NORTHUMBRIAN WATER *living water*

NORTHUMBRIAN WATER LIMITED

REGULATORY ACCOUNTS

FOR THE YEAR ENDED 31 MARCH 2014

REGULATORY ACCOUNTS
FOR THE YEAR ENDED 31 March 2014

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CHIEF EXECUTIVE OFFICER'S REPORT

It is a privilege to serve our customers in the North East, Essex and Suffolk. Our customers are always at the heart of everything we do. We are working hard to continually improve service and are making great progress as we continue on our journey 'to be the national leader in the provision of sustainable water and waste water services'.

I am delighted to report improved performance in a number of key areas. This includes our best-ever customer satisfaction scores, a continuation of our industry-leading performance for interruptions to supply and sewage treatment, a reduction in sewer flooding incidents and our best-ever microbiological performance at our service reservoirs. We also hope to regain our industry leading position in the near future in relation to bathing water quality. We continue to be recognised as industry leaders in leakage control and water efficiency and the completion of the major project to expand Abberton Reservoir has secured supplies to Essex for the next 25 years.

Alongside all these improvements, we are very proud of the external recognition the company has received in the last year for our commitment to providing the best service possible for our customers. We achieved numerous awards in 2013 including winning five of the seven categories of the Utility Week Achievement Awards 2013, including the coveted title of Utility of the Year. Our debt collections team also won the 'treating customers fairly award' at the National Credit Industry Awards 2014, which are the biggest awards in the financial sector.

Furthermore, we have been awarded the Queen's Award for Enterprise (sustainable development), for a second time. The judges' comments specifically mention the great work we've done to generate 20% of our energy from renewable sources, generating electricity from sludge through our Advanced Anaerobic Digestion (AAD) processes, using reed-beds and increasing the capacity of Abberton Reservoir. They also praised us for the way we work with the communities we serve and our 'Just an hour' employees' volunteering programme, in which nearly 55% of our workforce participate.

Whilst it is pleasing to receive such external recognition, we are never complacent and continually strive to improve the service we provide to our customers. We have been talking extensively to our customers and stakeholders about what they expect from us in the future so that this could underpin our business plan for the period 2015-2020.

To ensure we are listening to our customers and interpreting their views fairly we formed two independent Customer Challenge Groups (known as Water Forums), for our operating areas in the north east and south east of England. Members of the Forums challenged and advised us on behalf of our customers and stakeholders. I would like to thank the members of the Forums for their substantial contribution to the plan. Our plan was the better for their challenge.

After more than two years of meticulous planning and consulting with our customers, our plan for the period 2015-20 was submitted to our economic regulator, the Water Services Regulation Authority (Ofwat) in December 2013.

We have listened to our customers and our plan to keep customers' bills as low as possible while delivering great service received considerable support in extensive market research.

Ofwat were very complimentary about our plan and noted we were close to satisfying all their requirements. Since December, we have been addressing a few outstanding areas associated with our plan, and we submitted a revised plan to Ofwat on 2 May 2014. Under our revised plan, incentives are in place to drive even better services to our customers.

Ofwat examined the revised plan and published its draft decision (Draft Determination) on 30 May 2014. This described the services to be provided and the prices we can charge for the period 2015-20. All parties have recently responded to the Draft Determination and we await Ofwat's Final Determination in December 2014.

CHIEF EXECUTIVE OFFICER’S REPORT (continued)

Currently, only customers who use more than five megalitres of water per year are able to choose who they purchase their water and waste water services from. The opening of the water retail market in 2017 will change this position, and all business customers, charities and public bodies will be able to choose their supplier. In April 2014, we successfully secured a retail licence to supply business customers and we are looking forward to competing successfully in the market and being the retailer of choice for business customers.

I hope you find our regulatory accounts helpful and informative.

H Mottram
Chief Executive Officer

STRATEGIC REPORT
for the year ended 31 March 2014

The directors of Northumbrian Water Limited (NWL or the Company) are pleased to present their strategic report on the affairs of the Company, along with their directors' report, the audited regulatory accounts and the auditor's report for the year ended 31 March 2014. The regulatory accounts are separate from the statutory financial statements of the Company which were prepared, on a consolidated basis, to 31 December 2013. These regulatory accounts are prepared to comply with Condition F of the Company's Licence granted under the Water Industry Act 1991.

Cautionary statement
This report contains certain statements with respect to the future operations, performance and financial condition of NWL. 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 report and the Company undertakes no obligation to update such statements. Nothing in this report should be construed as a profit forecast. Certain regulatory performance data contained in this report is subject to regulatory audit.

Business overview
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.

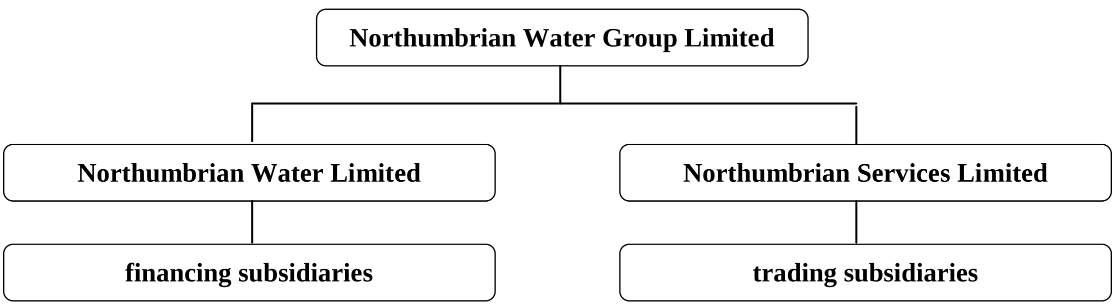
In the north east, the business comprises the supply of both potable and raw water and the collection, treatment and disposal of sewage and sewage sludge, serving 2.7 million people in the major population centres of Tyneside, Wearside and Teesside as well as the large rural areas of Northumberland and County Durham. We provide only waste water services in Hartlepool.

In the south, we supply water services to 1.5 million people in Essex and 0.3 million in Suffolk. Our Essex area is part rural and part urban and includes the main population centres of Chelmsford, Southend and the London Boroughs of Barking and Dagenham and Havering and Redbridge. Our Suffolk area is mainly rural with the largest towns being Great Yarmouth and Lowestoft.

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

Group structure
NWL owns a number of subsidiary companies which carry out financing activities on behalf of the Company (see Section A note 11) which, together with the Company, form the group. NWL's immediate parent company, and controlling party, is Northumbrian Water Group Limited (NWGL). NWGL has one other direct subsidiary, Northumbrian Services Limited (NSL), which acts as a holding company for the non-regulated trading companies in the Group. NWGL and its subsidiaries together form the Group. NWGL is indirectly wholly owned by Cheung Kong Infrastructure Holdings Limited (CKI), Cheung Kong (Holdings) Limited (CKH) and Li Ka Shing Foundation Limited.

The structure is shown in the chart below.



Regulatory and legislative developments

Water Act 2014

The Water Act 2014 was passed into legislation in May 2014. The most significant development is the establishment of a competitive market for retail water and sewerage services for all non households with a target date for market opening of 2017.

NWL looks forward to successfully competing in this new retail market and is heavily engaged in the Open Water programme which is driving the establishment of the new market arrangements. We are actively participating in the work of the programme at various levels from high level strategy and governance through market design to participation in detailed working groups and pilot studies.

Our aim is to provide excellent customer service at a competitive price to make us the retailer of choice for business customers.

Business Plan

A key focus for 2013-14 has been business planning for the medium and longer term. We published Future Horizons, our outlook to 2040, using an innovative web based format incorporating interactive features that would appeal to a younger audience and introducing characters that illustrate the challenges that the organisation is likely to face in the next 25 years.

In December 2013, we published our business plan for 2015-20. This plan is based on extensive customer consultation and sets out the outcomes we aim to deliver, the total expenditure required and what this means for customer bills. It represents the next step towards the future described in Future Horizons.

An important part of the process we used to develop our plan was the challenge and scrutiny provided by our Water Forums. These are stakeholder challenge groups we established, one in each operating area, to provide constructive challenge to our plans. This process helped us to maintain a strong customer focus and achieve a balanced plan recognising the views of a wide range of stakeholders. Our plan achieved strong customer support (75% found the plan acceptable).

After receiving further guidance from Ofwat, particularly in respect of their expectations on the balance of risk and reward, we resubmitted some elements of our plan in early May 2014. We have put forward a challenging plan that delivers on our customers' priorities and we believe represents great value for customers. Average bills from 2015-20 would rise by slightly less than inflation.

In late May 2014 we received our draft determination of prices, which would result in customer bills reducing by around 2% in real terms. Ofwat commented that our business plan was high quality in many areas, with a limited number of adjustments made. We responded to the draft determination and have continued to engage with Ofwat. We will receive our final determination of prices in December 2014.

The form of control for 2015-2020 will be different from previous periods with separate wholesale and retail controls, a move to a revenue (rather than price) based control and other changes to the methodology.

Business strategy and objectives

NWL's vision is to 'be the national leader in the provision of sustainable water and waste water services'. We want to continue to deliver value to customers and other stakeholders by focussing on our core competencies of water and waste water management.

We have underpinned our drive to be the best with five strategic themes, Competitiveness, Customer, People, Environment and Communities, described below, and achieving the right balance between them is essential to our success and reputation. After extensive consultation with our customers, we have developed a set of outcome statements which encapsulate our long-term goals and what we aim to achieve. A very high number of customers surveyed supported our outcome statements (88%) and they align with our corporate themes as shown below.

STRATEGIC REPORT (continued)

Business strategy and objectives (continued)

Competitiveness:
- Our finances are sound, stable and achieve a fair balance between customers and investors.
- We are an efficient and innovative company.
- We are the retailer of choice for business customers.

Customer:
- We provide excellent service and impress our customers.
- Our customers consider the services they receive to be value for money.
- Our customers are well informed about the services they receive and the value of their water.
- We supply clean, clear drinking water that tastes good.
- We provide a reliable and sufficient supply of water.
- We provide a sewerage service that deals effectively with sewage and heavy rainfall.
- We deliver water and waste water services that meet the needs of current and future generations in a changing world.

People:
- Our people are talented, committed and inspired to deliver great services to customers.
- Our people act in line with our values.
- We are seen as a great place to work.
- Our workplaces are healthy and safe.

Environment:
- We protect and enhance the environment in delivering our services, leading by example.
- We help to improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife.

Communities:
- We are proud to contribute to the success of local communities.
- We work in partnership towards common goals.

As important as our clear direction and goals is our clear sense of values. We have made a commitment to five core values, described below, and these are the principles which define how we will work to achieve the vision.

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 progress in these areas during the year ended 31 December 2013 is described below and we continue to achieve the right balance between these key areas as this is essential to our success and reputation. We remain committed to becoming ‘national leader’ by the end of 2014.

STRATEGIC REPORT (continued)

Performance
In order to measure delivery of the Company business plan and goals, a balanced scorecard of Key Performance Indicators (KPIs) is used spread across the strategic themes. Targets have been set on a trajectory to deliver the Company vision. In order to ensure alignment of the management team, this balanced scorecard represents 90% of the criteria contributing to their annual bonus, with a further 10% available for the achievement of bespoke personal targets. Further information about the executive directors' remuneration is provided in note 10 to Section B, on page 69.

The table below details actual performance against the KPI targets and future targets. Targets which are measured on a calendar year basis, denoted by C in the table below, reflect the performance period January to December 2013. Targets which are measured on a regulatory year basis, denoted by R in the table below, reflect the performance period April 2013 to March 2014.

Scorecard measure	**Performance period**	**2013 / 2013-14** Target 2013	Performance	Achieved	**2014 / 2014-15 Target**
Competitiveness					
Group EBIT	C	budget	achieved	Yes	budget
Group cash available for distribution	C	budget	achieved	Yes	budget
Customer					
Customer satisfaction					
- SIM quantitative score	R	<=115	119.6	No	<=120
- SIM qualitative score	R	>=4.6	4.62	Yes	>=4.7
Water supply interruptions >3 hours (average per property (minutes))					
- north	R	<=7.30	6.20	Yes	<=7.30
- south	R	<=7.30	2.49	Yes	<=7.30
Coliform incidents (no.)	C	<=10	16	No	<=8
People					
Employee engagement score	C	>=81%	75%	No	2*
Lost time reportable accidents (no.)	C	<=9	6	Yes	<=4
Environment					
Leakage (Mld)					
- north	R	<=141	134	Yes	<=141
- south	R	<=66	58.4	Yes	<=66
STW failing LUT consent (%)	C	0	0	Yes	0
Pollution incidents (categories 1 & 2)	C	<=3	5	No	<=2
Communities					
BITC Platinum Plus accreditation	R	retain status	status retained	Yes	retain status
Just an Hour (employee participation)	C	>=50%	54.9%	Yes	>=50%

We are pleased to report continued strong operational and financial performance for 2013-14 with improvements to service in a number of key areas. Our performance is described in detail in the following pages.

Our 'Annual performance review 2013-14' provides further detail about the performance of our regulated business during the year. This is available on our websites (www.nwl.co.uk and www.eswater.co.uk).

Competitiveness
The competitiveness KPIs were successfully achieved in the year. The financial performance of the Company is detailed in the financial performance section later in this report.

The health of our assets remained satisfactory with serviceability, which measures how effectively we are operating and maintaining our assets to deliver an expected level of service now and into the future, assessed as stable in all asset classes.

Performance (continued)

Customer

Customer service is at the heart of the Company and all employees have a clear focus on getting things 'right first time, every time'. Our aim is to deliver industry leading customer service. SIM was introduced by Ofwat to monitor both quantitative and qualitative aspects of customer service. In 2013-14, we have continued to focus upon delivering even better customer service and have seen our customer satisfaction scores from independent surveys improve from 4.46 to 4.62 (scored out of 5). This improvement has been delivered through keeping customers informed throughout their contact with us and ensuring they are fully satisfied with our service before closing the contact. Our performance on the quantitative measures has also improved significantly reducing from 157 in 2012-13 to 120 in 2013-14, though it did not reach the stretching target we set ourselves.

We understand our customers' expectations by undertaking customer research as part of our ongoing business activity. Our independent quarterly tracking research confirmed a high level of customer satisfaction, with net satisfaction levels for overall service and value for money of 88% and 80%, respectively, in 2013-14. This was supported by CCWater's survey of water and sewerage customers in 2013. CCWater highlighted NWL as 'one of the companies who really demonstrate what can be achieved when the right approaches are taken'. We have also continued to work with our Water Forum stakeholder groups which help ensure our decisions take account of customers' views, particularly on issues that may impact on standards of service or the level of customers' bills.

Informed by our customer research, we have improved our web self-service offerings to customers and enabled our website to be responsive to mobile devices. We are proactive in our customer communications using voice and text messages to keep our customers informed of operational incidents or appointment reminders and extending our use of web news, Twitter and web chat. Social media allows us to keep our customers up to date and helps us to identify and solve customers' concerns before they come to us with a problem.

Further investment in water network resilience has helped to ensure there have been no major water supply issues this year and we have continued our industry-leading performance on water supply interruptions. Construction of the Abberton Reservoir enhancement project has been completed and the reservoir has now filled to a level above its previous high and is well on its way to reaching its new top water level by spring 2015. The additional 15,000Ml of storage will secure drinking water supplies to 1.5 million people in Essex for many years into the future.

Our drinking water quality standards remain very high and we continue to adopt a catchment management approach to work with farmers and other land managers to prevent pesticides from entering the rivers supplying our treatment works. The number of microbiological (coliform) failures at our treatment works and service reservoirs reduced in 2013, though not as low as our target, and we have developed robust action plans to help us meet our ambitious long term target of preventing these failures from occurring.

We have continued to make progress on a major programme to clean over 200km of large diameter pipelines supplying 0.5 million customers in Newcastle, in order to reduce discoloured water contacts. We are making use of a cheaper and quicker new process called 'ice pigging' and have also initiated a programme of unidirectional flushing for local distribution mains to support the outcome.

People

We recognise that the service we give to customers depends massively on the contribution of our employees and the sense of pride and commitment our people feel about the work they do. We put great effort into creating an environment where people are encouraged to engage and perform to the best of their ability. We want to be recognised as a great place to work and, in 2013, we were proud to be awarded One Star status in the prestigious Sunday Times 'Best Companies' survey, achieving a 10% improvement in scores from our entry in 2011. Our target for 2014 is to achieve Two Star status. For our internal employee engagement score we set a stretching target of 81% for 2013 which we believe is in line with leading company performance. Whilst we were disappointed not to achieve the target in the year we are continuing to work with our employees to develop action plans to build on our current strong level of engagement.

Performance (continued)

People (continued)

We have kept our people fully informed of the performance of the business through a suite of new communications tools launched in the year, including a new newspaper called 'The Big Splash' and a vibrant and extensive intranet called Cascade, which includes a blog from our Chief Executive Officer (CEO), to complement our 62 annual face-to-face employee road shows, bi-monthly TeamTalk briefings and weekly newsletters. We maintain constructive employee relations through collaborative working with our trade union and employee representatives and actively engage with our people through an annual employee survey.

We have continued throughout the year to ensure that our people are fairly treated and we proactively promote diversity and inclusion to reap the benefits of a diverse workforce. 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 and 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, gender or sexual orientation. At the end of the year, the company had 3,006 employees of which 2,044 were male and 962 female. Of the 13 directors, 11 were male and 2 were female. The management team comprised 4 executive directors (3 male and 1 female) plus a further 5 senior managers (3 male and 2 female).

We welcome employment applications from people with disabilities and, where existing employees develop disabilities, they are supported to remain in employment, wherever practicable, by providing appropriate adjustments to their roles and/or effective redeployments. Occupational health physicians assist this process with professional medical advice. We have been recognised with a Silver Award in the Business in the Community (BiTC) 'Opportunity Now' benchmarking index for gender equality, an area which can be challenging in a traditional utility business.

In 2013, we have taken a lead role to develop skills at a national level in response to the government's Employee Ownership of Skills pilot, and we are strongly represented at Council and Board level of the new Energy and Efficiency Partnership, an important sector wide initiative. NWL is also the water sector representative in the government's Trailblazer programme, where 60 leading companies are working to develop a brand new approach to apprenticeships in the UK.

Health and safety remains our top priority and, in 2013, we have seen another improvement in performance with six lost time reportable accidents compared with a target of nine. We have also seen a reduction in less serious lost time accidents as we continue to focus upon root cause analysis, the promotion of good health and safety practice across the business and develop leading indicators of performance to supplement more conventional lagging indicators. Our performance and approach has been recognised by a Royal Society for the Prevention of Accidents gold award for outstanding health and safety policies and practices, the highest award available.

Environment

The 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 aim to adopt good environmental practice in all aspects of our activity. Our integrated quality and environmental management systems are certified under ISO 9001, ISO 14001 and OHSAS 18001.

We continue to be the industry leader in sewage treatment operations with a sixth consecutive year of full compliance with consent standards. The two recently constructed AAD plants, which take all of the sewage sludge by-products from the treatment process and convert them into renewable energy, have been fully commissioned and optimised. Plans are well advanced to further improve the process by injecting the generated gas direct to the gas grid. These innovative approaches have supported a reduction in our greenhouse gas (GHG) emissions for the sixth year in succession. More information on GHG emissions is provided in the Directors' report.

Performance (continued)

Environment (continued)

After the challenges of 2012's unprecedented rainfall we have seen bathing water quality return to normal levels with 100% compliance with the mandatory standard. The number of category 1 and 2 pollution incidents increased in the year from three to five, although the number of category 3 incidents reduced significantly. To improve our performance we continue to invest in sewer level monitoring technology to try to predict where pollutions might occur and to resolve problems before they cause an overflow. We have also continued our 'Love your Drain' campaign to engage with customers to try to prevent materials from entering the sewerage system which could cause blockages and incidents.

We continue to have a very strong focus on improving our sewer flooding performance and the total numbers of properties suffering internal flooding in the year reduced significantly in 2013-14. This improvement was the result of our significant investment in sewer flooding solutions and operational activity, through increased inspection, cleaning and root cutting, though it has also been influenced by weather patterns.

For the third consecutive year, we achieved our targets on leakage in our northern and southern operating areas. To process water treatment sludge in a sustainable way, we have constructed a sludge treatment reed bed system at Hanningfield Reservoir in Essex. This is the first reed bed system of its kind in the world for treating sludge from the drinking water treatment process. It has been constructed after extensive investigation and research to arrive at the best possible solution to manage the water treatment sludge in the long term.

Communities

We are dedicated to building strong relationships with the communities we serve and we ensure that corporate responsibility is embedded in the business. We support our communities in a number of ways focussing on five broad areas; investment in our communities, participation in our communities, educating our communities about their environment, supporting healthy communities and supporting developing communities through WaterAid.

More than 54% of our employees actively volunteered in their communities in 2013 through our Just an Hour scheme, supporting 728 different organisations and projects. This is a huge achievement and we are very proud of the contribution that our people are making to the communities in which we operate. The support provided, through donations, people's time and expertise and the use of our facilities, equates to giving back 1% of our annual pre-tax profits to our communities. In the year the Company was re-accredited as a Platinum Plus company by BiTC, their highest award.

Other achievements

In April 2014 NWL was awarded the Queen's Award for Enterprise (sustainable development) for the second time, in recognition of our leading performance in sustainable development. The judges' comments highlighted our efforts in generating 20% of our energy from renewable sources, in particular through our AAD processes, our use of reed-beds and investment to increase the capacity of Abberton Reservoir. They also praised our work with the communities we serve.

NWL has recently been named as Utility of the Year at the UK Utility Week Achievement Awards, picking up an additional four awards for Marketing initiative of the year for our 'Love your Drain' campaign, Environment award for Hanningfield reed beds, Community initiative of the year for our 'Just an Hour' employee volunteering scheme and the Supply Chain Excellence award.

NWL also gained recognition at the North of England Excellence Awards as best private company (over 250 employees) and North of England Business of the Year. The Kielder Water and Forest Park achieved the Visit England Tourism Awards Gold for Tourism Experience of the Year.

STRATEGIC REPORT (continued)

Financial performance

In addition to the balanced scorecard, we use a range of financial indicators to monitor performance. All financial KPIs remained better than the target for the period.

KPI	Target	Performance		Target
	2013-14	2013-14	2012-13	2014-15
Gearing: net debt to RCV[1] – group (%)[2]	<70	63	63	<70
Gearing: net debt to RCV – Appointed business only (%)	<65	61	62	<65
Cash interest cover (times)	>3.0	3.9	3.9	>3.0
Cash flow to net debt (%)	>13	18	19	>13

[1] Regulatory Capital Value (RCV)
[2] See note Section A 11.

The Company's historical cost profit and loss account and historical cost balance sheet are set out on pages 26 to 29. The historical cost financial statements have been prepared in accordance with guidance issued by Ofwat as detailed in note 1 of the notes to the historical cost regulatory accounts on pages 30 to 35. These accounting policies have been applied consistently throughout the current and preceding periods.

Turnover was £776.4m for the year ended 31 March 2014 (2013: £755.0m). This reflected the application of RPI of 3% on water and sewerage charges. However, both average demand for measured supplies to household customers and total volumes supplied to non-household customers declined, primarily as a result of the difficult prevailing economic conditions in the UK.

Operating costs, including capital maintenance costs, for the year ended 31 March 2014 were £446.5m (2013: £427.6m). This reflected increases in manpower costs, power prices, contractor costs and depreciation plus some restructuring costs and general inflationary increases, partially offset by the benefits of our efficiency programme. During the year, the Company invested £1.0m (2013: £1.2m) in research and development. The efficiency programme has continued to progress well in the year, focussing on continued identification and implementation of 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 2014.

Net interest payable was £120.3m in the year ended 31 March 2014 (2013: £116.6m). This reflected the impact of lower indexation on index-linked bonds, partially offset by the non-recurrence of a one-off benefit in the prior period arising from the transfer of a finance lease to a new counterparty on improved terms.

Profit on ordinary activities before taxation for the year ended 31 March 2014 was £212.3m (2013: £212.7m). The current tax charge of £42.9m and deferred tax credit of £56.9m are explained in Section A note 8 to the accounts. Profit for the financial year was £226.3m (2013: £150.0m).

The directors do not recommend payment of a final ordinary dividend (2013: £nil). Total dividends paid in the year ended 31 March 2014 were £190.2m (2013: £150.6m). The dividend policy is explained in Section A note 9 to the accounts.

Capital investment

Capital investment in the regulated business, net of grants and contributions, for the year was £212.5m under regulatory accounting guidelines (2013: £220.1m), primarily to ensure the continued provision of sustainable water and waste water services in the areas we serve. Continued investment in maintenance of our above ground assets along with rehabilitating 120km of sewers and 85km of water mains has maintained stable serviceability. Construction of the Abberton Reservoir scheme was completed successfully in the year.

Sewer flooding is one of the worst experiences our customers can have. In 2013-14, we completed the design development and preparation for the delivery of an extensive programme of investment in 2014. This programme is to resolve sewer flooding issues following the large amount of intensive rainfall experienced in 2012.

Capital structure and liquidity
The group's debt structure remained largely unchanged with 72% fixed at an average rate of 5.63%, 26% index linked at an average real rate of 1.93% and 2% on a variable rate basis. The blended average rate for the Company for the year ended 31 March 2014 was 5.8%.

In April 2013, the Company drew the third £50m tranche of a £150m facility from the European Investment Bank at a fixed rate of 2.896%. The Company subsequently signed a further £100m facility, the first £50m tranche of which was drawn in January 2014 on an index linked basis with a coupon of 0.34%. The remaining £50m was drawn after the balance sheet date in April 2014 on an index linked basis with a coupon of 0.38%.

The Company has cash resources and substantial undrawn committed five year bank facilities available to maintain general liquidity, which mature in 2016. The undrawn bank committed facilities amounted to £450m at 31 March 2014.

Cash interest cover and gearing measures have remained better than target levels, with the strong investment grade credit rating for the Company remaining at BBB+ stable (Standard & Poors and Fitch) 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 treasury function's 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 has in accordance with the treasury policy. On occasion, derivatives are used as part of this process, but the treasury policy prohibits their use for speculation.

PRINCIPAL RISKS AND UNCERTAINTIES

The Board sets the tone for risk management within the Company and determines the appropriate risk appetite. The Board's approach to monitoring and managing risk is set out in the directors' report.

The key business risks facing the Company are:
- funding and liquidity risk (explained below);
- unfavourable changes to the regulatory structure as a result of the Water White Paper;
- unfavourable outcome of the 2014 Price Review;
- unexpected shift in climate change impact;
- sewer flooding failures;
- loss of income through closure of large customers, lower industrial volumes or future retail competition; and
- risk of increasing pension contributions resulting from increasing longevity and the impact of economic conditions on investment returns.

Treasury activities
As noted above, the group's financing strategy reflects its treasury policies and the Board reviews and agrees policies for managing each of these risks. These are summarised below. The treasury activities of the group are conducted in accordance with these policies.

Funding risk
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. In order to raise this finance efficiently, the Board's aim is to retain strong investment grade credit rating at BBB+ stable (Standard & Poors and Fitch) and Baa1 stable (Moody's). A reduction in the credit rating would likely restrict future sources of funding and increase the associated cost of new borrowing.

Treasury activities (continued)

Liquidity risk

The Company's policy is to have available standby committed bank borrowing facilities with a value of no less than £50m and with a bank agreement availability period of no less than three months. At 31 March 2014, NWL had £450m (2013: £450m) of undrawn facilities, which mature in 2016.

Interest rate risk

The Company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and variable rates of interest and, 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 2014, 72% (2013: 73%) of the borrowings of the group were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

Credit risk

The Company invests surplus cash with banks on a short term basis. The treasury policy specifies which counterparties the Company can invest with and sets a limit for the maximum exposure to each counterparty. These limits take account of published credit ratings. The Company serves around 2 million properties and no individual customer accounts for a significant proportion of income or debt, therefore, there is no material customer credit risk. Note 1o of Section A sets out the Company's bad debt policy.

Foreign currency risk

The Company'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 as soon as they are identified. At 31 March 2014, the Company had forward foreign exchange contracts of £2.1m (2013: £2.4m) for the purpose of hedging the foreign currency risk of committed future purchases.

Market price risk

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

By order of the Board

M Parker, Company Secretary,
11 July 2014

DIRECTORS' REPORT
for the year ended 31 March 2014

DIRECTORS

The directors who served during the year were as follows:

A J Hunter	Non-Executive Chairman
P Rew *	Senior Independent Non-Executive Director
H Mottram OBE	Chief Executive Officer
C I Johns	Finance Director
G Neave	Operations Director
A C Jones	Regulation and Scientific Services Director
M Fay CBE *	Non-Executive Director
Dr S Lyster *	Non-Executive Director
M A B Nègre *	Non-Executive Director
F R Frame	Non-Executive Director
T C E Ip	Non-Executive Director
H L Kam	Non-Executive Director
D N Macrae	Non-Executive Director
L S Chan	Alternate Non-Executive Director
W C W Tong-Barnes	Alternate Non-Executive Director

* Independent Non-executive Directors (INEDs).

Information about directors' remuneration is contained in note 5 in Section A and note 10 in Section B to the accounts.

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR'S REPORT

As Senior Independent Non-executive Director I am pleased to be able to comment on the way the NWL Board works and to describe the role of the INEDs.

There have been no changes in the membership of the NWL Board since my last report and the Board continues to function as an integrated whole. It is clear that each Board director understands his or her individual responsibility to act in the best interests of the Company as well as the importance of the service provided to our customers and our environmental responsibilities. The directors play a full part in Board meetings and are given every opportunity to shape the Company's strategy, as well as ensuring that customers' interests are central to investment and operational decisions. I am again very happy to assure our stakeholders that NWL's special responsibilities as the only available provider of water and waste water services (for most of our customers) are recognised fully by the directors and influence all key decisions.

The independent directors are still of the firm view that the Board is well balanced. The directors appointed by the Group's shareholders, including the Chairman, bring great experience of operating infrastructure businesses around the globe, the executive directors are well respected in their fields and the INEDs bring a wide range of experience and skills. The Board has regard to the principles underpinning the UK Corporate Governance Code (UK CGC) as required by the Company's Instrument of Appointment (the Licence), but does not consider that full compliance with all the detailed provisions of the UK CGC is practicable, given that NWL is privately owned, or is necessary for sound governance. However, the Board has embraced the key elements of the UK CGC's principles and the Corporate Governance report (on page 15 of these accounts) describes and explains areas of non-compliance with the relevant provisions of the UK CGC. These disclosures summarise attendance at meetings and I would like to report, in addition, that the INEDs' attendance at our regular Board meetings was 100%. Over the past year, the Board of NWL has worked constructively with the Water Services Regulation Authority (Ofwat) to develop a governance document which balances the legitimate interests of all stakeholders. This document has been shared with Ofwat.

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR'S REPORT (continued)

The involvement of INEDs is seen as critically important to NWL's governance and the Company has four, rather than the three required by its Licence. I chair the Audit and Risk & Compliance Committees and other INEDs are members of both those Committees and the Remuneration Committee. We therefore have full transparency on all the main aspects of NWL's governance. Whilst these Committees are not entirely comprised of INEDs, as suggested by the UK CGC, the Board is satisfied that the composition of the Committees is appropriate to the Company's circumstances. The INEDs meet from time to time without management or the other directors being present and I have had very helpful discussions with the Ofwat Chairman.

Most decisions relating to NWL are made by the NWL Board alone and the only decisions referred to the NWGL Board are certain large contract awards, capital project approvals and substantial funding arrangements. During the last year, the NWGL Board has endorsed all the recommendations of the NWL Board. Although the INEDs are not members of the NWGL Board, we are present at its Board meetings and participate fully, encouraging a cohesive approach at both Boards. Dr S Lyster and I also sit on the Company's Corporate Responsibility Management Group, as does M Fay, which includes executive directors and managers and focuses on NWL's corporate responsibility strategy, as well as practical steps to give effect to the strategy.

The Board has been closely involved with PR14 throughout the process of producing the business plan. In January 2012, the Board agreed the main principles to be included in the Company's response to Ofwat's 'Future Price Limits' consultation. From that point on, the Board was kept up to date with all Ofwat guidance and agreed the Company's responses to consultations. The Board was integral to the planning process, confirming strategic direction and monitoring progress. It spent a substantial amount of time at Board meetings in 2012 and 2013 discussing strategy, reviewing assurance arrangements and outcomes and endorsing the plan. The Board set up a PR14 sub-group, the first meeting of which was in May 2013. Dr S Lyster and I sat on the sub-group from the start and we were joined by a third INED, M Fay, as the key decision-making time approached. Two other NEDs and the four Executive Directors also took part. The sub-group met monthly, and latterly more frequently, to advise management, challenge proposals and facilitate more detailed Board involvement. The Board also signed off the August data submission in July 2013.

The water forums were initiated in February 2012 and the Board was given regular updates on the issues raised. INEDs attended both the Northumbrian and Essex & Suffolk forum meetings in September and November 2013 to hear, first hand, the forums' views on the Company's proposals. As well as agreeing strategy, the Board had very close involvement in reviewing and commenting on each draft section of the business plan. After the Audit Committee had reviewed the report of the Company's Independent Assurance Assessor on the assurance underpinning the business plan, every member of the Board endorsed the plan on 21 November 2013. The Board was also fully involved in analysing Ofwat's response to the plan and in all the work leading up to its re-submission on 2 May 2014.

I would like to emphasise that, in addition to our work on PR14 and our participation in formal meetings, the INEDs have had very broad involvement in NWL's overall business. We have taken part in extensive sessions with management on water resources and customer service and have had regular direct exposure to customers, through stakeholder events, participation in customer forums and other channels.

I am satisfied that the balance of experience and expertise on the Board of NWL and its Committees ensures that the interests of all the Company's stakeholders, and especially customers, are protected and that the Company's governance is both sound and appropriate.

P Rew
Senior Independent Non-Executive Director

CORPORATE GOVERNANCE

Corporate Governance obligations

The Company's Instrument of Appointment by the Secretary of State for the Environment, Food and Rural Affairs contains provisions, beyond those which would otherwise apply to a private company, to ensure that the Company's governance is sound and that its directors, acting as such, act independently of parent companies. The Licence requires the Company to have particular regard to the UK CGC.

The arrangements and functioning of the Board and its committees have regard to the Licence obligations and the UK CGC, albeit in the context of a company which is not a listed public limited company, and the Board considers that an appropriate balance has been achieved between the interests of shareholders, customers and other stakeholders.

The Board considers that it complies substantially with the relevant provisions of the UK CGC, to the extent that it is compatible with NWL's ownership structure, except as explained on pages 19 to 20.

Review of Corporate Governance arrangements

Over the past year, Ofwat has engaged with the sector in a review of corporate governance compliance and disclosure. The Board of NWL has worked constructively with Ofwat in order to develop a governance document which balances the legitimate requirements of all stakeholders. This has been shared with Ofwat.

INEDs and the Company's Licence

The Licence requires the Company to obtain undertakings from its shareholders to underpin the Licence and to require the Company's Board to include "not less than three independent non-executive directors, who shall be persons of standing with relevant experience" and who have collective knowledge of, and connections with, the Company's areas of supply and customers. Throughout the year, the Company had four INEDs, as detailed below. P Rew, Dr S Lyster and M Fay were the three INEDs for the purpose of the Licence.

P Rew, who is a chartered accountant and was a partner in PricewaterhouseCoopers LLP (PwC) from 1987 until 2010, where he was lead partner for a diverse range of FTSE 100 clients and for PwC's UK energy, utilities and mining sector practice. Most recently, he was PwC's sustainability and climate change assurance leader and renewables leader. He is a non-executive director of both the Met Office and DEFRA and chairs their Audit Committees. In June 2014 he joined the board of the Care Quality Commission as a non-executive director. P Rew has been a director of NWL since 2010. He is Chairman of the Audit Committee and the Risk and Compliance Committee and is also a member of the Remuneration Committee.

Dr S Lyster, who is a lawyer by training, qualified in both the UK and the USA, was Chief Executive of LEAD International from 2005 to 2011. Before joining LEAD, he was Director General of The Wildlife Trusts and previously worked for World Wildlife Fund for nine years, where he was responsible for its global policy work on international conventions. He is Chairman of the World Land Trust and a Trustee of Conservation International–UK, the Kilverstone Wildlife Conservation Trust and the Rural Community Council of Essex. In July 2014 Dr Lyster was appointed to the Board of Natural England. Dr Lyster has been a director of NWL since 2006 and is a member of the Audit Committee and the Risk and Compliance Committee.

M Fay, who was Managing Director of Tyne Tees Television until December 2003 when she became Chairman of One North East, a position she held until August 2010. She is Deputy Chairman of The Sage Gateshead, a Governor of the University of Sunderland, Patron of Tees Valley Community Foundation and the Prince of Wales' Ambassador for the north east of England. M Fay has been a director of NWL since 2010 and is a member of the Remuneration Committee.

M Nègre, who was, between April 2000 and April 2001, the CEO of the former Northumbrian Water Group plc and the chief corporate representative of its parent company, Suez, in the UK. He currently chairs Ecofin Vista Hedge Fund Limited, is a non-executive Director of listed Investment Trust EW &

CORPORATE GOVERNANCE (continued)

INEDs and the Company's Licence (continued)

PO plc and holds a number of directorships focused on utilities. He is a Director of Promethean plc, an AIM-listed investment company, and sits on the supervisory board of Messieurs Hottinger & Cie. M Nègre has been a director of NWL since 2006 and is a member of the Audit Committee and the Risk and Compliance Committee.

The four independent non-executive directors attend and participate in decisions at all NWGL Board meetings and at meetings of NWGL's Audit, Risk & Compliance and Remuneration Committees. Whilst these are formally constituted at the NWGL level, the vast majority of their work relates to the Company's activities. The independent non-executive directors therefore play a full part in all strategic decisions both at the NWL and NWGL Boards. All directors' views are given full consideration and due weight in all proceedings of the Board and Committees.

The precise membership of the committees is set out below, as are details of their work.

Board responsibilities and processes

The Board sets, implements and supports the Company's vision, values and strategy and ensures compliance with Group policies and legal and regulatory obligations. Within the Group framework, NWL operates as a standalone company and its strategy is determined by the NWL Board. During the year, the only decisions referred to the NWGL Board were certain large contract awards, capital project approvals and substantial funding arrangements and, in each case, the NWGL Board accepted the recommendations of the NWL Board.

The Company has adopted terms of reference which set out the matters reserved to the Board for approval and matters which are, or can be, delegated to the committees and management. The Company has also adopted financial approval rules which set out the authorisation processes and financial limits to be applied to financial transactions within the Company. The terms of reference and financial approval rules are reviewed regularly by the Board and, with effect from 1 April 2015, such reviews will be at least annual. The Standing or Executive Committees can take decisions not delegated to specific committees between Board meetings. All directors receive notice of Standing Committee meetings and may participate if they wish. Decisions taken by the Standing or Executive Committees are reported at the next Board meeting. The Company's Board meets at least six times each year.

Authorisation of directors' conflicts of interest

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

Board balance and independence

The composition of the Board is as follows:

A J Hunter (Chairman) and D N Macrae were appointed by CKI, which is listed on the Hong Kong Stock Exchange and is a substantial shareholder in the Company. A J Hunter is Deputy Managing Director of CKI and is an executive director of Power Assets Holdings Limited, a listed company. D N Macrae is Head of International Business for CKI.

H L Kam and T C E Ip were appointed by CKH, which is listed on the Hong Kong Stock Exchange and is a substantial shareholder in the Company. H L Kam is Group Managing Director of CKI and Deputy Managing Director of CKI and CKH. T C E Ip is Deputy Chairman of CKI and Deputy Managing Director of CKH.

CORPORATE GOVERNANCE (continued)

Board balance and independence (continued)

F R Frame was appointed by Li Ka Shing Foundation Limited, a company limited by guarantee and a charity, which is a substantial shareholder in the Company.

The CEO, H Mottram, and the three independent non-executive directors for the purposes of the Licence (P Rew, Dr S Lyster and M Fay) were appointed on the recommendation of the Nomination Committee of Northumbrian Water Group plc when it was independently listed. M Nègre was a founding director of NWGL when it acquired the Group from Suez SA in 2003 and has served as a director on the NWL Board since 2006. G Neave, the Operations Director, joined the Board of NWL in January 2002 and A C Jones, the Regulation and Scientific Services Director, joined in January 2004. C I Johns, Finance Director, joined on 1 January 2013.

The Chairman and CEO have clearly defined roles and responsibilities. The Chairman leads the Board and creates the conditions for overall Board and individual director effectiveness, both inside and outside the boardroom. The CEO is responsible for running the Company's business on a day-to-day basis. A J Hunter, D N Macrae, H L Kam, T C E Ip, F R Frame and H Mottram are also directors of NWGL.

The non-executive directors bring to the Board many years of business experience as well as financial expertise and the ability and willingness to constructively challenge and help develop proposals on strategy.

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

Risk Management

The Board has ultimate responsibility for risk management and determines the appropriate risk appetite. It monitors the management of fundamental risks and approves major decisions affecting the Company's risk profile. The Board is supported in this by the Risk and Compliance Committee, as explained below.

The Board requires management to identify and assess the impact of risks to the business using a risk model. The Board's view of acceptable risk is based on a balanced view of all of the risks in the operating environment and it aims to ensure an appropriate balance between risk aversion and opportunities.

The management team reviews the approach to risk management in detail every year and reviews the significant risks every month. Any issues are reported by the CEO to the Board. Senior management implements policies on risk management and internal control.

The system of internal control incorporates risk management. It encompasses a number of elements, including policies and procedures, business planning and budgeting and the maintenance of a risk management framework, that together facilitate an effective and efficient operation, enabling the Company to respond effectively to a variety of challenges.

Board committees

During the year, the NWGL Board had Audit, Risk & Compliance and Remuneration Committees to assist it in the performance of its duties. The Board sets the terms of reference of the Committees and receives regular reports from their chairmen at Board meetings.

Remuneration Committee

The members of the Remuneration Committee are A J Hunter (Chairman), H Mottram, P Rew, M Fay and D N Macrae. S Salter, from the management team, provides advice to the Remuneration Committee from time to time. H Mottram does not participate in discussions relating to her own remuneration and her bonus targets are set directly by the Chairman.

DIRECTORS' REPORT (continued)

CORPORATE GOVERNANCE (continued)

Remuneration Committee(continued)
The work of the Remuneration Committee is explained in note 10 of Section B. The Company complies with its obligations under Section 35A of the Water Act 2003 by disclosing in its regulatory accounts a detailed breakdown of remuneration paid to the executive directors of NWL, which includes those elements linked to NWL's standards of performance.

Audit Committee
The members of the Audit Committee are P Rew (Chairman), Dr S Lyster, M Nègre, D N Macrae and L S Chan.

During the year, and in the period up to the approval of these financial statements, the Audit Committee assisted both executive and non-executive directors to discharge their individual and collective responsibilities by undertaking the following work:

a. reviewed and provided comments on the draft statutory accounts, received reports from the external auditor setting out the audit approach and plan, significant audit risks and conclusions on the group's internal controls and risk management and confirming auditor independence, reviewed the appropriateness of accounting policies, significant accounting judgements and evidence supporting the going concern basis for the accounts and recommended approval of the accounts to the Board;
b. reviewed and provided comments on the NWL regulatory accounts and annual performance review, received reports from the external auditor on the audit opinion for the accounts, considered and endorsed the approach to produce and provide assurance for the annual performance review, reviewed evidence to support the Condition F6A.2A certificate (statement of sufficiency of financial resources) and recommended approval of both the documents to the Board;
c. reviewed and approved the approach to Board assurance for the regulatory price review business plan, monitored progress of the business plan assurance, and received reports from the independent assurance advisor and reported to the Board recommending signing of the Board assurance statement;
d. reviewed the effectiveness of the external auditor utilising an external best practice assessment framework and discussing the outputs with the audit partner;
e. reviewed the effectiveness of the internal audit function, including approving the appointment of an external co-sourcing partner to carry out specialist assurance work, requesting and considering a report on the effectiveness of the internal audit function carried out by the external co-sourcing partner and, whilst acknowledging that the function was professional and highly regarded, approving the resultant action plan to build on the existing strong base;
f. considered and approved external auditor's fees for both audit and non-audit services, by reference to the Committee's policy on approval of non-audit fees, requiring the audit partner to demonstrate independence particularly in respect of consultancy work in relation to workforce operations;
g. approved the internal audit work programme for the year, reviewed progress against the programme and received reports on the outputs of internal audits;
h. reviewed risk and control framework and reporting, including management of customer debt, tax and treasury compliance matters and approval of financial approval rules; and
i. monitored compliance with the Company's procedures designed to prevent bribery, having regard to the provisions of the Bribery Act 2010, including receiving reports on any whistleblowing allegations.

The Audit Committee also reviews the Company's arrangements for assuring the content and balance of the annual regulatory Risk and Compliance Statement and reports to the Board.

The Audit Committee Chairman reports formally to the NWGL and NWL Boards following each Audit Committee meeting and its minutes are circulated to both Boards.

CORPORATE GOVERNANCE (continued)

Risk and Compliance Committee
This Committee, which comprises the same members as the Audit Committee, enables a clearer focus on risk and compliance matters, formerly dealt with by the Audit Committee. This includes advising the Board on overall risk appetite, tolerance, strategy and any risk exposures, monitoring and reviewing risk assessment processes, monitoring the management of significant risks and keeping the effectiveness of the risk and internal control management systems under review. In addition, this Committee considers business continuity arrangements and monitors treasury risks and compliance with covenants.

The Board is able to monitor the impact of environmental, social and governance matters on the Company's business, to assess the impact of significant risks on the business and to evaluate methods of managing these risks through reports it receives from the Audit Committee and the Risk and Compliance Committee.

The UK Corporate Governance Code
The Board considers that it complies substantially with the relevant provisions of the UK CGC where they are appropriate for a privately held company, except as explained below.

Code Provisions
A.3.1: The Chairman was appointed by the Group's shareholders.

A.4.2: The Chairman has informal discussions with the non-executive directors as the need arises, though it has not been necessary to hold formal meetings with them without the executives present. This is consistent with the senior independent non-executive director's comment (in his report on page 13) that the "NWL Board functions as an integrated whole". The non-executive directors have not appraised the performance of the Chairman, but the Company has confirmed in its governance document, referred to below, that it intends to commence such appraisals with effect from April 2015.

B.1.1: The Board has determined that M Nègre is independent, notwithstanding that he served on the NWGL Board for more than nine years and has served on the NWL Board since 2006. M Nègre has no prior connections with the Group's shareholders. He is a very experienced director, and brings to the Board an excellent understanding of the business coupled with sound commercial judgment. He continues to contribute a constructive and challenging perspective to Board discussions. The Board is therefore satisfied that M Nègre is independent for the purposes of the UK CGC.

B.1.2: The Board comprises a Chairman appointed by the Group's shareholders, four further non-executive directors who are not independent as defined by the UK CGC, four independent non-executive directors and four executive directors (including the CEO). This balance has served the Company and its stakeholders well to date. The Company has confirmed in its governance document that it intends, by 1 April 2015, to reduce the number of executive directors to three.

B.2.1, B.2.2 and B.2.4: There is not a permanent Nomination Committee. The Company has confirmed (in its governance document) that new independent non-executive directors and executive directors will be appointed on an objective basis and by means of a formal, rigorous and transparent procedure, in which all non-executive directors will participate. Moreover, the Board has agreed to ensure that the recruitment process for independent non-executive directors is such that a diverse range of candidates is encouraged to apply.

B.4: Independent non-executive directors receive induction on joining the Board and continually update their knowledge of and familiarity with the Company. The Chairman does not formally review with each director their training and development needs. For executive directors this is managed by the CEO; independent directors keep up to date with developments in the sector via updates at Board meetings and external seminars.

CORPORATE GOVERNANCE (continued)

The UK Corporate Governance Code (continued)

B.6: As reported above, the Company has confirmed its intention to commence performance evaluations in accordance with principle B.6 with effect from April 2015. The performance of executive directors is appraised by the CEO and all executive directors participate in NWL's extensive 360^{o} feedback system.

B.7: Annual re-election is not relevant to a privately owned company.

D.1: The Company's policy on remuneration and the detailed remuneration disclosures are set out in note 10 of Section B.

D.2.1: The membership of the Remuneration Committee is disclosed on page 17, and this is considered to be appropriate given the Company's ownership.

Schedule B: There were eight Board meetings during the year, as well as six meetings of the Audit Committee, three meetings of the Risk and Compliance Committee and one meeting of the Remuneration Committee. Attendance at Board meetings was in excess of 90%, whilst attendance at the Audit, Risk and Compliance and Remuneration Committees was 80%, 93% and 100%, respectively.

Code of Conduct

The Group has a code of ethics, 'Our Code of Conduct', covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators. This is currently under review; it is intended to provide clearer guidance to employees in relation to personal conduct, conflicts of interest and a number of other matters.

OTHER DISCLOSURES

Results and dividends

Information on results and dividends is contained in the Financial Performance section of the Strategic report.

Financial instruments and treasury policies

Our policies in relation to the use of financial instruments and treasury operations are set out in the Strategic report under the 'Treasury policies' heading.

Employment policies

Our policies in respect of the employment for disabled persons and employee involvement are set out in the performance section of our Strategic report under the 'People' heading.

Political

NWL does 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 Company 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 the year were as follows:

Name of political party	£
Conservative	1,875
Labour	2,796
Liberal Democrats	2,073
Total	**6,744**

DIRECTORS' REPORT (continued)

Greenhouse gas emissions
The protocol that we use for measuring our emissions is based on the Carbon Accounting Workbook developed and updated annually by the Water Research Council, on behalf of the water industry, and published by UK Water Industry Research. This is founded on international and Defra protocols but includes additions that are specific to the water industry.

Our total net operational GHG emissions for the year ended 31 March 2014 were 199.7 ktonnes CO2e (2013: 214.8 ktonnes CO2e). Our carbon emissions are now a third lower than in 2008 and our carbon management plan aims to reduce our emissions to 150 ktonnes CO2e by 2020, which represents a fall of 50% in our emissions from a baseline of 2008.

In addition to absolute emissions we also monitor the emissions intensity of our operations using three measures, one relating to the water service and two for wastewater. It should be noted that these measures can be volatile depending upon levels of rainfall and pumping requirements, therefore we focus on longer term trends.

Annual operational GHG intensity ratio	**2013-14**	**2012-13**
Emissions/Ml of water	223.6	217.8
Emissions/Ml of sewage treated (flow to full treatment)	264.4	271.3
Emissions/Ml of sewage treated (water distribution input)	505.8	619.9

Figures in kgCO2e/Ml

Directors' indemnification
NWGL had directors' and officers' insurance in place for the period to 31 March 2014. On 28 November 2005 NWGL entered into a deed of indemnity to grant the directors of NWGL and its subsidiaries further protection against liability to third parties, and this remains in place.

Directors' statement
As required under s418 of the Companies Act 2006, so far as each current director is aware, there is no relevant audit information of which the Company's auditor is 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 auditor is aware of that information.

Auditor
Pursuant to s487 of the Companies Act 2006, Deloitte LLP is deemed to be re-appointed as the Company's auditor for the ensuing year.

Financial statements preparation and going concern
The directors believe that the Company is well placed to manage its business risks successfully. 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 Licence which is in place on a rolling 25 year basis;
- the certainty on customer tariffs to March 2015 resulting from the acceptance of the 2009 Final Determination by the Board, as well as the 2014 Price Review Draft Determination received from Ofwat on 30 May 2014;
- the financial strength of the group at the balance sheet date and performance for the year ended 31 March 2014, which is in line with expectations and reviewed at each Board meeting, most recently in May 2014;
- the key financial ratios over the planning horizon of the group's one year budget and medium term plan to 2018 as reflected in strong investment grade credit ratings with stable outlook;
- the fact that the Company has arranged £450m of five year committed bank facilities as back up liquidity (maturing in 2016), all of which remains undrawn at 31 March 2014; and
- the group's formal risk and governance arrangements which are monitored by the Audit Committee, Risk and Compliance Committee and Board.

Directors' responsibilities statement

The directors are responsible for preparing the report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial period. 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), with certain exceptions required by Ofwat which are detailed in note 1a of Section A. 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.

The directors consider that the report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the company's performance, business model and strategy. In reaching this conclusion, the Board has taken advice from the Audit Committee which has considered the process by which the report and financial statements has been produced as well as reviewing and commenting on the report.

The directors are responsible for the maintenance and integrity of the corporate and financial information on the Company's website. 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 2014

Registered office
Northumbria House
Abbey Road
Pity Me
Durham
DH1 5FJ

Registered in England and Wales
Registered no: 2366703

INDEPENDENT AUDITOR'S 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 2014 on pages 26 to 75 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 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 22, 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 in the regulatory accounts to identify material inconsistencies with the audited Regulatory Accounts and to identify any information that is apparently materially incorrect based on, or materially inconsistent with the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

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

Scope of the audit of the Regulatory Accounts (continued)

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 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 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).

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 and the accounting policies set out on pages 30 to 35 and 57 to 58 (including the accounting separation methodology), the state of the Company's affairs at 31 March 2014 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 and the accounting policies (including the accounting separation methodology).

Basis of preparation

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

The Regulatory Accounts are separate from the statutory financial statements of the Company 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 26 to 29 have been drawn up in accordance with Regulatory Accounting Guideline 3.07 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice 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 54.

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.

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

Other matters

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

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 December 2013 on which we report, which are prepared for a different purpose. Our audit report 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 work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by 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.

Anthony Matthews FCA (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Newcastle Upon Tyne, United Kingdom
11 July 2014

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2014

	Note	2014	2013
		£'m	£'m
Turnover	2	776.4	755.0
Operating costs	3(a)	(308.6)	(295.2)
Capital maintenance costs	3(b)	(137.9)	(132.4)
Total operating costs		(446.5)	(427.6)
OPERATING PROFIT		329.9	327.4
Other income		2.7	1.9
Net interest payable	4	(120.3)	(116.6)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		212.3	212.7
Taxation	8(a)	14.0	(62.7)
PROFIT FOR THE FINANCIAL YEAR	24	226.3	150.0

All results are from continuing operations in the United Kingdom.

HISTORICAL COST STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2014

	Note	2014	2013
		£'m	£'m
Profit for the financial year		226.3	150.0
Pension liability actuarial (loss) / gain in the year	26	(6.3)	2.3
Deferred tax related to pension adjustments	26	(3.0)	(2.0)
Total recognised gains and losses relating to the year		217.0	150.3

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2014

Analysis of historical cost financial information between appointed and non appointed business.

		2014			2013		
		Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	Note	£'m	£'m	£'m	£'m	£'m	£'m
Turnover	A	750.3	26.1	776.4	730.0	25.0	755.0
Operating costs		(293.1)	(15.5)	(308.6)	(280.6)	(14.6)	(295.2)
Infrastructure renewals charge		(50.8)	(0.1)	(50.9)	(50.0)	(0.1)	(50.1)
Historical cost depreciation		(87.8)	(0.8)	(88.6)	(83.9)	(0.6)	(84.5)
Operating income		1.6	-	1.6	2.2	-	2.2
OPERATING PROFIT	A	320.2	9.7	329.9	317.7	9.7	327.4
Other income		0.2	2.5	2.7	0.1	1.8	1.9
Net interest (payable) / receivable		(130.0)	9.7	(120.3)	(126.5)	9.9	(116.6)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		190.4	21.9	212.3	191.3	21.4	212.7
Taxation - current		(39.4)	(3.5)	(42.9)	(47.7)	(3.6)	(51.3)
- deferred	A	56.5	0.4	56.9	(11.5)	0.1	(11.4)
PROFIT FOR THE FINANCIAL YEAR		207.5	18.8	226.3	132.1	17.9	150.0
Dividends		(144.0)	(46.2)	(190.2)	(140.1)	(10.5)	(150.6)
RETAINED PROFIT / (LOSS) FOR THE YEAR		63.5	(27.4)	36.1	(8.0)	7.4	(0.6)

HISTORICAL COST STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE APPOINTED BUSINESS

for the year ended 31 March 2014

	2014	2013
	£'m	£'m
Profit for the financial year	207.5	132.1
Pension liability actuarial (loss) / gain in the year	(6.3)	2.3
Deferred tax related to pension adjustments	(3.0)	(2.0)
Total recognised gains and losses relating to the year	198.2	132.4

HISTORICAL COST BALANCE SHEET
at 31 March 2014
(Registered number 2366703)

	Note	2014	2013
		£'m	£'m
FIXED ASSETS			
Tangible assets	10	3,535.3	3,470.8
Investments	11	160.9	160.9
		3,696.2	3,631.7
CURRENT ASSETS			
Stocks	12	2.8	2.8
Debtors due in less than one year	13	191.1	166.1
Debtors due in more than one year	14	0.8	1.5
Investments	15	15.0	5.0
Cash at bank and in hand		9.6	17.4
		219.3	192.8
CREDITORS			
Amounts falling due within one year	16	(215.7)	(196.9)
NET CURRENT ASSETS / (LIABILITIES)		3.6	(4.1)
TOTAL ASSETS LESS CURRENT LIABILITIES		3,699.8	3,627.6
CREDITORS: Amounts falling due after more than one year	17	(2,360.8)	(2,272.2)
PROVISIONS FOR LIABILITIES AND CHARGES	21	(139.8)	(193.5)
ACCRUALS AND DEFERRED INCOME	22	(198.6)	(203.8)
		(2,699.2)	(2,669.5)
NET ASSETS EXCLUDING PENSION LIABILITY		1,000.6	958.1
Pension liability	26	(88.3)	(72.6)
NET ASSETS INCLUDING PENSION LIABILITY		912.3	885.5
CAPITAL AND RESERVES			
Called up share capital	23	122.7	122.7
Profit and loss account	24	789.6	762.8
SHAREHOLDERS' FUNDS	24	912.3	885.5

Approved by the Board of Directors on 11 July 2014 and signed on their behalf by:

H Mottram

HISTORICAL COST BALANCE SHEET
at 31 March 2014
(Registered number 2366703)

Analysis of historical cost financial information between appointed and non appointed business

	Note	2014 Appointed business	2014 Non-appointed business	2014 Aggregated basis	2013 Appointed business	2013 Non-appointed business	2013 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	A	3,434.7	100.6	3,535.3	3,370.6	100.2	3,470.8
Investments - loans to group companies		-	160.9	160.9	-	160.9	160.9
		3,434.7	261.5	3,696.2	3,370.6	261.1	3,631.7
Infrastructure renewals prepayment/ (accrual)		21.2	(1.9)	19.3	10.8	(1.9)	8.9
Other current assets		196.4	4.1	200.5	168.1	37.0	205.1
CREDITORS: Amounts falling due within one year							
Borrowings		(38.1)	-	(38.1)	(35.9)	-	(35.9)
Other creditors		(170.5)	(7.6)	(178.1)	(176.5)	(5.7)	(182.2)
Total creditors: amounts falling due within one year		(208.6)	(7.6)	(216.2)	(212.4)	(5.7)	(218.1)
NET CURRENT ASSETS / (LIABILITIES)		9.0	(5.4)	3.6	(33.5)	29.4	(4.1)
TOTAL ASSETS LESS CURRENT LIABILITIES		3,443.7	256.1	3,699.8	3,337.1	290.5	3,627.6
CREDITORS: Amounts falling due after more than one year							
Borrowings		(2,359.1)	-	(2,359.1)	(2,271.2)	-	(2,271.2)
Other creditors		(1.7)	-	(1.7)	(1.0)	-	(1.0)
TOTAL CREDITORS: amounts falling due after one year		(2,360.8)	-	(2,360.8)	(2,272.2)	-	(2,272.2)
PROVISIONS FOR LIABILITIES AND CHARGES	A	(280.7)	(146.0)	(426.7)	(316.9)	(153.0)	(469.9)
NET ASSETS EMPLOYED		802.2	110.1	912.3	748.0	137.5	885.5
CAPITAL AND RESERVES		802.2	110.1	912.3	748.0	137.5	885.5

Approved by the Board of Directors on 11 July 2014 and signed on their behalf by:

H Mottram

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS for the year ended 31 March 2014

1. STATEMENT OF ACCOUNTING POLICIES

(a) Basis of accounting and consolidation

These financial statements are regulatory accounts prepared in accordance with guidance issued by Ofwat. They have been prepared under the historical cost convention in accordance with applicable Accounting Standards in the United Kingdom with the exception of:

- capital grants and contributions to infrastructure assets which is not in accordance with the Companies Act 2006 (as described in note e below).
- infrastructure renewals accounting which, in accordance with RAG 3.07 Guideline for the format and disclosure of the regulatory accounts has been accounted for in accordance with RAG 2.04 Guideline for classification of Capital Expenditure. RAG 2.04 is not in accordance with FRS 12 Provisions, Contingent Liabilities and Contingent Assets and FRS 15 Tangible Fixed Assets as described in note d(i) below.
- recognition of income relating to energy generation and rental income as described in note b below.

The Appointed business consists of regulated activities, defined in Condition A of the Licence to be ‘functions of’ and the ‘duties imposed on’ a water and sewerage undertaker by the Water Industry Act 1991. Such duties are consequently those necessary for the Company to fulfil its duty as a water and sewerage undertaker.

Non-appointed activities are those for which the Company is not a monopoly supplier, such as the sale of laboratory services to external organisations or recreation and holiday letting facilities at Kielder Waterside Park.

The accounts have been prepared on a going concern basis which assumes that the Company will have adequate funding to meet its liabilities as they fall due in the foreseeable future.

(b) Turnover and revenue recognition

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.

The revenue recognition policy is the same in the regulatory and statutory accounts, except where Ofwat has decided to depart from UK GAAP and disapply the provisions of Application Note G of FRS 5, which states that turnover should not include amounts that the Company does not expect to collect. Income relating to energy generation is recorded as turnover in the statutory accounts but as negative operating expenditure in the regulatory accounts (Note A).

In addition, rental income is recognised within turnover in the statutory accounts but in the regulatory accounts is recognised within other income below operating profit, as required by RAG 4.04 Guideline for the definitions for the regulatory accounts tables (Note A).

An accrual is made for unmeasured consumption not yet billed at year end.

In respect of measured income, an accrual is also made for the amount of mains water and wastewater charges unbilled at the year end. This is estimated using a defined methodology based upon weighted average water consumption by tariff, calculated using historical information, and is recognised in turnover.

Invoices raised or payments received where the service has not been provided are not recognised in turnover in the year but are treated as payments in advance.

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. They are not recognised in turnover.

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.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(b) Turnover and revenue recognition (continued)

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.

(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 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 3.07 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 prepayments and provisions at years ended 31 March 2013 and 31 March 2014 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 through relining or replacing pipes. The ‘overlap’ represented the extra cost of replacing pipes rather than relining them where their structural condition was insufficient to withstand the relining process. Such expenditure was included in the infrastructure renewals charge in the regulatory accounts. The statutory financial statements classified such expenditure as capital in nature, included in infrastructure assets in the fixed asset note.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation (continued)

(ii) Non-infrastructure assets

Additions are included at cost. Other assets are included at cost less accumulated depreciation. Tangible fixed assets are reviewed for impairment wherever circumstances indicate that the carrying value of such assets may not be recoverable in accordance with FRS 11 Impairment of fixed assets and goodwill.

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

(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

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets, in accordance with RAG 3.07. 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.

(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 a defined benefit section 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.

(i) Taxation

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

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(i) Taxation (continued)

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 2014.

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 receivable or 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.

(n) Liquid resources

Liquid resources comprise external deposits and cash.

(o) Bad debts

(i) Bad debt write offs

The Company's bad debt write-off policy has remained unchanged during the year and has been consistently applied in the current and prior years. There has been no significant variation in the level of write off from the prior year.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(o) Bad debts (continued)

(i) Bad debt write offs (continued)

Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is considered to be impossible, impractical, inefficient or uneconomic to collect.

Situations where this may arise and where debt may be written off are as follows:

- where the customer has absconded without paying and strategies to trace their whereabouts and collect outstanding monies have been fully exhausted;
- where the customer has died without leaving an estate or has left an insufficient estate on which to levy execution;
- where the customer does not have any assets or has insufficient assets on which to levy execution;
- where the value of the debt makes it uneconomic to pursue;
- where county court proceedings and attempts to recover the debt by debt collection agencies have proved unsuccessful; and
- where the customer has been declared bankrupt, is in liquidation or is subject to insolvency proceedings or a debt relief order and no dividend has been or is likely to be received.

For debt to be written off there must be a legitimate charge against the debtor. If it is considered that part or all of the debt is incorrect or unsubstantiated, then such elements are dealt with through the issue of a credit note.

(ii) Bad debt provisioning

The Company's bad and doubtful debts provision policy has remained unchanged during the year and has been consistently applied in the current and prior years.

The bad debt provision is charged to operating costs to reflect the company's assessment of the risk of non recoverability of debtors. It is calculated by applying expected recovery rates to debts outstanding at the end of the accounting period. These recovery rates take into account the age of the debt, payment history and type of debt.

Higher provisioning percentages are applied to categories of debt which are considered to be of greater risk, including those with a poor payment history as well as to those of greater age. Bad debt provisioning rates are reviewed annually to reflect the latest collection performance data from the company's billing system. All debt greater than 48 months old is fully provided for. Actual amounts recovered may differ from the estimated levels of recovery which could impact on operating results.

The provision has increased from £58.4m at 31 March 2013 to £66.2m at 31 March 2014. This reflects the additional provision made in the year as outstanding debt has aged. This has added to the existing provision for older debt which remains fully provided for as the debt is only written off in the specific circumstance outlined above. In addition we have implemented a more thorough recovery process for previous occupier debt which, whilst improving the overall collection rate, has extended the period over which this debt is recovered.

(p) Capitalisation policy

The capitalisation policies applied in the regulatory accounts comply with FRS 15, other than for infrastructure renewals accounting for which FRS 15 is dis-applied in accordance with RAG 1.05 Guideline for accounting for capital maintenance charges and current costs.

Construction or purchase of new assets is capitalised. Subsequent maintenance expenditure is treated as opex unless it provides an enhancement of economic benefits in excess of the expected standard of performance such as an extension in the estimated useful life or an increase in capacity, in which case it is capitalised.

Replacement of assets, including full pipe lengths, stop taps, valves, meter chambers and manhole covers, are capitalised. Repair work and cleaning are charged to opex. All 'find and fix' leakage costs are charged to opex. CCTV work is charged to opex unless it leads specifically to a capital job.

Activities such as zonal studies or catchment studies, which are integral to the capital planning and prioritisation process, are capitalised.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(p) Capitalisation policy (continued)

Increases in operating costs incidental to a capital project are not capitalised, for example, higher treatment costs resulting from a works being taken out of service for refurbishment.

Direct labour costs are initially charged as operating costs and, for staff working on capital schemes, time is allocated by timesheets and recharged to the capital project based on an hourly rate reflecting actual costs.

Further detail is provided in the accounting separation methodology statement published on our websites.

2. SEGMENTAL INFORMATION

The directors consider that the Company has one class of business, the provision of water and sewerage services. All turnover is generated from within the United Kingdom.

Appointed business turnover for the year ended 31 March 2014 of £750.3m was £21.6m lower than the 2009 price review final determination target of £771.9m. Of this variance, £13.7m related to the water service and £7.9m to the sewerage service. The lower income is largely due to lower tariff basket income (£18.3m) as a result of fewer new properties being constructed and lower average consumption per measured property. In addition, non-household demand has continued to decline year on year as a result of the difficult prevailing economic conditions.

As at 31 March 2014, there were no significant differences between the measured income accrual of £51.2m (2013: £48.0m) and amounts subsequently billed to customers of £51.2m (2013: £48.0m).

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

(a) Operating costs comprise:

	2014	2013
	£'m	£'m
Materials and consumables	19.6	20.0
Other external charges	79.2	74.5
Net manpower costs (note 7)	116.3	110.3
Other operating charges	128.1	122.6
Own work capitalised	(34.6)	(32.2)
	308.6	295.2

(b) Capital maintenance costs comprise:

	2014	2013
	£'m	£'m
Depreciation:		
Non-infrastructure assets	87.3	83.5
Assets held under finance leases	3.8	4.1
Infrastructure renewals expenditure	61.1	64.8
Infrastructure renewals prepayment	(10.2)	(14.7)
Amortisation of capital grants and contributions	(2.5)	(3.1)
Profit on disposal of fixed assets	(1.6)	(2.2)
	137.9	132.4

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

(c) Profit on ordinary activities before taxation:

	2014	2013
	£'m	£'m
Profit on ordinary activities before taxation is stated after charging:		
Operating leases:		
Plant and machinery	0.1	0.1
Other assets	0.9	1.2
Costs of research and development	1.0	1.2
Directors' emoluments (note 5)	1.7	1.4

Auditor's remuneration in respect of the statutory audit amounted to £126k (2013: £120k), including fees for a subsidiary, Northumbrian Water Finance plc (NWF), of £6k (2013: £6k). Fees of £53k (2013: £45k) were incurred in respect of regulatory reporting, including the audit of the regulatory accounts, the principal statement and the statement of sufficiency of financial resources and facilities. Fees of £808k (2013: £52k) were incurred for non-audit services comprising consultancy work in relation to workforce operations, regulatory price control business plan assurance and pension, tax compliance and cash collection advice.

4. NET INTEREST PAYABLE

	2014	2013
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	19.6	18.9
Group loans	107.9	106.7
Financing charges payable under finance leases	5.6	0.9
Total interest payable	133.1	126.5
Interest receivable:		
Group interest	(9.9)	(10.0)
External interest	(0.4)	(0.5)
Total interest receivable	(10.3)	(10.5)
Other finance (income) / costs relating to pension scheme (note 26)	(2.5)	0.6
Net interest payable	120.3	116.6

5. DIRECTORS' EMOLUMENTS

(a) Directors' remuneration

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

	2014	2013
	£'000	£'000
Emoluments (including benefits in kind)	1,669	1,425

For those directors holding office with both NWL and NWGL, or contributing significantly to the day to day operations of NWGL, costs are apportioned between the companies to reflect the level of activity carried out for each company. This note reflects only the proportion of costs charged to NWL.

The executive directors' remuneration policy was restructured in 2013, reducing the value of bonus and long term incentive plan (LTIP) awards and offsetting this with an adjustment to basic pay. The increase from 2013 to 2014 in the table above is a consequence of the basic pay adjustment being included whilst payments under the LTIP are deferred until the completion of three years from the start of each performance period and the first payment is not due until 2014-15.

The directors' remuneration policy and a detailed report showing total remuneration for each director are provided in note 10 of Section B to the accounts.

One of the directors at 31 March 2014 was a member of a defined benefit pension scheme where the Company makes contributions towards the cost (2013: 1).

Two of the directors at 31 March 2014 were members of a defined contribution scheme where the Company makes contributions towards the cost (2013: 2).

(b) Highest paid director

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

	2014	2013
	£'000	£'000
Emoluments (including benefits in kind)	568	462

In 2013/14, the highest paid director was a member of the defined contribution scheme and the payments made to that scheme of £33k (2013: £36k) 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:

	2014	2013
	£'m	£'m
Gross costs charged to the profit and loss account:		
Wages and salaries	68.6	67.0
Social security costs	6.4	6.1
Other pensions costs	12.7	10.7
	87.7	83.8
Costs recharged to other Group companies:		
Wages and salaries	1.9	2.0
Social security costs	0.2	0.2
Other pensions costs	0.3	0.3
	2.4	2.5
Net costs charged to the profit and loss account:		
Wages and salaries	66.7	65.0
Social security costs	6.2	5.9
Other pensions costs	12.4	10.4
	85.3	81.3
Costs charged to capital schemes and infrastructure renewals:		
Wages and salaries	24.5	23.1
Social security costs	2.3	2.1
Other pensions costs	4.2	3.8
	31.0	29.0
Total net employee costs	116.3	110.3

The average monthly number of employees on the payroll during the financial year was 2,996 (2013: 2,960) and the total at the year end was 3,006 (2013: 2,986).

8. TAXATION

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

	2014	2013
	£'m	£'m
Current tax:		
UK corporation tax on profits for the year at 22.811% (2013: 23.828%)	6.4	19.7
Adjustments in respect of prior years	(1.5)	(0.3)
Payable in respect of group relief for the current year at 22.811% (2013: 23.828%)	29.5	31.0
Adjustments in respect of prior years	0.3	0.3
Payable in respect of consortium relief for the current year	8.2	0.6
Total current tax charge (note 8b)	42.9	51.3
Deferred tax:		
Reduction due to opening tax rate change	(50.0)	(16.6)
Decrease in discount arising from above rate change	20.6	8.1
Net reduction in opening deferred tax	(29.4)	(8.5)
Movement in the year at 20% (2013: 23%):		
Origination and reversal of timing differences in the year	0.8	1.7
Adjustments in respect of prior periods	0.7	-
	1.5	1.7
(Increase) / decrease in discount arising from current year movements	(29.0)	18.2
	(27.5)	19.9
Total deferred tax (credit) / charge (note 21)	(56.9)	11.4
Tax (credit) / charge on profit on ordinary activities	(14.0)	62.7

The rate of UK corporation tax was reduced from 24% to 23% by the Finance Act 2012 with effect from 1 April 2013. The rate has been reduced further to 21% with effect from 1 April 2014 and to 20% with effect from 1 April 2015 by the Finance Act 2013. Accordingly, deferred tax was restated as at 1 April 2013 from 23% to 20%, being 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 £126.4m (2013: £126.0m) for which payment will be made at the rate of 22.811% (2013: 23.828%).

Tax losses have provisionally been claimed as group relief from other Group companies, for which payment is being made at the full rate of tax. In addition, tax losses have been provisionally claimed as consortium relief from a related company for which payment is being made at less than the full rate of tax.

Discount has increased due to rising gilt rates offset by the impact of the opening reduction in the corporation tax rate.

8. TAXATION (continued)

(b) Reconciliation of the current tax charge:

	2014	2013
	£'m	£'m
Profit on ordinary activities before tax	212.3	212.7
Profit on ordinary activities multiplied by standard rate of corporation tax of 22.811% (March 2013: 23.828%)	48.4	50.7
Expenses not deductible for tax purposes	0.2	0.2
Non-taxable income and other tax reliefs	(1.8)	(2.1)
Depreciation in respect of non-qualifying items	4.7	4.7
(Decelerated) / accelerated tax depreciation	(0.1)	1.7
Pension deficit	2.2	3.2
Other timing differences	(3.1)	(6.6)
Adjustments in respect of prior periods	(1.2)	-
Consortium relief paid for at less than full value	(6.4)	(0.5)
Transfer pricing adjustments	(0.7)	(1.0)
Balancing payment payable	0.7	1.0
Total current tax charge (note 8a)	42.9	51.3

(c) Factors that may affect future tax charges:

Legislation has already been enacted to reduce the UK rate of corporation tax to 20% by 1 April 2015 (see note 8(a)). Had that rate applied in the year to 31 March 2014, the current period's corporation tax charge would have been reduced by £5.5m to £38.6m.

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 legislation, should result in claims for tax relief in excess of depreciation.

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

	2014	2013
	£'m	£'m
Equity:		
Dividends paid:		
Interim paid for the year ended 31 December 2013 of 74.28p (year ended 31 March 2012: 80.61p) per share on an aggregated basis	91.1	98.9
Interim paid for the year ended 31 December 2013 of 80.80p (period ended 31 December 2012: 42.18p) per share on an aggregated basis	99.1	51.7
Total dividends paid in the year	190.2	150.6
Dividends proposed:		
Interim proposed for the year ended 31 December 2014 of 84.18p (period ended 31 December 2013: 74.28p) per share on an aggregated basis	103.3	91.1

No final dividend was proposed for the year ended 31 December 2013 (31 December 2012: nil), the Company's statutory accounting reference date.

The directors have a policy which 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. Following the Board's creation of a more efficient capital structure during the year, the dividend has been rebased.

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 2013	126.4	1,600.9	2,466.3	202.0	169.1	4,564.7
Additions	-	-	-	-	166.2	166.2
Schemes commissioned	2.9	107.5	122.0	14.0	(246.4)	-
Reclassifications	-	-	(0.1)	0.1	-	-
Grants and contributions	-	(8.6)	-	-	(1.4)	(10.0)
Disposals	(0.5)	(0.1)	(2.6)	(0.2)	-	(3.4)
At 31 March 2014	128.8	1,699.7	2,585.6	215.9	87.5	4,717.5
Depreciation:						
At 1 April 2013	45.1	-	896.0	152.8	-	1,093.9
Charge for the year	2.7	-	77.8	10.6	-	91.1
Reclassifications	-	-	(0.1)	0.1	-	-
Disposals	(0.1)	-	(2.5)	(0.2)	-	(2.8)
At 31 March 2014	47.7	-	971.2	163.3	-	1,182.2
Net book value:						
At 31 March 2014	81.1	1,699.7	1,614.4	52.6	87.5	3,535.3
At 31 March 2013	81.3	1,600.9	1,570.3	49.2	169.1	3,470.8
Leased assets included above:						
Net book value:						
At 31 March 2014	-	49.9	20.9	-	-	70.8
At 31 March 2013	-	49.9	20.9	-	-	70.8

11. FIXED ASSET INVESTMENTS

	Loans to Group companies
	£'m
At 1 April 2013 and 31 March 2014	160.9

The Company holds 100% of the nominal value of issued ordinary £1 shares of NWF, whose principal activity is to hold certain finance instruments on behalf of the Company.

The Company holds 100% of the nominal value of issued ordinary £1 shares of Reiver Holdings Limited, which in turn has a wholly owned subsidiary, Reiver Finance Limited, whose principal activity is as a special purpose financing vehicle.

The Company also has two quasi-subsidiary special purpose entities, Bakethin Holdings Limited, which is wholly owned by Bakethin Charitable Trust, and Bakethin Finance plc, which is a wholly owned subsidiary of Bakethin Holdings Limited. The principal activity of Bakethin Finance plc is as a special purpose financing vehicle.

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

In May 2004, the Company made a loan of £1.5m to Bakethin Holdings Limited, maturing in January 2034**.** The interest on the loan is capitalised and at 31 March 2014 the balance was £1.9m (2013: £1.9m).

12. STOCKS

	2014	2013
	£'m	£'m
Raw materials and consumables	2.8	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

	2014	2013
	£'m	£'m
Trade debtors	89.3	84.1
Corporation tax repayable	6.4	3.8
Amounts owed by other group companies	8.1	3.9
Other debtors	5.9	4.1
Infrastructure renewals prepayment (note 21)	19.3	8.9
Prepayments and accrued income	62.1	61.3
	191.1	166.1

Trade debtors are shown net of bills raised in advance and provision for doubtful debts. There has not been a significant movement in the trade debtor balance from the prior year.

14. DEBTORS DUE IN MORE THAN ONE YEAR

	2014	2013
	£'m	£'m
Loan facility prepayments	0.8	1.5

15. INVESTMENTS

	2014	2013
	£'m	£'m
Short term deposits	15.0	5.0

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2014	2013
	£'m	£'m
Obligations under finance leases (note 19)	7.5	7.2
Loans (note 18)	30.6	28.7
Trade creditors	5.9	5.6
Amounts owed to other Group companies	27.0	24.3
Amounts owed to related parties	7.1	-
Taxation and social security	2.4	2.3
Other creditors	12.7	14.3
Receipts in advance	22.2	20.2
Accruals and deferred income	100.3	94.3
	215.7	196.9

Accruals and deferred income includes accruals related to capital projects of £33.2 m (2013: £31.1m).

Included in amounts owed to other Group companies is £22.6m (2013: £23.0m) payable in respect of tax losses surrendered from fellow Group companies.

Amounts owed to related parties of £7.1m (2013: £nil) are payable in respect of tax losses surrendered as consortium relief from associated companies outside of the Group.

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

	2014	2013
	£'m	£'m
Obligations under finance leases (note 19)	102.3	101.3
Loans (note 18)	388.7	319.0
Amounts owed to other Group companies (note 20)	1,868.1	1,850.9
Amounts owed to related parties	1.7	0.6
Other creditors	-	0.4
	2,360.8	2,272.2

Amounts owed to related parties of £1.7m (2013: £0.6m) are payable in respect of tax losses surrendered as consortium relief from associated companies outside of the Group.

18. LOANS

	2014	2013
	£'m	£'m
Loans are repayable as follows:		
Within one year (note 16)	30.6	28.7
Between one and two years	32.6	30.6
Between two and five years	114.4	105.6
After five years	241.7	182.8
	419.3	347.7

Loans wholly repayable within 5 years amount to £43.9 m (2013: £54.3m).

Loans not wholly repayable within 5 years amount to £375.4m (2013: £293.4m) and bear interest rates in the range 1.48% to 5.19%.

At 31 March 2014, the fair value loss on the Company's outstanding interest rate swaps was £9.4m (2013: £15.3m).

19. OBLIGATIONS UNDER FINANCE LEASES

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

	2014	2013
	£'m	£'m
Amounts due:		
Within one year	7.5	7.2
Between one and two years	7.2	6.7
Between two and five years	64.4	66.3
After five years	86.7	77.6
	165.8	157.8
Less:		
Finance charge allocated to future periods	(56.0)	(49.3)
	109.8	108.5
Disclosed as due:		
Within one year (note 16)	7.5	7.2
After more than one year (note 17)	102.3	101.3
	109.8	108.5

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 £60.4m (2013: £97.4m).

20. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	2014	2013
	£'m	£'m
After five years	1,868.1	1,850.9

NWF issued £200m and £150m 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 (2013: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2013: £0.3m).

NWF issued £300m 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 (2013: £0.1m).

NWF issued £250m and £100m 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 (2013: £0.2m).

NWF issued £150m 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 £6.0m (2013: £5.9m).

NWF issued £60m 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 £2.1m (2013: £2.3m).

NWF issued two £100m 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 £7.9m (2013: £7.7m).

NWF issued £360m 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 £0.7m (2013: £0.7m).

21. PROVISIONS FOR LIABILITIES AND CHARGES

	£'m
Pension provision for former employees:	
At 1 April 2013	2.2
Utilised during the year	(0.2)
At 31 March 2014	2.0
Deferred tax:	
At 1 April 2013	191.3
Total movement in the year (note 8a)	(56.9)
Included above relating to pensions (note 26)	3.4
At 31 March 2014	137.8
Infrastructure renewals:	
At 1 April 2013	(8.9)
Transferred from the profit and loss account (note 3b)	50.9
Utilised during the year	(61.3)
At 31 March 2014	(19.3)

	2014	2013
	£'m	£'m
Disclosed as:		
Debtors due < 1 year - infrastructure renewals prepayment (note 13)	(19.3)	(8.9)
Provisions for liabilities and charges	139.8	193.5

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 £2.0m represents the full future amounts payable, based on an actuarial assessment, for which the Company is directly liable.

The provision for deferred tax comprises:

	2014	2013
	£'m	£'m
Accelerated capital allowances	329.3	378.1
Other timing differences	(1.9)	(5.6)
Held over gains	1.0	1.0
Undiscounted provision for deferred tax	328.4	373.5
Discount	(190.6)	(182.2)
Disounted provision for deferred tax	137.8	191.3

22. ACCRUALS AND DEFERRED INCOME

	Capital grants and contributions	Proceeds from Kielder securitisation	Total
	£'m	£'m	£'m
At 1 April 2013	54.7	149.1	203.8
Additions	4.4	-	4.4
Amortised during the year	(2.5)	(7.1)	(9.6)
At 31 March 2014	56.6	142.0	198.6

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.

23. CALLED UP SHARE CAPITAL

	2014	2013
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2013: 122,650,000)	122.7	122.7

	2014	2013
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2013: 122,650,000)	122.7	122.7

NWL is a company limited by shares.

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

	Profit and loss account	Total shareholders' funds	
	2014	2014	2013
	£'m	£'m	£'m
At 1 April 2013	762.8	885.5	885.8
Profit for the year	226.3	226.3	150.0
Actuarial (loss) / gain on pension liability in the year (note 26)	(6.3)	(6.3)	2.3
Deferred tax related to actuarial loss / gain on pension liability in the year (note 26)	(3.0)	(3.0)	(2.0)
Dividends paid (note 9)	(190.2)	(190.2)	(150.6)
At 31 March 2014	789.6	912.3	885.5

25. COMMITMENTS

(a) Capital expenditure:

	2014	2013
	£'m	£'m
Expenditure contracted but not provided for	107.4	76.1

(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:

	2014	2013
	£'m	£'m
Land and buildings:		
Leases which expire:		
Not later than one year	0.1	0.1
After one year but not more than five	-	0.1
In five years or more	0.6	0.6
	0.7	0.8

	2014	2013
	£'m	£'m
Other:		
Leases which expire:		
Not later than one year	-	0.1
	-	0.1

(c) Foreign exchange contracts:
At 31 March 2014 the Company held forward foreign exchange contracts of £2.1m (2013: £2.4) for the purpose of hedging the foreign currency risk of committed future purchases.

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 1,679 active members at 31 March 2014 (2013: 1,751). 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 £70m 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. Contributions for the current period amounted to £1.6m and are expected to be £0.5m for the year to 31 March 2015.

The scheme also has a defined contribution section which had 1,200 active members at 31 March 2014 (2013: 616). 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 £2.9m (2013: £1.3m).

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 2014. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions:	2014	2013
Discount rate	4.4%	4.3%
Pay increases[1]	3.95%	3.85%
Price inflation (RPI)	3.3%	3.2%
Price inflation (CPI)	2.3%	2.2%
Pension increases linked to RPI	3.3%	3.2%
Pension increases linked to CPI	2.3%	2.2%
Mortality assumptions[2]	PCMA/PCFA00	PCMA/PCFA00
- Life expectancy for a member aged 65 - female (years)	24.6	24.5
- Life expectancy for a member aged 65 - male (years)	22.3	22.2

1. including promotional salary scale

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

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

	Long term expected rate of return 2014 %	2014 £'m	Long term expected rate of return 2013 %	2013 £'m
Equities	6.9	359.5	7.0	349.1
Corporate bonds	4.4	156.0	4.3	164.8
Government bonds	3.4	80.7	3.0	86.6
Property	5.9	82.0	4.5	75.9
Insurance policy	5.9	2.3	5.0	2.4
Cash	2.9	26.5	2.0	32.2
Other	5.3	79.2	4.5	75.7
Total fair value of assets		786.2		786.7
Present value of liabilities		(896.6)		(881.0)
Deficit under FRS17		(110.4)		(94.3)
Related deferred tax[1]		22.1		21.7
Net pension liability		(88.3)		(72.6)

Deferred tax is not discounted because the deficit to which it relates has itself been computed on a discounted basis by the Company's actuaries.

1. The movement in deferred tax of £0.4m comprises a reduction of £4.2m to reflect the 3% cut in the rate of UK corporation tax and £1.2m relating to the actuarial loss in the year, which are shown as a net charge of £3.0m in the statement of total recognised gains and losses, and an increase of £3.4m relating to other items which are recognised as credits 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:

	2014	2013
	£'m	£'m
Current service cost	13.2	13.0
Past service cost	0.7	0.2
Recognised in operating costs in arriving at operating profit	13.9	13.2

	2014	2013
	£'m	£'m
Interest cost on plan obligations	37.4	38.7
Expected return on plan assets	(39.9)	(38.1)
Recognised in net interest payable (note 4)	(2.5)	0.6

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

	2014	2013
	£'m	£'m
Net actuarial (loss) / gain by NWL	(6.3)	2.3
Cumulative amounts recognised since adopting the standard	(92.7)	(86.4)

History of experience gains and losses:

	2014	2013	2012	2011	2010
Fair value of assets	786.2	786.7	731.3	706.4	656.7
Present value of defined benefit obligation	(896.6)	(881.0)	(814.6)	(751.9)	(788.3)
Deficit	(110.4)	(94.3)	(83.3)	(45.5)	(131.6)
Experience adjustments arising on plan assets	(8.2)	48.8	(42.1)	10.4	175.3
Experience adjustments arising on plan liabilities	4.1	(4.0)	30.5	(0.3)	5.1

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

	2014	2013
	£'m	£'m
At 1 April	881.0	814.6
Current service cost	13.2	13.0
Past service cost	0.7	0.2
Interest cost	37.4	38.7
Contributions by plan participants	0.2	0.1
Actuarial losses on obligations	(1.9)	46.5
Benefits paid	(34.0)	(32.1)
At 31 March	896.6	881.0

26. PENSIONS (continued)

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

	2014	2013
	£'m	£'m
At 1 April	786.7	731.3
Expected return on plan assets	39.9	38.1
Actuarial (losses) / gains on plan assets	(8.2)	48.8
Contributions by employer	1.6	0.5
Contributions by plan participants	0.2	0.1
Benefits paid	(34.0)	(32.1)
At 31 March	786.2	786.7

Nature of benefits, regulatory framework and other entity's responsibilities for governance of the scheme
The scheme is a registered defined benefit final salary scheme subject to the UK regulatory framework for pensions, including the scheme specific funding requirements. The scheme is operated under trust and as such, the trustees of the scheme are responsible for operating the scheme and they have a statutory responsibility to act in accordance with the scheme's Trust Deed and Rules, in the best interest of the beneficiaries of the scheme, and UK legislation (including Trust law). The Trustees have the power to set the contributions that are paid to the Scheme.

Risks to which the scheme exposes the Company
The nature of the scheme exposes the Company to the risk of paying unanticipated additional contributions to the scheme in times of adverse experience. The most financially significant risks are likely to be:

- members living for longer than expected;
- higher than expected actual inflation and salary increase experience,
- lower than expected investment returns, and
- the risk that movements in the value of the scheme's liabilities are not met by corresponding movements in the value of the scheme's assets.

Asset-liability matching strategies used by the scheme or the Company
The scheme does not use any asset-liability matching strategies. The Trustees' current investment strategy, having consulted with the Company, is to invest the majority of the scheme's assets in a mix of equities and corporate bonds, in order to strike a balance between:

- maximising the returns on the scheme's assets, and
- minimising the risks associated with the lower than expected returns on the scheme's assets.

The Trustees are required to regularly review their investment strategy in light of the revised term and nature of the scheme's liabilities.

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.

26. PENSIONS (continued)

These assumptions imply an assumed life expectancy for a member aged 65 at 31 March 2014 of 22.3 years (2013: 22.2 years) for males and 24.6 years (2013: 24.5 years) for females. The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around £26.0m (3.0%).

27. RELATED PARTY DISCLOSURES

The Company is a wholly owned subsidiary of NWGL, whose publicly available consolidated financial statements 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 NWGL.

Transactions with related parties outside of the NWGL group comprised purchases of £2.2m (2013: £0.9m) and sales of £nil (2013: £nil). There were no amounts due from or to these companies at 31 March 2014 (2013: £nil) in respect of sales or purchases. £8.8m (2013: £nil) is owed in respect of tax losses surrendered to Hutchison 3G UK Limited (notes 16 and 17).

The companies with which NWL had transactions during the year, included in the above balances, were as follows:

Northern Gas Networks Limited
Hutchison 3G UK Limited
Hutchison Whampoa Limited
Hutchison Whampoa (Europe) Limited
UK Power Networks (Operations) Limited.

28. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

At the balance sheet date, the Company's immediate parent undertaking was NWGL, which is incorporated in England and Wales. In the directors' opinion, the Company's ultimate parent undertaking and controlling party, at the balance sheet date, was NWGL. NWGL is indirectly wholly owned by CKI, CKH and Li Ka Shing Foundation Limited.

Copies of NWGL's Group financial statements, which include the Company, are available from Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ.

(A) RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS for the year ended 31 March 2014

The Company prepared its statutory financial statements on a consolidated basis for the year ended 31 December 2013. These regulatory accounts are prepared for the entity only to 31 March 2014. Where there is also a difference relating to accounting treatment, the table below shows the impact of these consolidation and timing differences.

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's Regulatory Accounting Guidelines require that FRS 15 is not applied for infrastructure renewals accounting. In addition, Ofwat has instructed that the provisions of Application Note G of FRS 5, which states that turnover should not include amounts that the Company does not expect to collect, be disapplied. A reconciliation of accounting treatment differences between the statutory and historical cost regulatory accounts is set out below:

	Note	Statutory UK GAAP financial statements at 31 December 2013	Historical cost regulatory accounts at 31 March 2014	Total difference	Analysis of difference: Consolidation	Timing	Accounting
		£'m	£'m	£'m	£'m	£'m	£'m
PROFIT AND LOSS ACCOUNT							
Turnover	1	782.0	776.4	5.6	7.4	(6.2)	4.4
Operating Profit	2	338.3	329.9	8.4	7.2	(3.3)	4.5
Deferred tax credit	3	53.7	56.9	(3.2)	-	(0.2)	(3.0)
BALANCE SHEET							
Tangible fixed assets	4	3,783.9	3,535.3	248.6	-	(23.9)	272.5
Provisions for liabilities and charges:							
Deferred tax	5	176.8	137.8	39.0	(0.9)	(0.3)	40.2
Capital grants and contributions	6	240.0	56.6	183.4	-	(3.1)	186.5
Post employment liability	7	69.4	88.3	(18.9)	-	(19.5)	0.6

Note	Explanation of accounting differences
1	Statutory accounts include provision for revenue recognition of £1.7m in accordance with Note G of FRS 5, which is disapplied for regulatory purposes. Rental income of £2.7m is disclosed within other income below operating profit in the regulatory accounts as required by RAG 4.04.
2	Adjustments relating to amortisation of infrastructure income (£1.7m) in the statutory accounts, an additional charge in statutory accounts for VLS pension scheme (£0.1m) and disclosure of rental income (£2.7m) within other income below operating profit in the regulatory accounts.
3	Adjustment relating to amortisation of infrastructure income (£0.4m), Section 19 'overlap' (£1.2m), index-linked interest ((£0.4m)) and discount ((£4.2m)).
4	Adjustments relating to infrastructure grants and contributions netted off (£212.8m), Section 19 'overlap' (£40.4m) and infrastructure renewals prepayment (£19.3m).
5	Adjustments relating to amortisation of infrastructure income (£4.9m), Section 19 'overlap' (£8.1m), index-linked interest ((£0.7m)) and discount (£27.9m).
6	Adjustments relating to gross up (£212.8m) and amortisation ((£26.3m)) of infrastructure grants and contributions.
7	Adjustment relating to additional credit in statutory accounts for VLS pension scheme (£0.6m).

CURRENT COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2014

	2014			2013		
	Water	Sewerage	Total	Water	Sewerage	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Turnover						
Unmeasured - household	220.4	165.0	385.4	219.8	163.5	383.3
- non-household	2.9	4.6	7.5	2.7	4.1	6.8
Measured - household	112.1	53.9	166.0	103.7	49.0	152.7
- non-household	67.1	61.9	129.0	63.7	59.6	123.3
Trade effluent	-	2.6	2.6	-	2.5	2.5
Bulk supplies / inter company payments	0.6	-	0.6	0.5	-	0.5
Other third party services (inc potable water)	10.5	0.3	10.8	10.2	0.3	10.5
Other sources	28.8	19.6	48.4	29.2	21.2	50.4
Total turnover	442.4	307.9	750.3	429.8	300.2	730.0
Current cost operating costs - wholesale	(269.7)	(178.5)	(448.2)	(256.1)	(175.4)	(431.5)
Current cost operating costs - retail	(41.7)	(16.5)	(58.2)	(42.2)	(16.6)	(58.8)
Operating income	0.9	(0.7)	0.2	1.0	(1.0)	-
Working capital adjustment	(0.6)	(0.4)	(1.0)	(0.6)	(0.4)	(1.0)
CURRENT COST OPERATING PROFIT	131.3	111.8	243.1	131.9	106.8	238.7
Other income			0.2			0.1
Net interest			(130.0)			(126.5)
Financing adjustment			46.7			60.5
CURRENT COST PROFIT BEFORE TAXATION			160.0			172.8
Net revenue movement out of tariff basket	-	(0.2)	(0.2)	0.2	0.2	0.4

No back-billing amounts were identified. This information will be included in the Revenue Correction Mechanism for the PR14 Business Plan.

CURRENT COST CASH FLOW STATEMENT
for the year ended 31 March 2014

	2014	2013
	£'m	£'m
Current cost operating profit	243.1	238.8
Working capital adjustment	1.0	1.0
Movement in working capital	8.4	(11.9)
Receipts from other income	0.2	-
Current cost depreciation	162.5	159.7
Current cost profit on sale of fixed assets	(0.2)	-
Infrastructure renewals charge	50.8	50.0
Other non-cash movements	4.2	15.4
Contributions in respect of retirement benefits	(1.0)	(0.5)
Net cash flow from operating activities	469.0	452.5
Returns on investment and servicing of finance	(113.6)	(110.3)
Taxation paid	(34.2)	(34.7)
Capital expenditure and financial investment		
Gross cost of purchase of fixed assets	(158.4)	(171.9)
Receipt of grants and contributions	14.1	10.1
Infrastructure renewals expenditure	(61.2)	(64.9)
Disposal of fixed assets	2.2	3.0
Net cash flow from investing activities	(203.3)	(223.7)
Equity dividends paid	(144.0)	(140.1)
Net cash flow from management of liquid resources	(10.0)	75.0
NET CASH FLOW BEFORE FINANCING	(36.1)	18.7
Net cash inflow / (outflow) from financing	67.4	(27.1)
INCREASE / (DECREASE) IN CASH	31.3	(8.4)

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS for the year ended 31 March 2014

1. STATEMENT OF CURRENT COST ACCOUNTING POLICIES

The accounting policies used are the same as those adopted in the historical cost regulatory accounts, 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.

(a) 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 asset management plan (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 were valued at 31 March 2008 on the basis of open market value for existing use and subsequently, annually revalued to take account of changes in the general level of inflation as measured by changes in the RPI. 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.

- **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.

- **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.

(b) Real financial capital maintenance adjustments

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

(c) 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.

1. STATEMENT OF CURRENT COST ACCOUNTING POLICIES (continued)

(d) 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.

(e) Accounting separation policy

Cost allocations have been prepared in accordance with RAG 4.04 Guideline for the definitions for the regulatory accounts tables. 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.

Fixed assets directly involved in the activities within each business unit are recorded against that business unit using direct allocation per the location or asset type. Where an asset is utilised in more than one business unit, the asset is allocated to the business unit of principal use and costs are recharged to other different business units on the same basis used to allocate operating expenditure.

Further detail is provided in the accounting separation methodology statement published on our websites.

2. OPERATING COST ANALYSIS for the year ended 31 March 2014

Wholesale Business only

	Water					**Sewerage**					
	Resources	Raw water distribution	Treatment	Treated distribution	Water sub-total	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Sewerage sub-total	Total
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Operating expenditure											
Power	4.6	1.3	2.5	8.9	17.3	4.9	6.9	-	-	11.8	29.1
Income treated as negative expenditure	-	(0.1)	-	-	(0.1)	-	-	(1.6)	-	(1.6)	(1.7)
Service charges	21.9	-	0.2	-	22.1	1.3	1.8	-	-	3.1	25.2
Bulk supply imports	2.3	-	-	-	2.3	-	-	-	-	-	2.3
Other operating expenditure	9.6	1.0	29.2	39.8	79.6	22.3	17.8	16.0	2.3	58.4	138.0
Local authority rates	-	-	22.1	-	22.1	0.2	9.4	-	-	9.6	31.7
Total operating expenditure excluding third party services	38.4	2.2	54.0	48.7	143.3	28.7	35.9	14.4	2.3	81.3	224.6
Capital maintenance											
Infrastructure renewals charge	1.4	0.7	-	33.1	35.2	14.7	0.9	-	-	15.6	50.8
Current cost depreciation	4.6	2.5	34.0	43.5	84.6	11.1	51.0	15.3	0.1	77.5	162.1
Recharges to other business units	-	-	-	(6.1)	(6.1)	-	(0.1)	-	-	(0.1)	(6.2)
Recharges from other business units	0.5	0.1	0.7	0.2	1.5	0.8	0.8	0.5	-	2.1	3.6
Amortisation of deferred credits	(0.2)	-	(0.2)	(1.2)	(1.6)	(0.8)	(0.1)	-	-	(0.9)	(2.5)
Total capital maintenance excluding third party services	6.3	3.3	34.5	69.5	113.6	25.8	52.5	15.8	0.1	94.2	207.8
Third party services											
Operating expenditure	8.1	3.0	0.4	1.3	12.8	0.3	2.7	-	-	3.0	15.8
Total operating costs	52.8	8.5	88.9	119.5	269.7	54.8	91.1	30.2	2.4	178.5	448.2

2. OPERATING COST ANALYSIS for the year ended 31 March 2014 (continued)

	Retail Business only		
	Household	Non-household	Total
	£'m	£'m	£'m
Operating expenditure			
Customer services	11.6	1.6	13.2
Debt management	4.3	0.3	4.6
Doubtful debts	18.5	1.6	20.1
Meter reading	2.1	0.4	2.5
Services to developers	-	0.2	0.2
Other operating expenditure	10.0	1.0	11.0
Local authority rates	0.3	-	0.3
Total operating expenditure excluding third party services	46.8	5.1	51.9
Third party services operating expenditure	0.8	-	0.8
Total operating expenditure	47.6	5.1	52.7
Current cost depreciation	2.9	-	2.9
Recharges to other business units	(0.6)	-	(0.6)
Recharges from other business units	2.7	0.5	3.2
Total capital maintenance	5.0	0.5	5.5
Total operating costs	52.6	5.6	58.2
Debt written off	5.4	0.9	6.3

3. CURRENT COST ANALYSIS OF FIXED ASSETS

Wholesale Business only

	Water					**Sewerage**					
	Resources	Raw water distribution	Treatment	Treated distribution	Water sub-total	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Sewerage sub-total	Total
Non infrastructure assets	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross replacement cost											
As at 1 April 2013	306.3	217.2	1,248.3	1,324.3	3,096.1	400.6	1,973.1	464.7	1.0	2,839.4	5,935.5
AMP adjustment	-	-	-	9.1	9.1	-	0.1	0.1	0.1	0.3	9.4
Reclassification adjustment	(21.4)	(0.9)	(22.2)	138.0	93.5	(24.8)	(22.2)	(12.4)	(0.7)	(60.1)	33.4
RPI adjustment	6.2	5.2	30.7	35.1	77.2	9.2	48.5	11.3	-	69.0	146.2
Disposals	(2.4)	-	(1.1)	(6.2)	(9.7)	(0.2)	(0.6)	(2.4)	-	(3.2)	(12.9)
Additions	7.5	0.1	17.6	38.2	63.4	10.2	27.3	6.8	0.1	44.4	107.8
As at 31 March 2014	296.2	221.6	1,273.3	1,538.5	3,329.6	395.0	2,026.2	468.1	0.5	2,889.8	6,219.4
Depreciation											
As at 1 April 2013	120.1	72.6	652.4	639.7	1,484.8	181.8	977.2	202.7	0.6	1,362.3	2,847.1
AMP adjustment	(0.1)	-	(0.8)	(4.3)	(5.2)	(0.1)	(0.9)	-	-	(1.0)	(6.2)
Reclassification adjustment	(9.9)	(0.4)	(9.6)	57.8	37.9	(9.0)	(9.6)	(6.1)	(0.5)	(25.2)	12.7
RPI adjustment	1.9	1.4	15.5	16.5	35.3	4.1	23.6	4.9	-	32.6	67.9
Disposals	(1.8)	-	(1.0)	(5.8)	(8.6)	(0.2)	(0.6)	(1.5)	-	(2.3)	(10.9)
Charge for the year	4.6	2.5	34.0	43.5	84.6	11.1	51.0	15.3	0.1	77.5	162.1
As at 31 March 2014	114.8	76.1	690.5	747.4	1,628.8	187.7	1,040.7	215.3	0.2	1,443.9	3,072.7
Net book amount at 31 March 2014	181.4	145.5	582.8	791.1	1,700.8	207.3	985.5	252.8	0.3	1,445.9	3,146.7
Net book amount at 1 April 2013	186.2	144.6	595.9	684.6	1,611.3	218.8	995.9	262.0	0.4	1,477.1	3,088.4
Infrastructure assets											
Gross replacement cost											
As at 1 April 2013	1,099.3	751.1	-	5,057.6	6,908.0	12,694.8	160.9	-	-	12,855.7	19,763.7
AMP adjustment	-	-	-	0.2	0.2	-	-	-	-	-	0.2
Reclassification adjustment	-	20.2	-	(20.2)	-	-	-	-	-	-	-
RPI adjustment	26.9	18.9	-	123.5	169.3	311.4	3.9	-	-	315.3	484.6
Additions	4.7	-	-	16.9	21.6	30.0	-	-	-	30.0	51.6
As at 31 March 2014	1,130.9	790.2	-	5,178.0	7,099.1	13,036.2	164.8	-	-	13,201.0	20,300.1

3. CURRENT COST ANALYSIS OF FIXED ASSETS (continued)

	Retail Business only		
	Household	**Non-household**	**Total**
	£'m	£'m	£'m
Gross Replacement Cost:			
At 1 April 2013	85.3	10.8	96.1
AMP adjustment	(0.3)	-	(0.3)
Reclassification adjustment	(22.6)	(10.8)	(33.4)
RPI adjustment	1.7	-	1.7
Disposals	(0.1)	-	(0.1)
Additions	5.7	-	5.7
At 31 March 2014	69.7	-	69.7
Depreciation:			
At 1 April 2013	48.8	5.3	54.1
AMP adjustment	(0.4)	-	(0.4)
Reclassification adjustment	(7.4)	(5.3)	(12.7)
RPI adjustment	0.9	-	0.9
Disposals	(0.1)	-	(0.1)
Charge for year	2.9	-	2.9
At 31 March 2014	44.7	-	44.7
Net book amount at 31 March 2014	25.0	-	25.0
Net book amount at 1 April 2013	36.5	5.5	42.0

4. ANALYSIS OF CAPITAL EXPENDITURE, GRANTS AND LAND SALES for the year ended 31 March 2014

	2014			2013		
	Gross	Grants & contributions	Net	Gross	Grants & contributions	Net
	£'m	£'m	£'m	£'m	£'m	£'m
Capital expenditure - water						
Base						
Infrastructure renewals expenditure (IRE)	39.9	(2.9)	37.0	45.5	(1.1)	44.4
Maintenance non-infrastructure (MNI)	53.8	(0.1)	53.7	52.0	(0.1)	51.9
Enhancements						
Infrastructure enhancements	21.6	(7.7)	13.9	29.4	(5.5)	23.9
Non-infrastructure enhancements	7.0	(2.3)	4.7	8.5	(1.7)	6.8
Total capital expenditure - water	122.3	(13.0)	109.3	135.4	(8.4)	127.0
Grants and contributions - water						
Developer contributions (ie Enhancement requisitions, grants and contributions)		(5.9)			(4.4)	
Infrastructure charge receipts - new connections		(4.1)			(2.8)	
Other Contributions		(3.0)			(1.2)	
Total grants and contributions - water		(13.0)			(8.4)	
Capital expenditure - sewerage						
Base						
Infrastructure renewals expenditure (IRE)	25.2	(1.0)	24.2	22.1	(1.6)	20.5
Maintenance non-infrastructure (MNI)	46.8	(0.1)	46.7	46.2	-	46.2
Enhancements						
Infrastructure enhancements	30.0	(2.2)	27.8	16.7	(1.6)	15.1
Non-infrastructure enhancements	5.9	(1.4)	4.5	12.5	(1.2)	11.3
Large projects capex						
Total capital expenditure - sewerage	107.9	(4.7)	103.2	97.5	(4.4)	93.1
Grants and contributions - sewerage						
Developer contributions (ie Enhancement requisitions, grants and contributions)		(0.9)			(0.7)	
Infrastructure charge receipts - new connections		(2.5)			(1.9)	
Other Contributions		(1.3)			(1.8)	
Total grants and contributions - sewerage		(4.7)			(4.4)	
Total capital expenditure - water and sewerage	230.2	(17.7)	212.5	232.9	(12.8)	220.1
Land sales - Proceeds from disposals of protected land			3.5			3.0

5. WORKING CAPITAL

	2014	2013
	£'m	£'m
Stocks	2.5	2.5
Trade debtors:		
-measured household	21.7	19.8
-unmeasured household	49.7	46.4
-measured non-household	9.8	9.4
-unmeasured non-household	0.8	0.6
-other	4.7	5.3
Measured income accrual	55.1	51.2
Prepayments and other debtors	17.4	20.2
Trade creditors	(5.6)	(5.5)
Deferred income - customer advance receipts	(17.0)	(16.0)
Capital creditors	(33.2)	(31.0)
Accruals and other creditors	(73.4)	(62.0)
Total working capital	32.5	40.9
Total revenue outstanding:		
Household	71.4	66.2
Non-household	10.6	10.0

6. ANALYSIS OF NET DEBT, GEARING AND INTEREST COSTS FOR THE APPOINTED BUSINESS

	Fixed rate	Floating rate	Index linked	Total
	£'m	£'m	£'m	£'m
Borrowings (excluding preference shares)	1,714.9	100.9	581.4	2,397.2
Preference share capital				-
Total borrowings				2,397.2
Cash				(10.1)
Short term deposits				(15.0)
Net debt				2,372.1
Regulatory capital value				3,883.4
Gearing				0.61
Full year equivalent nominal interest cost	101.6	3.2	26.2	131.0
Full year equivalent cash interest payment	101.6	3.2	9.9	114.7
Indicative interest rates:				
Indicative weighted average nominal interest rate			4.51%	4.51%
Indicative weighted average cash interest rate			1.70%	1.70%
Weighted average years to maturity	15	23	30	19

7. REGULATORY CAPITAL VALUE AT 2013-14 PRICES

	2013-14
	£'m
Closing Regulatory Value at 31 March 2013 (March 2013 prices)	3,747.1
RPI from March 2013 to March 2014 (2.5%)	91.9
Opening regulatory capital value at 1 April 2013	3,839.0
Infrastructure renewals expenditure (IRE)	64.7
Infrastructure renewals charge	(53.2)
Capital expenditure (excluding IRE)	230.3
Grants and contributions	(19.0)
Current cost depreciation	(175.4)
Outperformance adjustment	(3.0)
Closing regulatory capital value at 31 March 2014	3,883.4
Year average regulatory capital value	3,814.2

Note the average year 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 were 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”.

8. NON-FINANCIAL INFORMATION for the year ended 31 March 2014

	2014		2013	
	Water	Sewerage	Water	Sewerage
Number of properties	'000	'000	'000	'000
Total company				
Households billed	1,777	1,117	1,772	1,114
Non-households billed	97	56	97	56
Household voids	80	53	79	53
Non-household voids	16	12	16	13
Properties served by new appointee in supply area as at 1 April 2009	-	-	-	-
Per capita consumption (excluding supply pipe leakage)	l/h/d		l/h/d	
Northumbrian Water				
Unmeasured household	143.07		142.46	
Measured household	136.63		135.19	
Essex and Suffolk Water				
Unmeasured household	159.49		155.59	
Measured household	142.23		139.99	
Volume	Ml/d		Ml/d	
Northumbrian Water				
Bulk supply export	0.71		0.70	
Bulk supply import	0.01		-	
Distribution input	664.97		669.47	
Essex and Suffolk Water				
Bulk supply export	2.21		2.21	
Bulk supply import	84.27		84.16	
Distribution input	428.31		419.68	

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

Associate	Service	December 2013 Turnover	Terms of Supply	2013/14 Value
		£'m		£'m
Vehicle Lease and Service Limited (VLS)	Rental of garage and service charges	14.5	Negotiated	0.1
AquaGib	Sale of materials	12.9	Negotiated	0.2

Services supplied to the appointee by associated companies:

Associate	Service	December 2013 Turnover	Terms of Supply	2013/14 Value
		£'m		£'m
Northumbrian Water Group Limited	Holding company charges	5.9	No market	0.9
Three Rivers Insurance Company Limited	Public liability insurance (deductible infill policy)	0.5	No market	0.5
Vehicle Lease and Service Limited	Vehicle maintenance and capital finance charge	14.5	Competitive letting	7.3
Northern Gas Networks Limited	Gas main diversions	397.3	No market	0.2
Hutchison Whampoa Limited	Oracle licensing	21,148.2	Negotiated	1.7
Hutchison Whampoa (Europe) Limited	Marketing services	22.0	Competitive letting	0.2
UK Power Networks Limited	Gas mains diversions	1,607.6	No market	0.1

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 4.04.

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.

Amounts borrowed by the appointee from associated companies

The Company has loans amounting to £1,868.1m due to NWF, a subsidiary company. Details of these loans and the associated guarantees are provided in note 20 of the historical cost regulatory accounts.

The Company acquires vehicles from VLS, an associated company, on a finance lease basis. During the year, new finance leases of £3.8m were entered into and capital repayments of £3.2m were made. The year end finance lease creditor was £9.5m. 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.

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES (continued)

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

	£'m
Dividends paid:	
Interim paid for the year ended 31 December 2013	48.4
Interim paid for the year ended 31 December 2013	95.6
Total dividends paid in the year	144.0
Dividends proposed:	
Interim proposed for the year ended 31 December 2014	98.8

No final dividend was proposed for the year ended 31 December 2013 (31 December 2012: nil).

The directors have a policy which 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. Following the Board's creation of a more efficient capital structure during the year, the dividend has been rebased. 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.

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 transactions with associated companies have been disclosed.

10. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

(a) Compliance with legislation

The following statement on directors' remuneration is disclosed in accordance with section 35A of the Water Act 2003. It also has regard to the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 in respect of directors' remuneration reporting for quoted companies, albeit in the context of a company which is not a listed public limited company. The information in section (d) below has been audited.

(b) Statement by the Chairman of the Remuneration Committee

The members of the Remuneration Committee (the Committee) are A J Hunter (Chairman), H Mottram, P Rew, M Fay and D N Macrae. S Salter, from the management team, provides advice to the Committee from time to time. H Mottram does not participate in discussions relating to her own remuneration and her bonus targets are set directly by the Chairman.

The work of the Remuneration Committee comprises the adoption of principles and standards in relation to executive remuneration and benefits, as well as agreeing individual remuneration packages. All decisions regarding directors' remuneration are taken by the Committee, other than where stated.

During the year, the Committee:
- agreed bonuses for 2013;
- set performance targets for executive directors and senior managers for 2014; and
- agreed the level at which the Long Term Incentive Plan (LTIP) award in respect of the 2013 calendar year would vest.

A J Hunter
Chairman of the Remuneration Committee

(c) Remuneration Policy

The policy of the Remuneration Committee is to pay no more than necessary to attract and retain good quality directors, and to ensure that policy is aligned with market practice.

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

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.

Basic salary
Basic salary is reviewed annually based on individual contributions, periodic benchmarking to the external market and with regard to the expected pay award for other groups of employees.

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'. There is no variable performance related element.

Benefits in kind
Benefits provided to the executive directors comprise car and fuel allowances and healthcare. There is no variable performance related element.

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

(c) Remuneration Policy (continued)

Bonus

The annual bonus is related to performance in the year. The performance targets are firmly linked to NWL's strategic themes (customer, competitiveness, people, environment and communities). Stretching targets are set which are aligned to the Company's vision of being the national leader in the provision of sustainable water and waste water services.

Bonuses are paid in cash with no deferral. 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. The bonus is structured with three elements, determined by the Committee:

- up to 50% payable on financial targets;
- up to 40% payable on balanced scorecard targets; and
- up to 10% payable on performance against personal targets.

The maximum bonus payable, as a percentage of basic salary, is 70% for the CEO and 50% for the other executive directors.

LTIP

Executive directors participate in a cash based LTIP assessed against financial, customer service and asset performance targets. The purpose of the LTIP is to reward a balanced approach between finance and performance, encourage a one team approach, engender a longer term view, remain competitive in the executive market and encourage retention of key people. Vesting is based on performance in the first year after award. However, payment is deferred until the completion of three years from the start of the performance period.

The LTIP is structured with three elements, determined by the Committee:

- up to 70% payable on financial performance;
- up to 15% payable on customer service performance; and
- up to 15% payable on asset performance.

Financial performance is assessed through the generation of sufficient profits to make distributions to Group shareholders in line with the Board approved plan. There is no vesting if the distribution target is not achieved. If the target is achieved then 50% of the 70% vests. Vesting would increase on a sliding scale such that 100% of the 70% would vest if 105% of the target is achieved.

Customer service performance is assessed 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 is no vesting of this part of an award unless fifth position in the rankings is achieved. If the position achieved is fifth or higher, vesting is on a sliding scale with 50% of the 15% awarded for fifth place and 100% of 15% awarded for first place.

50% of the 15% available in respect of asset performance vests for stable serviceability assessments in the relevant regulatory year in three of the four asset classes (water non-infrastructure, water infrastructure, sewerage non-infrastructure and sewerage infrastructure). All of the 15% available vests for stable assessments in all four asset classes.

The maximum LTIP payable, as a percentage of basic salary, is 50% for the CEO and 30% for the other executive directors.

Pension

The Company operates the Northumbrian Water Pension Scheme (NWPS) which has defined benefit and defined contribution (money purchase) sections. The defined benefit section closed to new entrants on 31 December 2007.

A C Jones participates in a defined benefit section, making an employee contribution of 8% of basic salary (under a salary sacrifice arrangement) and receiving an employer contribution equivalent to 16.9% of salary. Benefits relate to final salary and accrue at 1/45th for each year of service.

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

(c) Remuneration Policy (continued)

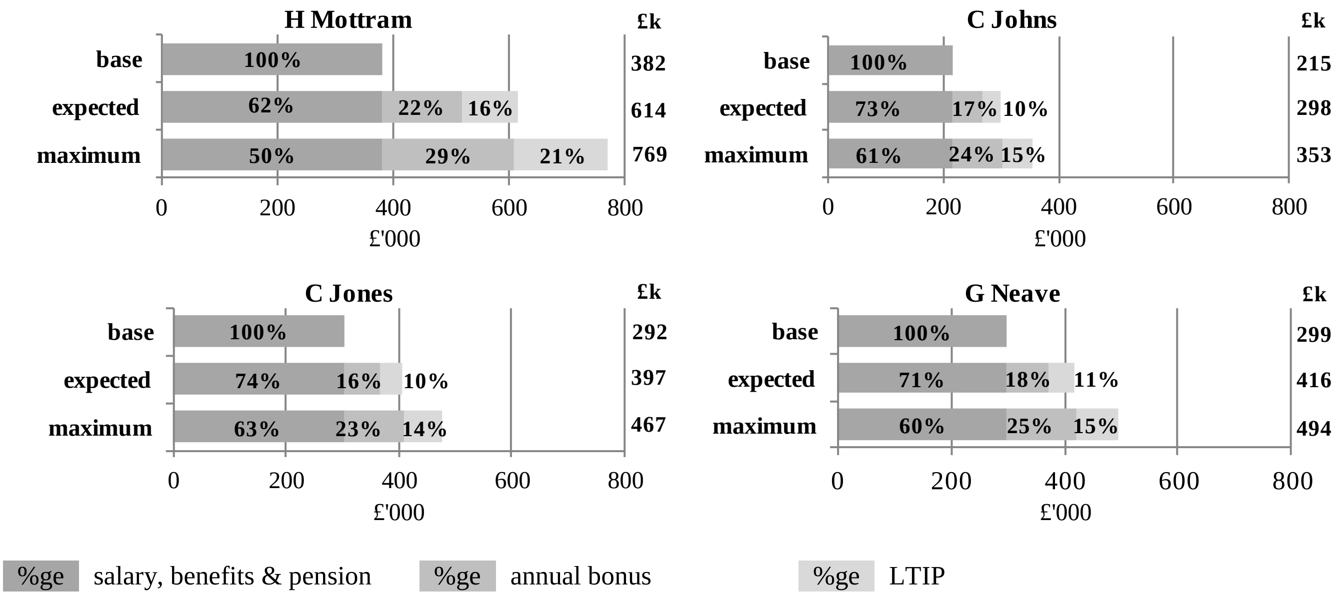
Pension (continued)

H Mottram and C I Johns participate in the defined contribution section of the NWPS. They each make an employee contribution of 8% of their respective basic salaries and receive an employer contribution of 15% of salary, up to the annual pension contribution taxation limits.

G Neave is a retired member of the NWPS. He receives a cash alternative to a pension contribution which equates to 15% of basic salary.

More details of the NWPS are provided in note 26 of Section A. There is no variable performance related element.

Illustration of remuneration policy



For the purposes of the graph, annual bonus and LTIP have been assumed to achieve 60% of their maximum potential value, though awards are dependent upon actual performance. Information on actual awards for bonus and LTIP in respect of 2013 is provided on pages 73 to 74.

Non-executive directors

The Company's policy is that the independent non-executive directors receive fees for their duties. The level of fees is set by reference to the market. An additional fee is paid to the Chair of the Audit Committee to reflect the additional responsibilities and time commitment involved. The non-executive directors do not receive benefits in kind and do not participate in bonus, LTIP or pension schemes operated by the Company.
The independent non-executive directors do not receive any other remuneration from the Company, the Group or its shareholders.

In respect of the non-executive directors appointed by the Group's shareholders, F R Frame receives the same base fee for performing his duties as a director of both the Company and NWGL. This fee is shared with NWL paying a 30% proportion and NWGL paying the remaining 70%. The other non-executive directors receive no remuneration from the Company.

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

(d) Directors' remuneration in 2013-14

The table below shows the total remuneration paid by the Company to directors during the current and previous years. The table has been produced in accordance with the requirements of Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and, as a result, the total remuneration differs from that reported in note 5 of Section A.

	salaries and fees		benefits in kind		bonus		LTIP		pension		total remuneration	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
H Mottram	303	240	11	10	196	134	94	151	58	57	662	592
C I Johns	155	37	14	2	52	-	30	-	41	13	292	52
A C Jones	209	165	13	11	67	66	38	62	74	75	401	379
G Neave	249	199	14	10	75	73	42	70	28	28	408	380
C M Green	-	123	-	8	-	86	-	108	-	19	-	344
M Fay	41	28	-	-	-	-	-	-	-	-	41	28
F R Frame	12	12	-	-	-	-	-	-	-	-	12	12
Dr S Lyster	41	28	-	-	-	-	-	-	-	-	41	28
M A B Nègre	41	12	-	-	-	-	-	-	-	-	41	12
P Rew	52	36	-	-	-	-	-	-	-	-	52	36
	1,103	880	52	41	390	359	204	391	201	192	1,950	1,863

The table shows only the proportion of remuneration borne by the Company. For two of the directors, H Mottram and C I Johns, NWL pays 70% of the remuneration and NWGL pays the remaining 30%. For F R Frame, NWL pays 30% of his remuneration and NWGL pays the remaining 70%. For the other directors reported in the table, NWL paid 100% of their remuneration in 2013-14. In 2012-13, NWL paid 70% of the remuneration of M Fay, Dr S Lyster and P Rew and 30% of the remuneration of M Nègre.

C I Johns was appointed to the Board on 1 January 2013, therefore the 2013 data only represents a partial year. C M Green resigned from the Board on 31 December 2012.

In 2012, after the change in ownership, the Committee agreed to restructure the remuneration of the executive directors by reducing the value of bonus and LTIP awards and offsetting this with an adjustment to basic pay. Specialist support was provided by Hay at that time to ensure jobs were sized correctly and a review of the market took place. This policy has remained in place for the calendar years 2013 and 2014.

Basic salary

In 2012 the Committee agreed to restructure the remuneration of the executive directors by reducing the value of bonus and LTIP awards and offsetting this with an adjustment to basic pay (with advice from Hay Group, independent external reward consultants). This became effective from January 2013. For 2014, senior executives were awarded an annual increase in their basic salaries of 2.6%. This was below the level awarded to all other employee groups, which was typically 2.75%.

Benefits

Taxable benefits provided to the executive directors comprise car and fuel allowance, healthcare and professional subscriptions. The values are not significant in the context of overall remuneration.

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

(d) Directors' remuneration in 2013-14 (continued)

Bonus

The annual bonus for 2013 was structured by the Committee, in accordance with the policy outlined above, as follows:

- up to 50% payable on Balanced Scorecard financial targets;
- up to 40% payable on Balanced Scorecard targets; and
- up to 10% payable on performance against personal targets.

The Balanced Scorecard targets and performance were as follows:

Strategic theme	Scorecard measure	Target 2013	Performance 2013	% of total bonus potential	% of total awarded
Competitiveness (financial targets)	Group EBIT	budget	achieved	25	15.02
	Group cash available for distribution	budget	achieved	25	12.5
Customer	Customer satisfaction				
	- SIM quantitative score	86	95.5	2	0
	- SIM qualitative score	4.6	4.63	2	2
	Water supply interruptions >3 hours (average per property (minutes))	8.20	6.57	4	4
	Coliform incidents (no.)	10	16	4	0
People	Employee engagement score	81%	75%	4	0
	Lost time reportable accidents (no.)	9	6	4	4
Environment	Leakage (Mld)				
	- north	144	136	2	2
	- south	66	53.9	2	2
	STW failing LUT consent (%)	0	0	4	4
	Pollution incidents (categories 1 & 2)	3	5	4	0
Communities	BITC Platinum Plus accreditation	retain status	status retained	4	4
	Just an Hour (employee participation)	50%	54.1%	4	4
Total bonus related to Balance Scorecard				**90**	**53.52**

In respect of the 10% of bonus related to personal targets, the individual targets and awards were as follows:

- H Mottram had targets related to delivering expected financial performance, specifically to ensure retention of existing credit ratings, leading the Company's progress towards achieving the vision of being the national leader, delivering exceptional service for our customers and leading preparation and the Board decision making process for the PR14 Business Plan submission to Ofwat.
- C I Johns had targets in respect of delivering expected financial performance, specifically to ensure retention of existing credit ratings, delivering a Group corporate structure reorganisation and delivery of a project to enable quicker decision making in the business.
- A C Jones had targets related to planning work for PR14 and developing a methodology for unit cost benchmarking with contractors and other utilities.
- G Neave had targets in respect of developing a business case for the injection of bio-gas into the grid and completion of an external review of the capital investment process.

A number of these targets related to NWL's performance as a relevant undertaker. In assessing overall performance, the Committee takes into account the Company's position in Ofwat reports. The relevant performance data published by Ofwat is also used by the CEO to assess G Neave's and A C Jones' performance and this informs the bonus recommendation put to the Committee.

For the CEO, in addition to the bonus calculation explained above, a further discretionary award was made by the Committee to reflect the Board's continued satisfaction with the CEO's performance and, in particular, the reputational impact of the significant external recognition achieved by the Company. This remained within the limit of the overall potential maximum bonus award.

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

(d) Directors' remuneration in 2013-14 (continued)

Bonus (continued)
The total annual bonus awards for 2013 were as follows:

	Bonus awarded (out of 100%)	Maximum bonus (% of basic salary)	Bonus awarded (% of basic salary)
H Mottram	88.89%	70%	62.22%
C I Johns	63.02%	50%	31.51%
A C Jones	63.52%	50%	31.76%
G Neave	62.52%	50%	31.26%

LTIP
A cash based LTIP was awarded by the Committee in 2013, structured in accordance with the policy outlined above, as follows:
- up to 70% payable on financial performance targets.
- up to 15% payable on SIM performance targets.
- up to 15% payable on asset performance targets.

The scheme related to the period January 2013 to December 2015. Performance targets were to be assessed in the first year of the scheme. However, payment will be deferred until early 2016, after the end of the three year scheme period.

The Committee assessed the performance against the scheme criteria in January 2014. In respect of financial performance, 35% out of the maximum of 70% available vested.

In respect of SIM performance, NWL's combined score was assessed as being fourth position, compared against the other water and sewerage companies in England and Wales. This resulted in 9.375% out of the maximum of 15% available against this metric vesting.

All asset classes were assessed at stable serviceability, therefore the full 15% available against this metric vested.

The Committee therefore approved that the 2013 LTIP should vest at 59.375%. This is not dependent upon any future performance conditions being met.

Pension
Pension arrangements operated in accordance with the policy outlined on pages 70 to 71 above.

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

(e) Implementation of remuneration policy in 2014

There have been no changes made by the Committee to the remuneration policy to be implemented in 2014.

Bonus

The Balanced scorecard targets for the 2014 bonus are as follows:

Strategic theme	Scorecard measure	Target 2014	% of total bonus potential
Competitiveness (financial targets)	Group EBIT	budget	25
	Group cash available for distribution	budget	25
Customer	Customer satisfaction		
	- SIM quantitative score	90	2
	- SIM qualitative score	4.7	2
	Water supply interruptions >3 hours (average per property (minutes))	7.30	4
	Coliform incidents (no.)	8	4
People	Employee engagement score (Sunday Times 'Best Companies' survey)	2*	4
	Lost time reportable accidents (no.)	4	4
Environment	Leakage (Mld)		
	- north	141	2
	- south	66	2
	STW failing LUT consent (%)	0	4
	Pollution incidents (categories 1 & 2)	2	4
Communities	BITC Platinum Plus accreditation	retain status	4
	Just an Hour (employee participation)	50%	4
Total bonus related to Balance Scorecard			**90**

Personal targets for 2014 have been set as follows:

- H Mottram has targets including delivering expected financial performance, specifically to ensure retention of existing credit ratings, delivery of outstanding customer service, a continued focus on improving sewer flooding performance and leading the regulatory business planning process through the year.
- C I Johns has targets including delivering expected financial performance, specifically to ensure retention of existing credit ratings, assessing the outcome of the December 2013 pension actuarial valuation and assessing the potential impact of changes in accounting standards and developing a transition plan.
- A C Jones has targets including planning for the impacts of retail separation and ensuring delivery of the 2014 Health & Safety Plan.
- G Neave has targets in relation to delivery of the capital investment programme, establishment of a Programme Management Office to drive future capital efficiencies and achievement of PAS55 certification for the Company's asset management processes.

LTIP

A new cash based LTIP was awarded by the Committee in 2014 for the period January 2014 to December 2016 structured in accordance with the policy outlined above, as follows:

- up to 70% payable on financial performance targets.
- up to 15% payable on SIM performance targets.
- up to 15% payable on asset performance targets.

The maximum LTIP payable, as a percentage of basic salary, is 50% for H Mottram and 30% for C I Johns, A C Jones and G Neave.

DIRECTORS' RESPONSIBILITIES AND DECLARATIONS for the year ended 31 March 2014

DIRECTORS' RESPONSIBILITIES STATEMENT

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.

RING FENCING

The directors confirm that, as at 31 March 2014, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment by the which the Appointee had available to it sufficient rights and assets to enable a special administrator to manage the affairs, business and property of the Appointee, should a special administrative order be made.

By order of the Board

M Parker
Company Secretary
11 July 2014