NORTHUMBRIAN WATER LIMITED

REGULATORY ACCOUNTS

FOR THE YEAR ENDED 31 MARCH 2013

Registered no: 2366703

Registered office
Northumbria House
Abbey Road
Pity Me
Durham
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CHIEF EXECUTIVE OFFICER'S REPORT

At Northumbrian Water Limited (NWL or the Company), we understand that water is essential to the lives of our customers. It is our job to 'live' the provision of excellent water services so that customers do not have to worry about them. They will have a clean, reliable and sufficient supply of water and we will provide an effective sewerage service. We will do this in a way that protects and enhances the environment.

Our Business Review, below, sets out our vision, strategy and objectives and reports our performance against a wide range of financial and non-financial key performance indicators.

Overall, our performance has been very pleasing, although we continuously strive to do better. I am delighted that we have further improved the service we provide to our customers in a number of areas. Most notably, our customer experience score and supply interruption performance have both improved significantly. We also continue to have industry-leading sewage treatment performance, a position we have held for a number of years.

The United Kingdom experienced dramatic weather extremes in 2012. The year started off with a drought, affecting reservoir replenishment and the recharge of underground water sources, but our water resources, both in the dry Essex and Suffolk region and the wetter north east, were resilient. Despite the drought, we did not need to apply restrictions on the use of water. The completion of the major and far-sighted reservoir enlargement scheme at Abberton will cater for planned development and secure supplies to Essex for the next 25 years.

The drought was then followed by a number of severe summer storms, of an intensity not often witnessed. This placed extreme pressure on the nation's flood defence and drainage infrastructure. Storm water running off agricultural land, and overflowing from the sewerage system, also affected coastal bathing water quality across England and Wales.

The storms resulted in an increase in properties flooded from sewers. We understand the distress caused to home owners and businesses alike by sewer flooding and are working closely with the other flooding agencies to find solutions to the problem of intense summer storms. As an example, our innovative and, we believe, industry-leading Tyneside Sustainable Sewerage project is progressing well. This brings together all of the relevant agencies to identify and address common problems in an integrated and sustainable way, drawing from various forms of funding.

We are successfully seeking innovative approaches to become more efficient and effective. For instance, we now treat virtually all the sludge from our sewage treatment plants in an advanced process that converts the sludge into power. In addition, we are using reed beds where we treat sludge from water treatment naturally (without power or chemicals) and are trialling biobeds to help farmers apply pesticides in a way that does not pollute water resources or harm wildlife. We are proud to contribute to the success of local communities and believe one of the keys to future success is working in partnership with others that have common goals.

This is a long term business and we need to plan carefully so that we can continue to provide the services our customers want at a price they can pay. We are in the process of refreshing our plans for the 25-year horizon. This will identify the outcomes to be delivered based on customers' priorities, the challenges we face and opportunities to improve service and efficiency. Our business plan, to be published in December, will describe our strategy for 2015-20, a step on the way to our 25-year aspirations.

We are committed to maintaining excellent corporate governance and I am very pleased that we are including, for the first time, a report from our Senior Independent Non-executive Director, P Rew, expressing his confidence in the structure and effectiveness of our Board and the Northumbrian Water Group Limited (NWGL) Board Committees. I share that confidence and believe we have achieved a very sound balance, which is serving our stakeholders well.

Finally, I would like to thank our very professional and hardworking employees, who often work in extremely challenging conditions in order to provide service to our customers. Our people demonstrate real personal pride in everything they do and our whole team is dedicated to providing the best possible customer service.

I hope you find our regulatory accounts helpful and informative.

H Mottram
Chief Executive Officer

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR'S REPORT

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

The NWL Board functions as an integrated whole. Each director understands his or her responsibility to act in the best interests of the Company as well as the importance of the service provided to our customers and our environmental responsibilities. All the directors play a full part in Board meetings and are given every opportunity to shape the Company's strategy, as well as ensuring that customers' interests are central to investment and operational decisions. I would like to assure our stakeholders that NWL's special responsibilities as the only available provider of water and waste water services (for most of our customers) are recognised fully by the directors and influence all key decisions.

The directors believe that the Board is well balanced. The directors appointed by the shareholders, including the Chairman, bring great experience of operating infrastructure businesses around the globe, the executive directors are well respected in their fields and the INEDs bring a wide range of experience and skills. The Board has regard to the principles underpinning the UK Corporate Governance Code (UK CGC) as required by the Company's Instrument of Appointment (the Licence), but does not consider that full compliance with all the detailed provisions of the UK CGC is practicable, given that NWL is privately owned, or is necessary for sound governance. However, the Board has embraced the key elements of the UK CGC's principles. The involvement of INEDs is seen as critically important and NWL has four, rather than the three required by its Licence. I chair the Audit and Risk & Compliance Committees and other INEDs are members of both those Committees and the Remuneration Committee. We therefore have full transparency on all the main aspects of NWL's governance. Whilst these Committees are not entirely comprised of INEDs, as suggested by the UK CGC, the Board is satisfied that the composition of the Committees is appropriate to the Company's circumstances. The INEDs meet from time to time without management or the other directors being present and there have also been helpful INED-only meetings with the Water Services Regulation Authority (Ofwat); the Board hopes that further such meetings can be held in the future.

The Company does not comply with the full provisions of the UK CGC in relation to the process for nomination of shareholder-nominated directors, because the shareholders have the contractual right to representation on the Board. This is considered to be appropriate by the whole Board and both executive directors and INEDs are appointed through a process consistent with the UK CGC. The Board has not conducted a performance evaluation since it was de-listed in 2011, but this is now under consideration. The provisions of the UK CGC dealing with the re-election of directors and relations with shareholders are not applicable to a privately owned company.

Most decisions relating to NWL are made by the NWL Board alone and the only decisions referred to the NWGL Board are certain large contract awards, capital project approvals and substantial funding arrangements. During the last year, the NWGL Board has endorsed all the recommendations of the NWL Board. Although the INEDs are no longer members of the NWGL Board, we are present at its Board meetings and participate fully, encouraging a cohesive approach at both Boards.

I would also like to emphasise that the INEDs have very broad involvement in the work of NWL, as well as participating in formal meetings. We take part in extensive sessions with management on water resources and customer service and have regular direct exposure to customers, through stakeholder events, participation in customer forums and other channels. Dr S Lyster and I sit on the regulatory sub-group of the NWL Board which meets monthly to ensure that the business planning work for PR14 is suitably challenged by the Board. He and I also sit on the Company's Corporate Responsibility Management Group, as does M Fay, which includes executive directors and managers and focuses on NWL's corporate responsibility strategy, as well as practical steps to give effect to the strategy.

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

P Rew
Senior Independent Non-executive Director

DIRECTORS' REPORT
for the year ended 31 March 2013

The directors of NWL are pleased to present their report on the affairs of the Company, along with the audited regulatory accounts and the auditor's report for the year ended 31 March 2013. The regulatory accounts are separate from the statutory financial statements of the Company which were prepared, on a consolidated basis, to 31 December 2012. These regulatory accounts are prepared to comply with Condition F of the Company's Licence granted under the Water Industry Act 1991.

Principal activities
The principal activities of the business comprise the supply of potable water in both the north east and south east of England and the collection, treatment and disposal of sewage and sewage sludge in the north east of England.

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

BUSINESS REVIEW

Business overview
NWL is one of the ten regulated water and sewerage businesses in England and Wales, operating in the north east of England, trading as Northumbrian Water, and in the south east of England, trading as Essex & Suffolk Water.

In the north east the business comprises the supply of both potable and raw water and the collection, treatment and disposal of sewage and sewage sludge, serving approximately 2.7 million people. In the south, we supply water services to approximately 1.5 million people in Essex and approximately 0.3 million in Suffolk.

At the start of the year, the Company's ultimate parent undertaking and controlling party was UK Water (2011) Limited (UKW) which, together with its subsidiaries, formed the Group. On 8 March 2013, UKW undertook a Group restructuring. This included the Company's immediate parent undertaking, Northumbrian Services Limited (NSL), selling its 100% shareholding in NWL to NWGL, another subsidiary of UKW. On the same date, UKW distributed its 100% shareholding in NWGL to its shareholders. As a consequence, NWGL became the Company's parent undertaking and controlling party and, together with its subsidiaries, formed the Group.

The new Group structure is simpler comprising a single holding company (NWGL) with one regulated subsidiary (NWL) and one non-regulated holding company (NSL).

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

Throughout the year, we have engaged constructively with Ofwat on the development of price controls and the licence changes required for the next price review. Ofwat published revised proposals for licence changes on 21 December 2012, which we accepted, and we are now moving forward in the preparation of our business plan for the next price review which will come into effect from 1 April 2015.

Regulatory and legislative developments (continued)
Ofwat published its proposed methodology, "Setting price controls for 2015-20 – framework and approach", in January 2013, for consultation. We have made good progress with the development of our business plan for 2015-20. Comprehensive customer research has been conducted and we have formed Water Forums (stakeholder engagement groups) in our operating areas which have helped to inform and strengthen our plans.

On 27 June 2013 the UK Government introduced a Water Bill to Parliament which had already undergone a process of pre-legislative scrutiny. The key elements of the Bill are proposals to introduce retail competition for business customers and outline plans for introducing upstream competition. Water companies are working with Government and regulators to prepare for business retail competition with a target implementation date of 2017, with upstream competition to follow at some point beyond 2019.

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

We have underpinned our drive to be the best with five strategic themes, Competitiveness, Customer, People, Environment and Communities, described below, and achieving the right balance between them is essential to our success and reputation. Specific medium term goals and targets have been agreed against these themes which will help us to achieve the vision. In addition, sustainability objectives are woven into our core business strategy to help achieve the goals.

Competitiveness will drive greater efficiency and use innovation to improve our business.

Customer focuses on delivering industry-leading customer service, going beyond the regulated standards.

People are our greatest asset and the aim is to be recognised as a great company to work for with high levels of employee satisfaction.

Environment is critical and we acknowledge our responsibilities to protect and enhance the natural environment.

Communities are important and we seek to build strong relationships with the communities we serve and to embed corporate responsibility in the business.

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

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

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

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

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

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

DIRECTORS' REPORT (continued)

Performance measures
In order to measure our performance against our business plan and goals, we use a balanced scorecard of key performance indicators (KPIs) reflecting the strategic themes. Targets have been set on a trajectory to deliver the Company vision. The Board reviews performance against the KPIs in detail at each meeting and receives regular detailed reports on key items, which have recently included sewer flooding and water quality. In order to ensure alignment of the management team, this balanced scorecard represents 90% of the criteria contributing to their annual bonus, with a further 10% available for the achievement of bespoke personal targets. Further information about the executive directors' remuneration is provided in note 9 to Section B, on page 60.

During the year, the Company changed its statutory accounting reference date from 31 March to 31 December, therefore, targets are now measured on a calendar year basis. The table below details performance against the KPI targets set for 2012 and shows the targets for 2013.

Scorecard measure	Target 2012	Performance	Achieved	Target 2013
Competitiveness				
Group EBIT	Budget	Achieved	Yes	Budget
Group cash available for distribution	Budget	Achieved	Yes	Budget
Customer				
Customer satisfaction				
- SIM quantitative score	84	117	No	115
- SIM qualitative score	4.50	4.43	No	4.60
Unplanned interruptions >6 hours (no.)	1,500	606	Yes	n/a
Unplanned interruptions >3 hours (mins)	n/a	n/a	n/a	7.30
Coliform incidents (no.)	7	27	No	10
People				
Employee engagement score	1* Best Companies	1* Best Companies	Yes	81%
Lost time reportable accidents (no.)	10	10	Yes	9
Environment				
Leakage (Mld)				
- Northumbrian	147.0	129.5	Yes	141.0
- Essex & Suffolk	66.0	59.1	Yes	66.0
STW failing LUT consent (%)	0	0	Yes	0
Pollution incidents (categories 1 & 2)	3	3	Yes	3
Communities				
BiTC Platinum Plus accreditation	Retain status	Status retained	Yes	Retain status
Just an Hour (employee participation)	50.0%	54.4%	Yes	50.0%

We are pleased to report strong performance for 2012-13 with improvements in a number of areas, including customer service, as measured by Ofwat's Service Incentive Mechanism (SIM) measure, a further reduction in water supply interruptions and 100% compliance with the standards for sewage treatment works discharges. The health (serviceability) of our assets remained satisfactory and we more than met our leakage targets in both Essex & Suffolk and Northumbrian Water.

This was a challenging year with drought conditions at the start of 2012 giving way to exceptional rainfall between April and December, which had an impact on many aspects of our operations. Sewer flooding, drinking water quality and pollution incident performance were affected to greater or lesser extents.

Performance is described below under the five strategic themes.

Competitiveness
The overall financial performance of the Company is detailed in the following section.

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

DIRECTORS' REPORT (continued)

Competitiveness (continued)
During the year, the Company invested £1.2m (2012: £1.1m) in research and development, continuing our efforts to innovate to support the sustainable and cost effective operation of our business and to meet the needs of our customers. Examples of innovative projects that we have implemented in the year include the use of 'ice-pigging' to clean large mains much more quickly than conventional methods, the construction of the world's first commercial reed bed to receive sludge from the water treatment process, providing a sustainable solution for disposing of the sludge and recycling the water flowing through the system, and the introduction of a landlord portal allowing landlords to share information with us improving working relationships and debt recovery.

In the year the Company was awarded the highest level of five stars by the British Quality Foundation in the 'Recognised for Excellence' programme. The scheme is Europe's leading recognition programme for company performance and forms part of the EFQM Levels of Excellence.

Customer
Customer service is at the heart of the Company and all employees have a clear focus on getting things 'right first time, every time'. The SIM was introduced by Ofwat to monitor both quantitative and qualitative aspects of customer service and our performance has shown a consistently improving trend towards our goal of becoming the national leader on SIM.

Our philosophy is one of continuous improvement and we have introduced a number of initiatives to improve service during the year. For example, we have restructured our northern contact centre to enable more specialisation of our customer advisors, facilitating a greater resolution of customers' problems at first contact, and we have introduced proactive call back of customers to check that we have delivered to customers' satisfaction. We have also evolved how we interact with our customers, implementing texting of appointments and updates during operational problems, and increasing the use of social media.

During the year we have also invested in a training programme, called 'Our Way', aimed at embedding a customer service culture across the whole business. Our Way has been rolled out company-wide to help everyone in the business to understand how they can take individual responsibility for delivering excellent customer service and to give them the tools and techniques to make it happen.

Operationally, we have sustained our industry-leading performance on unplanned interruptions. The definition of the measure for 2013 has been revised to be consistent with Ofwat's reporting requirements. We continue to focus on reducing coliform incidents and have continued our mains cleaning programme to reduce discoloured water complaints.

The extremely high levels of rainfall experienced in the north east of England between April and December 2012, including numerous high intensity storms, caused internal sewer flooding at an increased number of properties in the year. Resolving sewer flooding is a priority for both the company and our customers and we are delivering a comprehensive programme of measures including not only conventional schemes, to provide additional storage in the network, but also pilot studies to identify more innovative sustainable solutions, mitigation actions at properties at risk of flooding, increased sewer lining and cleansing and customer education to reduce flooding from blockages.

In line with our vision to 'be the national leader in the provision of sustainable water and waste water services', we have identified as priorities for 2013 three particular aspects of our services to customers; delivering industry-leading water quality, reducing the frequency and impact of sewer flooding and achieving best in industry customer service performance.

People

We recognise that the success of the business depends to a significant extent on the contribution of our employees. People are clear about our vision and values and the Group's Code of Conduct sets out our approach to doing business. Our employees are kept fully informed of our strategy and performance through an extensive employee road show programme and throughout the year we share key information through TeamTalk, a bi-monthly briefing which is cascaded through the business, and a wide range of newsletters and briefings which keep people informed of more local news. We maintain constructive employee relations through collaborative working with our trade union and employee representatives and actively engage with our people through an annual employee survey. Our target for the year was to achieve 1* status in the Sunday Times' Best Companies survey and we were pleased to succeed in this goal. Our target for 2013 is based on our internal employee survey.

We understand that having a diverse workforce enhances our performance, fostering innovation and creativity and helping us better understand how to serve the needs of our customers. Our equal opportunity policy seeks to ensure that all our current employees and potential employees are treated with respect. We welcome job applications from all parts of the community and it is our policy that all job applicants and employees are treated equally, regardless of their age, ability, marital or partnership status, race, religion or belief, gender or sexual orientation. We welcome employment applications from people with disabilities and, where existing employees develop disabilities, they are supported to remain in employment, wherever practicable, by providing appropriate adjustments to their roles and/or effective redeployments. Occupational health physicians assist this process with professional medical advice.

Health and safety is critical to us, and 2012-13 has seen the Company deliver an industry-leading health and safety performance with 10 lost time reportable injuries (LTRs) to our workforce in line with our target to deliver year-on-year improvements. In the period we received a Gold Award from the Royal Society for the Prevention of Accidents, recognising our high level performance in demonstrating well developed occupational health and safety management systems and culture, underpinned by an outstanding control of risks and very low levels of error, harm and loss.

Environment

The environment is also critical to us and our stakeholders and we acknowledge our responsibilities to protect and enhance the natural environment. Environmental measures also provide sustainable long term value for customers. We aim to adopt good environmental practice in all aspects of our activity. Our integrated quality and environmental management systems are certified under ISO 9001, ISO 14001 and OHSAS 18001.

In the year we delivered our second advanced anaerobic digestion (AAD) plant at Howdon, making us the first UK waste water company to use 100% of the sludge remaining after sewage treatment to produce renewable energy. This has not only generated operating cost efficiencies but, together with other energy saving measures and hydro schemes producing renewable energy, means we are on track to deliver our carbon reduction target of 35% in operational emissions by 2020, from a 2008 base position. It also helps protect us and our customers from uncertain future external energy costs.

Our drinking water compliance remains extremely high with 99.89% of samples passing in Essex & Suffolk and 99.94% in our Northumbrian area. The main reason for failures in Essex is pesticides and in the year we expanded our catchment management programme to significantly increase the number of farmers working in partnership with us to prevent polluting chemicals entering watercourses.

Despite drought conditions in the early part of 2012, our water resources were resilient and we did not need to apply restrictions on the use of water, even in our dry Essex and Suffolk operating region. Construction of the Abberton Reservoir enhancement project has continued in the year which, on completion, will secure future water supplies to more than 1.5 million people in Essex.

DIRECTORS' REPORT (continued)

Environment (continued)

Our water efficiency work continued, and we comfortably achieved our leakage target in both our Northumbrian and Essex & Suffolk operating regions. We also sustained our exceptional performance for sewage treatment, with all numerically consented works remaining compliant for the year, and we achieved our targets on serious pollution incidents with a significant reduction on the previous year. However, we did experience an increase in the total number of pollution incidents due to a combination of the level and intensity of rainfall causing overflows from the sewerage system and a change in EA guidance leading to a significant increase in the reporting of incidents by the Company.

Communities

We are dedicated to building strong relationships with the communities we serve and we ensure that corporate responsibility is embedded in the business. We provide support in a number of ways focussing on five broad areas: investment in our communities, participation in our communities, educating our communities about their environment, supporting healthy communities and supporting developing communities through WaterAid. 54% of our employees undertook voluntary activities in their communities in 2012-13, supporting over a thousand different charitable organisations.

We have been widely recognised as leaders in our support for projects that make the areas we serve better places in which to live, work or invest. This year, the Company has been re-accredited as a Platinum Plus company by Business in the Community (BiTC). The Queen's Award for Industry is still in place as it was awarded in 2009 for a five year period. The Group has continued to be recognised by Ethisphere, an American-based international think-tank, as one of the most ethical companies in the world. In the year, the Company gave £102,246 as charitable donations.

Regulatory Risk and Compliance Statement (RRCS)

Our 'Annual performance review 2012-13', also known as our RRCS, provides further detail about the performance of our regulated business during the year. This is available on our websites (www.nwl.co.uk and www.eswater.co.uk).

Financial performance

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

KPI	Target	Performance		Target
	2012-13	2012-13	2011-12	2013-14
Gearing: net debt to RCV[1] – NWL group[2] (%)	<70	63	64	<70
Gearing: net debt to RCV – Appointed business (%)	<65	62	63	<65
Cash interest cover (times)	>3.0	3.9	4.2	>3.0
Cash flow to net debt (%)	>13	19	18	>13

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

The Company's profit and loss account and balance sheet are set out on pages 21 to 24. The statutory financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. The key accounting policies are summarised in note 1 to the regulatory accounts on pages 25 to 28 and these have been applied consistently throughout the current and preceding periods.

Turnover was £756.9m for the year ended 31 March 2013 (2012: £729.1m). This reflected the application of the Ofwat price review in 2009, of 0.9% plus 5.2% in respect of retail price index (RPI) inflation, on water and sewerage charges. However, volumes of measured supplies to both household and non-household customers declined, primarily as a result of the difficult prevailing economic conditions in the UK.

Operating costs, including capital maintenance costs, for the year ended 31 March 2013 were £427.6m (2012: £410.2m). This reflected increases in business rates, depreciation, infrastructure renewals and general inflationary pressures, partially offset by the benefits of our efficiency programme.

Financial performance (continued)

Net interest payable was £116.6m in the year ended 31 March 2013 (2012: £106.2m). This reflected higher net finance costs relating to the defined benefit pension scheme and higher interest payable, due to the full period impact of a £360.0m bond issued in January 2012, partially mitigated by lower indexation on index linked bonds and the benefit arising from the transfer of a finance lease to a new counterparty on improved terms.

Profit on ordinary activities before taxation for the year ended 31 March 2013 was £212.7m (2012: £212.7m). The current tax charge of £51.3m and deferred tax charge of £11.4m are explained in note 8 to the accounts.
Profit for the financial year was £150.0m (2012: £142.5m).

Total dividends paid in the year ended 31 March 2013 were £150.6m (2012: £368.8m). The dividend policy is explained in note 9 to the accounts.

Capital investment

Capital investment in the regulated business for the year was £232.9m, under regulatory accounting guidelines (2012: £293.5m). As explained under our environmental performance above, investment in the Abberton scheme continued in the year and remains on target for completion in 2013 whilst the Howdon AAD project was completed in the year. In addition to maintaining our asset base at stable serviceability, we continued our significant investment programmes to address sewer flooding and acceptability of water in the north east of England.

Cumulative investment for the AMP5 period is currently below the final determination profile, inflated by the Construction Industry Price Index, by c.10%, and we remain focused on the efficient delivery of our regulatory programme.

Cash flows and liquidity

The level of capital expenditure which NWL is obliged to incur is such that we cannot be wholly financed by internally generated sources. As a result, we must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required by the regulated business. In November 2012, the Company drew the second £50.0m tranche of a £150.0m facility from the European Investment Bank at a fixed rate of 3.23%. The remaining £50.0m was drawn after the balance sheet date, in April 2013, at a fixed rate of 2.896%.

The Company has cash resources and substantial undrawn committed five year bank facilities available to maintain general liquidity. The undrawn bank committed facilities amounted to £450.0m at 31 March 2013.

Credit rating

The credit rating for NWL has remained consistent throughout the year at BBB+ (stable)/Baa1 (stable).

Treasury policies

The Board is responsible for the financing strategy of the Company which is consistent with treasury policies set by NWGL. The treasury function's main purposes are to assess the ongoing capital requirement, to maintain short term liquidity, ensuring access to medium term committed back up facilities, and to raise funding, taking advantage of any favourable market opportunities. It also invests any surplus funds the Company has in accordance with the treasury policy. On occasion, derivatives are used as part of this process, but the treasury policy prohibits their use for speculation.

PRINCIPAL RISKS AND UNCERTAINTIES

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

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

The Board sets the tone for risk management within the Company and determines the appropriate risk appetite. It monitors the management of fundamental risks and approves major decisions affecting the Company's risk profile. The management team reviews the approach to risk management in detail every year and reviews the significant risks every month. Any issues are reported by the Chief Executive Officer (CEO) to the Board. Senior management implements policies on risk management and internal control.

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

The Audit Committee oversees internal audit, external audit and management, as required, in its review of internal controls and reports to the Board on internal controls, alerting the Board to any emerging issues. The newly-formed Risk and Compliance Committee will focus on risk matters moving forward.

The key business risks facing the Company are:

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

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

Liquidity risk

The Company's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0m and with a bank agreement availability period of no less than three months. At 31 March 2013, the Company had £450.0m (2012: £450.0m) of undrawn facilities (maturing in 2016).

Interest rate risk

The Company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and floating rates of interest and, on occasion, uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. The Company's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2013, 73% (2012: 73%) of the borrowings of the Company were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

Foreign currency risk

The Company's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3.0m sterling equivalent of a translation nature, should be covered immediately on recognition. At 31 March 2013, after taking into account the effects of forward foreign exchange contracts, the Company had no currency exposures (2012: nil).

Market price risk

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

DIRECTORS' REPORT (continued)

CORPORATE GOVERNANCE

Directors

The directors who served during the year were as follows:

A J Hunter	Non-Executive Chairman
P Rew	Senior Independent Non-Executive Director
H Mottram OBE	Chief Executive Officer
C M Green	Finance Director (resigned 31 December 2012)
C I Johns	Finance Director (appointed 1 January 2013)
G Neave	Operations Director
A C Jones	Regulation and Scientific Services Director
M Fay CBE	Independent Non-Executive Director
Dr S Lyster	Independent Non-Executive Director
L S Chan	Alternate Director
F R Frame	Non-Executive Director
T C E Ip	Non-Executive Director
H L Kam	Non-Executive Director
S H Luk	Alternate Director (resigned 8 October 2012)
D N Macrae	Non-Executive Director
M A B Nègre	Independent Non-Executive Director
W C W Tong-Barnes	Alternate Director (appointed 8 October 2012)

Information about directors' remuneration is contained in note 5 in Section A and note 9 in Section B to the accounts.

The Company's Licence

The Company's Instrument of Appointment by the Secretary of State for the Environment, Food and Rural Affairs contains provisions, beyond those which would otherwise apply to a private company, to ensure that the Company's governance is sound and that its directors, acting as such, act independently of parent companies. More specifically, the Licence requires the Company to obtain undertakings from its shareholders to underpin the Licence and to require the Company's Board to include "not less than three independent non-executive directors, who shall be persons of standing with relevant experience" and who have collective knowledge of, and connections with, the Company's areas of supply and customers. Throughout the year, these directors were:

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

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

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

A fourth independent non-executive director, **M Nègre**, also served throughout the year. 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 currently chairs Ecofin Global Utilities Hedge Fund Limited, Ecofin Special Situations Utilities Fund, Ecofin North American Hedge Fund and Ecofin China Power & Infrastructure Fund, and holds a number of directorships focused on utilities. He is a Director of Promethean plc, an AIM-listed investment company, and sits on the supervisory board of Banque Jean-Philippe Hottinger & Cie. Mr Nègre has been a director of NWL since 2006 and is a member of the Audit Committee and the Risk and Compliance Committee.

The Licence also requires the Company to have particular regard to what is now the UK Corporate Governance Code. Up until 8 March 2013, the independent non-executive directors of the Company sat on and participated fully in NWGL's Board, as well as its Audit and Remuneration Committees. Whilst these are formally constituted at the NWGL level, the vast majority of their work relates to the Company's activities. The independent non-executive directors have therefore played a full part in all strategic decisions both at the NWL and NWGL Boards.

On 8 March 2013, the group simplified its structure, such that NWGL is now both the immediate and ultimate UK parent undertaking of NWL. Although the four independent non-executive directors resigned from the NWGL Board on the same date, they continue to attend and participate in decisions at NWGL Board meetings and associated committees.

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

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

The Company has adopted terms of reference which set out the matters reserved to the Board for approval and matters which are, or can be, delegated to the committees and management. The Company has also adopted financial approval rules which set out the authorisation processes and financial limits to be applied to financial transactions within the Company. The Standing or Executive Committees can take decisions not delegated to specific committees between Board meetings. All directors receive notice of Standing Committee meetings and may participate if they wish. Decisions taken by the Standing or Executive Committees are reported at the next Board meeting. The Company's Board meets at least every two months.

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

Board balance and independence
The composition of the Board is as follows:

A J Hunter (Chairman) and D N Macrae were appointed by Cheung Kong Infrastructure Holdings Limited. H L Kam and T C E Ip were appointed by Cheung Kong (Holdings) Limited and F R Frame by Li Ka Shing Foundation Limited. The CEO, H Mottram, and the three independent non-executive directors for the purposes of the Licence (P Rew, Dr S Lyster and M Fay) were appointed on the recommendation of the Nomination Committee of Northumbrian Water Group plc when it was independently listed. M Nègre was a founding director of NWGL when it acquired the Group from Suez SA in 2003 and has served as a director on the NWL Board since 2006. G Neave, the Operations Director, joined the Board of NWL in January 2002 and A C Jones, the Regulation and Scientific Services Director, joined in January 2004. C I Johns, Finance Director, joined on 1 January 2013.

The Chairman and CEO have clearly defined roles and responsibilities. The Chairman leads the Board and creates the conditions for overall Board and individual director effectiveness, both inside and outside the boardroom. The CEO is responsible for running the Company's business on a day-to-day basis.

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

The arrangements and functioning of the Board and its committees have regard to the Licence obligations and the UK CGC, albeit in the context of a company which is not a listed public limited company, and the Board considers that an appropriate balance has been achieved between the interests of shareholders, customers and other stakeholders. All directors' views are given full consideration and due weight in all proceedings of the Board and Committees.

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

Board committees
During the year, the NWGL Board had Audit 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.

Since the year end, a Risk and Compliance Committee has been established, alongside the Audit Committee, to strengthen the assurance provided to the Board in certain areas.

Remuneration Committee
The members of the Remuneration Committee are A J Hunter (Chairman), P Rew, M Fay and D N Macrae. H Mottram attends the meetings of the Committee and S Salter, from the management team, provides advice to the Committee from time to time.

The Company complies with its obligations under Section 35A of the Water Act 2003 by disclosing in its regulatory accounts a detailed breakdown of remuneration paid to the executive directors of NWL, which includes those elements linked to NWL's standards of performance.

The work of the Remuneration Committee comprises the adoption of principles and standards in relation to executive remuneration and benefits, as well as agreeing individual remuneration packages.

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

During the year, the Audit Committee assisted both executive and non-executive directors to discharge their individual and collective responsibilities in relation to:

- ensuring the financial and accounting systems of NWGL, NWL and their subsidiaries are providing accurate and up-to-date information on their current position;
- ensuring the 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.

The Committee has now assumed responsibility for the practical work being done to ensure that the Company's procedures designed to prevent bribery are adequate (having regard to the provisions of the Bribery Act 2010 and the official guidance published in relation to that Act). This builds on significant work done by the NWGL Board, with advice from the Company Secretary and Internal Audit Manager, to assess the bribery risk faced by the Group, clarify policies and map the procedures to be put in place.

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

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

Risk and Compliance Committee
This new Committee, which comprises the same members as the Audit Committee, will enable a clearer focus on risk and compliance matters, formerly dealt with by the Audit Committee, as well as increasing the scope of issues to be analysed in the context of risk and compliance and therefore strengthening the overall assurance provided to the Board.

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

Code of Conduct
The Group has a code of ethics, 'Our Code of Conduct', covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators.

Review of Corporate Governance arrangements
In recent months, Ofwat has engaged with the sector in a review of corporate governance compliance and disclosure and the Board of NWL is working constructively with Ofwat in order to develop an approach which balances the legitimate requirements of all stakeholders.

DIRECTORS' REPORT (continued)

OTHER DISCLOSURES

Political

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

Name of political party	£
Conservative	1,850
Labour	1,348
Liberal Democrats	1,150
Total	**4,348**

Company payment policy

The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. The Company's policy is to make payment not more than 30 days after receipt of a valid invoice, except as otherwise agreed. The ratio, expressed in days, between the amount invoiced by its suppliers during the year and the amount owed to its trade creditors at 31 March 2013, was 15 days (2012: 15 days).

Fixed assets

Freehold land and buildings are carried in the financial statements at historical cost with a net book value of £81.3m (2012: £81.1m). In the opinion of the directors, at 31 March 2013, there is no significant difference between the net book value and market value of property capable of disposal within the foreseeable future. Note 10 gives more details of the fixed asset movements during the year.

Directors' indemnification

UKW had directors' and officers' insurance in place for the period to 31 December 2012. NWGL had directors' and officers' insurance in place for the period from 1 January 2013. On 28 November 2005 NWGL entered into a deed of indemnity to grant the directors of NWGL and its subsidiaries further protection against liability to third parties, and this remains in place.

Directors' statement

As required under s418 of the Companies Act 2006, so far as each current director is aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

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

Financial statements preparation and going concern

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

In arriving at their decision, the directors have taken into account:

- the Company's Licence, which is in place on a rolling 25 year basis;
- the certainty on customer tariffs to March 2015 provided by the 2009 Final Determination of prices by Ofwat, following its acceptance by the Board;
- the financial strength of the Company at the balance sheet date and performance during the year;
- the key financial ratios over the planning horizon of the Company's one year budget and medium term plan to 2015 as reflected in strong investment grade credit ratings;
- the fact that the Company has arranged £450.0m of five year committed bank facilities as back up liquidity (maturing in 2016), and that these remained undrawn at 31 March 2013; and
- the Company's formal risk and governance arrangements which are monitored by the appropriate committees, and Board.

Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial period. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

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

By order of the Board

M Parker,
Company Secretary,
11 July 2013

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

We have audited the Regulatory Accounts of Northumbrian Water Limited (the Company) for the year ended 31 March 2013 on pages 21 to 63 which comprise:

• the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; and

• the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies.

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

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

Respective responsibilities of the WSRA, the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 17, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Regulatory Accounts

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

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

Scope of the audit of the Regulatory Accounts (continued)

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

Opinion on Regulatory Accounts

In our opinion the Regulatory Accounts:

• fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 25 to 28 and 50 to 51 (including the accounting separation methodology), the state of the Company's affairs at 31 March 2013 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and

• have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies (including the accounting separation methodology).

Basis of preparation

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

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 21 to 24 have been drawn up in accordance with Regulatory Accounting Guideline 3.07 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 47.

Opinion on other matters prescribed by Condition F

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

• proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and

• the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts.

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

Other matters

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

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

Paul Feechan (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Newcastle Upon Tyne, United Kingdom
11 July 2013

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2013

	Note	2013	2012
		£'m	£'m
Turnover	2	756.9	729.1
Operating costs	3(a)	(295.2)	(285.3)
Capital maintenance costs	3(b)	(132.4)	(124.9)
Total operating costs		(427.6)	(410.2)
OPERATING PROFIT		329.3	318.9
Net interest payable	4	(116.6)	(106.2)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		212.7	212.7
Taxation	8(a)	(62.7)	(70.2)
PROFIT FOR THE FINANCIAL YEAR	24	150.0	142.5

All results are from continuing operations in the United Kingdom.

HISTORICAL COST STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2013

	Note	2013	2012
		£'m	£'m
Profit for the financial year		150.0	142.5
Pension liability actuarial gain / (loss) in the year	26	2.3	(83.2)
Deferred tax related to pension adjustments	26	(2.0)	18.8
Total recognised gains and losses relating to the year		150.3	78.1

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2013

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

		2013			2012		
		Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	Note	£'m	£'m	£'m	£'m	£'m	£'m
Turnover	A	730.1	26.8	756.9	702.5	26.6	729.1
Operating costs		(280.6)	(14.6)	(295.2)	(271.4)	(13.9)	(285.3)
Infrastructure renewals charge		(50.0)	(0.1)	(50.1)	(45.1)	(0.1)	(45.2)
Historical cost depreciation		(83.9)	(0.6)	(84.5)	(80.0)	(0.5)	(80.5)
Operating income		2.2	-	2.2	0.8	-	0.8
OPERATING PROFIT	A	317.8	11.5	329.3	306.8	12.1	318.9
Net interest (payable) / receivable		(126.5)	9.9	(116.6)	(116.2)	10.0	(106.2)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		191.3	21.4	212.7	190.6	22.1	212.7
Taxation - current		(47.7)	(3.6)	(51.3)	(33.5)	(3.8)	(37.3)
- deferred	A	(11.5)	0.1	(11.4)	(32.6)	(0.3)	(32.9)
PROFIT FOR THE FINANCIAL YEAR		132.1	17.9	150.0	124.5	18.0	142.5
Dividends		(140.1)	(10.5)	(150.6)	(358.3)	(10.5)	(368.8)
RETAINED (LOSS) / PROFIT FOR THE YEAR		(8.0)	7.4	(0.6)	(233.8)	7.5	(226.3)

HISTORICAL COST STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE APPOINTED BUSINESS
for the year ended 31 March 2013

	2013	2012
	£'m	£'m
Profit for the financial year	132.1	124.5
Pension liability actuarial gain / (loss) in the year	2.3	(82.0)
Deferred tax related to pension adjustments	(2.0)	18.5
Total recognised gains and losses relating to the year	132.4	61.0

HISTORICAL COST BALANCE SHEET
at 31 March 2013

	Note	2013	2012
		£'m	£'m
FIXED ASSETS			
Tangible assets	10	3,470.8	3,400.3
Investments	11	160.9	160.9
		3,631.7	3,561.2
CURRENT ASSETS			
Stocks	12	2.8	2.6
Debtors due in less than one year	13	166.1	162.6
Debtors due in more than one year	14	1.5	4.9
Investments	15	5.0	80.0
Cash at bank and in hand		17.4	25.5
		192.8	275.6
CREDITORS			
Amounts falling due within one year	16	(196.9)	(252.7)
NET CURRENT (LIABILITIES) / ASSETS		(4.1)	22.9
TOTAL ASSETS LESS CURRENT LIABILITIES		3,627.6	3,584.1
CREDITORS: Amounts falling due after more than one year	17	(2,272.2)	(2,239.1)
PROVISIONS FOR LIABILITIES AND CHARGES	21	(193.5)	(184.6)
ACCRUALS AND DEFERRED INCOME	22	(203.8)	(211.3)
		(2,669.5)	(2,635.0)
NET ASSETS EXCLUDING PENSION LIABILITY		958.1	949.1
Pension liability	26	(72.6)	(63.3)
NET ASSETS INCLUDING PENSION LIABILITY		885.5	885.8
CAPITAL AND RESERVES			
Called up share capital	23	122.7	122.7
Profit and loss account	24	762.8	763.1
EQUITY SHAREHOLDERS' FUNDS	24	885.5	885.8

Approved by the Board and signed on their behalf by:

H Mottram C I Johns
11 July 2013
Registered number 2366703

HISTORICAL COST BALANCE SHEET
at 31 March 2013

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

		2013			2012		
	Note	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	A	3,370.6	100.2	3,470.8	3,300.1	100.2	3,400.3
Investments - loans to group companies		-	160.9	160.9	-	160.9	160.9
		3,370.6	261.1	3,631.7	3,300.1	261.1	3,561.2
Infrastructure renewals prepayment/ (accrual)		10.8	(1.9)	8.9	(4.1)	(1.9)	(6.0)
Other current assets		168.1	37.0	205.1	248.3	40.1	288.4
CREDITORS: Amounts falling due within one year							
Borrowings		(35.9)	-	(35.9)	(81.1)	-	(81.1)
Other creditors		(176.5)	(5.7)	(182.2)	(175.1)	(9.3)	(184.4)
Total creditors: amounts falling due within one year		(212.4)	(5.7)	(218.1)	(256.2)	(9.3)	(265.5)
NET CURRENT (LIABILITIES) / ASSETS		(33.5)	29.4	(4.1)	(12.0)	28.9	16.9
TOTAL ASSETS LESS CURRENT LIABILITIES		3,337.1	290.5	3,627.6	3,288.1	290.0	3,578.1
CREDITORS: Amounts falling due after more than one year							
Borrowings		(2,271.2)	-	(2,271.2)	(2,238.8)	-	(2,238.8)
Other creditors		(1.0)	-	(1.0)	(0.3)	-	(0.3)
TOTAL CREDITORS: amounts falling due after one year		(2,272.2)	-	(2,272.2)	(2,239.1)	-	(2,239.1)
PROVISIONS FOR LIABILITIES AND CHARGES	A	(316.9)	(153.0)	(469.9)	(293.3)	(159.9)	(453.2)
NET ASSETS EMPLOYED		748.0	137.5	885.5	755.7	130.1	885.8
CAPITAL AND RESERVES		748.0	137.5	885.5	755.7	130.1	885.8

Approved by the Board and signed on their behalf by:

H Mottram　　　　C I Johns

11 July 2013

Registered number 2366703

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS
for the year ended 31 March 2013

1. STATEMENT OF ACCOUNTING POLICIES

(a) Basis of accounting and consolidation

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

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

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

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

The accounts have been prepared on a going concern basis which assumes that the Company will have adequate funding to meet its liabilities as they fall due in the foreseeable future. As at 31 March 2013 the Company had net current liabilities of £4.1m (2012: net current assets of £22.9m). The directors have reviewed cash flow requirements and are confident that they will be able to meet these from funds available, including the undrawn committed bank facilities £450.0m. Accordingly, the directors believe it is appropriate to prepare the financial statements on a going concern basis.

(b) Turnover recognition

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

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

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

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

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

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

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

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(b) Turnover recognition (continued)

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

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

(c) Cash flow statement

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

(d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

(i) Infrastructure assets

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

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

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

In accordance with RAG 3.07 the Company has not applied FRS 12 and FRS 15, in respect of infrastructure renewals accounting and has continued to charge infrastructure renewal costs (calculated in accordance with our Asset Management Plan (AMP)) to the profit and loss account. Expenditure during the year is charged to the provision.

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

- restatement of the cost and accumulated depreciation of infrastructure fixed assets to reflect infrastructure renewals expenditure, depreciation and retirement of assets since renewals accounting was first adopted. Accordingly, infrastructure renewals provisions and prepayments at years ended 31 March 2012 and 31 March 2013 would have been included within infrastructure fixed assets.
- the depreciation of infrastructure assets and the inclusion of the infrastructure renewals charge as a component of the depreciation charge for the year.
- restatement of the cost of infrastructure fixed assets to reflect the treatment of Section 19 ‘overlap’ expenditure. The objective of the Section 19 quality programme was to address water discolouration problems caused by iron pipes, either through relining those pipes or replacing them where relining is not possible. The ‘overlap’ represents the extra cost of replacing pipes rather than relining them where their structural condition is insufficient to withstand the relining process. Such expenditure is included in the infrastructure renewals charge in the regulatory accounts. The statutory financial statements classify such expenditure as capital in nature and include this under infrastructure assets in the fixed asset note, resulting in a higher profit in the statutory financial statements.

(ii) Non-infrastructure assets

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

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation (continued)

(ii) Non-infrastructure assets (continued)

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

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

(iii) Assets in the course of construction

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

(e) Grants and contributions

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets, in accordance with RAG 3.07. This is not in accordance with the Companies Act 2006 which requires fixed assets to be stated at their purchase price or production cost without deduction of grants and contributions which are accordingly accounted for as deferred income. The effect of the departure on the value of tangible fixed assets is disclosed in note (A). The statutory financial statements reflect grants and contributions as deferred income and amortise them to profit and loss account over the expected useful economic lives of the assets, resulting in a higher operating profit in the statutory financial statements.

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

(f) Hire purchase and leasing

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

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

(g) Stocks

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

(h) Pension costs

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

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

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

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(i) Taxation

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

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

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

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

(j) Foreign currency

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

(k) Research and development

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

(l) Fixed asset investments

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

(m) Derivative financial instruments

The Company utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments. In accordance with the Companies Act 2006, disclosure is given of the nature and extent of each class of derivative held by the Company, along with the fair value of the derivatives, by class, at the balance sheet date. No amounts are shown in the balance sheet of the Company in respect of these derivatives at 31 March 2013.

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

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

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

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

(n) Liquid resources

Liquid resources comprise external deposits and cash.

(o) Bad debt provisioning

The bad debt provision is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied. All debt greater than 48 months old is fully provided for.

2. SEGMENTAL INFORMATION

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

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

(a) Operating costs comprise:

	2013	2012
	£'m	£'m
Materials and consumables	20.0	20.3
Other external charges	74.5	74.4
Net manpower costs (note 7)	110.3	106.3
Other operating charges	122.6	115.9
Own work capitalised	(32.2)	(31.6)
	295.2	285.3

(b) Capital maintenance costs comprise:

	2013	2012
	£'m	£'m
Depreciation:		
Non-infrastructure assets	83.5	79.8
Assets held under finance leases	4.1	3.9
Infrastructure renewals expenditure	64.8	59.9
Infrastructure renewals prepayment	(14.7)	(14.7)
Amortisation of capital grants and contributions	(3.1)	(3.2)
Profit on disposal of fixed assets	(2.2)	(0.8)
	132.4	124.9

(c) Profit on ordinary activities before taxation:

	2013	2012
	£'m	£'m
Profit on ordinary activities before taxation is stated after charging:		
Operating leases:		
Plant and machinery	0.1	0.1
Other assets	1.2	1.0
Costs of research and development	1.2	1.1
Directors' emoluments (note 5)	1.4	1.5

Auditors' remuneration for the regulatory audit amounted to £40,000 (2012: £20,000). Fees of £5,000 (2012: £5,000) were incurred in respect of the statement of sufficiency of financial resources and facilities. Fees of £51,689 (2012: nil) were incurred for non-audit services on information systems consultancy work.

4. NET INTEREST PAYABLE

	2013	2012
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	18.9	21.0
Group loans	106.7	98.8
Financing charges payable under finance leases	0.9	5.2
Total interest payable	126.5	125.0
Interest receivable:		
Group interest	(10.0)	(9.9)
External interest	(0.5)	(1.0)
Total interest receivable	(10.5)	(10.9)
Other finance costs / (income) relating to pension scheme (note 26)	0.6	(7.9)
Net interest payable	116.6	106.2

5. DIRECTORS' EMOLUMENTS

(a) Directors' remuneration

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

	2013	2012
	£'000	£'000
Emoluments (including benefits in kind)	1,425.4	1,483.8

For those directors holding office with both NWL and NWGL, or contributing significantly to the day to day operations of NWGL, costs are apportioned between the companies to reflect the level of activity carried out for each company. This note reflects only the proportion of costs charged to NWL. A detailed report is provided in note 9 of Section B to the accounts showing total remuneration from the Group for each director and the apportionment between NWL and NWGL.

One of the directors at 31 March 2013 was a member of a defined benefit pension scheme where the Company makes contributions towards the cost (2012: 3).

Two of the directors at 31 March 2013 were members of a defined contribution scheme where the Company makes contributions towards the cost (2012: 1).

(b) Highest paid director

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

	2013	2012
	£'000	£'000
Emoluments (including benefits in kind)	462.2	461.1

In 2012/13, the highest paid director was a member of the defined contribution scheme and the payments made to that scheme of £52.0k (2012: £44.9k) are included within the emoluments figure above.

6. TRANSACTIONS WITH DIRECTORS AND OFFICERS

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

7. EMPLOYEE INFORMATION

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

	2013	2012
	£'m	£'m
Gross costs charged to the profit and loss account:		
Wages and salaries	67.0	64.9
Social security costs	6.1	5.6
Other pensions costs	10.7	10.4
	83.8	80.9
Costs recharged to other Group companies:		
Wages and salaries	2.0	2.3
Social security costs	0.2	0.2
Other pensions costs	0.3	0.4
	2.5	2.9
Net costs charged to the profit and loss account:		
Wages and salaries	65.0	62.6
Social security costs	5.9	5.4
Other pensions costs	10.4	10.0
	81.3	78.0
Costs charged to capital schemes and infrastructure renewals:		
Wages and salaries	23.1	22.7
Social security costs	2.1	1.9
Other pensions costs	3.8	3.7
	29.0	28.3
Total net employee costs	110.3	106.3

The average monthly number of employees on the payroll during the financial year was 2,957 (2012: 2,894) and the total at the year end was 2,981 (2012: 2,933).

8. TAXATION

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

	2013	2012
	£'m	£'m
Current tax:		
UK corporation tax on profits for the year at 23.828% (2012: 26%)	19.7	17.5
Adjustments in respect of prior years	(0.3)	(1.2)
Payable in respect of group relief for the current year at 23.828% (2012: 26%)	31.0	19.9
Adjustments in respect of prior years	0.3	1.1
Payable in respect of consortium relief for the current year	0.6	-
Total current tax charge (note 8b)	51.3	37.3
Deferred tax:		
Reduction due to opening tax rate change	(16.6)	(31.6)
Decrease in discount arising from above rate change	8.1	17.4
Net reduction in opening deferred tax	(8.5)	(14.2)
Movement in the year at 23% (2012: 24%):		
Origination and reversal of timing differences in the year	1.7	18.9
Adjustments in respect of prior periods	-	0.9
	1.7	19.8
Decrease in discount arising from current year movements	18.2	27.3
	19.9	47.1
Total deferred tax charge (note 21)	11.4	32.9
Tax on profit on ordinary activities	62.7	70.2

Tax losses have provisionally been claimed from other Group companies in the current year of £126.0m (2012: £58.8m) for which payment will be made at the rate of 23.828% (2012: 26%).

The rate of UK corporation tax was reduced from 24% to 23% by the Finance Act 2012 with effect from 1 April 2013. As a result, deferred tax was restated as at 1 April 2012 at the rate at which timing differences are expected to reverse.

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

8. TAXATION (continued)

(b) Reconciliation of the current tax charge:

	2013	2012
	£'m	£'m
Profit on ordinary activities before tax	212.7	212.7
Profit on ordinary activities multiplied by standard rate of corporation tax of 23.828% (March 2012: 26%)	50.7	55.3
Expenses not deductible for tax purposes	0.2	0.2
Non-taxable income and other tax reliefs	(2.1)	(2.7)
Depreciation in respect of non-qualifying items	4.7	5.0
Decelerated / (accelerated) tax depreciation	1.7	(3.0)
Pension deficit	3.2	(11.8)
Other timing differences	(6.6)	(5.6)
Adjustments in respect of prior periods	-	(0.1)
Consortium relief paid for at less than full value	(0.5)	-
Transfer pricing adjustments	(1.0)	(0.8)
Balancing payment payable	1.0	0.8
Total current tax charge (note 8a)	51.3	37.3

(c) Factors that may affect future tax charges:
The Finance Act 2013 will contain provisions to reduce the UK rate of corporation tax to 21% by 1 April 2014 and to 20% by 1 April 2015. While the Act has not yet received Royal Assent, the Bill has had its third reading in the House of Commons such that the rate changes were substantively enacted on 2 July 2013. Had the 20% rate applied in the year to 31 March 2013 the closing deferred tax liability after discount would have been reduced by £28.0m to £141.6m and the current period's corporation tax charge would have been reduced by £8.2m to £43.1m.

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

9. DIVIDENDS

	2013	2012
	£'m	£'m
Equity:		
Dividends paid:		
Interim paid for the year ended 31 March 2012 of 80.61p (year ended 31 March 2011: 37.75p) per share on an aggregated basis	98.9	46.3
Final paid for the year ended 31 March 2012 of nil (year ended 31 March 2010: 35.75p and year ended 31 March 2011: 38.05p) per share on an aggregated basis	-	90.5
Interim paid for the period ended 31 December 2012 of 42.18p (year ended 31 March 2012: nil) per share on an aggregated basis	51.7	-
Special dividend paid for the period ended 31 December 2012 of nil (year ended 31 March 2012: 189.16p) per share on an aggregated basis	-	232.0
Total dividends paid in the year	150.6	368.8
Dividends proposed:		
Interim proposed for the period ended 31 December 2013 of 74.28p (year ended 31 March 2012: 80.61p) per share on an aggregated basis	91.1	98.9

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

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

Excluding the special dividend, which was declared during the previous year following the change of control, the Company has applied a dividend policy of steady real growth of 2.1% per annum for the appointed business. This is calculated in accordance with the regulatory accounting calendar which has a 31 March accounting reference date. An estimated inflation for the year ended 31 March 2013 of 3.1% has been applied. Dividends from the non-appointed business are determined by the directors and are based on performance.

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

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

10. TANGIBLE FIXED ASSETS

	Freehold land and buildings	Infrastructure assets	Operational structures, plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 April 2012	121.4	1,545.1	2,330.9	194.4	219.9	4,411.7
Additions	-	-	-	-	166.0	166.0
Schemes commissioned	7.9	66.3	134.0	8.2	(216.4)	-
Reclassifications	(1.9)	(3.7)	6.1	(0.5)	-	-
Grants and contributions	-	(6.7)	-	-	(0.4)	(7.1)
Disposals	(1.0)	(0.1)	(4.7)	(0.1)	-	(5.9)
At 31 March 2013	126.4	1,600.9	2,466.3	202.0	169.1	4,564.7
Depreciation:						
At 1 April 2012	40.3	-	828.6	142.5	-	1,011.4
Charge for the year	2.4	-	73.9	11.3	-	87.6
Reclassifications	2.9	-	(2.0)	(0.9)	-	-
Disposals	(0.5)	-	(4.5)	(0.1)	-	(5.1)
At 31 March 2013	45.1	-	896.0	152.8	-	1,093.9
Net book value:						
At 31 March 2013	81.3	1,600.9	1,570.3	49.2	169.1	3,470.8
At 31 March 2012	81.1	1,545.1	1,502.3	51.9	219.9	3,400.3
Leased assets included above:						
Net book value:						
At 31 March 2013	-	49.9	20.9	-	-	70.8
At 31 March 2012	-	49.9	21.8	-	-	71.7

11. FIXED ASSET INVESTMENTS

	Loans to Group companies
	£'m
At 1 April 2012 and 31 March 2013	160.9

In May 2004, NWL made a loan of £159.0m to NSL, maturing in January 2034.

In May 2004, NWL made a loan of £1.5m to Bakethin Holdings Limited, a quasi-subsidiary company, maturing in January 2034**.** The interest on the loan is capitalised and at 31 March 2013 the balance was £1.9m (2012: £1.9m).

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

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

12. STOCKS

	2013	2012
	£'m	£'m
Raw materials and consumables	2.8	2.6

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

13. DEBTORS DUE IN LESS THAN ONE YEAR

	2013	2012
	£'m	£'m
Trade debtors	84.1	79.1
Corporation tax repayable	3.8	11.9
Amounts owed by other group companies	3.9	4.2
Other debtors	4.1	6.6
Infrastructure renewals prepayment (note 21)	8.9	-
Prepayments and accrued income	61.3	60.8
	166.1	162.6

Trade debtors are shown net of bills raised in advance.

14. DEBTORS DUE IN MORE THAN ONE YEAR

	2013	2012
	£'m	£'m
Loan facility prepayments	1.5	4.9

15. INVESTMENTS

	2013	2012
	£'m	£'m
Short term deposits	5.0	80.0

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2013	2012
	£'m	£'m
Obligations under finance leases (note 19)	7.2	7.2
Loans (note 18)	28.7	73.9
Trade creditors	5.6	8.6
Amounts owed to other Group companies	24.3	20.3
Taxation and social security	2.3	2.4
Other creditors	14.3	11.1
Receipts in advance	20.2	22.6
Accruals and deferred income	94.3	106.6
	196.9	252.7

Accruals and deferred income includes accruals related to capital projects of £31.1m (2012: £41.0m).

Included in amounts owed to other Group companies is £23.0m (2012: £18.8m) payable in respect of tax losses surrendered from fellow Group companies.

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

	2013	2012
	£'m	£'m
Obligations under finance leases (note 19)	101.3	104.4
Loans (note 18)	319.0	297.8
Amounts owed to other Group companies (note 20)	1,850.9	1,836.6
Other creditors	1.0	0.3
	2,272.2	2,239.1

Other creditors includes £0.6m (2012: £nil) payable in respect of tax losses surrendered as consortium relief from associated companies outside of the Group.

18. LOANS

	2013	2012
	£'m	£'m
Loans are repayable as follows:		
Within one year (note 16)	28.7	73.9
Between one and two years	30.6	28.7
Between two and five years	105.6	96.0
After five years	182.8	173.1
	347.7	371.7

Loans wholly repayable within 5 years amount to £54.3m (2012: £45.5m).

Loans not wholly repayable within 5 years amount to £293.4m (2012: £326.2m) and bear interest rates in the range 1.56% to 7.23%.

At 31 March 2013, the fair value loss on the Company's outstanding interest rate swaps was £15.3m (2012: £15.1m).

19. OBLIGATIONS UNDER FINANCE LEASES

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

	2013	2012
	£'m	£'m
Amounts due:		
Within one year	7.2	7.2
Between one and two years	6.7	6.6
Between two and five years	66.3	17.8
After five years	77.6	147.5
	157.8	179.1
Less:		
Finance charge allocated to future periods	(49.3)	(67.5)
	108.5	111.6
Disclosed as due:		
Within one year (note 16)	7.2	7.2
After more than one year (note 17)	101.3	104.4
	108.5	111.6

The aggregate gross amount of obligations under hire purchase contracts and finance leases, any part of which falls due for repayment in five years or more, is £97.4m (2012: £179.1m).

20. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	2013	2012
	£'m	£'m
After five years	1,850.9	1,836.6

NWF issued £200.0m and £150.0m Guaranteed Eurobonds in February 1998 and September 2001 respectively, maturing February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £194.2m and £163.2m respectively. Finance costs allocated during the year amounted to £0.2m (2012: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2012: £0.3m).

NWF issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £301.0m. Amortisation of loan receipts during the year amounted to £0.1m (2012: £0.1m).

NWF issued £250.0m and £100.0m Guaranteed Eurobonds in December 2002 and December 2004, maturing April 2033 with an annual coupon of 5.625%. Both issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £246.6m and £100.8m respectively. Finance costs allocated during the year amounted to £0.2m (2012: £0.2m).

NWF issued £150.0m Guaranteed Index Linked Eurobonds in September 2005, maturing July 2036, with a real coupon of 2.033%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £150.0m. Indexation accretion during the year amounted to £5.9m (2012: £8.8m).

NWF issued £60.0m Guaranteed Index Linked Eurobonds in January 2006, maturing January 2041, with a real coupon of 1.6274%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £60.0m. Indexation accretion during the year amounted to £2.3m (2012: £3.5m).

NWF issued two £100.0m Guaranteed Index Linked Eurobonds in June 2006 with real coupons of 1.7118% and 1.7484% and with maturities of 2049 and 2053 respectively. Both issues were guaranteed by the Company who received the issue proceeds by way of two inter-company loans of £100.0m. Indexation accretion during the year amounted to £7.7m (2012: £11.5m).

NWF issued £360.0m Guaranteed Eurobonds in January 2012, maturing January 2042, with an annual coupon of 5.125%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £338.8m. Finance costs allocated during the year amounted to £0.7m (2012: £0.2).

21. PROVISIONS FOR LIABILITIES AND CHARGES

	£'m
Pension provision for former employees:	
At 1 April 2012	2.4
Utilised during the year	(0.2)
At 31 March 2013	2.2
Deferred tax:	
At 1 April 2012	176.2
Total movement in the year (note 8a)	11.4
Included above relating to pensions (note 26)	3.7
At 31 March 2013	191.3
Infrastructure renewals:	
At 1 April 2012	6.0
Transferred from the profit and loss account (note 3b)	50.1
Utilised during the year	(65.0)
At 31 March 2013	(8.9)

	2013	2012
	£'m	£'m
Disclosed as:		
Debtors due < 1 year - infrastructure renewals prepayment (note 13)	(8.9)	-
Provisions for liabilities and charges	193.5	184.6

The pension provision for former employees relates to pensions payable mainly to former employees of water-only companies which have since merged with the Company. The provision of £2.2m represents the full future amounts payable, based on an actuarial assessment, for which the Company is directly liable.

The provision for deferred tax comprises:

	2013	2012
	£'m	£'m
Accelerated capital allowances	378.1	396.2
Other timing differences	(5.6)	(12.5)
Held over gains	1.0	1.0
Undiscounted provision for deferred tax	373.5	384.7
Discount	(182.2)	(208.5)
Disounted provision for deferred tax	191.3	176.2

22. ACCRUALS AND DEFERRED INCOME

	Gilt lock	Capital grants and contributions	Proceeds from Kielder securitisation	Total
	£'m	£'m	£'m	£'m
At 1 April 2012	0.5	54.7	156.1	211.3
Additions	-	3.1	-	3.1
Amortised / transferred during the year	(0.5)	(3.1)	(7.0)	(10.6)
At 31 March 2013	-	54.7	149.1	203.8

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

23. CALLED UP SHARE CAPITAL

	2013	2012
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2012: 122,650,000)	122.7	122.7

	2013	2012
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2012: 122,650,000)	122.7	122.7

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

	Profit and loss account	Total shareholders' funds	
	2013	2013	2012
	£'m	£'m	£'m
At 1 April 2012	763.1	885.8	1,176.5
Profit for the year	150.0	150.0	142.5
Actuarial gain / (loss) on pension liability in the year (note 26)	2.3	2.3	(83.2)
Deferred tax related to actuarial gain on pension liability in the year (note 26)	(2.0)	(2.0)	18.8
Dividends paid (note 9)	(150.6)	(150.6)	(368.8)
At 31 March 2013	762.8	885.5	885.8

25. COMMITMENTS

(a) Capital expenditure:

	2013	2012
	£'m	£'m
Expenditure contracted but not provided for	76.1	99.8

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

	2013	2012
	£'m	£'m
Land and buildings:		
Leases which expire:		
Not later than one year	0.1	-
After one year but not more than five	0.1	0.1
In five years or more	0.6	0.5
	0.8	0.6

	2013	2012
	£'m	£'m
Other:		
Leases which expire:		
Not later than one year	0.1	-
Between two and five years	-	0.1
	0.1	0.1

(c) Foreign exchange contracts:
At 31 March 2013 the Company held forward foreign exchange contracts of £2.4m (2012: £nil) for the purpose of hedging the foreign currency risk of committed future purchases.

26. PENSIONS

NWL participates in the Group defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 1,751 active members at 31 March 2013 (2012: 1,830). The assets of the NWPS are held separately from those of the Group in independently administered funds.

The most recent actuarial valuation of the NWPS was at 31 December 2010. At that date the value of assets amounted to £680.1m and the funding level was 84.7%. The future service contribution rate jointly payable by members and the employers from 31 December 2010 was 24.2% of pensionable salaries. Members’ contributions are 7.3% on average with the employers paying 16.9%.

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

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

26. PENSIONS (continued)

With the agreement of the NWPS Trustee, the employers have made capital contributions of £70.0m to cover the period 1 January 2011 to 31 March 2015. These payments comprise employers' contributions, the deficit recovery funding assumed in the final determination and employees contributions under a salary sacrifice arrangement. Contributions for the current period amounted to £0.5m and are expected to be £0.5m for the year to 31 March 2014.

The scheme also has a defined contribution section which had 616 active members at 31 March 2013 (2012: 542). Members can choose to contribute either 3%, 4% or 5% of salary, with employers contributing at either 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Company in the year totalled £1.3m (2012: £0.9m).

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

A qualified actuary, using revised assumptions that are consistent with the requirements of FRS 17, has updated the actuarial valuation described above as at 31 March 2013. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions:	2013	2012
Discount rate	4.3%	4.8%
Pay increases[1]	3.85%	3.9%
Price inflation (RPI)	3.2%	3.2%
Price inflation (CPI)	2.2%	2.5%
Pension increases linked to RPI	3.2%	3.2%
Pension increases linked to CPI	2.2%	2.5%
Mortality assumptions[2]	PCMA/PCFA00	PCMA/PCFA00
- Life expectancy for a member aged 65 - female (years)	24.5	24.3
- Life expectancy for a member aged 65 - male (years)	22.2	22.0

1. including promotional salary scale

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

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

	Long term expected rate of return		Long term expected rate of return	
	2013	2013	2012	2012
	%	£'m	%	£'m
Equities	7.0	349.1	6.3	436.5
Corporate bonds	4.3	164.8	4.8	126.8
Government bonds	3.0	86.6	3.3	78.6
Property	4.5	75.9	4.8	75.3
Insurance policy	5.0	2.4	2.5	2.2
Cash	2.0	32.2	2.5	11.9
Other	4.5	75.7	-	-
Total fair value of assets		786.7		731.3
Present value of liabilities		(881.0)		(814.6)
Deficit under FRS17		(94.3)		(83.3)
Related deferred tax[1]		21.7		20.0
Net pension liability		(72.6)		(63.3)

1. The movement in deferred tax of £1.7m comprises reductions of £1.5m to reflect the 1% cut in the rate of UK corporation tax and £0.5m relating to the actuarial gain in the year, which are both recognised as credits in the statement of total recognised gains and losses, and an increase of £3.7m relating to other items which are recognised as credits in the profit and loss account.

26. PENSIONS (continued)

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

	2013	2012
	£'m	£'m
Current service cost	13.0	12.3
Past service cost	0.2	0.3
Recognised in operating costs in arriving at operating profit	13.2	12.6

	2013	2012
	£'m	£'m
Interest cost on plan obligations	38.7	40.9
Expected return on plan assets	(38.1)	(48.8)
Recognised in net interest receivable (note 4)	0.6	(7.9)

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

	2013	2012
	£'m	£'m
Net actuarial gain / (loss) by NWL	2.3	(83.2)
Cumulative amounts recognised since adopting the standard	(86.4)	(88.7)

History of experience gains and losses:

	2013	2012	2011	2010	2009
Fair value of assets	786.7	731.3	706.4	656.7	474.0
Present value of defined benefit obligation	(881.0)	(814.6)	(751.9)	(788.3)	(592.3)
Deficit	(94.3)	(83.3)	(45.5)	(131.6)	(118.3)
Experience adjustments arising on plan assets	48.8	(42.1)	10.4	175.3	(203.5)
Experience adjustments arising on plan liabilities	(4.0)	30.5	(0.3)	5.1	18.6

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

	2013	2012
	£'m	£'m
At 1 April	814.6	751.9
Current service cost	13.0	12.3
Past service cost	0.2	0.3
Interest cost	38.7	40.9
Contributions by plan participants	0.1	0.2
Actuarial losses on obligations	46.5	41.1
Benefits paid	(32.1)	(32.1)
At 31 March	881.0	814.6

26. PENSIONS (continued)

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

	2013	2012
	£'m	£'m
At 1 April	731.3	706.4
Expected return on plan assets	38.1	48.8
Actuarial gains / (losses) on plan assets	48.8	(42.1)
Contributions by employer	0.5	50.1
Contributions by plan participants	0.1	0.2
Benefits paid	(32.1)	(32.1)
At 31 March	786.7	731.3

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

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

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

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

These assumptions imply an assumed life expectancy for a member aged 65 at 31 March 2013 of 22.2 years (2012: 22.0 years) for males and 24.5 years (2012: 24.3 years) for females. The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around £25.0m (3.0%).

27. RELATED PARTY DISCLOSURES

The Company is a wholly owned subsidiary of NWGL, whose publicly available consolidated financial statements include the Company. Accordingly, the Company is exempt under the terms of FRS 8 'Related Party Disclosures' from disclosing transactions with other members of the Group headed by NWGL.

Transactions with related parties outside of the NWGL group comprised purchases of £0.9m (2012: £nil) and sales of £nil (2012: £nil). There were no amounts due from or to these companies at 31 March 2013 (2012: £nil).

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

Northern Gas Networks
Hutchison Whampoa Limited
Hutchison Whampoa (Europe) Limited

28. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

In the directors' opinion, for the period up to 8 March 2013, the Company's ultimate parent undertaking and controlling party was UKW, which is incorporated in England and Wales. UKW is indirectly wholly owned by Cheung Kong Infrastructure Holdings Limited, Cheung Kong (Holdings) Limited and Li Ka Shing Foundation Limited.

As a consequence of the Group restructuring described in the business review, which was effected on 8 March 2013, NWGL became the Company's immediate parent undertaking and, in the directors' opinion, the Company's ultimate parent undertaking and controlling party. NWGL is incorporated in England and Wales. NWGL is indirectly wholly owned by Cheung Kong Infrastructure Holdings Limited, Cheung Kong (Holdings) Limited and Li Ka Shing Foundation Limited.

NWGL's shareholders receive dividend payments and interest payments on shareholder loans from the Group which are, in part, funded from NWL dividends.

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

(A) RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS
For the year ended 31 March 2013

The Company prepared its statutory financial statements on a consolidated basis for the nine months to 31 December 2012. These regulatory accounts are prepared for the entity only to 31 March 2013. Where there is also a difference relating to accounting treatment, the table below shows the impact of these consolidation and timing differences.

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

	Note	Statutory UK GAAP financial statements at 31 December 2012	Historical cost regulatory accounts at 31 March 2013	Total difference	Analysis of difference: Consolidation	Timing	Accounting
		£'m	£'m	£'m	£'m	£'m	£'m
PROFIT AND LOSS ACCOUNT							
Turnover	1	578.1	756.9	(178.8)	5.5	(186.0)	1.7
Operating Profit	2	258.6	329.3	(70.7)	5.3	(77.6)	1.6
Deferred tax (credit) / charge	3	(3.2)	11.4	(14.6)	-	(0.1)	14.7
BALANCE SHEET							
Tangible fixed assets	4	3,706.0	3,470.8	235.2	-	(16.9)	252.1
Provisions for liabilities and charges:							
Deferred tax	5	227.0	191.3	35.7	(0.9)	(0.6)	37.2
Capital grants and contributions	6	231.1	54.7	176.4	-	(1.9)	178.3
Post employment liability	7	78.4	72.6	5.8	-	5.2	0.6

Note	Explanation of accounting differences
1	Statutory accounts include provision for revenue recognition of £1.7m in accordance with Note G of FRS 5, which is disapplied for regulatory purposes (see note 1(b)).
2	Adjustments relating to amortisation of infrastructure income (£1.7m) (see note 1(e) and additional charge in statutory accounts for VLS pension scheme (£0.1m).
3	Adjustment relating to amortisation of infrastructure income (£0.1m), Section 19 ‘overlap’ (£0.4m), index-linked interest (£1.1m) and discount (£13.3m).
4	Adjustments relating to infrastructure grants and contributions netted off (£202.8m), Section 19 ‘overlap’ (£40.4m) and infrastructure renewals prepayment (£8.9m) (see note 1(d)(i)).
5	Adjustments relating to amortisation of infrastructure income (£5.2m), Section 19 ‘overlap’ (£9.3m), index-linked interest (£1.1m) and discount (£23.8m).
6	Adjustments relating to gross up (£202.8m) and amortisation (£24.5m) of infrastructure grants and contributions (see note 1(e)).
7	Adjustment relating to additional charge in statutory accounts for VLS pension scheme (£0.6m).

CURRENT COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2013

	2013			2012		
	Water	Sewerage	Total	Water	Sewerage	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Turnover						
Unmeasured - household	219.8	163.5	383.3	212.8	159.4	372.2
- non-household	2.7	4.1	6.8	2.6	4.2	6.8
Measured - household	103.7	49.0	152.7	94.7	43.5	138.2
- non-household	63.7	59.6	123.3	63.8	59.6	123.4
Trade effluent	-	2.5	2.5	-	2.7	2.7
Bulk supplies / inter company payments	0.5	-	0.5	0.6	-	0.6
Other third party services (inc potable water)	10.2	0.3	10.5	7.8	0.2	8.0
Other sources	29.3	21.2	50.5	29.8	20.8	50.6
Total turnover	429.9	300.2	730.1	412.1	290.4	702.5
Current cost operating costs - wholesale	(256.1)	(175.4)	(431.5)	(240.1)	(165.5)	(405.6)
Current cost operating costs - retail	(42.2)	(16.6)	(58.8)	(46.2)	(19.9)	(66.1)
Operating income	1.0	(1.0)	-	(0.6)	0.1	(0.5)
Working capital adjustment	(0.6)	(0.4)	(1.0)	(0.7)	(0.5)	(1.2)
CURRENT COST OPERATING PROFIT	132.0	106.8	238.8	124.5	104.6	229.1
Net interest			(126.5)			(116.2)
Financing adjustment			60.5			51.9
CURRENT COST PROFIT BEFORE TAXATION			172.8			164.8
Net revenue movement out of tariff basket	0.2	0.2	0.4	-	(0.3)	(0.3)

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

CURRENT COST CASH FLOW STATEMENT
for the year ended 31 March 2013

	2013	2012
	£'m	£'m
Current cost operating profit	238.8	229.1
Working capital adjustment	1.0	1.2
Movement in working capital	(11.9)	(1.8)
Current cost depreciation	159.7	155.2
Current cost profit on sale of fixed assets	-	0.5
Infrastructure renewals charge	50.0	45.2
Other non-cash movements	15.4	0.3
Contributions in respect of retirement benefits	(0.5)	(49.4)
Net cash flow from operating activities	452.5	380.3
Returns on investment and servicing of finance	(110.3)	(100.4)
Taxation paid	(34.7)	(36.8)
Capital expenditure and financial investment		
Gross cost of purchase of fixed assets	(171.9)	(218.1)
Receipt of grants and contributions	10.1	9.6
Infrastructure renewals expenditure	(64.9)	(59.8)
Disposal of fixed assets	3.0	0.9
Net cash flow from investing activities	(223.7)	(267.4)
Equity dividends paid	(140.1)	(358.3)
Net cash flow from management of liquid resources	75.0	36.9
NET CASH FLOW BEFORE FINANCING	18.7	(345.7)
Net cash (outflow) / inflow from financing	(27.1)	362.7
(DECREASE) / INCREASE IN CASH	(8.4)	17.0

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS for the year ended 31 March 2013

1. STATEMENT OF CURRENT COST ACCOUNTING POLICIES

The accounting policies used are the same as those adopted in the historical cost regulatory accounts, except as set out below. This financial information has been prepared for the appointed business of NWL in accordance with guidance issued by Ofwat for modified real time financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance in the context of assets which are valued at their current cost value to the business.

(a) Tangible fixed assets

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

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

- **Land and buildings**
  Non-specialised operational properties were valued at 31 March 2008 on the basis of open market value for existing use and subsequently, annually revalued to take account of changes in the general level of inflation as measured by changes in the RPI. Specialised operational properties are valued at the lower of depreciated replacement cost and recoverable amount.

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

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

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

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

(b) Real financial capital maintenance adjustments

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

(c) Working capital adjustment

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

1. STATEMENT OF CURRENT COST ACCOUNTING POLICIES (continued)

(d) Financing adjustment

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

(e) Accounting separation policy

Cost allocations have been prepared in accordance with RAG 4.04, "Guideline for the definitions for the regulatory accounts tables". All costs are recorded in the general ledger by cost centre. Cost centres are defined as either direct departments, comprising operational and customer functions, or support departments. Direct departments are mostly directly allocated to service activities based on the nature of the function, although some costs require apportionment on an appropriate basis. Support departments are apportioned to direct departments either based upon a specific analysis of the costs or by apportionment by an appropriate cost driver. Once allocated to the direct departments the costs are then allocated to service activities pro-rata to the direct cost allocations of the direct department costs.

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

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

(f) Capitalisation policy

The capitalisation policies applied in the regulatory accounts comply with FRS 15 "Tangible Fixed Assets", other than for infrastructure renewals accounting for which FRS 15 is dis-applied in accordance with RAG 1.05.

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

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

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

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

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

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

(g) Bad debt policy

There are only two scenarios in which debt is written off. The first is where a customer has absconded without paying and our strategies to trace the whereabouts and collect any outstanding amount have been fully exhausted. The second is where an outstanding amount is subject to an insolvency procedure, a proof of debt is filed and the debt is written off pending any final dividend.

2. OPERATING COST ANALYSIS for the year ended 31 March 2013

Wholesale Business only

	Water					Sewerage					
	Resources	Raw water distribution	Treatment	Treated distribution	Water sub-total	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Sewerage sub-total	Total
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Operating expenditure											
Power	3.5	0.9	1.6	7.8	13.8	4.7	6.8	0.4	-	11.9	25.7
Income treated as negative expenditure	-	-	(0.2)	-	(0.2)	-	-	(1.4)	-	(1.4)	(1.6)
Service charges	21.0	-	0.1	-	21.1	-	-	-	-	-	21.1
Bulk supply imports	2.0	-	-	-	2.0	-	-	-	-	-	2.0
Other operating expenditure	9.4	0.8	27.6	35.3	73.1	23.8	17.7	15.0	3.6	60.1	133.2
Local authority rates	-	-	21.6	-	21.6	0.2	9.0	-	-	9.2	30.8
Total operating expenditure excluding third party services	35.9	1.7	50.7	43.1	131.4	28.7	33.5	14.0	3.6	79.8	211.2
Capital maintenance											
Infrastructure renewals charge	3.6	-	-	31.0	34.6	14.3	1.1	-	-	15.4	50.0
Current cost depreciation	5.6	2.5	34.5	36.8	79.4	11.6	51.5	15.6	0.1	78.8	158.2
Amortisation of deferred credits	(0.1)	-	(0.1)	(1.1)	(1.3)	(0.8)	(0.9)	-	-	(1.7)	(3.0)
Total capital maintenance excluding third party services	9.1	2.5	34.4	66.7	112.7	25.1	51.7	15.6	0.1	92.5	205.2
Third party services											
Operating expenditure	-	10.6	0.4	1.0	12.0	0.3	2.8	-	-	3.1	15.1
Total operating costs	45.0	14.8	85.5	110.8	256.1	54.1	88.0	29.6	3.7	175.4	431.5

2. OPERATING COST ANALYSIS for the year ended 31 March 2013 (continued)

	Retail Business only		
	Household	Non-household	Total
	£'m	£'m	£'m
Operating expenditure			
Customer services	11.5	1.2	12.7
Debt management	4.2	0.7	4.9
Doubtful debts	17.8	1.4	19.2
Meter reading	1.9	0.3	2.2
Other operating expenditure	12.7	1.6	14.3
Local authority rates	0.2	-	0.2
Total operating expenditure excluding third party services	48.3	5.2	53.5
Third party services operating expenditure	0.7	0.1	0.8
Total operating expenditure	49.0	5.3	54.3
Current cost depreciation	4.1	0.4	4.5
Total capital maintenance	4.1	0.4	4.5
Total operating costs	53.1	5.7	58.8
Debt written off	3.5	1.5	5.0

3. CURRENT COST ANALYSIS OF FIXED ASSETS

Wholesale Business only

	Water					**Sewerage**					
	Resources	Raw water distribution	Treatment	Treated distribution	Water sub-total	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Sewerage sub-total	Total
Non infrastructure assets	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Gross replacement cost											
As at 1 April 2012	290.1	210.5	1,186.6	1,088.5	2,775.7	365.8	1,888.6	442.5	1.4	2,698.3	5,474.0
AMP adjustment	(0.2)	-	0.9	6.2	6.9	(0.2)	0.5	(0.2)	-	0.1	7.0
Reclassification adjustment	(0.4)	(0.3)	(1.5)	169.7	167.5	7.0	(7.0)	0.4	(0.3)	0.1	167.6
RPI adjustment	8.6	6.8	40.6	40.9	96.9	12.3	63.6	15.1	-	91.0	187.9
Disposals	(1.2)	-	(1.5)	(5.6)	(8.3)	(0.7)	(1.7)	(3.6)	(0.1)	(6.1)	(14.4)
Additions	9.4	0.2	23.2	24.6	57.4	16.4	29.1	10.5	-	56.0	113.4
As at 31 March 2013	306.3	217.2	1,248.3	1,324.3	3,096.1	400.6	1,973.1	464.7	1.0	2,839.4	5,935.5
Depreciation											
As at 1 April 2012	113.3	68.6	601.4	490.3	1,273.6	164.4	901.3	182.9	0.8	1,249.4	2,523.0
AMP adjustment	(0.5)	-	(1.4)	(3.4)	(5.3)	(0.5)	(1.5)	(0.2)	-	(2.2)	(7.5)
Reclassification adjustment	(0.4)	(0.2)	(0.6)	102.1	100.9	1.7	(2.4)	0.2	(0.2)	(0.7)	100.2
RPI adjustment	2.9	1.7	19.8	18.9	43.3	5.2	29.8	6.4	-	41.4	84.7
Disposals	(0.8)	-	(1.3)	(5.0)	(7.1)	(0.6)	(1.5)	(2.2)	(0.1)	(4.4)	(11.5)
Charge for the year	5.6	2.5	34.5	36.8	79.4	11.6	51.5	15.6	0.1	78.8	158.2
As at 31 March 2013	120.1	72.6	652.4	639.7	1,484.8	181.8	977.2	202.7	0.6	1,362.3	2,847.1
Net book amount at 31 March 2013	186.2	144.6	595.9	684.6	1,611.3	218.8	995.9	262.0	0.4	1,477.1	3,088.4
Net book amount at 1 April 2012	176.8	141.9	585.2	598.2	1,502.1	201.4	987.3	259.6	0.6	1,448.9	2,951.0
Infrastructure assets											
Gross replacement cost											
As at 1 April 2012	1,051.3	113.4	-	5,498.0	6,662.7	12,273.2	155.7	-	-	12,428.9	19,091.6
AMP adjustment	-	-	-	(3.9)	(3.9)	-	-	-	-	-	(3.9)
Reclassification adjustment	-	613.7	-	(613.7)	-	-	-	-	-	-	-
RPI adjustment	34.8	24.0	-	161.0	219.8	404.9	5.2	-	-	410.1	629.9
Additions	13.2	-	-	16.2	29.4	16.7	-	-	-	16.7	46.1
As at 31 March 2013	1,099.3	751.1	-	5,057.6	6,908.0	12,694.8	160.9	-	-	12,855.7	19,763.7

3. CURRENT COST ANALYSIS OF FIXED ASSETS (continued)

	Retail Business only		
	Household	Non-household	Total
	£'m	£'m	£'m
Gross Replacement Cost:			
At 1 April 2012	225.6	30.4	256.0
AMP adjustment	(0.2)	-	(0.2)
Reclassification adjustment	(147.2)	(20.4)	(167.6)
RPI adjustment	2.8	0.3	3.1
Disposals	(0.9)	(0.1)	(1.0)
Additions	5.2	0.6	5.8
At 31 March 2013	85.3	10.8	96.1
Depreciation:			
At 1 April 2012	129.8	20.7	150.5
AMP adjustment	(1.4)	(0.1)	(1.5)
Reclassification adjustment	(84.4)	(15.8)	(100.2)
RPI adjustment	1.5	0.2	1.7
Disposals	(0.8)	(0.1)	(0.9)
Charge for year	4.1	0.4	4.5
At 31 March 2013	48.8	5.3	54.1
Net book amount at 31 March 2013	36.5	5.5	42.0
Net book amount at 1 April 2012	95.8	9.7	105.5

In accordance with RAG 4.04 customer meters have been reclassified from the retail business to the water wholesale business.

4. ANALYSIS OF CAPITAL EXPENDITURE, GRANTS AND LAND SALES for the year ended 31 March 2013

	2013			2012		
	Gross	Grants & contributions	Net	Gross	Grants & contributions	Net
	£'m	£'m	£'m	£'m	£'m	£'m
Capital expenditure - water						
Base						
Infrastructure renewals expenditure (IRE)	45.5	(1.1)	44.4	40.9	(1.1)	39.8
Maintenance non-infrastructure (MNI)	52.0	(0.1)	51.9	50.3	-	50.3
Enhancements						
Infrastructure enhancements	29.4	(5.5)	23.9	64.2	(6.1)	58.1
Non-infrastructure enhancements	8.5	(1.7)	6.8	7.1	(1.4)	5.7
Total capital expenditure - water	135.4	(8.4)	127.0	162.5	(8.6)	153.9
Grants and contributions - water						
Developer contributions (ie Enhancement requisitions, grants and contributions)		(4.4)			(5.0)	
Infrastructure charge receipts - new connections		(2.8)			(2.4)	
Other Contributions		(1.2)			(1.2)	
Total grants and contributions - water		(8.4)			(8.6)	
Capital expenditure - sewerage						
Base						
Infrastructure renewals expenditure (IRE)	22.1	(1.6)	20.5	20.6	(0.5)	20.1
Maintenance non-infrastructure (MNI)	46.2	-	46.2	75.9	-	75.9
Enhancements						
Infrastructure enhancements	16.7	(1.6)	15.1	24.6	(1.1)	23.5
Non-infrastructure enhancements	12.5	(1.2)	11.3	9.9	(0.8)	9.1
Large projects capex						
Total capital expenditure - sewerage	97.5	(4.4)	93.1	131.0	(2.4)	128.6
Grants and contributions - sewerage						
Developer contributions (ie Enhancement requisitions, grants and contributions)		(0.7)			(0.4)	
Infrastructure charge receipts - new connections		(1.9)			(1.4)	
Other Contributions		(1.8)			(0.6)	
Total grants and contributions - sewerage		(4.4)			(2.4)	
Total capital expenditure - water and sewerage	232.9	(12.8)	220.1	293.5	(11.0)	282.5
Land sales - Proceeds from disposals of protected land			3.0			1.4

5. WORKING CAPITAL

	2013	2012
	£'m	£'m
Stocks	2.5	2.3
Trade debtors:		
-measured household	19.8	20.3
-unmeasured household	46.4	43.1
-measured non-household	9.4	9.6
-unmeasured non-household	0.6	0.6
-other	5.3	3.5
Measured income accrual	51.2	48.0
Prepayments and other debtors	20.2	23.4
Trade creditors	(5.5)	(8.4)
Deferred income - customer advance receipts	(16.0)	(18.3)
Capital creditors	(31.0)	(40.9)
Accruals and other creditors	(62.0)	(54.2)
Total working capital	40.9	29.0
Total revenue outstanding:		
Household	66.2	63.4
Non-household	10.0	10.2

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

	Fixed rate	Floating rate	Index linked	Total
	£'m	£'m	£'m	£'m
Borrowings (excluding preference shares)	1,691.7	100.7	514.7	2,307.1
Preference share capital				-
Total borrowings				2,307.1
Overdraft				21.2
Short term deposits				(5.0)
Net debt				2,323.3
Regulatory capital value				3,747.3
Gearing				0.62
Full year equivalent nominal interest cost	101.1	3.2	25.2	129.5
Full year equivalent cash interest payment	101.1	3.2	9.4	113.7
Indicative interest rates:				
Indicative weighted average nominal interest rate			4.90%	4.90%
Indicative weighted average cash interest rate			1.83%	1.83%
Weighted average years to maturity	15.0	23.0	31.0	19.0

7. NON-FINANCIAL INFORMATION for the year ended 31 March 2013

	2013		2012	
	Water	Sewerage	Water	Sewerage
Number of properties	'000	'000	'000	'000
Total company				
Households billed	1,772	1,114	1,767	1,112
Non-households billed	97	56	96	55
Household voids	79	53	76	51
Non-household voids	16	13	16	13
Properties served by new appointee in supply area as at 1 April 2009	-	-	-	-
Per capita consumption (excluding supply pipe leakage)	l/h/d		l/h/d	
Northumbrian Water				
Unmeasured household	142.46		148.01	
Measured household	135.19		140.74	
Essex and Suffolk Water				
Unmeasured household	155.59		159.99	
Measured household	139.99		145.86	
Volume	Ml/d		Ml/d	
Northumbrian Water				
Bulk supply export	0.70		0.91	
Bulk supply import	-		-	
Distribution input	669.47		684.35	
Essex and Suffolk Water				
Bulk supply export	84.16		87.52	
Bulk supply import	2.21		2.41	
Distribution input	419.68		443.79	

8. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

Associate	Service	December 2012 Turnover	Terms of Supply	2012/13 Value
		£'m		£'m
Vehicle Lease and Service Limited (VLS)	Rental of garage and service charges	14.1	Negotiated	0.1
AquaGib *	Sale of materials	9.1	Negotiated	0.1

Services supplied to the appointee by associated companies:

Associate	Service	December 2012 Turnover	Terms of Supply	2012/13 Value
		£'m		£'m
Northumbrian Water Group Limited *	Holding company charges	4.1	No market	0.5
Three Rivers Insurance Company Limited *	Public liability insurance (deductible infill policy)	-	No market	0.5
Vehicle Lease and Service Limited	Vehicle maintenance and capital finance charge	14.1	Competitive letting	7.7
Northern Gas Networks	Gas main diversions	378.1	No market	0.1
Hutchison Whampoa Limited	Oracle licensing	19,714.9	Negotiated	0.8

* Due to the change in accounting reference date, the turnover figure is for a nine month period.

8. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES (continued)

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

Turnover is separately recorded between water services and sewerage services and no apportionment has been necessary. Operating costs have been allocated between water and sewerage services in accordance with the guidance set out in RAG 4.04.

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

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

Amounts borrowed by the appointee from associated companies
The Company has loans amounting to £1,850.9m due to NWF, a subsidiary company. Details of these loans and the associated guarantees are provided in note 20 of the historical cost regulatory accounts.

The Company acquires vehicles from VLS, an associated company, on a finance lease basis. During the year, new finance leases of £3.3m were entered into and capital repayments of £3.1m were made. The year end finance lease creditor was £8.9m. All leases are at a fixed interest rate of 6%.

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

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

	£'m
Dividends paid:	
Interim paid for the year ended 31 March 2012	91.9
Interim paid for the period ended December 2012	48.2
Total dividends paid in the year	140.1
Dividends proposed:	
Interim proposed for the year ended 31 December 2013	48.4

No final dividend was proposed for the period ended 31 December 2012 (31 March 2012: nil). Excluding the special dividend, which was paid during the previous year, following the change of control, the Company has applied a dividend policy of steady real growth of 2.1% per annum for the appointed business. This is calculated in accordance with the regulatory accounting calendar which has a 31 March accounting reference date. An estimated inflation for the year ended 31 March 2013 of 3.1% has been applied.

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

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

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

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

9. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

The following statement on directors' remuneration is disclosed in accordance with section 35A of the Water Act 2003.

All decisions regarding directors' remuneration are taken by the NWGL Remuneration Committee (the Committee). During the year, the Committee:

- agreed bonuses for 2011/12;
- set performance targets for executive directors and senior managers for 2013; and
- agreed the level at which the Long Term Incentive Plan (LTIP) award in respect of the 2012 calendar year would vest.

Elements of remuneration
The remuneration of the executive directors comprises:

- basic salary;
- benefits (including pension);
- a performance related annual bonus; and
- annual LTIP awards.

In addition to reviewing each constituent element, the Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure and quantum. In 2012 the Committee agreed to restructure the remuneration of the executive directors by reducing the value of bonus and LTIP awards and offsetting this with an adjustment to basic pay (with advice from independent external reward consultants).

The table below shows the total remuneration paid by the Group to directors during the year and the proportion borne by NWL.

	Basic Pay	Bonus	Other benefits	Fees	Total remuneration	NWL proportion	Total paid by NWL
	£'000	£'000	£'000	£'000	£'000		£'000
H Mottram OBE	341.8	191.9	126.6	-	660.3	70%	462.2
C M Green	182.3	122.2	33.0	-	337.5	70%	236.3
C I Johns	58.8	-	13.4	-	72.2	70%	50.5
G Neave	184.5	73.0	58.1	-	315.6	100%	315.6
A C Jones	164.5	66.1	15.1	-	245.7	100%	245.7
M Fay CBE	-	-	-	39.7	39.7	70%	27.8
Dr S Lyster	-	-	-	39.7	39.7	70%	27.8
F R Frame	-	-	-	39.7	39.7	30%	11.9
M A B Nègre	-	-	-	39.7	39.7	30%	11.9
P Rew	-	-	-	51.0	51.0	70%	35.7
	931.9	453.2	246.2	209.8	1,841.1		1,425.4

The other directors received no remuneration from the Group or Company. As a consequence of their resignation from the Board of NWGL, the costs of M Fay, Dr S Lyster, M Nègre and P Rew will be fully borne by NWL with effect from 1 April 2013. The executive directors and INEDs do not receive any other remuneration from the Group or its shareholders other than as disclosed above.

(i) Executive directors: basic salary and benefits
Basic salary is the only pensionable element of the executive directors' remuneration package. The basic salaries payable to directors of NWL are not directly linked to specific standards of performance in connection with the carrying out of functions of a "relevant undertaker". Basic salary is reviewed annually based on individual contributions and periodic benchmarking to the external market. For 2013, senior executives were awarded an annual increase in their basic salaries of approximately 2.1%, in line with the typical award made to NWL's senior managers. Benefits provided to the executive directors comprise membership of pension schemes, car allowance and healthcare.

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

(ii) Annual bonus

Following a change in NWL's financial year to align with the calendar year, 2012 was a transitional year during which a combination of full year and transitional targets were determined by the Committee in March 2012 and confirmed at the Committee's meeting on 9 May 2012. The performance period was 1 April 2012 to 31 December 2012, meaning that 75% of any award made would be payable. The maximum bonuses payable in respect of the 2012 transitional year, and thereafter, are as follows (as percentages of basic pay):

Role	1 April to 31 December 2012	From 1 January 2013
Chief Executive Officer	100%	70%
Finance Director	100%	50%
Executive Directors (A C Jones & G Neave)	80%	50%

The performance conditions were determined by the Committee to be:

Up to 50% payable on financial targets.
Up to 40% payable on Balanced Scorecard targets.
Up to 10% payable on performance against personal targets.

The Balanced Scorecard targets were as follows:

Theme	Measure	Relevant date	% of total available bonus potential
Competitiveness	Group EBIT vs budget	Dec 2012	25
	Group cash available for distribution vs budget	Dec 2012	25
Customer	Customer satisfaction (each SIM score)	Dec 2012	4
	Unplanned interruptions >6 hours (combined)	Mar 2012	4
	Coliform incidents	Dec 2012	4
People	Employee engagement score	Dec 2012	4
	Lost time reportable accidents	Dec 2012	4
Environment	Leakage (Mld)	Mar 2012	4
	STW failing LUT consent (%)	Dec 2012	4
	Pollution incidents 1 & 2	Dec 2012	4
Communities	BITC Platinum Plus	Dec 2012	4
	Just an Hour	Dec 2012	4
Personal targets		Dec 2012	10
TOTAL			**100**

The specific targets and outturn for 2012 are set out below. The Balanced Scorecard targets, in more detail, were as follows:

Customer satisfaction	Service Incentive Mechanism targets have been pro-rated for nine months. They are evaluated separately.
Unplanned interruptions	This regulatory target is anchored at 31 March and to accommodate the transition year the March 2012 figure was used. The 2013 target will use the March 2013 achievement, for which the performance period has already started.
Coliform incidents	2012 target for the full calendar year.
NWG EBIT	This is a new financial measure for the competitiveness theme and is based on the budget for the 12 months to 31 December 2012.
Cash available for distributions	This is defined as distributions paid compared to budget, from UK Water (2011) Limited to the shareholders, as interest on shareholder loans and dividends.
Employee engagement score	2012 target is to achieve 1* rating in the Sunday Times Best Companies Survey.
Lost time reportable accidents	2012 target for the full calendar year.
Leakage	This regulatory target is anchored at 31 March and to accommodate the transition year the March 2012 figure was used. The 2013 target will use the March 2013 achievement, for which the performance period has already started.
SWT failing LUT consent	100% compliance is our target – so zero failures in the full calendar year.
Pollution incidents category 1&2	2012 target for the full calendar year.
Business in the Community	Retain Platinum Plus status.
Just an Hour	Employees who have been involved in community support activities in the year to December 2012.

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

(ii) Annual bonus (continued)

These metrics are firmly linked to NWL's strategic goals (customer, competitiveness, people, environment and communities). The EBIT performance metric reflects competitiveness while the other elements of the balanced scorecard are linked to the other strategic goals. The EBIT element of the bonus is scored on a sliding scale around the target figure. A simple pass/fail measure applies to the other targets and most of the targets are set at levels which require significant improvements over previous actual results. The customer goal underpins targets based on customer satisfaction (by reference to SIM scores), unplanned interruptions and coliform failures. In 2012, up to 4% of a director's maximum bonus entitlement related to each such measure and the awards were 0% (customer satisfaction), 4% (unplanned interruptions) and 0% (coliform failures). The people goal is reflected in targets for employee engagement and lost time reportable accidents. In 2012, up to 4% of a director's maximum bonus entitlement related to each such measure and the awards were 4% (engagement score) and 4% (lost time reportable accidents). The environment goal targets comprise leakage, sewage treatment performance and pollution incidents. In 2012, up to four per cent of a director's maximum bonus entitlement related to each such measures and the awards were 4% (leakage), 4% (sewage treatment performance) and 4% (pollution incidents). The communities targets are based on external recognition of the Company's corporate social responsibility achievements. In 2012, up to 4% of a director's maximum bonus entitlement related to each such measures and the awards were 4% (BITC Platinum Plus) and 4% (Just an Hour).

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

For 2012, two of the four executive directors had personal targets which related to NWL's performance as a "relevant undertaker". Their targets, in summary, were as follows:

G Neave: investigating the use of systems to give early warning of potential water quality failures and supporting the implementation of business change via a more constructive employee relations climate.

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

These targets were, in the opinion of the Committee, substantially achieved and, therefore, of the 10% of their total maximum bonuses available in respect of personal targets, Mr Neave was awarded 9% and Mr Jones 10%.

Taking account of performance against personal targets, the balanced scorecard measures and EBIT, Mrs Mottram and Mr Green were awarded bonuses equal to 75% and 67% of their respective basic salaries; and Mr Neave and Mr Jones were awarded bonuses equal to 52.8% and 53.6% of their respective basic salaries. Only 75% of the awards were payable as they related to a nine month period.

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

Bonus deferral

Bonuses are paid in cash with no deferral.

Bonus claw back

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

(iii) Pension

Mrs Mottram and Mr Johns (with effect from 1 January 2013) are the only executive directors in the money purchase section of the Northumbrian Water Pension Scheme, to which they each receive an employer contribution equal to 15% of their respective basic salaries and each make an employee contribution of 8%.

Mr Jones participates in a defined benefit pension scheme which is not linked to NWL's performance as a "relevant undertaker".

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

(iv) LTIP arrangements

A cash based LTIP was introduced on 1 January 2012. The maximum LTIP award for 2012 was equal to 100% of base salary (in the relevant financial year) for executive directors on the Boards of both NWGL and NWL and 60% for executive directors on the Board of NWL only. The awards made on 1 January 2012 were at those levels with payment deferred until 2015. From 1 January 2013 onwards, the maximum LTIP awards have been reduced to 50% for executive directors on the Boards of both NWGL and NWL (and the Finance Director of NWL) and 30% for other executive directors on the Board of NWL only. The awards made on 1 January 2013 were at those levels. The LTIP targets relate to financial performance (70%), SIM (customer services performance) (15%) and serviceability (asset performance) (15%).

In respect of 2012, 35% out of the maximum of 70% available against the financial performance metric vested.

SIM performance is assessed for bonus purposes by comparing NWL's SIM score (quantitative and qualitative combined) with those of the other water and sewerage companies in England and Wales in the relevant regulatory year. There is no vesting of this part of an award unless fifth position in the rankings is achieved (this would be the median position). If the position achieved is fifth or higher, vesting is on a sliding scale with 50% of the 15% awarded for fifth place and 100% of 15% awarded for first place. In respect of 2012, 13.2% out of the maximum of 15% available against this metric vested.

50% of the 15% available in respect of serviceability vests for stable Ofwat assessments in the relevant regulatory year in three of the four asset classes (water non-infrastructure, water infrastructure, sewerage non-infrastructure and sewerage infrastructure). The entire 15% available (i.e. 15% of an individual's potential maximum award) vests for stable assessments in all four asset classes. There will be no vesting of this part of an award for less than three stable assessments. In respect of 2012, the full 15% available against this metric vested.

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

(v) Consideration of Ofwat Reports by the Committee

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

(vi) Future Targets for the year 1 January 2013 to 31 December 2013

The maximum bonuses available to executive directors in respect of the year 1 January 2013 to 31 December 2013 are shown above. 50% of the maximum bonus will relate to financial targets. 4% relate to targets based on each of the following: customer satisfaction (by reference to SIM scores), unplanned interruptions greater than six hours, coliform failures, leakage, sewage treatment works performance and pollution incidents. 8% will relate to people based targets and 8% to communities targets. The remaining 10% will relate to personal targets.

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

G Neave: (1) developing a business case for the injection of bio-gas into the grid for Howdon and Bran Sands (and, if approved, completing design and tender award and beginning construction); (2) completing an external review of the capital investment process to identify opportunities to become more efficient and deliver capital projects in a shorter timescale.

C Jones: (1) planning work for PR14; (2) developing a methodology for unit costs across repair and maintenance activity to allow accurate comparison of unit rates with contractors and other utilities (and reducing operating costs where opportunities are identified).

DIRECTORS' RESPONSIBILITIES AND DECLARATIONS for the year ended 31 March 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible under Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991 for:

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

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

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

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

RING FENCING

The directors confirm that, as at 31 March 2013, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment by the which the Appointee had available to it sufficient rights and assets to enable a special administrator to manage the affairs, business and property of the Appointee, should a special administrative order be made.

By order of the Board

M Parker
Company Secretary
11 July 2013