

**NORTHUMBRIAN WATER LIMITED**

**FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED 31 DECEMBER 2013**

Registered number 2366703

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# **FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 December 2013**

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## **STRATEGIC REPORT**

### **for the year ended 31 December 2013**

The directors of Northumbrian Water Limited (NWL or the Company) and its subsidiary companies, which together with NWL form the group, are pleased to present their strategic report on the affairs of the group and Company, along with their directors' report, the audited financial statements and the auditor's report for the year ended 31 December 2013.

On 23 January 2013 the Board approved the change of the Company's accounting reference date from 31 March to 31 December, therefore, the comparative numbers in this report relate to the nine month period from 1 April 2012 to 31 December 2012.

#### **Cautionary statement**

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

#### **Business overview**

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

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

In the south, we supply water services to 1.5 million people in Essex in the main population centres of Chelmsford, Southend and the London Boroughs of Barking and Dagenham and Havering and Redbridge; as well serving a population of 0.3 million in Suffolk in mainly rural areas with the largest towns being Great Yarmouth and Lowestoft.

NWL also owns a number of subsidiary companies which carry out financing activities on behalf of NWL (see note 11). The enclosed financial statements incorporate both the group's consolidated financial statements and the Company's financial statements.

NWL operates within a strict regulatory environment. The Water Services Regulation Authority (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).

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 Northumbrian Water Group Limited (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**

##### **Water Bill**

The Water Bill currently before Parliament is expected to pass into legislation in 2014. The most significant development is the establishment of a competitive market for retail water and sewerage services for all non households with a target date for market opening of 2017.

## STRATEGIC REPORT (continued)

### Water Bill (continued)

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

### Business Plan

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

In December, we published our business plan for 2015-20. This plan is based on extensive customer consultation and sets out the outcomes we aim to deliver, the total expenditure required and what this means for customer bills. It represents the next step towards the future described in Future Horizons. We have put forward a challenging plan that delivers on our customers' priorities and we believe represents great value for customers. Average bills from 2015-20 would rise in line with inflation in our north east area of supply and by slightly less than inflation in Essex and Suffolk.

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

The business plan will form the basis for Ofwat's determination of our price controls for 2015-20. The form of control will be different from previous periods with separate wholesale and retail controls, a move to a revenue (rather than price) based control and other changes to the methodology which were confirmed during 2013. The review of price controls comes to a conclusion in 2014 with draft determinations issued in the summer and the final determination of prices in December.

### Business strategy and objectives

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

We have underpinned our drive to be the best with five strategic themes, Competitiveness, Customer, People, Environment and Communities, described below, and achieving the right balance between them is essential to our success and reputation. 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.

## STRATEGIC REPORT (continued)

### Business strategy and objectives (continued)

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

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

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

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

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

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

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

### Performance

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

The table below details performance against the KPI targets set for 2013 and shows the targets for 2014.

Strategic theme	Scorecard measure	Target 2013	Performance	Achieved	Target 2014
Competitiveness	Group EBIT	budget	achieved	Yes	budget
	Group cash available for distribution	budget	achieved	Yes	budget
Customer	Customer satisfaction				
	- SIM quantitative score	86	95.5	No	90
	- SIM qualitative score	4.6	4.63	Yes	4.7
	Water supply interruptions >3 hours (average per property (minutes))	8.20	6.57	Yes	7.30
People	Coliform incidents (no.)	10	16	No	8
	Employee engagement score	81%	75%	No	2*
Environment	Lost time reportable accidents (no.)	9	6	Yes	4
	Leakage (Mld)				
	- north	144	136	Yes	141
	- south	66	53.9	Yes	66
	STW failing LUT consent (%)	0	0	Yes	0
Communities	Pollution incidents (categories 1 & 2)	3	5	No	2
	BITC Platinum Plus accreditation	retain status	status retained	Yes	retain status
	Just an Hour (employee participation)	50%	54.1%	Yes	50%

The 2013 targets for the Service Incentive Mechanism (SIM) quantitative score, water supply interruptions and leakage (north) measures were amended during the year in order to better align with the Company’s balanced scorecard performance reporting period.

NWL has continued its strong operational and financial performance through 2013, despite the backdrop of continued challenging economic conditions and continued income shortfalls. We have continued to deliver significant progress in our key focus areas of competitiveness, customer, people, environment and communities.

#### Competitiveness

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

## STRATEGIC REPORT (continued)

### Performance (continued)

#### *Customer*

Customer service is at the heart of the Company and all employees have a clear focus on getting things ‘right first time, every time’. Our aim is to deliver industry leading customer service. SIM was introduced by Ofwat to monitor both quantitative and qualitative aspects of customer service. In 2013, we have continued to focus upon delivering even better customer service and have seen our customer satisfaction scores from independent surveys improve from 4.46 to 4.63 (scored out of 5). This improvement has been delivered through keeping customers informed throughout their contact with us and ensuring they are fully satisfied with our service before closing the contact. Our performance on the quantitative measures has also improved during the period, though it did not reach the stretching target we set ourselves.

We now routinely text customers in advance of appointments and to notify them of interruptions to water supply, impending discoloured water problems and for those at risk of flooding, where we have fitted emergency flood prevention measures, we notify of approaching bad weather. We are also extending our use of web self service, web news, Twitter and web chat. These proactive customer communication channels have also reduced contact with our call centres, leaving more time to deal with more difficult issues.

Further investment in water network resilience has helped to ensure there have been no major water supply issues this year and we have continued our industry-leading performance on water supply interruptions. We have reduced the number of coliform incidents, though not as low as our target, and continue to focus our efforts on reducing these incidents further.

Construction of the Abberton Reservoir enhancement project is almost complete and the reservoir has recently filled to a level above its previous high and is well on its way to reaching its new top water level by spring 2015. The additional 15,000MI of storage will secure drinking water supplies to 1.5 million people in Essex for many years into the future.

A major project to clean over 200km of large diameter pipelines supplying 0.5 million customers in Newcastle is progressing, making use of a new process called ‘ice pigging’. This innovative solution is cheaper and quicker with less traffic disruption and is much less intrusive for customers than conventional techniques. This project will significantly reduce discoloured water complaints, improve water quality and improve network resilience.

#### *People*

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

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

We have continued throughout the year to ensure that our people are fairly treated and we proactively promote diversity and inclusion to reap the benefits of a diverse workforce. Our equal opportunity policy seeks to ensure that all our current employees and potential employees are treated with respect. We welcome job applications from all parts of the community and it is our intention that all job applicants and employees are treated equally, regardless of their age, ability, marital or partnership status, race, religion or belief, gender or sexual orientation. At the end of the year, the company had 2,996 employees of which 2,039 were male and 957 female. Of the 13 directors, 11 were male and 2 were female. The management team comprised 4 executive directors (3 male and 1 female) plus a further 5 senior managers (3 male and 2 female).

## STRATEGIC REPORT (continued)

### Performance (continued)

#### *People (continued)*

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

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

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

#### *Environment*

The environment is critical to us and our stakeholders and we acknowledge our responsibilities to protect and enhance the natural environment. Our carbon management plan will help reduce our carbon footprint and we aim to adopt good environmental practice in all aspects of our activity. Our integrated quality and environmental management systems are certified under ISO 9001, ISO 14001 and OHSAS 18001.

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

After the challenges of 2012's unprecedented rainfall we have seen bathing water quality return to normal levels with 100% compliance with the mandatory standard. The number of category 1 and 2 pollution incidents increased in the year from three to five, although the number of category 3 incidents reduced significantly. Increased investment to deal with the consequences of last year's flooding is underway which will remove over 700 properties from our 'at risk' register by March 2015.

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

#### *Communities*

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

More than 54% of our employees actively volunteered in their communities in 2013 through our Just an Hour scheme, supporting 673 different organisations. This is a huge achievement and we are very proud of the contribution that our people are making to the communities in which we operate. In the year the Company was re-accredited as a Platinum Plus company by BiTC, their highest award.

## STRATEGIC REPORT (continued)

### Other achievements

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

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

### 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 2013	Performance		Target 2014
		Current period	Previous period	
Gearing: net debt to RCV – group (%) <sup>1</sup>	<70	63	63	<70
Gearing: net debt to RCV – Appointed business only (%) <sup>1</sup>	<65	61	62	<65
Cash interest cover (times)	>3.0	3.8	6.1	>3.0
Cash flow to net debt (%)	>13	18	20	>13

<sup>1</sup> Regulatory Capital Value (RCV) for the current year is calculated by interpolating the actual March 2013 published RCV and the forecast March 2014 RCV, based on a March 2014 forecast RPI of 255.0.

The group's profit and loss account and balance sheet, and Company's balance sheet, are set out on pages 15 to 17. The statutory financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. The key accounting policies are summarised in note 1 to the statutory financial statements on pages 18 to 21 and these have been applied consistently throughout the current and preceding periods. Because of the change in accounting reference date, the prior period values relate to a nine month period only and are, therefore, not comparable to the current year results which reflect 12 months trading.

Turnover was £782.0m for the year ended 31 December 2013 (nine months ended 31 December 2012: £578.1m). This reflected the application of RPI of 3% 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 December 2013 were £443.7m (nine months ended 31 December 2012: £319.5m). This reflected increases in manpower costs, power prices, contractor costs and depreciation plus some restructuring costs and general inflationary increases, partially offset by the benefits of our efficiency programme. During the year, the Company invested £1.1m (nine months ended 31 December 2012: £0.9m) in research and development. The efficiency programme has continued to progress well in the year, focussing on continued identification and implementation of sustainable operating cost efficiencies in order to achieve our medium term goal of being in the top efficiency band for both water and sewerage, as measured by Ofwat, by 2014.

Net interest payable was £133.9m in the year ended 31 December 2013 (nine months ended 31 December 2012: £102.5m). This reflected the impact of lower indexation on index-linked bonds, partially offset by the non-recurrence of a one-off benefit in the prior period arising from the transfer of a finance lease to a new counterparty on improved terms.

Profit on ordinary activities before taxation for the year ended 31 December 2013 was £204.4m (nine months ended 31 December 2012: £156.1m). The current tax charge of £43.1m and deferred tax credit of £53.7m are explained in note 8 to the accounts. Profit for the financial year was £215.0m (nine months ended 31 December 2012: £119.1m).

The directors do not recommend payment of a final ordinary dividend (nine months ended 31 December 2012: £nil). Total dividends paid in the year ended 31 December 2013 were £190.2m (nine months ended 31 December 2012: £150.6m). The dividend policy is explained in note 9 to the accounts.



## **STRATEGIC REPORT (continued)**

### **Capital investment**

Capital investment in the regulated business for the year was £221.7m, under regulatory accounting guidelines (nine months ended 31 December 2012: £181.2m), primarily to ensure the continued provision of sustainable water and waste water services in the areas we serve. Continued investment in maintenance of our above ground assets along with rehabilitating 120km of sewers and 85km of water mains has maintained stable serviceability. Construction of the Abberton Reservoir scheme was completed successfully in the year.

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

### **Capital structure and liquidity**

The group's debt structure remained largely unchanged with 75% fixed at an average rate of 5.66%, 22% index linked at an average real rate of 2.07% and 3% on a variable rate basis. The blended average rate for the group for the year ended 31 December 2013 was 5.25%.

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

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 £420m at 31 December 2013.

Cash interest cover and gearing measures have remained better than target levels, with the strong investment grade credit rating for the Company remaining at BBB+ stable (Standard & Poors and Fitch) and Baa1 stable (Moody's).

### **Treasury policies**

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

## **PRINCIPAL RISKS AND UNCERTAINTIES**

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

The 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 CEO to the Board. Senior management implements policies on risk management and internal control.

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

## STRATEGIC REPORT (continued)

### PRINCIPAL RISKS AND UNCERTAINTIES (continued)

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. During the year, a Risk and Compliance Committee was introduced, with the same membership as the Audit Committee, to further strengthen management of risk and compliance matters and to enhance the assurance provided to the Board.

The key business risks facing the Company are:

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

### Treasury activities

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

#### *Funding risk*

The level of capital expenditure which NWL is obliged to incur is such that we cannot be wholly financed by internally generated sources. As a result, we must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required by the regulated business. In order to raise this finance efficiently, the Board's aim is to retain strong investment grade credit rating at BBB+ stable (Standard & Poors and Fitch) and Baa1 stable (Moody's). A reduction in the credit rating would likely restrict future sources of funding and increase the associated cost of new borrowing.

#### *Liquidity risk*

The Company's policy is to have available standby committed bank borrowing facilities with a value of no less than £50m and with a bank agreement availability period of no less than three months. At 31 December 2013, NWL had £420m (2012: £450m) of undrawn facilities, which mature in 2016.

#### *Interest rate risk*

The Company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and variable rates of interest and, on occasion, uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. The Company's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 December 2013, 75% (2012: 74%) of the borrowings of the group 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 £3m sterling equivalent of a translation nature, should be covered as soon as they are identified. At 31 December 2013, the Company had forward foreign exchange contracts of £2.1m (2012: £2.4m) for the purpose of hedging the foreign currency risk of committed future purchases.

#### *Market price risk*

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

By order of the Board

M Parker, Company Secretary, 10 April 2014

## **DIRECTORS' REPORT**

### **for the year ended 31 December 2013**

#### **CORPORATE GOVERNANCE**

##### **Directors**

The directors who served during the year were as follows:

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

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

##### **The Company's Licence**

The Company's Instrument of Appointment by the Secretary of State for the Environment, Food and Rural Affairs (the Licence) 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 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 and is the Senior Independent Non-Executive Director. He is Chairman of the Audit Committee and the Risk and Compliance Committee and is also a member of the Remuneration Committee.

**M Fay CBE** 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.

**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. In October 2013, he was appointed as Deputy Lieutenant for the County 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.

## **DIRECTORS' REPORT (continued)**

### **The Company's Licence (continued)**

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 (the Code) and the Company maintains high standards of corporate governance and endeavours to comply with the main principles of the Code.

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 board composition of NWL is different to that of NWGL, all of NWL's directors attend and participate in decisions at NWGL Board meetings and its associated committees. Whilst the committees are formally constituted at the NWGL level, the vast majority of their work relates to the Company's activities. All of NWL's directors therefore have visibility over, and have played a full part in, strategic decisions at both the NWL and NWGL levels.

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 Board meets at least six times per year. 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, M Fay and Dr S Lyster) 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 joined the Board in January 2002 and A C Jones joined in January 2004. C I Johns joined the Board on 1 January 2013.

## **DIRECTORS' REPORT (continued)**

### **Board balance and independence (continued)**

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 Code, 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.

In respect of new appointments to the Board, external search consultancies, with expertise appropriate to the role being filled, are appointed to make recommendations to the Board.

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

### **Remuneration Committee**

The members of the Remuneration Committee are A J Hunter (Chairman), H Mottram, P Rew, M Fay and D N Macrae. S Salter, from the management team, provides advice to the 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, and in the period up to the approval of these financial statements, the Audit Committee assisted both executive and non-executive directors to discharge their individual and collective responsibilities by undertaking the following work:

- reviewed and provided comments on the draft statutory accounts, received reports from the external auditor setting out the audit approach and plan, significant audit risks and conclusions on the group's internal controls and risk management and confirming auditor independence, reviewed the appropriateness of accounting policies, significant accounting judgements and evidence supporting the going concern basis for the accounts and recommended approval of the accounts to the Board;
- reviewed and provided comments on the NWL regulatory accounts and annual performance review, received reports from the external auditor on the audit opinion for the accounts, considered and endorsed the approach to produce and provide assurance for the annual performance review, reviewed evidence to support the Condition F6A.2A certificate (statement of sufficiency of financial resources) and recommended approval of both the documents to the Board;
- reviewed and approved the approach to Board assurance for the regulatory price review business plan, monitored progress of the business plan assurance, and received reports from the independent assurance advisor and reported to the Board recommending signing of the Board assurance statement;

## **DIRECTORS' REPORT (continued)**

### **Audit Committee (continued)**

- reviewed the effectiveness of the external auditor utilising an external best practice assessment framework and discussing the outputs with the audit partner;
- reviewed the effectiveness of the internal audit function, including approving the appointment of an external co-sourcing partner to carry out specialist assurance work, requesting and considering a report on the effectiveness of the internal audit function carried out by the external co-sourcing partner and, whilst acknowledging that the function was professional and highly regarded, approving the resultant action plan to build on the existing strong base;
- considered and approved external auditor's fees for both audit and non-audit services, by reference to the Committee's policy on approval of non-audit fees, requiring the audit partner to demonstrate independence particularly in respect of consultancy work in relation to workforce operations;
- approved the internal audit work programme for the year, reviewed progress against the programme and received reports on the outputs of internal audits;
- reviewed risk and control framework and reporting, including management of customer debt, tax and treasury compliance matters and approval of financial approval rules; and
- monitored compliance with the Company's procedures designed to prevent bribery, having regard to the provisions of the Bribery Act 2010, including receiving reports on any whistleblowing allegations.

The Audit Committee Chairman has reported formally to the NWGL and NWL Boards following each meeting of the Committee and Committee minutes have been circulated to both Boards.

### **Risk and Compliance Committee**

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

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

### **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.

## **OTHER DISCLOSURES**

### **Results and dividends**

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

### **Financial instruments and treasury policies**

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

### **Employment policies**

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

## DIRECTORS' REPORT (continued)

### Political

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

Name of political party	£
Conservative	1,875
Labour	3,223
Liberal Democrats	1,102
<b>Total</b>	<b>6,200</b>

### Greenhouse gas emissions

We monitor our emissions on an April to March period which we report to Ofwat. The protocol that we use is based on the Carbon Accounting Workbook developed and updated annually by the Water Research Council, on behalf of the water industry, and published by UK Water Industry Research. This is founded on international and Defra protocols but includes additions that are specific to the water industry.

Our total net operational GHG emissions for the year ended 31 March 2013 were 214.8 ktonnes CO<sub>2</sub>e (year ended 31 March 2012: 220.2 ktonnes CO<sub>2</sub>e). Our carbon emissions are now 28% lower than in 2008 and our carbon management plan aims to reduce our emissions to 150 ktonnes CO<sub>2</sub>e by 2020, which represents a fall of 50% in our emissions from a baseline of 2008.

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

Annual operational GHG intensity ratio	2012-13	2011-12
Emissions/MI of water	217.8	244.2
Emissions/MI of sewage treated (flow to full treatment)	271.3	363.0
Emissions/MI of sewage treated (water distribution input)	619.9	552.1

Figures in kgCO<sub>2</sub>e/MI

### Directors' indemnification

NWGL had in place directors' and officers' insurance for the year. 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' declaration

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.

## **DIRECTORS' REPORT (continued)**

### **Financial statements preparation and going concern**

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

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

- the Licence which is in place on a rolling 25 year basis;
- the certainty on customer tariffs to March 2015 resulting from the acceptance of the 2009 Final Determination by the Board;
- the financial strength of the group at the balance sheet date and performance for the year ended 31 December 2013, which is in line with expectations and reviewed at each Board meeting, most recently in March 2014;
- the key financial ratios over the planning horizon of the group's one year budget and medium term plan to 2018 as reflected in strong investment grade credit ratings with stable outlook;
- the fact that the Company has arranged £450m of five year committed bank facilities as back up liquidity (maturing in 2016), of which £420m remains undrawn at 31 December 2013; and
- the group's formal risk and governance arrangements which are monitored by the Audit Committee, Risk and Compliance Committee and Board.

### **Directors' responsibility statement**

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

Company law requires the directors to prepare financial statements for each financial period. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). 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 group and Company and of the profit or loss of the group and 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 group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the group and 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 group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

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, 10 April 2014



**GROUP PROFIT AND LOSS ACCOUNT**  
for the year ended 31 December 2013

	Note	12 months ended December 2013 £'m	9 months ended December 2012 £'m
Turnover		782.0	578.1
Operating costs	3(a)	(308.3)	(222.5)
Capital maintenance costs	3(b)	<u>(135.4)</u>	<u>(97.0)</u>
Total operating costs		<u>(443.7)</u>	<u>(319.5)</u>
<b>OPERATING PROFIT</b>		338.3	258.6
Net interest payable	4	<u>(133.9)</u>	<u>(102.5)</u>
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>		204.4	156.1
Taxation	8(a)	10.6	(37.0)
<b>PROFIT FOR THE FINANCIAL PERIOD</b>	24	<u><u>215.0</u></u>	<u><u>119.1</u></u>

All results are from continuing operations in the United Kingdom.

**GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES**  
for the year ended 31 December 2013

	Note	12 months ended December 2013 £'m	9 months ended December 2012 £'m
Profit for the financial period		215.0	119.1
Pension liability actuarial gain/(loss) in the year	26	25.2	(7.4)
Deferred tax related to pension adjustments	26	<u>(9.6)</u>	<u>0.2</u>
<b>Total recognised gains and losses relating to the period</b>		<u><u>230.6</u></u>	<u><u>111.9</u></u>

**GROUP BALANCE SHEET**  
**at 31 December 2013**

	Note	2013	2012
		£'m	£'m
<b>FIXED ASSETS</b>			
Tangible assets	10	3,783.9	3,706.0
Investments	11	170.3	170.3
		3,954.2	3,876.3
<b>CURRENT ASSETS</b>			
Stocks	12	2.8	2.9
Debtors due in less than one year	13	176.8	164.7
Debtors due in more than one year	14	1.0	1.6
Investments	15	-	40.0
Cash at bank and in hand		33.8	21.4
		214.4	230.6
<b>CREDITORS</b>			
Amounts falling due within one year	16	(293.1)	(257.3)
<b>NET CURRENT LIABILITIES</b>		(78.7)	(26.7)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		3,875.5	3,849.6
CREDITORS: Amounts falling due after more than one year	17	(2,562.0)	(2,526.0)
PROVISIONS FOR LIABILITIES AND CHARGES	21	(178.8)	(229.2)
ACCRUALS AND DEFERRED INCOME	22	(240.0)	(231.1)
		(2,980.8)	(2,986.3)
<b>NET ASSETS EXCLUDING PENSION LIABILITY</b>		894.7	863.3
Pension liability	26	(69.4)	(78.4)
<b>NET ASSETS INCLUDING PENSION LIABILITY</b>		825.3	784.9
<b>CAPITAL AND RESERVES</b>			
Called up share capital	23	122.7	122.7
Profit and loss account	24	702.6	662.2
<b>SHAREHOLDERS' FUNDS</b>	24	825.3	784.9

Approved by the Board on 10 April 2014 and signed on their behalf by:

H Mottram  
Registered number 2366703

**COMPANY BALANCE SHEET**  
**at 31 December 2013**

	Note	2013	2012
		£'m	£'m
<b>FIXED ASSETS</b>			
Tangible assets	10	3,783.9	3,706.0
Investments	11	160.9	160.9
		3,944.8	3,866.9
<b>CURRENT ASSETS</b>			
Stocks	12	2.8	2.9
Debtors due in less than one year	13	176.4	163.9
Debtors due in more than one year	14	1.0	1.6
Investments	15	-	40.0
Cash at bank and in hand		22.8	10.2
		203.0	218.6
<b>CREDITORS</b>			
Amounts falling due within one year	16	(286.6)	(250.6)
<b>NET CURRENT LIABILITIES</b>		(83.6)	(32.0)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		3,861.2	3,834.9
<b>CREDITORS: Amounts falling due after more than one year</b>	17	(2,316.7)	(2,280.9)
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>	21	(179.7)	(230.1)
<b>ACCRUALS AND DEFERRED INCOME</b>	22	(383.7)	(381.9)
		(2,880.1)	(2,892.9)
<b>NET ASSETS EXCLUDING PENSION LIABILITY</b>		981.1	942.0
Pension liability	26	(69.4)	(78.4)
<b>NET ASSETS INCLUDING PENSION LIABILITY</b>		911.7	863.6
<b>CAPITAL AND RESERVES</b>			
Called up share capital	23	122.7	122.7
Profit and loss account	24	789.0	740.9
<b>SHAREHOLDERS' FUNDS</b>	24	911.7	863.6

Approved by the Board on 10 April 2014 and signed on their behalf by:

H Mottram  
Registered number 2366703

## **NOTES TO THE STATUTORY FINANCIAL STATEMENTS for the year ended 31 December 2013**

### **1. STATEMENT OF ACCOUNTING POLICIES**

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

**(a) Basis of accounting and consolidation**

The financial statements have been prepared under the historical cost convention. These group financial statements consolidate the financial statements of the Company and its subsidiary undertakings. Accordingly, the Company has taken advantage of the exemption from publishing a profit and loss account. The Company's profit for the period is reported in note 24. The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

The financial statements have been prepared on a going concern basis, having considered the principal risks and uncertainties, which assumes that the group will have adequate funding to meet its liabilities as they fall due in the foreseeable future. As at 31 December 2013 the group had net current liabilities of £78.7m (2012: £26.7m). 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 of £420m (2012: £450m). Accordingly, the directors believe it is appropriate to prepare the financial statements on a going concern basis.

**(b) Turnover**

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

**(c) Cash flow statement**

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

**(d) Tangible fixed assets and depreciation**

Tangible fixed assets comprise:

**(i) Infrastructure assets**

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

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

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

**(ii) Non-infrastructure assets**

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

## 1. STATEMENT OF ACCOUNTING POLICIES (continued)

### (d) Tangible fixed assets and depreciation (continued)

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

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

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

### (iii) Assets in the course of construction

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

### (e) Grants and contributions

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

### (f) Hire purchase and leasing

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

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

### (g) Stocks

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

### (h) Pension costs

The Company is the principal employer 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 year as adjusted for taxation purposes using the rates of tax enacted or substantively enacted by the balance sheet date.

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

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

As permitted by FRS 19, the Company has adopted a policy of discounting deferred tax assets and liabilities to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained at the balance sheet date on 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 December 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 used to hedge committed future transaction. Resultant gains and losses are deferred until the transaction occurs.

## 1. STATEMENT OF ACCOUNTING POLICIES (continued)

### (n) Liquid resources

Liquid resources comprise cash and short term deposits with a maturity on acquisition of three months or less, which are held for the purpose of meeting short term cash commitments rather than for investment or other purposes.

### (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.

## 2. SEGMENTAL INFORMATION

The directors consider that the group and 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:

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Materials and consumables	19.9	15.3
Other external charges	79.9	56.1
Net manpower costs (note 7)	114.1	82.7
Other operating charges	128.0	92.8
Own work capitalised	(33.6)	(24.4)
	<u>308.3</u>	<u>222.5</u>

### (b) Capital maintenance costs comprise:

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Depreciation:		
Non-infrastructure assets	86.2	61.9
Infrastructure assets	50.2	37.6
Assets held under finance leases	4.9	3.3
Amortisation of capital grants and contributions	(4.3)	(3.7)
Profit on disposal of fixed assets	(1.6)	(2.1)
	<u>135.4</u>	<u>97.0</u>

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

(c) Profit on ordinary activities before taxation:

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Profit on ordinary activities before taxation is stated after charging:		
Operating leases:		
Plant and machinery	0.1	0.1
Other assets	0.8	0.8
Costs of research and development	1.1	0.9
Directors' emoluments (note 5)	1.7	1.1

Auditor's remuneration in respect of the statutory audit amounted to £140k (nine months ended 31 December 2012: £133k), including subsidiaries' fees of £19k (nine months ended 31 December 2012: £18k). Fees of £50k (nine months ended 31 December 2012: £5k) were incurred in respect of regulatory reporting, including the audit of the regulatory accounts, the principal statement and the statement of sufficiency of financial resources and facilities. Fees of £811k (nine months ended 31 December 2012: £53k) were incurred for non-audit services comprising consultancy work in relation to workforce operations, regulatory price control business plan assurance and pension, tax compliance and cash collection advice.

### 4. NET INTEREST PAYABLE

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	146.8	111.0
Total interest payable	146.8	111.0
Interest receivable:		
Group interest	(9.8)	(7.3)
External interest	(1.1)	(1.0)
Financing income receivable under finance leases	-	(0.6)
Total interest receivable	(10.9)	(8.9)
Other finance (income) / charges relating to pension scheme (note 26)	(2.0)	0.4
Net interest payable	133.9	102.5



## 5. DIRECTORS' EMOLUMENTS

### (a) Directors' remuneration

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

	12 months ended December 2013	9 months ended December 2012
	£'000	£'000
Emoluments (including benefits in kind)	<u>1,665.3</u>	<u>1,130.8</u>

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

One of the directors at 31 December 2013 was a member of a defined benefit pension scheme where the Company makes contributions towards the cost (2012: 1).

Two of the directors at 31 December 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:

	12 months ended December 2013	9 months ended December 2012
	£'000	£'000
Emoluments (including benefits in kind)	<u>571.6</u>	<u>364.1</u>

In the year ended 31 December 2013, the highest paid director was a member of the defined contribution scheme and the payments made to that scheme of £35k (nine months ended 31 December 2012: £28k) 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:

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Gross costs charged to the profit and loss account:		
Wages and salaries	67.7	49.8
Social security costs	6.3	4.6
Other pensions costs	12.4	8.2
	<u>86.4</u>	<u>62.6</u>
Costs recharged to other Group companies:		
Wages and salaries	1.9	1.5
Social security costs	0.2	0.1
Other pensions costs	0.3	0.2
	<u>2.4</u>	<u>1.8</u>
Net costs charged to the profit and loss account:		
Wages and salaries	65.8	48.3
Social security costs	6.1	4.5
Other pensions costs	12.1	8.0
	<u>84.0</u>	<u>60.8</u>
Costs charged to capital schemes:		
Wages and salaries	23.9	17.4
Social security costs	2.2	1.6
Other pensions costs	4.0	2.9
	<u>30.1</u>	<u>21.9</u>
Total net employee costs	<u>114.1</u>	<u>82.7</u>

The average monthly number of employees on the payroll during the financial year was 2,983 (2012: 2,951) and the total at the year end was 2,996 (2012: 2,969).

## 8. TAXATION

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

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Current tax:		
UK corporation tax on profits for the year at 23.25% (nine months ended 31 December 2012: 24%)	7.3	16.8
Adjustments in respect of prior periods	(1.5)	(0.3)
Payable in respect of group relief for the current year at 23.25% (nine months ended 31 December 2012: 24%)	37.2	23.4
Adjustments in respect of prior periods	0.1	0.3
Total current tax charge (note 8b)	<u>43.1</u>	<u>40.2</u>
Deferred tax:		
Reduction due to opening tax rate change	(51.6)	(17.2)
Decrease in discount arising from above rate change	17.2	6.4
Net reduction in opening deferred tax	<u>(34.4)</u>	<u>(10.8)</u>
Movement in the year at 20% (nine months ended 31 December 2012: 23%):		
Origination and reversal of timing differences in the period	1.5	0.7
Adjustments in respect of prior periods	0.7	-
	<u>2.2</u>	<u>0.7</u>
(Increase) / decrease in discount arising from current period movements	(21.5)	6.9
Movement in the year	<u>(19.3)</u>	<u>7.6</u>
Total deferred tax credit (note 21)	<u>(53.7)</u>	<u>(3.2)</u>
Tax on profit on ordinary activities	<u>(10.6)</u>	<u>37.0</u>

The rate of UK corporation tax was reduced from 24% to 23% by the Finance Act 2012 with effect from 1 April 2013. The rate has been reduced further to 21% with effect from 1 April 2014 and to 20% with effect from 1 April 2015 by the Finance Act 2013. Accordingly, deferred tax was restated at 1 January 2013 from 23% to 20%, being the rate at which timing differences are expected to reverse.

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

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

## 8. TAXATION (continued)

### (b) Reconciliation of the current tax charge:

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Profit on ordinary activities before tax	204.4	156.1
Profit on ordinary activities multiplied by standard rate of corporation tax of 23.25% (nine months ended 31 December 2012: 24%)	47.5	37.5
Effects at 23.25% (nine months ended 31 December 2012: 24%) of:		
Expenses not deductible for tax purposes	0.6	0.1
Non-taxable income and other tax reliefs	(0.8)	(0.3)
Depreciation in respect of non-qualifying items	4.7	3.7
Capital allowances in excess of depreciation	(3.8)	(2.4)
Pension scheme deficit	2.3	2.4
Other timing differences	(0.4)	(0.9)
Tax losses carried forward	0.1	0.1
Consortium relief paid for at less than the standard rate	(5.8)	-
Adjustments in respect of prior years	(1.3)	-
Transfer pricing adjustments	0.8	0.7
Balancing payment payable	(0.8)	(0.7)
Total current tax charge (note 8a)	43.1	40.2

### (c) Factors that may affect future tax charges:

Legislation has already been enacted to reduce the UK rate of corporation tax to 20% by 1 April 2015 (see note 8(a)). Had that rate applied in the year to 31 December 2013, the current period's corporation tax charge would have been reduced by £6.3m to £38.2m.

The company expects to continue to incur high levels of capital expenditure during the remainder of the 2010-15 regulatory review period which, under current tax legislation, should result in claims for tax reliefs in excess of depreciation.

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

	12 months ended December 2013	9 months ended December 2012
	£'m	£'m
Equity:		
Dividends paid:		
Interim paid for the year ended 31 December 2013 of 74.28p (year ended 31 March 2012: 80.61p) per share on an aggregated basis	91.1	98.9
Interim paid for the year ended 31 December 2013 of 80.80p (period ended 31 December 2012: 42.18p) per share on an aggregated basis	99.1	51.7
Total dividends paid in the period	190.2	150.6

## 9. DIVIDENDS (continued)

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

The directors have a policy which aims to grow dividends on a slow but regular basis and which takes into account the principle of incentive based price cap regulation, including operating and investment performance. Following the Board's creation of a more efficient capital structure during the year, the dividend has been rebased.

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

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

## 10. TANGIBLE FIXED ASSETS

Group and Company	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 January 2013	125.4	2,259.8	2,409.0	200.0	220.2	5,214.4
Additions	-	-	-	-	219.9	219.9
Schemes commissioned	5.1	99.5	100.4	10.3	(215.3)	-
Reclassifications	(2.0)	(3.7)	6.0	(0.3)	-	-
Disposals	(0.5)	(5.7)	(1.4)	(0.3)	-	(7.9)
At 31 December 2013	<u>128.0</u>	<u>2,349.9</u>	<u>2,514.0</u>	<u>209.7</u>	<u>224.8</u>	<u>5,426.4</u>
Depreciation:						
At 1 January 2013	42.1	437.0	879.4	149.9	-	1,508.4
Charge for the year	2.7	50.7	76.6	11.3	-	141.3
Reclassifications	2.3	-	(2.1)	(0.2)	-	-
Disposals	(0.1)	(5.6)	(1.3)	(0.2)	-	(7.2)
At 31 December 2013	<u>47.0</u>	<u>482.1</u>	<u>952.6</u>	<u>160.8</u>	<u>-</u>	<u>1,642.5</u>
Net book value:						
At 31 December 2013	<u>81.0</u>	<u>1,867.8</u>	<u>1,561.4</u>	<u>48.9</u>	<u>224.8</u>	<u>3,783.9</u>
At 31 December 2012	<u>83.3</u>	<u>1,822.8</u>	<u>1,529.6</u>	<u>50.1</u>	<u>220.2</u>	<u>3,706.0</u>
Leased assets included above:						
Net book value:						
At 31 December 2013	<u>-</u>	<u>45.9</u>	<u>20.6</u>	<u>-</u>	<u>-</u>	<u>66.5</u>
At 31 December 2012	<u>-</u>	<u>46.4</u>	<u>21.8</u>	<u>-</u>	<u>-</u>	<u>68.2</u>

## 11. FIXED ASSET INVESTMENTS

	Loans to group companies		Guaranteed investment contracts	Total	
	Group £'m	Company £'m	Group only £'m	Group £'m	Company £'m
At 1 January 2013	159.0	160.9	11.7	170.7	160.9
Additions	-	-	0.1	0.1	-
Matured	-	-	(0.4)	(0.4)	-
At 31 December 2013	<u>159.0</u>	<u>160.9</u>	<u>11.4</u>	<u>170.4</u>	<u>160.9</u>

	2013		2012	
	Group £'m	Company £'m	Group £'m	Company £'m
Disclosed as:				
Due within one year (note 13)	0.1	-	0.4	-
Due in more than one year	<u>170.3</u>	<u>160.9</u>	<u>170.3</u>	<u>160.9</u>
	<u>170.4</u>	<u>160.9</u>	<u>170.7</u>	<u>160.9</u>

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 special purpose financing vehicle.

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

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

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

The group has guaranteed investment contracts with Financial Security Assurance (UK) Limited of which £0.1m matured on 16 January 2014, £1.2m matures in instalments between 16 January 2014 and 16 January 2034 and £10.0m matures on 16 January 2034.

## 12. STOCKS

	Group and Company	
	2013 £'m	2012 £'m
Raw materials and consumables	<u>2.8</u>	<u>2.9</u>

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	
	Group £'m	Company £'m	Group £'m	Company £'m
Trade debtors	77.0	77.0	77.5	77.5
Corporation tax repayable	8.4	8.4	2.1	2.1
Amounts owed by other Group companies	12.0	12.0	8.6	8.6
Other debtors	5.3	5.3	5.0	5.0
Investments (note 11)	0.1	-	0.4	-
Prepayments and accrued income	74.0	73.7	71.1	70.7
	<u>176.8</u>	<u>176.4</u>	<u>164.7</u>	<u>163.9</u>

Trade debtors are shown net of bills raised in advance.

### 14. DEBTORS DUE IN MORE THAN ONE YEAR

	Group and Company	
	2013 £'m	2012 £'m
Loan facility prepayments	<u>1.0</u>	<u>1.6</u>

### 15. INVESTMENTS

	Group and Company	
	2013 £'m	2012 £'m
Short term deposits	<u>-</u>	<u>40.0</u>

### 16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2013		2012	
	Group £'m	Company £'m	Group £'m	Company £'m
Obligations under finance leases (note 19)	7.4	7.4	7.2	7.2
Loans (note 18)	60.5	60.6	28.7	28.7
Trade creditors	2.9	2.9	5.1	5.1
Amounts owed to other Group companies	28.0	28.0	25.9	25.9
Amounts owed to related parties	7.1	7.1	-	-
Taxation and social security	2.4	2.4	2.4	2.4
Other creditors	14.0	14.0	13.2	13.2
Receipts in advance	47.3	47.3	51.3	51.3
Accruals and deferred income	123.5	116.9	123.5	116.8
	<u>293.1</u>	<u>286.6</u>	<u>257.3</u>	<u>250.6</u>

Accruals and deferred income includes accruals related to capital projects in both the group and Company of £29.4m (2012: £30.5m).

## 16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR (continued)

Included in amounts owed by the group and the Company to other Group companies is £22.7m (2012: £23.3m) payable in respect of tax losses surrendered from fellow group companies.

Amounts owed by the group and Company to related parties are in respect of tax losses surrendered from related parties (note 27).

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

	2013		2012	
	Group £'m	Company £'m	Group £'m	Company £'m
Obligations under finance leases (note 19)	101.6	101.6	100.9	100.9
Loans (note 18)	2,460.4	347.6	2,424.8	328.1
Amounts owed to other group companies (note 20)	-	1,867.5	-	1,851.6
Other creditors	-	-	0.3	0.3
	<u>2,562.0</u>	<u>2,316.7</u>	<u>2,526.0</u>	<u>2,280.9</u>

Amounts owed to other group companies is net of £17.9m of related gilt locks being amortised over the term of the loans.

## 18. LOANS

	2013		2012	
	Group £'m	Company £'m	Group £'m	Company £'m
Loans are repayable as follows:				
Within one year (note 16)	60.5	60.6	28.7	28.7
Between one and two years	32.8	32.6	30.6	30.6
Between two and five years	410.6	107.3	405.9	105.6
After five years	2,017.0	207.7	1,988.3	191.9
	<u>2,520.9</u>	<u>408.2</u>	<u>2,453.5</u>	<u>356.8</u>

*Group:* Loans wholly repayable within 5 years amount to £374.1m (2012: £354.6m). Loans not wholly repayable within 5 years amount to £2,146.8m (2012: £2,098.9m) and bear interest rates in the range 1.5% to 7.23%.

At 31 December 2013, the fair value loss on the group's outstanding derivatives was £58.3m (2012: £63.9m). This comprised £48.9m (2012: £48.0m) in relation to an RPI swap to convert variable inflation-linked revenues on a contract with the EA, calculated on a quarterly basis on a notional principal of £2.9m (2012: £2.9m), and £9.4m (2012: £15.9m) in relation to an interest rate swap with a notional principal of £85.0m (2012: £95.0m).

*Company:* Loans wholly repayable within 5 years amount to £73.9m (2012: £54.3m). Loans not wholly repayable within 5 years amount to £334.3m (2012: £302.5m) and bear interest rates in the range 1.5% to 7.23%.

At 31 December 2013, the fair value loss on the Company's outstanding derivatives was £9.4m (2012: £15.9m) in relation to an interest rate swap with a notional principal of £85.0m (2012: £95.0m).



## 19. OBLIGATIONS UNDER FINANCE LEASES

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

	Group and Company	
	2013	2012
	£'m	£'m
Amounts due:		
Within one year	7.4	7.2
Between one and two years	7.0	6.7
Between two and five years	64.2	66.4
After five years	75.7	77.5
	<u>154.3</u>	<u>157.8</u>
Less:		
Finance charge allocated to future periods	(45.3)	(49.7)
	<u>109.0</u>	<u>108.1</u>
Disclosed as due:		
Within one year (note 16)	7.4	7.2
After more than one year (note 17)	101.6	100.9
	<u>109.0</u>	<u>108.1</u>

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 £96.3m (2012: £97.4m).

## 20. AMOUNTS DUE TO OTHER GROUP COMPANIES

Amounts due to other group companies from the Company include loans repayable as follows:

	Company only	
	2013	2012
	£'m	£'m
Between two and five years	300.2	300.3
After five years	1,567.3	1,551.3
	<u>1,867.5</u>	<u>1,851.6</u>

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 (nine months ended 31 December 2012: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (nine months ended 31 December 2012: £0.2m).

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 (nine months ended 31 December 2012: £nil).

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 (nine months ended 31 December 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 £5.6m (nine months ended 31 December 2012: £6.2m).

## 20. AMOUNTS DUE TO OTHER GROUP COMPANIES (continued)

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 £2.2m (nine months ended 31 December 2012: £2.4m).

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 £3.6m (nine months ended 31 December 2012: £8.1m).

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 £356.4m. Finance costs allocated during the year amounted to £3.6m (nine months ended 31 December 2012: £0.5m).

## 21. PROVISIONS FOR LIABILITIES AND CHARGES

	Pension provision for former directors
	Group and Company
	£'m
At 1 January 2013	2.2
Utilised during the year	(0.2)
At 31 December 2013	<u>2.0</u>

	Deferred tax	
	Group	Company
	£'m	£'m
At 1 January 2013	227.0	227.9
Total movement in the year (note 8a)	(53.7)	(53.7)
Included above relating to pensions (note 26)	3.5	3.5
At 31 December 2013	<u>176.8</u>	<u>177.7</u>
Total provisions for liabilities and charges	<u>178.8</u>	<u>179.7</u>

The pension provision for former employees relates to pensions payable mainly to former employees of water-only companies which have since merged with the Company. The provision of £2.0m represents the full future amounts payable, based on an actuarial assessment, for which the Company is directly liable.

The provision for deferred tax comprises:

	2013		2012	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Accelerated depreciation	377.1	377.1	429.3	429.3
Other timing differences	(38.5)	(37.9)	(44.9)	(44.2)
Tax losses	(0.4)	-	(0.3)	-
Held-over gains	1.0	1.0	1.0	1.0
Undiscounted provision for deferred tax	<u>339.2</u>	<u>340.2</u>	<u>385.1</u>	<u>386.1</u>
Discount	(162.4)	(162.5)	(158.1)	(158.2)
Discounted provision for deferred tax	<u>176.8</u>	<u>177.7</u>	<u>227.0</u>	<u>227.9</u>

## 22. ACCRUALS AND DEFERRED INCOME

	Proceeds from Kielder securitisation	Capital grants and contributions	Total	
	Company only £'m	Group and Company £'m	Group £'m	Company £'m
At 1 January 2013	150.8	231.1	231.1	381.9
Additions	-	13.2	13.2	13.2
Amortised during the year	(7.1)	(4.3)	(4.3)	(11.4)
At 31 December 2013	<u>143.7</u>	<u>240.0</u>	<u>240.0</u>	<u>383.7</u>

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

## 23. CALLED UP SHARE CAPITAL

	Group and Company	
	2013 £'m	2012 £'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2012: 122,650,000)	<u>122.7</u>	<u>122.7</u>
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2012: 122,650,000)	<u>122.7</u>	<u>122.7</u>

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

	Profit and loss account		Total shareholders' funds			
	2013		2013		2012	
	Group £'m	Company £'m	Group £'m	Company £'m	Group £'m	Company £'m
At beginning of period	662.2	740.9	784.9	863.6	823.6	896.5
Profit for the period	215.0	222.7	215.0	222.7	119.1	124.9
Actuarial gain / (loss) on pension liability in the period (note 26)	25.2	25.2	25.2	25.2	(7.4)	(7.4)
Deferred tax related to actuarial (loss) / gain on pension liability in the period (note 26)	(9.6)	(9.6)	(9.6)	(9.6)	0.2	0.2
Dividends paid (note 9)	(190.2)	(190.2)	(190.2)	(190.2)	(150.6)	(150.6)
At end of period	<u>702.6</u>	<u>789.0</u>	<u>825.3</u>	<u>911.7</u>	<u>784.9</u>	<u>863.6</u>

## 25. COMMITMENTS

### (a) Capital expenditure:

	Group and Company	
	2013	2012
	£'m	£'m
Expenditure contracted but not provided for	105.0	103.3

### (b) Lease commitments:

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

	Group and Company	
	2013	2012
	£'m	£'m
Land and buildings:		
Leases which expire:		
In less than one year	0.1	-
After one year but not more than five	-	0.1
In five years or more	0.6	0.6
	<u>0.7</u>	<u>0.7</u>
	2013	2012
	£'m	£'m
Other:		
Leases which expire:		
In less than one year	0.1	-
Between two and five years	-	0.1

## 26. PENSIONS

The Company participates in the Group defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 1,705 active members at 31 December 2013 (2012: 1,782).

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. Additional contributions for the current period, in respect of early retirements, amounted to £1.6m and are expected to be £0.5m for the year to 31 December 2014.

The scheme also has a defined contribution section which had 1,180 active members at 31 December 2013 (2012: 594). 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 £1.8m (period ended 31 December 2012: £0.9m). Membership of the defined contribution section increased significantly during the year, as a result of changes in the law which required the Company to automatically enrol staff into a workplace pension if they weren't already a member.

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

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

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

FRS 17 actuarial assumptions:	2013	2012
Discount rate	4.6%	4.3%
Pay increases <sup>1</sup>	3.95%	3.6%
Price inflation (RPI)	3.3%	2.9%
Price inflation (CPI)	2.3%	2.2%
Pension increases linked to RPI	3.3%	2.9%
Pension increases linked to CPI	2.3%	2.2%
Mortality assumptions <sup>2</sup>	-	-
- 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).

## 26. PENSIONS (continued)

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

	Long term expected rate of return 2013	2013	Long term expected rate of return 2012	2012
	%	£'m	%	£'m
Equities	7.1	359.1	7.0	354.3
Corporate bonds	4.6	153.1	4.3	161.6
Government bonds	3.6	80.1	3.0	85.5
Property	6.1	80.4	4.5	75.8
Cash	3.0	36.0	1.9	32.6
Other (includes listed infrastructure)	6.1	76.8	4.5	35.6
Total fair value of assets		785.5		745.4
Present value of liabilities		(872.2)		(847.2)
Deficit under FRS17		(86.7)		(101.8)
Related deferred tax <sup>1</sup>		17.3		23.4
Net pension liability		(69.4)		(78.4)

1. The decrease in related deferred tax of £6.1m comprises a reduction of £4.6m to reflect the 3% cut in the rate of UK corporation tax and a decrease of £5.0m relating to the actuarial gain in the year (which are both recognised in the statement of total recognised gains and losses), and £3.5m relating to items which are recognised as a credit in the profit and loss account.

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

	2013	2012
	£'m	£'m
Current service cost	12.9	10.0
Past service cost	0.8	0.2
Recognised in operating costs in arriving at operating profit	<u>13.7</u>	<u>10.2</u>
	2013	2012
	£'m	£'m
Interest cost on plan obligations	36.0	29.3
Expected return on plan assets	(38.0)	(28.9)
Recognised in net interest receivable (note 4)	<u>(2.0)</u>	<u>0.4</u>

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	25.2	(7.4)
Cumulative amounts recognised since adopting the standard	<u>(71.8)</u>	<u>(97.0)</u>

## 26. PENSIONS (continued)

History of experience gains and losses:

	31 December 2013	31 December 2012	31 March 2012	31 March 2011	31 March 2010
	£'m	£'m	£'m	£'m	£'m
Fair value of assets	785.5	745.4	738.3	713.3	663.4
Present value of defined benefit obligation	(872.2)	(847.2)	(822.4)	(759.3)	(796.5)
Deficit	(86.7)	(101.8)	(84.1)	(46.0)	(133.1)
Experience adjustments arising on plan assets	32.4	2.3	(42.2)	10.7	177.4
Experience adjustments arising on plan liabilities	-	-	31.0	-	-

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

	31 December 2013	31 December 2012
	£'m	£'m
At start of period	847.2	822.4
Current service cost	12.9	10.0
Past service cost	0.8	0.2
Interest cost	36.0	29.3
Contributions by plan participants	0.2	0.2
Actuarial losses on obligations	7.2	9.7
Benefits paid	(32.1)	(24.6)
At end of period	872.2	847.2

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

	31 December 2013	31 December 2012
	£'m	£'m
At start of period	745.4	738.3
Expected return on plan assets	38.0	28.9
Actuarial gains on plan assets	32.4	2.3
Contributions by employer	1.6	0.3
Contributions by plan participants	0.2	0.2
Benefits paid	(32.1)	(24.6)
At end of period	785.5	745.4

### Nature of benefits, regulatory framework and other entity's responsibilities for governance of the scheme

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

### Risks to which the scheme exposes the Company

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

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

## 26. PENSIONS (continued)

### Asset-liability matching strategies used by the scheme or the Company

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

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

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

### Sensitivity to key assumptions:

FRS 17 requires disclosure of the sensitivity of the results to the methods and assumptions used.

The costs of a pension arrangement require estimates regarding future experience. The financial assumptions used for 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 (1.6%).

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 December 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 £26m (3.0%).

## 27. RELATED PARTY DISCLOSURES

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

Transactions with related parties outside of the NWGL group comprised purchases of £1.9m (nine months ended 31 December 2012: £nil), sales of £0.1m (nine months ended 31 December 2012: £nil) and consortium tax relief of £7.1m (nine months ended 31 December 2012: £nil). There were no amounts due from or to these companies at 31 December 2013 (2012: £nil) in respect of sales or purchases. £7.1m (2012: £nil) is owed in respect of tax losses surrendered to Hutchison 3G UK Limited (note 16).

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

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



## **28. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY**

At the balance sheet date, the Company's immediate parent undertaking was NWGL, which is incorporated in England and Wales. In the directors' opinion, the Company's ultimate parent undertaking and controlling party, at the balance sheet date, was NWGL. NWGL is indirectly wholly owned by a consortium comprising Cheung Kong Infrastructure Holdings Limited, Cheung Kong (Holdings) Limited and Li Ka Shing Foundation Limited.

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

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

We have audited the group financial statements of Northumbrian Water Limited for the year ended 31 December 2013 which comprise the group Profit and Loss Account, the group Statement of Total Recognised Gains and Losses, the group and Company Balance Sheets and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

### **Respective responsibilities of directors and auditor**

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

### **Scope of the audit of the financial statements**

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

### **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the group and Company's affairs as at 31 December 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Strategic Report and the Directors' Report for the financial period for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Paul Feechan (Senior statutory auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
Newcastle Upon Tyne, United Kingdom, 10 April 2014