REGULATORY FINANCIAL STATEMENTS

NORTHUMBRIAN WATER LIMITED

FOR THE YEAR ENDED 31 MARCH 2004

Registered no: 2366703

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FOR THE YEAR ENDED 31 MARCH 2004

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DIRECTORS' REPORT
For the year ended 31 March 2004

The directors present their report and the audited regulatory financial statements for the year ended 31 March 2004. The company has changed the end date of its statutory financial reporting period from 31 December to 31 March bringing the regulatory and statutory reporting periods into line.

Results and dividends

The group's profit after taxation for the year ended 31 March 2004 amounts to £77.8m (2003: £49.9m – as restated). The directors propose a final dividend on the ordinary shares of the company for the twelve months ended 31 December 2003 of £42.2m (2003: £43.9m), together with a final dividend for the three months ended 31 March 2004 of £21.1m (note 10). During the year an exceptional interim dividend of £46.0m was paid from the non appointed business along with an interim dividend of £42.2m, making a total for the fifteen month period of £151.5m (2003: £87.8m).

Prior year adjustment

The company has changed its accounting treatment for court costs and solicitors fees charged to customers as part of the debt recovery process. Previously these were credited to the profit and loss account as they were invoiced. However, due to the high degree of uncertainty surrounding recovery of these items, the policy has changed so that court costs and solicitors fees are not shown in the accounts until the cash is received. The prior year adjustment restates the opening balance sheet to remove all court costs and solicitors fees for which a charge had been raised but no cash received as at the opening balance sheet date (£6.2m) along with an adjustment for taxation in relation to the same item (£1.9m).

Principal activities and review of business

The principal activities of the business comprise the supply of potable water in both the Northern and Southern regions, and the collection, treatment and disposal of sewage and sewage sludge throughout the North East of England.

The company improved on its excellent customer service record against five of the seven Ofwat customer service measures in 2003/04. The regulator has not yet published comparative results for 2003/04, but NWL anticipates that it will improve on the performance it achieved in 2002/03. In the three years to 2001/02 NWL had achieved seven out of a possible seven Ofwat customer service 'stars' and it is still the only water and sewerage company to have ever achieved this. During August 2002, severe storms meant NWL lost the two stars that relate to sewer flooding.

These storm events also had a dramatic effect on NWL's ranking in Ofwat's overall performance assessment in 2002/03, accounting for two thirds of the points lost, losing NWL the 'top of the league' position it occupied in 2000/01 and 2001/02. The results for 2003/04 have not yet been published, but NWL's own performance has improved.

The appointed business turnover has increased by 3.3% from £421.7m to £435.8m. This mainly reflects increases due to the application of RPI of 2.71% to the previous year's tariff income of £410.3m (£11.1m), additional income arising from a project to identify occupiers of properties which had previously been classed as empty (£0.9m), a change in the method for accruing unbilled income which depressed income in 2002/03 (£0.9m) and an increase in commercial contract income from Bran Sands (£0.6m).

The appointed business operating costs show an increase on the prior year of £8.5m. This mainly reflects increases in abstraction charges and rates (£3.1m), increased manpower costs (£4.0m), higher sludge treatment costs (£1.9m) and bad debt costs (£1.2m). It also reflects the impact of leakage costs which were charged to profit rather than capital, following the achievement of the economic level of leakage in 2002/03 (£2.5m). These cost increases were partially offset by efficiencies and some provision releases.

The appointed business capital maintenance costs decreased by £1.1m, mainly reflecting the impact of commissioning new assets (£3.5m), which was more than offset by a £5.5m reduction in depreciation charges, following a comprehensive review of the asset lives of operational assets. This review was undertaken to support the depreciation charges included in the final business plan submitted to Ofwat in April 2004, and resulted in shorter asset lives for civil structures and longer asset lives for electrical, mechanical and instrumentation equipment.

DIRECTORS' REPORT (continued)

Principal activities and review of business (continued)

Net interest payable in the appointed business increased by £10.0m, mainly reflecting the increase of £109.1m in the underlying level of net debt due to the investment in new assets (£4.4m) and the higher interest rates payable on long term loans raised in late 2002 to fund future capital investment (£3.6m). Non appointed business interest charges were also incurred on a new loan for £46.0m which was raised in June 2003 (£1.8m), and on committed facilities which were required to back up the existing EIB loans (£1.5m) following the change in control of the holding company. Offsetting these increased interest charges was the impact of the lower interest rates in 2003/04 on the variable rate loans.

The tax position improved significantly from a charge of £22.5m in 2002/03 to a credit of £6.9m in 2003/04, mainly due to favourable movements on prior year deferred tax and on the amount of deferred tax discount available which are shown in detail in note 9.

The gearing of the appointed business, based on the net debt divided by the regulatory asset value, has reduced slightly to 60%, while the interest cover has fallen again to just 1.74, well below the interest cover ratio assumed as a floor for PR99. This deterioration reflects the impact of a flat tariff income profile which has been adversely affected by further volumetric income losses, additional operating and capital maintenance costs and higher financing costs due to the increasing debt.

The future focus of the company continues to be improving efficiency levels and driving down operating costs while maintaining high standards of customer service and developing the skills and effectiveness of its employees. Continuous improvement will be necessary to ensure the company is successful in the competitive market.

Events since the balance sheet date

On 12 May 2004, the Group's financial position was improved by the securitisation of the contract with the Environment Agency for the operation of the Kielder Water transfer scheme. The proceeds were used to repay short term debt of £159.0m owed by the immediate holding company, Northumbrian Services Limited (NSL), and £46.0m repayable by the non appointed business, both arising from the acquisition of the Group business in May 2003.

Financial statements preparation and going concern

The directors consider that it is appropriate to prepare the financial statements for the financial year on the going concern basis. The directors have arrived at their decision based on consideration of the company's detailed budget for 2004/05 and the forecast for 2005/06. Their analysis included a review of the capital expenditure and investment plans, the anticipated funding requirements and facilities available, and the reasonableness of the underlying assumptions of both the budget and the forecast.

Research and development

The company places a high priority on research and technological innovation to serve the needs of customers. Northumbrian Water Technical Centre Limited (NWTC), a specialist subsidiary of Northumbrian Water Group plc ("NWG"), co-ordinates all research and development activities relating to underground assets for the NWG group. The company maintains a programme of research and development activities which are linked to UK business operations. The company incurred costs of research and development in the year of £5.0m (2003: £5.6m).

Northumbrian Water Limited payment policy

The company's policy is to agree payment terms with suppliers when agreeing the terms of each transaction, also ensuring that suppliers are made aware of and abide by the terms of payment. The year end trade creditors expressed as a number of days of purchases made during the year is 22 days (2003: 24 days).

DIRECTORS' REPORT (continued)

Fixed assets

Freehold land and buildings are carried in the financial statements at historical cost with a net book value of £62.3m (2003: £64.3m). In the opinion of the directors, at 31 March 2004, there is no significant difference between the net book value and the market value of property capable of disposal within the foreseeable future. Note 11 gives more details of the fixed asset movements during the year.

Financial review

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

Directors

The directors who served during the year were as follows:

Professor Sir F G T Holliday CBE (68)
Non-Executive Chairman

J A Cuthbert (51)
Executive Managing Director

C M Green (49)
Executive Finance Director

G Neave (48)
Executive Director

A C Jones (38)
Executive Director -appointed 1 January 2004

R R Allan (69)
Independent Non-Executive Director

A G Balls (60)
Independent Non-Executive Director

A M Frew (46)
Independent Non-Executive Director

B Guirkinger (52)
Non-Executive Director

J F Petry (49)
Non-Executive Director – resigned 27 May 2004

A Chaigneau (52)
Non-Executive Director – resigned 23 May 2003

Directors' interests are disclosed in note 6 to the financial statements.

DIRECTORS' REPORT (continued)

Employees and employment policies

Equal Opportunities
The company operates an equal opportunity policy and promotes equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment than another. The company is a member of 'Opportunity Now', which demonstrates our commitment to equal opportunity, and has been awarded an 'Exemplars of Best Practice' certificate.

Training and Development
Training and development of employees is a priority of the company. The company has developed a management development programme from which all senior managers in the business have benefited. The programme is shortly to be extended to team leaders. The company also has an accelerated development programme for employees with management potential. Annual appraisals are conducted and training needs properly assessed.

Communication

Communication with staff is achieved through a weekly newsletter 'lowdown', the company's bi-monthly corporate magazine 'Hel'eau', a bi-monthly 'team talk' cascading briefing process, occasional information booklets and widespread use of noticeboards. The intranet is increasingly used for the provision of news and information and also for the storage of corporate documents. Employees are regularly informed about matters concerning their interests and the financial and economic factors affecting the company. During the period the company won a silver award from the northern region of the Institute of Public Relations for its internal communication activities. The company encourages open feedback and protects employees who wish to voice concerns about behaviour or decisions that they believe to be unethical. The company also invites employee feedback through the use of annual questionnaires.

Employees also receive the bi-annual group-wide magazine 'Watermark', produced by NWG, which includes articles on NWG activities and news from subsidiary companies. Urgent information is communicated via a 'news flash' facility ensuring employees are kept abreast of important news.

Health and Safety
Health and safety policies are maintained and implemented through the company's safety team. Occupational health services are provided by the company's medical adviser, Previa UK. Most employees are members of a company wide corporate health care plan.

Employee Investment Schemes
The directors believe that employee investment is a valuable method of strengthening the ties between NWG and its employees by providing the opportunity for employees to participate more closely in NWG's economic performance and results.

In January 2004, NWG launched its Share Incentive Plan (SIP). All UK tax paying employees of NWG with at least 3 months service are eligible to participate in the SIP. The SIP enables NWG employees to purchase ordinary shares in a flexible and tax efficient way. In addition, for every three shares purchased, the employee receives a bonus of one free share. Shares must be held in the plan for five years to obtain the full tax benefits.

DIRECTORS' REPORT (continued)

Employees and employment policies (continued)

Long Term Incentive Plan

Under this plan, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, a conditional award of shares in NWG with a value of up to 75% of basic salary. In relation to the LTIP awards made in the period, however, the Committee decided that the value of awards would not exceed the value of the annual cash bonus opportunity of the relevant directors or managers. Executive directors were therefore made conditional LTIP awards worth 40% of their basic salaries, based on NWG's share price on 1 October 2003, which was 102.9p per share. The proportion of the shares awarded that will vest is based on NWG's performance in terms of total shareholder return ("TSR") (i.e. share price movements and re-invested dividends) during a fixed three-year period (from 1 October 2003) against the TSR of two comparator groups of companies. Up to 70% of the shares awarded will vest based on a comparison of NWG's TSR against the TSR of other quoted water companies, comprising Kelda Group plc, AWG plc, Pennon Group plc, Severn Trent plc, United Utilities plc, Bristol Water plc and East Surrey Holdings plc. Up to the remaining 30% of the shares awarded will vest based on a comparison of NWG's TSR against the TSR of companies (other than investment trusts) included in the FTSE 250 Total Return Index.

These performance targets will be applied on a graduated scale so that the better the performance of NWG, the greater the proportion of each award that will vest and thus the greater the number of shares that each participant will be able to acquire. For example, in relation to the performance based on the other quoted water companies, 30% of the 70% allocated to this target will vest if NWG has a median performance compared to the comparator group. The proportion of the award that will vest will increase the higher the relative position of NWG compared to the comparator group. Where NWG is the top performing company in the comparator group, 100% of the 70% will vest. None of the 70% will vest where NWG's performance is below the median performance.

Similarly, in relation to the performance based on the FTSE 250 Total Return Index, 30% of the 30% allocated to this target will vest if NWG's TSR equals that of the index and 100% of the 30% will vest where NWG's performance is the index growth plus at least 6%, with a sliding scale for pro rata performance.

The performance conditions described above were chosen to align the interests of participants in the LTIP with those of NWG shareholders. An independent firm of chartered accountants will be engaged to assess the extent to which the performance conditions have been met, so that the process is rigorous and transparent.

Pensions

Information about the pension schemes operated by the group is contained in note 28 to the financial statements.

DIRECTORS' REPORT (continued)

Charitable and political contributions

During the year the company made charitable donations of £33,084 (2003: £56,827) and political donations of £7,961 (2003: £nil).

It is the company's policy that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party. The definition of donations in the Political Parties, Elections and Referendums Act 2000 (PPERA 2000) is wide and covers activities that form part of the normal relationship between the company and political organisations (such as sponsoring receptions and fringe meetings at party conferences and taking tables at dinners) intended to heighten awareness within the political arena of key industry issues and matters affecting the company. Political expenditure and/or donations up to a total of £40,000 for the Group for the period of two years from the date of the approval were approved by the shareholders at the Extraordinary General Meeting of NWG held on 16 December 2003. During the period the company did not incur any political expenditure as defined in the PPERA 2000 but did make political donations, applying the wide definitions from the PPERA 2000, as follows:

Name of EU Political Organisation	**Donations for the Year**
Labour	£5,989.00
Liberal Democrats	£889.00
Conservative	£1,082.83
Total	**£7,960.83**

Auditors

The company has appointed Ernst & Young LLP as its auditors and has, by written resolution pursuant to section 386 of the Companies Act 1985, dispensed with the obligation to appoint auditors annually.

Directors' responsibilities

The directors are responsible, under Condition F of the Instrument of Appointment by the Secretary of State for the Environment, for the company, as a water and sewerage undertaker under the Water Industry Act 1991, to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and of the group as at the end of the financial year and of the profit or loss of the group for that year.

The directors confirm that suitable accounting policies have been used and applied consistently, and reasonable, prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 March 2004. The directors also confirm that, except for the departure in relation to infrastructure renewals accounting explained in note 1 to the financial statements, which arises from the instructions of the Director General of Water Services, applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis.

The directors are responsible for keeping proper accounting records as required by United Kingdom company law, for taking reasonable steps to safeguard the assets of the group, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

ON BEHALF OF THE BOARD

M Parker
Company Secretary

4 August 2004

GROUP HISTORICAL COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2004

		2004			2003 (as restated)		
	Note	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
Turnover	3	435.8	18.9	454.7	421.7	18.2	439.9
Operating costs - ordinary	4(a)	(208.4)	(4.9)	(213.3)	(199.9)	(4.2)	(204.1)
- exceptional	4(d)	(1.1)	-	(1.1)	(4.4)	-	(4.4)
Total operating costs		(209.5)	(4.9)	(214.4)	(204.3)	(4.2)	(208.5)
Capital maintenance costs	4(b)	(86.7)	(0.6)	(87.3)	(87.8)	(0.6)	(88.4)
OPERATING PROFIT		139.6	13.4	153.0	129.6	13.4	143.0
Net interest payable	5	(80.1)	(2.0)	(82.1)	(70.1)	(0.5)	(70.6)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	4(c)	59.5	11.4	70.9	59.5	12.9	72.4
Taxation	9(a)	11.6	(4.7)	6.9	(18.8)	(3.7)	(22.5)
PROFIT FOR THE FINANCIAL YEAR		71.1	6.7	77.8	40.7	9.2	49.9
Dividends	10	(98.0)	(53.5)	(151.5)	(74.9)	(12.9)	(87.8)
LOSS RETAINED FOR THE YEAR	25	(26.9)	(46.8)	(73.7)	(34.2)	(3.7)	(37.9)

All activities are continuing.

GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
For the year ended 31 March 2004

		2004			2003 (as restated)		
	Note	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
Total recognised gains in the period		71.1	6.7	77.8	40.7	9.2	49.9
Prior year adjustment	2b	(4.3)	-	(4.3)	-	-	-
Total gains and losses recognised since last annual report and financial statements		66.8	6.7	73.5	40.7	9.2	49.9

GROUP HISTORICAL COST BALANCE SHEET
At 31 March 2004

	Note	2004	2003 (as restated)
		£'m	£'m
FIXED ASSETS			
Tangible assets	11	2,499.6	2,399.5
CURRENT ASSETS			
Stocks	13	3.1	3.2
Debtors	14	102.5	98.8
Investments	15	-	95.2
Cash at bank and in hand		4.9	13.0
		110.5	210.2
CREDITORS			
Amounts falling due within one year	16	(289.2)	(230.3)
NET CURRENT LIABILITIES		(178.7)	(20.1)
TOTAL ASSETS LESS CURRENT LIABILITIES		2,320.9	2,379.4
CREDITORS: Amounts falling due after more than one year	17	(1,336.6)	(1,328.0)
PROVISIONS FOR LIABILITIES AND CHARGES	22	(167.2)	(166.7)
ACCRUALS AND DEFERRED INCOME	23	(42.2)	(36.1)
		(1,546.0)	(1,530.8)
NET ASSETS		774.9	848.6
CAPITAL AND RESERVES			
Called up share capital	24	122.7	122.7
Profit and loss account	25	652.2	725.9
EQUITY SHAREHOLDERS' FUNDS	26	774.9	848.6

Approved on behalf of the board

J A Cuthbert

C M Green

4 August 2004

COMPANY HISTORICAL COST BALANCE SHEET
At 31 March 2004

	Note	2004 Appointed business	2004 Non-appointed business	2004 Aggregated basis	2003 (as restated) Appointed business	2003 (as restated) Non-appointed business	2003 (as restated) Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	11	2,403.0	96.6	2,499.6	2,302.6	96.9	2,399.5
Investments	12	-	-	-	89.4	-	89.4
		2,403.0	96.6	2,499.6	2,392.0	96.9	2,488.9
CURRENT ASSETS							
Stocks	13	3.0	0.1	3.1	3.1	0.1	3.2
Debtors	14	100.7	1.8	102.5	97.9	0.9	98.8
Investments	15	-	-	-	95.2	-	95.2
Cash at bank and in hand		4.9	-	4.9	13.0	-	13.0
		108.6	1.9	110.5	209.2	1.0	210.2
CREDITORS Amounts falling due within one year	16	(271.4)	(17.8)	(289.2)	(212.3)	(18.0)	(230.3)
NET CURRENT LIABILITIES		(162.8)	(15.9)	(178.7)	(3.1)	(17.0)	(20.1)
TOTAL ASSETS LESS CURRENT LIABILITIES		2,240.2	80.7	2,320.9	2,388.9	79.9	2,468.8
CREDITORS: Amounts falling due after more than one year	17	(1,290.6)	(46.0)	(1,336.6)	(1,417.1)	(0.3)	(1,417.4)
PROVISIONS FOR LIABILITIES AND CHARGES	22	(159.5)	(7.7)	(167.2)	(160.9)	(5.8)	(166.7)
ACCRUALS AND DEFERRED INCOME	23	(41.7)	(0.5)	(42.2)	(35.6)	(0.5)	(36.1)
		(1,491.8)	(54.2)	(1,546.0)	(1,613.6)	(6.6)	(1,620.2)
NET ASSETS		748.4	26.5	774.9	775.3	73.3	848.6
CAPITAL AND RESERVES							
Called up share capital	24	92.1	30.6	122.7	92.1	30.6	122.7
Profit and loss account	25	656.3	(4.1)	652.2	683.2	42.7	725.9
EQUITY SHAREHOLDERS' FUNDS	26	748.4	26.5	774.9	775.3	73.3	848.6

Approved on behalf of the board

J A Cuthbert

C M Green

4 August 2004

GROUP HISTORICAL COST CASH FLOW STATEMENT
For the year ended 31 March 2004

	Note	2004 Appointed business	2004 Non-appointed business	2004 Aggregated basis	2003 Appointed business	2003 Non-appointed business	2003 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
NET CASH INFLOW FROM CONTINUING OPERATING ACTIVITIES	a	193.8	22.7	216.5	161.7	20.5	182.2
Returns on investments and servicing of finance							
Interest received		2.7	-	2.7	4.5	-	4.5
Interest paid		(70.4)	(2.0)	(72.4)	(71.0)	(0.5)	(71.5)
Interest element of finance lease rentals		(1.9)	-	(1.9)	(1.8)	-	(1.8)
Net cash outflow from returns on investments and servicing of finance		(69.6)	(2.0)	(71.6)	(68.3)	(0.5)	(68.8)
Taxation							
United Kingdom corporation tax paid		(0.8)	(3.1)	(3.9)	(5.3)	(2.7)	(8.0)
Net cash outflow from taxation		(0.8)	(3.1)	(3.9)	(5.3)	(2.7)	(8.0)
Capital expenditure and financial investment							
Purchase of tangible fixed assets		(168.1)	(0.2)	(168.3)	(170.5)	(0.1)	(170.6)
Sale of tangible fixed assets		0.5	-	0.5	2.3	-	2.3
Grants, contributions and connection charges		16.1	-	16.1	9.1	-	9.1
Net cash outflow from capital expenditure and financial investment		(151.5)	(0.2)	(151.7)	(159.1)	(0.1)	(159.2)
Equity dividend paid		(76.7)	(55.4)	(132.1)	(74.2)	(11.8)	(86.0)
CASH (OUTFLOW)/INFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(104.8)	(38.0)	(142.8)	(145.2)	5.4	(139.8)
Management of liquid resources							
Purchase of short term deposits		(550.3)	-	(550.3)	(155.0)	-	(155.0)
Sale of short term deposits		645.4	-	645.4	93.5	-	93.5
Net cash inflow/(outflow) from management of liquid resources	b	95.1	-	95.1	(61.5)	-	(61.5)
Financing							
New loans		52.0	46.0	98.0	355.7	-	355.7
New leases		-	-	-	0.8	-	0.8
Loan repayments		(47.6)	-	(47.6)	(150.1)	-	(150.1)
Capital element of finance lease rental payments		(2.8)	-	(2.8)	(2.9)	-	(2.9)
Net cash inflow from financing	b	1.6	46.0	47.6	203.5	-	203.5
(DECREASE)/INCREASE IN CASH IN THE YEAR	b	(8.1)	8.0	(0.1)	(3.2)	5.4	2.2

NOTES TO THE HISTORICAL COST CASH FLOW STATEMENT
For the year ended 31 March 2004

a. RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2004			2003 (as restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Operating profit	139.6	13.4	153.0	129.6	13.4	143.0
Depreciation on tangible fixed assets	53.0	0.5	53.5	55.0	0.5	55.5
Infrastructure renewals expenditure	(25.5)	-	(25.5)	(36.4)	-	(36.4)
Provision for infrastructure renewals	34.1	0.1	34.2	33.7	0.1	33.8
Amortisation of grants	(2.1)	-	(2.1)	(1.7)	-	(1.7)
Profit on sale of fixed assets	(0.4)	-	(0.4)	(0.9)	-	(0.9)
Decrease/(increase) in stock	0.1	-	0.1	(0.6)	0.1	(0.5)
Increase in debtors	-	(0.9)	(0.9)	(1.4)	-	(1.4)
Increase in creditors	4.3	0.2	4.5	0.4	-	0.4
Increase/(decrease) in provisions	0.1	-	0.1	(9.6)	-	(9.6)
(Decrease)/increase in inter business creditor/debtor	(9.4)	9.4	-	(6.4)	6.4	-
Net cash inflow from operating activities	193.8	22.7	216.5	161.7	20.5	182.2

The operating cash flows are all from continuing operations.

b. ANALYSIS AND RECONCILIATION OF NET DEBT

	Appointed business			
	1 April 2003	Cash Flow	Other non-cash changes	31 March 2004
	£'m	£'m	£'m	£'m
Cash in hand and at bank	13.0	(8.1)	-	4.9
Debt due after 1 year	(1,270.3)	-	38.1	(1,232.2)
Debt due within 1 year	(47.6)	(4.4)	(38.1)	(90.1)
Finance leases	(59.4)	2.8	(4.3)	(60.9)
	(1,377.3)	(1.6)	(4.3)	(1,383.2)
Current asset investments	95.1	(95.1)	-	-
Net debt	(1,269.2)	(104.8)	(4.3)	(1,378.3)

NOTES TO THE HISTORICAL COST CASH FLOW STATEMENT (continued)
For the year ended 31 March 2004

b. ANALYSIS AND RECONCILIATION OF NET DEBT (continued)

	Non-appointed business			
	1 April 2003	Cash Flow	Other non-cash changes	31 March 2004
	£'m	£'m	£'m	£'m
Overdrafts	(12.6)	8.0	-	(4.6)
Debt due after 1 year	-	(46.0)	-	(46.0)
Net debt	(12.6)	(38.0)	-	(50.6)

	Group			
	1 April 2003	Cash Flow	Other non-cash changes	31 March 2004
	£'m	£'m	£'m	£'m
Group net debt (note 18)	(1,281.8)	(142.8)	(4.3)	(1,428.9)

Reconciliation of cash flow movement to net debt:

	2004	2004			2003
	Group	Appointed business	Non-appointed business	Aggregated business	Group and Aggregated business
	£'m	£'m	£'m	£'m	£'m
(Decrease)/increase in cash in the year	(0.1)	(8.1)	8.0	(0.1)	2.2
Cash inflow from increase in debt and lease financing	(47.6)	(1.6)	(46.0)	(47.6)	(203.5)
Cash (inflow)/outflow from reduction in liquid resources	(95.1)	(95.1)	-	(95.1)	61.5
Change in net debt resulting from cash flows	(142.8)	(104.8)	(38.0)	(142.8)	(139.8)
Finance costs amortised during the year	-	-	-	-	0.2
Finance lease interest capitalised	(0.5)	(0.5)	-	(0.5)	(1.0)
Finance lease non cash movement	(3.8)	(3.8)	-	(3.8)	(2.5)
Movement in net debt in year	(147.1)	(109.1)	(38.0)	(147.1)	(143.1)
Net debt at 1 April 2003	(1,281.8)	(1,269.2)	(12.6)	(1,281.8)	(1,138.7)
Net debt at 31 March 2004	(1,428.9)	(1,378.3)	(50.6)	(1,428.9)	(1,281.8)

NOTES TO THE HISTORICAL COST FINANCIAL STATEMENTS
For the year ended 31 March 2004

1. STATEMENT OF ACCOUNTING POLICIES

In accordance with Condition F of "the Instrument", these financial statements have been prepared to show separately in respect of each of:

i. the appointed business;
ii. the non-appointed business; and
iii. on an aggregated basis, the appointed and non-appointed businesses;

a profit and loss account, a statement of assets and liabilities and a cash flow statement, together with notes thereto prepared under the historical cost basis.

These financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom with the exception of:

- capital grants and contributions to infrastructure assets which is not in accordance with the Companies Act 1985 (as described in (e) below).

- infrastructure renewals accounting which, in accordance with RAG 3.05, has been accounted for in accordance with RAG 2.03, “Classification of Infrastructure Expenditure”. RAG 2.03 is not in accordance with Financial Reporting Standard No. 12, “Provisions, Contingent Liabilities and Contingent Assets” and Financial Reporting Standard No. 15, “Tangible Fixed Assets” as described in section (d) (i) below.

A summary of the more important accounting policies, which have been applied consistently throughout the year and in the preceding year, is set out below.

(a) Basis of accounting

These financial statements have not been prepared for the purposes of Section 226 of the Companies Act 1985, “Duty to prepare individual company accounts,” and are therefore not statutory financial statements.

The financial statements have been prepared under the historical cost convention on the going concern basis.

(b) Basis of consolidation

The consolidated financial statements include the company and its subsidiary undertakings. Intra-group sales and profits are eliminated fully on consolidation.

(c) Turnover

Turnover, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

(i) Infrastructure assets

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

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

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

In accordance with RAG 3.05 the Group and Company have not applied Financial Reporting Standard No. 12, “Provisions, Contingent Liabilities and Contingent Assets” (“FRS12”) and Financial Reporting Standard No. 15, “Tangible Fixed Assets” (“FRS15”) in respect of infrastructure renewals accounting and have continued to charge infrastructure renewal costs (calculated in accordance with their Asset Management Plan) to the profit and loss account. Expenditure during the year is charged to the provision.

Under FRS12 it is not permitted to recognise a provision for the costs of renewals expenditure. Adoption of FRS12, taken together with FRS15, would require:

- restatement of the cost and accumulated depreciation of infrastructure fixed assets to reflect infrastructure renewals expenditure, depreciation and retirement of assets since renewals accounting was first adopted. Accordingly, infrastructure renewals provisions and prepayments at years ended 31 March 2003 and 31 March 2004 would have been included within infrastructure fixed assets.

- the depreciation of infrastructure assets and the inclusion of the infrastructure renewals charge as a component of the depreciation charge for the year.

- restatement of the cost of infrastructure fixed assets to reflect the treatment of Section 19 “overlap” expenditure. The objective of the Section 19 quality programme is to address water discolouration problems caused by iron pipes, either through relining these pipes or replacing them where relining is not possible. The “overlap” represents the extra cost of replacing pipes rather than relining them where their structural condition is insufficient to withstand the relining process. Such expenditure is included in the infrastructure renewals charge in the regulatory financial statements. The statutory financial statements classify such expenditure as capital in nature and include this under infrastructure assets in the fixed asset note, resulting in a higher profit in the statutory financial statements (2004 difference: £5.0m).

(ii) Other assets

Other assets (including properties, overground plant and equipment) are included at cost less accumulated depreciation and provisions for diminution in value. Additions are included at cost.

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.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(e) Grants and contributions

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

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets, in accordance with RAG 3.05. This is not in accordance with the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost without deduction of grants and contributions which are accordingly accounted for as deferred income. The effect of the departure on the value of tangible fixed assets is disclosed in note 11. The statutory financial statements reflect grants and contributions as deferred income and amortise them to profit and loss account over the expected useful economic lives of the assets, resulting in a higher operating profit in the statutory financial statements (2004 difference: £1.5m).

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

(f) Hire purchase and leasing

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

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

(g) Stocks

Raw materials and consumables are stated at purchased cost less any provision necessary to recognise damage and obsolescence. Cost of work in progress includes labour, materials, transport and an element of overheads.

(h) Pension costs

The company is a member of the Northumbrian Water Pension Scheme which is a multi employer scheme and the assets cannot be apportioned to individual companies. Accordingly, these financial statements account for pension costs as a defined contribution scheme and charges are made as incurred.

The company also operates a defined contribution scheme. The costs are charged to the profit and loss account in the year they are incurred.

(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 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 measured at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse.

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 decided to adopt 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 on government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(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 or applicable foreign forward contract rate. 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 year in which it is incurred.

(l) 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.

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.

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

(n) 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. PRIOR YEAR ADJUSTMENT

The company has changed its accounting policy for court costs and solicitors fees charged to customers as part of the debt recovery process. As a result the comparatives have been restated as follows :

(a) Group profit and loss account

	Operating costs - ordinary			Taxation		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Year ended 31 March 2003 as previously reported	(199.7)	(4.2)	(203.9)	(18.9)	(3.7)	(22.6)
Prior year adjustment	(0.2)	-	(0.2)	0.1	-	0.1
Year ended 31 March 2003 as restated	(199.9)	(4.2)	(204.1)	(18.8)	(3.7)	(22.5)

	Profit for the financial year		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Year ended 31 March 2003 as previously reported	40.8	9.2	50.0
Prior year adjustment	(0.1)	-	(0.1)
Year ended 31 March 2003 as restated	40.7	9.2	49.9

The brought forward reserves for 2003 have been restated by £4.2m (appointed business: £4.2m, non-appointed business: £nil).

(b) Group balance sheet

	Debtors Trade debtors			Provisions for liabilities and charges Deferred tax		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Year ended 31 March 2003 as previously reported	57.2	0.4	57.6	(158.6)	(4.5)	(163.1)
Prior year adjustment	(6.2)	-	(6.2)	1.9	-	1.9
Year ended 31 March 2003 as restated	51.0	0.4	51.4	(156.7)	(4.5)	(161.2)

	Profit and loss reserve		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Year ended 31 March 2003 as previously reported	687.5	42.7	730.2
Prior year adjustment	(4.3)	-	(4.3)
Year ended 31 March 2003 as restated	683.2	42.7	725.9

3. TURNOVER AND OPERATING PROFIT

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

4. OPERATING COSTS AND CAPITAL MAINTENANCE COSTS

(a) Operating costs comprise:

	2004			2003 (as restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Materials and consumables	13.5	0.6	14.1	11.9	0.6	12.5
Other external charges	57.0	1.8	58.8	48.7	1.8	50.5
Manpower costs (note 8a)	67.4	1.4	68.8	62.3	1.7	64.0
Other operating charges	88.2	1.1	89.3	93.2	0.1	93.3
Own work capitalised	(17.7)	-	(17.7)	(16.2)	-	(16.2)
	208.4	4.9	213.3	199.9	4.2	204.1

The value of own work capitalised represents both employment costs (note 8a) and some other costs incurred on capital projects.

(b) Capital maintenance costs comprise:

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Depreciation:						
Owned tangible fixed assets	49.2	0.5	49.7	50.1	0.5	50.6
Tangible fixed assets held under finance leases	3.8	-	3.8	4.9	-	4.9
Infrastructure renewals expenditure (note 22)	25.5	-	25.5	36.4	-	36.4
Infrastructure renewals accrued/(prepaid) (note 22)	8.6	0.1	8.7	(2.7)	0.1	(2.6)
Profit on disposal of fixed assets	(0.4)	-	(0.4)	(0.9)	-	(0.9)
	86.7	0.6	87.3	87.8	0.6	88.4

The decrease in the capital maintenance costs in 2003/04 is explained in the Directors Report.

4. OPERATING COSTS AND CAPITAL MAINTENANCE COSTS (continued)

(c) Profit on ordinary activities before taxation

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Profit on ordinary activities before taxation is stated after crediting:						
Receipt and amortisation of capital grants and contributions	4.2	-	4.2	3.4	-	3.4
And after charging:						
Operating leases:						
Plant and machinery	0.1	-	0.1	0.2	-	0.2
Other assets	0.8	-	0.8	1.0	-	1.0
Costs of research and development	5.0	-	5.0	5.6	-	5.6
Directors' emoluments (note 6)	0.9	-	0.9	0.7	-	0.7

Auditors' remuneration for the regulatory audit amounted to £22,000 (2003: £31,543). Fees of £25,000 and £12,000 were also incurred in the auditing of RAG 5 information and the June Return respectively. Auditor's remuneration in respect of the statutory audit amounted to £63,300 (2002: 66,000).

Non audit services were also incurred in respect of reviewing the Draft Business Plan for Ofwat (£17,308), reviewing the IdoK Clause 14.3 claim (£5,000) and tax and accounting advice in respect of the Kielder Securitisation (£30,500).

(d) Exceptional operating costs comprise:

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Pension provision	-	-	-	3.0	-	3.0
Severance provision	1.1	-	1.1	1.4	-	1.4
Total exceptional costs	1.1	-	1.1	4.4	-	4.4

The pension charge relates to pensions payable to former directors of water-only companies which have since merged with Northumbrian Water Limited.

The severance charge of £1.1m (2003: £1.4m) relates to severance and pension costs relating to senior managers who are leaving the business.

5. NET INTEREST PAYABLE

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Net interest payable comprises:						
Interest payable:						
Bank loans and overdrafts	78.2	2.0	80.2	70.2	0.5	70.7
Debenture stock interest	1.4	-	1.4	2.1	-	2.1
Financing charges payable under finance leases	2.4	-	2.4	2.8	-	2.8
Total interest payable	82.0	2.0	84.0	75.1	0.5	75.6
Interest receivable	(1.9)	-	(1.9)	(5.0)	-	(5.0)
Net interest payable	80.1	2.0	82.1	70.1	0.5	70.6

6. DIRECTORS' EMOLUMENTS AND INTERESTS

(a) Directors' remuneration

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

	2004	2003
	£'000	£'000
Emoluments (including benefits in kind)	998.4	740.6

Four of the directors at 31 March 2004 were members of a defined benefit pension scheme where the company makes contributions towards the cost (2003: 3)

The directors who held office at 31 March 2004 had no interest in the shares of the company.

The directors who held office as at 31 March 2004 had the following interests in the debentures of the Company's immediate parent company, Northumbrian Services Limited:

Name of Director	**Class of Debentures**	**Amount of debentures held as at 1 January 2003**	**Amount of debentures held as at 31 March 2004**
John Arthur Cuthbert	8.625% bonds 28/6/06	-	40,000
Christopher Michael Green (1)	8.625% bonds 28/6/06	-	25,000

(1) These are beneficially owned by Mrs Geraldine Green.

The directors who held office as at 31 March 2004 had the following interests in the shares of the Company's ultimate parent company, Northumbrian Water Group plc:

Name of Director	**Class of Shares**	**Number of shares held as at 1 January 2003**	**Number of shares held as at 31 March 2004**
John Arthur Cuthbert	Ordinary 10p	-	80,000
Christopher Michael Green	Ordinary 10p	-	50,000
Sir Frederick George Thomas Holliday	Ordinary 10p	-	8,700
Andrew Ceri Jones	Ordinary 10p	-	4,433

6. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

The directors who held office as at 31 March 2004 held the following conditional interests in Ordinary 10p shares of the Company's ultimate parent company, Northumbrian Water Group plc ("NWG"), awarded in accordance with the terms of its Long Term Incentive Plan:

Name of Director	Number of awards held as at 1 January 2003	Number of shares awarded during the period	Number of awards vested during the period*	Number of awards held as at 31 March 2004
John Arthur Cuthbert	-	85,603	-	85,603
Christopher Michael Green	-	56,618	-	56,618
Andrew Ceri Jones	-	22,463	-	22,463
Graham Neave	-	40,000	-	40,000

* Some or all of the shares will vest only if specified performance targets are achieved during the three year period 1 October 2003 to 30 September 2006. The performance conditions are complex but, in essence, shares can vest depending on NWG's total shareholder return ("TSR") in this three year period compared with the TSR of a group of other water companies (in respect of 70% of the shares awarded) and with the FTSE 250 Total Return Index (in respect of 30% of the shares awarded). No awards lapsed or vested during the period.

As at 31 March 2004, no directors hold any other interests required to be disclosed, in accordance with Schedule 7 of the Companies Act 1985.

(b) Highest paid director

The amounts for remuneration in note 6a include the following in respect of the highest paid director:

	2004	2003
	£'000	£'000
Emoluments (including benefits in kind)	316.4	238.0

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 March 2004 was £91,789 (2003: £68,700)

7. TRANSACTIONS WITH DIRECTORS AND OFFICERS

No transactions or arrangements with Directors and Officers which are disclosable under the provisions of the Companies Act 1985 have occurred during the year.

8. EMPLOYEE INFORMATION

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

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Costs charged to the profit And loss account:						
Wages and salaries	43.2	1.2	44.4	40.5	1.4	41.9
Social security costs	3.8	0.1	3.9	3.2	0.1	3.3
Other pension costs	3.9	0.1	4.0	3.2	0.2	3.4
	50.9	1.4	52.3	46.9	1.7	48.6
Costs charged to capital schemes and infrastructure renewals:						
Wages and salaries	14.0	-	14.0	13.3	-	13.3
Social security costs	1.2	-	1.2	1.0	-	1.0
Other pension costs	1.3	-	1.3	1.1	-	1.1
	16.5	-	16.5	15.4	-	15.4
Total employee costs	67.4	1.4	68.8	62.3	1.7	64.0

(b) The average monthly number of employees on the payroll during the financial year was as follows:

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	No.	No.	No.	No.	No.	No.
Average during the year	2,274	46	2,320	2,221	61	2,282
Total at 31 March	2,375	45	2,420	2,281	59	2,340

9. TAXATION

(a) Analysis of charge in the year:

	2004			2003 (as restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Current tax:						
UK corporation tax on profits for the year at 30%	1.6	0.4	2.0	1.6	-	1.6
Adjustments in respect of prior years	(5.3)	-	(5.3)	(14.8)	-	(14.8)
Payable in respect of group relief for the current year at 30%	0.1	2.5	2.6	2.3	3.1	5.4
Adjustments in respect of prior years	0.3	-	0.3	0.8	-	0.8
Total current tax	(3.3)	2.9	(0.4)	(10.1)	3.1	(7.0)
Deferred tax:						
Origination and reversal of timing differences in the year	17.8	0.5	18.3	16.2	0.6	16.8
Adjustment in respect of prior years	(9.6)	0.5	(9.1)	12.4	-	12.4
	8.2	1.0	9.2	28.6	0.6	29.2
(Decrease)/increase due to discount	(16.5)	0.8	(15.7)	0.3	-	0.3
Total deferred tax	(8.3)	1.8	(6.5)	28.9	0.6	29.5
Tax on profit on ordinary activities	(11.6)	4.7	(6.9)	18.8	3.7	22.5

The appointed business has provisionally claimed tax losses from fellow subsidiaries in the current year of £0.4m (2003: £8.0m) for which payment will be made at the rate of 30%.

The non-appointed business has provisionally claimed tax losses from fellow subsidiaries in the current year of £8.2m (2003: £10.0m) for which payment will be made at the rate of 30%.

9. TAXATION (continued)

(b) Factors affecting the tax charge for the year:

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2004			2003 (as restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Profit on ordinary activities before tax	59.5	11.4	70.9	59.5	12.9	72.4
Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%)	17.9	3.4	21.3	17.8	3.9	21.7
Effects of:						
Expenses not deductible for tax purposes	1.6	-	1.6	2.0	0.1	2.1
Capital allowances in excess of depreciation	(18.7)	(0.5)	(19.2)	(22.7)	(0.6)	(23.3)
Other timing differences	0.9	-	0.9	6.5	-	6.5
Other items	-	-	-	0.3	(0.3)	-
Adjustment to tax charge in respect of previous periods	(5.0)	-	(5.0)	(14.0)	-	(14.0)
Current tax (credit)/charge	(3.3)	2.9	(0.4)	(10.1)	3.1	(7.0)

(c) Factors that may affect future tax charges:

The company expects to continue to incur high levels of capital expenditure and accordingly it expects to be able to claim capital allowances in excess of depreciation at a similar level to the current year.

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

10. DIVIDENDS

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Equity:						
Interim paid of 34.41p (2003: 35.81p) per share on an aggregated basis	39.2	3.0	42.2	37.4	6.5	43.9
Exceptional paid of 37.51p (2003: nil) per share on an aggregated basis	-	46.0	46.0	-	-	-
Final for 12 months ended 31 December 2003 of 34.41p (2003: 35.81p) per share on an aggregated basis	39.2	3.0	42.2	37.5	6.4	43.9
Final for 3 months ended 31 March 2004 of 17.21p per share on an aggregated basis	19.6	1.5	21.1	-	-	-
	98.0	53.5	151.5	74.9	12.9	87.8

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

The company has maintained its policy of a steady 2% real growth per annum for the appointed business dividend. Dividends from the non-appointed business are determined by the directors and are based upon performance.

The dividend charge is artificially high in the period due to the change in statutory accounting year end from 31 December to 31 March. This means that the charge for the regulatory year is effectively for a 15 month period. The Final Business Plan used the 12 month dividend of £78.4m in its projections. From 2004/05, the company will revert to a 12 month dividend as per the business plan.

The directors are of the opinion that it is appropriate to maintain the current dividend policy notwithstanding the significant reduction in profit before tax, as this has been influenced by factors outside the company's control, as described in the directors' report, such as interest cover of 1.74.

In accordance with the principle of incentive based price cap regulation, rewards to shareholders will reflect company performance against Ofwat targets, in particular operating and investment targets.

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
- Directors' judgement as to a fair reward for shareholders in the context of market conditions.

11. TANGIBLE FIXED ASSETS – GROUP AND COMPANY

The net book value of infrastructure assets, including infrastructure assets in the course of construction, is stated after the deduction of grants and contributions amounting to £109.4m (2003: £101.5m) in order to give a true and fair view (note 1e).

	Freehold land and buildings	Infra-structure assets	Operational structures, plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Aggregated Basis
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 April 2003	86.0	1,064.9	1,395.4	106.8	143.8	2,796.9
Additions	-	-	-	-	161.6	161.6
Schemes commissioned	1.7	62.3	125.3	35.0	(224.3)	-
Disposals	-	-	(0.1)	-	-	(0.1)
Grants and contributions	-	(0.4)	-	-	(7.5)	(7.9)
At 31 March 2004	87.7	1,126.8	1,520.6	141.8	73.6	2,950.5
Depreciation:						
At 1 April 2003	21.7	-	308.7	67.0	-	397.4
Provision for year	3.7	-	35.7	14.1	-	53.5
Disposals	-	-	-	-	-	-
At 31 March 2004	25.4	-	344.4	81.1	-	450.9
Net book value:						
At 31 March 2004	62.3	1,126.8	1,176.2	60.7	73.6	2,499.6
At 31 March 2003	64.3	1,064.9	1,086.7	39.8	143.8	2,399.5
Leased assets included above:						
Net book value						
At 31 March 2004	-	2.2	25.7	0.7	-	28.6
At 31 March 2003	-	2.2	25.4	1.1	-	28.7

	Appointed business Water Supply	Appointed business Sewerage services	Non-Appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Cost:				
At 1 April 2003	1,166.3	1,511.6	119.0	2,796.9
Additions	85.2	76.2	0.2	161.6
Disposals	(0.1)	-	-	(0.1)
Grants and contributions	(4.6)	(3.3)	-	(7.9)
At 31 March 2004	1,246.8	1,584.5	119.2	2,950.5
Depreciation:				
At 1 April 2003	134.8	240.5	22.1	397.4
Provision for year	18.9	34.1	0.5	53.5
Disposals	-	-	-	-
At 31 March 2004	153.7	274.6	22.6	450.9
Net Book Value:				
At 31 March 2004	1,093.1	1,309.9	96.6	2,499.6
At 31 March 2003	1,031.5	1,271.1	96.9	2,399.5

12. FIXED ASSET INVESTMENTS – COMPANY

	2004	2003
	£'m	£'m
At 1 April and 31 March	-	89.4

At 31 March 2003, the company had a wholly owned subsidiary undertaking, Newcastle and Gateshead Water plc, whose principal activity was the holding of a loan note due from the company. This investment equated to a 100% holding in Newcastle and Gateshead Water plc of £40.7m, and a long term loan investment of £6.5m. Included in the net assets of Newcastle and Gateshead Water plc was a loan note receivable from Northumbrian Water Limited of £47.2m. During the year, Newcastle and Gateshead Water plc was in liquidation and repaid the £6.5m loan to Northumbrian Water Limited along with dividends and capital of £40.7m. Northumbrian Water Limited repaid the £47.2m loan note in full at par (note 21).

At 31 March 2003 the company had a wholly owned subsidiary undertaking in Suffolk Water plc, whose principal activity was the holding of a loan note due from the company. This investment was valued at £42.2m which equated to the net assets of that company. During the year, Suffolk Water plc was in liquidation and repaid capital and dividends totalling £42.2m to Northumbrian Water Limited. Northumbrian Water Limited repaid the £42.2m loan note in full at par (note 21).

The company has a wholly owned subsidiary undertaking, Northumbrian Water Finance plc, whose principal activity is to hold certain finance instruments on behalf of Northumbrian Water Limited.

The company has a wholly owned subsidiary undertaking, Reiver Holdings Limited, incorporated on 20 August 2003, which in turn has a new wholly owned subsidiary Reiver Finance Limited, whose principal activity is a sole special purpose financing vehicle.

13. STOCKS – GROUP AND COMPANY

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Raw materials and consumables	3.0	0.1	3.1	3.1	0.1	3.2

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

14. DEBTORS – GROUP AND COMPANY

	2004			2003 (as restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Trade debtors (note 2b)	46.4	0.4	46.8	51.0	0.4	51.4
Amounts owed by other group companies	6.5	-	6.5	1.5	0.2	1.7
Other debtors	6.1	0.1	6.2	6.8	0.1	6.9
Prepayments and accrued income	30.5	1.3	31.8	31.2	0.2	31.4
Corporation tax	11.2	-	11.2	5.6	-	5.6
Infrastructure renewals prepayment (note 22)	-	-	-	1.8	-	1.8
	100.7	1.8	102.5	97.9	0.9	98.8

Trade debtors are shown net of bills raised in advance.

15. INVESTMENTS – GROUP AND COMPANY

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Short term deposits	-	-	-	95.1	-	95.1
Assets held for resale	-	-	-	0.1	-	0.1
	-	-	-	95.2	-	95.2

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

Creditors due in less than one year as at 31 March 2004:

	2004	2004		
	Group	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	3.6	3.6	-	3.6
Bank overdraft	4.6	-	4.6	4.6
Loans (note 18)	33.1	33.1	-	33.1
Debenture stock (note 19)	5.0	5.0	-	5.0
Trade creditors	12.8	12.3	0.5	12.8
Amounts owed to other group companies	71.8	92.0	1.4	93.4
Taxation and social security	1.5	1.5	-	1.5
Corporation tax	0.1	-	0.1	0.1
Receipts in advance	15.9	15.9	-	15.9
Other creditors	13.7	13.7	-	13.7
Dividend payable	63.3	58.8	4.5	63.3
Accruals and deferred income	63.8	41.7	0.5	42.2
Inter business balance	-	(6.2)	6.2	-
	289.2	271.4	17.8	289.2

Creditors due in less than one year as at 31 March 2003:

	2003	2003		
	Group	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	3.2	3.2	-	3.2
Bank overdraft	12.6	-	12.6	12.6
Loans (note 18)	18.4	18.4	-	18.4
Debenture stock (note 19)	-	-	-	-
Trade creditors	9.9	9.7	0.2	9.9
Amounts owed to other group companies	46.2	57.0	1.4	58.4
Taxation and social security	1.7	1.6	0.1	1.7
Corporation tax	-	-	-	-
Receipts in advance	14.9	14.9	-	14.9
Other creditors	14.3	14.2	0.1	14.3
Dividend payable	43.9	37.5	6.4	43.9
Accruals and deferred income	65.2	52.6	0.4	53.0
Inter business balance	-	3.2	(3.2)	-
	230.3	212.3	18.0	230.3

Accruals and deferred income includes accruals related to capital projects of £16.9m (2003: £25.3m). Amounts owed to other group companies includes amounts related to capital projects of £2.7m (2003: £4.8m).

Included in amounts owed to other group companies is £9.7m (appointed business £8.3m (2003: £6.7m), non-appointed business £1.4m (2003: £1.4m)) payable in respect of tax losses surrendered by fellow subsidiaries. Also included in amounts owed to other group companies is £52.0m (2003: £29.2m) relating to loans repayable within one year (note 21).

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

Creditors due in more than one year as at 31 March 2004:

	2004	2004		
	Group	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	57.3	57.3	-	57.3
Loans (note 18)	917.4	324.0	46.0	370.0
Debenture stock (note 19)	9.2	9.2	-	9.2
Amounts owed to other group companies	351.6	899.0	-	899.0
Other creditors	1.1	1.1	-	1.1
	1,336.6	1,290.6	46.0	1,336.6

Creditors due in more than one year as at 31 March 2003:

	2003	2003		
	Group	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	56.2	56.2	-	56.2
Loans (note 18)	904.5	357.1	-	357.1
Debenture stock (note 19)	14.2	14.2	-	14.2
Amounts owed to other group companies	351.9	988.4	0.3	988.7
Other creditors	1.2	1.2	-	1.2
	1,328.0	1,417.1	0.3	1,417.4

At 31 March 2004 the group and company had entered into the following interest swap arrangements: £15.0m (2003: £15.0m) over a ten year period commencing on 10 May 1994 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 9.00%.

Included in amounts owed to other group companies is £nil (appointed business £nil (2003: £nil), non-appointed business £nil (2003: £0.3m)) payable in respect of tax losses surrendered by fellow subsidiaries.

Included in other creditors is £nil (appointed business £nil (2003: £0.1m), non-appointed business £nil (2003: £nil)) in respect of corporation tax payable.

18. LOANS

Details of loans as at 31 March 2004

	2004			
	Group	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
External loans are repayable as follows:			-	
Within one year	33.1	33.1	-	33.1
Between one and two years	64.8	18.8	46.0	64.8
Between two and five years	143.7	143.7	-	143.7
After five years	708.9	161.5	-	161.5
	950.5	357.1	46.0	403.1

18. LOANS (continued)

Details of loans as at 31 March 2003:

	2003			
	Group	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
External loans are repayable as follows:			-	
Within one year	18.4	18.4	-	18.4
Between one and two years	48.1	48.1	-	48.1
Between two and five years	53.0	53.0	-	53.0
After five years	803.4	256.0	-	256.0
	922.9	375.5	-	375.5

Loans repayable by instalments wholly repayable within 5 years amount to £23.0 m (2003: £23.4m).

Loans repayable by instalments not wholly repayable within 5 years amount to £229.1m (2003: £247.2m) and bear interest rates in the range of 4.15% to 8.55% of which £67.7m (2003: £66.2m) falls due in less than 5 years and £161.4m (2003: £181.0m) falls due after more than 5 years.

Loans repayable otherwise than by instalments which fall due in less than 5 years amount to £151.0m (2003: £30.0m) and bear interest rates in the range of 4.09% to 7.95%.

Loans repayable otherwise than by instalments which fall due after more than 5 years amount to £547.4m (2003: £622.3m) and bear interest at rates in the range of 5.60% to 6.0%.

Treasury operations

The company's board is responsible for the financing strategy of the company which is determined within treasury policies set by the company's ultimate parent company, Northumbrian Water Group plc. The aim of this strategy is to assess the ongoing capital requirement of the company and to raise funding on a timely basis, taking advantage of any favourable market opportunities.

The Treasury department carries out treasury operations on behalf of the company. Surplus funds are invested based upon forecast requirements, in accordance with the treasury policy. On occasion, derivatives are used as part of this process, but the treasury policies prohibit their use for speculation.

Risks arising from the company's financial instruments

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

Liquidity risk

As regards day to day liquidity, the company is responsible for cash management but is reliant upon the committed borrowing facilities available to Northumbrian Water Group plc. Northumbrian Water Group plc'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 3 months.

Interest rate risk

The company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and floating rates of interest and, as noted above, on occasion uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. Northumbrian Water Group plc's policy is to keep a minimum 60 per cent of its borrowings at fixed rates of interest.

18. LOANS (continued)

Foreign currency risk

Northumbrian Water Group plc's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered immediately on recognition.

Interest rate risk profile of financial assets and financial liabilities

The interest rates and currency profile of the net borrowings of the group at 31 March 2004 were:

			Fixed Rate Net Borrowings				
	Total net borrowings	Variable rate net borrowings	Fixed Rate Borrowings	Weighted average interest rate	Weighted average period until maturity	Weighted average period for which rate is fixed	Financial liabilities on which no interest is paid
	£'m	£'m	£'m	%	Years	Years	£'m
Sterling borrowings:							
External loans	(403.1)	(200.2)	(202.9)	6.43	9.9	9.9	-
Eurobonds	(547.4)	-	(547.4)	5.85	20.6	20.6	-
Debentures	(14.2)	-	(14.2)	9.84	3.2	3.2	-
Internal loans	(403.6)	(52.0)	(351.6)	6.75	18.9	18.9	-
Finance leases	(60.9)	(53.0)	(7.9)	7.55	5.0	5.0	-
Bank overdraft	(4.6)	(4.6)	-	-	-	-	-
Total borrowings	(1,433.8)	(309.8)	(1,124.0)	6.44	16.9	16.9	-
Cash	4.9	4.9	-				-
Net borrowings	(1,428.9)	(304.9)	(1,124.0)				-

The interest rates and currency profile of the net borrowings of the group at 31 March 2003 were:

			Fixed Rate Net Borrowings				
	Total net borrowings	Variable rate net borrowings	Fixed Rate Borrowings	Weighted average interest rate	Weighted average period until maturity	Weighted average period for which rate is fixed	Financial liabilities on which no interest is paid
	£'m	£'m	£'m	%	Years	Years	£'m
Sterling borrowings:							
External loans	(375.5)	(135.5)	(240.0)	6.55	10.3	10.3	-
Eurobonds	(547.4)	-	(547.4)	5.85	21.6	21.6	-
Debentures	(14.2)	-	(14.2)	9.84	4.2	4.2	-
Internal loans	(380.8)	(29.2)	(351.6)	6.75	19.9	19.9	-
Finance leases	(59.4)	(52.6)	(6.8)	7.09	5.5	5.5	-
Bank overdraft	(12.6)	(12.6)	-	-	-	-	-
Total borrowings	(1,389.9)	(229.9)	(1,160.0)	6.32	18.4	18.4	-
Cash	13.0	13.0	-				-
Short term investments	95.1	95.1	-				-
Net borrowings	(1,281.8)	(121.8)	(1,160.0)				-

The variable rate net borrowings comprise sterling denominated bank borrowings, overdrafts and deposits that bear interest at rates based upon up to twelve months LIBOR. In addition there are provisions due after more than one year of £4.3 million, on which no interest is payable.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Included in the debentures above are £2.0 million of irredeemable debentures that have been excluded from the calculation of the weighted average maturity and fixed periods.

18. LOANS (continued)

Currency exposures

At 31 March 2004, the group and the company had no currency exposures (2003: nil).

Borrowing facilities

Northumbrian Water Limited has an undrawn committed borrowing facility. The facility available at 31 March 2004, in respect of which all conditions precedent have been met are as follows:

	£'m
Expiring in more than one year but not more than three years	90.0

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities of the group as at 31 March 2004:

	Book value	Fair value
	£'m	£'m
Primary financial instruments held or issued to finance the Group's operations:		
Short-term financial liabilities and current portion of long-term borrowings	(46.1)	(49.0)
Short-term loan from parent company	(52.0)	(52.0)
Long-term borrowings	(1,335.7)	(1,391.0)
Financial assets	4.9	4.9
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	-	2.1
As at 31 March 2004	(1,428.9)	(1,485.0)

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities of the group as at 31 March 2003:

	Book value	Fair value
	£'m	£'m
Primary financial instruments held or issued to finance the Group's operations:		
Short-term financial liabilities and current portion of long-term borrowings	(63.5)	(67.4)
Long-term borrowings	(1,326.4)	(1,384.6)
Financial Assets	108.1	108.1
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	-	1.0
As at 31 March 2003	(1,281.8)	(1,342.9)

18. LOANS (continued)

The fair values of the interest rate swaps, and sterling denominated long-term fixed rate debt with a book value of £913.2m (2003: £913.5m), have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

Gains and losses on hedges

The company's board uses the Northumbrian Water Limited treasury function to enter into any necessary forward foreign currency contracts on the company's behalf to eliminate the currency exposures that arise on sales denominated in foreign currencies immediately those sales are transacted. The company also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. An analysis of these unrecognised gains and losses for the group is as follows:

	Gains	Losses	Total net Gains/Losses
	£'m	£'m	£'m
Unrecognised gains and losses on hedges at 1 April 2003	1.4	0.4	1.0
Gains and losses arising in previous years that were recognised in 2003/2004	(0.6)	(0.4)	(0.2)
Gains and losses arising before 1 April 2003 that were not recognised in 2003/2004	0.8	-	0.8
Gains and losses arising in 2003/2004 that were not recognised in 2003/2004	0.5	-	0.5
Unrecognised gains and losses on hedges at 31 March 2004	1.3	-	1.3
Of which:			
Gains and losses expected to be recognised in 2004/2005	1.3	-	1.3
Gains and losses expected to be recognised in 2005/2006 or later	-	-	-
	1.3		1.3

Market price risk

The company's exposure to market price risk principally comprises interest rate exposure. The company's policy is to accept a degree of interest rate risk. On the basis of the company's analysis, it is estimated that a 1% rise in interest rates would not have a material affect on its pre-tax profits.

19. DEBENTURE STOCKS – GROUP AND COMPANY

	2004	2003
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Debenture stocks are repayable as follows:		
In less than one year:		
£1, 12.0% Redeemable 2004	5.0	-
Between one and two years		
£1, 12.0% Redeemable 2004	-	5.0
£1, 12.0% Redeemable 2005	2.0	-
£1, 11.2% Redeemable 2005/09	3.5	-
Between two and five years:		
£1, 12.0% Redeemable 2005	-	2.0
£1, 11.2% Redeemable 2005/09	-	3.5
In five years or more:		
£1, 3.75% Redeemable 2012	0.3	0.3
£1, 4.25% Redeemable 2012	0.7	0.7
£1, 5.25% Redeemable 2012	0.7	0.7
£1, 3.5% Irredeemable	0.2	0.2
£1, 4.0% Irredeemable	0.8	0.8
£1, 5.0% Irredeemable	1.0	1.0
Total due in more than one year	9.2	14.2
At 31 March	14.2	14.2

The debenture stocks are secured by a floating charge on the company's business undertaking and on its assets.

20. OBLIGATIONS UNDER FINANCE LEASES – GROUP AND COMPANY

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

	2004	2003
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Amounts due:		
Within one year	3.6	3.2
Between one and two years	4.0	3.3
Between two and five years	10.4	8.7
After five years	66.1	68.8
	84.1	84.0
Less:		
Finance charge allocated to future periods	(23.2)	(24.6)
	60.9	59.4
Disclosed as due:		
Within one year (note 16)	3.6	3.2
After more than one year (note 17)	57.3	56.2
	60.9	59.4

21. AMOUNTS DUE TO OTHER GROUP COMPANIES

Amounts due to other group companies relate to loans repayable as follows:

	2004		2003	
	Group	Company Appointed and aggregated basis	Group	Company Appointed and aggregated basis
	£'m	£'m	£'m	£'m
Within one year	52.0	52.0	29.2	29.2
Between one and two years	-	-	-	-
Between two and five years	-	-	-	-
After five years	351.6	899.0	351.6	988.4
	403.6	951.0	380.8	1,017.6

At 31 March 2003 £47.2m was owed to a subsidiary undertaking of the group, Newcastle and Gateshead Water plc, in the form of an unsecured loan note repayable, at par. At that time there was no intention to repay and the loan was therefore classified as being due in five years or more. In March 2004, the company exercised its option to repay the loan note at any time, also at par.

At 31 March 2003 £42.2m was owed to a subsidiary undertaking of the group, Suffolk Water plc, in the form of an unsecured loan note repayable, at par. At that time there was no intention to repay and the loan was therefore classified as being due in five years or more. In March 2004, the company exercised its option to repay the loan note at any time, also at par.

£351.6m is owed to the immediate parent company, Northumbrian Services Limited. Northumbrian Services Limited issued £200.0m Guaranteed Eurobonds in February 1998 and issued a further £150.0m Guaranteed Eurobonds in September 2001, maturing 6 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 £156.2m respectively. Finance costs allocated during the year amounted to £0.2m (2003: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2003: £0.3m).

£300.8m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by Northumbrian Water Limited who received the issue proceeds by way of an inter company loan. Amortisation of loan issue receipts during the year amounted to £0.1m (2003: £0.1m).

£246.6 m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £250.0m Guaranteed Eurobonds during December 2002, maturing April 2033, with an annual coupon of 5.625%. The issue was guaranteed by Northumbrian Water Limited who received the issue proceeds by way of an inter-company loan. Finance costs allocated during the year amounted to £0.1m (2003: £nil).

22. PROVISIONS FOR LIABILITIES AND CHARGES – GROUP AND COMPANY

	2004		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Infrastructure renewals:			
At 1 April	(1.8)	1.3	(0.5)
Transferred from profit and loss account	34.1	0.1	34.2
Utilised during the year (note 4b)	(25.5)	-	(25.5)
At 31 March	6.8	1.4	8.2
Deferred tax :			
As at 1 April as originally reported	158.6	4.5	163.1
Prior year adjustment (note 2b)	(1.9)	-	(1.9)
As at 1 April as restated	156.7	4.5	161.2
Movement in the year	(8.3)	1.8	(6.5)
At 31 March	148.4	6.3	154.7
Severance provision:			
As at 1 April	1.2	-	1.2
Transferred from profit and loss account	1.2	-	1.2
Utilised during the year	(1.3)	-	(1.3)
At 31 March	1.1	-	1.1
Pension provision for former directors:			
As at 1 April	3.0	-	3.0
Transferred from profit and loss account	0.5		0.5
Utilised during the year	(0.3)	-	(0.3)
At 31 March	3.2	-	3.2
Balance at 31 March 2004	159.5	7.7	167.2

The severance provision of £1.1m relates to severance and pension costs relating to senior managers who are leaving the business.

The pension provision for former directors relates to pensions payable to those former directors of water-only companies which have since merged with Northumbrian Water Limited. The provision of £3.2m represents the full future amounts payable, based on an actuarial assessment, for which NWL is directly liable.

22. PROVISIONS FOR LIABILITIES AND CHARGES – GROUP AND COMPANY (continued)

The provision for deferred tax comprises:

	2004			2003 (as restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Accelerated capital allowances	428.7	17.5	446.2	419.0	16.5	435.5
Other timing differences	(27.1)	(0.6)	(27.7)	(25.6)	(0.6)	(26.2)
Undiscounted provision for deferred tax	401.6	16.9	418.5	393.4	15.9	409.3
Discount	(253.2)	(10.6)	(263.8)	(236.7)	(11.4)	(248.1)
Discounted provision for deferred tax	148.4	6.3	154.7	156.7	4.5	161.2

23. ACCRUALS AND DEFERRED INCOME – GROUP AND COMPANY

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Non infrastructure capital grants and contributions:						
At 1 April	35.6	0.5	36.1	33.0	0.5	33.5
Additions	8.2	-	8.2	4.3	-	4.3
Amortised during the year	(2.1)	-	(2.1)	(1.7)	-	(1.7)
At 31 March	41.7	0.5	42.2	35.6	0.5	36.1

24. CALLED UP SHARE CAPITAL – GROUP AND COMPANY

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Authorised: 122,650,000 Ordinary Shares at £1 each (2003: 122,650,000)	92.1	30.6	122.7	92.1	30.6	122.7

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Allotted, called up and fully paid: 122,650,000 Ordinary Shares of £1 each (2003: 122,650,000)	92.1	30.6	122.7	92.1	30.6	122.7

25. PROFIT AND LOSS ACCOUNT – GROUP AND COMPANY

	2004		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
At 1 April as previously reported	687.5	42.7	730.2
Prior year adjustment (note 2b)	(4.3)	-	(4.3)
At 1 April as restated	683.2	42.7	725.9
Loss retained for the year	(26.9)	(46.8)	(73.7)
At 31 March	656.3	(4.1)	652.2

As permitted by Section 230 of the Companies Act 1985, the company's profit and loss account has not been included in these financial statements. The profit for the financial year of £77.8m (2003 restated: £49.9m) relates to the operations of the company.

The retained profit of the appointed business reflects the accounting treatments for both section 19 infrastructure expenditure and for amortisation of infrastructure grants which are explained in notes 1 (d) and 1 (e). If the statutory accounting treatment had been applied to the regulatory financial statements, the retained profits would have been increased.

26. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS – GROUP AND COMPANY

	2004		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Opening equity shareholders' funds as previously reported	779.6	73.3	852.9
Prior year adjustment (note 2b)	(4.3)	-	(4.3)
Opening equity shareholders' funds as restated	775.3	73.3	848.6
Profit for the financial year	71.1	6.7	77.8
Dividends	(98.0)	(53.5)	(151.5)
Closing equity shareholders' funds	748.4	26.5	774.9

27. COMMITMENTS – GROUP AND COMPANY

(a) Capital expenditure:

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Expenditure contracted for	53.3	-	53.3	67.6	-	67.6

(b) Lease commitments:

The company and group has entered into non-cancellable operating leases in respect of land and buildings. The total amount payable under these leases in the next year is as follows:-

	2004			2003		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Land and buildings: Leases which expire:						
Within one year	0.1	-	0.1	0.1	-	0.1
In five years or more	0.6	-	0.6	0.6	-	0.6
	0.7	-	0.7	0.7	-	0.7

28. PENSIONS

Northumbrian Services Limited operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,406 employees. The Scheme, named the Northumbrian Water Pension Scheme, comprises four unitised sub-funds – WPS, Northumbrian Water (North), Northumbrian Water (South) and MIS.

The assets of the Scheme are held separately from those of Northumbrian Services Limited in independently administered funds.

The most recent actuarial valuation of the Scheme was at 31 December 2001. At that date the market value of the assets amounted to £441.0m in aggregate (excluding MIS which was valued at approximately £20.0m). The 2001 valuation disclosed that the combined value of the assets represented 109% of the value of the accrued liabilities.

The following table sets out the contributions agreed based on the 31 December 2001 valuations for WPS, North and South sub-funds. The contributions for the MIS sub-fund were agreed on the 31 March 2001 valuation.

Section	**WPS**	**North**	**South**	**MIS**
Members' contributions	6%	5%	5%	5%/6%
Employer's contributions	15.5%	10.5%	Nil	6%/7.2%

The MIS employer contributions increased to 21% and 20.7% of Pensionable Earnings for 5% and 6% members respectively from July 2003 following advice from the actuary. In addition the company have agreed to pay £275,000 p.a. for 10 years starting on 1 January 2005.

The company contribution rate was assessed at the December valuation using the Projected Unit Method and the following actuarial assumptions: -

Investment Return	
- Pre Retirement	6.1%
- Post Retirement	5.7%
Pay Increases	3.5%
Pension Increases	2.5%
Price Inflation	2.5%

During the year the group made contributions amounting to £5.3m (2003: £4.5m).

The next valuation will be carried out as at 31 December 2004. An independent qualified actuary performs the actuarial valuation.

Under the transitional provisions of FRS 17 "Retirement benefits", additional disclosures regarding the group defined benefit pension scheme are required. In accordance with FRS 17, the company will account for its contributions to the Scheme as if it were a defined contribution scheme because it is not possible to identify the company's share of the net assets and liabilities in the Scheme on a consistent and reasonable basis.

The latest actuarial valuation of the Scheme, prepared for the purposes of making the transitional disclosures in accordance with FRS 17 in the consolidated financial statements of the parent company, shows a deficit of £90.6m. Further details of this valuation can be found in the consolidated financial statements of the parent company.

In addition, Northumbrian Services Limited operates the Northumbrian Water Group Personal Pension Plan which provides defined contribution benefits to 705 employees.

29. INFORMATION IN RELATION TO ALLOCATIONS AND APPORTIONMENTS

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

Overhead costs incurred in the appointed business which relate to the non-appointed business have been allocated using an activity based approach to comply with Regulatory Accounting Guideline No 5.

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

Turnover is separately recorded between water services and sewerage services and therefore no apportionment has been necessary. Operating costs have been allocated between water and sewerage services in accordance with the guidance set out in Regulatory Accounting Guideline No 4.

30. RELATED PARTY DISCLOSURES

The company is a wholly owned subsidiary of Northumbrian Water Group plc which produces publicly available financial statements which include the results of the company. Consequently the company is exempt under the terms of Financial Reporting Standard No 8 “Related Party Disclosures” from disclosing transactions with other members of the group headed by Northumbrian Water Group plc.

31. ULTIMATE PARENT COMPANY

The ultimate parent company and controlling party of the company is Northumbrian Water Group plc, incorporated in England and Wales. The group which consolidates the results of the company is Northumbrian Water Group plc and copies of the consolidated financial statements are available to the public from Communications, Northumbrian Water Group plc, Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ.

32. POST BALANCE SHEET EVENT

On 12 May 2004, the Group’s financial position was improved by the securitisation of the contract with the Environment Agency for the operation of the Kielder Water transfer scheme. The proceeds were used to repay short term Group debt of £205.0m, arising from the acquisition of the Group business in May 2003 (see Director’s Report).

33. RECONCILIATION OF BALANCE SHEETS IN STATUTORY AND REGULATORY FINANCIAL STATEMENTS

In the preparation of its statutory accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS 15 “Tangible Fixed Assets”. However, for the purposes of regulatory accounts, OFWAT has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the statutory accounts is set out below:

	March 2004 Infrastructure Assets
	£’m
Cost	
At 31 March 2004 per Regulatory Financial Statements	1,126.8
Adjustments to opening balance	262.2
Infrastructure renewals expenditure capitalised in the year	23.8
Infrastructure disposals in the year	(17.9)
Cost at 31 March 2004 per Statutory Financial Statements	1,394.9
Depreciation	
At 31 March 2004 per Regulatory Financial Statements	-
Adjustment to opening balance	153.7
Depreciation charge for infrastructure renewals expenditure	27.5
Infrastructure disposals in the year	(17.9)
At 31 March 2004 per Statutory Financial Statements	163.3
Net book Value	
At 31 March 2004 per Regulatory Financial Statements	1,126.8
Adjustment relating to infrastructure grants and contributions	93.6
Adjustment for infrastructure renewals accounting	(8.2)
Adjustment in respect of Section 19 “overlap” – note 1(d)((i))	19.4
At 31 March 2004 per Statutory Financial Statements	1,231.6
Provisions and Liabilities – infrastructure renewals	
At 31 March 2004 per Regulatory Financial Statements	8.2
Less infrastructure renewals accrual	(8.2)
At 31 March 2004 per Statutory Financial Statements	-
Deferred tax	
At 31 March 2004 per Regulatory Financial Statements	(154.7)
Adjustment relating to infrastructure grants and contributions	(2.0)
Adjustment relating to Section 19 “overlap”	(3.2)
At 31 March 2004 per Statutory Financial Statements	(159.9)

CURRENT COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2004

	Note	2004	2003 (as restated)
		£'m	£'m
Turnover	2	435.8	421.7
Current cost operating costs - ordinary	3	(208.4)	(199.9)
Current cost operating costs - exceptional	3	(1.1)	(4.4)
Total current cost operating costs		(209.5)	(204.3)
Capital maintenance costs	3	(125.4)	(120.4)
Profit on sale of fixed assets	2	0.4	0.9
CURRENT COST OPERATING PROFIT		101.3	97.9
Working capital adjustment	2	(1.7)	0.5
CURRENT COST OPERATING PROFIT		99.6	98.4
Net interest payable		(80.1)	(70.1)
Financing adjustment	6	39.7	40.0
CURRENT COST PROFIT BEFORE TAXATION		59.2	68.3
Taxation:			
Current tax		3.3	10.1
Deferred tax		8.3	(28.9)
CURRENT COST PROFIT ATTRIBUTABLE TO SHAREHOLDERS		70.8	49.5
Dividends		(98.0)	(74.9)
CURRENT COST LOSS RETAINED		(27.2)	(25.4)

CURRENT COST BALANCE SHEET
At 31 March 2004

	Note	2004	2003 as restated
		£'m	£'m
FIXED ASSETS			
Tangible fixed assets	4	11,278.3	11,769.3
Third party contributions since 1989/90		(69.7)	(62.1)
		11,208.6	11,707.2
Working capital	5	(73.1)	63.7
NET OPERATING ASSETS		11,135.5	11,770.9
Investment		-	89.4
Non trade debtors		24.4	8.3
Non trade creditors due within one year		(62.1)	(37.6)
Creditors due after more than one year		(1,290.6)	(1,417.1)
Provisions for liabilities and charges – deferred tax		(148.4)	(156.7)
Provisions for liabilities and charges – other		(4.3)	(4.2)
Dividends payable		(58.8)	(37.5)
NET ASSETS EMPLOYED		9,595.7	10,215.5
CAPITAL AND RESERVES			
Called up share capital		92.1	92.1
Profit and loss account		367.4	394.5
Current cost reserve	6	9,136.2	9,728.9
TOTAL CAPITAL AND RESERVES		9,595.7	10,215.5

CURRENT COST CASH FLOW STATEMENT
For the year ended 31 March 2004

	Note	2004	2003
		£'m	£'m
NET CASH INFLOW FROM CONTINUING OPERATING ACTIVITIES	7	219.3	198.1
Returns on investments and servicing of finance			
Interest received		2.7	4.5
Interest paid		(70.4)	(71.0)
Interest element of finance lease rentals		(1.9)	(1.8)
Dividends received from subsidiary companies		66.9	-
Net cash outflow from returns on investments and servicing of finance		(2.7)	(68.3)
Taxation			
United Kingdom corporation tax paid		(0.8)	(5.3)
Net cash outflow from taxation		(0.8)	(5.3)
Capital expenditure and financial investment			
Gross cost of purchase of fixed assets		(168.1)	(170.5)
Infrastructure renewals expenditure		(25.5)	(36.4)
Loan repayment from subsidiary		6.5	-
Receipt of grants and contributions		16.1	9.1
Sale of tangible fixed assets		0.5	2.3
Net cash outflow from capital expenditure and financial investment		(170.5)	(195.5)
Acquisitions and disposals			
Repayment of capital from subsidiaries		16.0	-
Equity dividends paid		(76.7)	(74.2)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(15.4)	(145.2)
Management of liquid resources			
Purchase of short term deposits		(550.3)	(155.0)
Sale of short term deposits		645.4	93.5
Net cash inflow/(outflow) from management of liquid resources		95.1	(61.5)
Financing			
New loans		52.0	355.7
New leases		-	0.8
Loan repayment		(47.6)	(150.1)
Loan repayments to subsidiaries		(89.4)	-
Capital element of finance lease rental payments		(2.8)	(2.9)
Net cash (outflow)/inflow from financing		(87.8)	203.5
DECREASE IN CASH IN THE YEAR		(8.1)	(3.2)

NOTES TO THE CURRENT COST FINANCIAL INFORMATION
For the year ended 31 March 2004

1. CURRENT COST ACCOUNTING POLICIES

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

(a) Tangible fixed assets

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

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

(i) Land and Buildings

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

(ii) Infrastructure assets

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

(iii) Other fixed assets

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

(iv) Surplus land

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

(v) Grants and contributions

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

(b) Real financial capital maintenance adjustments

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

(c) Working capital adjustment

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

(d) Financing adjustment

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

(e) Infrastructure renewals accrual/prepayment adjustment

The infrastructure renewals accrual/prepayment adjustment is calculated by applying the RPI change over the year to the opening balance of the renewals accrual/prepayment.

2. TURNOVER

	2004			2003		
	Water services	Sewerage services	Appointed business	Water services	Sewerage services	Appointed business
	£'m	£'m	£'m	£'m	£'m	£'m
Measured	67.1	43.1	110.2	61.3	39.0	100.3
Unmeasured	147.2	120.8	268.0	145.6	119.0	264.6
Trade effluent	-	4.0	4.0	-	4.0	4.0
Large user revenues	21.1	7.0	28.1	21.1	7.2	28.3
Other sources	1.5	1.1	2.6	1.4	1.1	2.5
Third party services	10.5	12.4	22.9	10.4	11.6	22.0
Total turnover	247.4	188.4	435.8	239.8	181.9	421.7
Operating income:						
Current cost profit on disposal of fixed assets	0.2	0.2	0.4	0.7	0.2	0.9
Working capital adjustment	(1.0)	(0.7)	(1.7)	0.3	0.2	0.5

3. OPERATING COSTS

2004

Activity cost table

	Service analysis								Business analysis		
	Water supply			Sewerage services							
	Resources & Treatment	Distribution	**Water Supply Subtotal**	Sewerage	Sewage Treatment	Sludge Treatment & Disposal	Sewage T & D Subtotal	**Sewerage Service Subtotal**	Customer Services	Scientific Services	Cost of Regulation
	£'m	£'m	**£'m**	£'m	£'m	£'m	£'m	**£'m**	£'m	£'m	£'m
Direct Costs											
Employment costs	7.5	9.7	**17.2**	3.4	3.1	3.4	6.5	**9.9**			
Power	3.0	5.3	**8.3**	1.5	3.7	2.8	6.5	**8.0**			
Hired & contracted services	2.2	5.9	**8.1**	1.3	1.0	8.0	9.0	**10.3**			
Associated companies	0.7	-	**0.7**	-	0.4	1.8	2.2	**2.2**			
Materials and consumables	5.1	0.9	**6.0**	0.1	0.5	0.8	1.3	**1.4**			
Service charges (EA)	16.1	-	**16.1**	1.3	1.3	-	1.3	**2.6**			
Bulk supply imports	1.0	-	**1.0**	-	-	-	-	**-**			
Other direct costs	0.4	2.4	**2.8**	0.7	0.2	0.2	0.4	**1.1**			
Total direct costs	36.0	24.2	**60.2**	8.3	10.2	17.0	27.2	**35.5**	11.7	8.5	1.7
General and support expenditure	10.4	12.4	**22.8**	2.7	4.4	4.8	9.2	**11.9**	5.1	0.9	0.2
Functional expenditure	46.4	36.6	**83.0**	11.0	14.6	21.8	36.4	**47.4**	16.8	9.4	1.9
Business analysis			**18.7**					**9.4**			
Total business activities c/fwd			**101.7**					**56.8**			

3. OPERATING COSTS (continued)

2004

Activity cost table

Service Analysis

	Water supply			Sewerage services				
	Resources & Treatment	Distribution	**Water Supply Subtotal**	Sewerage	Sewage Treatment	Sludge Treatment & Disposal	Sewage T & D Subtotal	**Sewerage Service Subtotal**
	£'m	£'m	**£'m**	£'m	£'m	£'m	£'m	**£'m**
Total business activities b/fwd			**101.7**					**56.8**
Rates			**15.0**					**4.8**
Doubtful debts			**7.0**					**7.3**
Exceptional costs			**0.6**					**0.5**
Total opex less third party services			**124.3**					**69.4**
Third party services – opex			**9.5**					**6.3**
Total operating expenditure			**133.8**					**75.7**
Capital costs								
Infrastructure renewal expenditure	0.8	20.4	**21.2**	4.3	-	-	-	**4.3**
Movement in infrastructure renewals accrual/prepayment	-	3.0	**3.0**	5.6	-	-	-	**5.6**
Current cost depreciation (allocated)	22.4	7.9	**30.3**	4.9	28.0	11.8	39.8	**44.7**
Business activities current cost depreciation (non allocated)			**11.4**					**4.9**
Total capital maintenance			**65.9**					**59.5**
Total operating costs			**199.7**					**135.2**
CCA (MEA) values								
Service activities			**5,579.3**					**5,673.6**
Business activities			**18.0**					**10.0**
Service totals			**5,597.3**					**5,683.6**

3. OPERATING COSTS (continued)

2003 (as restated)

Activity cost table

	Service analysis								**Business analysis**		
	Water supply			Sewerage services							
	Resources & Treatment	Distribution	**Water Supply Subtotal**	Sewerage	Sewage Treatment	Sludge Treatment & Disposal	Sewage T & D Subtotal	**Sewerage Service Subtotal**	Customer Services	Scientific Services	Cost of Regulation
	£'m	£'m	**£'m**	£'m	£'m	£'m	£'m	**£'m**	£'m	£'m	£'m
Direct Costs											
Employment costs	7.0	8.7	**15.7**	3.2	2.6	3.9	6.5	**9.7**			
Power	2.7	5.1	**7.8**	1.8	3.9	2.5	6.4	**8.2**			
Hired & contracted services	1.9	3.5	**5.4**	1.1	0.4	8.0	8.4	**9.5**			
Associated companies	0.4	-	**0.4**	-	0.7	1.1	1.8	**1.8**			
Materials and consumables	5.0	1.0	**6.0**	0.1	0.6	1.5	2.1	**2.2**			
Service charges (EA)	15.2	-	**15.2**	1.2	1.2	-	1.2	**2.4**			
Bulk supply imports	0.9	-	**0.9**	-	-	-	-	**-**			
Other direct costs	0.2	4.4	**4.6**	0.9	0.1	0.1	0.2	**1.1**			
Total direct costs	33.3	22.7	**56.0**	8.3	9.5	17.1	26.6	**34.9**	10.3	8.0	1.4
General and support expenditure	11.1	12.4	**23.5**	3.6	4.5	5.3	9.8	**13.4**	4.8	1.4	0.2
Functional expenditure	44.4	35.1	**79.5**	11.9	14.0	22.4	36.4	**48.3**	15.1	9.4	1.6
Business analysis			**16.7**					**9.4**			
Total business activities c/fwd			**96.2**					**57.7**			

3. OPERATING COSTS (continued)

2003

Activity cost table

	Water supply			Sewerage services				
	Resources & Treatment	Distribution	**Water Supply Subtotal**	Sewerage	Sewage Treatment	Sludge Treatment & Disposal	Sewage T & D Subtotal	**Sewerage Service Subtotal**
	£'m	£'m	**£'m**	£'m	£'m	£'m	£'m	**£'m**
Total business activities b/fwd			**96.2**					**57.7**
Rates			**14.8**					**3.7**
Doubtful debts			**7.1**					**6.4**
Exceptional costs			**3.9**					**0.5**
Total opex less third party services			**122.0**					**68.3**
Third party services – opex			**9.1**					**4.9**
Total operating expenditure			**131.1**					**73.2**
Capital costs								
Infrastructure renewal expenditure	1.6	23.8	**25.4**	11.0	-	-	-	**11.0**
Movement in infrastructure renewals accrual/prepayment	-	(1.6)	**(1.6)**	(1.1)	-	-	-	**(1.1)**
Current cost depreciation (allocated)	20.2	7.9	**28.1**	6.0	37.8	4.0	41.8	**47.8**
Business activities current cost depreciation (non allocated)			**5.9**					**4.9**
Total capital maintenance			**57.8**					**62.6**
Total operating costs			**188.9**					**135.8**
CCA (MEA) values								
Service activities			**5,598.4**					**6,094.2**
Business activities			**51.0**					**25.7**
Service totals			**5,649.4**					**6,119.9**

4. TANGIBLE FIXED ASSETS

Analysis by asset type

Water Service	Specialised operational assets	Non specialised properties	Infrastructure assets	Other tangible assets	Total
	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:					
At 1 April 2003	1,678.1	64.2	4,719.6	115.9	6,577.8
Asset management plan revaluation	(457.6)	(23.3)	(8.3)	(23.3)	(512.5)
Revised replacement cost as at 1 April 2003	1,220.5	40.9	4,711.3	92.6	6,065.3
RPI Adjustment	33.1	1.2	123.0	1.0	158.3
Disposals	(0.2)	-	-	-	(0.2)
Additions	48.6	0.6	26.2	5.3	80.7
At 31 March 2004	1,302.0	42.7	4,860.5	98.9	6,304.1
Depreciation:					
At 1 April 2003	847.6	15.9	-	64.9	928.4
Asset management plan revaluation	(264.4)	1.6	-	(14.8)	(277.6)
Revised provision as at 1 April 2003	583.2	17.5	-	50.1	650.8
RPI Adjustment	16.0	0.5	-	0.5	17.0
Disposals	(0.1)	-	-	-	(0.1)
Charge for year	30.8	1.3	-	9.6	41.7
At 31 March 2004	629.9	19.3	-	60.2	709.4
Net Book Value at 31 March 2004	672.1	23.4	4,860.5	38.7	5,594.7
Net Book Value at 31 March 2003	830.5	48.3	4,719.6	51.0	5,649.4

Analysis by asset type

Sewerage Services	Specialised operational assets	Non specialised properties	Infrastructure assets	Other tangible assets	Total
	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:					
At 1 April 2003	2,237.8	15.3	5,139.4	62.8	7,455.3
Asset management plan revaluation	(808.5)	10.5	(565.6)	(40.6)	(1,404.2)
Revised replacement cost as at 1 April 2003	1,429.3	25.8	4,573.8	22.2	6,051.1
RPI Adjustment	37.3	0.6	119.6	0.6	158.1
Disposals	-	-	-	-	-
Additions	51.0	0.2	18.5	3.1	72.8
At 31 March 2004	1,517.6	26.6	4,711.9	25.9	6,282.0
Depreciation:					
At 1 April 2003	1,295.9	2.4	-	37.1	1,335.4
Asset management plan revaluation	(784.3)	9.1	-	(25.4)	(800.6)
Revised provision as at 1 April 2003	511.6	11.5	-	11.7	534.8
RPI Adjustment	13.3	0.3	-	0.4	14.0
Disposals	-	-	-	-	-
Charge for year	45.0	0.8	-	3.8	49.6
At 31 March 2004	569.9	12.6	-	15.9	598.4
Net Book Value at 31 March 2004	947.7	14.0	4,711.9	10.0	5,683.6
Net Book Value at 31 March 2003	941.9	12.9	5,139.4	25.7	6,119.9

4. TANGIBLE FIXED ASSETS (continued)

Analysis by asset type

Total	Specialised operational assets	Non specialised properties	Infrastructure assets	Other tangible assets	Total
	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:					
At 1 April 2003	3,915.9	79.5	9,859.0	178.7	14,033.1
Asset management plan revaluation	(1,266.1)	(12.8)	(573.9)	(63.9)	(1,916.7)
Revised replacement cost as at 1 April 2003	2,649.8	66.7	9,285.1	114.8	12,116.4
RPI Adjustment	70.4	1.8	242.6	1.6	316.4
Disposals	(0.2)	-	-	-	(0.2)
Additions	99.6	0.8	44.7	8.4	153.5
At 31 March 2004	2,819.6	69.3	9,572.4	124.8	12,586.1
Depreciation:					
At 1 April 2003	2,143.5	18.3	-	102.0	2,263.8
Asset management plan revaluation	(1,048.7)	10.7	-	(40.2)	(1,078.2)
Revised provision as at 1 April 2003	1,094.8	29.0	-	61.8	1,185.6
RPI Adjustment	29.3	0.8	-	0.9	31.0
Disposals	(0.1)	-	-	-	(0.1)
Charge for year	75.8	2.1	-	13.4	91.3
At 31 March 2004	1,199.8	31.9	-	76.1	1,307.8
Net Book Value at 31 March 2004	1,619.8	37.4	9,572.4	48.7	11,278.3
Net Book Value at 31 March 2003	1,772.4	61.2	9,859.0	76.7	11,769.3

The asset valuation for the year ended 31 March 2004 has been adjusted to reflect the revaluation of the assets which arose following the modern equivalent asset valuation exercise undertaken for the final business plan which was submitted to Ofwat in April 2004.

The company has also calculated the modern equivalent asset values using the old MEAV methodology. The table below compares the gross and net MEAV values as at 31 March 2004, and the current cost depreciation charge for the year then ending, resulting from the revaluation exercise upon which the final business plan was based and the old MEAV methodology.

Total	Specialised operational assets	Non specialised properties	Infrastructure assets	Other tangible assets	Total
	£'m	£'m	£'m	£'m	£'m
Gross MEAV at 31 March 2004:					
Old MEAV methodology	4,126.7	81.6	10,161.2	183.4	14,552.9
Final business plan revaluation	(2,819.6)	(69.3)	(9,572.4)	(124.8)	(12,586.1)
Reduction in gross MEAV	1,307.1	12.3	588.8	58.6	1,966.8
Net MEAV at 31 March 2004:					
Old MEAV methodology	1,861.9	59.4	10,161.2	70.0	12,152.5
Final business plan revaluation	(1,619.8)	(37.4)	(9,572.4)	(48.7)	(11,278.3)
Reduction in net MEAV	242.1	22.0	588.8	21.3	874.2
Depreciation for the year ending 31 March 2004:					
Final business plan revaluation	75.8	2.1	-	13.4	91.3
Old MEAV methodology	(65.5)	(3.3)	-	(8.7)	(77.5)
Increase in depreciation	10.3	(1.2)	-	4.7	13.8

4. TANGIBLE FIXED ASSETS (continued)

The gross MEAV values calculated by the new MEAV methodology are significantly lower than the values calculated by the old methodology, particularly in the category of specialised operational assets where the new gross values are more than 30% lower than the old values. This reflects that the new methodology has used up to date cost information, obtained from the actual costs of NWL's recent investment in new assets, to produce the MEAV values. The old methodology is based simply on the application of inflation to the prior years valuation for every year since AMP2. The difference principally reflects the efficiencies made in delivering capital investment since AMP 2.

The current cost depreciation calculated by the new MEAV methodology is significantly higher than the value calculated by the old methodology. The main reason is that the old methodology did not revalue assets which had become fully depreciated in the year, despite the fact that these assets are still in use. This resulted in electrical and mechanical assets which were still in use at a large number of water treatment (48) and sewage treatment works (71) becoming fully depreciated at the end of the prior year. The old model did not allow any more depreciation to be charged on these assets in the year ending 31 March 2004.

The new MEAV methodology has given an appropriate current cost value to all assets which were still in use at the end of March 2003, including all the treatment assets referred to above, and therefore produces a full year depreciation charge for these assets. This valuation has then been adjusted for investment in the year to 31 March 2004 and for inflation.

5. WORKING CAPITAL

	2004	2003 (as restated)
	£'m	£'m
Stocks	3.0	3.1
Trade debtors	46.4	51.0
Working cash balances	4.9	108.2
Trade creditors	(12.3)	(9.7)
Short term capital creditors	(19.6)	(30.1)
Infrastructure renewals (accruals) / prepayment	(6.8)	1.8
Other trade accruals	(46.4)	(39.5)
Trade payments in advance	30.5	31.2
Payroll related taxes and DSS contributions	(1.5)	(1.6)
Other creditors due in less than one year	(71.3)	(50.7)
At 31 March	(73.1)	63.7

6. MOVEMENT ON CURRENT COST RESERVE

	2004 £'m	2003 £'m
At 1 April	9,728.9	9,419.3
AMP adjustment	(838.5)	-
RPI Adjustments:		
Fixed assets	285.4	350.9
Working capital	1.7	(0.5)
Financing	(39.7)	(40.0)
Grants and third party contributions	(1.6)	(0.8)
At 31 March	9,136.2	9,728.9

7. RECONCILIATION OF CURRENT COST OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2004 £'m	2003 £'m
Current cost operating profit	99.6	98.4
Working capital adjustment	1.7	(0.5)
Change in stocks	0.1	(0.6)
Current cost depreciation	91.3	86.7
Current cost profit on sale of assets	(0.4)	(0.9)
Increase in debtors and prepaid expenses	-	(1.4)
Increase in creditors and accrued expenses	(5.1)	(6.0)
Infrastructure renewals expenditure	25.5	36.4
Movement in provisions	8.7	(12.3)
Effect of other deferrals and accruals on operating activity cashflow	(2.1)	(1.7)
Net cash flow from operating activities	219.3	198.1

8. ANALYSIS OF NET DEBT

	At 1 April 2003 £'m	Cash Flow £'m	Other non cash changes £'m	At 31 March 2004 £'m
Cash in hand and at bank	13.0	(8.1)	-	4.9
Loans due after one year	(1,359.7)	89.4	38.1	(1,232.2)
Loans due within one year	(47.6)	(4.4)	(38.1)	(90.1)
Finance leases	(59.4)	2.8	(4.3)	(60.9)
Current asset investment	95.1	(95.1)	-	-
Total	(1,358.6)	(15.4)	(4.3)	(1,378.3)

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

Associate	Service	December 2003 or March 2004 Turnover	Terms of Supply	2003/04 Value
		£'m		£'m
Analytical & Environmental Services Ltd	Rental of laboratories and service charges	13.0	Negotiated	0.3
SITA	Treatment of waste	3,716.0	Negotiated	0.3
Vehicle Lease and Services Ltd	Rental of garage and service charges	12.0	Negotiated	0.1

Services supplied to the appointee by associated companies:

Associate	Service	December 2003 or March 2004 Turnover	Terms of Supply	2003/04 Value
		£'m		£'m
Analytical & Environmental Services Ltd	Sampling and analysis	13.0	No market	9.5
Ondeo Degremont	Construction and engineering design	579.0	Competitive letting	2.5
Entec UK Ltd	Engineering design consultancy	39.4	Competitive letting	9.8
Entec UK Ltd	Engineering design consultancy	39.4	Other market testing	1.0
Fastflow Pipeline Services Ltd	Mains renewals, sewer repairs	16.3	Competitive letting	13.0
Ondeo Nalco	Chemical supplier	1,680.0	Competitive letting	1.7
SITA	Waste disposal	3,716.0	Competitive letting	0.3
Suez Environnement	Group research and development costs	26,547.0	No market	8.7
Vehicle Lease and Services	Maintenance and capital finance charge	12.0	Competitive letting	5.8
Fabricom	Electrical, Mechanical & Instrumentation contractor	6,295.0	Other market testing	0.1

10. ROLLING SUMMARY: CURRENT COST PROFIT AND LOSS ACCOUNT

	1999/00	2000/01	2001/02	2002/03	2003/04
	£'m	£'m	£'m	£'m	£'m
Turnover	395.0	434.1	443.1	433.6	435.8
Current cost operating costs	(215.0)	(304.0)	(309.1)	(328.2)	(333.4)
Exceptional items	(9.4)	(2.1)	-	(4.5)	(1.1)
Working capital adjustment	(2.1)	0.5	0.5	0.5	(1.7)
Current cost operating profit	168.5	128.5	134.5	101.4	99.6
Net interest	(38.6)	(68.7)	(70.7)	(72.1)	(80.1)
Financing adjustment	12.2	25.6	15.8	41.1	39.7
Current cost profit before taxation	142.1	85.4	79.6	70.4	59.2
Taxation	(27.6)	(49.1)	13.5	(19.4)	11.6
Current cost profit on ordinary activities	114.5	36.3	93.1	51.0	70.8
Dividends	(58.5)	(69.3)	(76.4)	(77.0)	(98.0)
Current cost profit/(loss) retained	56.0	(33.0)	16.7	(26.0)	(27.2)

The rolling summary financial information for prior years has been compiled in accordance with Regulatory Accounting Guideline No 1, "Accounting for current costs", with adjustments being made to reflect changes in the general level of inflation as measured by changes in the RPI.

The figures from 2000/01 onwards include the full year results of the business of Northumbrian Water Limited and of that previously carried out by Essex & Suffolk Water plc.

11. ROLLING SUMMARY: CURRENT COST BALANCE SHEET

	31 March 2000	31 March 2001	31March 2002	31 March 2003	31 March 2004
	£'m	£'m	£'m	£'m	£'m
Tangible fixed assets	9,933.1	11,731.5	11,996.4	12,076.8	11,278.3
Third party contributions since 89/90	(59.9)	(61.8)	(62.1)	(63.7)	(69.7)
Working capital	(18.9)	(42.2)	(17.1)	71.7	(73.1)
Net operating assets	9,854.3	11,627.5	11,917.2	12,084.8	11,135.5
Investments	52.2	95.8	94.6	91.7	-
Non trade debtors	23.4	13.1	7.9	8.5	24.4
Non trade creditors	(39.0)	(181.5)	(35.0)	(38.6)	(62.1)
Creditors due after > 1 year	(729.3)	(1,043.4)	(1,298.1)	(1,454.0)	(1,290.6)
Provisions for liabilities and charges	-	(152.8)	(137.1)	(167.1)	(152.7)
Dividends payable	(28.6)	(36.7)	(38.9)	(38.5)	(58.8)
Net assets employed	9,133.0	10,322.0	10,510.6	10,486.8	9,595.7
Called up share capital	101.9	98.7	97.5	94.5	92.1
Profit and loss account	598.8	437.4	448.6	409.2	367.4
Current cost reserve	8,432.3	9,785.9	9,964.5	9,983.1	9,136.2
Total capital and reserves	9,133.0	10,322.0	10,510.6	10,486.8	9,595.7

The rolling summary financial information for prior years has been compiled in accordance with Regulatory Accounting Guideline No 1, "Accounting for current costs", with adjustments being made to reflect changes in the general level of inflation as measured by changes in the RPI.

The figures from 2000/01 onwards include the impact of the transfer of assets and liabilities to Northumbrian Water Limited from Essex & Suffolk Water plc on 1 April 2001.

12. REGULATORY CAPITAL VALUE AT 2003/2004 PRICES

	2003/2004
	£'m
Opening regulatory capital value	2,227.6
Capital expenditure (excluding IRE)	140.4
Infrastructure renewals expenditure	34.3
Infrastructure renewals charge	(28.9)
Grants and contributions	(7.5)
Current cost depreciation	(75.0)
Out-performance of regulatory assumptions (5 years in arrears)	31.1
Interim determination adjustments	(3.8)
Closing regulatory capital value	2,318.2
Average year regulatory capital value	2,249.0

The table shows the regulatory capital value used by Ofwat in setting the price limits for 2003/2004.

The numbers included above from capital expenditure to current cost depreciation (inclusive) are taken from Ofwat's final determination published in November 1999, and therefore do not agree exactly with the corresponding actual numbers in these financial statements.

Differences from the actual capital expenditure, infrastructure renewals expenditure, infrastructure renewals charge, grants and contributions and depreciation will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation for the next periodic review.

STATEMENT OF DIRECTORS' RESPONSIBILITIES
For the year ended 31 March 2004

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

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

(b) preparing on a consistent basis for each financial year regulatory financial statements in accordance with Condition F, having regard also to the terms of guidelines notified by the Director from time to time, which so far as is reasonably practicable have the same content as the annual financial statements of the Appointee prepared under the Companies Act 1985 and which are prepared in accordance with the formats, accounting policies and principles which apply to those financial statements;

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

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

ON BEHALF OF THE BOARD

M Parker
Company Secretary

4 August 2004

INDEPENDENT AUDITORS' REPORT TO THE DIRECTOR GENERAL OF WATER SERVICES (THE "REGULATOR") AND NORTHUMBRIAN WATER LIMITED

We have audited the regulatory financial statements of Northumbrian Water Limited ("the company") for the year ended 31 March 2004, which comprise the historic cost financial statements (Section B), itself comprising the group historical cost profit and loss account, group statement of total recognised gains and losses, group historical cost balance sheet, company historical cost balance sheet, group historical cost cash flow statement, notes to the cash flow statement a and b and related notes to the historical cost financial statements numbered 1 to 33, and the current cost financial information (Section C), itself comprising the current cost profit and loss account, current cost balance sheet, current cost cash flow statement and related notes to the current cost financial information numbered 1 to 12.

This report is made, on terms that have been agreed, solely to the company and the Regulator in order to meet the requirements of the company's Instrument of Appointment as a water and sewerage undertaker. Our audit work has been undertaken so that we might state to the company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligations under the the company's Instrument of Appointment as a water and sewerage undertaker to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Regulator, for our audit work, for our report, or for the opinions we have formed.

Basis of preparation

The regulatory financial statements have been prepared in accordance with the company's Instrument of Appointment as a water and sewerage undertaker, the Regulatory Accounting Guidelines 1 to 4 issued by the Regulator, and the accounting policies set out in the statement of accounting policies set out in note 1 to the historical cost financial statements and note 1 to the current cost financial information.

The regulatory financial statements are separate from the statutory financial statements of the company and have not been prepared under the basis of Generally Accepted Accounting Principles in the United Kingdom ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the directors and auditors

The Regulator determines the nature, form and content of the regulatory financial statements. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly, we make no such assessment.

The directors are responsible for preparing the regulatory financial statements in accordance with the company's Instrument of Appointment as a water and sewerage undertaker.

Our responsibility is to audit the regulatory financial statements in accordance with United Kingdom auditing standards issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion' below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report our opinion as to whether the regulatory financial statements present fairly, in accordance with the company's Instrument of Appointment as a water and sewerage undertaker, the Regulatory Accounting Guidelines 1 to 4 issued by the Regulator and the accounting policies set out in note 1 to the historical cost financial statements and note 1 to the current cost financial information, the results and financial position of the company. We also report to you if, in our opinion, the company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

Bases of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the regulatory financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the regulatory financial statements, and of whether the accounting policies are consistently applied and adequately disclosed.

INDEPENDENT AUDITORS' REPORT TO THE DIRECTOR GENERAL OF WATER SERVICES (THE "REGULATOR") AND NORTHUMBRIAN WATER LIMITED (continued)

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the regulatory financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of regulatory financial statements are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the regulatory financial statements is separate from our opinion on the statutory financial statements of the company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the company (our "Statutory" audit) was made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the company's members those matters that we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the company and the company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

Opinion

In our opinion, the regulatory financial statements fairly present in accordance with the company's Instrument of Appointment as a water and sewerage undertaker, the Regulatory Accounting Guidelines issued by the Regulator, and the accounting policies set out in note 1 to the historical cost financial statements and note 1 to the current cost financial information, the state of the company's affairs at 31 March 2004 on an historical cost and current cost basis, the historical cost and current cost profit for the year then ended and current cost cash flow for the year then ended, and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

In respect of this information, we report that in our opinion:

a) proper accounting records have been kept by the Appointee as required by paragraph 3 of Condition F of the Instrument;

b) the information is in agreement with the Appointee's accounting records, complies with the requirements of Condition F of the Instrument and has been properly prepared in accordance with the Regulatory Accounting Guidelines 1 to 4 issued by the Office of Water Services;

c) except for the treatment of infrastructure assets, the historical cost financial statements fairly present the revenues, costs, assets and liabilities of the Appointee and its Appointed Business. In accordance with Ofwat guidelines, the provision for infrastructure renewals remains in provisions for liabilities and charges which is contrary to the requirements of FRS 12; and

d) the current cost financial information has been properly prepared in accordance with Regulatory Accounting Guideline 1.03, "Accounting for current costs", issued in January 2003 by the Office of Water Services.

Ernst & Young LLP

Registered auditors

Newcastle-upon-Tyne

13 August 2004