NORTHUMBRIAN WATER GROUP

Annual report and financial statements 2009

Northumbrian Water Group plc is an independent company quoted on the FTSE 250 Index of the London Stock Exchange. The Group principally works in the provision of water supply and waste water services.

Our mission: To be the national leader in the provision of sustainable water and waste water services.

Contents

Cautionary statement

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

Highlights

Revenue 2009 (2008: £670.4m)

£694.1m

Profit before interest 2009 (2008: £277.8m)

£273.6m

Profit before tax 2009 (2008: £170.3m)

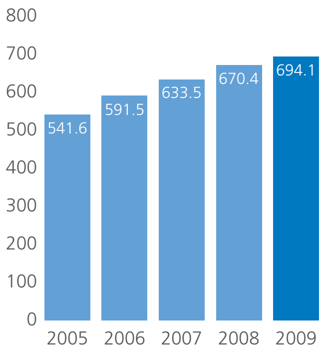
£152.7m

(Loss)/profit for the year 2009 (2008: £158.3m)

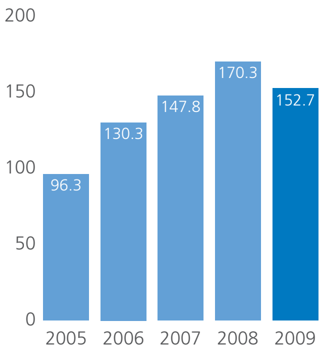
(£11.9m)

- > Revenue increase mainly reflects the uplift in tariffs to support continuing high capital investment
- > Energy costs are over 50% higher than last year, well above the level assumed at the last price review
- > Increased interest charges reflecting higher RPI on index linked bonds (£6.2 million) and increased pension financing costs (£7.4 million)
- > Deferred tax includes a one-off charge of £117.2 million following the withdrawal of industrial buildings allowances in the Finance Act 2008
- > Current funding is sufficient to meet all of the Group's requirements through to 2011
- > Regulated capital investment in the period of £228.9 million (2008: £232.6 million) is delivering regulatory outputs, an extended sewer flooding programme and the advanced digestion plant at Bran Sands
- > Planning permission for the expansion of Abberton reservoir granted
- > Continued high levels of customer satisfaction
- > Proposed final dividend of 8.50 pence (2008: 8.07 pence) per share to be paid on 11 September 2009, giving a full year ordinary dividend of 12.79 pence (2008: 12.07 pence) per share, an increase of 6%
- > External recognition of performance through awards, most notably 'The Queen's Award for Enterprise: Sustainable Development' and 'Utility Company of the Year'

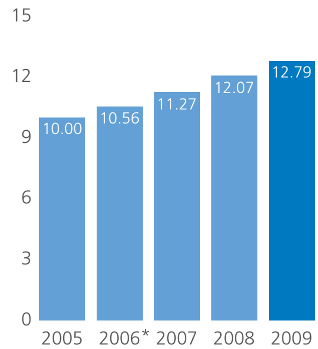
Revenue £m



Profit before tax £m



Dividend per share pence



* 2006 – excludes special dividend of 2.82 pence

NWG at a glance

Northumbrian Water Group plc
Northumbrian Water Group plc (NWG) owns a number of companies which, together with NWG, form the Group. The largest of these companies, Northumbrian Water Limited (NWL), is one of the ten regulated water and sewerage businesses in England and Wales. The emphasis given to NWL, throughout this report, reflects its importance to the overall performance of the Group.

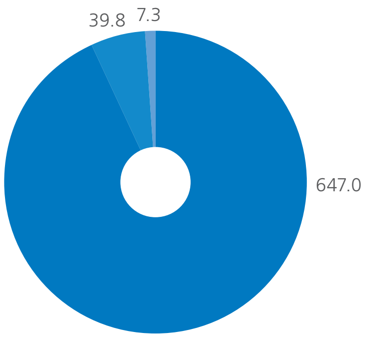
Northumbrian Water Limited
NWL operates in the north east of England, where it trades as Northumbrian Water, and in the south east of England, where it trades as Essex & Suffolk Water. Northumbrian Water currently provides water and sewerage services to 2.6 million people and Essex & Suffolk Water provides water services to 1.8 million people.

Water and waste water contracts
NWG controls a number of special purpose companies which have water and waste water contracts in Scotland, Ireland and Gibraltar.

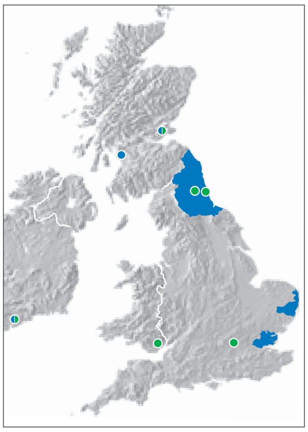
Other
SA Agrer NV (Agrer) carries out project work in developing countries through a number of overseas aid funded agencies.

North east England
Northumbrian Water provides water and sewerage services to 2.6 million people in the north east of England. The major population centres of Tyneside, Wearside and Teesside are in our area but we also serve large rural areas in Northumberland and County Durham (provision of waste water services only in Hartlepool).

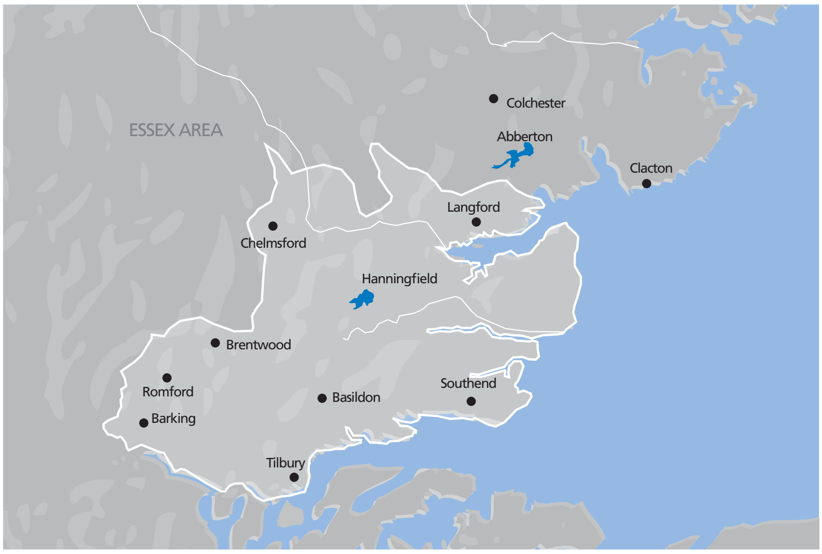
NWG revenue £m



■ Northumbrian Water Limited
■ Water and waste water contracts
■ Other



● Water and waste water contracts
● Northumbrian Water Scientific Services
● SA Agrer NV



South east England

Essex & Suffolk Water provides water services to two separate supply areas. We serve a population of 0.3 million in our Suffolk area, which is mainly rural with the biggest towns being Great Yarmouth and Lowestoft.

Our Essex area, which has a population of 1.5 million, is part rural and part urban with the main areas of population being in Chelmsford, Southend and the London Boroughs of Barking and Dagenham, Havering and Redbridge.

Measuring performance

NWL performance against non-financial KPIs summary (unaudited)

	North (N) South (S)	Target 2009/10	Target 2008/09	Target achieved	Performance Current year	Performance Previous year
Customer satisfaction						
Overall service (%)	N/S	90	90	✗	88	89
Value for money (%)	N/S	85	85	✗	84	83
Customer – levels of service						
Properties at risk of low pressure	N	274	274	✓	271	181
	S	126	126	✓	40	60
Properties subject to unplanned interruption of 6 hours or more	N	3,000	3,000	✗	8,278[1]	3,318
	S	2,000	2,000	✗	3,353[2]	3,405
Properties subject to hosepipe bans at any time during the year	N/S	0	0	✓	0	0
Properties subject to sewer flooding incidents (other causes)	N	150	150	✗	286	290
Properties at risk of sewer flooding incidents (once in ten years)	N	44	61	✗	189	125
Properties at risk of sewer flooding incidents (twice in ten years)	N	32	41	✗	370	329
Billing contacts responded to (within five working days) (%)	N	99.2	99.2	✓	99.2	99.3
	S	99.2	99.2	✓	99.6	99.6
Written complaints responded to (within ten working days) (%)	N	99.8	99.8	✓	99.9	99.9
	S	99.8	99.8	✗	99.7	99.7
Bills based on meter readings (%)	N	99.95	99.95	✗	99.90	99.80
	S	99.95	99.95	✓	99.95	99.96
All telephone lines busy (%)	N	0.05	0.25	✓	0.07	0.03
	S	0.25	0.25	✓	0.06	0.00
Abandoned telephone calls (%)	N	3.00	2.50	✗	3.43	2.85
	S	2.00	2.50	✓	1.95	3.27
Water						
DWI Mean Zonal Compliance (%)	N	99.90	99.90	✓	99.92	99.94
	S	99.98	99.98	✓	99.99	99.99
DWI Operational Performance Index (%)	N	99.65	99.65	✓	99.67	99.66
	S	99.98	99.98	✓	99.98	99.98
Distribution Maintenance Index (%)	N	99.70	99.70	✗	99.52	99.47
	S	99.85	99.80	✓	99.96	99.96
Environment						
Sewage treatment works (%)	N	99.7	99.7	✓	100	98.4
Bathing waters Mandatory Standard (%)	N	100	100	✓	100	100
Pollution incidents	N	89	96	✓	94	119
Employees						
Employee turnover (rolling %)[3]	N/S	–	Industry average 10.4	–	6.4	7.4
Lost time reportable accidents (per 1,000 employees)	N/S	10[4]	5	✗	6	6
Sickness absence (%)	N/S	2.85	2.85	✗	2.94	3.25

Notes:
1. Performance affected by a major burst in Northumberland.
2. Performance affected by a major burst in Suffolk.
3. No target set, data for information.
4. Scope of target widened for 2009/10 to include all lost time accidents.

Abberton reservoir

Chairman's statement

£1.27bn

Investment programme from 2010 to 2015

The water industry has been affected less by the current recession than many others but we are not immune. The decline in industrial demand for water has had an impact on revenue; many of our customers are finding it more difficult to pay their bills while our energy costs rose significantly.

Against that difficult and uncertain background we have submitted our Final Business Plan for 2010-2015 to Ofwat. The plan proposes an average real annual price increase over the five years of 3.4% to support a £1.27 billion investment programme – an increase of 20% on the amount being invested in 2005-2010. Ofwat will use the plan to set draft price limits in July 2009. We believe our plan is well balanced and reflects the views of customers, for whom affordability is a key issue, and all our other stakeholders and regulators. Everyone will have a further opportunity to comment before Ofwat's final determination of price limits in November 2009. In the plan, we are proposing major investment to alleviate sewer flooding, to reduce the incidence of discoloured drinking water and to build a £150 million expansion of Abberton reservoir near Colchester to safeguard water supplies in the region.

We have also produced our carbon management plan aiming to reduce our own emissions by 35% by 2020. This year will see the completion of an advanced anaerobic digestion plant at Bran Sands. Together with planned works at Howdon, this will increase our use of renewable energy to over 20%, a significant step towards our target. We have also achieved a significant reduction in energy consumption as we strive to control use of energy and, therefore, our costs.

Our plans seek to build on the strong reputation we have gained over a long period by balancing and satisfying the needs of our customers, employees, investors and regulators. The evidence is that we have achieved that again this year.

Our customers tell us we have had another successful year with high levels of satisfaction reported through our own independent surveys and those of the Consumer Council for Water. We are not complacent, however, and the new 'Our Promise to You' customer service initiative promises to get things right first time and every time.

It is our employees who deliver these high standards of service. We are committed to supporting them through our 'People Plan' to ensure that all employees have the training, development and skills for their roles. We are determined to have the right people in place to take the business forward and to reward them fairly, in recognition of their important contribution.

Investors are vital to the delivery of our long term plans. We are pleased to recommend dividends in line with the progressive dividend policy we set out for this five year period.

Our regulators set many standards and in this report you will see the substantial progress we are making against these. This year, there has also been a great deal of discussion with all of our regulators as we move towards the new five year investment period to ensure we achieve an appropriate balance of cost, quality and risk.

At the heart of our approach to business we believe we have wide-ranging responsibilities to the communities we serve. We were delighted, therefore, to receive many important awards this year which recognise our success. The Queen's Award for Enterprise, in the category for Sustainable Development, was a particularly welcome accolade. The citation recognises work across the business to support society, the economy and the environment. This had been preceded by receipt of the Utility Company of the Year award from Utility Week magazine. The judges nominated NWL for that award because it 'builds its business around customers and the community'.

We only receive such recognition because of the excellent work of our employees and from the productive partnerships with all those with whom we work. On behalf of the Board, I thank them all but I must make special mention of John Cuthbert, the Company's Managing Director, who has worked for companies in the Group for many years and who has led the Group since 2001. John is retiring on 31 March 2010 and will step down from the Board then. He has made an outstanding contribution both to the water industry and to creating a business which we all believe is well placed to build on its past successes and deliver more in the future.

Sir Derek Wanless
Chairman
2 June 2009

Sir Derek Wanless presents Malcolm Huggins with his Health & Safety award.

Directors' report and business review

The NWG directors are pleased to present their report on the affairs of the Company, along with the audited financial statements and the auditors' report for the year ended 31 March 2009.

Directors

The directors are Sir Derek Wanless, Sir Patrick Brown, John Cuthbert, Chris Green, Claude Lamoureux, Martin Nègre, Alex Scott-Barrett and Jenny Williams. All were directors of the Company as at 31 March 2009 and served throughout the year.

In accordance with the Combined Code on Corporate Governance (the Combined Code) and the Company's Articles of Association (the Articles), two directors will retire by rotation and offer themselves for re-appointment at this year's annual general meeting (AGM). Those directors are John Cuthbert and Chris Green. The directors' biographies are set out on pages 46 and 47.

Activities

The principal activities of the Group during the year were the provision of water and waste water services.

Kielder Water & Forest Park

Contents

Directors' report and business review

1. Business strategy

John Cuthbert, Managing Director, presenting at a partnership conference.

Strategic direction
Our strategy is to focus on the Group's core competences of water and waste water management and, through that focus, to deliver value to all of our stakeholders. Our activities and priorities continue to be directed to achieving our mission to be the national leader in the provision of sustainable water and waste water services. Our three priorities are:

- to maintain our strong reputation and relationships by:
  - delivering excellent service to customers;
  - delivering regulatory outputs;
  - creating shareholder value; and
  - involving our main stakeholder groups.
- to ensure a stable financial profile by:
  - maximising revenue;
  - delivering operational efficiency; and
  - securing low cost long term funds.
- to develop a culture of continuous improvement by:
  - ensuring a focus on safety and rigorous risk management;
  - encouraging employees to fulfil their potential;
  - promoting a flexible and proactive attitude; and
  - embracing a sustainable and responsible approach.

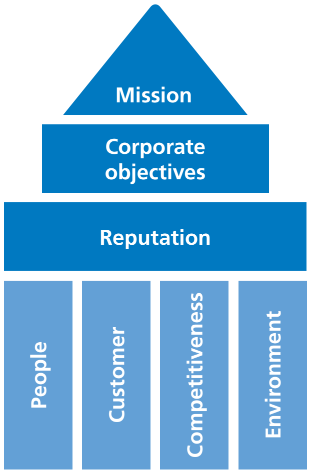
A clear framework
Our core business, NWL, has identified five key strategic themes. Four of these, People, Customer, Competitiveness and Environment, are important individually and also contribute to the fifth, Reputation. These themes underpin our drive for performance and delivery of our corporate objectives. The themes are mutually supportive and achieving the right balance between them is an essential part of our success.

People
We believe strongly that our people are the key to business success.

Customer
Customers are central to our thinking and our overriding objective is to properly understand and meet their needs.

Competitiveness
To grow our business and meet the challenges of a developing market we strive to be competitive in everything we do.

Environment
Our business is founded on water and environmental engineering and a great deal of what we do influences the environment. We seek to understand our impact on the environment and, also taking into account our



impact on, and contribution to, the economy and communities in which we operate, aim always to deliver sustainable outputs from our activities.

Reputation

Our ability to develop our business will be influenced by our reputation. A good reputation is often the starting point for good stakeholder relationships on which business growth can be achieved.

By staying focused, motivated and innovative we are confident we will be able to continue to supply our customers with an excellent service at the right price and, by satisfying our customers, we provide a platform on which we will build, expand and develop our business.

NWL's corporate objectives are:

- to deliver industry leading customer service;
- to be the most efficient water company;
- to be recognised as a great company to work for;
- to be the company of choice for investors; and
- to protect and enhance the natural environment.

Looking to the future

NWL consulted key stakeholders before publishing 'Looking to the future', our long term operational strategy for the next 25 years. We published different versions for each of our operational areas and they have been well received by a range of stakeholders. They are available on our websites at www.nwl.co.uk and www.eswater.co.uk

In our strategy, we set out our long term aims for NWL alongside intermediate targets for the period to 2015 for the key areas of:

- customer satisfaction;
- water quality;
- availability of water;
- waste water services;
- sustainability, the environment and climate change;
- finance; and
- employees.

Our long term operational strategy was produced to help inform our plans for the period 2010-15. The strategy builds on our achievements of the past 20 years and re-affirms our commitment to long term planning and investment to deliver value to all our stakeholders.

We identified three key challenges for the future:

- sustaining and, where appropriate, improving services while keeping bills affordable;
- maintaining healthy and stable finances to ensure we can continue to borrow money to meet the investment needed in the business; and
- responding to climate change by further reducing greenhouse gas emissions and future-proofing our operations.

Last year, we developed our plans for the period 2010-15 in support of our long term strategy and submitted initially a Draft and then, in April this year, our Final Business Plan to Ofwat. Part A of the Final Business Plan is available on our websites.

2. Operating environment

Our external environment
The largest of NWG's businesses, NWL, operates in the north east and south east of England. The two areas have very different economic, demographic and water resource characteristics.

In the north east there has been a gradual fall in overall water demand in recent decades as a consequence of a reduction in industrial demand for water. This trend is expected to continue for at least the next five years with a faster decline in the short term due to the impact of the economic recession. The north east compares well to the rest of the country as far as water resources are concerned and our major regional rivers can all be supported by Kielder reservoir. This provides very high security of supply for our customers.

In contrast, NWL's southern operating area is in a water scarce region that is forecast to experience further economic and population growth in the medium term. While this area has also seen a reduction in demand from heavy industry and the recession is likely to dampen housing growth in the near future, we have a current deficit, meaning supplies are not secure in a severe drought. Future growth will intensify the pressure on the balance between supply and demand. NWL is implementing long term plans to ensure the availability of water supplies to meet both current and future demand in a region where water resources are already constrained. The project to increase the capacity of Abberton reservoir near Colchester, which has recently obtained full planning approval, coupled with ongoing demand management measures, will secure supplies to the Essex area for the foreseeable future.

The current pressures within financial markets have been well documented and the credit crunch has resulted in reduced availability of certain types of finance (such as index linked bonds). It is highly unlikely there will be a return to the exceptionally low cost of debt experienced from late 2005 to early 2007. It is not clear how long current difficult market conditions will persist. With the financing we have already put in place, we are well sheltered from the current short term volatility in the debt markets as we will not need to raise any new debt before 2011.

Regulatory environment
As a monopoly supplier of an essential public service, the UK

Abberton plans move forward

Essex is the driest county in the UK receiving on average less than 600mm of rain a year. In a dry year Essex already has a deficit of water supply to demand, making development of the Abberton scheme essential for the area. Demand for water is predicted to continue to rise, almost entirely due to a significant increase in population in the area.

This means there is a need for a long term and sustainable increase in water resources for the Essex area. We need to enlarge the existing reservoir at Abberton by 58 per cent as part of the Abberton Scheme to ensure that Essex has a secure water supply for future generations.

Planning permission has been granted to enlarge the reservoir, and build a new pumping station, a pipeline between Wormingford and the reservoir and a further pipeline between Kirtling Green and Wixoe as part of the scheme.

As well as providing a vital new water resource, the scheme has been designed to enhance the reservoir for both people and wildlife. The plan to enlarge the reservoir is the culmination of 15 years of investigation and consultation, during which over 250 locations for a new reservoir were considered.

Construction work is due to start at the reservoir in 2010 and it is expected that the enlarged reservoir will be fully operational by 2014.

water industry operates within a demanding regulatory environment.

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

NWL aims to maintain good working relationships with its regulators and with regional organisations, such as local authorities, which have an interest in the services it provides and can influence the company's business.

The 'Cave Review: competition and innovation in water markets' (Cave Review) published its final report in April 2009. Government has welcomed the report and intends to bring forward measures into the 'Flooding and Water Management Bill' in light of its recommendations. In our view, the vital test for any change must be 'will it improve outcomes for customers?'. While the essential characteristics of the sector mean the scope for competition is likely to be less than in other utilities, we agree that there are opportunities to expand competition beyond its current very limited level. We remain to be convinced that retail business separation would bring benefits for customers. We welcome the emphasis in the report on measures to increase innovation.

Protecting supplies to customers is a high priority. We submitted our 'Water Safety Plan' to the DWI in October 2008 and this underpins our drinking water quality proposals.

We commenced Phase I of Operator Self Monitoring in April 2009. This involves NWL taking on responsibility for sampling and analysing the final effluent at sewage treatment works for compliance purposes. This task had previously been undertaken by the EA. The transfer is consistent with the Better Regulation principles and we expect it to result in a small cost saving. The second and final stage of the transfer will happen in January 2010.

We are pleased that the draft 'River Basin Management Plan' published by the EA for the rivers in our regions proposed an appropriate balance between challenging environmental targets and a clear evidence base for action. We support the emphasis on tackling diffuse pollution at source rather than end of pipe solutions.

NWL intends to increase the emphasis given to catchment management across its operating areas. This will help tackle emerging challenges from water soluble pesticides and also bring a range of other benefits in terms of habitat protection, biodiversity and carbon management.

Putting customers first

As in the prior year, we have only increased our prices for 2009/10 by inflation and have not used the real increase that Ofwat's price limits allow. This is the third consecutive year in which we have not implemented the maximum price increase.

By 2010, we expect our combined water and sewerage bill in the north east to be one of the lowest in the country and, in our Essex and Suffolk regions, our water bills will compare favourably with other local suppliers.

We submitted our Final Business Plan, covering the period from April 2010 to March 2015, to Ofwat in April 2009 setting out the short term proposals to deliver our 25 year strategy published in 'Looking to the future'. Our significant investment programme will continue to deliver high levels of service to our customers and value to our stakeholders. However, within the investment programme, there is a change in emphasis from achieving new quality standards to maintaining the high standards already achieved. We will also be working to tackle the challenges posed by climate change, reducing our operational carbon emissions and improving the resilience of our assets. We believe we are well placed to deliver these objectives and propose raising prices by the minimum

2. Operating environment continued

amount consistent with both maintaining safe and secure water supplies and our commitment to protect the environment.

Our customers

Our relationship with our customers is vital to the success of our business.

We keep our customers informed about our activities through leaflets sent out with bills and also through an annual magazine called 'Source'. Customers also have access via our website at www.nwl.co.uk and www.eswater.co.uk to a range of information about our services and any supply issues.

Customers directly affected by our work receive prior notification explaining both the need for, and timing of, the work we intend to carry out. We also communicate more broadly with local communities through public meetings and written material explaining the impact of any work we are planning.

We carry out regular surveys and focus group research to understand our customers' needs, and their perceptions of our service and its value for money. Affordability and value for money are important to our customers and are, therefore, key issues for the business.

Our reputation for providing value for money and working to maintain high levels of customer satisfaction has undoubtedly helped achieve a positive response to our appeals to use water carefully.

NWG is actively involved in the business community in both of its operating areas through direct membership and involvement in the councils/boards of the CBI, Chambers of Commerce and other similar organisations.

NWL has longstanding relationships with its key industrial and commercial customers in the areas it serves. The north east, in particular, has a significant industrial base and existing customers and potential investors in the region value the availability of not only high quality potable and raw water but also access to reliable effluent treatment services.

Stakeholder relations

NWG has a code of ethics, 'Our Code of Conduct', which is available on the Company's website, covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators. NWG meets its stakeholders regularly and also communicates by printed and electronic forms of communication and through the media.

National

NWL is an active member of Water UK, the industry association which represents all UK water and waste water service suppliers at national and European level. It provides a very effective framework for the industry to engage with Government, regulators, stakeholder organisations and the public and helps to develop policy and improve understanding of the industry.

We also meet regularly with national, regional and local authorities and other appropriate organisations to explain NWL's activities and related issues.

Political

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

We do not support any political party and we do not, directly or through any subsidiary, make what are commonly regarded as donations to any political party or other political organisations. 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

Castle View Enterprise Academy

We are lead sponsors for Castle View Enterprise Academy in Sunderland, which will have a business and enterprise specialism. Our aim is to use our expertise to support academic and vocational attainment and help bring lasting improvement to this community. The area contains some of the most deprived wards in the region; it relied heavily on employment in mining and shipbuilding (neither of which has been available for over 20 years). In many cases, families are experiencing third generation unemployment and ACORN classifies 61%-80% of the school catchment population as being 'struggling families'.

We have committed funding, work in kind, and many work hours from senior employees to the Academy. More importantly, when the Academy opens its doors to 850 pupils in September 2009, we are committed to supporting the new Principal to run and manage a successful school. We intend to do this through our involvement on the Academy's Trust Board, employee volunteers and community partnerships.

Our support has leveraged in £16 million of Government funding to build a state of the art new building and ICT facilities. This is the largest investment ever made in this community and will provide the young people of Castle View with excellent opportunities for a successful future.

John Cuthbert, Managing Director, and Janet Bridges, Principal Designate of Castle View Enterprise Academy, laying one of the first bricks of the Academy's new building.

Photo credit: Sunderland Echo.

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 2008/09 were as follows:

Name of political party	£
Conservative	4,118
Labour	8,247
Liberal Democrats	2,025
Total	**14,390**

Shareholder authority to permit the Company to continue with these activities until the 2010 AGM will be sought at this year's AGM.

Our investors

Our main communication with shareholders is through the publication of the annual report and financial statements, half-yearly financial report, interim management statements and through information on the Company's website. In addition, the executive directors have regular contact with the Company's large institutional investors, as well as giving presentations to analysts and stockbrokers. During the year, the executive directors met 29 times with a range of institutional investors. Further information on NWG's shareholder relations is contained in the corporate governance report on page 53.

Employees

Each company within the Group has developed its own employee policies, reflecting the framework set out in NWG's 'Our Code of Conduct'. These policies are tailored to specific business objectives and operating environments. Each company aims to recruit and retain the best people, with a diverse range of skills, experience and backgrounds, who are committed to making the company successful. In return, each company aims to provide opportunities and training for employees to develop their skills and capabilities to equip them to meet the challenges of their roles, while rewarding the contributions of both teams and individuals.

Equality and diversity

The Group operates an equal opportunity policy and promotes equality of opportunity in recruitment and selection, terms and conditions of employment, and training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment on the grounds of age, gender, marital status, disability, race, ethnic or national origin, religion or sexual orientation. NWL monitors its workforce profile against the communities it operates in and aims to ensure it takes full advantage of the rich backgrounds and abilities of current and potential employees.

2. Operating environment continued

We properly consider employment applications from people with disabilities and, where existing employees develop disabilities, it is our policy, wherever practicable, to support them through providing appropriate adjustments to their roles and/or effective redeployments. Our Occupational Health Physicians assist this process with professional medical advice.

Consultation and engagement
Each company engages with its employees through a variety of means appropriate to its working environment. The importance of an inclusive and engaging management style is fully recognised and, in 2008, NWL continued to develop in this area through over 120 workshops covering all our employees. The aim was to engage employees in a dialogue on improvements to our working practices and environment and seek their views on the areas that should be covered in our 2010-15 People Plan. In March 2009, the Chartered Institute of Personnel and Development presented NWL with the Employee Engagement Award in recognition of its proactive and inclusive employee engagement activities.

Training and development
All Group companies train and develop their employees to benefit both the company and the individual. Annual appraisals are given high priority, as is the identification of training needs, in recognition of the importance of training and development in achieving the Group's goals and policies.

Communication
The Group uses a wide range of communication methods including magazines, newsletters, intranet, notice boards and regular team meetings. 'Unplugged', the Group magazine, contains articles on activities and news from across the business, focusing on employees and their achievements. NWL issues all employees with a series of information booklets clearly explaining areas such as the company's mission and values, terms, conditions and benefits of employment, occupational health and wellbeing programmes and People Plan objectives.

Disclosure (Whistleblowing)
The Group encourages open feedback and is committed to protecting employees who wish to voice concerns about behaviour or decisions that they believe to be illegal or unethical. The Audit Committee regularly reviews the Disclosure Policy.

Health and safety
A safe working environment is given high priority across the Group. A health and safety policy is maintained and implemented at each subsidiary.

Employees celebrate their success at the northern skills awards with Kriss Akabusi.

John Cuthbert and Ceri Jones with players from the Newcastle Eagles basketball team (l-r Darius Defoe, Lynard Stewart and Reggie Jackson) supporting Children in Need.

Employee Share Incentive Plan (SIP)
The directors believe that employee investment strengthens the ties between the Group and its employees. More than a third of employees participate in the SIP, with an interest in 0.5% of the issued share capital. The scheme provides one free matching share for every three shares bought by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants. There are no performance conditions attached to the SIP but free shares not held in trust for at least 12 months are forfeited. Employees participating in the SIP are given the opportunity to exercise their voting rights through the Trustee of the SIP.

Corporate responsibility

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

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

We take our corporate responsibilities seriously. Our aim of balancing economic, social and environmental priorities underpins all of our activities and is an integral part of the way we do business.

We have significant resources in our assets, land and employees and believe we have a responsibility to use these resources for the benefit of our customers, our shareholders and the wider communities we serve.

The Managing Director is directly accountable to the NWL and NWG boards for both the environment and sustainable development policies.

We have developed our own model to integrate corporate responsibility as an essential part of normal business practice in NWL. This model is published on our websites with links to our policy, action plan, key performance indicators, trend data and case studies for 25 key areas of our business.

The Corporate Responsibility Committee (CRC) is a subcommittee of the NWL board and comprises non-executive directors, management team members and senior managers from the business. The CRC maintains a strategic overview of corporate responsibility policies and issues. Within the business a Corporate Responsibility Management Group (CRMG) drives and manages our

2. Operating environment continued

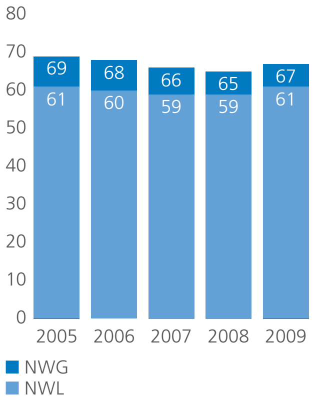
corporate responsibility programme both prioritising activity and facilitating reporting and monitoring.

The CRMG is supported by two regional groups and by teams of community and environmental champions drawn from across the business to ensure communication and influence is as effective and widespread as possible. We also have specialist working groups responsible for investigating, advising on and driving change on specific projects, such as climate change, energy use, transport, waste and recycling.

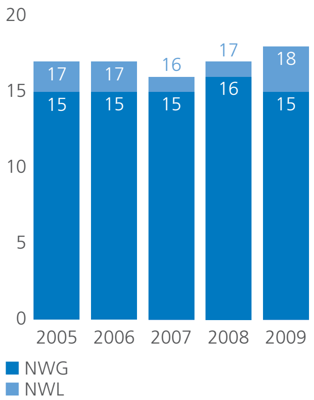
NWL’s corporate responsibility model.

3. Financial performance

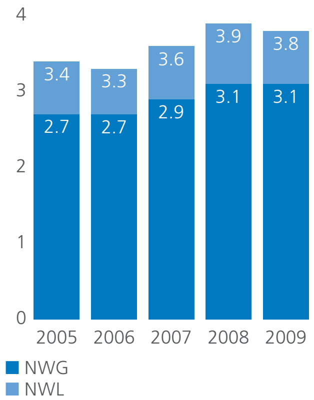
Gearing to RCV %



Cash flow to net debt %



Cash interest cover times



NWG and its subsidiaries use a range of indicators to monitor performance. For NWG, the key performance indicators (KPIs) are all financial. The non-financial KPIs relating to NWL are summarised on page 4. The definition, purpose and source of each KPI are shown on pages 44 and 45.

Performance against the financial KPIs is set out below:

	Target		Performance			
			Current year		Previous year	
KPI	NWG	NWL	NWG	NWL	NWG	NWL
Gearing to RCV (%)	<75	<70[1]	67[3]	61[2]	65	59
Cash interest cover (times)	>2.5	>3.0	3.1	3.8	3.1	3.9
Cash flow to net debt (%)	>13	>13	15	18	16	17

Notes:
1. Less than 65% for the regulated business of NWL.
2. NWL's Regulatory Capital Value (RCV), as advised by Ofwat, at 31 March 2009 was £2,998 million (2008: £2,976 million).
3. NWG's pro forma RCV at 31 March 2009 was £3,324.4 million (2008: £3,300.6 million) (see below).

As a consequence of the current economic climate, there has been an increased focus on gearing across many sectors. The Group's gearing has previously been expressed as a percentage of NWL's RCV. However, this overstates gearing as it ignores any value attributable to the Kielder securitisation and the two PFI contracts. The level of associated debt included in the Group's net debt relating to those assets amounts to £215.6 million (2008: £214.9 million) and £110.8 million (2008: £109.7 million) for the Kielder securitisation and PFI contracts respectively. Adding these amounts to NWL's RCV of £2,998.0 million (2008: £2,976.0 million) results in a pro forma Group RCV of £3,324.4 million (2008: £3,300.6 million). This change results in gearing being restated from 72% to 65% at 31 March 2008.

The Group's gearing on this pro forma basis has increased from 65% to 67%, with net debt increasing by £79.3 million to £2,229.7 million over the year. The increase in the Group's gearing is principally due to the impact on the RCV of negative inflation of 0.4% at 31 March 2009.

At NWL, gearing has also been reviewed and net debt has been restated to include £159.0 million (2008: £159.0 million) in respect of an intra-group loan, repayable on demand, as the Company believes this is a better reflection of NWL's net debt. This change results in gearing being restated from 64% to 59% at 31 March 2008.

NWL's gearing has increased from 59% to 61%. For the regulated business within NWL, gearing increased by 2% to 60%.

Cash interest cover has remained stable for the year.

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

3. Financial performance continued

Financial results and dividends

	Year to 31.3.2009 £m
Profit before tax	152.7
Loss for the year	(11.9)
Interim dividend paid (ordinary – 4.29 pence per share)	22.2
Final dividend proposed (ordinary – 8.50 pence per share)	44.0

Revenue for the year to 31 March 2009 was £694.1 million (2008: £670.4 million). This 3.5% increase is mainly due to the application of Retail Price Index (RPI) (4.28%) to water and sewerage charges, partially offset by a small overall reduction in demand for both water and sewerage services and a reduction in other services related to the housing market. The difficult economic climate continues to have an impact on industrial and commercial customers where volumes are down by c.4% compared to the prior year.

Profit on ordinary activities before interest for the year was £273.6 million (2008: £277.8 million). Operating costs increased by £27.9 million (7.1%) to £420.5 million. At NWL, operating costs have increased from £356.0 million to £380.1 million. This increase principally reflects the impact of inflation, increases in energy costs and bad debt charges. These increases have been partially offset by efficiencies including lower manpower costs following the changes made to our defined benefit pension scheme where, from 1 January 2008, the scheme was closed to new entrants, the benefit structure amended and employee contribution rates were increased.

Energy costs at NWL for 2008/09 (£38.8 million) are over 50% higher than both last year and the level assumed by the regulator at the last price review. Although energy prices have softened recently, we expect them to remain volatile for the future. NWL has procured all its requirements for 2009/10, at prices c.5% lower than 2008/09, and procured 44% for the following year. This has been purchased in small tranches, in accordance with its risk management policy, to mitigate energy price movements.

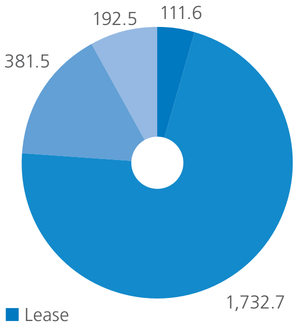
Interest charges increased by £13.7 million within which, cash interest charges decreased by £0.6 million. The non-cash elements of the increase reflect inflation on the index linked bonds (£6.2 million), a reduction in the expected return on pension assets (£4.1 million), an increase in the interest cost of pension plan obligations (£3.3 million) and an increase in other non-cash movements of £0.7 million.

At 31 March 2008, the Group's debt structure included £440 million of index linked bonds which increase in line with the July RPI. The RPI adjustment for July 2008 was 5.05% and, therefore, the principal accretion and interest charge for the year ending 31 March 2009 increased by £22 million. Current forecasts for the July 2009 RPI indicate a negative adjustment, in which case the interest charge for 2009/10 would be reduced significantly.

Profit on ordinary activities before tax for the year was £152.7 million, 10.3% lower than the previous year (2008: £170.3 million). The current tax charge of £32.1 million (2008: £25.6 million) has increased, despite a reduction in profitability, mainly due to changes in the tax rules on capitalised maintenance expenditure, the phased abolition of industrial buildings allowances and the timing of relief for prepaid pension contributions, offset by a 2% reduction in the corporation tax rate.

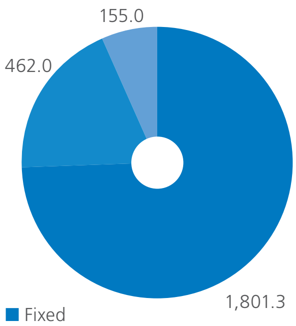
The deferred tax charge of £132.5 million (2008: credit, £13.6 million) includes a one-off charge of £117.2 million following the withdrawal of industrial buildings allowances in the Finance Act 2008. NWL included the impact of reduced allowances in its Final Business Plan submission to Ofwat for the period 2010-2015. The deferred

NWG's funding source £m



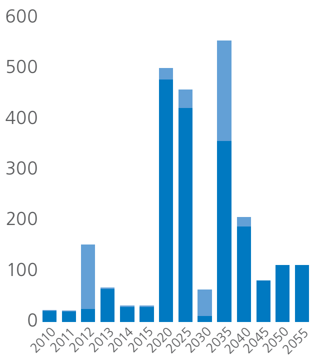
- Lease
- Bonds
- EIB
- Bank

NWG's interest structure £m



- Fixed
- Index linked
- Floating

NWG's gross debt maturity profile £m



- NWL regulated
- Other

tax credit in 2008 reflected the change in the tax rate from 30% to 28% and resulted in a credit of £35.4 million.

Excluding the one-off charge of £117.2 million attributable to the Finance Act 2008, the effective tax rate for the period was 31% (2008: 28% excluding the credit of £35.4 million).

Earnings per share and dividend cover

Basic and diluted loss per share for the year were 2.45 pence. In 2008, basic and diluted earnings per share were 30.52 pence and 30.48 pence respectively. Earnings per share from continuing operations, adjusted for deferred tax and the amortisation of debt fair value, were 22.05 pence (2008: 26.72 pence).

A final dividend of 8.50 pence per share for the year ended 31 March 2009 will be recommended by the Board to shareholders at the AGM on 30 July 2009 and, if approved, will be paid on 11 September 2009 to shareholders on the Company's Register of Members at the close of business on 14 August 2009. Together with the ordinary interim dividend of 4.29 pence per share, the ordinary dividends paid and proposed for the year will be 12.79 pence per share (2008: 12.07 pence per share). This represents an increase of 6%, based on average inflation over the year of 3%, on the ordinary dividend for the previous year and is consistent with the Board's decision to maintain a progressive dividend policy with real increases of around 3% per annum. The board of our main subsidiary, NWL, has proposed a dividend policy consistent with the underlying assumptions adopted by Ofwat at its price review in 2004.

The dividend cover for the year, excluding deferred tax and the amortisation of debt fair value, was 1.8x (2008: 2.3x). The cover level has reduced principally as a consequence of the application of higher RPI to the index linked bonds and a significant increase in energy costs.

Northumbrian Water Share Scheme Trustees Limited, which at the date of this report held 1,038,252 shares to be used in the future to satisfy the vesting and exercise of awards under the Company's Long Term Incentive Plan (LTIP), has waived the right to all dividends on the shares it holds. Further details of the LTIP can be found in the directors' remuneration report on page 57.

Accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). This is consistent with IFRS as adopted by the European Union as it applies to the financial statements of the Group for the year ended 31 March 2009.

Capital structure

On 19 September 2008, a further European Investment Bank (EIB) facility of £120 million was drawn by NWL on a fixed rate basis with a 17 year maturity and an amortising principal repayment profile.

On 29 September 2008, a £50 million lease facility was fully drawn by way of a further tranche of £20.8 million. The lease was for renewed infrastructure assets and is at a variable rate linked to RPI with a final maturity in March 2043.

In October 2008, a variable rate EIB loan of £100 million maturing in March 2022 was swapped to a fixed rate of 4.98%.

In January 2009, £125 million variable rate debt at Northumbrian Services Limited was fixed at a rate of 2.80% to its maturity in May 2011.

As stated, the Group has converted £225 million of variable rate borrowing to fixed rate. As a consequence, the Group's and NWL's regulated business debt structure has changed to 75% (NWL: 71%) fixed at an average rate of 5.80% (NWL: 5.99%), 19% (NWL: 22%) index linked at an average real rate of 1.85% (all NWL) and 6% (NWL: 7%) on a variable rate basis.

Total cash and short term cash deposits available to meet the requirements of the business through to 2011 amounted to £252.9 million at 31 March 2009.

3. Financial performance continued

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

Treasury policy
The main purposes of the Group's treasury function are to assess the Group's ongoing capital requirement, to maintain short term liquidity and to raise funding, taking advantage of any favourable market opportunities. It ensures access to medium term committed back up facilities renewable on a five year basis.

It also invests any surplus funds the Group may have, based on its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process, but the Group's policies prohibit their use for speculation. Full details are provided in note 20 to the financial statements. The Group is operating in compliance with its policies.

Cash flow/liquidity
As noted previously, the Group has substantial cash resources and undrawn committed bank facilities available to maintain general liquidity.

Pensions
The Group operates both a defined benefit pension scheme, which closed to new entrants on 31 December 2007, and an occupational defined contribution arrangement which began on 1 January 2008.

The surplus (under IAS 19) of the defined benefit scheme of £90.5 million, at 31 March 2008 has moved to a deficit of £119.4 million at 31 March 2009. This is mainly due to the fall in the market value of the scheme's assets since March 2008 and a reduction in the discount rate assumption to 6.1% (March 2008: 6.8%) to better match the average duration of the schemes liabilities.

The triennial actuarial valuation of the final salary scheme as at 31 December 2007 is complete and the formal report and certificates were signed in November 2008. The valuation resulted in a surplus of £42 million (6%) on an 'ongoing' basis, which takes into account the prepaid contributions (in 2006 and 2007) for the period up to 31 December 2010. While the actuarial valuation incorporates longer term forecasts and assumptions than the IAS 19 valuation, the prevailing market conditions are difficult and we will continue to monitor carefully. The Final Business Plan submission to Ofwat included a proposal for deficit recovery contributions.

Creditors
The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. The Company's policy is to make payment not more than 30 days after receipt of a valid invoice, except as otherwise agreed. The ratio, expressed in days, between the amount invoiced by its suppliers during the year and the amount owed to its trade creditors at 31 March 2009, was 20 days (2008: 13 days).

Structure of the Company's share capital
The authorised share capital of the Company is £70,000,000 divided into 700,000,000 ordinary shares of 10 pence each. As at 31 March 2009, the Company had 518,623,845 ordinary 10 pence shares admitted to trading.

Rights and obligations attaching to the shares
The rights attaching to the shares in the Company are set out in the Articles and may be changed with the approval of the shareholders. Subject to the provisions of the Companies Acts, shares may be issued with or have attached thereto such preferred, deferred, qualified or other rights or such restrictions, whether in regard to dividend, voting, return of capital or otherwise, as the Company may by ordinary resolution determine or, if there has not been any such determination, as the Board may determine.

Shareholders are entitled to requisition a general meeting of the Company and to attend, vote and speak at general meetings, in accordance with the Companies Acts and the Articles. Shareholders have the right to appoint proxies.

Restrictions on the transfer of shares

Any shareholder may transfer a certificated share, as defined in the Articles, by an instrument of transfer in the usual form or in such other form as the Board may approve. However, the transfer of an uncertificated share, as defined in the Articles, need not be in writing and shall comply with any rules adopted by the Board under Article 13.7. The Board may, however, in its absolute discretion and without assigning any reason, decline to register any transfer of any share that is not a fully paid up share or on which the Company has a lien, provided that such discretion may not be exercised in such a way as to prevent dealings in the shares from taking place on an open and proper basis. The Board may also decline to register any transfer unless:

- in the case of a certificated share, the instrument of transfer, duly stamped, is lodged with the Company accompanied by the certificate for the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer;
- in the case of a certificated share, the instrument of transfer is in respect of only one class of share; and
- in the case of a transfer to joint holders of a certificated or uncertificated share, the number of joint holders to whom the share is to be transferred does not exceed four.

If the share to be transferred is an uncertificated share, the Board may refuse to register a transfer if the Uncertificated Securities Regulations 2001 allow it to do so.

Additionally, where a member or other person on whom a Disclosure Notice has been served (pursuant to section 793 of the Companies Act 2006) and has not, within the period specified, supplied to the Company the information required in respect of any shares, the Board may impose a sanction declining to register any transfer of shares, other than a sale to a bona fide unconnected third party.

Significant shareholdings

Details of shareholders with significant holdings in the Company's issued share capital are set out below:

	Number of shares at 31.3.2009	**% share capital**	Number of shares at 2.6.2009	% share capital
Ontario Teachers' Pension Plan Board	**138,776,864**	**26.76**	138,776,864	26.76
Amvescap PLC	**78,021,024**	**15.04**	78,007,151	15.04
Pictet Asset Management SA	**35,407,090**	**6.83**	35,399,120	6.83
Legal & General Investment Management Ltd	**16,536,333**	**3.19**	16,715,683	3.22

Restrictions on voting rights

In accordance with the Company's Articles, no member shall, unless the Board otherwise determines, be entitled to be present or to vote, either personally or by proxy, unless all calls or other sums presently payable by him in respect of shares in the Company have been paid.

Additionally, where a member or other person on whom a Disclosure Notice (pursuant to section 793 of the Companies Act 2006) has been served and has not, within the period specified, supplied to the Company the information required in respect of any shares, the Board may impose a sanction preventing the member from attending and voting at any general meeting.

Shares required to fulfil vested awards made under the Northumbrian Water Group plc Employee Trust are acquired through Northumbrian Water Share Scheme Trustees Limited. In line with ABI guidelines, dividends and voting rights are waived on these shares. At 31 March 2009, the Employee Trust held a total of 1,038,252 shares.

The deadline for delivering either written or electronic proxy voting forms is 48 hours before the appointed time of the meeting.

3. Financial performance continued

Appointment and replacement of directors

The Company may by ordinary resolution appoint any person to be a director. The Board may also appoint directors, either to fill casual vacancies or as an addition to the Board, but any director so appointed shall hold office only until the next following AGM and shall then be eligible for re-appointment, but shall not be taken into account in determining the number of directors who are to retire by rotation at such meeting. These provisions will apply to John Cuthbert's successor if the appointee is not an existing director. A director retiring by rotation at an AGM shall be eligible for re-appointment. Details of the directors retiring by rotation at this year's AGM are set out in the Notice of Meeting.

The main duty of the Nomination Committee is to identify and nominate candidates to fill Board vacancies for approval by the Board. The work of the Nomination Committee is described in the corporate governance report.

The Company may by special resolution, or by ordinary resolution of which special notice has been given in accordance with the provisions of the Companies Acts, remove any director before the expiration of his period of office and may by ordinary resolution appoint another person in his place. Any person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed a director. The Company will be proposing a Special Resolution at this year's AGM to amend its Articles of Association to provide for the annual re-election of all directors.

Amendments to the Company's Articles

The Company may amend its Articles by passing a special resolution of its members. The Company will be proposing a Special Resolution at this year's AGM to amend its Articles, as mentioned above. The proposed changes are explained in the Notice of Meeting.

Powers of the Board

The Articles provide that the business of the Company shall be managed by the Board, which may exercise all such powers of the Company as are not required (by the Companies Acts or the Articles) to be exercised by the Company in general meeting. Subject to the Companies Acts, the Memorandum of Association, the Articles and any directions given by special resolution, the Board may, inter alia:

- establish local or divisional boards or agencies to manage any of the Company's affairs and appoint any persons to be members of such local or divisional boards, or agents, and fix their remuneration;

- appoint attorney(s) for such purposes and with such powers, authorities and discretions and for such period and subject to such terms and conditions as it may think fit;
- delegate its powers to any director;
- sign, draw, accept, endorse or otherwise execute all cheques, promissory notes, drafts, bills of exchange and other instruments and all receipts for moneys paid to the Company in such manner as the Board shall from time to time determine;
- exercise all of the powers of the Company to grant and pay pensions, annuities, gratuities, superannuation or other allowances and benefits in favour of any person; and
- exercise all the powers of the Company to borrow money and to mortgage or charge all or any part of the undertaking, property and assets and uncalled capital of the Company and to issue debentures and other securities for any debt, liability or obligation of the Company or of any third party.

Allotment of shares

Subject to the provision of the Companies Acts, the Articles and any authorising resolutions passed in general meeting, the unissued shares of the Company shall be at the disposal of the Board, which may offer, allot, grant options over or otherwise dispose of them to such persons, at such times, for such consideration and upon such terms and conditions as the Board may determine. The directors are not currently authorised to allot shares but the Company will be seeking authority from shareholders at this year's AGM for the directors to allot shares during the ensuing year, although, at present, the Company has no intention of doing so.

Purchase of own shares

Subject to the provisions of the Companies Acts and the Articles and to any confirmation or consent required by law, the Company may from time to time purchase its own shares. The Company is not currently authorised to purchase its own shares but will be seeking authority from shareholders at this year's AGM to purchase its own shares during the ensuing year, although, at present, the Company has no intention of doing so.

Significant agreements

As at 31 March 2009, NWL had £381.5 million of loans provided by the EIB and the applicable terms include change of control clauses. If, after consultation with NWL, the EIB is of the opinion that a change of control has had or is likely to have a material adverse effect, then the EIB could seek early repayment of the loans plus, in certain circumstances, a premium.

4. Operational performance

Helen Charlton, customer advisor.

NWL uses a range of indicators to monitor performance. In addition to the financial indicators shown on page 19, NWL also uses non-financial indicators throughout the business. Performance against these indicators is reviewed by the management team each month. The definition, purpose and source of the main KPIs are shown on pages 44 and 45.

NWL performance against non-financial KPIs (unaudited) is shown in each section.

Customer satisfaction

	North (N) South (S)	Target 2008/09	Performance 2008/09
Overall service (%)[1]	N/S	90	88
Value for money (%)[1]	N/S	85	84

Note:
1. Satisfaction measured on a net basis (see appendix to the directors' report and business review).

NWL carries out regular quarterly tracking surveys of domestic customers and, during the year, customer satisfaction levels remained very high, with 90% of customers satisfied or very satisfied with the service NWL provides and 87% feeling it provides value for money.

CCWater has carried out its third annual survey for domestic customers on a number of key themes, including value for money. This year's survey again concluded that, of all water companies' customers, ours are the most satisfied with the fairness of charges and value for money.

Domestic customers

	North (N) South (S)	Target 2008/09	Performance 2008/09
Properties at risk of low pressure	N S	274 126	271 40
Properties subject to unplanned interruption of six hours or more	N S	3,000 2,000	8,278[1] 3,353[2]
Properties subject to hosepipe bans at any time during the year	N/S	0	0
Properties subject to sewer flooding incidents (other causes)	N	150	286
Properties at risk of sewer flooding incidents (once in ten years)	N	61	189
Properties at risk of sewer flooding incidents (twice in ten years)	N	41	370
Billing contacts responded to (within five working days) (%)	N S	99.2 99.2	99.2 99.6
Written complaints responded to (within ten working days) (%)	N S	99.8 99.8	99.9 99.7
Bills based on meter readings (%)	N S	99.95 99.95	99.90 99.95
All telephone lines busy (%)	N S	0.25 0.25	0.07 0.06
Abandoned telephone calls (%)	N S	2.50 2.50	3.43 1.95

Notes:
1. Performance affected by a major burst in Northumberland.
2. Performance affected by a major burst in Suffolk.

Understanding and meeting the needs of customers is at the heart of our strategy and NWL is committed to providing a high standard of customer service that meets those needs and those of our regulators. The introduction of our 'right first time every time' philosophy during 2008/09 was part of the re-launch of our customer care charter and a campaign to reinforce a strong customer service ethos across the business.

Ensuring we receive payment for the services we provide remains a priority and our ongoing focus on debt recovery inevitably generates contact from customers in arrears. In the current economic climate we expect the level of our debt recovery activity to increase.

During the year, CCWater introduced a new quality assessment process for complaint handling. We work very closely with CCWater and welcome feedback on our performance which helps to identify areas for further improvement to our high standards.

In a further reflection of focus on customer service excellence, one of a number of awards for NWL this year was the North East Contact Centre of the Year 2008.

Business customers

The economic situation has had a significant impact on some business sectors which are important in our operating regions and NWL has been working closely with major customers in those sectors to mitigate the impact where possible. It has also taken the opportunity to work with potential new businesses in its regions and with the regional economic agencies to both secure existing and encourage new business.

4. Operational performance continued

Leisure customers

NWL is one of the founding members of Kielder Water & Forest Park Charitable Trust. This will replace the existing Kielder Partnership and seek to promote sustainable development, recreation, access and leisure, education, infrastructure and a range of other charitable purposes at Kielder and in the surrounding area. The Trust is seeking registration as a charity and will be chaired by John Cuthbert, Managing Director.

The development of Kielder Water & Forest Park is supported by the Northumberland Strategic Partnership, Government Office Northeast and One NorthEast. This year has seen the completion of a 27 mile lakeside multi-user track and water access points as well as the opening of an award winning observatory and a range of mountain biking tracks. The new website at www.visitkielder.com provides further details of all facilities.

NWL continues to develop its leisure facilities at all strategic sites, investing in fishing facilities, holiday accommodation and supporting 'Access for All'.

Kielder Water & Forest Park's award winning observatory.

Biogas holding vessels at Bran Sands, on Teesside.

Bran Sands turns anaerobic

This autumn, work will be completed on a green energy scheme at one of our largest treatment works at Bran Sands, on Teesside, which will help generate energy to run the plant.

The thermal hydrolysis advanced anaerobic digestion will enable us to use waste sludge to generate methane to fuel gas engines and produce c.4.7MW of green electricity. This will reduce the site demand for grid electricity by half.

Raw sludge is placed in stainless steel vessels, injected with steam and held under pressure at high temperatures to break the sludge down. The pressure and temperature is reduced and the sludge is then passed to the next step to be digested by billions of tiny methane producing bacteria. This methane will be used to fuel the gas engines and reduce our carbon footprint. We plan to build a similar plant on Tyneside and, together with the Teesside plant, this will increase our use of renewable energy to over 20%.

The sludge cake that remains after this process is odourless, harmless and can be used as a fertiliser for agricultural land.

Water

As shown in the table below, the quality of drinking water supplied by NWL remained excellent in 2008/09.

	North (N) South (S)	Target 2008/09	Performance 2008/09
DWI Mean Zonal Compliance (%)	N	99.90	99.92
	S	99.98	99.99
DWI Operational Performance Index (%)	N	99.65	99.67
	S	99.98	99.98
Distribution Maintenance Index (%)	N	99.70	99.52
	S	99.80	99.96

During the year, projects to improve water treatment processes were completed at a number of sites. At Lartington, in County Durham, a new sludge treatment process was installed. Sludge from this facility is now recycled, increasing the recycled volumes of sludge from water treatment works to above 50%. Work to increase the output from Layer water treatment works in Essex, by 20%, was completed successfully, improving the resilience of supplies throughout the region.

One of NWL's key priorities is to continue to reduce the amount of water lost from its networks and the leakage targets agreed with Ofwat have been met despite increases arising from the colder than average winter. The leakage in our southern operating area remains amongst the lowest in the country as it has been for many years. NWL aims to set best practice standards to manage leakage and is playing a leading role in a review of leakage methodologies with the EA and Ofwat.

A large diameter mains cleaning programme, which began in February 2007 and will be complete by 2011, will improve tap water quality to 500,000 customers in south east Northumberland, north Tyneside and the north of Newcastle. This work is progressing well and will make a significant contribution to the planned reduction in customer complaints.

Water resources

Our plan to increase the capacity of Abberton reservoir near Colchester by 58% reached a key milestone, in April 2009, with the granting of planning permission for the reservoir raising, pipelines and pumping stations. This successful conclusion was the culmination of years of extensive work with environmental scientists, lawyers and planners to produce the environmental statement and supporting documentation submitted to the planning authorities. The EA is continuing to prepare the application to vary its licences at Denver and Blackdyke, in Norfolk, which, together with the enhanced transfer facilities and the enlarged reservoir, will secure water supplies for customers in one of the driest areas in the UK.

Our long running water efficiency promotions and good relationship with our customers continue to produce a positive response. This will become even more important in future following the introduction by Ofwat of water efficiency targets for companies.

Metering also has an important role to play in managing the demand for water. For several years we have been installing water meters on change of occupier in properties in the Essex area. This is in addition to the optional metering scheme available to all customers. Around 43% of domestic households in Essex, 56% in Suffolk and over 20% of Northumbrian are now metered.

Although supplies are plentiful in the north east, we believe it is still important to manage the demand for water so that it does not exceed levels that can be supplied in a sustainable way.

4. Operational performance continued

Environment

(Northern operating area only)	Target 2008/09	Performance 2008/09
Sewage treatment works (%)	99.7	100
Bathing waters Mandatory Standard (%)	100	100
Pollution incidents	96	94

All 33 bathing waters in NWL's area passed the EU Mandatory Standard and 20 of these also met the more demanding Guideline Standard, despite poor weather in the summer of 2008. We are working with the EA to identify the impact of other stakeholders, including local authorities, highway authorities, farmers and land holders, on the quality of bathing waters.

All 158 (2008: 157) consented sewage treatment works met their required standards during the year. Improved operating practices based upon timely interventions from our enhanced performance monitoring system, together with focused capital maintenance investment, contributed to this performance. Significant investment was made at strategic works in Darlington, Sunderland and Browney (County Durham).

NWL continues to benefit from its ongoing investment in real time monitoring devices in the sewer network which provide information on flow levels. Further improvements linking this data with rainfall information allow operational teams to focus on significant overflows from the network which can cause pollution. The downward trend of pollution incidents over the last five years has been maintained. Last year, there were 94 incidents attributed to our assets, mainly from foul sewers and combined storm overflows (25 less than the previous year).

Intense rainfall during localised summer storms caused extensive flooding

The Right Honourable Hilary Benn MP, Secretary of State for Environment, Food and Rural Affairs on his recent visit to view the radar.

Understanding the weather

We are committed to reducing the risk of flooding for our customers but the lack of reliable weather data in the north east has meant that predicting storms and the subsequent impact of rainfall on our sewerage network has been problematic.

We need access to information to make accurate network performance predictions and understand how our 16,000km long sewerage network copes in different weather conditions, including the severe localised storms we have seen in recent years.

We have joined forces with the Meteorological Office and the Environment Agency to install a £1 million rain radar at High Moorsley, near Durham City, which will record the location and intensity of rainfall. The central location of the radar will provide excellent coverage of the major urban areas, including those most vulnerable to flooding. The coverage we currently receive is in 5km grids but will reduce to 1km grids.

The radar will help us to focus flood alleviation work in the risk areas and help the Meteorological Office and the Environment Agency give more accurate and timely flood warnings. The rain radar is a perfect complement to the NWL sponsored network of 85 school weather stations as part of the Northumbrian Water GLOBE project. This unique project forms part of the international GLOBE programme, a network linking weatherstations in schools in 110 countries, the data from which can be used by us locally but which can also be accessed by scientists internationally including those at NASA.

David Chapman, NWL's Climate Change Manager.

during the year with 829 properties flooded internally, well above the long term average and second only to 2005/06 with 1,160 properties. Investment to reduce the risk of sewer flooding has been increased. During the year, 20 schemes were completed to alleviate flooding risk for 114 properties and we improved 102 combined sewer overflows. This will further improve rivers and water courses, enhance their visual appearance and reduce pollution incidents.

Climate change

The water industry is one of the largest users of energy in the UK and we aim to play a full part in support of Government's plans to reduce emissions. We have been working over recent years to reduce our carbon footprint while preparing ourselves for the future challenges of a change in climate and the weather events we may face as a consequence. We will shortly commence commissioning of an advanced anaerobic digestion plant at Bran Sands which, when operational, will provide 50% (c.4.7 MW) of the energy requirements of the site. A similar investment for our site at Howdon, on Tyneside, has been included in our Final Business Plan submission.

Detailed below are some of our projects to reduce our impact on climate change:

- limiting tertiary UV disinfection outside the bathing water season at five major works reduces energy consumption and carbon emissions with no detrimental effect on the marine environment;
- introducing anaerobic digestion, as part of our sludge strategy, will generate power at three smaller sites initially, and at two larger sites (Bran Sands will be complete in 2009 and Howdon is planned for the next five year investment period) increasing our total renewable energy to over 20%;
- generating our own renewable energy with hydroelectric plants at Kielder, Derwent, Lartington and Wear Valley reservoirs and biogas combined heat and power at Stressholme, Hexham and Aycliffe;
- contributing to the project in the North Pennines, which has 27% of England's peat-forming blanket bog which locks in carbon, preventing it being released into the atmosphere;
- encouraging customers, through our 'Water is precious' campaign, to use water wisely and recognise that if they waste water, they also waste energy (a water carbon footprint calculator is now available for customers on our websites to emphasise this link); and
- introducing a new work management system which will improve customer service and efficient working, and will also significantly reduce mileage in our vehicles.

Through these projects we have reduced the amount of energy used by almost 9% over the last five years. We are continuing to develop our understanding of the potential impacts of a changing climate. The UK Climate Projections will be published later this year and we will be revisiting our assessment in light of the new science that emerges.

Our work to date includes:

- publishing our Water Resource Management Plan and our strategic direction statement 'Looking to the future' which include an assessment of climate change on water resource needs for the next 25 years;
- undertaking an assessment of the main threats to service provisions and continuity from flooding, in response to the floods seen elsewhere in 2007 and the subsequent 'Pitt Review: Lessons learned from the 2007 floods' (Pitt Review);
- aiming by 2013 to have completed, with relevant agencies, a major study on Tyneside to explore sustainable drainage options that take into account regional development and the impact of climate change (building on similar work carried out in Hartlepool as part of the Defra 'Making space for water' scheme); and
- working with experts to understand the potential impact on our assets and sharing information with the North East Climate Change Adaptation Study and Action Plan published on 1 May 2008.

4. Operational performance continued

Quality

NWL has maintained its certification to the international quality standard ISO 9001:2000 and to the international environmental standard ISO 14001:2004 across all areas of the business, including operational sites and office based teams.

The company also achieved companywide certification to the international occupational health and safety management standard OHSAS 18001 in 2007.

Employees

Throughout the Group we have 3,147 employees, as set out below:

Group business unit	Average number of employees	%
Northumbrian Water Limited	2,966	94
Water and waste water contracts	156	5
Other	25	1
Total employees	**3,147**	**100**

NWG's key asset is its employees and one of the strengths of NWL is employee loyalty; employee turnover is relatively low at 6.4%, well below the UK water industry average of 10.4%. NWG ensures its terms and conditions both attract and retain the best employees in the areas it serves. NWL employees also have access to a scheme which provides a wide range of benefits including childcare vouchers and discounted store vouchers.

Currently 62% of employees participate in the scheme, up from 27% last year.

NWG places great emphasis on health and safety and employees are actively encouraged to be involved in identifying and eliminating hazards in the workplace. This has resulted in a significant reduction in accidents over recent years.

	North (N) South (S)	Target 2008/09	Performance 2008/09
Employee turnover (rolling %)[1]	N/S	Industry average 10.4	6.4
Lost time reportable accidents (per 1,000 employees)	N/S	5	6
Sickness absence (%)	N/S	2.85	2.94

Notes:
1. No target set, data for information.

The active involvement and engagement of everyone across the business is an important part of delivering performance and NWL continues to formally seek the views of employees through an annual employee attitude survey. This year's survey was completed by 57% who gave their views on their working life, training, communications, managers and the company. The results were reported back to all employees at workshops and employees participated in the development of action plans with their managers. Overall, employee satisfaction levels remain very high with over 77% of respondents stating they are proud to work for the company and 71% telling us that NWL is a great organisation to work for.

Training and development

NWL introduced an extensive People Plan in 2007 in which it set out a programme to support and develop employees.

Everyone who joins NWL receives a personalised induction plan outlining their familiarisation and training programme for the first weeks of their employment. In addition they are invited to an induction day where they meet senior managers and are introduced to the company and our approach to key areas including health and safety, terms and conditions, pensions and 'Just an hour'.

We are committed to the continuous development of occupational skills and signed the Government's 'Skills Pledge', committing to 90% of employees achieving the National Vocational Framework (NVQ) Level 2 standard by December 2009 and 95% as soon as possible thereafter.

An ambitious NVQ programme is being rolled out in our customer and operational areas. Funding has been secured from the Learning and Skills Council's 'Train to Gain' fund and also through Business Link. In December 2008, NWL was the first water and sewerage company in the UK to have all its 138 water treatment production operators meet the requirements of the 'Competent Operator Framework' and achieve a nationally recognised qualification, the NVQ Level 2 in Operating Process Plant.

Since the re-introduction of our apprenticeship scheme in September 2007 we have recruited 18 apprentices for the maintenance area across the business. In 2009, we plan to recruit nine new apprentices, including the first apprentice for our information services team. Candidates undertake a four year development programme and have excellent career prospects when they complete their apprenticeships being guaranteed employment on successful completion of their training.

Our Graduate Development Programme was re-launched in 2008, to provide potential leaders for the future. Candidates undertake a two year programme with three to six month placements in different parts of the business. In addition to a line manager they are also given a senior management mentor. Employment is guaranteed on successful completion of the programme. We recruited four graduates in 2008 and plan to recruit an additional four to start in 2009.

One of the objectives of the People Plan is to develop leadership skills in current and potential managers. NWL continues to implement its Management Development Framework which is structured to cover the training needs of those who show the potential for management right through to development at director level. As part

Investing in our people

As a business we rely on our people and are committed to giving them the best training possible. We encourage them to gain qualifications even if they lack self confidence when it comes to formal study.

National Vocational Qualifications (NVQs) measure and recognise competence at work and are designed around the skills and knowledge people use in their jobs. We are making great progress towards our published skills pledge target of 90% of our workforce to be qualified to a minimum of level 2 NVQ by the end of 2009.

In 2006, when the programme began, this figure was only 60% but since then NVQs have been achieved in a wide range of areas including customer service, business administration, engineering maintenance, team leading and assessing.

We were the first water and sewerage company in the country to have all of our 138 treatment works operators gain the new NVQ in Operating Process Plant. This has been developed specifically to meet the national occupational standards set by the water, electricity, gas and waste management industries to achieve competent operator status. This qualification incorporates the best possible working practices and means we are setting the standard of best practice in our field.

Everyone who achieves a qualification is invited to annual skills awards ceremonies to celebrate their success and applaud their dedication and hard work.

John Cuthbert and Kriss Akabusi present Kenny Allport his award at the southern skills awards.

4. Operational performance continued

NWL's Management Development Framework model.

of this framework we are working in partnership with Newcastle Business School to provide qualifications from a Diploma to a Masters degree in leadership and management.

Employees' academic achievements were celebrated this year at our third annual skills awards. Attended by senior managers from around the business, and with guest speaker Kriss Akabusi, the events were again motivational and memorable.

Health and safety

Our emphasis on the importance of health and safety within NWL has resulted in major improvements to our safety record in recent years. This year we experienced six lost time reportable accidents per 1,000 employees, which is a 57% reduction over the previous five years. This has been accompanied by a further reduction in days lost through accidents.

We have established a medium term plan for taking health and safety forward in the business to 2014. We aim to further reduce the number of accidents by 10% each year and to reinforce the safety culture in the business.

NWL proactively supports and encourages employees to strive for high standards of health and wellbeing by providing a wide range of services, support and resources relating to occupational health, with the Group's medical advisor providing comprehensive occupational health services, general health promotion and stress management. NWL employees also have on and offsite access to specialist advice and treatment to support recovery from musculoskeletal disorders (MSD).

We continue to promote healthy eating, hydration and discourage smoking in our workforce and offer excellent health screening and medical insurance schemes. Around 1,700 employees have been through our health screening and fitness standards programmes, both of which now include lifestyle advice elements. In the first year we have reduced sickness absence due to MSD by just over 9%.

NWL's current level of sickness absence is 2.94% which is the lowest ever achieved and well below the norm for the sector.

Research and development

We run a programme of research and development linked to our core business operations. This includes the development of technical solutions for water and waste water management, collaborative research within the sector and through partnerships with academic and research organisations.

During the year, the Group invested £1.8 million (2008: £1.8 million) in research and development.

Water and waste water contracts

Revenue for the Group's water and waste water contracts was £39.8 million for the year to 31 March 2009 (2008: £35.5 million) and profit on ordinary activities before interest was £9.1 million (2008: £8.4 million). The increase is principally due to a credit in respect of gas indexation (£2.4 million) on tariffs at Caledonian Environmental Services offset slightly by increased power and sludge disposal costs. All contracts are performing well, in line with expectations.

The Group is a member of two consortiums delivering long term private finance initiative contracts with Scottish Water for waste water treatment. At Levenmouth, the Group has a 75% shareholding in both project and operating companies and the benefit of a 40 year contract. Funding was provided through a 37 year fixed interest rate corporate bond with the principal amortising from 2008.

In Ayrshire, the Group has a 75% shareholding in the project company and a 100% shareholding in the company that operates the three effluent treatment plants that make up this 30 year contract. Finance was provided through a 27 year loan on a fixed interest basis with the principal amortising from 2003.

In Ireland, the Group is part of a contractual consortium that designed and built a waste water treatment plant for Cork City Council. Under the consortium agreement, the Group has responsibility for a 20 year contract for the operation and maintenance of the plant.

AquaGib Limited, two thirds owned by the Group in a joint venture with the Government of Gibraltar, operates Gibraltar's dual drinking water and sea water distribution systems under its 30 year contract with the Government of Gibraltar. The project to install two new reverse osmosis plants to replace ageing and relatively inefficient distillation plants, a £3.4 million investment, has been completed.

Other

Agrer

Revenue for the year to 31 March 2009 was £7.2 million (2008: £6.9 million). During the year, the level of new projects has been lower than the previous year but the order book at the end of the period, as Agrer enters its 50th year, is reasonable. Several contracts have been extended and the most significant new contracts are: technical assistance to the management and development of natural resources in Chad (€0.9 million – two years); a study for the privatisation of the coffee sector in Burundi (€0.6 million – ten months); and the study of the agricultural development of the Guiers Lake area in Senegal (€0.4 million – one year).

Corporate responsibility

NWL supports the communities we serve in a number of different ways. As well as providing financial support and facilities, we encourage employees to volunteer their time, skills and expertise. These activities generally support projects that make the areas we serve better places in which to live, work or invest. The programme focuses on key themes throughout these communities but, increasingly, we are developing initiatives designed to tackle lasting and sustainable change in specific areas.

In April 2009, NWL received the Queen's Award for Enterprise, in the category of Sustainable Development and the citation read:

"Northumbrian Water Limited receives the Award for its ongoing and impressive commitment to sustainability.

"It has actively striven to promote best practice within its sector and is committed to ongoing review and continuous improvement.

"With a commendable and ever improving environmental performance in place, it is, however, Northumbrian's

THE QUEEN'S AWARDS FOR ENTERPRISE: SUSTAINABLE DEVELOPMENT 2009

FTSE4Good

2008 UTILITY INDUSTRY ACHIEVEMENT AWARDS

4. Operational performance continued

extremely impressive social and economic initiatives which elevate it to the status of sector leaders.

"A diverse suite of programmes have been implemented, encompassing local procurement, strong apprenticeship programmes, individual up skilling and the continuous leverage of their spending power, employment and wider economic presence to ensure maximum benefit for local communities.

"Northumbrian's driving commitment to sustainability governance provides an example and benchmark across sectors, demonstrating that strong leadership and ambition can make a tangible difference to communities both local and more widely."

NWL was also named 'Utility Company of the Year' at the Utility Week Awards in December 2008. Steve Hobson, the Editor said:

"Last year for the first time we asked our panel of eminent judges to nominate and vote for the utility they felt deserved the accolade 'Utility Company of the Year'. The aim was to open this top category to companies that deserve such recognition but often don't enter awards for various reasons.

"Northumbrian Water was a worthy winner for the way it builds its business around customers and the community, principles that usually do not make headlines but show that a successful utility really does put customers at the heart of its business."

In addition to the awards outlined above we were:

- members of the FTSE4GoodIndex again;
- ranked by Business in the Community (BITC) as one of the top 100 'Companies for corporate responsibility' and as a Platinum ranked company. It also awarded the company its Big Tick award for its impact on society and for being a healthy workplace;
- leading water company in Britain's Most Admired Companies survey;
- North East Call Centre of the Year in the 2008 contact centre awards;
- the employee engagement winner at the North East of England Chartered Institute of Personnel Development HR&D awards; and
- the category winner of Culture for Success Large Employer Award for employee development, customer service, business growth and the contribution we have made to the community.

Over many years, we have donated at least 1% of our pre-tax profits (through cash, employee time and expertise, or use of our facilities) to projects which benefit the communities we serve. We reported this publicly as part of BITC's Per Cent Club standard and, although this ended in October 2007, NWG has maintained this commitment.

The Group made charitable donations totalling £134,415 during the year.

Community support

Employees and volunteering

Currently 22% of employees participate in the 'Just an hour' volunteering scheme and last year gave over 6,500 hours to the community. Over 500 different organisations were given financial and in-kind support during the year. The 'Care for safety' scheme, which encourages employees to reduce accidents and associated lost time, has triggered payments totalling £52,655 for our nominated charities (Great North Air Ambulance Service, Mencap's Dilston College, RNLI, St Teresa's Hospice and East Anglia's Children's Hospices). Since it began over £250,000 has been raised for charity.

Education

Further to the launch of the 'Northumbrian Water GLOBE' programme, which saw us link up with the international environmental education initiative set up by Al Gore in 1996, we donated 85 fully automated weather stations and associated training to schools throughout the northern region, to collect weather data in areas where Meteorological Office coverage is poor. This data is now helping to increase understanding of the impact of climate change, and is a valuable curriculum tool.

'Just an hour' employees at Percy Hedley School, Newcastle, (l-r) Ash Harrison, Andy Armstrong, Jayne Simpson, Dave Allen, Fay Pickup and Andrew Blenkharn.

The 'Northumbrian Water Schools Awards', now in their third year in the northern region, are designed to recognise and celebrate the achievements being made by our schools. They cover both community and curriculum based projects and honour whole schools, classes and individuals.

In our southern operating area, we support 'Cash for Schools' along with the Essex Chronicle. This recognises excellence, with a focus on environmental projects from primary and secondary schools, within the newspaper's distribution area.

A wide range of educational materials are available on our websites for children and teachers.

Partnerships

Water for health

NWL is at the forefront in the water industry in communicating the health benefits of drinking tap water. To date, over £244,000 has been provided for mains-fed water coolers in schools and around 600 have been supplied in nearly 300 schools. We also continue to promote bottle-free water coolers as a sustainable alternative to bottle-fed coolers.

We also support the Water UK and Unison led 'Water@work' initiative to encourage employers to ensure that employees have adequate access to drinking water.

Environmental

Key partnerships have been developed with NWL to help the conservation of biodiversity on our sites. Our contribution to the partnerships includes funding project officers and current partnerships include:

- Northumberland Wildlife Trust (Kielder and Bakethin);
- Durham Wildlife Trust;
- Essex Wildlife Trust (Hanningfield);
- Broads Authority (Lound and Trinity Broads); and
- Davy Down Trust.

Sustainable communities

We have a continuing commitment to support projects and organisations within the areas in which we work and contribute to the long term sustainability not only of our business, but also of the environment, society and communities we serve. Corporate responsibility is integral to how we do business and as part of this commitment we are working in different ways within our communities to promote lasting change.

We are working with partners to create models of sustainable change and also methods of evaluating their success, which can be replicated in other communities. The focus has been on health, education, economy and affordable housing as well as creating new ways to support areas helped by our chosen charity WaterAid.

Health

Healthworks has been open for nearly two years now after we reached an agreement with County Durham Primary Care Trust (PCT) granting them a 99 year lease on a redundant building at our Easington waterworks. We worked in partnership with the PCT, the District of Easington Council, the Neighbourhood Management Pathfinder and other stakeholders to develop services for the local community in an area where census records show one of the worst health records in the country.

Our commitment has gone beyond providing the building. There is a natural synergy between our own

4. Operational performance continued

Tony Blair with 'Just an hour' employees at the launch of The Tony Blair Sports Foundation, (l-r) Mike Ciaraldi, Sharon Stewart, Simon May, Jane Morland, Jane Davison, Sharon Martin, Karen Scott and Leanne Clough.

'Water for health' campaign and the 'Healthy Living' agenda, so we devised new ways for NWL to work at a strategic level with the partners of the Healthworks to ensure the sustainability of the building and its facilities for the community. We contributed research, marketing and communications support to improve awareness of the centre and helped with events to promote healthy living, targeted at primary and secondary schools and day centres.

We sit on the steering group for Healthworks which achieved almost 10,000 visitors in its first year alone and now provides more than 30 health and community support services. It acts as a community focal point where service providers and community groups can come together to address issues that affect the quality of life in the local community. Facilities range from a juice bar to a gym and information kiosks, some of which can be used in a privacy setting with many more planned. Healthworks has been so successful that the plans for phase two have been brought forward and will include a GP walk-in surgery thus securing the future of Healthworks for the community.

As part of the support, we developed the 'Oceans of Fun' activity which is supported by sponsorship of 'Everyday Swim' an innovative swimming programme run by the Amateur Swimming Association to promote physical exercise and an arts programme run by Creative Partnerships to use arts-based activities to change children's attitudes to eating and drinking, supported by research from Durham University. Our contribution to the work of Healthworks is a unique approach to tackling the poor long term health of the residents in Easington.

Sporting partnerships

NWL prides itself on being immersed in the community and working with a wide and diverse range of sporting partners is a natural extension of our 'Water for Health' campaign, which encourages people to lead a healthy lifestyle. Working with our sporting partners we support a diverse range of sports to get people active as well as educating them on healthy eating and good hydration. Through our partnerships we reach over 55,000 children and adults annually. We provide:

- links and networks to enable sporting partners to get together to share ideas and resources;
- financial support of over £50,000 per annum which then levered over £80,000 from other sources;

- approximately 200 employee volunteer hours per annum;
- advice and marketing support on programme development;
- bottled tap water, sports bottles or mains-fed bottle-free coolers to reinforce the importance of drinking tap water to re-hydrate during sporting activities; and
- help with fundraising and raising the profile to attract additional investment.

We can generate wider support for projects by adding our name and commitment to them and by encouraging others to get involved thus generating additional funding sources for projects. Our involvement acts as a key catalyst to raise confidence that projects present real opportunities for the private sector.

Education

NWL is lead sponsor for Castle View Enterprise Academy, a new and exciting independent school for 11-16 year olds serving the areas of Castletown, Town End Farm and Hylton Castle in Sunderland. The area contains some of the most deprived wards in the region and 61%-80% of the school catchment population is categorised as being 'struggling families'.

Castle View Enterprise Academy will offer a new approach to education and is one of three academies being created in Sunderland with the City Council as co-sponsor. It is a unique model under the 'Building Schools for the Future' programme. Our aim as lead sponsor is to create a centre of excellence with a clear focus on raising standards of academic performance and enabling every student to achieve their personal best in all areas of academy life within a safe, secure and stable environment. The project is now in its third year and we have committed time and resources to support the Principal of the Academy. The Managing Director chairs the Trust Board and employees have helped in the design, build and management arrangements. The Academy will open in September 2009 and the company will use its business networks to complement the specialism which is business and enterprise.

Economy

North East Enterprise Bond

Our investment in the bond is a five year interest free loan, which helped fund the purchase and running of a number of 'Launch Pads' – mobile vehicles that tour the region to help trigger and encourage enterprise start-ups to make real, long term change. Working with creative enterprise promoters such as Big Ideas, People into Enterprise and Newcastle Education Business Partnership, the bond serves as a catalyst to encourage people to set up their own business or social enterprise.

NEL Growth Fund

Our investment in the fund is to provide start up capital in eligible high growth businesses based in the north east of England. The fund is managed by NEL Capital the specialist venture capital division of NEL Fund Managers.

WaterAid

NWL has continued to raise funds and awareness for the work of WaterAid which brings sustainable water and sanitation solutions as well as hygiene education to the poorest parts of Africa and Asia. The employee fundraising committee has raised more than £3 million, since 1997, with the help of the company and last year focused its fundraising support on specific projects in Malawi and Burkina Faso.

Community Foundations

Community Foundations covering our areas of supply hold endowment funds totalling nearly £1 million contributed by NWL over the last 17 years. These are long term investments with the income from the funds used to support community initiatives. Recipients are chosen by committees of our own employees (64 groups this year).

5. Risks and resources

Kevin McNeill, NWL contractor, on site for the mains cleaning programme on Tyneside.

The NWG Board requires all subsidiaries within the Group to identify and assess the impact of risks to their business. For each risk, the likelihood and consequences are identified, management controls and frequency of monitoring are reported and the scale of the risk is assessed. Apart from NWL, none of the subsidiaries has risks considered to be significant to the Group's short and long term value.

For NWL, the management team reviews the approach to risk management in detail every year and the Audit Committee considers the outcome. The NWL management team review the significant risks every month and summary reports on these reviews are submitted to the NWL board.

Going concern and treasury risk

The financial ratios, financial results, liquidity position and credit ratings are described in the financial performance section on pages 19 to 22. In addition, note 20 to the financial statements includes details on the Group's strategy and treasury operations for managing its capital; its exposures to liquidity risk, interest rate risk, foreign currency risk and counterparty risk; and details of its financial instruments.

The current pressures within the financial markets have been well documented and the credit crunch has resulted in reduced availability of certain types of finance (such as index linked bonds) and a significant increase in the cost of corporate debt. It is not clear how long current difficult market conditions will persist. However, as the Group has sufficient funding in place to 2011, the effects on the Group are minimal.

The current economic climate is also having an impact on revenues, particularly those from industrial and commercial customers and those associated with the housing market. We continue to monitor the uncertain situation very carefully.

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

Regulatory risk

The key risk for the business is the outcome of the PR09 (periodic review of prices), the process by which Ofwat sets limits on the prices which

NWL can charge customers for the five years from 1 April 2010. Ofwat will publish its draft determination in July 2009 and will consider representations before issuing its final determination in November 2009.

The Government published a consultation paper on the draft Flood and Water Management Bill in April 2009. The Bill includes measures to implement the recommendations of the 'Pitt Review' on flooding as well as a range of other measures to tidy up aspects of water related legislation. The flooding measures primarily relate to local authorities and the Environment Agency but also have implications for water companies, particularly with regard to how they interact and cooperate with these bodies.

It is intended that the Bill will ultimately incorporate measures in response to the 'Cave Review' (published in April 2009) and the 'Walker Report' on charging and metering (published in June 2009). These measures will be added at a later date and will be subject to separate consultation.

The 'Cave Review' proposes a cautious step-by-step approach to the introduction of competition and envisages the main benefits arising from greater innovation. It proposes a number of regulatory changes including providing Ofwat with a duty to promote innovation and the incorporation of negotiated agreements involving customer representatives (eg CCWater) as part of future price reviews.

The most significant competition proposal, at least in the short term, is the legal separation of retail businesses. This will need to be considered in greater detail as part of a separate consultation. We remain to be convinced of the benefits of this proposal.

The Government has confirmed that it intends to proceed with the transfer of certain private drains and sewers into water company ownership by 2011, which would increase the sewerage network owned and maintained by NWL by about 60%. Further details on the transfer process are expected later in the year but this will be too late for the costs to be included in the PR09 price review. It is, therefore, likely that all sewerage companies will see an adjustment to price limits post 2010.

Another item of new legislation that will have a significant impact on the business, as and when the provisions are implemented by local authorities, is the Traffic Management Act which came into effect in April 2008.

Environmental, social and governance risks

There are two environmental, social or governance risks considered to be significant to the value of the Group.

The first relates to the use of sewage sludge as a soil conditioner on agricultural land. If this disposal route was lost, the sector would need to find or develop alternative ways to re-use or dispose of its sewage sludge. This could mean higher capital and revenue costs to provide additional sludge processing facilities. The development of the 'Safe Sludge Matrix' and the proposed revision of the Sludge (Use in Agriculture) Regulations have reduced the immediate risk in this area. NWL is introducing advanced digestion to both reduce sludge volumes and the carbon impact of its activities. NWL will retain a facility to dry sludge and produce pellets as a fuel replacement, as a viable alternative way of using sludge in the medium term.

The second is the potential for sewer flooding. As rainfall patterns become more variable and intense storms more frequent, localised heavy rainfall can result in sewers becoming overloaded. We welcome the focus on integrated flood management in Defra's strategic document 'Future Water' and in the 'Pitt Review' on recent flooding.

Affordability and customer debt

Although our average household bills are relatively low, affordability is an issue for NWL with income deprivation levels in the northern area the highest of all water and sewerage companies and in the southern area, close to the national average.

5. Risks and resources continued

Providing our customers with a range of payment facilities and frequencies that suit their individual circumstances is a critical element of successful income collection and debt prevention. We ensure that customers are aware of options which help reduce charges and ease the establishment of payment arrangements.

Customers who deliberately avoid paying charges are actively pursued and we continue to work with Ofwat and Defra to seek changes to legislation to assist the industry to impose and collect charges.

Water resources

The way we retain, recycle and distribute our water resources is a central part of our business. While NWL has sufficient water resources in the north east, we believe it is still important to manage the demand for water so that it does not exceed levels that can be supplied in a sustainable way.

In our Essex and Suffolk areas, however, water resource availability is a key issue. We have been successful over many years in encouraging our customers to use less water and in keeping leakage at or below the economic level. Nonetheless, we need to continue to invest to achieve our aim of ensuring our customers have a safe, secure and reliable supply of water well into the future. In spring 2008, we published our draft 'Water Resources Management Plan' for consultation and, in January 2009, we produced a Statement of Response to the consultation and provided an updated draft of the plan to Defra. A final plan will be published once approval has been received.

In April 2009, Colchester Borough Council formally approved our application for planning permission for raising Abberton reservoir which will increase its capacity by 58%. The one remaining part of the overall Abberton Scheme that requires permissions is the variation of abstraction licences at Denver and Blackdyke, in Norfolk. Once this Scheme is in operation in 2014, it is unlikely we will need to develop major resources in Essex for the next 25 years.

We will continue to play a leading role in the industry on water efficiency measures and to encourage customers to use water wisely. We will work with other stakeholders to develop a coordinated strategy for reducing water use to sustainable levels.

In areas where water is scarce, water meters have a key role to play in reducing demand. We aim to achieve as near to universal metering as possible in Essex by 2020 and in Suffolk by

The Right Honourable David Miliband MP, Secretary of State for Foreign and Commonwealth Affairs with residents of Newlands Court, an area where work is underway to protect homes from flooding.

Photo credit: Shields Gazette.

2023. On current policies it will take considerably longer to achieve full metering in the north east as there is no economic, environmental or social driver to move more quickly.

Changing weather patterns

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

We have carried out research into the likely impact of climate change on all our assets and water resources and this has been incorporated in our 'Climate Change Policy' as part of our corporate responsibility work. We will continue to do work in this area using the latest projections of the impacts of climate change soon to be published by the UK Climate Impacts Programme.

Employees

People are our key asset and if we are to continue to meet the needs of our customers, and to achieve our regulatory obligations, we need to continue to recruit and retain talented and skilled people as a leading employer in our regions. We will continue to offer all our employees terms and conditions at least commensurate with other major employers as well as appropriate training and development to support their career progression. This includes the comprehensive management development framework, graduate and apprentice programmes, as well as initiatives such as the NVQ programme which reach many employees.

Directors' remuneration and interests

Information about directors' remuneration and their interests in the shares of the Company is contained in the directors' remuneration report on pages 54 to 63.

Indemnification of directors

The Company has in place directors' and officers' insurance and, on 28 November 2005, entered into a deed of indemnity to grant the directors further protection against liability to third parties, subject to the conditions set out in the Companies Acts. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report and business review. The deed, together with directors' service contracts, will be available for inspection by shareholders at the AGM, or from the Company Secretary.

Annual general meeting

The notice convening the AGM, to be held on 30 July 2009, was sent to shareholders with this report, together with an explanation of the business to be conducted at the meeting and a form of proxy.

Auditors

Ernst & Young LLP have indicated their willingness to continue in office and a resolution proposing their re-appointment as auditors will be put to shareholders at the AGM.

Directors' declaration

As required under section 234ZA of the Companies Act 1985, so far as each current director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board

Martin Parker
General Counsel and Company Secretary
2 June 2009

Registered office: Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ
Registered in England and Wales No. 4760441

Appendix to the directors' report and business review

Group financial KPIs

Gearing to RCV

Definition and calculation: The ratio of Group net debt to NWL's Regulatory Capital Value (RCV) plus a pro forma RCV for the Kielder securitisation and the PFI contracts (at the level of associated debt included in the Group's net debt relating to those assets). The NWL RCV represents the total capital value of the appointed water and sewerage business on which The Water Services Regulation Authority (Ofwat) allows a rate of return at price reviews based on its view of the cost of capital.

Purpose: The RCV generates most of the revenue stream of the Group and regulatory gearing is an important factor in credit ratings.

Source of underlying data: NWL's RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to five years ahead, based on its last price determination. Group net debt is disclosed in the audited financial statements.

Cash interest cover

Definition and calculation: Cash generated from operations less tax divided by net interest paid.

Purpose: Measures the ability of the Group to service its debt.

Source of underlying data: Audited financial statements.

Cash flow to net debt

Definition and calculation: Cash generated from operations less tax paid divided by net debt.

Purpose: Indicates the Group's ability to reduce debt in the absence of need for additional investment, without resorting to asset disposal.

Source of underlying data: Audited financial statements.

NWL financial KPIs

Regulatory gearing

Definition and calculation: The ratio of NWL net debt (including borrowings to group subsidiaries) to NWL's RCV. The RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews based on its view of the cost of capital.

Purpose: The RCV generates most of the revenue stream of the Group and regulatory gearing is an important factor in credit ratings.

Source of underlying data: NWL's RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to five years ahead, based on its last price determination. NWL's net debt can be found in the audited regulatory accounts and Ofwat annual reports on financial performance.

NWL non-financial KPIs

■ Water

Drinking water quality

Definition and calculation: Compliance with drinking water regulations as monitored by the Drinking Water Inspectorate (DWI).

Purpose: To monitor drinking water quality.

Source of underlying data: Samples recorded by NWL and audited by the DWI.

■ Environment

Sewage treatment works

Definition and calculation: Percentage of population equivalent served by non-compliant works failing Look Up Tables' consents.

Purpose: To monitor the performance of NWL's sewage treatment works and their impact on the environment.

Source of underlying data: Information recorded by NWL and the Environment Agency (EA) and reported on by the latter.

Bathing waters Mandatory Standard

Definition and calculation: Percentage of bathing waters complying with Mandatory Standards.

Purpose: To monitor the impact of NWL's coastal treatment works on the environment.

Source of underlying data: Information recorded and reported by the EA.

Pollution incidents

Definition and calculation: Number of category 1, 2 and 3 pollution incidents in the calendar year as defined by the EA.

Purpose: To monitor the performance of NWL's sewerage system and its impact on the environment.

Source of underlying data: Information recorded and reported to Ofwat by the EA.

■ Customer

Customer – levels of service

Definition and calculation: Customer service standards are established by Ofwat and calculated using source data in the company.

Purpose: To monitor customer service performance of NWL.

Source of underlying data: Information collected by the company and submitted to Ofwat. It is independently certified.

Customer satisfaction

Definition and calculation: Domestic customers' satisfaction with overall service and overall value for money, expressed as satisfaction averaged over the surveys carried out during the year. Average satisfaction is based on a scale of 1 to 10 using the score of 6 and above as satisfied. Net scores are used to show true satisfaction by taking into consideration those who are dissatisfied who score between 1 and 3.

Purpose: To enable tracking of perception of reputation, service and value for money over time.

Source of underlying data: Independent surveys of 500 customers (300 north, 200 south) chosen at random, but representative of the customer base, carried out each quarter – a total of 2,000 customers.

■ Employee

Lost time reportable accidents

Definition and calculation: Injury accidents that are reported to the Health & Safety Executive as required by the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995. Calculated as number of accidents reported in financial year per 1,000 employees.

Purpose: To monitor the safety performance of NWL over time.

Source of underlying data: Completed NWL accident/incident report forms. Employee numbers provided by the human resources department.

Sickness absence

Definition and calculation: Sickness absence days as a percentage of total working days multiplied by the end of month headcount.

Purpose: To track and trend sickness absence levels across the organisation.

Source of underlying data: Sicknotes, return to work interviews and weekly returns by managers.

Employee turnover

Definition and calculation: Number of leavers within the year as a percentage of average headcount.

Purpose: To track the employee turnover within the business to ensure that it is within benchmark data.

Source of underlying data: Current employees' details are held within the human resources management system – reports show leavers against headcount.

Board directors' biographies

1. Sir Derek Wanless
Chairman

Sir Derek Wanless was appointed to the Board as an independent non-executive director in December 2003. He was appointed to the board of NWL in January 2006 and, in July 2006, became Chairman of NWG and NWL. Sir Derek chairs the Nomination Committee and is a member of the Remuneration Committee. He became a director of National Westminster Bank in 1991 and its Group Chief Executive in 1992. He retired from this position in 1999. Sir Derek is currently Chairman of Legal and General plc's Longevity Science Advisory Panel and a member of the Board for Actuarial Standards at the Financial Reporting Council.

2. John Cuthbert
Managing Director

John Cuthbert was appointed to the Board in May 2003. John joined the water industry in 1991 and was appointed Managing Director of North East Water plc in 1993. Following the acquisition of the former Northumbrian Water Group plc by Lyonnaise des Eaux in 1995, he transferred within the Group to become Managing Director of Essex and Suffolk Water plc. John took over as Managing Director of the former Northumbrian Water Group plc, and also of NWL, in 2001 and is a member of the Nomination Committee. John is Chairman of Castle View Enterprise Academy, in Sunderland, of which NWL is lead sponsor. John will retire on 31 March 2010 and the Nomination Committee has initiated a process to seek a successor, which is described in the corporate governance report on page 50.

3. Chris Green
Finance Director

Chris Green was appointed to the Board in May 2003. Chris joined the former Northumbrian Water Group plc in January 1990 and was initially involved in its diversified business activities before being appointed as Group Finance Director in 1997. Chris was appointed as Finance Director of NWL in April 2000 following the merger of that company with Essex and Suffolk Water plc.

4. Sir Patrick Brown
Senior Independent Non-executive Director

Sir Patrick Brown was appointed to the Board in May 2003 and to the board of NWL in January 2006. Sir Patrick chairs the Audit Committee and is a member of the Nomination and Remuneration Committees. He held various positions in the Department of Transport and the Department of the Environment, becoming Second Permanent Secretary and Chief Executive of the Property Services Agency in 1990. He was Permanent Secretary for the Department of Transport from 1991 to 1997. Sir Patrick became a non-executive director of the Go-Ahead Group plc in 1999 and its Chairman in 2002.

5. Claude Lamoureux
Non-executive Director

Claude Lamoureux was appointed to the boards of NWG and NWL on 1 December 2006. Claude was, until 1 December 2007, President and CEO of the Ontario Teachers' Pension Plan Board (OTPP). Previously, he spent 25 years as a financial executive with Metropolitan Life in Canada and the US. He is Chairman of Cordiant Capital and is also a director of Xstrata plc, The Foundation for Investor Rights, Glass Lewis, Maple Leaf Foods Inc, Atrium Innovations Inc, the Canadian Institute for Advanced Research, The Learning Partnership and the York University Foundation. OTPP holds 27% of the issued share capital of Northumbrian Water Group plc and Claude is, therefore, not regarded as an independent director.

6. Martin Nègre

Independent Non-executive Director

Martin Nègre was appointed to the Board in May 2003 and to the board of NWL in January 2006. Martin chairs the Remuneration Committee and is a member of the Nomination Committee. He 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 is currently the Chairman of Ecofin Global Utilities Hedge Fund Limited, an Irish Stock Exchange listed fund, Chairman of Ecofin Special Situations Utilities Fund and of Ecofin North American Hedge Fund, a director of Ecofin Water & Power Opportunities plc, a London listed investment trust of which he was Chairman for three years, as well as a director of Bolux Utilities (Sicav Luxembourg), Mercurius Utilities (Liechtenstein), EFMI Global Utilities and Infrastructure Funds plc and EFMI UBAM Global Utilities 130/130 Fund. All the above funds are focused on utilities. In 2005, he was appointed a director of Promethean plc, an AIM-listed investment company.

7. Alex Scott-Barrett

Independent Non-executive Director

Alex Scott-Barrett was appointed to the Board of NWG in September 2006, having previously joined the board of NWL in November 2005 and is a member of the Audit, Nomination and Remuneration Committees. Alex qualified as a chartered accountant with Coopers & Lybrand in 1981 and joined Cazenove, a city corporate stockbroker, in 1982. He worked initially as an analyst and transferred to the corporate finance department in 1986, becoming a partner of the firm in 1988. In 1996 he became a director of the firm's fund management division and from 2000 to 2003 was the Chief Operating Officer of that division. Alex left Cazenove in 2003. He is a non-executive director of General Capital Group plc and Lighthouse Group plc and is a Trustee of L'Arche and Help for Heroes.

8. Jenny Williams

Independent Non-executive Director

Jenny Williams joined the Board in May 2004, and the board of NWL in January 2006, and is a member of the Audit and Nomination Committees. She is a Commissioner and Chief Executive of the Gambling Commission and a Trustee of the charity, Connections at St Martins. In addition to being Head of Water Finance and Flotation at the time of water privatisation, Jenny has held a variety of directorships in a range of Government departments, including the Home Office, the Department of the Environment, Transport and the Regions and the Inland Revenue. She was previously a Director-General of the Lord Chancellor's Department (now the Department for Justice).

9. Martin Parker

General Counsel and Company Secretary

Martin Parker was appointed as Company Secretary of NWG in May 2003. Martin joined the former Northumbrian Water Group plc in 1990, concentrating on acquisitions, overseas projects and contracts with industrial customers, before being appointed Head of Group Legal Services in 1998 and General Counsel and Company Secretary of NWL in 2000. Martin is Secretary of all the Board committees.

Corporate governance report

Introduction and general compliance statement

The Board believes best practice in corporate governance is an important tool in helping it carry out its responsibilities. The Board considers that, during the year and up to the date of this report, it has complied with the main principles and provisions of the Combined Code 2006. This report, the directors' report and business review and the directors' remuneration report describe how the Company has applied the principles of the Combined Code during the year.

The board of NWL also endeavours to maintain its own high standards of corporate governance and to comply with the Combined Code, wherever practicable.

The Board endeavours to act in accordance with the Group's Code of Conduct, which addresses the Group's responsibilities to a range of stakeholders and for the environment. This Code of Conduct is on the Company's website.

The Board

The Board sets and implements the Company's strategy and ensures compliance with Group policies and legal and regulatory obligations. The Group's mission and strategy is set out in the directors' report and business review on pages 10 and 11.

Board agendas are proposed by the Managing Director and Company Secretary, with input from NWL's management team, for approval by the Chairman.

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 within the Company to financial transactions. NWL has adopted its own version of these guidelines. 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 following table sets out the attendance of directors at Board and committee meetings during 2008/09:

Name	Board	Nomination	Remuneration	Audit
Number of meetings	6	3	3	3
Sir Derek Wanless	6	3	2	3†
Sir Patrick Brown	6	3	3	3
John Cuthbert	6	2	3†	3†
Chris Green	6	–	–	3†
Claude Lamoureux	5	–	–	–
Martin Nègre	6	3	3	–
Alex Scott-Barrett	6	3	3	3
Jenny Williams	5	2	–	3

† Not a member, but attended at the invitation of the Committee Chairman.

At each meeting the directors receive reports from the Managing Director, the Finance Director and the chairmen of any committees which have met since the previous Board meeting.

The Chairman ensures that important issues are given enough time at meetings and that all directors can express their views. This enables full and vigorous discussion of key items.

The non-executive directors met formally once without the executive directors and are in regular contact with each other throughout the year. The non-executive directors also met once without the Chairman but did not consider additional formal meetings to be necessary.

Authorisation of directors' conflicts of interest

Directors now have a statutory duty, under section 175 of the Companies Act 2006, to avoid a situation in which they have, or can 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. Changes to the Articles, which took effect on 1 October 2008, now permit directors to authorise any such situations and, during the year, directors were asked to confirm any known or potential conflicts of interest and a list of the interests thought to require authorisation was submitted to the Board in November 2008. At the meeting, directors (other than the director having the interest in question) were asked to authorise the situations 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

There are currently eight directors – the Chairman, two executive directors, the senior independent non-executive director and four other non-executive directors. Sir Derek Wanless is the non-executive Chairman. The executive directors are John Cuthbert (Managing Director) and Chris Green (Finance Director). Sir Patrick Brown is the senior independent non-executive director and the other independent non-executive directors are Martin Nègre, Alex Scott-Barrett and Jenny Williams. Claude Lamoureux is also a non-executive director but is not independent as he was, until 1 December 2007, President and CEO of OTPP, which holds 27% of the issued share capital of the Company.

The Company complies with the Combined Code's requirement that half of the directors, excluding the Chairman, are independent non-executive directors. The Chairman was independent on appointment. Biographical details of the directors appear on pages 46 and 47 and details of their service contracts are in the directors' remuneration report on page 59.

The Chairman and Managing Director have clearly defined written responsibilities which have been agreed by the Board. The Chairman leads the Board and creates the conditions for overall Board and individual director effectiveness, both inside and outside the boardroom. The Managing Director is responsible for running the Company's business on a day to day basis.

Sir Patrick Brown, as senior independent non-executive director, is available to shareholders who wish to raise any concerns and leads the non-executive directors in their evaluation of the Chairman's performance.

The non-executive directors bring to the Board many years of business experience as well as financial expertise and the ability and willingness to challenge and support the executive directors.

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

Information and professional development

All directors have access to independent professional advice to assist them in the performance of their duties, at the Company's expense, and to the Company Secretary for advice and assistance. The Chairman, with the assistance of the Company Secretary, monitors the induction and training requirements of directors. All new directors receive an induction information pack and are offered site visits and meetings with managers. Managers from within the Group submit papers or give presentations at Board meetings. Water industry representatives meet the NWL board to discuss current issues.

The Company Secretary ensures that directors are kept informed and that information flows effectively within the Group by:

- keeping in regular contact with directors;
- sending Board papers to directors before each Board meeting;
- sending briefing packs to directors in the months when Board meetings are not held; and
- providing a directors' team room intranet site containing Board and committee papers, minutes, analysts' reports and reference and regulatory documents, to which all directors have access.

Performance evaluation

A full evaluation of the performance of the Board, the NWL board and the committees was conducted during the year by an external consultant with significant relevant experience. Each director completed a detailed questionnaire prior to a one to one meeting with the consultant. The questionnaire was designed to address the dynamics of the Board and the effectiveness of its approach to strategic, operational and financial matters, as well as the contributions of the directors. The consultant observed the NWG and NWL board meetings in November 2008 and delivered a report to both boards in February 2009. The results of the evaluation were generally very positive and a number of actions were agreed, with a view to consolidating the performance of the boards.

The Chairman has also appraised the performance of each NWG and NWL director by means of one to one meetings. The Chairman's comments on the performance of the directors seeking re-appointment at the AGM are provided in the Notice of Meeting.

External appointments

To date, executive directors have only accepted non-executive positions outside the Group where this would benefit either the Group or the local community. These positions have tended to be with educational institutions, economic regeneration groups or similar bodies. The Board has agreed that executive directors of the Company who are appointed to non-executive directorships of a more commercial nature may retain the fees, subject to obtaining the Chairman's consent before an appointment is accepted. Only one such external appointment per director will generally be permitted and there are currently no such appointments.

Board committees

The Board has Audit, Nomination 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. The terms of reference of committees are available on the Company's website or from the Company Secretary.

Remuneration Committee

The work of the Remuneration Committee and details of the directors' remuneration are set out in the directors' remuneration report on pages 54 to 63.

Nomination Committee

The members of the Nomination Committee are Sir Derek Wanless (Chairman), Sir Patrick Brown, John Cuthbert, Martin Nègre, Alex Scott-Barrett and Jenny Williams, and the membership is compliant with the Combined Code.

The main duty of the Nomination Committee is to identify and nominate candidates to fill Board vacancies for approval by the Board. The Committee also reviews succession planning for the Board, NWL board and senior appointments and will make recommendations to the Board when appropriate. The Committee's general policy is to use external recruitment consultants or to advertise in order to identify suitable candidates. All non-executive directors are appointed for a term of one year. In accordance with the existing Articles, all directors are subject to re-election at the AGM at least every three years. However, an amendment to the Articles proposing that, in future, all directors will be subject to annual re-election, will be put to shareholder vote at this year's AGM. Please refer to the Notice of Meeting for further details on the proposed amendment. If shareholders approve the amendment, directors will be subject to annual re-election with effect from the 2010 AGM.

During the year, the Committee considered extensions to the appointments of non-executive directors on the NWG and NWL boards whose contracts for services expired during the year. Extensions to the appointments of Sir Patrick Brown and Martin Nègre take them into their seventh year as non-executive directors of the NWG Board and, having been subject to a rigorous review as required by the Combined Code, the Committee remains satisfied with the performance of these two directors. Following the announcement of John Cuthbert's decision to retire on 31 March 2010, the Committee has agreed the process to be followed in seeking a successor, prepared a person specification and engaged an executive recruitment specialist to advise on and assist in the process.

Accountability and audit

Audit Committee

The Audit Committee members are Sir Patrick Brown (Chairman), Alex Scott-Barrett and Jenny Williams. Alex Scott-Barrett is a chartered accountant and the Board is satisfied that he has recent and relevant financial experience.

The Committee's membership complies with the Combined Code. The Chairman, Managing Director and Finance Director are invited to Audit Committee meetings with the permission of its Chairman but have no right of attendance. Managers from within the Group are invited to Audit Committee meetings to discuss issues relating to their areas of the business. During the year, the Committee met with both the external Audit Partner and Internal Audit Manager to discuss audit business, without the executive directors being present. The Committee remains satisfied that the internal audit function is able to operate with independence and is not under any pressure from the executive management of the Company to produce particular results.

The Committee members receive regular briefings from the external auditors to enable them to keep up to date on financial reporting standards.

The purpose of the Audit Committee is to assist both executive and non-executive directors of NWG to discharge their individual and collective responsibilities in relation to:

- ensuring the financial and accounting systems of NWG and its subsidiaries are providing accurate and up to date information on their current position;
- ensuring NWG's published financial statements represent a true and fair reflection of this position; and
- assessing the scope and effectiveness of the Group's risk management systems and the integrity of its internal financial controls.

During the year its work included:

- monitoring the integrity of the financial statements of the Company;
- reviewing the Company's internal financial controls by considering reports of both the internal and external auditors, directing questions to management and reviewing the financial risks and controls information provided to them on an annual basis;
- monitoring and reviewing the effectiveness of the internal audit function by reviewing the scope of the annual audit plan, the results of those audits and monitoring the completion of actions identified during the audit;
- monitoring and reviewing the performance and effectiveness of the external auditors, in particular, by reviewing the scope and costs of the audit process;
- reviewing the external auditors' independence by monitoring the extent of the provision of non-audit services and receiving reports from the external auditors;
- monitoring the potential impact and management of significant risks to the business using a risk methodology (meeting the recommendations of the 2005 Turnbull Review Group guidance) which sets out and rates all identified risks, including operational, external, financial, environmental, social and governance risks;
- reviewing the Committee's terms of reference;
- reviewing the Group's accounting and treasury policies; and
- reviewing the Company's interim management statements, half-yearly and preliminary results' announcements and final published annual report and financial statements.

Given the importance of NWL to the Group's business, the Committee works closely with the Audit Committee of NWL. In particular, both committees review significant regulatory reports for Ofwat and regularly review NWL's debt recovery strategy and performance. In addition, meetings were held with the Ofwat Reporter during the year to discuss the June Return and Draft and Final Business Plans.

The Audit Committee Chairman reports to the Board following each meeting of the Committee and committee minutes are circulated to the Board.

External auditors

Ernst & Young LLP have been the Group's auditors since 2003. The audit engagement partner is subject to change every five years and was last changed in 2008.

Non-audit services

The Committee has approved a procedure for the approval of non-audit services to safeguard the objectivity and independence of the external auditors, which complies with the requirements of the Auditing Practices Board's Ethical Standard No. 5. The external auditors are not permitted to provide bookkeeping, financial information systems design and implementation, or internal audit outsourcing services. Permitted services require prior approval, either from the Audit Committee Chairman, if under £50,000, or from the Audit Committee, if over £50,000. The Company requires the auditors to report annually details of all non-audit services provided. A breakdown of the cost of audit and non-audit services provided by the auditors is set out in note 4 to the financial statements.

On 27 May 2009, Ernst & Young confirmed to the Audit Committee, in accordance with ISA 260 (Communication of audit matters to those charged with governance), that they have considered their relationship with the Company and that, in their professional judgement, the objectivity of the audit engagement partner and audit staff is not impaired.

Review of internal control
The Board has overall responsibility for maintaining a sound system of internal control and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives. Regular reviews of the effectiveness of the internal control system are carried out in accordance with the 2005 Turnbull Review Group guidance. The actions necessary to address weaknesses and otherwise improve the system of internal control are communicated to management. Internal Audit monitors implementation of these actions and reports back to the Audit Committee. This process has been in place throughout the year and up to the date of approval of the 2008/09 annual report and financial statements. There are inherent limitations in any system of internal control and even the most effective system can only provide a reasonable, and not absolute, assurance against material misstatement or loss.

The Board has reviewed the effectiveness of the Group's system of internal control, as follows, during the year. The Internal Audit team manages a process whereby all of the financial controls within the Group are identified and certified by the relevant manager as having operated for the full year. As part of a programme of work (which is agreed with the Audit Committee), these controls are tested throughout the year. A report detailing any areas of concern is produced after each audit. As part of the same process all of the key business risks are identified. Each risk is assessed on an unmanaged basis, the controls in place to mitigate the risks are detailed and the risk is then re-assessed after these controls.

Internal Audit's findings and recommendations are presented to the Audit Committee along with agreed actions. Internal Audit updates progress against any agreed actions until the control weakness is resolved.

Organisational structure
The trading subsidiaries have their own boards of directors (the Subsidiary Boards) which are responsible for the operational and financial control of their own businesses. The Subsidiary Boards report to the Managing Director, or Finance Director, and to the Company's Board on matters including major strategic, financial, organisational, compliance and regulatory issues.

The NWL management team manages the major business of the Group and consists of John Cuthbert (Managing Director), Chris Green (Finance Director), Graham Neave (Operations Director and on NWL board), Ceri Jones (Regulation & Scientific Services Director and on NWL board), John Devall (Water & Networks (South) Director), Ian Donald (Customer Services Director), Diane Morton (HR Director), Colin Price (Technical Director) and Henry Wilson (Waste water & Networks (North) Director). The NWL management team meets monthly to consider and discuss progress against annual and monthly financial and operational targets. It prepares an annual budget and business plan for consideration and approval by the NWL board. NWL operates a balanced scorecard system which monitors progress against KPIs and which covers all areas of operation of the business.

The Board is able to monitor the impact of environmental, social and governance matters on the Group'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 Subsidiary Boards and the Audit Committee. The environmental risks considered to be significant by the Board are described on page 41, together with a summary of how NWL is managing these risks.

For a number of years, the Subsidiary Boards have performed a full annual business risk analysis to meet the recommendations of the 2005 Turnbull Review Group guidance. This methodology is described above in relation to the work of the Audit Committee. The results of the risk reviews are reported in detail to the Audit Committee and a summary is reported to the Company's directors. Accompanying the risk model is a detailed review of each company's internal financial controls along with either confirmation that the controls have operated throughout the year or details of any exceptions. Action points arising from these reviews are followed up as part of the internal audit process.

Some subsidiaries, such as NWL, consider risks more frequently. The Managing Director and Finance Director consider significant risks in a structured way on a monthly basis, assessing the likelihood and potential impact of the relevant risks both before and after risk management measures have been put in place. Further details about how risks and uncertainties facing the Group are assessed and managed are included in the directors' report and business review on pages 40 to 43.

On a monthly basis, the Managing Director and the Finance Director compare the actual operational and financial performance of each business with its plan and budget. Targets are set to measure performance and regular forecasts are made.

Information and reporting system
Each Subsidiary Board holds a copy of the Company's financial approval rules and terms of reference, which contain full details of the procedures for distribution of information and financial reporting. Each Subsidiary Board has developed financial control systems appropriate to its activities.

Budgets and business planning
The Group prepares detailed medium term business plans and annual budgets which are reviewed by the Managing Director and Finance Director and submitted to the Board for approval. Business plans and budgets include an assessment of the key risks and success factors facing each business unit.

The approval of the Board is required for major investments, including those in new markets, and large capital expenditure programmes. The treasury strategy, which is approved by the Board, requires that investments are limited to certain money market and treasury instruments, and that the Group's exposure to any single bank, building society or market is controlled, with maximum deposits allowed with any single counterparty. The Group's investment strategy aims to fix interest rates for part of the Group's borrowings and investments for periods determined by the forecast cash flow of the individual businesses. This manages the exposure to the risk of changes in short term interest rates. Foreign currency exposure is also managed as part of the treasury strategy approved by the Board.

The Board, therefore, believes that there are effective systems in place to identify and manage significant risks and that it receives sufficient information to enable it to assess these risks.

The work of NWL's Corporate Responsibility Committee is described on pages 17 and 18 and on the corporate responsibility section of the company's website.

Investor relations
The Company welcomes constructive communication with all its shareholders. Details of the Company's investor relations activities during the year are described in the directors' report and business review on page 15. Investor feedback reports from investor meetings, prepared by the Company's advisers, are considered at Board meetings and analysts' notes on the Company are made available to all directors on the Board's intranet team room. The Board believes that these methods of investor feedback provide the senior independent non-executive director and the other non-executive directors with a balanced understanding of the issues and concerns of major shareholders. The senior independent director is available to shareholders who wish to raise any matters of concern and the Chairman welcomes contact with any shareholders who have matters they wish to discuss. The Company has not received any requests from institutional shareholders to meet with non-executive directors.

All shareholders are encouraged to contact the Company with queries or suggestions. A welcome letter is sent to all new non-corporate shareholders, which includes information on services available to shareholders.

AGM
Shareholders are encouraged to attend the Company's AGM at which they can meet and question the directors. The Company will make a presentation at the AGM to highlight the key business developments and events during the year. The full Board is expected to be available at the AGM to answer shareholders' questions. Voting at the AGM will be on a show of hands but the proxy votes cast on each resolution will be displayed after each resolution has been voted on. If the voting on a show of hands produces a different result from that which would have been achieved on a poll, the Chairman will call a poll so that the result of the voting on that resolution reflects the wishes of the majority of shareholders. The proxy votes cast at each AGM are disclosed on our website.

Martin Parker
General Counsel and Company Secretary
2 June 2009

Directors' remuneration report

In this report, which will be submitted for approval at the Annual General Meeting on 30 July 2009, we describe how the executive directors are remunerated. Those parts of the Remuneration Report which are subject to audit by Ernst & Young are marked 'audited'.

The Remuneration Committee

The role of the Remuneration Committee

The Remuneration Committee of the Board (the Committee) determines the remuneration and terms of employment of the Chairman of the Company, executive directors of NWG and NWL and a further seven senior managers, in accordance with a remuneration policy approved by the Board. The terms of reference for the Committee are published on our website at www.nwg.co.uk (in the 'about us: corporate governance' section) or a copy can be requested from the Company Secretary.

The Committee is always available to engage with major shareholders and their representatives to discuss remuneration matters, although no such approaches were received in 2008/09.

Remuneration Committee members

The Committee members are Martin Nègre (Chairman), Sir Patrick Brown, Alex Scott-Barrett, who are all considered by the Company to be independent, and Sir Derek Wanless. The membership of the Committee was, therefore, compliant with the Combined Code throughout the year. Martin Parker, the Company Secretary, is secretary to the Committee.

External advice

The Committee continued to receive advice during the year from Hewitt New Bridge Street (HNBS) and also from the Managing Director (although never about his own remuneration). HNBS was paid £15,825 for these services in 2008/09 and continues to assist the Committee in maintaining best practice in relation to remuneration. HNBS does not provide any other service to the Company.

The Committee's work in 2008/09

The Committee met three times during the year with 100% attendance by all members, except Sir Derek Wanless who attended two meetings, to:

- agree bonus payments for 2007/08;
- agree salaries for 2009/10;
- determine the vesting percentage to be applied to the LTIP awards made on 9 December 2005, which vested on 9 December 2008;
- grant LTIP awards on 15 December 2008 (to vest on 15 December 2011); and
- set performance targets for executive directors and senior managers.

As the Committee works closely with NWL's remuneration committee, Committee papers and minutes are circulated to all NWL and NWG non-executive directors, who can give their views direct to the Committee Chairman and can attend meetings if they wish.

Remuneration policy

The Committee considers the principles and provisions of the Combined Code when setting its policy and believes it is fully compliant. The policy of the Company, which applied throughout 2008/09 and applies for 2009/10 and subsequent financial years, is to provide remuneration that is sufficient to attract, retain and motivate directors of the quality required to run the Company successfully, while paying fairly. Although HNBS provides the Committee with detailed comparative data on other companies in the sector, the Committee is aware of, and avoids the risk of, remuneration being ratcheted up as a result of benchmarking exercises.

Consistent with its fair pay policy, when considering the remuneration packages of senior executives and directors, the Committee takes into account pay awards to other employees in the Group. The Committee also considers environmental, social, risk management and governance issues when setting remuneration terms.

The remuneration policy of the Committee is:

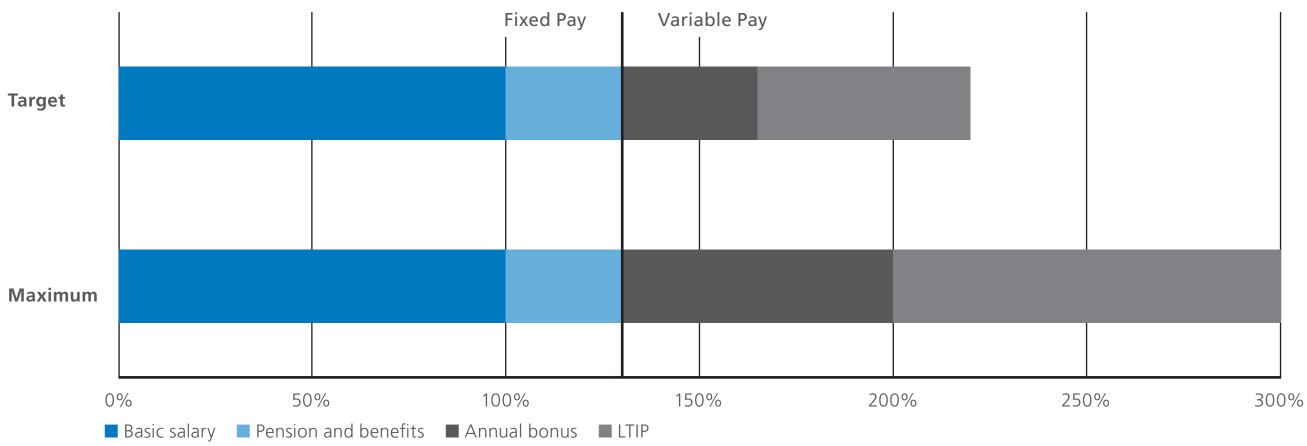
- that the setting of base salaries is largely influenced by individual contributions and internal relativities rather than external comparators (although for 2009/10 the Committee has been influenced by general economic conditions);
- that the annual bonus plan recognises the interests of all of the Company's stakeholders (shareholders, customers and employees) rather than being focused solely on profit; and
- that management shares in the longer term value created for the Company's investors, but equity incentive schemes should only reward if there is clear outperformance of the market and other relevant companies.

Elements of remuneration

The remuneration of the executive directors comprises:

- basic salary;
- benefits (including pension and participation in the Company's SIP);
- a performance related annual bonus; and
- annual LTIP awards.

In addition to reviewing each constituent element, the Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure, gearing and quantum. The chart below shows the composition of the Managing Director's remuneration (as a percentage of basic salary) both at 'target' and 'maximum' levels of performance. Maximum performance assumes the achievement of maximum bonus and full vesting of LTIP awards.



Basic salary and benefits

Basic salary is reviewed annually based on individual contributions and internal relativities. The Committee also has regard to market practice in other quoted water companies and similar sized companies more generally.

Current basic salaries, together with the previous year's salaries, are set out below:

	As at 1.4.2009	As at 1.4.2008
John Cuthbert	**£295,000**	£295,000
Chris Green	**£225,000**	£225,000

The basic salaries of the executive directors have not been increased for 2009/10 in recognition of the fact that RPI at the date of the review was zero. All other employees have been awarded a 3% increase (in line with the November 2008 RPI) in basic pay for 2009/10.

Benefits provided to the executive directors comprise membership of a defined benefit pension scheme, car allowance and healthcare.

Directors' remuneration report continued

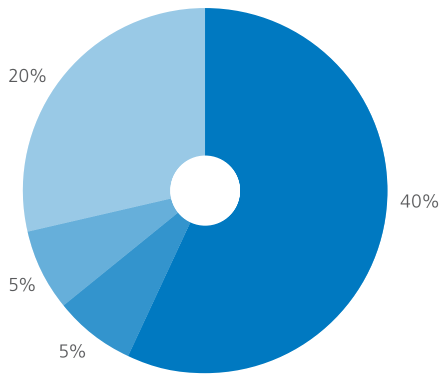
Pensions

The main features of the Northumbrian Water Pension Scheme are set out in note 25 to the financial statements. Basic salary is the only pensionable element of the executive directors' remuneration packages.

The executive directors' pensions were modified with effect from 1 January 2008, in line with the changes proposed for the pension scheme as a whole, and the executive pension arrangements were closed to new entrants on that date. The accrued defined benefit pensions and corresponding transfer values for the executive directors are set out in Table 5 on page 62.

Annual bonus

The annual bonus plan has been designed to reflect the interests of all of the Company's stakeholders. Consistent with prior years, maximum annual bonus potential for the executive directors for 2009/10 is 70% of salary, which is apportioned as follows:



- Shareholders – profit before tax (PBT)
- Customers – Ofwat's Overall Performance Assessment (OPA) rating
- Employees – percentage lost time through sickness
- Bespoke personal targets

Actual performance against the 2008/09 targets was as follows:

Bonus metric	Max bonus (% of salary)	John Cuthbert Actual bonus (% of salary)	Chris Green Actual bonus (% of salary)
PBT	40	–	–
OPA rating	5	1.0	1.0
Percentage lost time through sickness	5	1.5	1.5
Bespoke personal targets	20	15.0	15.0
Total	**70**	**17.5**	**17.5**
		£51,625	**£39,375**

Notes:
1. The PBT bonus is based on actual PBT performance compared to the budget PBT set by the Board at the beginning of the year. PBT has been chosen because it is a primary financial measure for the Company, for which the executive directors are accountable. In 2008/09, PBT was below budget.
2. NWL's estimated OPA score for 2008/09 is 356, against a range for bonus purposes of 341 to 419, being the published range of performance across the ten water and sewerage companies in 2007/08. NWL's score was adversely affected by sewer flooding.
3. The year end percentage of time lost through sickness was 2.94%, against a range for bonus purposes of 2.6% to 3.1%.
4. In 2008/09, John Cuthbert's personal targets related principally to managing the PR09 process, maintaining key financial ratios and measures, ensuring that good relationships are maintained with major investors and analysts, implementing the agreed approach to succession planning, ensuring that investment needs are properly quantified and the investment programme is delivered with regulatory outputs met and identifying further opportunities to impact the cost base of NWL and improve its efficiency ranking. Chris Green's personal targets were focused mainly on managing the PR09 process, maintaining key financial ratios and measures, relationships with major investors and analysts, positioning NWL to respond to Ofwat's proposals on accounting separation, ensuring that investment needs are properly quantified and the investment programme is delivered with regulatory outputs met and identifying further opportunities to impact the cost base of NWL and improve its efficiency ranking.
5. The Remuneration Committee has decided that, in respect of the bonus for 2009/10 and beyond, the calculation of PBT performance will be adjusted to exclude the impact of any variance between the actual and budget interest charge on index linked bonds issued by Northumbrian Water Finance plc, which depends entirely on RPI in July of each year and is, therefore, outside of management control.

LTIP

Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Company worth up to 100% of annual salary at grant, although only the executive directors participate at this level. All awards have three year pre-vesting performance conditions. These are described in detail below but, in summary, the current policy is for half of an award to be subject to relative total shareholder return (TSR) performance against the FTSE 250 (excluding investment trusts) and the other half to be subject to a relative return on capital target as monitored by Ofwat.

The Committee, with advice from HNBS, has reviewed the LTIP and is still of the view that it remains the most appropriate equity incentive plan, particularly in the light of the Company's dividend policy.

TSR remains an appropriate performance measure because it ensures that executives are rewarded fairly for value created for the Company's investors. Relative return on capital employed was chosen as a complementary measure because:

- it directly compares NWL's financial performance against that of its peers;
- it is objectively measured and verified by a third party (Ofwat);
- there is no subjectivity in determining what level of return would be a good and excellent result (it being a relative measure to which quartile analysis is applied); and
- the comparative approach should be able to deal with the five year pricing reviews without the Remuneration Committee having to reset targets.

On 15 December 2008, the Remuneration Committee granted the following LTIP awards:

	Number of conditional awards granted	Face value of awards granted as a % of salary†
John Cuthbert	103,100	88%
Chris Green	78,650	88%

† Based on a closing share price on 15 December 2008 of 251.5 pence.

For the awards set out above, the three years to be reviewed are 2008/09, 2009/10 and 2010/11. Over the three year performance period, the return on capital employed will be calculated on a compounded annualised return basis.

In addition, awards will only vest if the Committee is satisfied that the Company's TSR performance is consistent with the underlying business performance of the Company. An independent firm is engaged by the Committee to calculate the TSRs and to assess the extent to which the performance conditions have been met, so that the process is rigorous and transparent.

In the event of a change of control, the Committee would determine the extent to which the performance conditions had been met and the proportion of the performance period that had elapsed in deciding whether or not any vesting of awards would take place.

The LTIP award, granted on 9 December 2005, became available to vest on 9 December 2008. The Committee instructed PricewaterhouseCoopers (PwC) to assess the level of vesting of this award. PwC reported that 29.7% of the award was available to vest (being 99% of the award relating to the Company's TSR performance against the FTSE 250 Index and 0% of the award relating to the Company's TSR performance against the other listed water companies). Prior to vesting, the Committee satisfied itself that the recorded TSR performance was a genuine reflection of the Company's underlying performance. Details of the number of awards which lapsed and those which were exercised by the directors of the Company are shown in Table 3 on page 61.

Full details of award levels and performance conditions are shown in Table 2 on pages 60 and 61.

Responsible investment

The Committee is aware of Guideline 3.2 of the ABI Guidelines on Responsible Investment Disclosure and is satisfied that neither the executive directors' annual bonus targets nor the LTIP performance conditions are likely, inadvertently, to motivate irresponsible behaviour.

Non-executive directors' fees

The Company's remuneration policy is that the Chairman and the non-executive directors should receive a fixed fee for their normal duties. Reflecting the added responsibilities and time commitment, chairing the Remuneration and Audit Committees attracts an additional fee over the non-executive directors' standard base fee.

Fees payable during 2008/09 and the Company's policy from 1 April 2009 (in line with the approach taken in respect of the salaries of the NWG executive directors) are:

	2008/09 £	2009/10 £
Chairman	157,500	157,500
Non-executive director base fee	36,750	36,750
Audit Committee chairing fee	10,500	10,500
Remuneration Committee chairing fee	5,250	5,250

The Chairman and the non-executive directors do not receive benefits in kind and do not participate in bonus, pension or share schemes operated by the Company. Further details of non-executive directors' remuneration are set out in Table 1 on page 60.

Directors' interests in LTIP awards

The directors' conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP as at 31 March 2009, are set out in Table 3 on page 61.

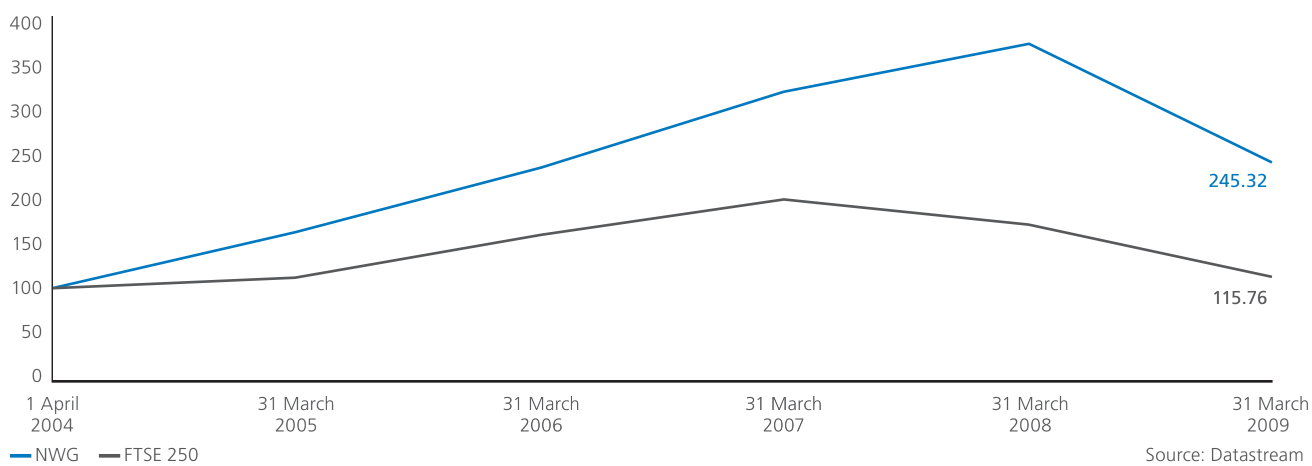
Ordinary 10 pence shares required to fulfil LTIP awards which have vested may be provided by the Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited. The Trustees are Sir Patrick Brown, Martin Nègre and Anita Frew (a non-executive director of NWL). At 31 March 2009, the Trust held a total of 1,038,252 ordinary 10 pence shares. This represents 0.2% of the Company's total issued share capital, so is materially less than the 5% limit on shares that can be held in trust. In line with the ABI Guidelines, dividends are waived on these shares and the voting rights attached to these shares will not be exercised at the AGM.

Share dilution

The Company's share plans contain dilution limits that comply with the ABI Guidelines. Shares for both the LTIP and SIP schemes are provided by purchase on the market. There has, therefore, been no dilution to date and there is no commitment to issue new shares in relation to either scheme.

Performance graph

The graph below shows a comparison between the TSR for the Company's shares for the five year period to 31 March 2009, and the TSR for the companies comprising the FTSE 250 Index (excluding investment trusts) over the same period. This index has been selected as the Company is a constituent of the FTSE 250.



Note:
This graph shows the value, by 31 March 2009, of £100 invested in Northumbrian Water Group plc on 1 April 2004 compared with the value of £100 invested in the FTSE 250 Index (excluding investment trusts) over the same period.

Service contracts

All non-executive directors are appointed for a term of 12 months with a six month notice period for the Company and the director. The executive directors have service contracts with 12 months' notice periods and which expire when the directors reach normal retirement age. Details of the contracts of the executive and non-executive directors who served during the year are shown in Table 4 on page 62.

Terms and conditions of appointment of non-executive directors are available for inspection at the Company's registered office during normal business hours and at the AGM. The terms of appointment set out the expected time commitment for each non-executive director.

External appointments of executive directors

The Board's position on external appointments is described in the corporate governance report on page 50. To date, no fees for external appointments have been retained by executive directors.

Directors' interests in shares

The directors' beneficial interests in the ordinary 10 pence shares of the Company, as at 31 March 2009, are set out in Table 6 on page 63.

Directors' interests in shares under the SIP

The Company SIP is open to UK employees with more than three months service. Further details of the SIP are set out in the directors' report and business review on page 17. During the year, the executive directors had the opportunity to participate in the SIP and their interests in the ordinary 10 pence shares of the Company, purchased and held in accordance with the terms of the SIP, are set out in Table 7 on page 63.

This directors' remuneration report, which has been produced in accordance with Schedule 7A of the Companies Act 1985, as introduced by the Directors' Remuneration Report Regulations 2002, was approved by the Board and signed on its behalf by the Chairman of the Remuneration Committee. It will be put to the shareholders for approval at the Company's AGM.

Martin Nègre
Chairman of Remuneration Committee
2 June 2009

These tables form the part of the directors' remuneration report which are audited (except for Tables 2 and 4 which do not require auditing).

Table 1
Directors' emoluments (audited)

The emoluments of the directors of the Company for their services as directors of the Company and (where relevant) its subsidiaries, are set out below, rounded to the nearest thousand pounds:

	Fees £000	Basic salary £000	Benefits[1] £000	Bonus[2] £000	**Total for the year ended 31.3.2009 £000**	Total for the year ended 31.3.2008 £000
Executive Directors						
John Cuthbert	–	295	8	52	**355**	403
Chris Green	–	225	9	39	**273**	317
Non-executive Directors						
Sir Derek Wanless	158	–	–	–	**158**	150
Sir Patrick Brown[3]	47	–	–	–	**47**	45
Claude Lamoureux[4]	37	–	–	–	**37**	35
Martin Nègre[5]	42	–	–	–	**42**	40
Alex Scott-Barrett	37	–	–	–	**37**	35
Jenny Williams	37	–	–	–	**37**	35
Total remuneration	358	520	17	91	**986**	1,060

Notes:
1. The remuneration of each executive director includes non-cash benefits comprising the provision of car allowances and healthcare.
2. The annual bonus is payable in June 2009, for performance during the year ended 31 March 2009.
3. Includes additional fee paid as Chairman of Audit Committee.
4. Up until 15 February 2008, fee was payable to OTPP.
5. Includes additional fee paid as Chairman of Remuneration Committee.

Table 2
Summary of LTIP performance conditions (unaudited)

LTIP award made 9 December 2005

Maximum award	75% of salary permitted. Actual grants to executive directors related to shares worth 70% of salary.
Performance conditions	Comparison of TSR with two comparator groups over three years: (1) 70% of award depends on the Company's TSR performance against other listed water companies: AWG plc, Bristol Water Group plc, East Surrey Holdings plc, Kelda Group plc, Pennon Group plc, Severn Trent plc and United Utilities plc; and (2) 30% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts. East Surrey Holdings plc de-listed on 28 October 2005, Bristol Water Group plc de-listed on 18 May 2006, AWG plc de-listed on 21 December 2006 and Kelda Group de-listed on 12 February 2008. These companies have been left in the comparator group for the purpose of the awards and their performance was frozen on the date each company de-listed. This means that a constant TSR has been applied at each date after the de-listing.
Vesting schedules	(1) 30% vests at median performance and 100% if the Company tops the group. Between median and upper quartile, the vesting will be calculated on a straight line basis comparing the Company's TSR to that of the median and upper quartile positions. Where the Company's TSR performance is below the median, none of that element of the award will vest. (2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where the Company's TSR performance is below the median, none of that element of the award will vest.

Table 2 continued

LTIP award made 21 December 2006

Maximum award	75% of salary permitted. Actual grants to executive directors related to shares worth 70% of salary.
Performance conditions	(1) 50% of award depends on NWL's return on capital employed relative to that of the other water and sewerage companies of England and Wales. (2) 50% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts.
Vesting schedules	(1) 30% vests at median performance. At upper quartile or above, all of that half of the award will vest. Between median and upper quartile, straight line pro-rating will apply. Where the return on capital employed performance is below the median, none of this element of the award will vest. (2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where the Company's TSR performance is below the median, none of this element of the award will vest.

LTIP award made 13 December 2007 and future awards

Maximum award	100% of salary permitted and actual grants to executive directors related to shares worth 100% of salary.
Performance conditions and vesting schedules	As per LTIP award made 21 December 2006.

Table 3
Directors' interests in LTIP awards (audited)

As at 31 March 2009, the directors had the following conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP:

	Award date	Awards held at the start of the year	Awarded during the year	Awards lapsed during the year	Awards vested during the year	**Awards held as at 31.3.2009[1]**
John Cuthbert	9.12.2005[2]	75,903	–	53,359	22,544[3]	**–**
	21.12.2006[4]	66,721	–	–	–	**66,721**
	13.12.2007[5]	79,230	–	–	–	**79,230**
	15.12.2008[6]	–	103,100	–	–	**103,100**
Totals		221,854	103,100	53,359	22,544	**249,051**
Chris Green	9.12.2005[2]	50,602	–	35,573	15,029[3]	**–**
	21.12.2006[4]	49,423	–	–	–	**49,423**
	13.12.2007[5]	61,620	–	–	–	**61,620**
	15.12.2008[6]	–	78,650	–	–	**78,650**
Totals		161,645	78,650	35,573	15,029	**189,693**

Notes:
1. There have been no changes to any of the above interests in awards under the LTIP from the end of the year to 2 June 2009.
2. The market value of the shares on the date of the award was 252.00 pence per share. The three year performance period ran from 1 October 2005 to 30 September 2008.
3. Shares vested on 9 December 2008 and the closing price on that date was 245.75 pence per share.
4. The market value of the shares on the date of the award was 302.75 pence per share. The three year performance period runs from 1 October 2006 to 30 September 2009.
5. The market value of the shares on the date of the award was 334.00 pence per share. The three year performance period runs from 1 October 2007 to 30 September 2010.
6. The market value of the shares on the date of the award was 251.50 pence per share. The three year performance period runs from 1 October 2008 to 30 September 2011.
7. The cost of conditional awards is charged to the income statement over the three year performance period to which they relate after taking account of the probability of performance criteria being met. In the year, £0.5 million was charged to the income statement (2008: £0.5 million).
8. Details of the performance conditions are shown at Table 2 on pages 60 and 61.
9. The market price of the shares on 31 March 2009 was 218.25 pence per share. During the year, the highest market price was 352.31 pence per share and the lowest market price was 206.75 pence per share.
10. Aggregate gross gains made by directors on exercise of awards at date of vesting was £92,336 (2008: £277,516).

Table 4

Directors' service contracts (unaudited)

Details of the contracts of the directors who served during the year are shown below:

	Initial appointment	Current contract start date	Unexpired term[1]	Notice period by either party	Current contract end date
Executive Directors[2]					
John Cuthbert	23.5.2003	23.5.2003	Not fixed term	12 months	Normal retirement age (65)
Chris Green	23.5.2003	23.5.2003	Not fixed term	12 months	Normal retirement age (65)
Non-executive Directors[3]					
Sir Derek Wanless	1.12.2003	1.12.2008	6 months	6 months	30.11.2009
Sir Patrick Brown	12.5.2003	12.5.2009	11 months	6 months	11.5.2010
Martin Nègre	12.5.2003	12.5.2009	11 months	6 months	11.5.2010
Alex Scott-Barrett	26.9.2006	26.9.2008	4 months	6 months	25.9.2009
Claude Lamoureux	1.12.2006	1.12.2008	6 months	6 months	30.11.2009
Jenny Williams	27.5.2004	27.5.2009	12 months	6 months	26.5.2010

Notes:
1. Calculated as at 2 June 2009 and rounded to nearest whole month.
2. The service contracts of the executive directors do not contain provisions relating to compensation for termination. In the event of termination by the Company, the Remuneration Committee would make recommendations to the Board on what payments, if any, should be made to the director, depending on the circumstances of the termination, taking into account the Combined Code which discourages payment for failure. The Company would also expect directors to seek to mitigate their loss.
3. Contracts do not provide for compensation for loss of office in excess of fees accrued.

Table 5

Directors' pensions and pension benefits (audited)

The accrued defined benefit pensions and corresponding transfer values for the executive directors are set out below:

	Accrued pension at 31.3.2008 £000	**Accrued pension at 31.3.2009 £000**	Increase in accrued pension £000	Increase in accrued pension net of inflation £000	Transfer value of net increase in accrued pension less directors' contributions £000	Transfer value of accrued pension at 1.4.2008 £000	**Transfer value of accrued pension at 31.3.2009 £000**	Total change in transfer value less directors' contributions £000
John Cuthbert	141.7	**163.4**	21.7	22.3	327.9	2,503.1	**3,119.0**	615.9
Chris Green	88.0	**99.3**	11.3	11.6	189.3	1,492.1	**1,838.4**	346.3

Notes:
1. Accrued pensions shown are the amounts that would be paid annually at the normal retirement age based on service to the end of the year.
2. Voluntary contributions paid by the directors and resulting benefits are not shown.
3. The change in transfer value reflects fluctuations in the transfer value due to factors beyond the control of the Company and directors, such as changes in stock market conditions.
4. The transfer values have been calculated in line with the relevant legislation and using actuarial assumptions agreed by the Trustee.
5. The directors participate in a salary sacrifice arrangement and, therefore, paid no contributions to the scheme during the year.

Table 6

Directors' interests in shares (audited)

The directors had the following beneficial or family interests in the ordinary 10 pence shares of the Company as at 31 March 2009:

	Number of shares held at the start of the year	**Number of shares held as at 31.3.2009**	Number of shares held as at 2.6.2009
Sir Patrick Brown	43,000	**43,000**	43,000
John Cuthbert	163,892[1]	**232,436[2]**	232,436
Chris Green	107,865[3]	**152,894[4]**	152,894
Claude Lamoureux	–	**25,000**	25,000
Martin Nègre	70,000	**70,000**	70,000
Alex Scott-Barrett	10,000	**10,000**	10,000
Sir Derek Wanless	30,000	**30,000**	30,000
Jenny Williams	6,000	**6,000**	6,000

Notes:

1. At 1 April 2008, 46,892 of these shares were beneficially owned by Mrs Lynn Cuthbert, 8,000 were beneficially owned by Mr I M Cuthbert and 9,000 were beneficially owned by Miss S L Cuthbert.
2. At 31 March 2009, 69,436 of these shares were beneficially owned by Mrs Lynn Cuthbert, 4,000 were beneficially owned by Mr I M Cuthbert and 9,000 were beneficially owned by Miss S L Cuthbert.
3. At 1 April 2008, these shares were beneficially owned by Mrs Geraldine Green.
4. At 31 March 2009, 137,894 of these shares were beneficially owned by Mrs Geraldine Green, and 5,000 were beneficially owned by each of Miss P J Green, Mr M F Green and Mr J M Green.

Table 7

Directors' interests in shares under the SIP (audited)

The directors who held office as at 31 March 2009 had the following interests in the ordinary 10 pence shares of the Company, purchased and held in accordance with the terms of the SIP:

	Number of SIP shares held at the start of the year[1]	**Number of SIP shares held as at 31.3.2009[1]**	Number of SIP shares held as at 2.6.2009[1]
John Cuthbert	4,176	**4,785**	5,652
Chris Green	4,176	**4,785**	5,652

Notes:

1. These figures include the shares paid for by the participant and the free shares granted by the Company.
2. A summary of the SIP can be found in the directors' report and business review on page 17.

Statement of directors' responsibilities in relation to the Group financial statements

The directors are responsible for preparing the annual report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards (IFRS) as adopted by the European Union.

The directors are required to prepare Group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group financial statements the directors are required to:

- select suitable accounting policies in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- state that the Group has complied with IFRS, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Responsibility statements

Each of the directors listed on page 8 confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the undertakings included in the consolidation taken as a whole; and
- the directors' report and business review includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Sir Derek Wanless
Chairman

John Cuthbert
Managing Director

Report of the Auditors on the Group financial statements

Independent auditors' report to the members of Northumbrian Water Group plc
We have audited the Group financial statements of Northumbrian Water Group plc for the year ended 31 March 2009 which comprise the Consolidated income statement, the Consolidated statement of recognised income and expense, the Consolidated balance sheet, the Consolidated cash flow statement, and the related notes 1 to 29. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent Company financial statements of Northumbrian Water Group plc for the year ended 31 March 2009 and on the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors
The directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors' report and business review is consistent with the financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only Highlights, NWG at a glance, the Chairman's statement, the Directors' report and business review, Appendix to the directors' report and business review, Board directors' biographies, the unaudited part of the Directors' remuneration report and Shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Report of the Auditors on the Group financial statements continued

Basis of audit opinion

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

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 March 2009 and of its loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report and business review is consistent with the Group financial statements.

Ernst & Young LLP
Registered Auditor
Newcastle upon Tyne
2 June 2009

Consolidated income statement

For the year ended 31 March 2009

	Notes	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Continuing operations			
Revenue	2	**694.1**	670.4
Operating costs	3	**(420.5)**	(392.6)
Profit on ordinary activities before interest	2	**273.6**	277.8
Finance costs payable	6	**(183.5)**	(173.5)
Finance income receivable	6	**61.8**	65.5
Share of profit after tax of associates and jointly controlled entities		**0.8**	0.5
Profit on ordinary activities before taxation	2	**152.7**	170.3
– current taxation	7	**(32.1)**	(25.6)
– deferred taxation	7	**(132.5)**	13.6
(Loss)/profit for the year		**(11.9)**	158.3
Attributable to:			
Equity shareholders of the parent Company		**(12.7)**	158.1
Minority interests		**0.8**	0.2
		(11.9)	158.3
Basic (loss)/earnings per share attributable to ordinary equity holders of the parent Company	8	**(2.45p)**	30.52p
Diluted (loss)/earnings per share attributable to ordinary equity holders of the parent Company	8	**(2.45p)**	30.48p
Adjusted earnings per share for profit from continuing operations attributable to ordinary equity holders of the parent Company (excluding deferred tax and amortisation of debt fair value)	8	**22.05p**	26.72p
Ordinary final dividend proposed per share	9	**8.50p**	8.07p
Dividend paid per share	9	**12.36p**	11.52p

Consolidated statement of recognised income and expense

For the year ended 31 March 2009

	Notes	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Actuarial (losses)/gains	25	**(207.8)**	27.3
Losses on cash flow hedges taken to equity		**(11.7)**	–
Translation differences		**0.9**	0.3
		(218.6)	27.6
Transferred to the income statement on cash flow hedges		**(0.1)**	–
Tax on items charged or credited to equity		**61.5**	(7.8)
Total income and expense recognised in equity		**(157.2)**	19.8
(Loss)/profit for the year		**(11.9)**	158.3
Total recognised income and expense		**(169.1)**	178.1
Attributable to:			
Equity shareholders of the parent Company	22	**(169.9)**	177.9
Minority interests	22	**0.8**	0.2
		(169.1)	178.1

Consolidated balance sheet

As at 31 March 2009

	Notes	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Non-current assets			
Goodwill	10	**3.6**	3.6
Other intangible assets	10	**64.2**	64.2
Property, plant and equipment	11	**3,388.2**	3,256.3
Investments in jointly controlled entities	12	**3.8**	3.8
Financial assets		**14.0**	16.4
Pension asset	25	**–**	90.5
Amounts receivable relating to consortium relief		**1.7**	–
		3,475.5	3,434.8
Current assets			
Inventories	13	**3.2**	3.4
Trade and other receivables	14	**131.7**	125.1
Short term cash deposits	15	**160.6**	–
Cash and cash equivalents	15	**108.8**	294.2
		404.3	422.7
Total assets		**3,879.8**	3,857.5
Non-current liabilities			
Interest bearing loans and borrowings	17	**2,465.3**	2,326.4
Provisions	19	**2.5**	2.8
Deferred income tax liabilities	7	**596.5**	525.4
Pension liability	25	**119.4**	–
Other payables		**8.1**	9.0
Grants		**215.6**	209.0
		3,407.4	3,072.6
Current liabilities			
Interest bearing loans and borrowings	17	**49.2**	136.3
Provisions	19	**0.2**	0.2
Trade and other payables	16	**147.8**	152.9
Interest rate swaps	20	**11.7**	–
Income tax payable		**6.1**	3.7
		215.0	293.1
Total liabilities		**3,622.4**	3,365.7
Net assets		**257.4**	491.8
Capital and reserves			
Issued capital	21/22	**51.9**	51.9
Share premium reserve	22	**446.5**	446.5
Cash flow hedge reserve	22	**(7.6)**	1.0
Treasury shares	22	**(2.3)**	(0.8)
Currency translation	22	**1.0**	0.1
Retained earnings	22	**(234.5)**	(8.6)
Equity shareholders' funds		**255.0**	490.1
Minority interests	22	**2.4**	1.7
Total capital and reserves		**257.4**	491.8

Approved by the Board on 2 June 2009 and signed on its behalf by:

Sir Derek Wanless
Chairman

John Cuthbert
Managing Director

Consolidated cash flow statement

For the year ended 31 March 2009

	Notes	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Operating activities			
Reconciliation of profit before interest to net cash flows from operating activities			
Profit on ordinary activities before interest		**273.6**	277.8
Depreciation		**100.7**	98.3
Other non-cash charges and credits		**(4.3)**	(5.0)
Net credit for provisions, less payments		**(0.3)**	(0.1)
Difference between pension contributions paid and amounts recognised in the income statement		**7.9**	15.3
Decrease in inventories		**0.2**	0.3
Increase in trade and other receivables		**(8.6)**	(1.0)
Decrease in trade and other payables		**(0.3)**	(3.8)
Cash generated from operations		**368.9**	381.8
Advanced contributions in respect of retirement benefits		**–**	(22.6)
Interest paid		**(120.6)**	(131.3)
Income taxes paid		**(29.6)**	(26.3)
Net cash flows from operating activities		**218.7**	201.6
Investing activities			
Interest received		**12.0**	18.2
Capital grants received		**11.2**	20.5
Proceeds on disposal of property, plant and equipment		**1.2**	1.8
Dividends received from jointly controlled entities		**0.8**	0.5
Short term cash deposits		**(160.6)**	–
Maturity of investments		**1.7**	1.8
Purchase of property, plant and equipment		**(231.8)**	(236.8)
Net cash flows from investing activities		**(365.5)**	(194.0)
Financing activities			
New borrowings		**141.4**	31.4
Purchase of treasury shares		**(1.7)**	–
Dividends paid to minority interests		**(0.1)**	(0.2)
Dividends paid to equity shareholders		**(64.0)**	(59.7)
Repayment of borrowings		**(95.9)**	(22.1)
Payment of principal under hire purchase contracts and finance leases		**(7.0)**	(6.4)
Net cash flows from financing activities		**(27.3)**	(57.0)
Decrease in cash and cash equivalents		**(174.1)**	(49.4)
Cash and cash equivalents at start of year	15	**266.4**	315.8
Cash and cash equivalents at end of year	15	**92.3**	266.4
Cash and cash equivalents at end of year	15	**92.3**	266.4
Short term cash deposits	15	**160.6**	–
Total cash and cash equivalents and short term cash deposits		**252.9**	266.4

Notes to the consolidated financial statements

1. Accounting policies

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union as it applies to the financial statements of the Group for the year ended 31 March 2009 and in accordance with the Companies Act 1985. The consolidated financial statements are also consistent with IFRS as issued by the IASB.

The Group has adopted 'IFRIC 14: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' during the year. Adoption of this interpretation did not have any effect on the financial performance or position of the Group.

The directors consider the following accounting policies to be relevant in relation to the Group's financial statements. The financial statements of the Group for the year ended 31 March 2009 were authorised for issue by the Board of directors on 2 June 2009 and the balance sheet was signed on the Board's behalf by Sir Derek Wanless (Chairman) and John Cuthbert (Managing Director).

Northumbrian Water Group plc is a public limited company incorporated and domiciled in England and Wales. The Company's ordinary shares are traded on the London Stock Exchange.

The Group financial statements are presented in sterling and all values are rounded to the nearest one hundred thousand pounds (£0.1 million) except where otherwise indicated.

(b) Basis of consolidation

The consolidated financial statements include the Company and its subsidiary undertakings. The results of subsidiaries acquired during the period are included from the date of their acquisition. The results of subsidiaries disposed of during the period are included to the date of their disposal. Inter segment sales and profits are eliminated fully on consolidation. Where, for commercial reasons, the accounting reference date of a subsidiary is a date other than that of the Company, management accounts made up to the Company's accounting reference date have been used. In accordance with SIC 12 'Consolidation – Special Purpose Entities', the financial statements of two companies are consolidated as special purpose entities, with effect from 12 May 2004, the date of the transaction which utilised these entities.

Where necessary, adjustments are made to bring the accounting policies used under relevant local GAAP in the individual financial statements of the Company, subsidiaries and jointly controlled entities into line with those used by the Group under IFRS.

Minority interests represent the portion of profit or loss and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separately from parent shareholders' equity.

(c) Associates and jointly controlled entities

Investments in associates and jointly controlled entities in the Group financial statements are accounted for using the equity method of accounting where the Group exercises significant influence over the associate. Significant influence is generally presumed to exist where the Group's effective ownership is 20% or more. The Group's share of the post tax profits less losses of associates and jointly controlled entities is included in the consolidated income statement and the carrying value in the balance sheet comprises the Group's share of their net assets/liabilities less distributions received and any impairment losses. Goodwill arising on the acquisition of associates and jointly controlled entities, representing the excess of the cost of investment compared to the Group's share of net fair value of the associate's identifiable assets, liabilities and contingent liabilities, is included in the carrying amount of the associate and is not amortised. Financial statements of jointly controlled entities and associates are prepared for the same reporting period as the Group. Where necessary, adjustments are made to bring the accounting policies used into line with those of the Group to take into account fair values assigned at the date of acquisition and to reflect impairment losses where appropriate. Adjustments are also made to the Group's financial statements to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its jointly controlled entities and associates.

1. Accounting policies continued

(d) Goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses represents the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Prior to 1 April 2004, goodwill was amortised over its estimated useful life; such amortisation ceased on 31 March 2004. Goodwill relating to acquisitions since 1 April 2004 is not amortised. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. For the purposes of impairment testing, goodwill is allocated to the related cash-generating units monitored by management at statutory company level. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement. The carrying amount of goodwill allocated to a cash-generating unit is taken into account when determining the gain or loss on disposal of the unit, or of an operation within it.

(e) Intangible assets other than goodwill

Other intangible fixed assets represent the right to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme. The value of this intangible asset has been assessed with reference to the net monies raised in accordance with the 'Kielder securitisation' on 12 May 2004. The term of the operating agreement is in perpetuity and, accordingly, no amortisation is provided. The value of this intangible is assessed for impairment on an annual basis in accordance with IAS 36 'Impairment of Assets'.

Expenditure on internally developed intangible assets, excluding development costs, is taken to the income statement in the year in which it is incurred. Intangible assets acquired separately from a business are carried initially at cost. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably. Development expenditure is recognised as an intangible asset only after its technical feasibility and commercial viability can be demonstrated, the availability of adequate technical and financial resources and an intention to complete the project have been confirmed and the correlation between development costs and future revenues has been established.

(f) Property, plant and equipment

Property, plant and equipment and depreciation

Property, plant and equipment, including assets in the course of construction, comprise infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, overground plant and equipment).

Property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment. Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended. Borrowing costs attributed to assets under construction are recognised as an expense as incurred.

Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows: freehold buildings, 30-60 years; operational structures, plant and machinery, 4-92 years; infrastructure assets 13-200 years (see below); and fixtures, fittings, tools and equipment, 4-10 years.

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and where adjustments are required these are made prospectively.

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

Infrastructure assets

In the regulated water services business, infrastructure assets comprise a network of systems being mains and sewers, reservoirs, dams and sea outfalls.

Infrastructure assets were measured at a date prior to transition to IFRS (23 May 2003) at their fair value, which was adopted as deemed historical cost on transition to IFRS. The assets and liabilities were measured at fair value as a result of the acquisition on 23 May 2003.

1. Accounting policies continued
Expenditure on infrastructure assets which enhances the asset base is treated as fixed asset additions while maintenance expenditure which does not enhance the asset base is charged as an operating cost.

Infrastructure assets are depreciated evenly to their estimated residual values over their estimated economic lives, which are principally as follows:

Dams and impounding reservoirs	150 years
Water mains	100 years
Sea outfalls	60 years
Sewers	200 years
Dedicated pipelines	4-20 years

(g) Financial assets
Financial assets comprise loans to third parties, recoverable in more than one year and include cash held on long term deposit as a guaranteed investment contract relating to the Kielder securitisation. These assets are recognised at cost and are measured annually based on the ability of the borrower to repay. Any impairment is taken to the income statement in the period in which it arises. Loans and receivables are measured at amortised cost using the effective interest rate method. The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

(h) Foreign currencies and foreign currency transactions
Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated at the functional currency rate of exchange ruling at the balance sheet date. The functional and presentational currency of Northumbrian Water Group plc is United Kingdom sterling (£). Assets and liabilities of subsidiaries and jointly controlled entities in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial period and the results of foreign subsidiaries are translated at the average rate of exchange for the period. Differences on exchange arising from the re-translation of the opening net investment in subsidiary companies and jointly controlled entities, and from the translation of the results of those companies at average rate, are taken to equity. All other foreign exchange differences are taken to the income statement in the period in which they arise.

Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities, where material, and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

(i) Inventories
Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs, as well as an element of overheads that have been incurred in bringing the inventories to their present locations and condition.

(j) Revenues
Provision of services
Revenue, which excludes value added tax, represents the fair value of the income receivable in the ordinary course of business for services provided. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Revenue is not recognised until the services have been provided to the customer. Revenue for services relates to the year, excluding any amounts paid in advance. Revenue for measured water and waste water charges includes amounts billed plus an estimation of the amounts unbilled at the year end. The accrual is estimated using a defined methodology based upon daily average water consumption, which is calculated based upon historical billing information.

1. Accounting policies continued

Interest

Revenue is recognised as the interest accrues, taking into account the effective yield of the asset.

Dividends

Revenue is recognised when the shareholders' right to receive the revenue is established.

(k) Grants and contributions

Grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Revenue grants are credited to the income statement in the period to which they relate. Capital grants and contributions relating to property, plant and equipment are treated as deferred income and amortised to the income statement over the expected useful economic lives of the related assets.

(l) Leases

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the Group, the assets are treated as if they had been purchased at their fair value or, if lower, at the present value of the minimum lease payments. Rentals or leasing payments are treated as consisting of a capital element and finance charges, the capital element reducing the outstanding liability and the finance charges being charged to the income statement over the period of the leasing contract at a constant rate on the reducing outstanding liability.

Rentals under operating leases (where the lessor retains a significant proportion of the risks and rewards of ownership) are expensed in the income statement on a straight line basis over the lease term.

(m) Pensions and other post-employment benefits

Defined benefit scheme

The cost of providing benefits under the defined benefit scheme is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight line basis over the vesting period or immediately if the benefits have vested. When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs, the obligation and related plan assets are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year.

The service cost is disclosed in employment costs and the expected interest income and interest cost on obligations have been disclosed within finance costs payable/(income receivable).

Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the consolidated statement of recognised income and expense.

Defined contribution scheme

The Group also operates a defined contribution scheme. Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

1. Accounting policies continued

(n) Share-based payments

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

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

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

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

(o) Taxes

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in jointly controlled entities, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in jointly controlled entities, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

1. Accounting policies continued

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted, or substantively enacted, at the balance sheet date.

Deferred tax is recognised in the income statement unless it relates to items accounted for in equity.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax except:

- where the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables.

The net amount of value added tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

(p) Derivative financial instruments

The Group utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Group in line with the Group's risk management policies. Interest rate swap agreements are used to manage interest rate exposures. Derivative financial instruments are stated at their fair value.

Under IAS 39, derivative financial instruments are always measured at fair value, with hedge accounting employed in respect of those derivatives fulfilling the stringent requirements for hedge accounting as prescribed under IAS 39. In summary, these criteria relate to initial designation and documentation of the hedge relationship, prospective testing of the relationship to demonstrate the expectation that the hedge will be highly effective throughout its life and subsequent retrospective testing of the hedge to verify effectiveness.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swaps is determined by reference to market values for similar instruments.

Hedging transactions undertaken by the Company are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to variability in currency cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in equity. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement. Where the adjustment is to the carrying amount of a hedged interest bearing financial instrument, the adjustment is amortised to the net profit and loss such that it is fully amortised by maturity.

1. Accounting policies continued

In relation to cash flow hedges to hedge firm currency commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or a non-financial liability then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same periods in which the hedged firm commitment affects the net profit and loss.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for special hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

(q) Interest bearing loans and borrowings

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period. The carrying amount of index linked borrowings increases annually in line with the July RPI, with the accretion being charged to the income statement as finance costs payable. Other borrowing costs are recognised as an expense when incurred.

Loans and borrowings acquired at acquisition are restated to fair value. The adjustment arising on acquisition is amortised to the income statement on the basis of the maturity profile of each instrument. Realised gains and losses that occur from the early termination of loans and borrowings are taken to the income statement in that period.

Net debt is the sum of all current and non-current liabilities less cash and cash equivalents, short term cash deposits, financial investments and loans receivable.

(r) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available for sale. Gains and losses are recognised in income when the investments are de-recognised or impaired, as well as through the amortisation process.

(s) Cash and cash equivalents and short term cash deposits

Cash and cash equivalents disclosed in the balance sheet comprise cash at bank and in hand and short term deposits with a remaining maturity of up to three months or less, which are held for the purpose of meeting short term cash commitments rather than for investment or other purposes. Cash equivalents are readily convertible to a known amount of cash and subject to an insignificant risk of changes in value.

Short term cash deposits disclosed in the balance sheet comprise cash deposited with a remaining maturity of greater than three months, a fixed interest rate and which do not constitute as cash equivalents under IAS 7 'Statement of Cash Flows'.

For the purpose of the consolidated cash flow statement, cash and cash equivalents are as defined above, net of outstanding bank overdrafts.

1. Accounting policies continued

(t) Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. Invoices for unmeasured water and waste water charges are due on fixed dates; other receivables generally have 30 day payment terms. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified. Trade and other receivables do not carry any interest.

(u) Investments

Investments are initially recorded at the fair value of the consideration given and including the acquisition charges associated with the investment.

(v) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required and a reliable estimate can be made of the amount of the obligation.

(w) Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses on continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(x) De-recognition of financial assets and liabilities

A financial asset or liability is generally de-recognised when the contract that gives rise to it is settled, sold, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the income statement.

1. Accounting policies continued

(y) Accounting standards

During the year, the IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

International Accounting Standards (IAS/IFRS)	Effective for accounting periods beginning on or after
IFRS 2: Share-based Payments – Vesting Conditions and Cancellations	1.1.2009
IFRS 3: Business Combinations (Revised)	1.7.2009
IFRS 8: Operating Segments	1.1.2009
IAS 1: Presentation of Financial Statements (Revised)	1.1.2009
IAS 23: Borrowing Costs (Revised)	1.1.2009
IAS 27: Consolidated and Separate Financial Statements (Revised)	1.7.2009
Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation	1.1.2009
Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items	1.7.2009
Improvements to IFRS May 2008	1.1.2009, 1.7.2009
Improvements to IFRS April 2009	1.7.2009, 1.1.2010

International Financial Reporting Interpretation Committee (IFRIC)	Effective for accounting periods beginning on or after
IFRIC 15: Agreements for the Construction of Real Estate	1.1.2009
IFRIC 16: Hedges of a Net Investment in a Foreign Operation	1.10.2008
IFRIC 17: Distributions of Non-Cash Assets to Owners	1.7.2009
IFRIC 18: Transfers of Assets from Customers	1.7.2009

With the exception of IAS 23: Borrowing Costs (Revised), the directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application. The directors continue to assess the impact of IAS 23: Borrowing Costs (Revised) on the Group's financial statements.

(z) Key assumptions

The directors consider that the key assumptions applied at the balance sheet date, which may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are:

- those assumptions used in arriving at the pension asset/liability under IAS 19. These key assumptions and their possible impact are disclosed in note 25, 'Pensions and other post-retirement benefits';
- the bad debt provision which is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied; and
- the asset lives assigned to property, plant and equipment, details of which can be found in note 1(f).

2. Segmental analysis

The primary segment reporting format is determined to be business segments. The secondary segment reporting format is determined to be geographical. However, as more than 98% of the Group's activities are within the UK, revenue, profit before interest, assets and liabilities have been attributed to one geographical segment.

Northumbrian Water Limited

NWL is one of the ten regulated water and sewerage businesses in England and Wales. NWL operates in the north east of England, where it trades as Northumbrian Water, and in the south east of England, where it trades as Essex & Suffolk Water. NWL also has non-regulated activities closely related to its principal regulated activity.

Water and waste water contracts

NWG owns a number of special purpose companies for specific water and waste water contracts in Scotland, Ireland and Gibraltar.

2. Segmental analysis continued

Other

Agrer provides overseas aid funded project work in developing countries through a number of funding agencies. Central unallocated costs and provisions are also included.

Transfer prices between business segments are set on an arm's length basis in a manner similar to transactions with third parties. Segment revenue, segment expense and segment result include transfers between business segments. Those transfers are eliminated on consolidation.

Revenue

	Northumbrian Water Limited £m	Water and waste water contracts £m	Other £m	Total £m
Year ended 31 March 2009				
Segment revenue	**647.0**	**39.8**	**13.0**	**699.8**
Inter segment revenue	**–**	**–**	**(5.7)**	**(5.7)**
Revenue to external customers	**647.0**	**39.8**	**7.3**	**694.1**
Year ended 31 March 2008				
Segment revenue	628.0	35.5	12.6	676.1
Inter segment revenue	–	–	(5.7)	(5.7)
Revenue to external customers	628.0	35.5	6.9	670.4

All revenue above represents services provided.

Profit on ordinary activities before interest

	Northumbrian Water Limited £m	Water and waste water contracts £m	Other £m	Total £m
Year ended 31 March 2009				
Segment profit on ordinary activities before interest	**266.9**	**9.1**	**(2.4)**	**273.6**
Net finance costs				**(121.7)**
Share of profit from associates and jointly controlled entities				**0.8**
Profit on ordinary activities before taxation				**152.7**
Taxation				**(164.6)**
Loss for the year from continuing operations				**(11.9)**
Year ended 31 March 2008				
Segment profit on ordinary activities before interest	272.0	8.4	(2.6)	277.8
Net finance costs				(108.0)
Share of profit from associates and jointly controlled entities				0.5
Profit on ordinary activities before taxation				170.3
Taxation				(12.0)
Profit for the year from continuing operations				158.3

Assets and liabilities

	Northumbrian Water Limited		Water and waste water contracts		Other		Total	
	31.3.2009 £m	31.3.2008 £m	**31.3.2009 £m**	31.3.2008 £m	**31.3.2009 £m**	31.3.2008 £m	**31.3.2009 £m**	31.3.2008 £m
Segment assets	**3,446.1**	3,398.9	**131.7**	133.1	**302.0**	325.5	**3,879.8**	3,857.5
Segment liabilities	**431.9**	303.8	**20.8**	23.0	**3,169.7**	3,038.9	**3,622.4**	3,365.7

Other comprises taxation, interest and net debt.

2. Segmental analysis continued

Other segment information:

	Northumbrian Water Limited		Water and waste water contracts		Total	
	31.3.2009 £m	31.3.2008 £m	**31.3.2009 £m**	31.3.2008 £m	**31.3.2009 £m**	31.3.2008 £m
Property, plant and equipment additions	**229.6**	233.8	**3.0**	1.5	**232.6**	235.3
Depreciation	**95.0**	93.0	**5.7**	5.3	**100.7**	98.3

3. Operating costs

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Materials and consumables	**23.3**	22.3
Manpower costs (see note 5)	**103.0**	106.9
Own work capitalised	**(27.0)**	(26.2)
Depreciation of property, plant and equipment	**100.7**	98.3
Profit on disposal of property, plant and equipment	**(1.2)**	(1.2)
Amortisation of capital grants	**(4.8)**	(4.8)
Costs of research and development	**1.8**	1.8
Operating lease payments	**1.6**	1.1
Bad debt charge	**17.5**	13.7
Other operating costs	**205.6**	180.7
Operating costs	**420.5**	392.6

4. Auditors' remuneration

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Audit of the financial statements†	**0.3**	0.3
Other fees to auditors:		
Taxation services	**0.1**	0.1

† £97,000 of this relates to the Company (2008: £90,000)

5. Employee information

The total employment costs of all employees (including directors) of the Group were:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Wages and salaries	**85.2**	82.8
Social security costs	**7.1**	7.0
Defined benefit pension service cost (see note 25)	**9.9**	15.7
Other pension costs	**0.8**	1.4
Total employment costs	**103.0**	106.9
Total employment costs were charged as follows:		
Capital schemes and infrastructure renewals	**23.3**	25.9
Manpower costs	**79.7**	81.0
	103.0	106.9

Included in wages and salaries is a total expense of shared-based payments of £0.9 million (2008: £0.8 million) which arises from transactions accounted for as equity-settled share-based payments.

5. Employee information continued

The average monthly number of employees of the Group during the year was:

	Year to 31.3.2009 Number	Year to 31.3.2008 Number
Northumbrian Water Limited	**2,966**	2,890
Water and waste water contracts	**156**	155
Other	**25**	25
	3,147	3,070

The information required by Schedule 6 of the Companies Act is contained in the directors' remuneration report under directors' emoluments, directors' pensions and pension benefits, directors' interests in shares and debentures, directors' interests in LTIP awards and directors' interests in shares under the Share Incentive Plan.

6. Finance costs payable/(income receivable)

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Finance costs payable on debentures, bank and other loans and overdrafts	**122.8**	125.3
Amortisation of discount, fees, loan issue costs and other financing items	**(4.9)**	(5.6)
Accretion on index linked bonds	**22.4**	16.2
Interest cost on pension plan obligations	**38.5**	35.2
Finance costs payable on hire purchase contracts and finance leases	**4.7**	2.4
Total finance costs payable	**183.5**	173.5
Expected return on pension plan assets	**(44.3)**	(48.4)
Finance income receivable	**(17.5)**	(17.1)
Net finance costs payable	**121.7**	108.0

7. Taxation

(a) Tax on profit on ordinary activities

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Current tax:		
Current income tax charge at 28% (2008: 30%)	**33.0**	28.1
Income tax reported in equity on cash flow hedges	**0.1**	–
Adjustment in respect of prior periods	**(1.1)**	(2.7)
UK corporation tax	**32.0**	25.4
Overseas tax	**0.1**	0.2
Total current tax	**32.1**	25.6
Deferred tax:		
Origination and reversal of temporary differences in the year at 28%	**13.8**	15.1
Effect of changes in tax rates and laws:		
– Impact of Industrial Buildings Allowances abolition	**117.2**	–
– Impact of opening rate reduction	**–**	(35.4)
Income tax reported in equity on cash flow hedges	**(0.1)**	–
Adjustment in respect of prior periods	**1.6**	6.7
Total deferred tax	**132.5**	(13.6)
Tax charge in the income statement	**164.6**	12.0

7. Taxation continued

(b) Tax relating to items charged or credited to equity

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Current tax:		
Current tax recycled to income statement on cash flow hedges	**(0.1)**	–
Deferred tax:		
Actuarial gains and losses on pension schemes	**(58.2)**	7.6
Deferred tax recycled to income statement on cash flow hedges	**0.1**	–
Interest rate swaps	**(3.3)**	–
Share-based payment	**–**	0.2
Tax (credit)/charge in the statement of recognised income and expense	**(61.5)**	7.8

(c) Reconciliation of the total tax charge

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Accounting profit before tax	**152.7**	170.3
Accounting profit multiplied by standard rate of corporation tax (28%) (2008: 30%)	**42.8**	51.1
Effects of:		
Expenses not deductible for tax purposes	**3.6**	3.0
Depreciation in respect of non-qualifying items	**0.9**	0.8
Non-taxable income and enhanced tax reliefs	**(0.1)**	(0.6)
Non-taxable amortisation of financing items	**(1.6)**	(1.8)
Refinancing of infrastructure assets	**1.6**	(7.7)
Adjustment to tax charge in respect of prior periods	**0.5**	4.0
Other	**(0.3)**	(0.3)
	47.4	48.5
Effect of changes in tax rates and laws:		
– Impact of Industrial Buildings Allowances abolition	**117.2**	–
Impact of rate reduction on deferred tax:		
– Restatement of opening balance	**–**	(35.4)
– Movement in the year	**–**	(1.1)
Total tax expense reported in the income statement	**164.6**	12.0

The effective tax rate for the year to 31 March 2009 was 107.8% (2008: 7.0%). The increase of 100.8% is mainly due to the impact of the abolition of Industrial Buildings Allowances (IBA), the restatement of deferred tax in 2008 and the refinancing of certain infrastructure assets. In the absence of the IBA adjustment, the effective rate would have been 31.0%.

(d) Unrecognised tax losses

The Group has tax losses of £8.2 million (2008: £8.7 million) which have arisen in its Gibraltar subsidiary for which a deferred tax asset has not been recognised as they may not be used to offset taxable profits elsewhere in the Group and it is not expected that the subsidiary will utilise significant amounts in the foreseeable future. The losses are, however, available for offset against future taxable profits without time limit.

(e) Temporary differences associated with Group investments

At 31 March 2009, there was no recognised deferred tax liability (2008: £nil) for taxes that would be payable on the unremitted earnings of the Group's subsidiaries as the Group has determined that undistributed profits of its subsidiaries will not be distributed in the foreseeable future. The temporary difference associated with investments in subsidiaries for which a deferred tax liability has not been recognised aggregate to £10.9 million (2008: £8.5 million).

7. Taxation continued

(f) Deferred tax

The deferred tax included in the income statement is as follows:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Accelerated capital allowances	**134.3**	(18.0)
Intangible asset	**–**	(1.3)
Shared-based payments	**–**	(0.1)
Provisions	**–**	0.5
Deferred grant income	**(1.7)**	(0.5)
Retirement benefits	**0.5**	6.1
Losses carried forward	**(0.3)**	0.8
Fair value adjustment on previous business combinations	**(0.2)**	(1.1)
Other	**(0.1)**	–
	132.5	(13.6)

The deferred tax included in the balance sheet is as follows:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Deferred tax assets:		
Provisions	**1.2**	1.2
Deferred income	**58.9**	57.2
Retirement benefits	**34.2**	–
Losses available for offset against future taxable income	**5.1**	4.8
Interest rate swaps	**3.3**	–
Share-based payments	**0.2**	0.2
Cash flow hedges	**1.0**	1.1
Other	**0.3**	0.2
Deferred tax asset	**104.2**	64.7
Deferred tax liabilities:		
Accelerated capital allowances	**671.4**	537.1
Intangible asset	**18.0**	18.0
Fair value adjustment on previous business combinations	**11.3**	11.5
Retirement benefits	**–**	23.5
Deferred tax liability	**700.7**	590.1
Net deferred tax liability	**596.5**	525.4

(g) Factors that may affect future tax charges

The Group expects to continue to incur high levels of capital expenditure and be able to claim tax relief in excess of depreciation for the remainder of NWL's current regulatory period. The annual excess has been falling mainly because, since 1 April 2005, tax deductions for deferred revenue expenditure are claimed on a depreciation basis (as originally set out in HM Revenue and Customs' Tax Bulletin 53).

In addition to abolition of industrial buildings allowances, future capital allowances claims will be made at the revised rates introduced by the Finance Act 2008. The main changes being a reduction in the rate of allowance for items of general plant and machinery from 25% to 20% per annum and an increase in the rate for long life assets from 6% to 10% per annum with effect from 1 April 2008.

8. Earnings per share

Basic earnings per share (EPS) is calculated by dividing the (loss)/profit attributable to ordinary equity holders of the parent Company by the weighted average number of ordinary shares in issue during the year. Treasury shares held are excluded from the weighted average number of shares for basic EPS.

	Loss 31.3.2009 £m	Weighted average number of shares 31.3.2009 million	Loss per share 31.3.2009 pence	Earnings 31.3.2008 £m	Weighted average number of shares 31.3.2008 million	Earnings per share 31.3.2008 pence
Basic EPS	**(12.7)**	**518.0**	**(2.45)**	158.1	518.0	30.52

The weighted average number of shares for diluted EPS is calculated by including the treasury shares held.

	Loss 31.3.2009 £m	Weighted average number of shares 31.3.2009 million	Loss per share 31.3.2009 pence	Earnings 31.3.2008 £m	Weighted average number of shares 31.3.2008 million	Earnings per share 31.3.2008 pence
Diluted EPS	**(12.7)**	**518.6**	**(2.45)**	158.1	518.6	30.48

Adjusted EPS is considered by the directors to give a better indication of the Group's underlying performance and is calculated as follows:

	Loss/(earnings) 31.3.2009 £m	Weighted average number of shares 31.3.2009 million	Loss/(earnings) per share 31.3.2009 pence	Earnings 31.3.2008 £m	Weighted average number of shares 31.3.2008 million	Earnings per share 31.3.2008 pence
Basic EPS	**(12.7)**	**518.0**	**(2.45)**	158.1	518.0	30.52
Deferred tax	**132.5**		**25.58**	(13.6)		(2.62)
Amortisation of debt fair value	**(5.6)**		**(1.08)**	(6.1)		(1.18)
Adjusted EPS	**114.2**	**518.0**	**22.05**	138.4	518.0	26.72

9. Dividends paid and proposed

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Declared and paid during the year:		
Equity dividends on ordinary shares:		
Final dividend for 2007/08: 8.07 pence (2006/07: 7.52 pence)	**41.8**	39.0
Interim dividend for 2008/09: 4.29 pence (2007/08: 4.00 pence)	**22.2**	20.7
Dividends paid	**64.0**	59.7
Proposed for approval by shareholders at the AGM:		
Final dividend for 2008/09: 8.50 pence (2007/08: 8.07 pence)	**44.0**	41.8

10. Intangible assets

	Goodwill £m	Other £m	Total £m
Cost:			
At 1 April 2007, 1 April 2008 and 31 March 2009	**3.8**	**64.2**	**68.0**
Impairment:			
At 1 April 2007, 1 April 2008 and 31 March 2009	**(0.2)**	**–**	**(0.2)**
Net book value at 31 March 2009	**3.6**	**64.2**	**67.8**
Net book value at 1 April 2007 and 31 March 2008	3.6	64.2	67.8

As from 1 April 2004, the date of transition to IFRS, goodwill is no longer amortised but is now subject to an annual impairment review.

Goodwill has been allocated to the water and waste water cash-generating unit and the other intangible asset has been allocated to the Northumbrian Water Limited cash-generating unit, which are also the reportable segments.

The other intangible asset represents the right in perpetuity to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme and, therefore, the directors consider the asset has an indefinite life. Accordingly, future cash flows, which increase in line with inflation, have been discounted at a rate of 6.83% in perpetuity. This represents a long term nominal gilt yield and an assumed credit spread. This calculation satisfied the Group that the carrying value at 31 March 2009 had not been impaired. Furthermore, it is improbable that the discount rate would increase to such a level that the carrying value would be impaired.

11. Property, plant and equipment

	Freehold land and buildings £m	Infrastructure assets £m	Operational structures, plant and machinery £m	Fixtures, fittings, tools and equipment £m	Assets in the course of construction £m	Total £m
Cost:						
At 1 April 2007	92.4	1,534.5	1,942.0	167.3	100.0	3,836.2
Additions	–	0.1	1.4	–	233.8	235.3
Schemes commissioned	0.4	82.2	96.8	7.9	(187.3)	–
Reclassifications	0.9	(0.1)	(0.8)	–	–	–
Disposals	(0.4)	(7.5)	(2.5)	–	–	(10.4)
At 1 April 2008	93.3	1,609.2	2,036.9	175.2	146.5	4,061.1
Additions	–	0.1	2.7	0.2	229.6	232.6
Schemes commissioned	2.0	101.5	96.6	5.5	(205.6)	–
Disposals	–	(7.9)	(11.2)	–	–	(19.1)
At 31 March 2009	**95.3**	**1,702.9**	**2,125.0**	**180.9**	**170.5**	**4,274.6**
Depreciation:						
At 1 April 2007	30.1	56.3	521.1	108.8	–	716.3
Charge for the year	2.0	21.2	65.3	9.8	–	98.3
Disposals	–	(7.5)	(2.3)	–	–	(9.8)
At 1 April 2008	32.1	70.0	584.1	118.6	–	804.8
Charge for the year	1.9	21.6	67.8	9.4	–	100.7
Disposals	–	(7.9)	(11.2)	–	–	(19.1)
At 31 March 2009	**34.0**	**83.7**	**640.7**	**128.0**	**–**	**886.4**
Net book value at 31 March 2009	**61.3**	**1,619.2**	**1,484.3**	**52.9**	**170.5**	**3,388.2**
Net book value at 31 March 2008	61.2	1,539.2	1,452.8	56.6	146.5	3,256.3
Net book value at 1 April 2007	62.3	1,478.2	1,420.9	58.5	100.0	3,119.9

11. Property, plant and equipment continued

Operational structures, plant and machinery include an element of land and buildings dedicated to those assets. The Group does not capitalise finance costs.

The net book value of property, plant and equipment held under hire purchase contracts and finance leases was as follows:

	31.3.2009 £m	31.3.2008 £m
Infrastructure assets	**48.3**	28.9
Operational structures, plant and machinery	**24.1**	23.7
	72.4	52.6

12. Investments

	31.3.2009 £m	31.3.2008 £m
Investments in jointly controlled entities	**3.8**	3.8

(a) Investments in jointly controlled entities

The Group holds 50% of the nominal value of issued ordinary £1 shares in Vehicle Lease and Service Limited (VLS), the Group's principal jointly controlled entity. VLS was incorporated in England and Wales and undertakes the business of hiring, leasing and servicing of vehicles and plant.

The Group also holds a 50% interest in Agreco, a jointly controlled entity incorporated in Belgium.

The following table illustrates summarised financial information of the Group's share of the results of VLS and Agreco.

	VLS 31.3.2009 £m	Agreco 31.3.2009 £m	VLS 31.3.2008 £m	Agreco 31.3.2008 £m
Revenue	**6.5**	**2.5**	5.8	1.7
Operating costs	**(5.7)**	**(2.0)**	(5.1)	(1.5)
Profit on ordinary activities before interest	**0.8**	**0.5**	0.7	0.2
Finance costs payable	**(0.4)**	**–**	(0.4)	–
Finance income receivable	**–**	**–**	0.1	–
Profit on ordinary activities before taxation	**0.4**	**0.5**	0.4	0.2
– current taxation	**(0.1)**	**–**	(0.1)	–
Profit for the year	**0.3**	**0.5**	0.3	0.2
Share of the jointly controlled entities' balance sheet:				
Non-current assets	**7.2**	**–**	5.7	–
Current assets	**6.5**	**2.9**	6.0	3.5
Share of gross assets	**13.7**	**2.9**	11.7	3.5
Current liabilities	**(3.9)**	**(2.4)**	(3.6)	(3.1)
Non-current liabilities	**(6.5)**	**–**	(4.7)	–
Share of gross liabilities	**(10.4)**	**(2.4)**	(8.3)	(3.1)
Share of net assets	**3.3**	**0.5**	3.4	0.4

12. Investments continued

(b) The Group's interests in principal subsidiaries at 31 March 2008 and 31 March 2009 were as follows:

Name of undertaking	Country of incorporation or registration and operation	Description of shares held	Proportion of nominal value of issued shares held by Group (%)	Business activity
Northumbrian Services Limited	England and Wales	Ordinary shares of £1	100	Holding of investments and loans
Northumbrian Water Limited	England and Wales	Ordinary shares of £1	100	Water and sewerage services
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Caledonian Environmental Services plc	Scotland	Ordinary shares of £1	75	Waste water services
Caledonian Environmental Levenmouth Treatment Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Operations Limited	Scotland	Ordinary shares of £1	100	Waste water services
AquaGib Limited	Gibraltar	Ordinary shares of £1	67	Water and sewerage services
Northumbrian Water Projects Limited	England and Wales	Ordinary shares of £1	100	Waste water services
SA Agrer NV	Belgium	Ordinary shares of £1	100	Aid funded project work

The directors consider that to give full particulars of all subsidiary and associated undertakings would lead to a statement of excessive length. The above information relates to those subsidiary and associated undertakings or groups of undertakings whose results or financial position, in the opinion of the directors, principally affect the figures of the Group. A full list of the Company's subsidiaries is attached to the Company's latest annual return filed at Companies House.

13. Inventories

	31.3.2009 £m	31.3.2008 £m
Stores	**3.2**	3.4

14. Trade and other receivables

	31.3.2009 £m	31.3.2008 £m
Trade receivables	**68.7**	66.5
Amounts owed by jointly controlled entities	**0.5**	0.7
Prepayments and accrued income	**51.7**	48.9
Financial assets	**1.4**	1.7
Other receivables	**9.4**	7.3
	131.7	125.1

14. Trade and other receivables continued

As at 31 March 2009, trade receivables at nominal value of £31.7 million (2008: £27.3 million) were impaired. Movements in the provision for impairment of trade receivables were as follows:

	£m
At 1 April 2007	24.7
Charge for the year	13.7
Utilised	(11.1)
At 1 April 2008	27.3
Charge for the year	17.5
Utilised	(13.1)
At 31 March 2009	**31.7**

At 31 March, the analysis of trade receivables overdue but not impaired is as follows:

	0–3 months £m	3–12 months £m	12–24 months £m	24–36 months £m	36–48 months £m	>48 months £m	Total £m
2009	**0.5**	**23.9**	**10.3**	**5.3**	**2.6**	**0.4**	**43.0**
2008	0.4	21.4	9.1	4.7	2.0	0.4	38.0

15. Cash and cash equivalents and short term cash deposits

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise the following at 31 March:

	31.3.2009 £m	31.3.2008 £m
Cash at bank and in hand	**40.0**	92.3
Short term deposits	**68.8**	201.9
	108.8	294.2
Bank overdrafts	**(16.5)**	(27.8)
Cash and cash equivalents	**92.3**	266.4

	31.3.2009 £m	31.3.2008 £m
Short term cash deposits > 3 months	**120.8**	–
Short term cash deposits < 3 months	**39.8**	–
Short term cash deposits	**160.6**	–

Short term cash deposits of £39.8 million, with a maturity of less than three months represent amounts on deposit at fixed rates with the Northumbrian Water Pension Scheme.

16. Trade and other payables

	31.3.2009 £m	31.3.2008 £m
Trade payables	**10.4**	9.7
Other payables	**19.2**	16.7
Interest payable	**35.9**	38.7
Accruals and deferred income	**82.3**	87.8
	147.8	152.9

17. Interest bearing loans and borrowings

	31.3.2009 £m	31.3.2008 £m
Current:		
Bank overdrafts	**16.5**	27.8
Current instalments due on borrowings (principal £20.6 million, 2008: £96.8 million)	**25.8**	102.4
Current obligations under finance leases and hire purchase contracts (see note 18)	**6.9**	6.1
	49.2	136.3
Non-current:		
Non-current obligations under finance leases and hire purchase contracts (principal £104.8 million, 2008: £83.6 million) (see note 18)	**104.8**	83.7
Non-current instalments on borrowings (principal £2,326.6 million, 2008: £2,204.1 million)	**2,360.5**	2,242.7
	2,465.3	2,326.4
Borrowings comprise the following:		
Loans (principal £567.4 million, 2008: £543.6 million)	**572.6**	550.5
Subordinated loan stock	**6.6**	6.4
Eurobonds – due 11 October 2017 bearing interest rate of 6.0% (principal £300.0 million, 2008: £300.0 million)	**309.8**	311.0
Eurobonds – due 6 February 2023 bearing interest rate of 6.875% (principal £350.0 million, 2008: £350.0 million)	**389.7**	392.7
Eurobonds – due 29 April 2033 bearing interest rate of 5.625% (principal £350.0 million, 2008: £350.0 million)	**346.0**	345.6
Eurobonds – due 23 January 2034 bearing interest rate of 5.87526% (principal £248.0 million, 2008: £248.0 million)	**240.7**	240.4
Eurobonds – due 31 March 2037 bearing interest rate of 6.627% (principal £61.6 million, 2008: £61.6 million)	**58.9**	58.8
Index linked Eurobonds – due 15 July 2036 bearing interest rate of 2.033% (principal £171.9 million, 2008: £163.7 million)	**170.9**	162.6
Index linked Eurobonds – due 30 January 2041 bearing interest rate of 1.6274% (principal £67.7 million, 2008: £64.4 million)	**67.5**	64.3
Index linked Eurobonds – due 16 July 2049 bearing interest rate of 1.7118% (principal £112.0 million, 2008: £106.6 million)	**111.8**	106.4
Index linked Eurobonds – due 16 July 2053 bearing interest rate of 1.7484% (principal £112.0 million, 2008: £106.6 million)	**111.8**	106.4
	2,386.3	2,345.1
Less current instalments due on bank loans (principal £20.6 million, 2008: £96.8 million)	**(25.8)**	(102.4)
	2,360.5	2,242.7

The difference between the principal value of £2,326.6 million (2008: £2,204.1 million) and the carrying value of £2,360.5 million (2008: £2,242.7 million) are unamortised issue costs of £15.4 million (2008: £15.9 million) and a credit of £49.3 million (2008: £54.5 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

The Eurobonds – due 23 January 2034 are secured on the income receivable under the Kielder Water transfer scheme for the period to 23 January 2034.

The value of the capital and interest elements of the index linked Eurobonds are linked to movements in the UK Retail Price Index (see note 1(q)).

18. Obligations under hire purchase contracts and finance leases

	31.3.2009 £m	31.3.2008 £m
Amounts due:		
Not later than one year	**6.9**	6.1
After one year but not more than five years	**23.2**	19.2
Later than five years	**160.0**	123.8
	190.1	149.1
Less finance charges allocated to future periods	**(78.4)**	(59.3)
Present value of minimum lease payments	**111.7**	89.8
Disclosed as due:		
Not later than one year	**6.9**	6.1
After more than one year	**104.8**	83.7
	111.7	89.8

Lease commitments
The Group has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The future minimum rentals payable under non-cancellable operating leases are as follows:

	31.3.2009 £m	31.3.2008 £m
Not later than one year	**0.9**	0.7
After one year but not more than five years	**3.1**	2.6
After five years	**26.8**	25.7
	30.8	29.0

19. Provisions

	£m
At 1 April 2008	
Current	0.2
Non-current	2.8
At 1 April 2008	3.0
Utilised	(0.3)
At 31 March 2009	**2.7**
Analysed as:	
Current	0.2
Non-current	2.5
	2.7

The provision represents outstanding discretionary pension liabilities. The discretionary pension liabilities have been calculated by an independent actuary and are expected to be paid over the remaining lives, which is approximately twelve years.

20. Financial instruments

(a) Group strategy

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

20. Financial instruments continued

(b) Treasury operations

The main purpose of the Group's treasury function is to assess the Group's ongoing capital requirement and to raise funding on a timely basis, taking advantage of any favourable market opportunities. It also invests any surplus funds the Group may have, based upon its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process but the Group's policies prohibit their use for speculation.

(c) Risks arising from the Group's financial instruments

The main risks arising from the Group's financial instruments are liquidity risk, interest rate risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. All treasury activities are conducted in accordance with these policies.

(d) Liquidity risk

As regards day to day liquidity, the Group's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0 million and with a bank agreement availability period of no less than three months. At 31 March 2009, the Group had £75.0 million of undrawn committed bank facilities (2008: £75.0 million).

(e) Interest rate risk

The Group finances its operations through a mixture of retained profits and bank borrowings. It borrows at both fixed and floating rates of interest and, accordingly, uses interest rate swaps to generate the desired interest profile and to manage the Group's exposure to interest rate fluctuations. The Group's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2009, 75% (2008: 63%) of the Group's borrowings were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

(f) Foreign currency risk

The Group's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3.0 million sterling equivalent of a translation nature, should be covered immediately on identification.

(g) Market price risk

The Group's exposure to market price risk principally comprises interest rate exposures. 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 material effect on the Group's pre-tax profits.

(h) Credit risk

There are no significant concentrations of credit risk within the Group. Management's assessment of the maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date. A significant proportion of the trade debtor balances are with domestic customers who are unlikely to have a published credit rating.

(i) Counterparty risk

The treasury strategy which is approved by the Board, requires that investments are limited to certain money market and treasury instruments, and that the Group's exposure to any single bank, building society or market is controlled, with maximum deposits allowed with any single counterparty. The investment criteria cover credit rating and asset size, including sovereign and political risk. Current market conditions have resulted in closer monitoring of counterparties and cancellation or suspension of deposits.

20. Financial instruments continued

(j) Interest rate risk table

In relation to financial liabilities, the following table shows the impact on profit and equity of an increase in the variable cost of borrowing. The 2009 analysis below reflects a larger possible change in interest rates than in 2008, due to the increased volatility in the financial markets. The range is considered a reasonable basis and highlights this is not material to the Group:

Increase in basis points	Effect on profit/equity £m
2009	
+50	**0.8**
+100	**1.5**
+150	**2.3**
2008	
+35	0.5
+25	0.4
+10	0.2

(k) Contractual maturity of financial liabilities (principal and future interest payments)

The table below summarises the maturity profile of the Group's financial liabilities at 31 March based on contractual undiscounted payments:

Year ended 31 March 2009

	On demand £m	Less than 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Interest bearing loans and borrowings	16.5	40.7	113.9	671.6	4,632.9	5,475.6
Trade and other payables	–	63.0	27.6	0.2	–	90.8
	16.5	**103.7**	**141.5**	**671.8**	**4,632.9**	**5,566.4**

Year ended 31 March 2008

	On demand £m	Less than 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Interest bearing loans and borrowings	27.8	42.7	208.0	797.2	4,531.3	5,607.0
Trade and other payables	–	65.5	28.3	–	–	93.8
	27.8	108.2	236.3	797.2	4,531.3	5,700.8

Notes to the consolidated financial statements continued

20. Financial instruments continued

(l) Interest rate risk profile of financial assets and liabilities

The interest rate profile of the financial assets and liabilities of the Group as at 31 March is as follows:

Year ended 31 March 2009

	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Fixed rate:							
Eurobonds	(3.9)	(4.0)	(4.1)	(4.1)	(4.1)	(1,324.9)	(1,345.1)
Subordinated loan stock	–	–	–	–	–	(6.6)	(6.6)
Bank loans	(19.3)	(17.8)	(24.5)	(21.0)	(21.1)	(189.4)	(293.1)
Obligations under finance leases and hire purchase contracts	(2.7)	(2.1)	(1.8)	(1.1)	(0.5)	(0.3)	(8.5)
Other loans	–	(0.4)	(0.3)	(0.3)	(0.3)	(1.5)	(2.8)
Fixed rate at 31 March 2009	**(25.9)**	**(24.3)**	**(30.7)**	**(26.5)**	**(26.0)**	**(1,522.7)**	**(1,656.1)**
Variable rate:							
Cash and cash equivalents	108.8	–	–	–	–	–	108.8
Short term cash deposits	160.6	–	–	–	–	–	160.6
Financial investments	1.4	1.2	0.9	0.6	0.2	11.1	15.4
Eurobonds	–	–	–	–	–	(462.0)	(462.0)
Bank loans	(2.5)	(2.5)	(171.7)	(10.0)	(10.0)	(80.0)	(276.7)
Overdrafts	(16.5)	–	–	–	–	–	(16.5)
Obligations under finance leases and hire purchase contracts	(4.2)	(4.3)	(4.4)	(4.5)	(4.5)	(81.3)	(103.2)
Variable rate at 31 March 2009	**247.6**	**(5.6)**	**(175.2)**	**(13.9)**	**(14.3)**	**(612.2)**	**(573.6)**
Net borrowings at 31 March 2009							**(2,229.7)**

Year ended 31 March 2008

	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Fixed rate:							
Loans receivable	–	–	–	–	–	1.0	1.0
Eurobonds	(4.1)	(4.1)	(4.4)	(5.0)	(5.3)	(1,325.6)	(1,348.5)
Subordinated loan stock	–	–	–	–	–	(6.4)	(6.4)
Bank loans	(20.2)	(19.3)	(17.9)	(16.2)	(13.3)	(106.6)	(193.5)
Obligations under finance leases and hire purchase contracts	(2.6)	(1.9)	(1.4)	(1.0)	(0.4)	(0.1)	(7.4)
Other loans	–	–	–	–	–	(2.3)	(2.3)
Fixed rate at 31 March 2008	(26.9)	(25.3)	(23.7)	(22.2)	(19.0)	(1,440.0)	(1,557.1)
Variable rate:							
Cash and cash equivalents	294.2	–	–	–	–	–	294.2
Financial investments	1.7	1.4	1.2	0.9	0.6	11.3	17.1
Eurobonds	–	–	–	–	–	(439.7)	(439.7)
Bank loans	(78.0)	(2.5)	(127.5)	(46.7)	–	(100.0)	(354.7)
Overdrafts	(27.8)	–	–	–	–	–	(27.8)
Obligations under finance leases and hire purchase contracts	(3.7)	(3.5)	(3.6)	(3.6)	(3.6)	(64.4)	(82.4)
Variable rate at 31 March 2008	186.4	(4.6)	(129.9)	(49.4)	(3.0)	(592.8)	(593.3)
Net borrowings at 31 March 2008							(2,150.4)

The variable rate net borrowings comprise sterling denominated bank borrowings and deposits that bear interest at rates based upon up to 12 months LIBOR.

20. Financial instruments continued

(m) Currency exposures

At 31 March 2009, after taking into account the effects of forward foreign exchange contracts, the Group had no currency exposures (2008: £nil).

(n) Borrowing facilities

The Group has various undrawn committed borrowing facilities. The facilities available at 31 March, in respect of which all conditions precedent have been met, are as follows:

	31.3.2009 £m	31.3.2008 £m
Expiring in more than one year but not more than two years	**75.0**	–
Expiring in more than two years but not more than four years	**–**	75.0
	75.0	75.0

(o) Fair values of financial assets and financial liabilities

A comparison by category of book values and fair values of the Group's financial assets and liabilities as at 31 March is set out below:

	Book value		Fair value	
	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m
Financial assets:				
Cash and cash equivalents	**108.8**	294.2	**108.8**	294.2
Short term cash deposits	**160.6**	–	**163.0**	–
Financial investments	**15.4**	17.1	**15.4**	17.1
Sterling loans receivable	**–**	1.0	**–**	1.0
Financial liabilities:				
Overdraft	**(16.5)**	(27.8)	**(16.5)**	(27.8)
Bank loans (principal of £567.4 million, 2008: £543.6 million)	**(572.6)**	(550.5)	**(589.0)**	(547.9)
Subordinated loan stock	**(6.6)**	(6.4)	**(6.6)**	(6.4)
Eurobonds (principal of £1,773.2 million, 2008: £1,750.9 million)	**(1,807.1)**	(1,788.2)	**(1,578.9)**	(1,819.6)
Obligations under finance leases and hire purchase contracts (principal of £111.6 million, 2008: £89.7 million)	**(111.7)**	(89.8)	**(111.7)**	(89.8)
Interest rate swaps	**–**	–	**(11.7)**	–
	(2,229.7)	(2,150.4)	**(2,027.2)**	(2,179.2)

The fair values of the interest rate swaps, forward foreign currency contracts and sterling denominated long term fixed rate debt with a book value of £1,807.1 million (2008: £1,788.2 million), have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

In the absence of an openly traded market value for the index linked bonds with a book value of £462.0 million, the fair value at the balance sheet date has been calculated by considering the remaining debt maturity, the relevant UK index linked gilt rate and an appropriate credit spread by reference to market evidence for conventional bonds.

The difference between the principal value of £2,452.2 million (2008: £2,384.2 million) and the carrying value of £2,491.4 million (2008: £2,428.5 million) are unamortised issue costs of £15.4 million (2008: £15.9 million) and a credit of £54.6 million (2008: £60.2 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

Notes to the consolidated financial statements continued

20. Financial instruments continued

(p) Hedges

Cash flow hedges – currency forward contracts

At 31 March 2009, the Group held no forward exchange contracts.

At 31 March 2008, the Group held the following forward exchange contracts, designated as hedges of expected future purchases for which the Group had firm commitments. The forward currency contracts were used to hedge the foreign currency risk of the firm commitments. The terms of these contracts were as follows:

Currency bought	Maturity	Exchange rate
EUR 473,100	30.4.2008	1.2669
USD 150,000	19.5.2008	2.0216
EUR 150,000	18.6.2008	2.0163

These hedges were designated as highly effective. At 31 March 2008, no change occurred in the fair value and, therefore, no gain or loss was included in equity.

Cash flow hedges – interest rate swap

At 31 March 2009, the Group held three interest rate swaps, designated as a hedge of future interest cash flows, for which the Group has firm commitments. The swap is used to convert variable rate interest payments to a fixed rate basis. The terms of these swaps are as follows:

Notional amount	Start date	Termination date	Fixed rate %
GBP 100 million	**15.9.2008**	**15.3.2022**	**4.79**
GBP 62.5 million	**29.1.2009**	**31.5.2011**	**2.345**
GBP 62.5 million	**29.1.2009**	**31.5.2011**	**2.435**

These hedges were designated as highly effective.

At 31 March 2008, the Group held one interest rate swap, designated as a hedge of future interest cash flows, for which the Group had firm commitments. The swap was used to convert cash deposit interest receipts to a fixed rate basis. The terms of this swap were as follows:

Notional amount	Start date	Termination date	Fixed rate %
GBP 50 million	16.3.2007	16.3.2009	5.665

This hedge was designated as highly effective.

21. Authorised and issued share capital

	31.3.2009 £m	31.3.2008 £m
Authorised: 700 million ordinary shares of 10 pence each	**70.0**	70.0
Allotted, called up and fully paid: 518.6 million ordinary shares of 10 pence each	**51.9**	51.9

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, currently holds 1,038,252 (2008: 443,507) ordinary 10 pence shares in the Company for use under the Company's Long Term Incentive Plan (LTIP). All of these shares have been conditionally awarded under the LTIP. Details of the main features of the LTIP and the conditions for vesting can be found in the directors' remuneration report on pages 57 to 61. As at 31 March 2009, the share price of the ordinary 10 pence shares in the Company was 218.25 pence (2008: 349.25 pence).

22. Reconciliation of movements in equity

	Equity share capital £m	Share premium reserve £m	Cash flow hedge reserve £m	Treasury shares £m	Currency translation £m	Retained earnings £m	Total equity £m	Minority interests £m	Total £m
At 1 April 2007	51.9	446.5	1.0	(1.3)	(0.2)	(126.5)	371.4	1.7	373.1
Total recognised income and expense for the year	–	–	–	–	0.3	177.6	177.9	0.2	178.1
Share-based payment	–	–	–	–	–	0.5	0.5	–	0.5
Exercise of LTIP awards	–	–	–	0.5	–	(0.5)	–	–	–
Equity dividends paid	–	–	–	–	–	(59.7)	(59.7)	(0.2)	(59.9)
At 1 April 2008	51.9	446.5	1.0	(0.8)	0.1	(8.6)	490.1	1.7	491.8
Shares purchased	–	–	–	(1.7)	–	–	(1.7)	–	(1.7)
Total recognised income and expense for the year	–	–	(8.6)	–	0.9	(162.2)	(169.9)	0.8	(169.1)
Share-based payment	–	–	–	–	–	0.5	0.5	–	0.5
Exercise of LTIP awards	–	–	–	0.2	–	(0.2)	–	–	–
Equity dividends paid	–	–	–	–	–	(64.0)	(64.0)	(0.1)	(64.1)
At 31 March 2009	**51.9**	**446.5**	**(7.6)**	**(2.3)**	**1.0**	**(234.5)**	**255.0**	**2.4**	**257.4**

Nature and purpose of other reserves

Cash flow hedge reserve

This reserve is used to reflect the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge.

Treasury shares

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, acquires shares to be used in the future to satisfy the vesting and exercise of awards under the Company's LTIP.

23. Additional cash flow information

Analysis of net debt as at 31 March 2009

	As at 1.4.2008 £m	Cash flow £m	Other non-cash movements £m	**As at 31.3.2009 £m**
Cash and cash equivalents	266.4	(174.1)	–	**92.3**
Short term cash deposits	–	160.6	–	**160.6**
Loans (principal of £2,331.8 million, 2008: £2,282.8 million)	(2,327.0)	(26.4)	(17.5)	**(2,370.9)**
Finance leases (principal of £111.6 million, 2008: £89.7 million)	(89.8)	(13.8)	(8.1)	**(111.7)**
	(2,150.4)	(53.7)	(25.6)	**(2,229.7)**

The difference between the principal value of £2,443.4 million (2008: £2,372.5 million) and the carrying value of £2,482.6 million (2008: £2,416.8 million) are unamortised issue costs of £15.4 million (2008: £15.9 million) and a credit of £54.6 million (2008: £60.2 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

Non-cash movements on loans relate to the principal uplift on index linked borrowings and amortisation of loan issue costs offset by the amortisation of debt fair value for the year. Non-cash movements on finance leases relate to the inception of new finance leases on the acquisition of plant and machinery during the year.

Notes to the consolidated financial statements continued

23. Additional cash flow information continued

Analysis of net debt as at 31 March 2008

	As at 1.4.2007 £m	Cash flow £m	Other non-cash movements £m	As at 31.3.2008 £m
Cash and cash equivalents	315.8	(49.4)	–	266.4
Loans (principal of £2,282.8 million, 2007: £2,284.0 million)	(2,334.1)	18.0	(10.9)	(2,327.0)
Finance leases (principal of £89.7 million, 2007: £61.2 million)	(61.3)	(22.7)	(5.8)	(89.8)
	(2,079.6)	(54.1)	(16.7)	(2,150.4)

The difference between the principal value of £2,372.5 million (2007: £2,345.2 million) and the carrying value of £2,416.8 million (2007: £2,395.4 million) are unamortised issue costs of £15.9 million (2007: £16.1 million) and a credit of £60.2 million (2007: £66.3 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

24. Financial commitments

Capital expenditure

	31.3.2009 £m	31.3.2008 £m
Expenditure contracted for	**168.8**	166.8

In addition to these commitments, the Group has longer term expenditure plans, which include investment to meet shortfalls in performance and condition, and to provide for new demand and growth within the water and sewerage business.

25. Pensions and other post-retirement benefits

The Group operates a defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 2,169 active members at 31 March 2009 (2008: 2,391).

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

The most recent actuarial valuation of the scheme was at 31 December 2007. At that date the value of assets amounted to £732.3 million and the funding level was 106.1%.

The future service contribution rate jointly payable by members and the employers from 31 December 2007 was 22.6% of pensionable salaries. Members' contributions are 7.3% on average with the employers paying 15.3%.

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

	%
Pre-retirement	6.1
Post-retirement	5.2
Pay increases	3.65
Pension increases	3.4
Price inflation	3.4

Following the 2004 actuarial valuation the employers had prepaid contributions to the scheme up to 31 December 2010. The scheme actuary recommended that regular contributions should recommence from 1 January 2011.

The scheme also has a defined contribution section which had 310 active members at 31 March 2009 (2008: 219). 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 Group in the year totalled £0.4 million (2008: £0.1 million).

25. Pensions and other post-retirement benefits continued

The additional disclosures regarding the Group's defined benefit scheme as required under IAS 19 'Employee benefits', and the relevant impact on the Group's financial statements are set out below.

A qualified actuary, using revised assumptions that are consistent with the requirements of IAS 19, has updated the actuarial valuation described above as at 31 March 2009. Investments have been valued, for this purpose, at fair value.

IAS 19 actuarial assumptions:

	31.3.2009	31.3.2008
Pay increases[1]	4.0%	4.5%
Pension increases	3.0%	3.5%
Price inflation	3.0%	3.5%
Discount rate	6.1%	6.8%
Mortality assumptions[2,3]	PCMA/PCFA00	PMA/PFA00
– Life expectancy for a member aged 60 – female (years)	–	28.0
– Life expectancy for a member aged 60 – male (years)	–	25.2
– Life expectancy for a member aged 65 – female (years)	22.9	–
– Life expectancy for a member aged 65 – male (years)	20.6	–

Notes:
1. Including promotional salary scale.
2. 115% of PCMA/PCFA00 and PMA/PFA00.
3. PCMA/PCFA00 and PMA/PFA00 (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 31.3.2009 %	31.3.2009 £m	Long term expected rate of return 31.3.2008 %	31.3.2008 £m
Equities	7.2	369.0	7.5	457.1
Corporate bonds	6.1	38.9	6.8	51.6
Government bonds	4.2	50.0	4.5	66.1
Property	5.7	58.7	6.0	76.3
Cash	4.0	1.8	5.3	15.6
Loan to scheme from Company	2.0	(39.8)	–	–
Total fair value of assets		478.6		666.7
Present value of liabilities		(598.0)		(576.2)
(Deficit)/surplus		(119.4)		90.5

The discount rate at 31 March 2009 has been set by reference to the yield on AA corporate bonds (AA over 15 years) at that date, extrapolated forward to a duration of 18 years which reflect the duration of the expected benefit payments. The expected rate of return on equities represents a 3% premium of the yield on long term Government bonds at 31 March 2009. The gross redemption yield on index linked UK Government stocks was 1.1%. The long term inflation rate implied by these yields is 3.1% which has been reduced by 0.1% to allow for an inflation risk premium. Mortality rates have been based on the PA00 tables, applying medium cohort adjustment of 115% loading to mortality rates based on the year of birth of membership.

25. Pensions and other post-retirement benefits continued

The amounts recognised in the income statement and in the statement of recognised income and expense for the year are analysed as follows:

	31.3.2009 £m	31.3.2008 £m
Recognised in the income statement:		
Current service cost	**9.6**	15.3
Past service cost	**0.3**	0.4
Recognised in operating costs in arriving at profit on ordinary activities before interest	**9.9**	15.7
Interest cost on plan obligations	**38.5**	35.2
Expected return on plan assets	**(44.3)**	(48.4)
Recognised in finance costs payable/(income receivable)	**(5.8)**	(13.2)
Recognised in the statement of recognised income and expense:		
Actual return on scheme assets	**(161.0)**	(45.0)
Less expected return on scheme assets	**(44.3)**	(48.4)
	(205.3)	(93.4)
Other actuarial gains and losses	**(2.5)**	120.7
Net actuarial (losses)/gains	**(207.8)**	27.3
Cumulative amounts recognised since adopting the standard	**(81.6)**	126.2

History of experience gains and losses:

	31.3.2009 £m	31.3.2008 £m	31.3.2007 £m	31.3.2006 £m	31.3.2005 £m
Fair value of assets	**478.6**	666.7	710.8	659.8	523.8
Present value of defined benefit obligation	**(598.0)**	(576.2)	(668.1)	(663.5)	(600.2)
(Deficit)/surplus	**(119.4)**	90.5	42.7	(3.7)	(76.4)
Experience adjustments arising on plan assets	**(205.3)**	(93.4)	0.6	87.1	25.6
Experience adjustments arising on plan liabilities	**18.7**	0.6	1.7	34.0	(4.4)

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

	31.3.2009 £m	31.3.2008 £m
At 1 April	**576.2**	668.1
Current service cost	**9.6**	15.3
Past service cost	**0.3**	0.4
Interest cost on plan obligations	**38.5**	35.2
Contributions by plan participants	**0.1**	0.1
Actuarial loss/(gain) on obligations	**2.5**	(120.7)
Benefits paid	**(29.2)**	(22.2)
At 31 March	**598.0**	576.2
Present value of funded defined benefit obligations	**598.0**	576.2

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

	31.3.2009 £m	31.3.2008 £m
At 1 April	**666.7**	710.8
Expected return on plan assets	**44.3**	48.4
Actuarial loss on plan assets	**(205.3)**	(93.4)
Contributions by employer	**2.0**	23.0
Contributions by plan participants	**0.1**	0.1
Benefits paid	**(29.2)**	(22.2)
At 31 March	**478.6**	666.7

25. Pensions and other post-retirement benefits continued

The Group through its subsidiary, AquaGib, also operates a non-contributory defined benefit scheme. The surplus at 31 March 2009, under local GAAP, was £0.3 million (2008: £0.2 million). The Group made contributions amounting to £0.5 million (2008: £0.6 million) to the defined benefit pension scheme.

Sensitivity to key assumptions:
IAS 1 requires 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 IAS 19 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 £12.0 million.

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 adopted for the 2007 formal valuation – namely the PCMA/PCFA00 tables, applying a medium cohort adjustment with a 115% loading to mortality rates based on the year of birth of the membership. These assumptions imply an assumed life expectancy for a member aged 65 at 31 March 2009 of 20.6 years (2008: member aged 60 years of 25.2 years) for males and 22.9 years (2008: member aged 60 years of 28.0 years) for females.

The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around 2.9%.

26. Share incentive plans

Long Term Incentive Plan (LTIP)

Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Company. Further details of the LTIP can be found in the directors' remuneration report on page 57.

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

	31.3.2009 Number	31.3.2008 Number
Outstanding at 1 April	**1,103,069**	1,114,715
Granted during the year	**462,700**	364,370
Forfeited/lapsed during the year	**(270,480)**	(102,606)
Exercised	**(105,255)**	(273,410)
Outstanding at 31 March	**1,190,034**	1,103,069
Exercisable at 31 March	**9,023**	4,062

The weighted average exercise price throughout the year was £nil (2008: £nil). The fair value of conditional share awards granted during the year was £0.1 million (2008: £0.1 million).

The weighted average share price at the date of exercise for the conditional share awards is 248.08 pence (2008: 343.34 pence).

For the conditional awards outstanding as at 31 March 2009, the weighted average remaining contractual life is 1.8 years (2008: 1.7 years).

26. Share incentive plans continued

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

	31.3.2009	31.3.2008
Dividend yield	**4.9%**	3.5%
Expected share price volatility	**28%**	24%
Share price at award	**251.50p**	334.00p
Expected FTSE 250 Index volatility	**23%**	13%
Risk free interest rate	**2.6%**	4.6%
Expected life of option (years)	**3**	3

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

Share Incentive Plan (SIP)

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

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

	31.3.2009 Number	31.3.2008 Number
Outstanding at 1 April	**97,876**	115,219
Granted during the year	**119,922**	100,721
Forfeited during the year	**(2,861)**	(3,647)
Exercised	**(97,250)**	(114,417)
Outstanding at 31 March	**117,687**	97,876

27. Special purpose entities

As noted under accounting policy 1(b), under SIC 12, two companies are consolidated as special purpose entities. The principal special purpose entity is Bakethin Holdings Limited, the shares in which are owned by Bakethin Charitable Trust. The other special purpose entity is Bakethin Finance plc, which is a wholly owned subsidiary of Bakethin Holdings Limited.

Bakethin Finance plc was established for the purpose of issuing guaranteed secured Eurobonds. On 12 May 2004, Bakethin Finance plc issued £248.0 million of guaranteed secured bonds maturing January 2034. Bakethin Finance plc used the proceeds of the bond issue to make a loan to Reiver Finance Limited to fund the consideration given by that company to Northumbrian Water Limited for the securitisation of the cash flows receivable from the Environment Agency under the Water Resources Operating Agreement relating to Kielder reservoir. The assignment is for a period of 30 years.

The summarised combined financial statements of the special purpose entities are as follows:

	31.3.2009 £m	31.3.2008 £m
Income statement:		
Finance costs receivable	**15.0**	15.0
Finance costs payable	**(15.0)**	(15.0)
Profit for the year	**–**	–
Balance sheet:		
Investments	**240.7**	240.4
Current assets	**4.7**	4.6
Non-current liabilities	**(242.6)**	(242.2)
Current liabilities	**(2.7)**	(2.7)
Net assets	**0.1**	0.1

28. Related parties

During the year, the Group entered into transactions, in the ordinary course of business, with other related parties. Those transactions with directors of the Company are disclosed in the directors' remuneration report on pages 54 to 63. In accordance with IAS 24, the directors consider that there are no further disclosures in respect of key management. Transactions entered into, and trading balances outstanding at 31 March with other related parties, are as follows:

	Sales to related party £m	Purchases from related party £m	Amounts owed by related party £m	Amounts owed to related party £m
Related party:				
Jointly controlled entities				
2009	**0.1**	**10.7**	**0.5**	**8.4**
2008	0.1	10.0	0.7	7.3

Purchases from jointly controlled entities include £3.9 million (2008: £3.8 million) in respect of capital purchases under finance leases, £0.2 million (2008: £0.4 million) in respect of operating leases, £6.0 million (2008: £5.0 million) in respect of costs payable under finance leases and £0.6 million (2008: £0.8 million) in respect of other purchases.

At 31 March 2009, the Group had a short term cash deposit with the Northumbrian Water Pension Scheme of £39.8 million (2008: £nil).

Outstanding balances due from related parties are expected to be settled within 60 days and amounts due to related parties are in respect of leasing arrangements, where the amounts owed will relate specifically to the terms of the lease.

29. Contingent liability

The Group's subsidiary responsible for a contract with Scottish Water, Caledonian Environmental Services plc (CES), has received a claim from its Design and Construction Consortium (DCC), primarily in respect of the DCC's additional costs attributed by it to non-conforming influent at the treatment works. CES is defending this claim and has also issued a counterclaim against the DCC. As non-conforming influent is ultimately the responsibility of the client, CES has protected its position by issuing a claim against Scottish Water. The directors do not expect any material loss to arise as a result of these claims.

Statement of directors' responsibilities in relation to the parent Company financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to 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 those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable United Kingdom 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 that 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 1985. 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.

Report of the Auditors on the Company financial statements

Independent auditors' report to the members of Northumbrian Water Group plc

We have audited the parent Company financial statements of Northumbrian Water Group plc for the year ended 31 March 2009 which comprise the balance sheet and the related notes 1 to 10. These parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

We have reported separately on the Group financial statements of Northumbrian Water Group plc for the year ended 31 March 2009.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the parent Company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the parent Company financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent Company financial statements give a true and fair view and whether the parent Company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' report and business review is consistent with the parent Company financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent Company financial statements. The other information comprises only Highlights, NWG at a glance, the Chairman's statement, the Directors' report and business review, Appendix to the directors' report and business review, Board directors' biographies, Corporate governance report, the unaudited part of the Directors' remuneration report and Shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent Company financial statements. Our responsibilities do not extend to any other information.

Report of the Auditors on the Company financial statements continued

Basis of audit opinion

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

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

Opinion

In our opinion:

- the parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2009;
- the parent Company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report and business review is consistent with the parent Company financial statements.

Ernst & Young LLP
Registered auditor
Newcastle upon Tyne
2 June 2009

Company balance sheet
As at 31 March 2009

	Notes	31.3.2009 £m	31.3.2008 £m
Fixed assets			
Investments in subsidiary undertakings	4	**1,022.6**	1,022.6
		1,022.6	1,022.6
Current assets			
Debtors: receivable within one year	5	**6.8**	10.2
Cash at bank		**11.4**	16.7
		18.2	26.9
Creditors: amounts falling due within one year	6	**(7.7)**	(15.7)
Net current assets		**10.5**	11.2
Total assets less current liabilities		**1,033.1**	1,033.8
Creditors: amounts falling due after more than one year	7	**(490.0)**	(490.0)
Net assets		**543.1**	543.8
Capital and reserves			
Called up share capital	8	**51.9**	51.9
Share premium account	9	**446.5**	446.5
Treasury shares	9	**(2.3)**	(0.8)
Profit and loss account	9	**47.0**	46.2
Equity shareholders' funds		**543.1**	543.8

Approved by the Board on 2 June 2009 and signed on its behalf by:

Sir Derek Wanless
Chairman

John Cuthbert
Managing Director

Notes to the Company financial statements

1. Accounting policies

(a) Basis of accounting

The financial statements have been prepared in accordance with applicable United Kingdom law and accounting standards. The accounting policies have been reviewed in accordance with the requirements of FRS 18. The directors consider the following accounting policies to be relevant in relation to the Company's financial statements. The Company's financial statements are included in the consolidated financial statements of Northumbrian Water Group plc. Accordingly, the Company has taken advantage of the exemption from publishing a profit and loss account and cash flow statement and from disclosing related party transactions with its subsidiaries. The Company is also exempt from disclosing the information otherwise required by FRS 29 Financial Instruments: Disclosures, as the consolidated financial statements, in which the Company is included, provide equivalent disclosures for the Group under IFRS 7 Financial Instruments: Disclosures.

(b) Fixed asset investments

Fixed asset investments are stated at their purchase cost, less any provision for impairment.

(c) Taxation

Corporation tax is based on the profit for the year as adjusted for taxation purposes using the rates of tax enacted at the balance sheet date. Provision is made for deferred tax in respect of all timing differences that have originated but not reversed at the balance sheet date that will result in an obligation to pay more, or a right to pay less, tax in future periods. Deferred tax is calculated at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

(d) Interest bearing loans and borrowings

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period.

2. Auditors' remuneration

Auditors' remuneration for the year ended 31 March 2009 was £97,000 (2008: £90,000).

Fees paid to Ernst & Young LLP for non-audit services to the Company itself are not disclosed in the individual financial statements of the Company because Group financial statements are prepared which are required to disclose such fees on a consolidated basis.

3. Profit attributable to members of the parent Company

The profit dealt with in the financial statements of the parent Company is £64.9 million (2008: £59.2 million).

4. Investments in subsidiary undertakings

	£m
At 1 April 2008 and 31 March 2009	**1,022.6**

The Company's interests in principal subsidiaries at 31 March 2008 and 31 March 2009 were as follows:

Name of undertaking	Country of incorporation or registration and operation	Description of shares held	Proportion of nominal value of issued shares held by Group (%)	Business activity
Northumbrian Services Limited	England and Wales	Ordinary shares of £1	100	Holding of investments and loans
Northumbrian Water Limited	England and Wales	Ordinary shares of £1	100	Water and sewerage services
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Caledonian Environmental Services plc	Scotland	Ordinary shares of £1	75	Waste water services
Caledonian Environmental Levenmouth Treatment Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Operations Limited	Scotland	Ordinary shares of £1	100	Waste water services
AquaGib Limited	Gibraltar	Ordinary shares of £1	67	Water and sewerage services
Northumbrian Water Projects Limited	England and Wales	Ordinary shares of £1	100	Waste water services
SA Agrer NV	Belgium	Ordinary shares of £1	100	Aid funded project work

The directors consider that to give full particulars of all subsidiary and associated undertakings would lead to a statement of excessive length. A full list of the Company's subsidiaries is attached to the Company's latest annual return filed at Companies House.

5. Debtors

	31.3.2009 £m	31.3.2008 £m
Amounts owed by subsidiary undertakings	**6.5**	9.7
Prepayments and accrued income	**0.1**	0.2
Other	**0.2**	0.3
	6.8	10.2

Amounts owed by subsidiary undertakings include amounts receivable for the provisional surrender of tax losses amounting to £4.7 million (2008: £5.5 million).

Notes to the Company financial statements
continued

6. Creditors: amounts falling due within one year

	31.3.2009 £m	31.3.2008 £m
Amounts owed to subsidiary undertakings	**7.3**	15.3
Accruals and deferred income	**0.4**	0.4
	7.7	15.7

7. Creditors: amounts falling due after more than one year

	31.3.2009 £m	31.3.2008 £m
Amounts owed to subsidiary undertakings	**490.0**	490.0

	31.3.2009 £m	31.3.2008 £m
Loans are repayable as follows:		
Not wholly repayable within five years	**490.0**	490.0

The loan bears a rate of interest linked to LIBOR. The loan will continue until such time as terminated by mutual agreement.

8. Authorised and issued share capital

	31.3.2009 £m	31.3.2008 £m
Authorised:		
700 million ordinary shares of 10 pence each	**70.0**	70.0
Allotted, called up and fully paid:		
518.6 million ordinary shares of 10 pence each	**51.9**	51.9

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, currently holds 1,038,252 (2008: 443,507) ordinary 10 pence shares in the Company for use under the Company's Long Term Incentive Plan (LTIP). All of these shares have been conditionally awarded under the LTIP. Details of the main features of the LTIP and the conditions for vesting can be found in the directors' remuneration report on pages 57 to 61. As at 31 March 2009, the share price of the ordinary 10 pence shares in the Company was 218.25 pence (2008: 349.25 pence).

9. Reserves

	Treasury shares £m	Share premium account £m	Profit and loss account £m
At 1 April 2007	(1.3)	446.5	47.1
Profit for the year	–	–	59.2
Share-based payment	–	–	0.1
Exercise of LTIP awards	0.5	–	(0.5)
Dividends	–	–	(59.7)
At 31 March 2008	(0.8)	446.5	46.2
Profit for the year	–	–	64.9
Purchase of own shares for the LTIP	(1.7)	–	–
Share-based payment	–	–	0.1
Exercise of LTIP awards	0.2	–	(0.2)
Dividends paid	–	–	(64.0)
At 31 March 2009	**(2.3)**	**446.5**	**47.0**

10. Commitments

The Company has issued letters of continuing support to subsidiary companies with net liabilities amounting to £7.1 million (2008: £5.6 million) and net current liabilities of £nil (2008: £nil). These subsidiary companies are expected to meet their working capital requirements from operating cash flows.

The Company is guarantor to the EIB in respect of borrowings by Northumbrian Water Limited. The loan principal outstanding at 31 March 2009 amounted to £381.5 million (2008: £356.0 million).

The Company is party to a cross guarantee arrangement with other group companies in respect of bank facilities. Overdrafts outstanding at 31 March 2009 in respect of the arrangement amounted to £17.5 million (2008: £26.4 million). The directors do not expect any loss to arise as a result of this arrangement.

The Group's subsidiary responsible for a contract with Scottish Water, Caledonian Environmental Services plc (CES), has received a claim from its Design and Construction Consortium (DCC), primarily in respect of the DCC's additional costs attributed by it to non-conforming influent at the treatment works. CES is defending this claim and has also issued a counterclaim against the DCC. As non-conforming influent is ultimately the responsibility of the client, CES has protected its position by issuing a claim against Scottish Water. The directors do not expect any material loss to arise as a result of these claims.

Shareholder information

Share portal (www.capitashareportal.com)

You can manage your shareholding online, through the website of our registrar, Capita Registrars, by registering for the share portal. This provides free, secure, online access to your shareholding. Facilities include:

Electronic communications
This allows you to register your email address to enable you to receive shareholder communications such as annual reports via the internet rather than by post.

Account enquiry
You can access your personal shareholding, including share transaction history, dividend payment history and to obtain an up-to-date shareholding valuation.

Amendment of standing data
This allows you to change your registered postal address and add, change or delete dividend mandate instructions.

You can also download from this site forms such as change of address, stock transfer and dividend mandates and buy and sell shares in the company.

To use any of these facilities, please log on to the Capita Registrars, website at www.capitashareportal.com

If you have any queries about the above facilities, please contact the Capita share portal helpline on 0871 664 0391 (calls cost 10 pence per minute plus network extras) overseas +44 (0)20 8639 3367, or by email at shareportal@capita.co.uk

Capita share dealing services

Capita Registrars provides a low cost share dealing service. Further information is available at www.capitadeal.com, or by telephoning 0871 664 0454 (calls cost 10 pence per minute plus network extras). This enables you to deal in the shares of the Company and other companies for which Capita acts as registrar, provided you are already a shareholder in the relevant company, and it offers the share deal facility to its shareholders.

ShareGift

You may donate your shares to charity free of charge through ShareGift. Further details are available at www.sharegift.org.uk or by telephoning 020 7930 3737.

Dividend re-investment plan

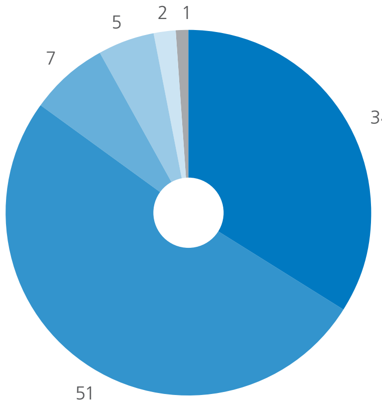
The Company receives occasional requests from shareholders wishing to receive their dividends in the form of shares instead of cash. There are costs involved in providing this service, and at present it would not be cost effective. This issue is kept under regular review.

Beneficial owners of shares with 'information rights'

Please note that beneficial owners of shares who have been nominated by the registered holder of those shares to receive information rights under section 146 of the Companies Act 2006 are required to direct all communications to the registered holder of their shares rather than to the Company's registrar, Capita Registrars, or the Company.

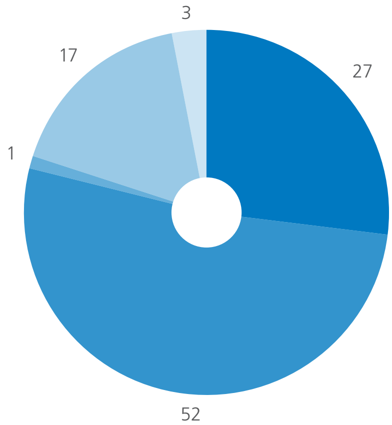
Shareholder analysis

Number of shareholders by size of holding as at 31 March 2009 %



- Shareholders with 1–1,000 shares
- Shareholders with 1,001–5,000 shares
- Shareholders with 5,001–10,000 shares
- Shareholders with 10,001–100,000 shares
- Shareholders with 100,001–1,000,000 shares
- Shareholders with over 1,000,000 shares

Breakdown of shareholdings by type as at 31 March 2009 %



- Ontario Teachers' Pension Plan Board
- Nominee accounts
- Investment trusts, pensions funds and other institutions
- Banks and bank nominees
- Individuals

Disability Discrimination Act

If you wish to receive a copy of our report on audio tape, in braille or in a large text version, please telephone us on 0191 301 6701, or email us at shareholders@nwl.co.uk

For general queries about your shares, please contact Capita Registrars:

Northern House
Woodsome Park
Fenay Bridge
Huddersfield
HD1 9UT
Tel: 0871 664 0300 (Calls cost 10 pence per minute plus network extras)
From overseas: +44 (0)20 8639 3399
Fax: +44 (0)1484 600 911
Email: ssd@capitaregistrars.com
Web: www.capitaregistrars.com

For general shareholder queries please contact Secretariat:

Tel: 0191 301 6701
Fax: 0191 301 6705
Email: shareholders@nwl.co.uk

To request financial statements and other Company literature please contact Communications:

Tel: 0191 301 6734
Email: shareholders@nwl.co.uk

Annual General Meeting

The Notice of Meeting, information about the AGM to be held on 30 July 2009 and the proxy voting card are enclosed with these financial statements. Shareholder questions and special needs requests should be addressed to Secretariat at our registered office address, raised by telephone on 0191 301 6701, or sent by email to shareholders@nwl.co.uk

Shareholder information continued

Warning to shareholders – boiler room scams

Over the last year, many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who target UK shareholders, offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. These operations are commonly known as 'boiler rooms'. These 'brokers' can be very persistent and extremely persuasive, and a 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors is around £20,000.

It is not just the novice investor that has been duped in this way; many of the victims had been successfully investing for several years. Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports. If you receive any unsolicited investment advice:

- make sure you get the correct name of the person and organisation;
- check that they are properly authorised by the FSA before getting involved by visiting www.fsa.gov.uk/register
- report the matter to the FSA either by calling 0845 606 1234 or visiting www.moneymadeclear.fsa.gov.uk
- if the calls persist, hang up.

General Counsel and Company Secretary

Martin Parker

Registered office

Northumbrian Water Group plc
Northumbria House
Abbey Road
Pity Me
Durham, DH1 5FJ
Tel: 0870 608 4820

Financial calendar

2009

30 July	AGM
30 July	Interim Management Statement
12 August	Ex-dividend date
14 August	Record date
11 September	Final dividend payment
23 November	Half-yearly announcement
16 December	Ex-dividend date
18 December	Record date

2010

29 January	Interim dividend payment

Group websites

www.nwg.co.uk
www.nwl.co.uk
www.eswater.co.uk
www.aes-services.co.uk
www.agrer.com

Northumbrian Water main switchboard

Tel: 0870 608 4820

Northumbrian Water customer queries

Customer services: 0845 717 1100
Customer accounts: 0845 733 5566

Essex & Suffolk Water customer queries

Customer services: 0845 782 0999
Customer accounts: 0845 782 0111

Notes

Notes

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Registered number 4760441

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