairment. Additions are included at cost.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation (continued)

(ii) Non-infrastructure assets (continued)

Freehold land is not depreciated. Other assets are depreciated evenly to their estimated residual values over their estimated economic lives, which are principally as follows:

Freehold buildings	30 – 60 years
Operational structures, plant and machinery	4 – 92 years
Fixtures, fittings, tools and equipment	4 – 10 years

Where the remaining useful economic life of the asset is estimated to be greater than 50 years, an impairment review is performed at the end of each reporting period to ensure that the carrying amount can be supported.

(iii) Assets in the course of construction

Assets in the course of construction are not depreciated until commissioned, which is when the asset is available for use.

(e) Grants and contributions

Revenue grants are credited to the profit and loss account when received.

Capital grants and contributions are treated as deferred income and amortised to the profit and loss account over the expected useful economic lives of the qualifying assets. Specifically in the case of infrastructure assets, the expected useful economic lives have been determined by reference to the physical replacement cycle of these assets.

(f) Hire purchase and leasing

Where assets are financed by hire purchase or leasing arrangements which transfer substantially all the risks and rewards of ownership to the Company, the assets are treated as if they had been purchased and the corresponding capital cost is treated as a liability. Rentals or leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the outstanding liability and the finance costs being charged to the profit and loss account over the period of the hire purchase contract or lease in proportion to the reducing outstanding liability.

Rental costs arising under operating leases are charged to the profit and loss account in the period in which they are incurred.

(g) Stocks

Raw materials and consumables are stated at cost less any provision necessary to recognise damage and obsolescence.

(h) Pension costs

The Company is a member of the Northumbrian Water Pension Scheme, which has both defined benefit sections and a defined contribution section. The Scheme is accounted for in accordance with FRS 17 “Retirement Benefits”.

The defined benefit sections provide benefits based on final pensionable remuneration. The scheme assets are measured at fair value and the scheme liabilities are measured at present value. The difference between the assets and liabilities is recognised in the balance sheet. The current service cost, past service cost, settlements and curtailments are recognised within operating costs in the profit and loss account. The expected return on plan assets and the change in present value of scheme obligations are recognised in the profit and loss account as interest receivable and interest payable, respectively. Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in the statement of total recognised gains and losses.

The costs of the defined contribution section are charged to the profit and loss account in the period they arise.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(i) Taxation

The charge for current UK corporation tax is based on the profit for the year as adjusted for taxation purposes using the rates of tax enacted or substantively enacted by the balance sheet date.

Provision is made for deferred tax in respect of all timing differences that have originated but not reversed at the balance sheet date that will result in an obligation to pay more, or a right to pay less, tax in future periods. Deferred tax is calculated at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

As permitted by FRS 19, the Company has adopted a policy of discounting deferred tax assets and liabilities to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained at the balance sheet date on UK government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

(j) Foreign currency

All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the date of transaction. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange gains or losses are recognised in the profit and loss account in the period incurred.

(k) Research and development

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

(l) Fixed asset investments

Fixed asset investments are stated at their purchase cost, less provision for diminution in value.

(m) Derivative financial instruments

The Company utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments. In accordance with the Companies Act 2006, disclosure is given of the nature and extent of each class of derivative held by the Company, along with the fair value of the derivatives, by class, at the balance sheet date. No amounts are shown in the balance sheet of the Company in respect of these derivatives at 31 March 2012.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Company in line with the Company's risk management policies.

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these derivatives are recognised over the period of the contracts as adjustments to net interest payable in the profit and loss account.

When interest rate swaps and underlying debt are terminated together, the net gain or loss is taken to the profit and loss account as interest payable. When interest rate swaps are terminated but the underlying debt is retained then the gain/loss is deferred and is amortised to interest payable over the remaining life of the underlying debt.

Forward exchange contracts are valued at the period end rates of exchange. Resultant gains and losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(n) Liquid resources

Liquid resources comprise external deposits and cash.

(o) Bad debt provisioning

The bad debt provision is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied.

(p) Share based payments

Prior to the change of control, 14 October 2011, NWG ran a share based Long Term Incentive Plan (LTIP). Accordingly, the accounting treatment is only relevant up to this date and was not in place at the balance sheet date.

The cost of equity-settled transactions with employees was measured by reference to the fair value at the date at which they were granted and was recognised as an expense over the vesting period. Fair value was determined by an external valuer using the Monte-Carlo simulation model. In valuing equity-settled transactions, no account was taken of any vesting conditions, other than conditions linked to the price of the shares of NWG (market conditions).

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

At each balance sheet date before vesting, the cumulative expense was calculated, representing the extent to which the vesting period had expired, management’s best estimate of the achievement or otherwise of non-market conditions and the number of equity instruments that would ultimately vest or in the case of an instrument subject to a market condition, was treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date was recognised in the income statement, with a corresponding entry in equity.

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

2. TURNOVER, PROFIT BEFORE TAX AND NET ASSETS

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

3. OPERATING COSTS, CAPITAL MAINTENANCE COSTS AND PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

(a) Operating costs comprise:

	2012	2011
	£'m	£'m
Materials and consumables	20.3	19.8
Other external charges	74.4	75.0
Net manpower costs (note 7)	106.3	102.5
Other operating charges	117.5	111.9
Own work capitalised	(31.6)	(28.7)
	286.9	280.5

(b) Capital maintenance costs comprise:

	2012	2011
	£'m	£'m
Depreciation:		
Non-infrastructure assets	79.8	78.9
Infrastructure assets	44.7	42.8
Assets held under finance leases	4.4	4.6
Amortisation of capital grants and contributions	(4.8)	(4.6)
Profit on disposal of fixed assets	(0.8)	(1.0)
	123.3	120.7

(c) Profit on ordinary activities before taxation:

	2012	2011
	£'m	£'m
Profit on ordinary activities before taxation is stated after charging:		
Operating leases:		
Plant and machinery	0.1	0.1
Other assets	1.0	1.1
Costs of research and development	1.1	2.3
Directors' emoluments (note 5)	1.5	1.3

Auditors' remuneration in respect of the statutory audit amounted to £110,000 (2011: £114,935). Auditors' remuneration for the regulatory audit amounted to £20,000 (2011: £18,424). Fees of £5,000 (2011: £nil) were incurred in respect of the statement of sufficiency of financial resources and facilities. In 2010/11, £12,693 and £13,735 were incurred in the auditing of transactions with associated companies and the June Return, respectively. The remuneration to auditors for non-audit services is disclosed on a consolidated basis in the group financial statements of the ultimate parent undertaking and controlling party.

4. NET INTEREST PAYABLE

	2012	2011
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	21.0	17.0
Group loans	98.7	92.7
Financing charges payable under finance leases	5.2	5.1
Total interest payable	124.9	114.8
Interest receivable:		
Group interest	(9.8)	(10.5)
External interest	(1.0)	(0.1)
Total interest receivable	(10.8)	(10.6)
Other finance income relating to pension scheme (note 26)	(8.0)	(2.2)
Net interest payable	106.1	102.0

5. DIRECTORS' EMOLUMENTS

(a) Directors' remuneration

The remuneration of the directors of the Company was as follows:

	2012	2011
	£'000	£'000
Emoluments (including benefits in kind)	1,483.8	1,370.7

For those directors holding office with both NWL and NWGL, costs are apportioned between the companies. This note reflects only the proportion of costs charged to NWL.

Three of the directors at 31 March 2012 were members of a defined benefit pension scheme where the Company makes contributions towards the cost (2011: 3).

One of the directors at 31 March 2012 was a member of a defined contribution scheme where the Company makes contributions towards the cost (2011: 1).

Long Term Incentive Plan (LTIP)
Prior to the change of control, NWG ran a share based Long Term Incentive Plan (LTIP). Awards under the LTIP had three year pre-vesting performance conditions. During September 2011, NWG's advisers undertook a final assessment of performance against the performance conditions to determine the number of shares that would vest under the three remaining awards. These shares were transferred to individuals, at market value, on 11 October 2011. The Scheme of Arrangement became effective on 14 October 2011 and NWG's listing on the Official List as well as trading on the London Stock Exchange's main market for listed securities, was cancelled.

5. DIRECTORS' EMOLUMENTS (continued)

The directors who held office as at 31 March 2012 held the following conditional interests in the ordinary 10p shares of NWG, awarded in accordance with the terms of its LTIP:

Name of Director	Award date	Awards held at the start of the year	Awarded during the year	Awards lapsed during the year	Awards vested during the year	Awards held as at 31 March 2012
H Mottram	8.12.2010[3]	96,212	-	11,844	84,368	-
Totals		96,212	-	11,844	84,368	-
C M Green	15.12.08[1]	78,650	-	39,325	39,325	-
	4.1.10[2]	83,240	-	18,904	64,336	-
	8.12.2010[3]	68,551	-	8,439	60,112	-
Totals		230,441	-	66,668	163,773	-
A C Jones	15.12.08[1]	28,850	-	14,425	14,425	-
	4.1.10[2]	34,429	-	7,819	26,610	-
	8.12.10[3]	25,887	-	3,187	22,700	-
Totals		89,166	-	25,431	63,735	-
G Neave	15.12.08[1]	34,800	-	17,400	17,400	-
	4.1.10[2]	41,606	-	9,449	32,157	-
	8.12.10[3]	31,209	-	3,842	27,367	-
Totals		107,615	-	30,691	76,924	-

Notes:

1. The market value of the shares on the date of the award was 251.50 pence per share. Due to the change of control, the performance period ran from 1 October 2008 to 23 September 2011.
2. The market value of the shares on the date of the award was 272.50 pence per share. Due to the change of control, the performance period ran from 1 October 2009 to 23 September 2011.
3. The market value of the shares on the date of the award was 328.70 pence per share. Due to the change of control, the performance period ran from 1 October 2010 to 23 September 2011.
4. The cost of conditional awards is charged to the profit and loss account over the performance period to which they relate after taking account of the probability of performance criteria being met. In the year, £nil was charged to the profit and loss account (2011: £0.1m).
5. Details of the performance conditions are shown in Note 11(iv) of Section B – regulatory accounts which, is incorporated by reference into these statutory financial statements.
6. The market price of the shares on 11 October 2011 was 464.40 pence per share.
7. Aggregate gross gains made by directors on exercise of awards at date of vesting was £1,805,587 (2011: £180,996).

Since the change of control, a new LTIP has been introduced, details of which can be found in note 11(v) of Section B – regulatory accounts which, is incorporated by reference into these statutory financial statements.

5. DIRECTORS' EMOLUMENTS (continued)

Share Incentive Plan
In previous years, NWG operated a Share Incentive Plan (the SIP) that provided one free matching share for every three shares purchased by an employee. The SIP closed in October 2011 following the change of control of NWG.

The directors who held office as at 31 March 2012 held the following interests in the ordinary 10p shares of NWG, purchased and held in accordance with the terms of the SIP:

Name of Director	Number of SIP shares held at the start of the year	Number of SIP shares held as at 31 March 2012
H Mottram	606	-
C M Green	6,372	-
A C Jones	6,372	-
G Neave	590	-

Aggregate gross gains made by directors during the year was £70,066.

(b) **Highest paid director**

The amounts for remuneration shown in note 5(a) include the following in respect of the highest paid director:

	2012	2011
	£'000	£'000
Emoluments (including benefits in kind)	461.1	399.4

In 2011/12, the highest paid director was a member of the defined contribution scheme and the payments made to that scheme of £44.9k (2011: £30.5k) are included within the emoluments figure above.

6. TRANSACTIONS WITH DIRECTORS AND OFFICERS

No transactions or arrangements with Directors and Officers which are disclosable under the provisions of the Companies Act 2006 have occurred during the year.

7. EMPLOYEE INFORMATION

The total employment costs of all employees (including directors) were as follows:

	2012	2011
	£'m	£'m
Gross costs charged to the profit and loss account:		
Wages and salaries	64.9	62.9
Social security costs	5.6	5.2
Other pensions costs	10.4	11.5
	80.9	79.6
Costs recharged to other Group companies:		
Wages and salaries	2.3	2.0
Social security costs	0.2	0.2
Other pensions costs	0.4	0.3
	2.9	2.5
Net costs charged to the profit and loss account:		
Wages and salaries	62.6	60.9
Social security costs	5.4	5.0
Other pensions costs	10.0	11.2
	78.0	77.1
Costs charged to capital schemes and infrastructure renewals:		
Wages and salaries	22.7	20.2
Social security costs	1.9	1.7
Other pensions costs	3.7	3.5
	28.3	25.4
Total net employee costs	106.3	102.5

The average monthly number of employees on the payroll during the financial year was 2,894 (2011: 2,875) and the total at the year end was 2,933 (2011: 2,866).

8. TAXATION

(a) Analysis of tax charge for the financial year:

	2012	2011
	£'m	£'m
Current tax:		
UK corporation tax on profits for the year at 26% (2011: 28%)	17.5	41.5
Adjustments in respect of prior years	(1.2)	(9.4)
Payable in respect of group relief for the current year at 26% (2011: 28%)	19.9	3.6
Adjustments in respect of prior years	1.1	(0.1)
Total current tax charge (note 8b)	37.3	35.6
Deferred tax:		
Reduction due to opening tax rate change	(32.8)	(31.8)
Decrease in discount arising from above rate change	14.8	13.1
Net reduction in opening deferred tax	(18.0)	(18.7)
Movement in the year at 24% (2011: 26%):		
Origination and reversal of timing differences in the year	19.2	6.2
Adjustments in respect of prior periods	0.9	6.9
	20.1	13.1
Decrease / (increase) in discount arising from current year movements	31.8	(3.1)
Movement in the year (note 21)	51.9	10.0
Total deferred tax charge / (credit) (note 21)	33.9	(8.7)
Tax on profit on ordinary activities	71.2	26.9

The rate of UK corporation tax was reduced from 26% to 24% on the passing of a resolution under the Provisional Collection of Taxes Act 1968 on 26 March 2012 at which point the new rate was substantively enacted. As a result, deferred tax was restated as at 1 April 2011 at the rate at which timing differences are expected to reverse.

Tax losses have provisionally been claimed from other Group companies in the current year of £73.4m (2011: £9.8m) for which payment will be made at the rate of 26% (2011: 28%). Further payments are due to Group companies of £0.8m (2011: £0.9m) in respect of UK:UK transfer pricing adjustments.

Discount has fallen mainly due to the impact of the opening reduction in the corporation tax rate and significant reduction in gilt rates.

8. TAXATION (continued)

(b) Reconciliation of the current tax charge:

	2012	2011
	£'m	£'m
Profit on ordinary activities before tax	214.3	179.6
Profit on ordinary activities multiplied by standard rate of corporation tax of 26% (2011: 28%)	55.7	50.3
Effects at 26% (2011: 28%) of:		
Expenses not deductible for tax purposes	0.2	0.1
Non-taxable income and other tax reliefs	(2.7)	(2.1)
Depreciation in respect of non-qualifying items	5.0	5.2
Industrial buildings allowances claimed in the year	-	(1.7)
Accelerated tax depreciation	(8.2)	(8.5)
Pension deficit	(11.8)	(3.5)
Other timing differences	(0.8)	5.3
Adjustments in respect of prior periods	(0.1)	(9.5)
Transfer pricing adjustments	(0.8)	(0.9)
Balancing payment payable	0.8	0.9
Total current tax charge (note 8a)	37.3	35.6

(c) Factors that may affect future tax charges:

The government has stated its intention to reduce the UK rate of corporation tax by a further 1% per annum until it reaches 22% on 1 April 2014. Had that rate applied in 2011/12 the closing deferred tax liability would have been reduced by £20.7m to £187.2m and the current year's corporation tax charge would have been reduced by £5.8m to £31.6m.

The Company expects to continue to incur high levels of capital expenditure during the remainder of the 2010-15 regulatory review period which, under current tax legislation, should result in claims for tax reliefs in excess of depreciation. However, it is expected that capital allowances will be claimed at a slower rate in future due to reduced capital allowance rates.

Deferred tax is provided on a discounted basis using post-tax yields on UK government gilts. The charge for deferred tax will, therefore, be influenced by future fluctuations in gilt rates.

9. DIVIDENDS

	2012	2011
	£'m	£'m
Equity:		
Dividends paid:		
Final paid for the year ended 31 March 2010 of 35.75p (2009: 34.64p paid in year ended 31 March 2010) per share on an aggregated basis	43.8	-
Interim paid for the year ended 31 March 2011 of 37.75p (2010: 35.43p proposed and paid in year ended 31 March 2010) per share on an aggregated basis	46.3	-
Special dividend paid for the year ended 31 March 2012 of 189.16p (2011: nil) per share on an aggregated basis	232.0	-
Final paid for the year ended 31 March 2011 of 38.05p (2010: 35.75p paid in year ended 31 March 2012) per share on an aggregated basis	46.7	-
Total dividends paid in the year	368.8	-
Dividends proposed:		
Interim proposed for the year ended 31 March 2012 of 80.61p (2011: 37.75p) per share on an aggregated basis	98.9	46.3
Final proposed for the year ended 31 March 2012 of nil (2011: 38.05p) per share on an aggregated basis	-	46.7
	98.9	93.0

The directors have a policy which, unless circumstances dictate otherwise, aims to grow dividends on a slow but regular basis and which takes into account the principle of incentive based price cap regulation, including operating and investment performance.

Excluding the special dividend which was paid during the year, following the change of control, the Company has applied a dividend policy of steady real growth of 2.1% per annum for the appointed business dividend with estimated inflation for the year ended 31 March 2012 of 4.77%. Dividends from the non-appointed business are determined by the directors and are based on performance.

Accordingly, the level of dividend has been declared by reference to:

- the Company’s ability to finance its functions;
- the Company’s cumulative financial performance and past outperformance; and
- maintaining the Company’s stable investment grade credit ratings.

10. TANGIBLE FIXED ASSETS

	Freehold land and buildings	Infrastructure assets	Operational structures, plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 April 2011	120.9	2,065.2	2,240.0	183.0	154.1	4,763.2
Additions	-	-	-	-	292.8	292.8
Schemes commissioned	0.5	119.8	92.9	11.6	(224.8)	-
Reclassifications	-	(0.1)	0.1	-	-	-
Disposals	-	(7.5)	(2.2)	-	-	(9.7)
At 31 March 2012	121.4	2,177.4	2,330.8	194.6	222.1	5,046.3
Depreciation:						
At 1 April 2011	38.0	367.1	759.4	132.2	-	1,296.7
Charge for the year	2.3	45.2	71.1	10.3	-	128.9
Disposals	-	(7.5)	(2.1)	-	-	(9.6)
At 31 March 2012	40.3	404.8	828.4	142.5	-	1,416.0
Net book value:						
At 31 March 2012	81.1	1,772.6	1,502.4	52.1	222.1	3,630.3
At 31 March 2011	82.9	1,698.1	1,480.6	50.8	154.1	3,466.5
Leased assets included above:						
Net book value:						
At 31 March 2012	-	46.8	21.8	-	-	68.6
At 31 March 2011	-	47.3	22.0	-	-	69.3

11. FIXED ASSET INVESTMENTS

	Loans to Group companies
	£'m
At 1 April 2011 and 31 March 2012	160.9

In May 2004, NWL made a loan of £159.0m to Northumbrian Services Limited (NSL), maturing in January 2034.

In May 2004, NWL made a loan of £1.5m to Bakethin Holdings Limited, a quasi-subsidiary company, maturing in January 2034**.** The interest on the loan is capitalised and at 31 March 2012 the balance was £1.9m (2011: £1.9m).

The Company has a wholly owned subsidiary undertaking, Northumbrian Water Finance plc (NWF), whose principal activity is to hold certain finance instruments on behalf of the Company.

The Company has a wholly owned subsidiary undertaking, Reiver Holdings Limited, which in turn has a wholly owned subsidiary, Reiver Finance Limited, whose principal activity is as a sole special purpose financing vehicle.

12. STOCKS

	2012	2011
	£'m	£'m
Raw materials and consumables	2.7	2.8

There is no material difference between the balance sheet value of stocks and their replacement cost.

13. DEBTORS DUE IN LESS THAN ONE YEAR

	2012	2011
	£'m	£'m
Trade debtors	79.1	71.5
Corporation tax repayable	11.9	-
Amounts owed by other Group companies	4.2	4.2
Other debtors	6.6	8.0
Prepayments and accrued income	60.8	54.7
	162.6	138.4

Trade debtors are shown net of bills raised in advance.

14. DEBTORS DUE IN MORE THAN ONE YEAR

	2012	2011
	£'m	£'m
Loan facility prepayments	4.9	3.1

15. INVESTMENTS

	2012	2011
	£'m	£'m
Short term deposits	80.0	116.9

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2012	2011
	£'m	£'m
Obligations under finance leases (note 19)	7.2	7.2
Loans (note 18)	73.9	23.1
Trade creditors	8.6	11.8
Amounts owed to other Group companies	20.3	9.9
Taxation and social security	2.4	2.3
Corporation tax	-	2.1
Other creditors	11.2	11.6
Receipts in advance	22.6	19.1
Accruals and deferred income	106.6	94.3
	252.8	181.4

Accruals and deferred income includes accruals related to capital projects of £41.0m (2011: £35.1m).

Included in amounts owed to other Group companies is £18.8m (2011: £8.2m) payable in respect of tax losses surrendered from fellow Group companies.

17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2012	2011
	£'m	£'m
Obligations under finance leases (note 19)	104.4	103.5
Loans (note 18)	297.8	321.7
Amounts owed to other Group companies (note 20)	1,836.6	1,473.7
Other creditors	0.3	0.2
	2,239.1	1,899.1

18. LOANS

	2012	2011
	£'m	£'m
Loans are repayable as follows:		
Within one year (note 16)	73.9	23.1
Between one and two years	28.7	73.9
Between two and five years	96.0	86.7
After five years	173.1	161.1
	371.7	344.8

Loans wholly repayable within 5 years amount to £45.5m (2011: £50.2m).

Loans not wholly repayable within 5 years amount to £326.2m (2011: £294.6m) and bear interest rates in the range 1.24% to 7.27%.

At 31 March 2012, the fair value loss on the Company's outstanding interest rate swaps was £15.1m (2011: £9.3m).

19. OBLIGATIONS UNDER FINANCE LEASES

Obligations under hire purchase contracts and finance leases are as follows:

	2012	2011
	£'m	£'m
Amounts due:		
Within one year	7.2	7.2
Between one and two years	6.6	6.5
Between two and five years	17.8	17.0
After five years	147.5	151.6
	179.1	182.3
Less:		
Finance charge allocated to future periods	(67.5)	(71.6)
	111.6	110.7
Disclosed as due:		
Within one year (note 16)	7.2	7.2
After more than one year (note 17)	104.4	103.5
	111.6	110.7

The aggregate gross amount of obligations under hire purchase contracts and finance leases, any part of which falls due for repayment in five years or more, is £179.1m (2011: £182.3m).

20. AMOUNTS DUE TO OTHER GROUP COMPANIES

Amounts due to other Group companies include loans repayable as follows:

	2012	2011
	£'m	£'m
After five years	1,836.6	1,473.7

NWF issued £200.0m and £150.0m Guaranteed Eurobonds in February 1998 and September 2001 respectively, maturing February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £194.2m and £163.2m respectively. Finance costs allocated during the year amounted to £0.2m (2011: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2011: £0.3m).

NWF issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £301.0m. Amortisation of loan receipts during the year amounted to £0.1m (2011: £0.1m).

NWF issued £250.0m and £100.0m Guaranteed Eurobonds in December 2002 and December 2004, maturing April 2033 with an annual coupon of 5.625%. Both issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £246.6m and £100.8m respectively. Finance costs allocated during the year amounted to £0.2m (2011: £0.2m).

NWF issued £150.0m Guaranteed Index Linked Eurobonds in September 2005, maturing July 2036, with a real coupon of 2.033%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £150.0m. Indexation accretion during the year amounted to £8.8m (2011: £8.1m).

NWF issued £60.0m Guaranteed Index Linked Eurobonds in January 2006, maturing January 2041, with a real coupon of 1.6274%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £60.0m. Indexation accretion during the year amounted to £3.5m (2011: £3.2m).

NWF issued two £100.0m Guaranteed Index Linked Eurobonds in June 2006 with real coupons of 1.7118% and 1.7484% and with maturities of 2049 and 2053 respectively. Both issues were guaranteed by the Company who received the issue proceeds by way of two inter-company loans of £100.0m. Indexation accretion during the year amounted to £11.5m (2011: £10.6m).

NWF issued £360.0m Guaranteed Eurobonds in January 2012, maturing January 2042, with an annual coupon of 5.125%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £338.8m. Finance Costs allocated during the year amounted to £0.2m (2011: £nil).

21. PROVISIONS FOR LIABILITIES AND CHARGES

	£'m
Pension provision for former employees:	
At 1 April 2011	2.6
Utilised during the year	(0.2)
At 31 March 2012	2.4
Deferred tax:	
At 1 April 2011	204.8
Total movement in the year (note 8a)	33.9
Included above relating to pensions (note 26)	(10.6)
At 31 March 2012	228.1
Provisions for liabilities and charges	230.5

The pension provision for former employees relates to pensions payable mainly to former employees of water-only companies which have since merged with the Company. The provision of £2.4m represents the full future amounts payable, based on an actuarial assessment, for which the Company is directly liable.

The provision for deferred tax comprises:

	2012	2011
	£'m	£'m
Accelerated depreciation	445.5	474.7
Other timing differences	(47.0)	(51.9)
Held-over gains	1.0	-
Undiscounted provision for deferred tax	399.5	422.8
Discount	(171.4)	(218.0)
Discounted provision for deferred tax	228.1	204.8

22. ACCRUALS AND DEFERRED INCOME

	Gilt lock	Capital grants and contributions	Proceeds from Kielder securitisation	Total
	£'m	£'m	£'m	£'m
At 1 April 2011	0.5	222.4	163.2	386.1
Additions	-	9.9	-	9.9
Amortised / transferred during the year	-	(4.8)	(7.1)	(11.9)
At 31 March 2012	0.5	227.5	156.1	384.1

The Kielder securitisation involved the assignment of the right to the future income stream associated with the Kielder operating contract to Reiver Finance Limited, a subsidiary company, up to 2034 in return for consideration of £212.1m. This income is amortised to the profit and loss account of the Company over the life of the assignment.

In 2006/07, the Company entered into a hedging instrument in order to protect the Company against movement in real interest rates prior to the launch of the two £100m index linked bonds issued in June 2006. The bonds were priced on 24 May 2006 and the hedging instrument was liquidated on the same day resulting in a gain of £0.5m. This income is amortised to the profit and loss account of the Company over the life of the bonds.

23. CALLED UP SHARE CAPITAL

	2012	2011
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2011: 122,650,000)	122.7	122.7

	2012	2011
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2011: 122,650,000)	122.7	122.7

24. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS AND MOVEMENT ON RESERVES

	Profit and loss account	Total shareholders' funds
	£'m	£'m
At 31 March 2011	1,064.2	1,186.9
Profit for the year	143.1	143.1
Actuarial loss on pension liability in the year (note 26)	(83.5)	(83.5)
Deferred tax related to actuarial gain on pension liability in the year (note 26)	18.8	18.8
Dividends paid (note 9)	(368.8)	(368.8)
At 31 March 2012	773.8	896.5

25. COMMITMENTS

(a) Capital expenditure:

	2012	2011
	£'m	£'m
Expenditure contracted but not provided for	99.8	222.3

(b) Lease commitments:
The Company has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The total amount payable under these leases in the next year is as follows:

	2012	2011
	£'m	£'m
Land and buildings:		
Leases which expire:		
After one year but not more than five	0.1	0.1
In five years or more	0.5	0.5
	0.6	0.6

	2012	2011
	£'m	£'m
Other:		
Leases which expire:		
Between two and five years	0.1	0.1

26. PENSIONS

NWL participates in the Group defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 1,830 active members at 31 March 2012 (2011: 1,908).

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

The most recent actuarial valuation of the NWPS was at 31 December 2010. At that date the value of assets amounted to £680.1m and the funding level was 84.7%.

The future service contribution rate jointly payable by members and the employers from 31 December 2010 was 24.2% of pensionable salaries. Members’ contributions are 7.3% on average with the employers paying 16.9%.

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

Pre-retirement discount rate	5.8%
Post-retirement discount rate	4.9%
Pay increases	3.85%
Price inflation (RPI)	3.6%
Price inflation (CPI)	2.9%
Pension increases linked to RPI	3.6%
Pension increases linked to CPI	2.9%

26. PENSIONS (continued)

With the agreement of the NWPS Trustee, the employers have made capital contributions of £70.0m to cover the period 1 January 2011 to 31 March 2015. These payments comprise employers' contributions, the deficit recovery funding assumed in the final determination and employees contributions under a salary sacrifice arrangement. Amounts totalling £22.9m were paid prior to 31 March 2011 with the remaining £47.1m paid in the current period. Further payments of £3.1m relating to early retirements were paid in the period bringing total contributions to £50.2m. Contributions for the next financial period, to 31 December 2012, are expected to be £0.4m, relating to early retirements.

The scheme also has a defined contribution section which had 542 active members at 31 March 2012 (2011: 460). Members can choose to contribute either 3%, 4% or 5% of salary, with employers contributing at either 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Company in the year totalled £0.9m (2011: £0.8m).

NWPS is a multi-employer scheme and it is not possible to separately identify the Company's share of the net assets and liabilities. However, as more than 99% of the active members of the scheme are employed by the Company, the full costs, assets and liabilities of the scheme have been recognised in the financial statements.

The additional disclosures regarding the defined benefit scheme as required under FRS 17 'Retirement benefits' and the relevant impact on the financial statements are set out below.

A qualified actuary, using revised assumptions that are consistent with the requirements of FRS 17, has updated the actuarial valuation described above as at 31 March 2012. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions:	2012	2011
Discount rate	4.8%	5.5%
Pay increases[1]	3.85%	4.5%
Price inflation (RPI)	3.2%	3.5%
Price inflation (CPI)	2.5%	2.8%
Pension increases linked to RPI	3.2%	3.5%
Pension increases linked to CPI	2.5%	2.8%
Mortality assumptions[2]	PCMA/PCFA00	PCMA/PCFA00
- Life expectancy for a member aged 65 - female (years)	24.3	23.00
- Life expectancy for a member aged 65 - male (years)	22.0	20.70

1. including promotional salary scale
2. 115% of PCMA00/PCFA00 (year of birth with medium cohort improvements).

26. PENSIONS (continued)

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

	Long term expected rate of return 2012	2012	Long term expected rate of return 2011	2011
	%	£'m	%	£'m
Equities	6.3	441.8	7.3	511.8
Corporate bonds	4.8	128.1	5.5	62.1
Government bonds	3.3	80.4	4.3	63.9
Property	4.8	76.0	5.8	71.6
Cash	2.5	12.0	3.8	3.9
Total fair value of assets		738.3		713.3
Present value of liabilities		(822.4)		(759.3)
Deficit under FRS17		(84.1)		(46.0)
Related deferred tax[1]		20.2		12.0
Net pension liability		(63.9)		(34.0)

1. The movement in deferred tax of £8.2m comprises a reduction of £1.2m to reflect the 2% cut in the rate of UK corporation tax and an increase of £20.0m relating to the actuarial loss in the year, which are both recognised as charges in the statement of total recognised gains and losses, and a reduction of £10.6m relating to other items which are recognised as a charge in the profit and loss account.

26. PENSIONS (continued)

Analysis of the amount that has been charged to the profit and loss account under FRS 17:

	2012	2011
	£'m	£'m
Current service cost	12.5	13.5
Past service cost	0.3	0.4
Recognised in operating costs in arriving at operating profit	12.8	13.9

	2012	2011
	£'m	£'m
Interest cost on plan obligations	41.3	43.3
Expected return on plan assets	(49.3)	(45.5)
Recognised in net interest receivable (note 4)	(8.0)	(2.2)

Analysis of the actuarial (loss) / gain that has been recognised in the statement of total recognised gains and losses:

	2012	2011
	£'m	£'m
Net actuarial (loss) / gain by NWL	(83.5)	74.4
Cash paid by other group company	-	(0.4)
Net actuarial (loss) / gain to the overall scheme	(83.5)	74.0
Cumulative amounts recognised since adopting the standard	(89.6)	(6.1)

History of experience gains and losses:

	2012	2011	2010	2009	2008
Fair value of assets	738.3	713.3	663.4	478.6	666.7
Present value of defined benefit obligation	(822.4)	(759.3)	(796.5)	(598.0)	(576.3)
(Deficit) / surplus	(84.1)	(46.0)	(133.1)	(119.4)	90.4
Experience adjustments arising on plan assets	(42.2)	10.7	177.4	(205.3)	(93.4)
Experience adjustments arising on plan liabilities	31.0	-	-	18.7	0.6

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

	2012	2011
	£'m	£'m
At 1 April	759.3	796.5
Current service cost	12.5	13.5
Past service cost	0.3	0.4
Interest cost	41.3	43.3
Contributions by plan participants	0.1	0.1
Actuarial losses / (gains) on obligations	41.3	(63.3)
Benefits paid	(32.4)	(31.2)
At 31 March	822.4	759.3

26. PENSIONS (continued)

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

	2012	2011
	£'m	£'m
At 1 April	713.3	663.4
Expected return on plan assets	49.3	45.5
Actuarial (losses) / gains on plan assets	(42.2)	10.7
Contributions by employer	50.2	24.8
Contributions by plan participants	0.1	0.1
Benefits paid	(32.4)	(31.2)
At 31 March	738.3	713.3

Sensitivity to key assumptions:
FRS 17 encourages disclosure of the sensitivity of the results to the methods and assumptions used.

The costs of a pension arrangement require estimates regarding future experience. The financial assumptions used for FRS 17 reporting are the responsibility of the directors of the Company. These assumptions reflect market conditions at the balance sheet date. Changes in market conditions which result in changes in the net discount rate (essentially the difference between the discount rate and the assumed rates of increases of salaries, deferred pension revaluation or pensions in payment), can have a significant effect on the value of the liabilities reported.

A reduction in the net discount rate will increase the assessed value of liabilities, as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have an opposite effect of similar magnitude. The overall effect of a change in the net discount rate of 0.1% would change the liabilities by around £14.0m.

There is also uncertainty around life expectancy for the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment. The disclosures have been prepared using the mortality assumptions basis used in the 2010 formal valuation. Specifically, the post-retirement mortality assumptions use a base table of 115% of PCMA00/PCFA00 with an allowance for future improvements in line with the medium cohort projections, lagged to apply 10 years later, based on each individual's year of birth. This is subject to a minimum improvement of 1.0% per annum.

These assumptions imply an assumed life expectancy for a member aged 65 at 31 March 2012 of 22.0 years (2010: 20.7 years) for males and 24.3 years (2010: 23.0 years) for females. The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around £25.0m (3.0%).

27. SHARE INCENTIVE PLANS

(a) Long Term Incentive Plan (LTIP)
Prior to the change of control, 14 October 2011, NWG ran a share based LTIP. Accordingly, the accounting treatment is only relevant up to this date and was not in place at the balance sheet date.

Under the LTIP, executive directors and senior managers received, at the discretion of the Remuneration Committee, annual conditional awards of shares in NWG. Further details of the LTIP can be found in note 5.

The following table illustrates the movements in conditional share awards during the year.

	March 2012 Number	March 2011 Number
Outstanding at 1 April	1,120,941	1,242,293
Granted during the year	-	378,503
Forfeited/lapsed during the year	(340,222)	(351,299)
Exercised	(780,719)	(148,556)
Outstanding at 31 March	-	1,120,941
Exercisable at 31 March	-	4,649

The weighted average exercise price throughout the year was £nil (2011: £nil). The fair value of conditional share awards granted during the year was £nil (2011: £nil).

The weighted average share price at the date of exercise for the conditional share awards was 465.00 pence (2011: 324.79 pence).

No conditional awards were outstanding as at 31 March 2012, the weighted average remaining contractual as at 31 March 2011, was 1.8 years.

The fair value of conditional share awards granted was estimated using the Monte-Carlo model. The significant inputs to the model were as follows:

	March 2012	March 2011
Dividend yield	-	4.7%
Expected share price volatility	-	29%
Share price at award	-	272.50p
Expected FTSE 250 index volatility	-	24%
Risk free interest rate %	-	2.1%
Expected life of option (years)	-	3

The expected life of these options was based on historical data and was not necessarily indicative of exercise patterns that may have occurred. The expected volatility reflects the assumption that the historical volatility was indicative of future trends, which was not necessarily the actual outcome.

27. SHARE INCENTIVE PLANS (continued)

(b) Share Incentive Plan (SIP)
Prior to the change of control, 14 October 2011, NWG ran a SIP. Accordingly, the accounting treatment is only relevant up to this date and was not in place at the balance sheet date.

The NWG SIP scheme provided one free matching share for every three shares purchased by an employee. Shares for the SIP were purchased at market price by the Trustee and dividends were paid in cash directly to participants.

The following table illustrates the movements in conditional share awards during the year for the NWG scheme. The costs of the scheme were apportioned to the participating subsidiary companies and the Company reports only the relevant proportion of scheme cost.

	March 2012 Number	March 2011 Number
Outstanding at 1 April	160,182	143,201
Granted during the year	150,596	115,519
Forfeited during the year	(1,497)	(3,383)
Exercised	(309,281)	(95,155)
Outstanding at 31 March	-	160,182

28. RELATED PARTY DISCLOSURES

The Company is ultimately a wholly owned subsidiary of UK Water (2011) Limited (‘UKW’), whose publicly available consolidated financial statements will include the Company. Accordingly, the Company is exempt under the terms of FRS 8 “Related Party Disclosures” from disclosing transactions with other members of the Group headed by UKW.

29. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The company’s immediate parent undertaking is Northumbrian Services Limited.

In the directors’ opinion, the Company’s ultimate parent undertaking and controlling party is UKW, which is incorporated in England and Wales. UKW acquired Northumbrian Water Group plc, the previous controlling party, on 14 October 2011. UKW is indirectly wholly owned by a consortium comprising Cheung Kong Infrastructure Holdings Limited, Cheung Kong (Holdings) Limited and Li Ka Shing Foundation Limited.

Copies of UKW’s group financial statements, which include the Company, will be available in due course from Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHUMBRIAN WATER LIMITED

We have audited the financial statements of Northumbrian Water Limited for the year ended 31 March 2012 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor
As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Paul Feechan (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Newcastle Upon Tyne, United Kingdom
11 July 2012

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2012

	Note	2012 Appointed business £'m	2012 Non-appointed business £'m	2012 Aggregated basis £'m	2011 Appointed business £'m	2011 Non-appointed business £'m	2011 Aggregated basis £'m
Turnover	2	702.5	26.6	729.1	655.2	25.7	680.9
Operating costs		(316.5)	(14.0)	(330.5)	(308.0)	(13.8)	(321.8)
Historical cost depreciation		(80.0)	(0.5)	(80.5)	(79.4)	(0.5)	(79.9)
Operating income		0.8	-	0.8	1.0	-	1.0
OPERATING PROFIT	A	306.8	12.1	318.9	268.8	11.4	280.2
Net interest (payable) / receivable		(116.2)	10.0	(106.2)	(111.9)	9.9	(102.0)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		190.6	22.1	212.7	156.9	21.3	178.2
Taxation - current		(33.5)	(3.8)	(37.3)	(31.5)	(4.1)	(35.6)
- deferred	A	(32.6)	(0.3)	(32.9)	11.5	(0.2)	11.3
PROFIT FOR THE FINANCIAL YEAR		124.5	18.0	142.5	136.9	17.0	153.9
Dividends		(358.3)	(10.5)	(368.8)	-	-	-
RETAINED (LOSS) / PROFIT FOR THE YEAR		(233.8)	7.5	(226.3)	136.9	17.0	153.9

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2012

	2012 Appointed business £'m	2012 Non-appointed business £'m	2012 Aggregated basis £'m	2011 Appointed business £'m	2011 Non-appointed business £'m	2011 Aggregated basis £'m
Profit for the financial year	124.5	18.0	142.5	136.9	17.0	153.9
Pension liability actuarial (loss) / gain in the year	(82.0)	(1.2)	(83.2)	72.1	1.2	73.3
Deferred tax related to pension adjustments	18.5	0.3	18.8	(21.4)	(0.3)	(21.7)
Total recognised gains and losses relating to the year	61.0	17.1	78.1	187.6	17.9	205.5

HISTORICAL COST BALANCE SHEET
at 31 March 2012

		2012			2011		
	Note	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	A	3,300.1	100.2	3,400.3	3,158.3	100.0	3,258.3
Investments - loans to Group companies		-	160.9	160.9	-	160.9	160.9
		3,300.1	261.1	3,561.2	3,158.3	260.9	3,419.2
CURRENT ASSETS							
Stocks		2.3	0.3	2.6	2.5	0.3	2.8
Debtors		166.0	1.5	167.5	137.7	3.8	141.5
Cash		-	38.3	38.3	-	36.1	36.1
Short term deposits		80.0	-	80.0	116.9	-	116.9
TOTAL CURRENT ASSETS		248.3	40.1	288.4	257.1	40.2	297.3
CREDITORS: Amounts falling due within one year							
Overdrafts		(12.8)	-	(12.8)	(29.8)	-	(29.8)
Infrastructure renewals accrual		(4.1)	(1.9)	(6.0)	(18.8)	(1.9)	(20.7)
Creditors		(162.3)	(9.3)	(171.6)	(140.3)	(8.7)	(149.0)
Borrowings		(81.1)	-	(81.1)	(30.3)	-	(30.3)
Corporation tax payable		-	-	-	(1.4)	(0.7)	(2.1)
TOTAL CREDITORS		(260.3)	(11.2)	(271.5)	(220.6)	(11.3)	(231.9)
NET CURRENT (LIABILITIES) / ASSETS		(12.0)	28.9	16.9	36.5	28.9	65.4
TOTAL ASSETS LESS CURRENT LIABILITIES		3,288.1	290.0	3,578.1	3,194.8	289.8	3,484.6
CREDITORS: Amounts falling due after more than one year							
Borrowings		(2,238.8)	-	(2,238.8)	(1,898.9)	-	(1,898.9)
Other creditors		(0.3)	-	(0.3)	(0.2)	-	(0.2)
TOTAL CREDITORS		(2,239.1)	-	(2,239.1)	(1,899.1)	-	(1,899.1)
PROVISIONS FOR LIABILITIES AND CHARGES							
Deferred tax provision	A	(174.4)	(1.8)	(176.2)	(152.3)	(1.6)	(153.9)
Deferred income - grants and contributions	A	(53.6)	(1.1)	(54.7)	(54.1)	(1.0)	(55.1)
Post employment liability	A	(62.4)	(0.9)	(63.3)	(33.2)	(0.5)	(33.7)
Other provisions		(2.4)	-	(2.4)	(2.6)	-	(2.6)
Other deferred income		(0.5)	(156.1)	(156.6)	(0.5)	(163.2)	(163.7)
NET ASSETS EMPLOYED		755.7	130.1	885.8	1,053.0	123.5	1,176.5
CAPITAL AND RESERVES							
Called up share capital		92.1	30.6	122.7	92.1	30.6	122.7
Profit and loss account		663.6	99.5	763.1	960.9	92.9	1,053.8
CAPITAL AND RESERVES		755.7	130.1	885.8	1,053.0	123.5	1,176.5

Approved by the Board and signed on their behalf by:
H Mottram G Neave, 11 July 2012

(A) RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS
For the year ended 31 March 2012

In preparing its statutory accounts, the Company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS 15: Tangible Fixed Assets. However, for the purpose of the regulatory accounts, Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. In addition, Ofwat has decided to depart from UK GAAP and disapply the provisions of Note G of FRS 5, which states that turnover should not include amounts that the Company does not expect to collect. A reconciliation between the statutory and historical cost regulatory accounts is set out below:

	Statutory UK GAAP	Regulatory	Explanation of Difference
	£'m	£'m	
PROFIT AND LOSS ACCOUNT			
Turnover	730.6	729.1	Statutory accounts include provision for revenue recognition of £1.5m in accordance with Note G of FRS 5, which is disapplied for regulatory purposes (see note 1(c)).
Operating Profit	320.4	318.9	Adjustments relating to the amortisation of infrastructure income (£1.6m) (see note 1(a)(ii)) and additional charge in statutory accounts for VLS pension scheme (£0.1m).
Deferred tax credit	(33.9)	(32.9)	Adjustments relating to amortisation of infrastructure income (£0.1m), Section 19 'overlap' (£0.8m) and discount (£1.9m).
BALANCE SHEET			
Tangible fixed assets (net book value)	3,630.3	3,400.3	Adjustments relating to infrastructure grants and contributions netted off (£195.7m), Section 19 'overlap' (£40.3m) and infrastructure renewals provision (£6.1m).
Provisions for liabilities and charges - deferred tax	228.1	176.2	Adjustments relating to amortisation of infrastructure income (£5.1m), Section 19 'overlap' (£9.7m) and discount (£37.1m).
Deferred income - grants and contributions	227.5	54.7	Adjustments relating to gross up (£195.7m) and amortisation (£22.9m) of infrastructure grants and contributions.
Post employment liability	63.9	63.3	Adjustment relating to additional charge in statutory accounts for VLS pension scheme (£0.6m).

CURRENT COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2012

	Note	2012 £'m	2011 £'m
Turnover	2	702.5	655.2
Current cost operating costs	3	(471.7)	(456.1)
Operating income	2	(0.5)	1.3
Working capital adjustment	2	(1.2)	(1.6)
CURRENT COST OPERATING PROFIT		229.1	198.8
Net interest payable		(116.2)	(111.9)
Financing adjustment		51.9	83.2
CURRENT COST PROFIT BEFORE TAXATION		164.8	170.1
Taxation:			
Current tax		(33.5)	(31.5)
Deferred tax		(32.6)	11.5
CURRENT COST PROFIT ATTRIBUTABLE TO SHAREHOLDERS		98.7	150.1
Dividends		(358.3)	-
CURRENT COST (LOSS) / PROFIT RETAINED		(259.6)	150.1

All note references to the summary current cost financial statements refer to the notes to the current cost accounts on pages 66 to 86.

CURRENT COST BALANCE SHEET
at 31 March 2012

	Note	2012	2011
		£'m	£'m
FIXED ASSETS			
Tangible assets	4	22,148.1	15,495.3
Third party contributions since 1989/90		(6,247.4)	(233.1)
		15,900.7	15,262.2
Working capital	5	29.0	33.1
Short term deposits		80.0	116.9
Overdraft		(12.8)	(29.8)
Infrastructure renewals accrual		(4.1)	(18.8)
NET OPERATING ASSETS		15,992.8	15,363.6
NON-OPERATING ASSETS AND LIABILITIES			
Borrowings		(81.1)	(30.3)
Non-trade debtors		17.5	3.1
Non-trade creditors due within one year		(40.5)	(36.3)
Corporation tax payable		-	(1.4)
Total non-operating liabilities		(104.1)	(64.9)
CREDITORS:AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
Borrowings		(2,238.8)	(1,898.9)
Other creditors		(0.3)	(0.2)
Trade creditors due after more than one year		(2,239.1)	(1,899.1)
PROVISIONS FOR LIABILITIES AND CHARGES			
Deferred tax provision		(174.4)	(152.3)
Post employment liability		(62.4)	(33.2)
Other provisions		(2.4)	(2.6)
Total provisions		(239.2)	(188.1)
NET ASSETS		13,410.4	13,211.5
CAPITAL AND RESERVES			
Called up share capital		92.1	92.1
Profit and loss account		323.3	646.4
Current cost reserve	6	12,995.0	12,473.0
TOTAL CAPITAL AND RESERVES		13,410.4	13,211.5

CURRENT COST CASH FLOW STATEMENT
for the year ended 31 March 2012

	Note	2012			2011		
		Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
NET CASH FLOW FROM OPERATING ACTIVITIES	7	380.3	7.5	387.8	375.5	1.8	377.3
Returns on investment and servicing of finance							
Interest received		1.0	9.9	10.9	0.8	9.9	10.7
Interest paid		(96.8)	-	(96.8)	(88.1)	-	(88.1)
Interest in finance lease rentals		(4.6)	-	(4.6)	(4.5)	-	(4.5)
Net cash flow from returns on investments and servicing of finance		(100.4)	9.9	(90.5)	(91.8)	9.9	(81.9)
Taxation paid		(36.8)	(4.0)	(40.8)	(39.4)	(4.2)	(43.6)
Capital expenditure and financial investment							
Gross cost of purchase of fixed assets		(218.1)	(0.9)	(219.0)	(175.2)	(0.6)	(175.8)
Receipt of grants and contributions		9.6	0.3	9.9	10.9	0.1	11.0
Infrastructure renewals expenditure		(59.8)	(0.1)	(59.9)	(40.4)	(0.1)	(40.5)
Disposal of fixed assets		0.9	-	0.9	1.3	7.0	8.3
Net cash flow from investing activities		(267.4)	(0.7)	(268.1)	(203.4)	6.4	(197.0)
Equity dividends paid		(358.3)	(10.5)	(368.8)	-	-	-
Management of liquid resources							
Net cash flow from management of liquid resources		36.9	-	36.9	(28.7)	-	(28.7)
NET CASH (OUTFLOW) / INFLOW BEFORE FINANCING		(345.7)	2.2	(343.5)	12.2	13.9	26.1
Financing							
Capital element in finance lease rentals		(3.1)	-	(3.1)	(3.4)	-	(3.4)
New bank loans		410.0	-	410.0	-	-	-
Repayment of bank loans		(44.2)	-	(44.2)	(17.6)	-	(17.6)
Net cash outflow from financing		362.7	-	362.7	(21.0)	-	(21.0)
INCREASE / (DECREASE) IN CASH		17.0	2.2	19.2	(8.8)	13.9	5.1

NOTES TO THE REGULATORY ACCOUNTS
for the year ended 31 March 2012

1. STATEMENT OF REGULATORY ACCOUNTING POLICIES

(a) Historical cost information

The accounts have been prepared in accordance with regulatory accounting guidelines (RAGs) published by Ofwat.

The accounting policies set out on pages 33 to 36 apply to the historical cost regulatory financial information, with the exception of:

- capital grants and contributions to infrastructure assets which is not in accordance with the Companies Act 2006 (as described in (ii) below).
- infrastructure renewals accounting which, in accordance with RAG 3.06, has been accounted for in accordance with RAG 2.03, "Classification of Infrastructure Expenditure". RAG 2.03 is not in accordance with FRS 12, "Provisions, Contingent Liabilities and Contingent Assets" and FRS 15, "Tangible Fixed Assets" as described in section (i) below.
- recognition of income relating to energy generation as described in section 1(c) below.

(i) Infrastructure assets

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

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

Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost. No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and, therefore, has no finite economic life.

In accordance with RAG 3.06 the Company has not applied FRS 12 and FRS 15, in respect of infrastructure renewals accounting and has continued to charge infrastructure renewal costs (calculated in accordance with our Asset Management Plan (AMP)) to the profit and loss account. Expenditure during the year is charged to the provision.

Under FRS 12 it is not permitted to recognise a provision for the costs of renewals expenditure. Adoption of FRS 12, taken together with FRS 15, would require:

- restatement of the cost and accumulated depreciation of infrastructure fixed assets to reflect infrastructure renewals expenditure, depreciation and retirement of assets since renewals accounting was first adopted. Accordingly, infrastructure renewals provisions and prepayments at years ended 31 March 2011 and 31 March 2012 would have been included within infrastructure fixed assets.
- the depreciation of infrastructure assets and the inclusion of the infrastructure renewals charge as a component of the depreciation charge for the year.
- restatement of the cost of infrastructure fixed assets to reflect the treatment of Section 19 "overlap" expenditure. The objective of the Section 19 quality programme was to address water discolouration problems caused by iron pipes, either through relining those pipes or replacing them where relining is not possible. The "overlap" represents the extra cost of replacing pipes rather than relining them where their structural condition is insufficient to withstand the relining process. Such expenditure is included in the infrastructure renewals charge in the regulatory accounts. The statutory financial statements classify such expenditure as capital in nature and include this under infrastructure assets in the fixed asset note, resulting in a higher profit in the statutory financial statements.

1. STATEMENT OF REGULATORY ACCOUNTING POLICIES (continued)

(ii) Grants and contributions

Revenue grants are credited to the profit and loss account when received.

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets, in accordance with RAG 3.06. This is not in accordance with the Companies Act 2006 which requires fixed assets to be stated at their purchase price or production cost without deduction of grants and contributions which are accordingly accounted for as deferred income. The effect of the departure on the value of tangible fixed assets is disclosed in note (A). The statutory financial statements reflect grants and contributions as deferred income and amortise them to profit and loss account over the expected useful economic lives of the assets, resulting in a higher operating profit in the statutory financial statements.

Capital grants and contributions relating to other assets are treated as deferred income and amortised in the profit and loss account over the expected useful economic lives of the qualifying assets.

(b) Current cost information

The accounting policies used are the same as those adopted in the historical cost financial statements, except as set out below. This financial information has been prepared for the appointed business of NWL in accordance with guidance issued by Ofwat for modified real time 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.

(i) Tangible fixed assets

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

A process of continuing refinement of the AMP, based on serviceability, will result in adjustments to the existing valuation of assets at the end of the regulatory review period. In intervening years, values are restated to take account of changes in the general level of inflation as measured by changes in RPI over the year.

- **Land and Buildings**
  Non-specialised operational properties are valued on the basis of open market value for existing use. Specialised operational properties are valued at the lower of depreciated replacement cost and recoverable amount.

- **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.

- **Private drains and sewers**
  The transfer of ownership of private drains and sewers took place on 1 October 2011, where approximately 13,510km were transferred. To comply with the requirements of RAG 1.04, the Company has valued these assets on their replacement cost. These assets have been disclosed as fixed asset additions with a corresponding credit entry in 'Third party contributions since 1989/90'. In order to estimate the length of sewer and lateral drain that transferred on 1 October 2011, we have used a version of a model constructed by the UK Water Industry Research (UKWIR). This was populated with Company specific data in order to give greater accuracy and the value derived from using current contractor rates. This replacement cost will be reviewed as any new information becomes available.

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

- **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.

1. STATEMENT OF REGULATORY ACCOUNTING POLICIES (continued)

- **Grants and contributions**
  Grants and contributions are revalued to take account of changes in the general level of inflation as measured by changes in the RPI over the year.

(ii) Real financial capital maintenance adjustments

The real financial capital maintenance adjustments are calculated by applying depreciation to the current cost value of fixed assets.

(iii) Working capital adjustment

The working capital adjustment is calculated by applying the change in the RPI over the year to the opening balance of working capital.

(iv) Financing adjustment

The financing adjustment is calculated by applying the RPI change over the year to the opening balance of net finance which comprises all monetary assets and liabilities in the balance sheet except those included in working capital.

(c) Turnover recognition

The revenue recognition policy is the same in the regulatory and statutory accounts, with the exception of income relating to energy generation. As required by Ofwat in their reporting guidance, income relating to energy generation, which is recorded as turnover in the statutory accounts, is recorded as negative operating expenditure in the regulatory accounts.

Additional charges added to a customer’s account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as negative operating costs when payment is received in both the statutory and regulatory accounts.

All water and sewerage charges billed to customers are recognised pro-rata over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

Charges for water and sewerage services remain due in full whilst a property contains furnishings and fittings or when a property is unfurnished and water is being used for any purpose including refurbishment. If the Company has turned off the supply of water at the mains to a property at a customer’s request then water supply charges are not payable.

If the supply of water is turned off and the property is unfurnished the property is considered unoccupied and charges are not payable. If, however, the supply of water is turned off and the property remains furnished it is considered ready for occupation and in this case sewerage charges in respect of the drainage of surface water and contribution to highway drainage continue to be payable.

If a property is recorded as empty in the billing system an empty property process is followed. The purpose of this process is to verify whether the property is occupied or not and, if occupied, to identify the chargeable person and raise a bill. No bills are raised in the name of “the occupier”.

The empty property process comprises a number of steps including an initial letter asking the occupier to either contact the Company or return a completed registration form, a check of the property record against Land Registry information and visits to the property by Company representatives. If these steps confirm that a property appears to be empty then the supply may be turned off.

New properties are charged from the date a meter is installed, if consumption is being recorded on the meter. If the property is unoccupied but water is being registered the developer will be charged. Once the developer is no longer responsible for a property, if no new occupier has been identified the property will be treated as unoccupied and the empty property process followed, as outlined above.

2. ANALYSIS OF TURNOVER AND OPERATING INCOME FOR THE APPOINTED BUSINESS

	2012			2011		
	Water services	Sewerage services	Aggregated basis	Water services	Sewerage services	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Unmeasured household	212.8	159.4	372.2	199.2	148.1	347.3
Unmeasured non-household	2.6	4.2	6.8	1.9	5.2	7.1
Measured household	94.7	43.5	138.2	83.2	37.3	120.5
Measured non-household	63.8	59.6	123.4	61.4	56.1	117.5
Trade effluent	-	2.7	2.7	-	2.5	2.5
Large user and special agreements	26.5	20.2	46.7	26.4	20.0	46.4
Non-potable large user and special agreements	6.2	-	6.2	7.3	-	7.3
Rechargeable works	1.1	0.2	1.3	1.2	0.1	1.3
Bulk supplies/inter-company payments	0.6	-	0.6	0.7	-	0.7
Other appointed business (third party)	1.6	0.2	1.8	1.8	0.3	2.1
Other sources	2.2	0.4	2.6	2.0	0.5	2.5
Total turnover	412.1	290.4	702.5	385.1	270.1	655.2
Operating income:						
Current cost (loss) / profit on disposal of fixed assets	(0.6)	0.1	(0.5)	1.1	0.2	1.3
Working capital adjustment	(0.7)	(0.5)	(1.2)	(0.9)	(0.7)	(1.6)

3. OPERATING COSTS

Cost allocation methodology

The table below has been prepared in accordance with RAG 4.03, “Guideline for the analysis of operating costs and assets”. All costs are recorded in the general ledger by cost centre. Cost centres are defined as either direct departments, comprising operational and customer functions, or support departments. Direct departments are mostly directly allocated to service activities based on the nature of the function, although some costs require apportionment on an appropriate basis. Support departments are apportioned to direct departments either based upon a specific analysis of the costs or by apportionment by an appropriate cost driver. Once allocated to the direct departments the costs are then allocated to service activities pro-rata to the direct cost allocations of the direct department costs.

3. OPERATING COSTS (continued)

	Water service				
	Water resources	Raw water distribution	Water treatment	Treated water distribution	Water service total
	£'m	£'m	£'m	£'m	£'m
Direct costs					
Employment costs	3.1	0.1	8.6	9.4	21.2
Power	3.6	1.0	1.8	8.1	14.5
Hired & contracted services	1.1	0.1	2.9	9.4	13.5
Associated companies	0.1	-	0.4	1.4	1.9
Materials and consumables	0.7	-	7.3	1.4	9.4
Service charges	21.2	-	-	-	21.2
Bulk supply imports	1.9	-	-	-	1.9
Other direct costs	0.1	-	0.4	3.2	3.7
Total direct costs	**31.8**	**1.2**	**21.4**	**32.9**	**87.3**
Operational expenditure					
General and support expenditure	4.1	0.5	4.0	10.5	19.1
Scientific services	0.5	-	1.4	1.4	3.3
Other business activities	-	-	0.1	0.2	0.3
Total business activities	0.5	-	1.5	1.6	3.6
Local authority rates	-	-	20.4	-	20.4
Total opex less third party services	36.4	1.7	47.3	45.0	130.4
Third party services - opex	-	10.1	0.3	1.4	11.8
Total operating expenditure	**36.4**	**11.8**	**47.6**	**46.4**	**142.2**
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure	-	-	-	22.4	22.4
Reactive and planned maintenance non-infrastructure	1.3	0.2	5.4	2.5	9.4
Capital maintenance					
Infrastructure renewals charge	1.6	-	-	30.9	32.5
Current cost depreciation	5.6	2.4	33.6	25.1	66.7
Amortisation of deferred credits	-	-	(0.2)	(1.1)	(1.3)
Total capital maintenance	**7.2**	**2.4**	**33.4**	**54.9**	**97.9**
Total operating costs	**43.6**	**14.2**	**81.0**	**101.3**	**240.1**

3 OPERATING COSTS (continued)

	Sewerage service				
	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Sewerage service total
	£'m	£'m	£'m	£'m	£'m
Direct costs					
Employment costs	5.1	6.2	3.5	-	14.8
Power	3.1	7.5	(0.9)	-	9.7
Agencies	4.0	1.5	6.6	3.3	15.4
Hired & contracted services	0.3	0.3	0.7	-	1.3
Associated companies	0.5	1.3	4.2	-	6.0
Materials and consumables	1.1	1.4	-	-	2.5
Other direct costs	1.4	0.3	0.1	-	1.8
Total direct costs	**15.5**	**18.5**	**14.2**	**3.3**	**51.5**
Operational expenditure					
General and support expenditure	3.8	5.7	2.8	0.2	12.5
Scientific services	-	2.2	-	-	2.2
Other business activities	0.1	-	-	-	0.1
Total business activities	0.1	2.2	-	-	2.3
Local authority rates	0.2	7.6	-	-	7.8
Total opex less third party services	19.6	34.0	17.0	3.5	74.1
Third party services - opex	0.2	3.5	-	-	3.7
Total operating expenditure	**19.8**	**37.5**	**17.0**	**3.5**	**77.8**
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure	7.8	-	-	-	7.8
Reactive and planned maintenance non-infrastructure	2.2	4.6	0.9	-	7.7
Capital maintenance					
Infrastructure renewals charge	12.7	-	-	-	12.7
Current cost depreciation	11.1	50.5	15.1	0.1	76.8
Amortisation of deferred credits	(0.8)	(1.0)	-	-	(1.8)
Total capital maintenance	**23.0**	**49.5**	**15.1**	**0.1**	**87.7**
Total operating costs	**42.8**	**87.0**	**32.1**	**3.6**	**165.5**

3 OPERATING COSTS (continued)

	Retail Services				
	Retail household	Retail household general & support memo	Retail non-household	Retail non-household general & support memo	Retail services total
	£'m	£'m	£'m	£'m	£'m
Direct costs					
Billing	4.6	1.7	0.5	0.2	5.1
Payment handling, remittance and cash handling	0.8	0.3	-	-	0.8
Debt management	3.2	1.2	0.7	0.2	3.9
Doubtful debts	17.1	-	1.3	-	18.4
Non network customer enquiries and complaints	4.1	1.5	0.5	0.2	4.6
Meter reading	2.0	0.8	0.3	0.1	2.3
Meter maintenance/installation non capex	0.1	-	-	-	0.1
Network customer enquiries and complaints	0.8	0.3	0.1	-	0.9
Disconnections	-	-	0.4	0.1	0.4
Demand side water efficiency initiatives	1.4	0.5	0.1	-	1.5
Support for trade effluent compliance	-	-	0.1	0.1	0.1
Customer side leaks	2.6	1.0	-	-	2.6
Other direct costs	0.1	-	-	-	0.1
Total direct costs	**36.8**	**7.3**	**4.0**	**0.9**	**40.8**
Operational expenditure					
General and support expenditure	7.4		1.0		8.4
Scientific services	1.5		0.2		1.7
Other business activities	0.1		-		0.1
Total business activities	1.6		0.2		1.8
Local authority rates	0.2		-		0.2
Total opex less third party services	46.0		5.2		51.2
Third party services - opex	0.1		-		0.1
Total operating expenditure	**46.1**		**5.2**		**51.3**
Capital maintenance					
Current cost depreciation	13.2		1.6		14.8
Total capital maintenance	**13.2**		**1.6**		**14.8**
Total operating costs	**59.3**		**6.8**		**66.1**

4. TANGIBLE FIXED ASSETS

Water Services	**Water Resources**				**Raw Water Distribution**			
	Infrastructure assets	Operational assets	Other tangible assets	Subtotal	Infrastructure assets	Operational assets	Other tangible assets	Subtotal
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:								
At 1 April 2011	979.0	203.0	22.6	1,204.6	109.1	220.2	14.2	343.5
AMP adjustment	(7.3)	47.2	-	39.9	-	(20.8)	-	(20.8)
Reclassification adjustment	-	-	(0.8)	(0.8)	-	-	(10.4)	(10.4)
RPI adjustment	34.6	8.1	0.8	43.5	3.9	7.2	-	11.1
Disposals	-	-	(0.1)	(0.1)	-	-	-	-
Additions	45.0	7.5	1.8	54.3	0.4	-	0.1	0.5
At 31 March 2012	1,051.3	265.8	24.3	1,341.4	113.4	206.6	3.9	323.9
Depreciation:								
At 1 April 2011	-	95.0	9.9	104.9	-	63.9	6.9	70.8
AMP adjustment	-	(0.2)	(0.2)	(0.4)	-	-	-	-
AMP adjustment -gross MEA	-	-	(0.1)	(0.1)	-	-	-	-
AMP adjustment -amendment	-	(0.2)	(0.1)	(0.3)	-	-	-	-
Reclassification adjustment	-	-	0.4	0.4	-	-	(6.4)	(6.4)
RPI adjustment	-	2.6	0.3	2.9	-	1.8	-	1.8
Disposals	-	-	(0.1)	(0.1)	-	-	-	-
Charge for year	-	4.5	1.1	5.6	-	2.3	0.1	2.4
At 31 March 2012	-	101.9	11.4	113.3	-	68.0	0.6	68.6
Net book value at 31 March 2012	1,051.3	163.9	12.9	1,228.1	113.4	138.6	3.3	255.3
Net book value at 31 March 2011	979.0	108.0	12.7	1,099.7	109.1	156.3	7.3	272.7

	Water Treatment				**Treated Water Distribution**			
	Infrastructure assets	Operational assets	Other tangible assets	Subtotal	Infrastructure assets	Operational assets	Other tangible assets	Subtotal
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:								
At 1 April 2011	-	1,109.9	23.1	1,133.0	5,317.9	959.1	59.9	6,336.9
AMP adjustment	-	(1.4)	(2.4)	(3.8)	(28.5)	10.3	0.8	(17.4)
Reclassification adjustment	-	-	(1.9)	(1.9)	-	-	14.7	14.7
RPI adjustment	-	40.1	0.8	40.9	189.8	21.9	3.0	214.7
Disposals	-	(1.4)	(0.1)	(1.5)	-	(3.1)	(0.7)	(3.8)
Additions	-	18.1	1.8	19.9	18.8	14.3	8.3	41.4
At 31 March 2012	-	1,165.3	21.3	1,186.6	5,498.0	1,002.5	86.0	6,586.5
Depreciation:								
At 1 April 2011	-	541.9	10.9	552.8	-	427.1	24.0	451.1
AMP adjustment	-	(0.9)	(1.2)	(2.1)	-	(0.1)	(1.6)	(1.7)
AMP adjustment -gross MEA	-	-	(0.9)	(0.9)	-	-	(0.3)	(0.3)
AMP adjustment -amendment	-	(0.9)	(0.3)	(1.2)	-	(0.1)	(1.3)	(1.4)
Reclassification adjustment	-	-	(0.6)	(0.6)	-	-	8.3	8.3
RPI adjustment	-	18.7	0.4	19.1	-	9.3	1.1	10.4
Disposals	-	(1.3)	(0.1)	(1.4)	-	(2.3)	(0.6)	(2.9)
Charge for year	-	32.4	1.2	33.6	-	20.9	4.2	25.1
At 31 March 2012	-	590.8	10.6	601.4	-	454.9	35.4	490.3
Net book value at 31 March 2012	-	574.5	10.7	585.2	5,498.0	547.6	50.6	6,096.2
Net book value at 31 March 2011	-	568.0	12.2	580.2	5,317.9	532.0	35.9	5,885.8

4. TANGIBLE FIXED ASSETS (continued)

Sewerage Services

	Sewage Collection				Sewage Treatment			
	Infrastructure assets	Operational assets	Other tangible assets	Subtotal	Infrastructure assets	Operational assets	Other tangible assets	Subtotal
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:								
At 1 April 2011	6,026.8	324.7	15.0	6,366.5	150.4	1,769.0	24.5	1,943.9
AMP adjustment	7.3	1.9	1.1	10.3	-	2.5	(3.3)	(0.8)
Reclassification adjustment	-	-	2.4	2.4	(0.1)	-	0.7	0.6
RPI adjustment	215.1	9.8	0.7	225.6	5.4	63.5	1.0	69.9
Disposals	(0.2)	(0.1)	(0.2)	(0.5)	-	(0.7)	(0.2)	(0.9)
Additions	6,024.2	8.2	2.3	6,034.7	-	28.8	2.8	31.6
At 31 March 2012	12,273.2	344.5	21.3	12,639.0	155.7	1,863.1	25.5	2,044.3
Depreciation:								
At 1 April 2011	-	141.1	7.2	148.3	-	813.0	11.7	824.7
AMP adjustment	-	-	(0.2)	(0.2)	-	(1.3)	(1.6)	(2.9)
AMP adjustment -gross MEA	-	-	0.1	0.1	-	-	(1.2)	(1.2)
AMP adjustment -amendment	-	-	(0.3)	(0.3)	-	(1.3)	(0.4)	(1.7)
Reclassification adjustment	-	-	1.5	1.5	-	-	0.8	0.8
RPI adjustment	-	3.7	0.3	4.0	-	28.5	0.5	29.0
Disposals	-	-	(0.2)	(0.2)	-	(0.7)	(0.2)	(0.9)
Charge for year	-	9.9	1.1	11.0	-	48.9	1.7	50.6
At 31 March 2012	-	154.7	9.7	164.4	-	888.4	12.9	901.3
Net book value at 31 March 2012	12,273.2	189.8	11.6	12,474.6	155.7	974.7	12.6	1,143.0
Net book value at 31 March 2011	6,026.8	183.6	7.8	6,218.2	150.4	956.0	12.8	1,119.2

	Sludge Treatment				Sludge Disposal			
	Infrastructure assets	Operational assets	Other tangible assets	Subtotal	Infrastructure assets	Operational assets	Other tangible assets	Subtotal
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:								
At 1 April 2011	-	377.1	11.1	388.2	-	-	1.7	1.7
AMP adjustment	-	-	0.6	0.6	-	-	0.1	0.1
Reclassification adjustment	-	-	(1.4)	(1.4)	-	-	(0.5)	(0.5)
RPI adjustment	-	13.7	0.3	14.0	-	-	0.1	0.1
Additions	-	40.5	0.6	41.1	-	-	-	-
At 31 March 2012	-	431.3	11.2	442.5	-	-	1.4	1.4
Depreciation:								
At 1 April 2011	-	157.6	4.9	162.5	-	-	1.0	1.0
AMP adjustment -gross MEA	-	-	0.1	0.1	-	-	-	-
AMP adjustment -amendment	-	-	(0.1)	(0.1)	-	-	-	-
Reclassification adjustment	-	-	(0.4)	(0.4)	-	-	(0.3)	(0.3)
RPI adjustment	-	5.7	0.1	5.8	-	-	-	-
Disposals	-	-	(0.1)	(0.1)	-	-	-	-
Charge for year	-	14.5	0.6	15.1	-	-	0.1	0.1
At 31 March 2012	-	177.8	5.1	182.9	-	-	0.8	0.8
Net book value at 31 March 2012	-	253.5	6.1	259.6	-	-	0.6	0.6
Net book value at 31 March 2011	-	219.5	6.2	225.7	-	-	0.7	0.7

4. TANGIBLE FIXED ASSETS (continued)

Retail Services	**Retail Household**				**Retail Non-Household**			
	Infrastructure assets	Operational assets	Other tangible assets	Subtotal	Infrastructure assets	Operational assets	Other tangible assets	Subtotal
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:								
At 1 April 2011	-	147.3	50.1	197.4	-	24.1	8.3	32.4
AMP adjustment	-	15.6	(2.0)	13.6	-	0.1	(0.1)	-
Reclassification adjustment	-	(19.6)	20.2	0.6	-	(2.6)	(0.7)	(3.3)
RPI adjustment	-	4.9	2.5	7.4	-	0.7	0.2	0.9
Disposals	-	(0.6)	(0.2)	(0.8)	-	(0.2)	(0.1)	(0.3)
Additions	-	2.5	4.9	7.4	-	0.2	0.5	0.7
At 31 March 2012	-	150.1	75.5	225.6	-	22.3	8.1	30.4
Depreciation:								
At 1 April 2011	-	93.5	24.0	117.5	-	15.2	4.0	19.2
AMP adjustment	-	0.9	(2.0)	(1.1)	-	(0.3)	(0.2)	(0.5)
AMP adjustment -gross MEA	-	2.0	(0.7)	1.3	-	0.2	(0.1)	0.1
AMP adjustment -amendment	-	(1.1)	(1.3)	(2.4)	-	(0.5)	(0.1)	(0.6)
Reclassification adjustment	-	(16.3)	13.1	(3.2)	-	0.5	(0.6)	(0.1)
RPI adjustment	-	2.7	1.3	4.0	-	0.5	0.2	0.7
Disposals	-	(0.4)	(0.2)	(0.6)	-	(0.2)	-	(0.2)
Charge for year	-	9.4	3.8	13.2	-	1.2	0.4	1.6
At 31 March 2012	-	89.8	40.0	129.8	-	16.9	3.8	20.7
Net book value at 31 March 2012	-	60.3	35.5	95.8	-	5.4	4.3	9.7
Net book value at 31 March 2011	-	53.8	26.1	79.9	-	8.9	4.3	13.2

Meters (included in Retail services)	**Retail household**	**Retail non-household**	
	Meters	Meters	Sub-total
	£'m	£'m	£'m
Gross Replacement Cost:			
At 1 April 2011	134.2	21.8	156.0
Depreciation:			
At 1 April 2011	85.0	13.8	98.8
Charge for year	1.9	2.8	4.7
At 31 March 2012	86.9	16.6	103.5
Net book value at 31 March 2012	62.1	4.8	66.9
Net book value at 31 March 2011	49.2	8.0	57.2

4. TANGIBLE FIXED ASSETS (continued)

Total Fixed Assets	**Water**	**Sewerage**	**Retail**	**Total**
	£'m	£'m	£'m	£'m
Gross Replacement Cost:				
At 1 April 2011	9,018.0	8,700.3	229.8	17,948.1
AMP adjustment	(2.1)	10.2	13.6	21.7
Reclassification adjustment	1.6	1.1	(2.7)	(0.0)
RPI adjustment	310.2	309.6	8.3	628.1
Disposals	(5.4)	(1.4)	(1.1)	(7.9)
Additions	116.1	6,107.4	8.1	6,231.6
At 31 March 2012	9,438.4	15,127.2	256.0	24,821.6
Depreciation:				
At 1 April 2011	1,179.6	1,136.5	136.7	2,452.8
AMP adjustment	(4.2)	(3.1)	(1.6)	(8.9)
AMP adjustment -gross MEA	(1.3)	(1.0)	1.4	(0.9)
AMP adjustment -amendment	(2.9)	(2.1)	(3.0)	(8.0)
Reclassification adjustment	1.7	1.6	(3.3)	-
RPI adjustment	34.2	38.8	4.7	77.7
Disposals	(4.4)	(1.2)	(0.8)	(6.4)
Charge for year	66.7	76.8	14.8	158.3
At 31 March 2012	1,273.6	1,249.4	150.5	2,673.5
Net book value at 31 March 2012	8,164.8	13,877.8	105.5	22,148.1
Net book value at 31 March 2011	7,838.4	7,563.8	93.1	15,495.3

5. WORKING CAPITAL

	2012	2011
	£'m	£'m
Stocks	2.3	2.5
Trade debtors:		
-measured household	20.3	16.7
-unmeasured household	43.1	38.7
-measured non-household	9.6	9.6
-unmeasured non-household	0.6	0.4
-other	3.5	3.8
Measured income accrual	48.0	44.2
Prepayments and other debtors	23.4	21.2
Trade creditors	(8.4)	(11.6)
Deferred income - customer advance receipts	(18.3)	(15.1)
Capital creditors	(40.9)	(35.0)
Accruals and other creditors	(54.2)	(42.3)
Total working capital	29.0	33.1

6. MOVEMENT ON CURRENT COST RESERVE

	2012	2011
	£'m	£'m
At 1 April	12,473.0	11,220.8
AMP adjustment	30.6	570.2
RPI adjustments:		
-fixed assets	550.4	775.1
-working capital	1.2	1.6
-financing	(51.9)	(83.2)
-grants and third party contributions	(8.3)	(11.5)
At 31 March	12,995.0	12,473.0

7. RECONCILIATION OF CURRENT COST OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES FOR THE APPOINTED BUSINESS

	2012	2011
	£'m	£'m
Current cost operating profit	229.1	198.8
Working capital adjustment	1.2	1.6
Movement in working capital	(1.8)	(6.4)
Current cost depreciation (net of grant amortisation)	155.2	148.1
Current cost loss / (profit) on sale of fixed assets	0.5	(1.3)
Infrastructure renewals charge	45.2	43.2
Other non-cash profit and loss items	0.3	15.3
Advanced contributions in respect of retirement benefits	(49.4)	(23.8)
Net cash flow from operating activities	380.3	375.5

8. ANALYSIS OF NET DEBT FOR THE APPOINTED BUSINESS

	Interest rate risk profile			
	Fixed rate	Floating rate	Index linked	Total
	£'m	£'m	£'m	£'m
Maturity profile:				
Less than one year	31.1	45.5	-	76.6
Between one and two years	30.7	-	-	30.7
Between two and five years	99.6	-	-	99.6
Between five and twenty years	824.5	65.2	-	889.7
Over twenty years	684.5	37.7	501.1	1,223.3
Total borrowings	1,670.4	148.4	501.1	2,319.9
Overdraft				12.8
Short term deposits				(80.0)
Net debt at 31 March 2012				2,252.7

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

		December 2011 or March 2012		2011/12
Associate	Service	Turnover	Terms of Supply	Value
		£'m		£'m
Vehicle Lease and Service Limited (VLS)	Rental of garage and service charges	13.7	Negotiated	0.1

Services supplied to the appointee by associated companies:

		December 2011 or March 2012		2011/12
Associate	Service	Turnover	Terms of Supply	Value
		£'m		£'m
Northumbrian Water Group plc/ Limited	Holding company charges	5.8	No market	0.4
Three Rivers Insurance Company Limited	Public liability insurance (deductible infill policy)	0.4	No market	0.4
Vehicle Lease and Service Limited	Vehicle maintenance and capital finance charge	13.7	Competitive letting	7.4

Information in relation to allocations and apportionments

The appointed and non-appointed businesses operate separate accounting ledgers including sales and purchase ledgers. Turnover, operating costs, assets and liabilities are taken directly from these ledgers.

Turnover is separately recorded between water services and sewerage services and no apportionment has been necessary. Operating costs have been allocated between water and sewerage services in accordance with the guidance set out in RAG 4.03.

Overhead costs incurred in the appointed business which relate to the non-appointed business have been allocated using an activity based approach to comply with RAG 5.04.

Interest has been allocated between the appointed and non-appointed businesses on the basis of actual cash balances held by these businesses during the year at market rates. Capital costs and the related depreciation charges are specifically identifiable to the appropriate business and service.

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES (continued)

Amounts borrowed by the appointee from associated companies
The Company has loans amounting to £1,836.6m due to NWF, a subsidiary company. Details of these loans and the associated guarantees are provided in note 20 of the statutory financial statements.

The Company acquires vehicles from VLS, an associated company, on a finance lease basis. During the year, new finance leases of £3.6m were entered into and capital repayments of £3.1m were made. The year end finance lease creditor was £8.7m. All leases are at a fixed interest rate of 6%.

Guarantees or other forms of security
There were no guarantees or other forms of security provided by the appointee to any associate during the year, other than those relating to amounts borrowed from NWF, outlined above.

Dividends paid and proposed
During the year, the appointed business paid and proposed dividends to its immediate parent company, NSL, as follows;

	£'m
Dividends paid:	
Final paid for the year ended 31 March 2010	40.3
Interim paid for the year ended 31 March 2011	42.8
Final paid for the year ended 31 March 2011	43.2
Special paid for the year ended 31 March 2012	232.0
Total dividends paid in the year	358.3
Dividends proposed:	
Interim proposed for the year ended 31 March 2012	91.9
Final proposed for year ended 31 March 2012	-
Total dividend proposed for the year ended 31 March 2012	91.9

Excluding the special dividend, the Company has applied a dividend policy of steady real growth of 2.1% per annum with estimated inflation for the year ended 31 March 2012 of 4.77%.

Omission of right
There were no omissions by the appointee to exercise any rights which would cause the net assets to decrease.

Waivers
There were no waivers by the appointee of any consideration, remuneration or other payment owed to it by any associated company.

The information in this note has been produced to comply with the requirements of RAG 5.04, 'Transfer Pricing in the Water Industry' and the disclosures required by paragraph 6 of Condition F of the Company's operating licence.

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

10. REGULATORY CAPITAL VALUE AT 2011/12 PRICES

Data from the 2005-10 Final Determination	2011/12
	£'m
Closing Regulatory Value at 31 March 2011 (March 2011 prices)	3,318.5
RPI from March 2011 to March 2012 (3.6%)	118.4
Opening regulatory capital value at 1 April 2011	3,436.9
Infrastructure renewals expenditure (IRE)	64.8
Infrastructure renewals charge (IRC)	(50.3)
Capital expenditure (excluding IRE)	275.5
Grants and contributions	(12.0)
Current cost depreciation	(162.1)
Outperformance adjustment	(2.8)
Closing regulatory capital value at 31 March 2012	3,550.0
Year average regulatory capital value	3,442.7

The year average regulatory capital value is in the average year price base, all other figures are in the year end price base.

Differences between the above figures and actual capital expenditure, infrastructure renewals expenditure, infrastructure renewals charge, grants and contributions and current cost depreciation do not affect the price limits set for the period 2010-15. They will be taken into account in the calculation of outperformance adjustments at the Periodic Review in 2014.

The figures above are consistent with Appendix 4 of the Ofwat publication: "Future Water and Sewerage Charges 2010-15: Final Determinations".

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

The following statement on directors' remuneration is a requirement for the regulatory accounts in accordance with the Water Act 2003. This information is not required for statutory financial reporting purposes.

Up until the change of control on 14 October 2011, the directors' remuneration policy was set by NWL's Remuneration Committee in conjunction with the Remuneration Committee of the Company's then ultimate parent company, Northumbrian Water Group plc (NWG) and NWG's appointed recruitment consultants, Hewitt New Bridge Street (HNBS). Prior to the change of control, the Remuneration Committee of NWG determined the vesting percentage to be applied to the three remaining NWG LTIP awards made on 15 December 2008, 4 January 2010 and 8 December 2010, which vested on 11 October 2011. The remuneration policy prior to the change of control was that:

- the setting of base salaries was largely influenced by individual contributions and internal relativities rather than external comparators;
- the annual bonus plan recognised the interests of all of NWG's stakeholders (including shareholders, customers and employees) rather than being focused solely on profit; and
- management shared in the longer term value created for NWG's investors and were incentivised to maintain the stable serviceability of the Company's regulated assets.

Following the change of control, NWG was re-registered as a private limited company under the name Northumbrian Water Group Limited (NWGL or the Group) and all decisions regarding directors' remuneration are now taken solely by the NWGL Remuneration Committee (the Committee). During the year, the Committee:

- agreed bonuses for 2010/11; and
- set performance targets for executive directors and senior managers.

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE (continued)

Elements of remuneration
The remuneration of the executive directors comprises:
- basic salary;
- benefits (including pension);
- a performance related annual bonus; and
- annual LTIP awards.

In addition to reviewing each constituent element, the Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure and quantum.

(i) Executive directors: basic salary and benefits
Basic salary is the only pensionable element of the executive directors' remuneration package. The basic salaries payable to directors of NWL are not directly linked to specific standards of performance in connection with the carrying out of functions of a "relevant undertaker". Basic salary is reviewed annually based on individual contributions and internal relativities. For 2012/13, salaries for senior executives have been increased by 2.8%. Benefits provided to the executive directors comprise membership of pension schemes, car allowance and healthcare.

(ii) Annual bonus

2011/12
For 2011/12, the range of annual bonus metrics was expanded by the Company to include a balanced scorecard to align annual incentive pay more closely with stakeholders' wider interests. In addition, the maximum annual bonus potential for the executive directors on the boards of both NWGL and NWL was increased from 70% to 100% of salary. The maximum annual bonus potential for the executive directors on the Board of NWL only was increased from 70% to 80% of salary.

In both cases it was apportioned as follows:

Bonus metric	(% of bonus)
PBT	40
Balanced scorecard measures	40
Bespoke personal targets	20
Total	**100**

These metrics are firmly linked to NWGL's and NWL's strategic goals (customer, competitiveness, people, environment and communities). The PBT performance metric reflects 'competitiveness' while the other elements of the balanced scorecard are linked to the other strategic goals. The PBT element of the bonus is scored on a sliding scale around the target figure. A simple pass/fail measure applies to the other targets and most of the targets are set at levels which require significant improvements over previous actual results. The 'customer' goal underpins targets based on customer satisfaction (by reference to SIM scores), unplanned interruptions and coliform failures. In 2011/12, up to four per cent of a director's maximum bonus entitlement related to each such measure and the awards were 2% (customer satisfaction), 4% (unplanned interruptions) and 0% (coliform failures). The 'people' goal is reflected in targets for employee engagement and lost time reportable accidents. In 2011/12, up to four per cent of a director's maximum bonus entitlement related to each such measure and the awards were 0% (engagement and satisfaction index) and 4% (lost time reportable accidents). The 'environment' goal targets comprise leakage, sewage treatment performance and pollution incidents. In 2010/11, up to four per cent of a director's maximum bonus entitlement related to each such measures and the awards were 4% (leakage), 4% (sewage treatment performance) and 0% (pollution incidents). The 'communities' targets are based on external recognition of the Group's corporate social responsibility achievement. In 2011/12, up to four per cent of a director's maximum bonus entitlement related to each such measures and the awards were 4% (FTSE4Good) and 4% (BITC Platinum Plus).

The Committee considers the overall bonus metrics to be stretching, and that they reflect operational performance and delivery to customers in a more structured way. A similar approach was adopted in relation to executives below Board level and senior managers, albeit at varying levels of bonus opportunity.

For 2011/12, all four executive directors had personal targets which related to NWL's performance as a "relevant undertaker". Their targets, in summary, were as follows:

11. STATEMENT ON DIRECTORS’ PAY AND STANDARDS OF PERFORMANCE (continued)

2011/12 (continued)
Heidi Mottram: maintaining key financial ratios in line with the NWGL and NWL approved budgets, maintaining good relationships with investors and analysts, delivering the operating efficiency plans for 2011/12 (and keeping the remainder of the plans for 2014/15 on track) and progressing the Group’s strategy on advanced anaerobic digestion, co-digestion and renewable energy.

Chris Green: maintaining the key financial ratios, maintaining good relationships with investors and analysts, refreshing the risk model and preparing a high level strategic risk matrix and work on current cost depreciation and its impact on return on capital employed.

Graham Neave: continuing improvement in customer satisfaction, reviewing the employee relations framework and progressing the co-digestion strategy.

Ceri Jones: refreshing the Strategic Direction Statement, reviewing customer service and implementing strategies to further improve customer service and maintaining improvements in occupational health.

These targets were, in the opinion of the Committee, substantially achieved and, therefore, of the 20% of their total maximum bonuses available in respect of personal targets, Mrs Mottram was awarded 20%, Mr Green 20%, Mr Neave 18% and Mr Jones 18%.

Taking account of performance against personal targets, the balanced scorecard measures and PBT, Mrs Mottram and Mr Green were awarded bonuses equal to 73% of their respective basic salaries; and Mr Neave and Mr Jones were awarded bonuses equal to 57% of their respective basic salaries.

The purpose of linking the relevant standards of performance to remuneration is to encourage directors to ensure that achievement of the standards was given appropriate priority during the year.

2012/13
In order to ensure alignment of the management team, the balanced scorecard now represents 90% of the criteria contributing to their annual bonus, with a further 10% available for the achievement of bespoke personal targets.

The table below details the KPIs and the targets set for 2012/13. A full explanation of each target is disclosed on pages 29 and 30. Bonus targets are based on the business plan scorecard, which is aligned to our medium term goals, as follows:

Strategic theme	Scorecard measure	Contribution to available bonus (%)
Customer	Customer satisfaction	
	- SIM quantitative score	2
	- SIM qualitative score	2
	Unplanned interruptions >6 hours (combined)	
	Coliform incidents (no.)	4
		4
Competitiveness	UKW EBIT	25
	Cash available for distributions	25
People	Employee engagement score	4
	Lost time reportable accidents (no.)	4
Environment	Leakage (Mld)	
	- north - south	4
	STW failing LUT consent (%)	4
	Pollution incidents (categories 1 & 2)	4
Communities	BITC Platinum Plus	4
	Just an Hour	4
Personal targets	Bespoke	10

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE (continued)

2012/13 (continued)

Following the move to private ownership, NWL is changing its financial year to align with the calendar year, commencing 1 January 2012. The performance year for incentive pay will align with the calendar year fully from 1 January 2013 and 2012 is a transitional year during which a combination of full year and transitional targets have been set by the Board, detailed as follows:

Customer satisfaction	Service Incentive Mechanism targets have been pro-rated for nine months. They are evaluated separately.
Unplanned interruptions	This regulatory target is anchored at 31 March and to accommodate the transition year the March 2012 figure will be used. The 2013 target will use the March 2013 achievement, for which the performance period has already started.
Coliform incidents	2012 target for the full calendar year.
UKW EBIT	This is a new financial measure for the competitiveness theme and is based on the budget for the 12 months to 31 December 2012.
Cash available for distributions	This is defined as distributions paid compared to budget, from UKW to the shareholders as interest on shareholder loans and dividends.
Employee engagement score	2012 target is to achieve 1* rating in the Sunday Times Best Companies Survey. The survey is conducted in November 2012 and the result will be known in February 2013.
Lost time reportable accidents	2012 target for the full calendar year.
Leakage	This regulatory target is anchored at 31 March and to accommodate the transition year the March 2012 figure will be used. The 2013 target will use the March 2013 achievement, for which the performance period has already started.
SWT failing LUT consent	100% compliance is our target – so zero failures in the full calendar year.
Pollution incidents category 1&2	2012 target for the full calendar year.
Business in the Community	Retain Platinum Plus status.
Just an Hour	Employees who have been involved in community support activities in the year to December 2012.

Bonus deferral

Prior to the change of control, the Committee had decided to pay part of directors' bonuses in shares and to defer payment for three years. Bonuses will now be paid in cash with no deferral.

Bonus claw back

A claw back applies in the event that results on which the bonus is paid are subsequently found to be inaccurate or there has been relevant misconduct on the part of the employee.

(iii) Pension

Mrs Mottram is the only executive director in the money purchase section of the Northumbrian Water Pension Scheme, to which she receives an employer contribution equal to 15% of her basic salary. She makes an employee contribution of 8%.

Mr Jones participates in a defined benefit pension scheme which is not linked to NWL's performance as a "relevant undertaker". The executive pension arrangements are now closed to new entrants.

(iv) Long Term Incentive Plan (LTIP)

Prior to the change of control, executive directors and senior managers received, at the discretion of the Committee, annual conditional awards of shares in NWG.

Details of the levels of award and performance conditions are shown in the table below.

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE (continued)

Summary of LTIP awards and performance conditions

LTIP AWARD MADE 15 DECEMBER 2008	
Maximum award	100% of salary permitted. Actual grants to executive directors related to shares worth up to 100% of salary.
Performance conditions	(1) 50% of award depends on NWL's return on capital employed relative to that of the other water and sewerage companies of England and Wales. (2) 50% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts.
Vesting schedules	(1) 30% vests at median performance. At upper quartile or above, all of that half of the award will vest. Between median and upper quartile, straight line pro-rating will apply. Where the return on capital employed performance is below the median, none of this element of the award will vest. (2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where the Company's TSR performance is below the median, none of this element of the award will vest.
LTIP AWARDS MADE ON 4 JANUARY 2010 AND 15 DECEMBER 2010	
Maximum award	100% of salary permitted and actual grants to executive directors related to shares worth up to 100% of salary.
Performance conditions and vesting schedules	See table below.

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

Summary of LTIP awards and performance conditions (continued)

Performance metric	Weighting	Description	Calibration
TSR	50%	Relative TSR against the FTSE 250 excluding investment trusts and companies in the following sectors: Banks, Financial Services, Life Insurance, Non-Life Insurance, Real Estate Investment & Services and Real Estate Investment Trusts, Oil & Gas Producers and Oil Equipment & Services. In addition, awards will only vest if the Committee is satisfied that the Company's TSR performance is consistent with the underlying business performance of the Company.	30% of this part of an award (i.e. 15% of the total award) will vest for median performance increasing on a straight line so that 100% (i.e. 50% of the total award) vests for upper quartile performance.
ROCE	20%	Average absolute ROCE over the three financial years starting from 1 April immediately preceding grant date.	30% of this part of an award (i.e. 6% of the total award) will vest for average three-year ROCE of 6.30%, increasing on a straight line so that 50% (i.e. 10% of the total award) will vest for average three-year ROCE of 6.45% and on a straight line so that 100% (i.e. 20% of the total award) will vest for an average ROCE of 6.75%.
Serviceability	20%	Ofwat serviceability targets for the four asset classes (i.e. water non-infrastructure, water infrastructure, sewerage non-infrastructure and sewerage infrastructure) in the final year of the relevant three-year performance period. Serviceability is measured by Ofwat based on a number of indicators which include asset performance indicators, water quality compliance, environmental compliance and consumer service.	50% of this part of an award (i.e. 10% of the total award) will vest for 'stable' assessments in three out of the four asset classes. 100% of this part of an award (i.e. 20% of the total award) will vest for 'stable' assessments in all four asset classes. No awards would vest under this part of an award for less than three 'stable' assessments.
Customer	10%	Results of NWL's independently run customer satisfaction index, measured in the final quarter of the relevant three-year performance period.	30% of this part of an award (i.e. 3% of the total award) will vest for a customer satisfaction index of 83%, increasing on a straight line so that 100% of this part of an award (i.e. 10% of the total award) vests for a customer satisfaction index of 93% or above.

Up until the change of control, the NWG Remuneration Committee was satisfied that the above metrics and targets remained appropriate for the following reasons:

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

Prior to the change of control, the NWG Remuneration Committee determined the extent to which the performance conditions had been met and the proportion of the performance period that had elapsed in deciding upon how many shares of the remaining three awards would vest.

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE (continued)

(v) New LTIP arrangements

A new, cash based, LTIP was put in place with effect from 1 January 2012. The maximum potential LTIP payment in relation to each annual award will be equal to 100% of base salary (in the relevant financial year) for executive directors on the boards of both NWGL and NWL and 60% for executive directors on the Board of NWL only. The new LTIP targets relate to financial performance (70%), SIM (customer services performance) (15%) and serviceability (asset performance) (15%).

SIM performance will be assessed for bonus purposes by comparing NWL's SIM score (quantitative and qualitative combined) with those of the other water and sewerage companies in England and Wales in the relevant regulatory year. There will be no vesting of this part of an award unless fifth position in the rankings is achieved (this would be the median position). If the position achieved is fifth or higher, vesting will be on a sliding scale with 50% of the 15% awarded for fifth place and 100% of 15% awarded for first place.

Fifty per cent of the 15% available in respect of serviceability will vest for "stable" Ofwat assessments in the relevant regulatory year in three of the four asset classes (water non-infrastructure, water infrastructure, sewerage non-infrastructure and sewerage infrastructure). The entire 15% available (i.e. 15% of an individual's potential maximum award) will vest for "stable" assessments in all four asset classes. There will be no vesting of this part of an award for less than three "stable" assessments.

LTIP payments which are approved by the Committee will be paid three years after the start of the performance period. The first payments under the award starting from January 2012 will therefore be in early January 2015.

(vi) Contribution to Remuneration by NWGL

NWGL contributes 30% of the cost of the basic salaries, benefits, bonus and pension of Mrs Mottram and Mr Green. NWG also contributed 50%, up to the date of the change of control on 14 October 2011, of the cost of basic salary and benefits of the Chairman. Due to the change in directors as a result of the change of control, NWG and NWGL contributed between 30% and 100% for other non-executive directors during the year.

(vii) Consideration of Ofwat Reports by the Committee

In assessing overall performance, the Committee takes into account the Company's position in the Ofwat reports. The relevant performance data published by Ofwat is also used by the Chief Executive Officer to assess Mr Neave's and Mr Jones' performance and this informs the bonus recommendation put to the Committee.

(viii) Future Targets for the period 1 April 2012 to 31 December 2012

The maximum bonuses available to executive directors in respect of the period 1 April 2012 to 31 December 2012 are, pro-rata, the same as in respect of 2011/12. Fifty per cent of the maximum bonus will relate to financial targets. Four per cent will relate to targets based on each of the following: customer satisfaction (by reference to SIM scores), unplanned interruptions greater than six hours, coliform failures, leakage, sewage treatment works performance and pollution incidents. Eight per cent will relate to "people" based targets and eight to "communities" targets. The remaining ten per cent will relate to personal targets.

For this period, Graham Neave and Ceri Jones also have personal targets which relate to NWL's performance as a "relevant undertaker". In summary, these are as follows:

Graham Neave: investigating the use of systems to give early warning of potential water quality failures and fostering excellent employee relations.

Ceri Jones: developing a customer focused business plan ahead of the next price review including NWL's long term vision "Future Horizons" and enhancing the management of contractor health and safety performance.

DIRECTORS' RESPONSIBILITIES AND DECLARATIONS
for the year ended 31 March 2012

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible under 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 for:

(a) ensuring that proper accounting records are maintained by the Appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by the Water Services Regulation Authority ("the Authority") to the Appointee from time to time;

(b) preparing on a consistent basis for each financial year regulatory accounts in accordance with Condition F, having regard also to the terms of guidelines notified by the Authority from time to time, which so far as is reasonably practicable have the same content as the annual financial statements of the Appointee prepared under the Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to those financial statements;

(c) preparing financial statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by the Authority from time to time; and,

(d) preparing such other financial and related information as is required by Condition F having regard also to the terms of guidelines issued by the Authority from time to time.

By order of the Board

M Parker
Company Secretary
11 July 2012

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY ("WSRA") AND DIRECTORS OF NORTHUMBRIAN WATER LIMITED

We have audited the Regulatory Accounts of Northumbrian Water Limited (the Company) for the year ended 31 March 2012 on pages 60 to 86 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; and
- the regulatory current cost accounting statements for the appointed business, comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies.

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

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

Respective responsibilities of the WSRA, the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 87, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Regulatory Accounts

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts sufficient to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the Regulatory Accounts. In addition, we read all the financial and non-financial information presented with the regulatory accounts to identify material inconsistencies with the audited Regulatory Accounts. If we become aware of any apparent misstatements or inconsistencies, we consider the implications for our report.

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

As permitted in IN 12/01, the Company has elected to replace certain tables set out in Regulatory Accounting Guideline 3.06 with the Accounting Separation Tables. The Company is under an obligation to present the Accounting Separation Tables in accordance with its Accounting Separation Methodology Statement (the "Methodology Statement"), provided by the Company to the WSRA with the Regulatory Accounts. We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF NORTHUMBRIAN WATER LIMITED (continued)

Opinion on Regulatory Accounts
In our opinion, the Regulatory Accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA, in respect of the Accounting Separation Tables, the Methodology Statement, and the accounting policies set out on pages 66 to 68, the state of the Company's affairs at 31 March 2012 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies and the Methodology statement.

Emphasis of Matter - Basis of preparation
Without modifying our opinion on the Regulatory Accounts, we draw attention to the fact that 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 and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice (UK GAAP). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 60 to 61 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 UK GAAP and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 62.

Opinion on other matters prescribed by Condition F
Under the terms of our contract, we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

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

Other matters

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

- Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2012 on which we report, which are prepared for a different purpose. Our audit opinion in relation to the statutory financial statements of the Company (our 'statutory audit') was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our statutory audit was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by the law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Paul Feechan (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Newcastle Upon Tyne, United Kingdom
11 July 2012