NORTHUMBRIAN WATER LIMITED

REGULATORY FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2005

Registered no: 2366703

Registered office
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CONDITION F REGULATORY FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2005

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DIRECTORS' REPORT
For the year ended 31 March 2005

The directors present their report and the audited regulatory financial statements for the year ended 31 March 2005.

Results and dividends

The group's profit after taxation for the year ended 31 March 2005 amounts to £85.9m (2004: £77.8m). The directors propose a final dividend on the ordinary shares of the company for the year ended 31 March 2005 of £25.7m (2004: £42.2m) which, together with the first interim dividend of £41.9m (2004: £42.2m) and an exceptional second interim dividend of £nil (2004: £46.0m), makes a total for the year of £67.6m (2004: £151.5m). Dividends for 2004 reflect a 15 month accounting period as explained in note 9.

The company's profit after taxation for the year ended 31 March 2005 amounts to £97.7m (2004: £77.8m). The results for the appointed business are identical for both group and company. The results for the non-appointed business differ between group and company because of differences in the accounting treatment of the issue of £212.1m of new debt to the non-appointed business, arising from the securitisation of the Environment Agency contract to operate the Kielder Water transfer scheme. These differences are explained in the following paragraphs.

Turnover for the non-appointed business is £20.5m for the group and £16.6m for the company. In May 2004, the non-appointed business assigned the contract to operate the Kielder Water transfer scheme to Reiver Finance Limited, a new subsidiary, in return for consideration of £212.1m. As a result, the company non-appointed business no longer received the £10.4m of income due from the Environment Agency in 2004/05, whilst the group non-appointed business still includes this income as it also consolidates the results of Reiver Finance Limited. In the company non-appointed business, the proceeds of the securitisation have been treated as an addition to deferred income of £212.1m, of which £6.5m has been amortised to the profit and loss account based on the 30 year life of the bonds, and included within the turnover of the company non-appointed business.

Other operating charges for the company non-appointed business are £0.2m lower than for the group non-appointed business. This relates to an incentive fee, which the non-appointed business charges Reiver Finance Limited for the operation of the Kielder Water transfer scheme, which is eliminated on consolidation.

Interest for the non-appointed business is £3.4m payable for the group and £13.3m receivable for the company, and reflects the impact of two items. The first item relates to the interest rate on the bonds issued as part of the securitisation, which was locked in advance of issuance. At completion of the securitisation, long term interest rates were higher than when the hedge was put in place, leading to a gain of £4.4m which has been included within additions to deferred income in the non-appointed business. This will be amortised in the group accounts over the 30 year life of the bonds, with £0.1m being released to the profit and loss in 2004/05, whilst in the company accounts the whole gain has been realised in the profit and loss account in the current trading period.

The second item relates to the treatment of interest accruals relating to the new loan which was obtained by Reiver Finance Limited as a result of the securitisation. A net interest accrual for £12.4m was included as a consolidation adjustment within the group non-appointed business, reflecting the interest payable by Reiver Finance Limited on the new debt. The company non-appointed business does not include such an accrual.

A summary profit and loss account has been included for the company as well as for the group on page 8 to show clearly the different accounting treatment adopted for the company non-appointed business.

Principal activities and review of business

The group comprises the company Northumbrian Water Limited (NWL) and its subsidiaries as detailed in note 11. 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.

NWL continues to provide its customers with excellent levels of service and is still the only water and sewerage company to have achieved a star rating by Ofwat for all aspects of its service standards. In 2004/05, the company improved on its excellent customer service record against three of the seven Ofwat customer service measures, and maintained its very strong performance on three of the remaining measures. The only measure which deteriorated in 2004/05 is the performance against the interruption to supply measure, which was adversely affected by the incident which occurred in Hexham in

DIRECTORS' REPORT (continued)

Principal activities and review of business (continued)

January 2005. Torrential rainfall increased the flow in the River Tyne to such an extent that the river washed away water mains serving Hexham, which is unprecedented, and the town was without water for several days.

The regulator has not yet published comparative results for 2004/05, but NWL anticipates that it will improve on the operating performance assessment it achieved in 2003/04.

Turnover increased from £454.7m in 2003/04 to £508.2m for the year to 31 March 2005. This increase is mainly due to the application of the price increase of 12.53% (£52.8m) in April 2004 to the previous regulatory year's tariff income of £421.4m. The price increase included an uplift for RPI of 2.53%, and a further increase of 10% following an interim determination of price limits by Ofwat. NWL successfully applied for an increase in its price limits to fund unanticipated additional costs caused by increased customer bad debt, water quality monitoring and new obligations requiring capital expenditure. In addition, the interim determination compensated for loss of revenue arising from actual demand for water being lower than that allowed for by Ofwat at its 1999 price review.

Total operating costs (excluding exceptional costs) have increased from £213.3m to £216.5m, an increase of £3.3m, principally reflecting the impact of inflation on manpower costs, power, chemicals, and also including £1.1m of additional costs relating to the loss of supply at Hexham during storms in January. These increases have been partially offset by efficiency savings. Operating costs for the appointed business in 2004/05 are £7.6m lower than those in the 1999 final determination, despite including additional costs not funded in that determination. This reflects the continual drive in the business to identify and deliver efficiencies.

Total capital maintenance costs have increased from £87.3m to £96.7m, mostly reflecting the depreciation charged on newly commissioned assets (£6.0m) and the write off of assets which are no longer in use by the business (£2.9m).

Net interest payable increased by £3.5m from £82.1m in 2003/04 to £85.6m in 2004/05. This mainly reflects £4.3m of additional interest incurred on the increase in the average net debt from £1,362.6m in 2003/04 to £1,453.0m in 2004/05. There has also been a £1.4m increase in net interest payable relating to the Kielder financing transaction, reflecting both the margin between the interest payable on the loan and interest receivable on the surplus cash, and the fact that the increase in interest payable by the non appointed business did not commence until late May 2003. These increases have been partially offset by a number of one off interest credits relating to the settlement of prior year tax claims and interest received on rates rebates relating to prior years.

The tax position has changed from a credit of £6.9m in 2003/04 to a charge of £23.5m in 2004/05. This movement is explained in detail in note 8, but mainly reflects the higher profits in the current year, a higher deferred tax charge and a lower level of discount which can be set off against the deferred tax provision

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 meeting the targets set by Ofwat in its final determination of price limits for 2005 to 2010.

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 2005/06, and the forecast for the next four years, following Ofwat's final determination. 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-ordinated all research and development activities relating to underground assets for the NWG group until March 2005, at which date the trade, assets and employees of NWTC were transferred to the company.

DIRECTORS' REPORT (continued)

Research and development (continued)

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 (2004: £5.0m).

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 27 days (2004: 22 days).

Fixed assets

Freehold land and buildings are carried in the financial statements at historical cost with a net book value of £59.4m (2004: £62.3m). In the opinion of the directors, at 31 March 2005, there is no significant difference between the net book value and the market value of property capable of disposal within the foreseeable future. Note 10 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 NWL is to finance such investment by raising medium to long term debt, providing a balance sheet match with long term assets, and to fix a major proportion of interest rates. In December 2004, the company issued a further £100.0m to its Eurobond due in 2033. In May 2004, net proceeds of £212.1m were raised in the non-appointed business by the issue of guaranteed secured bonds due in 2034, as a result of the securitisation of the Environment Agency contract to operate the Kielder Water transfer scheme.

DIRECTORS' REPORT (continued)

Directors

The directors who served during the year were as follows:

Professor Sir F G T Holliday CBE
Non-Executive Chairman

J A Cuthbert
Executive Managing Director

C M Green
Executive Finance Director

G Neave
Executive Operations Director

A C Jones
Executive Regulation and Compliance Director

R R Allan CB
Independent Non-Executive Director

A G Balls
Independent Non-Executive Director

A M Frew
Independent Non-Executive Director

B Guirkinger
Non-Executive Director – resigned 28 April 2005

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

A Chaigneau
Non-Executive Director – appointed 27 May 2004, resigned 17 March 2005

C Cros
Non-Executive Director – appointed 17 March 2005, resigned 28 April 2005

DIRECTORS' REPORT (continued)

Employees and employment policies

Equal Opportunities

The company operates an equal opportunity policy, incorporated into Our Code of Conduct. The company 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 on the grounds of age, gender, disability, race, religion or sexual orientation.

The company gives full consideration to applications for employment from disabled persons where the requirements of the job can be adequately fulfilled by a handicapped or disabled person. Where existing employees become disabled, it is the company's policy wherever practicable to provide continuing employment under normal terms and conditions and to provide training and career development and promotion to disabled employees wherever appropriate.

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 has been 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' cascade 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. 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 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 health and safety team. Occupational health services are provided by the company's medical adviser, Grosvenor Health. Most employees are members of a company-wide corporate health care plan.

Employee Investment Schemes

The directors believe that employee investment strengthens the ties between its employees and NWG by enabling employees to participate more closely in NWG's economic performance. In January 2004, NWG launched its Share Incentive Plan (SIP). All UK based employees of NWG are eligible to participate in the SIP. The SIP enables NWG employees to purchase ordinary shares in NWG in a flexible and tax efficient way. In addition, for every three shares purchased, employees receive one free share. Shares must be held in the plan for five years to obtain the full tax benefits.

Directors' remuneration and interests

Information about directors' remuneration and their interests in the shares of the company is contained in note 5 to the financial statements.

Indemnification of directors

The Companies (Audit, Investigations and Community Enterprise) Act 2004 permits companies to extend the indemnification it provides to directors against liabilities for legal costs in certain circumstances, and to fund a director's defence costs as they are incurred. The Company will therefore be asking shareholders at the forthcoming AGM for authority to amend the Articles to indemnify directors to the extent now permitted by company law.

Pensions

Information about the pension schemes operated by NWG is contained in note 26 to the financial statements.

DIRECTORS’ REPORT (continued)

Charitable and political contributions

During the year the company made charitable donations of £89,369 (2004: £33,084) and political donations of £1,497 (2004: £7,961).

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 NWG 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 year the company made political donations, applying the wide definitions from the PPERA 2000, as follows:

Name of EU Political Organisation	Donations for the year
Labour	£570
Liberal Democrats	£426
Conservative	£501
Total	**£1,497**

Auditors

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

Statement of 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. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

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 2005. 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 which disclose with reasonable accuracy at any time the financial position of the group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

BY ORDER OF THE BOARD

M Parker

Company Secretary

8 July 2005

GROUP HISTORICAL COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2005

	Note	2005			2004		
		Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
Turnover	2	487.7	20.5	508.2	435.8	18.9	454.7
Operating costs - ordinary	3(a)	(212.1)	(4.4)	(216.5)	(208.4)	(4.9)	(213.3)
- exceptional	3(d)	-	-	-	(1.1)	-	(1.1)
Total operating costs		(212.1)	(4.4)	(216.5)	(209.5)	(4.9)	(214.4)
Capital maintenance costs	3(b)	(96.2)	(0.5)	(96.7)	(86.7)	(0.6)	(87.3)
OPERATING PROFIT		179.4	15.6	195.0	139.6	13.4	153.0
Net interest payable	4	(82.2)	(3.4)	(85.6)	(80.1)	(2.0)	(82.1)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	3(c)	97.2	12.2	109.4	59.5	11.4	70.9
Taxation	8(a)	(19.2)	(4.3)	(23.5)	11.6	(4.7)	6.9
PROFIT FOR THE FINANCIAL YEAR		78.0	7.9	85.9	71.1	6.7	77.8
Dividends	9	(63.9)	(3.7)	(67.6)	(98.0)	(53.5)	(151.5)
PROFIT / (LOSS) RETAINED FOR THE YEAR	24	14.1	4.2	18.3	(26.9)	(46.8)	(73.7)

All activities are continuing.

All note references to the summary financial statements on pages 7 to 11 refer to the notes to the historical cost accounts.

GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
For the year ended 31 March 2005

Total recognised gains in the period	78.0	7.9	85.9	71.1	6.7	77.8
Prior year adjustment	-	-	-	(4.3)	-	(4.3)
Total gains and losses recognised since the last annual report and financial statements	14.1	4.2	18.3	66.8	6.7	73.5

COMPANY HISTORICAL COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2005

		2005			2004		
	Note	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
Turnover	2	487.7	16.6	504.3	435.8	18.9	454.7
Operating costs - ordinary	3(a)	(212.1)	(4.2)	(216.3)	(208.4)	(4.9)	(213.3)
- exceptional	3(d)	-	-	-	(1.1)	-	(1.1)
Total operating costs		(212.1)	(4.2)	(216.3)	(209.5)	(4.9)	(214.4)
Capital maintenance costs	3(b)	(96.2)	(0.5)	(96.7)	(86.7)	(0.6)	(87.3)
OPERATING PROFIT		179.4	11.9	191.3	139.6	13.4	153.0
Net interest payable	4	(82.2)	13.3	(68.9)	(80.1)	(2.0)	(82.1)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	3(c)	97.2	25.2	122.4	59.5	11.4	70.9
Taxation	8(a)	(19.2)	(5.5)	(24.7)	11.6	(4.7)	6.9
PROFIT FOR THE FINANCIAL YEAR		78.0	19.7	97.7	71.1	6.7	77.8
Dividends	9	(63.9)	(3.7)	(67.6)	(98.0)	(53.5)	(151.5)
PROFIT / (LOSS) RETAINED FOR THE YEAR	24	14.1	16.0	30.1	(26.9)	(46.8)	(73.7)

All activities are continuing.

GROUP HISTORICAL COST BALANCE SHEET
At 31 March 2005

	Note	2005	2004
		£'m	£'m
FIXED ASSETS			
Tangible assets	10	2,596.5	2,499.6
Investments	11	159.0	-
		2,755.5	2,499.6
CURRENT ASSETS			
Stocks	12	3.0	3.1
Debtors	13	99.4	102.5
Cash at bank and in hand		33.0	4.9
		135.4	110.5
CREDITORS			
Amounts falling due within one year	14	(270.5)	(289.2)
NET CURRENT LIABILITIES		(135.1)	(178.7)
TOTAL ASSETS LESS CURRENT LIABILITIES		2,620.4	2,320.9
CREDITORS: Amounts falling due after more than one year	15	(1,602.2)	(1,336.6)
PROVISIONS FOR LIABILITIES AND CHARGES	20	(173.8)	(167.2)
ACCRUALS AND DEFERRED INCOME	21	(51.2)	(42.2)
		(1,827.2)	(1,546.0)
NET ASSETS		793.2	774.9
CAPITAL AND RESERVES			
Called up share capital	22	122.7	122.7
Profit and loss account	23	670.5	652.2
EQUITY SHAREHOLDERS' FUNDS	24	793.2	774.9

Approved on behalf of the board

J A Cuthbert

C M Green

8 July 2005

COMPANY HISTORICAL COST BALANCE SHEET
At 31 March 2005

	Note	2005 Appointed business	2005 Non-appointed business	2005 Aggregated basis	2004 Appointed business	2004 Non-appointed business	2004 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	10	2,497.6	98.9	2,596.5	2,403.0	96.6	2,499.6
	11	-	160.6	160.6	-	-	-
		2,497.6	259.5	2,757.1	2,403.0	96.6	2,499.6
CURRENT ASSETS							
Stocks	12	2.9	0.1	3.0	3.0	0.1	3.1
Debtors	13	95.5	3.2	98.7	100.7	1.8	102.5
Cash at bank and in hand		-	4.2	4.2	4.9	-	4.9
		98.4	7.5	105.9	108.6	1.9	110.5
CREDITORS Amounts falling due within one year	14	(257.4)	(10.2)	(267.6)	(271.4)	(17.8)	(289.2)
NET CURRENT LIABILITIES		(159.0)	(2.7)	(161.7)	(162.8)	(15.9)	(178.7)
TOTAL ASSETS LESS CURRENT LIABILITIES		2,338.6	256.8	2,595.4	2,240.2	80.7	2,320.9
CREDITORS: Amounts falling due after more than one year	15	(1,362.9)	-	(1362.9)	(1,290.6)	(46.0)	(1,336.6)
PROVISIONS FOR LIABILITIES AND CHARGES	20	(166.8)	(8.2)	(175.0)	(159.5)	(7.7)	(167.2)
ACCRUALS AND DEFERRED INCOME	21	(46.4)	(206.1)	(252.5)	(41.7)	(0.5)	(42.2)
		(1,576.1)	(214.3)	(1,790.4)	(1,491.8)	(54.2)	(1,546.0)
NET ASSETS		762.5	42.5	805.0	748.4	26.5	774.9
CAPITAL AND RESERVES							
Called up share capital	22	92.1	30.6	122.7	92.1	30.6	122.7
Profit and loss account	23	670.4	11.9	682.3	656.3	(4.1)	652.2
EQUITY SHAREHOLDERS' FUNDS	24	762.5	42.5	805.0	748.4	26.5	774.9

Approved on behalf of the board

J A Cuthbert

C M Green

8 July 2005

GROUP HISTORICAL COST CASH FLOW STATEMENT
For the year ended 31 March 2005

	Note	2005 Appointed business	2005 Non-appointed business	2005 Aggregated basis	2004 Appointed business	2004 Non-appointed business	2004 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
NET CASH INFLOW FROM CONTINUING OPERATING ACTIVITIES	a	227.7	14.3	242.0	193.8	22.7	216.5
Returns on investments and servicing of finance							
Interest received		3.0	12.7	15.7	2.7	-	2.7
Interest paid		(78.2)	(11.4)	(89.6)	(70.4)	(2.0)	(72.4)
Issue costs of new borrowings		(2.7)	(9.0)	(11.7)	-	-	-
Interest element of finance lease rentals		(0.6)	-	(0.6)	(1.9)	-	(1.9)
Net cash outflow from returns on investments and servicing of finance		(78.5)	(7.7)	(86.2)	(69.6)	(2.0)	(71.6)
Taxation							
United Kingdom corporation tax paid		0.5	(4.0)	(3.5)	(0.8)	(3.1)	(3.9)
Net cash inflow / (outflow) from taxation		0.5	(4.0)	(3.5)	(0.8)	(3.1)	(3.9)
Capital expenditure and financial investment							
Purchase of tangible fixed assets		(157.2)	(2.5)	(159.7)	(168.1)	(0.2)	(168.3)
Sale of tangible fixed assets		1.6	-	1.6	0.5	-	0.5
Loan to immediate parent company		-	(159.0)	(159.0)	-	-	-
Grants, contributions and connection charges		21.2	-	21.2	16.1	-	16.1
Net cash outflow from capital expenditure and financial investment		(134.4)	(161.5)	(295.9)	(151.5)	(0.2)	(151.7)
Equity dividend paid		(99.7)	(5.5)	(105.2)	(76.7)	(55.4)	(132.1)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(84.4)	(164.4)	(248.8)	(104.8)	(38.0)	(142.8)
Management of liquid resources							
Purchase of short term deposits		(21.4)	-	(21.4)	(550.3)	-	(550.3)
Sale of short term deposits		21.4	-	21.4	645.4	-	645.4
Net cash inflow from management of liquid resources	b	-	-	-	95.1	-	95.1
Financing							
New loans		171.5	248.0	419.5	52.0	46.0	98.0
Debenture repayments		(5.0)	-	(5.0)	-	-	-
Loan repayments		(85.1)	(46.0)	(131.1)	(47.6)	-	(47.6)
Capital element of finance lease rental payments		(4.0)	-	(4.0)	(2.8)	-	(2.8)
Net cash inflow from financing		77.4	202.0	279.4	1.6	46.0	47.6

(DECREASE)/INCREASE IN CASH IN THE YEAR	b	(7.0)	37.6	30.6	(8.1)	8.0	(0.1)

NOTES TO THE GROUP HISTORICAL COST CASH FLOW STATEMENT
For the year ended 31 March 2005

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

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Operating profit	179.4	15.6	195.0	139.6	13.4	153.0
Depreciation on tangible fixed assets	59.1	0.4	59.5	53.0	0.5	53.5
Infrastructure renewals expenditure	(38.1)	-	(38.1)	(25.5)	-	(25.5)
Provision for infrastructure renewals	35.2	0.1	35.3	34.1	0.1	34.2
Amortisation of grants	(2.1)	-	(2.1)	(2.1)	-	(2.1)
Loss / (profit) on sale of fixed assets	1.9	-	1.9	(0.4)	-	(0.4)
Decrease in stock	0.1	-	0.1	0.1	-	0.1
(Increase) /decrease in debtors	(6.7)	0.2	(6.5)	-	(0.9)	(0.9)
(Decrease) / Increase in creditors	(2.0)	0.2	(1.7)	4.3	0.2	4.5
Decrease in other creditors greater than 1 year	(0.4)	-	(0.4)	-	-	-
(Decrease) / increase in provisions	(0.9)	-	(0.9)	0.1	-	0.1
Increase/(decrease) in inter business creditor/debtor	2.2	(2.2)	-	(9.4)	9.4	-
Net cash inflow from operating activities	227.7	14.3	242.0	193.8	22.7	216.5

The operating cash flows are all from continuing operations.

b. ANALYSIS AND RECONCILIATION OF NET DEBT

	Appointed business			
	1 April 2004	Cash Flow	Other non-cash changes	31 March 2005
	£'m	£'m	£'m	£'m
Cash in hand and at bank	4.9	(7.0)	-	(2.1)
Debt due after 1 year	(1,232.2)	(97.3)	24.6	(1,304.9)
Debt due within 1 year	(90.1)	18.6	(24.6)	(96.1)
Finance leases	(60.9)	4.0	(4.9)	(61.8)
Net debt	(1,378.3)	(81.7)	(4.9)	(1,464.9)

NOTES TO THE GROUP HISTORICAL COST CASH FLOW STATEMENT (continued)
For the year ended 31 March 2005

b. ANALYSIS AND RECONCILIATION OF NET DEBT (continued)

	Non-appointed business			
	1 April 2004	Cash Flow	Other non-cash changes	31 March 2005
	£'m	£'m	£'m	£'m
Overdrafts	(4.6)	37.6	-	33.0
Debt due after 1 year	(46.0)	(193.0)	(0.3)	(239.3)
Net debt	(50.6)	(155.4)	(0.3)	(206.3)

	Group			
	1 April 2004	Cash Flow	Other non-cash changes	31 March 2005
	£'m	£'m	£'m	£'m
Group net debt (note 16)	(1,428.9)	(237.1)	(5.2)	(1,671.2)

Reconciliation of cash flow movement to net debt:

	2005	2005			2004
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated business	Group and Aggregated business
	£'m	£'m	£'m	£'m	£'m
Increase /(decrease) in cash in the year	30.6	(7.0)	37.6	30.6	(0.1)
Cash inflow from increase in debt and lease financing	(279.4)	(77.4)	(202.0)	(279.4)	(47.6)
Cash inflow from reduction in liquid resources	-	-	-	-	(95.1)
Issue costs on new borrowings	11.7	2.7	9.0	11.7	-
Change in net debt resulting from cash flows	(237.1)	(81.7)	(155.4)	(237.1)	(142.8)
Finance lease interest capitalised	-	-	-	-	(0.5)
Finance lease non cash movement	(4.9)	(4.9)	-	(4.9)	(3.8)
Bonds and debentures non cash movement	(0.3)	-	(0.3)	(0.3)	-
Movement in net debt in year	(242.3)	(86.6)	(155.7)	(242.3)	(147.1)
Net debt at 1 April 2004	(1,428.9)	(1,378.3)	(50.6)	(1,428.9)	(1,281.8)
Net debt at 31 March 2005	(1,671.2)	(1,464.9)	(206.3)	(1,671.2)	(1,428.9)

Part of the increase in net debt during the year arises due to the on loan of proceeds from the issue of new debt to the company's parent undertaking. This loan of £159m, due from Northumbrian Services Limited ("NSL"), is classified as a capital expenditure and financial investment cashflow in the cash flow statement and is, therefore, excluded from the net debt calculation.

NOTES TO THE HISTORICAL COST FINANCIAL STATEMENTS
For the year ended 31 March 2005

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 both the group and the company, for 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 and a statement of assets and liabilities. A cash flow statement, together with notes thereto prepared under the historical cost basis, has been prepared for the group for each of the appointed, the non-appointed and the aggregated business.

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 2004 and 31 March 2005 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 (2005 difference: £5.2m).

(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 10. 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 (2005 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.

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

(n) Liquid resources

Liquid resources comprise external deposits.

(o) Bad debt provisioning

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

2. TURNOVER, PROFIT BEFORE TAX AND NET ASSETS

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

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

(a) Operating costs for the year ended 31 March 2005 comprise:

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Materials and consumables	14.8	14.2	0.6	14.8
Other external charges	54.5	53.1	1.4	54.5
Manpower costs (note 7a)	73.5	72.4	1.1	73.5
Other operating charges	94.6	93.3	1.1	94.4
Own work capitalised	(19.0)	(19.0)	-	(19.0)
Capital maintenance costs	94.8	94.3	0.5	94.8
	313.2	308.3	4.7	313.0

Other operating charges for the company are £0.2m lower than for the group. This relates to an incentive fee, which the non-appointed business charges Reiver Finance Ltd for the operation of Kielder reservoir, which is eliminated on consolidation.

Operating costs for the year ended 31 March 2004 comprise:

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Materials and consumables	14.1	13.5	0.6	14.1
Other external charges	58.8	57.0	1.8	58.8
Manpower costs (note 7a)	68.8	67.4	1.4	68.8
Other operating charges	89.3	87.8	1.1	88.9
Own work capitalised	(17.7)	(17.7)	-	(17.7)
Capital maintenance costs	87.3	87.1	0.6	87.7
Exceptional costs	1.1	1.1	1.1	1.1
	300.6	295.1	5.5	300.6

The value of own work capitalised represents both employment costs (note 7a) and some other costs incurred on capital projects.

Profit or loss on disposal has been included within other operating charges in the table above.

3. OPERATING COSTS AND CAPITAL MAINTENANCE COSTS (continued)

(b) Capital maintenance costs (including profit or loss on disposal) for both group and company comprise:

	2005			2004		
	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	56.2	0.4	56.6	49.2	0.5	49.7
Tangible fixed assets held under finance leases	2.9	-	2.9	3.8	-	3.8
Infrastructure renewals expenditure (note 21)	38.1	-	38.1	25.5	-	25.5
Infrastructure renewals accrued (note 21)	(2.9)	0.1	(2.8)	8.6	0.1	8.7
Loss / (profit) on disposal of fixed assets	1.9	-	1.9	(0.4)	-	(0.4)
	96.2	0.5	96.7	86.7	0.6	87.3

(c) Profit on ordinary activities before taxation for both group and company

	2005			2004		
	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	2.1	0.1	2.2	4.2	-	4.2
And after charging:						
Operating leases:						
Plant and machinery	0.1	-	0.1	0.1	-	0.1
Other assets	0.8	-	0.8	0.8	-	0.8
Costs of research and development	5.0	-	5.0	5.0	-	5.0
Directors' emoluments (note 5)	1.2	-	1.2	0.9	-	0.9

Auditors' remuneration for the regulatory audit amounted to £15,000 (2004: £22,000). Fees of £26,000 and £12,000 (2004: £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 £91,000 (2004: £63,300).

3. OPERATING COSTS AND CAPITAL MAINTENANCE COSTS (continued)

(d) Exceptional operating costs for both group and company comprise:

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Severance provision	-	-	-	1.1	-	1.1
Total exceptional costs	-	-	-	1.1	-	1.1

The severance charge of £nil (2004: £1.1m) related to severance and pension costs of senior managers who left the business.

4. NET INTEREST PAYABLE

Net interest payable for the year ended 31 March 2005 comprises:

	2005	2005		
	Group	Company	Company	Company
		Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Net interest payable comprises:				
Interest payable:				
Bank loans and overdrafts	70.8	60.3	0.3	84.4
Group loans	23.8	23.8	-	-
Debenture stock interest	1.0	1.0	-	1.0
Financing charges payable under finance leases	3.0	3.0	-	3.0
Total interest payable	98.6	88.1	0.3	88.4
Group interest receivable	(8.7)	-	(8.7)	(8.7)
Interest receivable	(4.3)	(5.9)	(4.9)	(10.8)
Net interest payable	85.6	82.2	(13.3)	68.9

Net interest payable for the year ended 31 March 2004 comprises:

	2004	2004		
	Group	Company	Company	Company
		Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Net interest payable comprises:				

Interest payable:				
Bank loans and overdrafts	56.2	54.2	2.0	56.2
Group loans	24.0	24.0		24.0
Debenture stock interest	1.4	1.4	-	1.4
Financing charges payable under finance leases	2.4	2.4	-	2.4
Total interest payable	84.0	82.0	2.0	84.0
Group interest receivable	-	-	-	-
Interest receivable	(1.9)	(1.9)	-	(1.9)
Net interest payable	82.1	80.1	2.0	82.1

5. DIRECTORS' EMOLUMENTS AND INTERESTS (GROUP AND COMPANY)

(a) Directors' remuneration

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

	2005	2004
	£'000	£'000
Emoluments (including benefits in kind)	1,158.5	998.4

Four of the directors at 31 March 2005 were members of a defined benefit pension scheme where the company makes contributions towards the cost (2004: 4)

The directors who held office at 31 March 2005 had no interest in the shares of the company.

The directors who held office as at 31 March 2005 had the following interests in the debentures of the Company's immediate parent company, Northumbrian Services Limited ("NSL"):

Name of Director	Class of Debentures	Amount of debentures held as at 1 April 2004	Amount of debentures held as at 31 March 2005
John Arthur Cuthbert	8.625% bonds 28/6/06	40,000	40,000
Christopher Michael Green (1)	8.625% bonds 28/6/06	25,000	25,000

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

The directors who held office as at 31 March 2005 had the following interests in the shares of the Company's ultimate parent company, NWG:

Name of Director	Class of Shares	Number of shares held as at 1 April 2004	Number of shares held as at 31 March 2005
John Arthur Cuthbert	Ordinary 10p	80,000	100,000
Christopher Michael Green (1)	Ordinary 10p	50,000	65,000
Sir Frederick George Thomas Holliday	Ordinary 10p	8,700	8,700
Andrew Ceri Jones (2)	Ordinary 10p	4,433	4,433

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

(2) These shares are beneficially owned by Mrs Kerry Jones.

The directors who held office as at 31 March 2005 held the following interests in the shares of NWG, purchased and held in accordance with the terms of the Share Incentive Plan:

Name of Director	Class of Shares	Number of shares held as at 1 April 2004	Number of shares held as at 31 March 2005
John Arthur Cuthbert	Ordinary 10p	-	1,716
Christopher Michael Green	Ordinary 10p	-	1,716
Andrew Ceri Jones	Ordinary 10p	-	1,716

5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

The directors who held office as at 31 March 2005 held the following conditional interests in Ordinary 10p shares of NWG, awarded in accordance with the terms of its Long Term Incentive Plan:

Name of Director	Number of awards held as at 1 April 2004 (1)	Number of shares awarded during the year (2)	Number of awards vested during the year	Number of awards held as at 31 March 2005
John Arthur Cuthbert	85,603	67,001	-	152,604
Christopher Michael Green	56,618	44,221	-	100,839
Andrew Ceri Jones	22,463	20,100	-	42,563
Graham Neave	40,000	25,125	-	65,125

Notes:

(1) Awards were made on 27 January 2004. The market value of the shares on the date of the award was 113.5 pence per share. The three year performance period runs from 1 October 2003 to 30 September 2006.

(2) Awards were made on 22 December 2004. The market value of the shares on the date of the award was 174.5 pence per share. The three year performance period runs from 1 October 2004 to 30 September 2007.

(3) Some or all of the shares will vest only if specified performance targets are achieved during the three year performance period. 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 year.

There have been no changes in any of the above interests from the end of the year to 7 June 2005. As at 31 March 2005, 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 shown in note 5a include the following in respect of the highest paid director:

	2005	2004
	£'000	£'000
Emoluments (including benefits in kind)	358.4	316.4

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 March 2005 was £108,687 (31 March 2004: £91,789).

6. 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.

7. EMPLOYEE INFORMATION – GROUP AND COMPANY

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

	2005			2004		
	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	45.6	0.9	46.5	43.2	1.2	44.4
Social security costs	4.2	0.1	4.3	3.8	0.1	3.9
Other pension costs	4.2	0.1	4.3	3.9	0.1	4.0
	54.0	1.1	55.1	50.9	1.4	52.3
Costs charged to capital schemes and infrastructure renewals:						
Wages and salaries	15.6	-	15.6	14.0	-	14.0
Social security costs	1.4	-	1.4	1.2	-	1.2
Other pension costs	1.4	-	1.4	1.3	-	1.3
	18.4	-	18.4	16.5	-	16.5
Total employee costs	72.4	1.1	73.5	67.4	1.4	68.8

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

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	No.	No.	No.	No.	No.	No.
Average during the year	2,427	48	2,475	2,274	46	2,320
Total at 31 March	2,478	51	2,529	2,375	45	2,420

8. TAXATION

(a) Analysis of charge in the year:

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
Current tax:	£'m	£'m	£'m	£'m
UK corporation tax on profits for the year at 30%	3.0	3.0	-	3.0
Adjustments in respect of prior years	3.1	3.1	-	3.1
Payable in respect of group relief for the current year at 30%	7.1	2.0	5.1	7.1
Total current tax	13.2	8.1	5.1	13.2
Deferred tax:				
Origination and reversal of timing differences in the year	23.6	25.0	0.6	25.6
Adjustment in respect of prior years	(4.1)	(4.1)	-	(4.1)
	19.5	20.9	0.6	21.5
Decrease due to discount	(9.2)	(9.8)	(0.2)	(10.0)
Total deferred tax	10.3	11.1	0.4	11.5
Tax on profit on ordinary activities	23.5	19.2	5.5	24.7

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
Current tax:	£'m	£'m	£'m	£'m
UK corporation tax on profits for the year at 30%	2.0	1.6	0.4	2.0
Adjustments in respect of prior years	(5.3)	(5.3)	-	(5.3)
Payable in respect of group relief for the current year at 30%	2.6	0.1	2.5	2.6
Adjustments in respect of prior years	0.3	0.3	-	0.3
Total current tax	(0.4)	(3.3)	2.9	(0.4)
Deferred tax:				
Origination and reversal of timing differences in the year	18.3	17.8	0.5	18.3
Adjustment in respect of prior years	(9.1)	(9.6)	0.5	(9.1)
	9.2	8.2	1.0	9.2
(Decrease)/increase due to discount	(15.7)	(16.5)	0.8	(15.7)
Total deferred tax	(6.5)	(8.3)	1.8	(6.5)
Tax on profit on ordinary activities	(6.9)	(11.6)	4.7	(6.9)

The appointed business has provisionally claimed tax losses from fellow subsidiaries in the current year of £5.4m (2004: £0.4m) for which payment will be made at the rate of 30%.

8. TAXATION (continued)

The non-appointed business has provisionally daimed tax losses from fellow subsidiaries in the current year of £17.2m (2004: £8.2m) for which payment will be made at the rate of 30%.

(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:

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Group profit on ordinary activities before tax	97.2	12.2	109.4	59.5	11.4	70.9
Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%)	29.2	3.6	32.8	17.9	3.4	21.3
Effects of:						
Expenses not deductible for tax purposes	1.3	0.1	1.4	1.6	-	1.6
Non-taxable income	(0.5)	-	(0.5)	-	-	-
Capital allowances in excess of depreciation	(18.8)	(0.6)	(19.4)	(18.7)	(0.5)	(19.2)
Other timing differences	(6.2)	1.3	(4.9)	0.9	-	0.9
Tax losses carried forward	-	0.7	0.7	-	-	-
Adjustment to tax charge in respect of previous periods	3.1	-	3.1	(5.0)	-	(5.0)
Current tax charge / (credit)	8.1	5.1	13.2	(3.3)	2.9	(0.4)

(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.

9. DIVIDENDS - GROUP AND COMPANY

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Equity:						
Interim paid of 34.16p (2004: 34.41p) per share on an aggregated basis	41.0	0.9	41.9	39.2	3.0	42.2
Exceptional paid of nil (2004: 37.51p) per share on an aggregated basis	-	-	-	-	46.0	46.0
Final for 12 months ended 31 March 2005 of 20.95p (2004: 34.41p) per share on an aggregated basis	22.9	2.8	25.7	39.2	3.0	42.2
Final for 3 months ended 31 March 2004 of 17.21p per share on an aggregated basis	-	-	-	19.6	1.5	21.1
	63.9	3.7	67.6	98.0	53.5	151.5

The Company has rebased the appointed business dividend in line with Ofwat's assumptions for dividends in the final determination.

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.

Dividends for the non-appointed business are determined by the directors and are based on performance.

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

- the company's ability to finance its functions;
- the company's cumulative financial performance; and
- the directors' judgement as to a fair reward for shareholders in the context of market conditions.

The dividend charge for 2003/04 reflected a 15 month trading period following the change in accounting reference date from 31 December to 31 March.

10. 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 £123.8m (2004: £109.4m) 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 2004	87.7	1,126.8	1,520.6	141.8	73.6	2,950.5
Additions	-	-	-	-	174.3	174.3
Schemes commissioned	0.4	55.3	125.2	7.6	(188.5)	-
Reclassifications	(1.6)	5.9	10.7	(15.0)	-	-
Disposals	(0.1)	-	(4.9)	(0.2)	-	(5.2)
Grants and contributions	-	(16.8)	-	-	2.4	(14.4)
At 31 March 2005	86.4	1,171.2	1,651.6	134.2	61.8	3,105.2
Depreciation:						
At 1 April 2004	25.4	-	344.4	81.1	-	450.9
Provision for year	1.6	-	54.8	3.1	-	59.5
Disposals	-	-	(1.7)	-	-	(1.7)
At 31 March 2005	27.0	-	397.5	84.2	-	508.7
Net book value:						
At 31 March 2005	59.4	1,171.2	1,254.1	50.0	61.8	2,596.5
At 31 March 2004	62.3	1,126.8	1,176.2	60.7	73.6	2,499.6
Leased assets included above:						
Net book value						
At 31 March 2005	-	2.2	25.9	0.3	-	28.4
At 31 March 2004	-	2.2	25.7	0.7	-	28.6

	Appointed business Water Supply	Sewerage services	Non-Appointed business	Aggregated basis
	£'m	£'m	£'m	£'m
Cost:				
At 1 April 2004	1,246.8	1,584.5	119.2	2,950.5
Additions	73.8	97.8	2.7	174.3
Disposals	(4.1)	(1.1)	-	(5.2)
Grants and contributions	(10.8)	(3.6)	-	(14.4)
At 31 March 2005	1,305.7	1,677.6	121.9	3,105.2
Depreciation:				
At 1 April 2004	153.7	274.6	22.6	450.9
Provision for year	19.8	39.3	0.4	59.5
Disposals	(1.6)	(0.1)	-	(1.7)
At 31 March 2005	171.9	313.8	23.0	508.7
Net Book Value:				
At 31 March 2005	1,133.8	1,363.8	98.9	2,596.5

At 31 March 2004	1,093.1	1,309.9	96.6	2,499.6

11. FIXED ASSET INVESTMENTS – GROUP AND COMPANY

The company has a wholly owned subsidiary undertaking, Northumbrian Water Finance plc ("NWF"), whose principal activity is to hold certain finance instruments on behalf of 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. The £159m loan to group undertakings is with NSL.

	Group			Company		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
At 1 April 2004	-	-	-	-	-	-
Loan to group undertakings	-	159.0	159.0	-	160.6	160.6
At 31 March 2005	-	159.0	159.0	-	160.6	160.6

12. STOCKS – GROUP AND COMPANY

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Raw materials and consumables	2.9	0.1	3.0	3.0	0.1	3.1

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

13. DEBTORS

Debtors due in less than one year as at 31 March 2005:

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Trade debtors	52.1	51.6	0.5	52.1
Amounts owed by other group companies	4.7	2.6	2.1	4.7
Other debtors	6.5	6.3	0.2	6.5
Prepayments and accrued income	36.1	35.0	0.4	35.4
	99.4	95.5	3.2	98.7

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

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Trade debtors	46.8	46.4	0.4	46.8

Amounts owed by other group companies	6.5	6.5	-	6.5
Other debtors	6.2	6.1	0.1	6.2
Prepayments and accrued income	31.8	30.5	1.3	31.8
Corporation tax	11.2	11.2	-	11.2
	102.5	100.7	1.8	102.5

13. DEBTORS (continued)

Trade debtors are shown net of bills raised in advance.

14. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

Creditors due in less than one year as at 31 March 2005:

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 18)	4.5	4.5	-	4.5
Bank overdraft	2.1	2.1	-	2.1
Loans (note 16)	18.9	18.9	-	18.9
Debenture stock (note 17)	5.7	5.7	-	5.7
Trade creditors	10.2	9.8	0.4	10.2
Amounts owed to other group companies	87.9	108.4	2.6	111.0
Taxation and social security	1.1	1.1	-	1.1
Corporation tax	1.1	1.1	-	1.1
Receipts in advance	17.6	17.6	-	17.6
Other creditors	12.2	12.1	0.1	12.2
Dividend payable	25.7	23.0	2.7	25.7
Accruals and deferred income	83.5	57.1	0.4	57.5
Inter business balance	-	(4.0)	4.0	-
	270.5	257.4	10.2	267.6

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

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 18)	3.6	3.6	-	3.6
Bank overdraft	4.6	-	4.6	4.6
Loans (note 16)	33.1	33.1	-	33.1
Debenture stock (note 17)	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

Accruals and deferred income includes accruals related to capital projects of £27.5m (2004: £16.9m). Amounts owed to other group companies includes amounts related to capital projects of £3.9m (2004: £2.7m).

Included in amounts owed to other group companies is £7.1m (appointed business £4.5m (2004: £8.3m), non-appointed business £2.6m (2004: £1.4m)) payable in respect of tax losses surrendered by fellow subsidiaries. Also included in amounts owed to other group companies is £71.5m (2004: £52.0m) relating to loans repayable within one year (note 19).

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

Creditors due in more than one year as at 31 March 2005:

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 18)	57.3	57.3	-	57.3
Loans (note 16)	1,189.2	305.2	-	305.2
Debenture stock (note 17)	3.5	3.5	-	3.5
Amounts owed to other group companies	351.5	996.2	-	996.2
Other creditors	0.7	0.7	-	0.7
	1,602.2	1,362.9	-	1,362.9

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

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 18)	57.3	57.3	-	57.3
Loans (note 16)	917.4	324.0	46.0	370.0
Debenture stock (note 17)	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

At 31 March 2005 the group and company had entered into the following interest swap arrangements: £nil (2004: £15.0m).

16. LOANS

Details of loans as at 31 March 2005

	2005			
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
External loans are repayable as follows:			-	
Within one year	18.9	18.9	-	18.9
Between one and two years	29.2	29.2	-	29.2

Between two and five years	133.6	133.6	-	133.6
After five years	1,026.4	142.4	-	142.4
	1,208.1	324.1	-	324.1

16. LOANS (continued)

Details of loans as at 31 March 2004:

	2004			
	Group	Company Appointed business	Company Non-appointed business	Company 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

Loans repayable by instalments wholly repayable within 5 years amount to £14.9m (2004: £23.0m).

Loans repayable by instalments not wholly repayable within 5 years amount to £458.5m (2004: £229.1m) and bear interest rates in the range of 4.88% to 8.55% of which £76.8m (2004: £67.7m) falls due in less than 5 years and £381.7m (2004: £161.4m) falls due after more than 5 years.

Loans repayable otherwise than by instalments which fall due in less than 5 years amount to £90.0m (2004: £151.0m) and bear interest rates in the range of 4.94% to 5.11%.

Loans repayable otherwise than by instalments which fall due after more than 5 years amount to £644.7m (2004: £547.4m) and bear interest at rates ranging from 5.63% to 6.0%. Included in loans due after five years is a Eurobond due 23 January 2034 which is secured on the income receivable under the Kielder water transfer scheme for the period to 23 January 2034.

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

16. LOANS (continued)

of its borrowings at fixed rates of interest. At 31 March 2005, 88% (2004: 78%) of the borrowings of NWG were at fixed rates of interest. At 31 March 2005, NWG had £90.0 million available in standby committed bank facilities.

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 2005 were:

			Fixed rate net borrowings		
	Total net borrowings	Variable rate net borrowings	Fixed Rate Borrowings	Weighted average interest rate	Weighted average period for which rate is fixed
	£'m	£'m	£'m	%	Years
Sterling borrowings:					
External loans	(324.1)	(151.7)	(172.4)	6.42	10.1
Eurobonds	(884.0)	-	(884.0)	5.92	23.0
Debentures	(9.2)	-	(9.2)	8.67	4.3
Group loans	(423.0)	(71.5)	(351.5)	6.76	17.9
Finance leases	(61.8)	(54.3)	(7.5)	5.94	4.4
Bank overdraft	(2.1)	(2.1)	-	-	-
Total borrowings	(1,704.2)	(279.6)	(1,424.6)	6.33	18.6
Cash	33.0	33.0	-		
Net borrowings	(1,671.2)	(246.6)	(1,424.6)		

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 for which rate is fixed
	£'m	£'m	£'m	%	Years
Sterling borrowings:					
External loans	(403.1)	(200.2)	(202.9)	6.43	9.9
Eurobonds	(547.4)	-	(547.4)	5.85	20.6
Debentures	(14.2)	-	(14.2)	9.84	3.2
Group loans	(403.6)	(52.0)	(351.6)	6.75	18.9
Finance leases	(60.9)	(53.0)	(7.9)	7.55	5.0
Bank overdraft	(4.6)	(4.6)	-	-	-
Total borrowings	(1,433.8)	(309.8)	(1,124.0)	6.44	16.9
Cash	4.9	4.9	-		
Net borrowings	(1,428.9)	(304.9)	(1,124.0)		

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 £3.4m (2004: £4.3m), on which no interest is payable. In addition there are provisions and other creditors due after more than one year of £4.1m (2004: £5.4m), 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.

16. LOANS (continued)

Currency exposures

At 31 March 2005, the group and the company had no currency exposures (2004: nil).

Borrowing facilities

Northumbrian Water Limited has an undrawn committed borrowing facility. The facility available at 31 March 2005, in respect of which all conditions precedent have been met are as follows:

	2005	2004
	£'m	£'m
Expiring in more than one year but not more than three years	90.0	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 2005. The value of financial assets and liabilities at 31 March 2005 includes the £159m loan which the company made to NSL. This loan is not included in the value of net debt at 31 March 2005 shown earlier in the notes to the cash flow statement.

	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	(29.1)	(30.7)
Short-term loan from parent company	(71.5)	(71.5)
Long-term borrowings	(1,601.5)	(1,692.6)
Financial assets	189.9	200.2
As at 31 March 2005	(1,512.2)	(1,594.6)

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)

The fair values of the interest rate swaps, and sterling denominated long-term fixed rate debt with a book value of £1,244.7m (2004: £913.2m), 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.

16. LOANS (continued)

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 2004	1.3	-	1.3
Gains and losses arising in previous years that were recognised in 2004/2005	(1.3)	-	(1.3)
Unrecognised gains and losses on hedges at 31 March 2005	-	-	-

	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.

17. DEBENTURE STOCKS – GROUP AND COMPANY

	2005	2004
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Debenture stocks are repayable as follows:		
In less than one year:	5.7	5.0
Between one and two years	3.5	5.5
In five years or more:		
£1, 3.75% Redeemable 2012	-	0.3
£1, 4.25% Redeemable 2012	-	0.7
£1, 5.25% Redeemable 2012	-	0.7
£1, 3.5% Irredeemable	-	0.2
£1, 4.0% Irredeemable	-	0.8
£1, 5.0% Irredeemable	-	1.0
Total due in more than one year	3.5	9.2
At 31 March	9.2	14.2

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

The debentures now repayable within one and two years were redeemed early on 20 April, 2005.

18. OBLIGATIONS UNDER FINANCE LEASES – GROUP AND COMPANY

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

	2005	2004
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Amounts due:		
Within one year	4.5	3.6
Between one and two years	4.0	4.0
Between two and five years	12.1	10.4
After five years	62.3	66.1

	82.9	84.1
Less:		
Finance charge allocated to future periods	(21.1)	(23.2)
	61.8	60.9
Disclosed as due:		
Within one year (note 15)	4.5	3.6
After more than one year (note 16)	57.3	57.3
	61.8	60.9

The aggregate gross amount of obligations under hire purchase contracts and finance leases, any part of which falls due for repayment in five years or more, is £82.5 million (2004: £82.9 million).

19. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	2005		2004	
	Group	Company Appointed and aggregated basis	Group	Company Appointed and aggregated basis
	£'m	£'m	£'m	£'m
Within one year	71.5	71.5	52.0	52.0
After five years	351.5	996.2	351.6	899.0
	423.0	1,067.7	403.6	951.0

£351.5m is owed to the immediate parent company, NSL. NSL 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 £0.3m (2004: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.2m (2004: £0.3m).

£300.7m is owed to NWF plc, a subsidiary undertaking of the group. NWF plc issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by NWL who received the issue proceeds by way of an inter company loan. Amortisation of loan issue receipts during the year amounted to £0.1m (2004: £0.1m).

£344.0m is owed to NWF plc, a subsidiary undertaking of the group. NWF plc issued £250.0m Guaranteed Eurobonds during December 2002, maturing April 2033, with an annual coupon of 5.625%. NWF plc issued a further £100.0m Guaranteed Eurobonds during December 2004, maturing April 2033, with an annual coupon of 5.625%. Both issues were guaranteed by NWL who received the issue proceeds by way of an inter-company loan. Finance costs allocated during the year amounted to £0.1m (2004: £0.1m).

20. PROVISIONS FOR LIABILITIES AND CHARGES

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Infrastructure renewals:				
At 1 April	8.2	6.8	1.4	8.2
Transferred from profit and loss account	35.3	35.2	0.1	35.3
Utilised during the year (note 3b)	(38.1)	(38.1)	-	(38.1)
At 31 March	5.4	3.9	1.5	5.4
Deferred tax :				
As at 1 April	154.7	148.4	6.3	154.7
Movement in the year (note 8a)	10.3	11.1	0.4	11.5
At 31 March	165.0	159.5	6.7	166.2
Severance provision:				
As at 1 April	1.1	1.1	-	1.1
Transferred to profit and loss account	(0.1)	(0.1)	-	(0.1)
Utilised during the year	(0.6)	(0.6)	-	(0.6)
At 31 March	0.4	0.4	-	0.4
Pension provision for former directors:				
As at 1 April	3.2	3.2	-	3.2
Utilised during the year	(0.2)	(0.2)		(0.2)
At 31 March	3.0	3.0	-	3.0
Balance at 31 March 2005	173.8	166.8	8.2	175.0

The severance provision of £0.4m relates to severance and pension costs relating to senior managers who are leaving the business. This represents the best estimate of amounts payable, principally in the next 24 months.

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 £3.0m represents the full future amounts payable, based on an actuarial assessment, for which NWL is directly liable.

20. PROVISIONS FOR LIABILITIES AND CHARGES (continued)

The provision for deferred tax as at 31 March 2005 comprises:

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Accelerated capital allowances	461.5	443.4	18.1	461.5
Other timing differences	(22.9)	(21.0)	(0.6)	(21.6)
Tax losses carried forward	(0.7)	-	-	-
Undiscounted provision for deferred tax	437.9	422.4	17.5	439.9
Discount	(272.9)	(262.9)	(10.8)	(273.7)
Discounted provision for deferred tax	165.0	159.5	6.7	166.2

The provision for deferred tax as at 31 March 2004 comprises:

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Accelerated capital allowances	446.2	428.7	17.5	446.2
Other timing differences	(27.7)	(27.1)	(0.6)	(27.7)
Undiscounted provision for deferred tax	418.5	401.6	16.9	418.5
Discount	(263.8)	(253.2)	(10.6)	(263.8)
Discounted provision for deferred tax	154.7	148.4	6.3	154.7

21. ACCRUALS AND DEFERRED INCOME

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Non infrastructure capital grants and contributions and other deferred income:				
At 1 April	42.2	41.7	0.5	42.2
Additions	11.2	6.8	216.5	223.3
Amortised during the year	(2.2)	(2.1)	(10.9)	(13.0)
At 31 March	51.2	46.4	206.1	252.5

Other deferred income relates to the company non-appointed business only and reflects two separate items. The first item relates to the interest rate on the bonds issued as part of the Kielder securitisation, which was locked in advance of issuance. At completion of the securitisation, long term interest rates were higher than when the hedge was put in place, leading to a gain of £4.4m which has been included within additions in the non-appointed business, which will be amortised in the group

21. ACCRUALS AND DEFERRED INCOME (continued)

accounts over the 30 year life of the bonds. In the company accounts, the whole gain has been realised in the profit and loss account in the current trading period.

The second item relates to the receipt and amortisation of the proceeds of the Kielder securitisation over the 30 year life of the bonds, amounting to an addition of £212.1m in the year and the amortisation of £6.5m to the profit and loss account in the company non-appointed business only.

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Non infrastructure capital grants and contributions and other deferred income:				
At 1 April	36.1	35.6	0.5	36.1
Additions	8.2	8.2	-	8.2
Amortised during the year	(2.1)	(2.1)	-	(2.1)
At 31 March	42.2	41.7	0.5	42.2

22. CALLED UP SHARE CAPITAL – GROUP AND COMPANY

	2005			2004		
	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 (2004: 122,650,000)	92.1	30.6	122.7	92.1	30.6	122.7

	2005			2004		
	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 (2004: 122,650,000)	92.1	30.6	122.7	92.1	30.6	122.7

23. PROFIT AND LOSS ACCOUNT

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
At 1 April	652.2	656.3	(4.1)	652.2
Profit retained for the year	18.3	14.1	16.0	30.1
At 31 March	670.5	670.4	11.9	682.3

	2004	2004		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
At 1 April	725.9	683.2	42.7	725.9
Profit retained for the year	(73.7)	(26.9)	(46.8)	(73.7)
At 31 March	652.2	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 £97.7m (2004: £77.8m) 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 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.

24. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

	2005	2005		
	Group	Company Appointed business	Company Non-appointed business	Company Aggregated basis
	£'m	£'m	£'m	£'m
Opening equity shareholders' funds as previously reported	774.9	748.4	26.5	774.9
Profit for the financial year	85.9	78.0	19.7	97.7
Dividends	(67.6)	(63.9)	(3.7)	(67.6)
Closing equity shareholders' funds	793.2	762.5	42.5	805.0

	2004	2004		
	Group	Company Appointed	Company Non-appointed	Company Aggregated

		business	business	basis
	£'m	£'m	£'m	£'m
Opening equity shareholders' funds as previously reported	848.6	775.3	73.3	848.6
Profit for the financial year	77.8	71.1	6.7	77.8
Dividends	(151.5)	(98.0)	(53.5)	(151.5)
Closing equity shareholders' funds	774.9	748.4	26.5	774.9

25. COMMITMENTS – GROUP AND COMPANY

(a) Capital expenditure:

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Expenditure contracted for	82.4	-	82.4	53.3	-	53.3

(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:-

	2005			2004		
	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	0.5	-	0.5	0.6	-	0.6
	0.6	-	0.6	0.7	-	0.7

	2005			2004		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Other:						
Leases which expire:						
Within one year	0.1	-	0.1	-	-	-
In five years or more	0.3	-	0.3	-	-	-
	0.4	-	0.4	-	-	-

26. PENSIONS

NWG 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 NWG 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.

26. PENSIONS (continued)

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

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

The company contribution rate was assessed 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%

Following an interim review of the funding position of the MIS sub-fund, employer contributions increased from July 2003 to 21.0%/20.7% for 5%/6% members respectively. In addition, further annual lump sum contributions of £275,000 to the MIS sub-fund have been agreed for a period of 10 years commencing from 1 January 2005.

The actuarial valuation as at 31 December 2004 is currently in progress. An independent qualified actuary performs the actuarial valuation. Employer contribution rates will be reviewed once the results of this valuation are known and will come into effect from 1 January 2006.

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 relevant sub-funds of 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 following table sets out the FRS 17 actuarial assumptions:

	31 March 2005	31 March 2004
	%	%
Pay Increases	3.9	4.0
Pension Increases	2.9	3.0
Price Inflation	2.9	3.0
Discount rate	5.4	5.5

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the long term expected rate of return at 31 March 2005 were:

	Long term expected rate of return 2005	2005	Long term expected rate of return 2004	2004
	%	£'m	%	£'m
Equities	6.7	373.9	6.8	335.4
Corporate bonds	5.4	39.7	5.5	37.7
Government bonds	4.7	45.2	4.8	41.8
Property	5.7	55.5	5.8	47.5
Cash	4.7	12.3	4.0	12.7
Total fair value of assets		526.6		475.1
Present value of scheme liabilities		(600.2)		(565.7)
Deficit in the scheme		(73.6)		(90.6)

26. PENSIONS (continued)

In addition, NWG operates a defined contribution scheme, the Northumbrian Water Group Personal Pension Plan, which provides defined contribution benefits to 886 employees

27. 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.

28. 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.

29. ULTIMATE PARENT COMPANY

NWG, incorporated in the UK, is regarded by the directors of the company as the company's ultimate parent company and controlling party.

The largest group in which the results of the company are consolidated is that of which NWG is the parent company. The consolidated financial statements of NWG may be obtained from Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ. The smallest group in which the results of the company are consolidated is that of which NSL is the parent company. The consolidated financial statements of NSL may be obtained from Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ. NSL is incorporated in the UK.

30. QUASI-SUBSIDIARIES

As noted under accounting policy 1(a), under FRS 5 two companies are consolidated as quasi-subsidiaries. The principal quasi-subsidiary is Bakethin Holdings Limited, the shares in which are owned by Bakethin Charitable Trust. The other quasi-subsidiary is Bakethin Finance plc, which is a wholly-owned subsidiary of Bakethin Holdings Limited.

Bakethin Finance plc was established for the purpose of issuing guaranteed secured bonds. On 12 May 2004 Bakethin Finance plc issued £248m of guaranteed secured bonds. The bonds are due to mature in January 2034. Bakethin Finance plc used the proceeds of the bond issue to make a loan to Reiver Finance Limited to fund the consideration given by that company to NWL for the securitisation of the cash flows receivable from the Environment Agency under the Water Resources Operating Agreement relating to Kielder Reservoir. The assignment is for a period of 30 years.

31. RECONCILIATION OF BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS BETWEEN STATUTORY AND REGULATORY FINANCIAL STATEMENTS (GROUP)

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 2005 Infrastructure Assets £'m
Cost	
At 31 March 2005 per Regulatory Financial Statements	1,171.2
Adjustments to opening balance	268.1
Infrastructure renewals expenditure capitalised in the year	53.9
Infrastructure disposals in the year	(14.6)
Cost at 31 March 2005 per Statutory Financial Statements	1,478.6
Depreciation	
At 31 March 2005 per Regulatory Financial Statements	-
Adjustment to opening balance	163.3
Depreciation charge for infrastructure renewals expenditure	30.1
Infrastructure provision adjustment	(0.9)
Infrastructure disposals in the year	(14.6)
At 31 March 2005 per Statutory Financial Statements	177.9
Net book Value	
At 31 March 2005 per Regulatory Financial Statements	1,171.2
Adjustment relating to infrastructure grants and contributions	110.4
Adjustment for infrastructure renewals accounting	(5.4)
Adjustment in respect of Section 19 "overlap" – note 1(d)((i))	24.5
At 31 March 2005 per Statutory Financial Statements	1,300.7
Provisions and Liabilities – infrastructure renewals	
At 31 March 2005 per Regulatory Financial Statements	5.4
Less infrastructure renewals accrual	(5.4)
At 31 March 2005 per Statutory Financial Statements	-
Deferred tax	
At 31 March 2005 per Regulatory Financial Statements	165.0
Adjustment relating to infrastructure grants and contributions	2.1
Adjustment relating to Section 19 "overlap"	4.2
At 31 March 2005 per Statutory Financial Statements	171.3
Accruals and deferred income	
At 31 March 2005 per Regulatory Financial Statements	51.2
Adjustment relating to infrastructure grants and contributions	117.8
Adjustment relating amortisation of infrastructure income	(7.9)
At 31 March 2005 per Statutory Financial Statements	161.1
Profit and loss for the year	
Year ended 31 March 2005 per Regulatory Financial Statements	85.9
Adjustment relating to Section 19 "overlap" – note 1(d)((i))	5.2
Adjustment relating to amortisation of infrastructure income	1.5
Difference in deferred tax charge	(1.1)
Year ended 31 March 2005 per Statutory Financial Statements	91.5

CURRENT COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2005

	Note	2005	2004
		£'m	£'m
Turnover	2	487.7	435.8
Current cost operating costs - ordinary	3	(212.1)	(208.4)
Current cost operating costs - exceptional	3	-	(1.1)
Total current cost operating costs		275.6	(209.5)
Capital maintenance costs	3	(136.4)	(125.4)
Profit on sale of fixed assets	2	-	0.4
CURRENT COST OPERATING PROFIT		139.2	101.3
Working capital adjustment	2	2.3	(1.7)
CURRENT COST OPERATING PROFIT		141.5	99.6
Net interest payable		(82.2)	(80.1)
Financing adjustment		47.3	39.7
CURRENT COST PROFIT BEFORE TAXATION		106.6	59.2
Taxation:			
Current tax		(8.1)	3.3
Deferred tax		(11.1)	8.3
CURRENT COST PROFIT ATTRIBUTABLE TO SHAREHOLDERS		87.4	70.8
Dividends		(63.9)	(98.0)
CURRENT COST PROFIT / (LOSS) RETAINED		23.5	(27.2)

All note references to the summary current cost financial statements on pages 45 to 47 refer to the notes to the current cost accounts.

CURRENT COST BALANCE SHEET
At 31 March 2005

	Note	2005	2004
		£'m	£'m
FIXED ASSETS			
Tangible fixed assets	4	11,818.7	11,278.3
Third party contributions since 1989/90		(76.6)	(69.7)
		11,742.1	11,208.6
Working capital	5	(73.8)	(73.1)
NET OPERATING ASSETS		11,668.3	11,135.5
Non trade debtors		8.9	24.4
Non trade creditors due within one year		(78.5)	(62.1)
Creditors due after more than one year		(1,359.4)	(1,290.6)
Provisions for liabilities and charges – deferred tax		(159.5)	(148.4)
Provisions for liabilities and charges – other		(3.4)	(4.3)
Dividends payable		(23.0)	(58.8)
NET ASSETS EMPLOYED		10,053.4	9,595.7
CAPITAL AND RESERVES			
Called up share capital		92.1	92.1
Profit and loss account		390.9	367.4
Current cost reserve	6	9,570.4	9,136.2
TOTAL CAPITAL AND RESERVES		10,053.4	9,595.7

CURRENT COST CASH FLOW STATEMENT
For the year ended 31 March 2005

	Note	2005	2004
		£'m	£'m
NET CASH INFLOW FROM CONTINUING OPERATING ACTIVITIES	7	265.8	219.3
Returns on investments and servicing of finance			
Interest received		3.0	2.7
Interest paid		(80.9)	(70.4)
Interest element of finance lease rentals		(0.6)	(1.9)
Dividends received from subsidiary companies		-	66.9
Net cash outflow from returns on investments and servicing of finance		(78.5)	(2.7)
Taxation			
United Kingdom corporation tax paid		0.5	(0.8)
Net cash inflow / (outflow) from taxation		0.5	(0.8)
Capital expenditure and financial investment			
Gross cost of purchase of fixed assets		(157.2)	(168.1)
Infrastructure renewals expenditure		(38.1)	(25.5)
Loan repayment from subsidiary		-	6.5
Receipt of grants and contributions		21.2	16.1
Sale of tangible fixed assets		1.6	0.5
Net cash outflow from capital expenditure and financial investment		(172.5)	(170.5)
Acquisitions and disposals			
Repayment of capital from subsidiaries		-	16.0
Equity dividends paid		(99.7)	(76.7)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(84.4)	(15.4)
Management of liquid resources			
Purchase of short term deposits		(21.4)	(550.3)
Sale of short term deposits		21.4	645.4
Net cash outflow from management of liquid resources		-	(95.1)
Financing			
New loans		171.5	52.0
Debenture repayments		(5.0)	-
Loan repayments		(85.1)	(47.6)
Loan repayments to subsidiaries		-	(89.4)
Capital element of finance lease rental payments		(4.0)	(2.8)
Net cash inflow / (outflow) from financing		77.4	(87.8)
DECREASE IN CASH IN THE YEAR		(7.0)	(8.1)

NOTES TO THE CURRENT COST FINANCIAL INFORMATION
For the year ended 31 March 2005

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

	2005			2004		
	Water services	Sewerage services	Appointed business	Water services	Sewerage services	Appointed business
	£'m	£'m	£'m	£'m	£'m	£'m
Measured	80.0	51.8	131.8	67.1	43.1	110.2
Unmeasured	162.5	134.9	297.4	147.2	120.8	268.0
Trade effluent	-	3.0	3.0	-	4.0	4.0
Large user revenues	20.4	7.4	27.8	21.1	7.0	28.1
Other sources	1.6	1.2	2.8	1.5	1.1	2.6
Third party services	11.4	13.5	24.9	10.5	12.4	22.9
Total turnover	275.9	211.8	487.7	247.4	188.4	435.8
Operating income:						
Current cost profit / (loss) on disposal of fixed assets	0.6	(0.6)	-	0.2	0.2	0.4
Working capital adjustment	1.3	1.0	2.3	(1.0)	(0.7)	(1.7)

3. OPERATING COSTS

2005

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	7.9	8.6	**16.5**	3.1	3.0	3.6	6.6	**9.7**			
Power	2.8	5.4	**8.2**	1.7	4.2	2.9	7.1	**8.8**			
Hired & contracted services	2.9	5.2	**8.1**	1.2	1.0	7.8	8.8	**10.0**			
Associated companies	0.6	-	**0.6**	-	0.2	1.6	1.8	**1.8**			
Materials and consumables	5.7	0.8	**6.5**	0.1	0.3	1.0	1.3	**1.4**			
Service charges (EA)	16.6	-	**16.6**	1.3	1.2	-	1.2	**2.5**			
Bulk supply imports	1.0	-	**1.0**	-	-	-	-	**-**			
Other direct costs	0.4	3.2	**3.6**	1.1	0.2	0.1	0.3	**1.4**			
Total direct costs	37.9	23.2	**61.1**	8.5	10.1	17.0	27.1	**35.6**	**12.3**	**8.5**	**1.5**
General and support expenditure	11.0	14.0	**25.0**	3.2	4.9	4.7	9.6	**12.8**	**5.9**	**1.0**	**0.3**
Functional expenditure	48.9	37.2	**86.1**	11.7	15.0	21.7	36.7	**48.4**	18.2	9.5	1.8
Business analysis			**19.8**					**9.7**			
Total business activities c/fwd			**105.9**					**58.1**			

3. OPERATING COSTS (continued)

2005

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			**105.9**					**58.1**
Rates			**14.4**					**4.5**
Doubtful debts			**6.6**					**6.6**
Exceptional costs			**-**					**-**
Total opex less third party services			**126.9**					**69.2**
Third party services – opex			**9.8**					**6.2**
Total operating expenditure			**136.7**					**75.4**
Capital costs								
Infrastructure renewal expenditure	1.7	21.7	**23.4**	6.9	-	-	-	**6.9**
Movement in infrastructure renewals accrual/prepayment	-	1.7	**1.7**	3.2	-	-	-	**3.2**
Current cost depreciation (allocated)	29.2	9.7	**38.9**	5.1	32.3	12.5	44.8	**49.9**
Business activities current cost depreciation (non allocated)			**8.5**					**3.9**
Total capital maintenance			**72.5**					**63.9**
Total operating costs			**209.2**					**139.3**
CCA (MEA) values								
Service activities			**5,829.4**					**5,912.5**
Business activities			**56.5**					**20.3**
Service totals			**5,885.9**					**5,932.8**

3. OPERATING COSTS (continued)

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**

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 2004	1,302.0	42.7	4,860.5	98.9	6,304.1
AMP adjustment	109.8	-	-	17.7	127.5
RPI Adjustment	45.0	1.6	155.9	3.8	206.3
Disposals	(0.6)	-	-	-	(0.6)
Additions	37.5	-	17.9	8.0	63.4
At 31 March 2005	1,493.7	44.3	5,034.3	128.4	6,700.7
Depreciation:					
At 1 April 2004	629.9	19.3	-	60.2	709.4
AMP adjustment	33.0	-	-	1.3	34.3
RPI Adjustment	22.0	0.6	-	1.1	23.7
Charge for year	36.3	1.8	-	9.3	47.4
At 31 March 2005	721.2	21.7	-	71.9	814.8
Net Book Value at 31 March 2005	772.5	22.6	5,034.3	56.5	5,885.9
Net Book Value at 31 March 2004	672.1	23.4	4,860.5	38.7	5,594.7

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 2004	1,517.6	26.6	4,711.9	25.9	6,282.0
AMP adjustment	15.0	-	-	14.4	29.4
RPI Adjustment	48.6	1.0	151.5	1.1	202.2
Disposals	(1.1)	-	-	-	(1.1)
Additions	69.7	1.0	18.8	4.3	93.8
At 31 March 2005	1,649.8	28.6	4,882.2	45.7	6,606.3
Depreciation:					
At 1 April 2004	569.9	12.6	-	15.9	598.4
AMP adjustment	(1.6)	-	-	3.8	2.2
RPI Adjustment	18.2	0.4	-	0.6	19.2
Disposals	(0.1)	-	-	-	(0.1)
Charge for year	47.6	1.1	-	5.1	53.8
At 31 March 2005	634.0	14.1	-	25.4	673.5
Net Book Value at 31 March 2005	1,015.8	14.5	4,882.2	20.3	5,932.8
Net Book Value at 31 March 2004	947.7	14.0	4,711.9	10.0	5,683.6

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 2004	2,819.6	69.3	9,572.4	124.8	12,586.1
AMP adjustment	124.8	-	-	32.1	156.9
RPI Adjustment	93.6	2.6	307.4	4.9	408.5
Disposals	(1.7)	-	-	-	(1.7)
Additions	107.2	1.0	36.7	12.3	157.2
At 31 March 2005	3,143.5	72.9	9,916.5	174.1	13,307.0
Depreciation:					
At 1 April 2004	1,199.8	31.9	-	76.1	1,307.8
AMP adjustment	31.4	-	-	5.1	36.5
RPI Adjustment	40.2	1.0	-	1.7	42.9
Disposals	(0.1)	-	-	-	(0.1)
Charge for year	83.9	2.9	-	14.4	101.2
At 31 March 2005	1,355.2	35.8	-	97.3	1,488.3
Net Book Value at 31 March 2005	1,788.3	37.1	9,916.5	76.8	11,818.7
Net Book Value at 31 March 2004	1,619.8	37.4	9,572.4	48.7	11,278.3

The opening cost balances in the fixed asset statements above are based on the MEA valuation which was undertaken for the company's final business plan submission to Ofwat in April 2004, following a comprehensive exercise to revalue the company's assets and reassess useful economic lives. This valuation covered all assets in service at 31st March 2003, other than Wear Head and Tunstall. Additions in 2003/04 were added to the March 2003 valuation to produce the fixed assets valuation in the current cost accounts at March 31st 2004.

However, more detailed work has been performed in 2004/05 to identify the value of expenditure which had already been incurred by March 2003, but did not relate to completed projects at that date and was therefore excluded from the MEA valuation. These projects have virtually all been completed and commissioned since March 2003, but the expenditure incurred prior to March 2003 needs to be reflected in the MEA valuation. This value of expenditure has therefore been included as an AMP adjustment of £156.9m in the fixed asset statement as at 31st March 2005.

Additions in the current cost fixed asset statements are shown net of grants. Additions in the historical cost asset statement (note 10) are shown gross, with grants shown as a separate line.

5. WORKING CAPITAL

	2005	2004
	£'m	£'m
Stocks	2.9	3.0
Trade debtors	51.6	46.4
Working cash balances	(2.1)	4.9
Trade creditors	(9.8)	(12.3)
Short term capital creditors	(31.4)	(19.6)
Infrastructure renewals (accruals)	(3.9)	(6.8)
Other trade accruals	(52.7)	(46.4)
Trade payments in advance	35.0	30.5
Payroll related taxes and DSS contributions	(1.1)	(1.5)
Other creditors due in less than one year	(62.3)	(71.3)
At 31 March	(73.8)	(73.1)

6. MOVEMENT ON CURRENT COST RESERVE

	2005	2004
	£'m	£'m
At 1 April	9,136.2	9,728.9
AMP adjustment	120.4	(838.5)
RPI Adjustments:		
Fixed assets	365.6	285.4
Working capital	(2.3)	1.7
Financing	(47.3)	(39.7)
Grants and third party contributions	(2.2)	(1.6)
At 31 March	9,570.4	9,136.2

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

	2005	2004
	£'m	£'m
Current cost operating profit	141.5	99.6
Working capital adjustment	(2.3)	1.7
Change in stocks	0.1	0.1
Current cost depreciation	101.2	91.3
Current cost profit on sale of assets	-	(0.4)
Increase in debtors and prepaid expenses	(6.7)	-
Increase in creditors and accrued expenses	(0.2)	(5.1)
Infrastructure renewals expenditure	38.1	25.5
Movement in provisions	(3.8)	8.7
Effect of other deferrals and accruals on operating activity cashflow	(2.1)	(2.1)
Net cash flow from operating activities	265.8	219.3

8. ANALYSIS OF NET DEBT

	At 1 April 2004	Cash Flow	Other non cash changes	At 31 March 2005
	£'m	£'m	£'m	£'m
Cash in hand and at bank	4.9	(7.0)	-	(2.1)
Loans due after one year	(1,232.2)	(97.3)	24.6	(1,304.9)
Loans due within one year	(90.1)	18.6	(24.6)	(96.1)
Finance leases	(60.9)	4.0	(4.9)	(61.8)
Total	(1,378.3)	(81.7)	(4.9)	(1,464.9)

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

Associate	Service	December 2004 or March 2005 Turnover	Terms of Supply	2004/05 Value
		£'m		£'m
Analytical & Environmental Services Limited	Rental of laboratories and service charges	13.2	Negotiated	0.3
SITA	Treatment of waste	7,726.0	Negotiated	0.2
Vehicle Lease and Service Limited	Rental of garage and service charges	12.1	Negotiated	0.1

Services supplied to the appointee by associated companies:

Associate	Service	December 2004 or March 2005 Turnover	Terms of Supply	2004/05 Value
		£'m		£'m
Analytical & Environmental Services Limited	Sampling and analysis	13.2	No market	9.2
Ondeo Degremont	Construction and engineering design	576.0	Competitive letting	0.7
Entec UK Limited	Engineering design consultancy	41.5	Competitive letting	8.4
Entec UK Limited	Engineering design consultancy	41.5	Other market testing	0.9
Fastflow Pipeline Services Limited	Mains renewals, sewer repairs	15.6	Competitive letting	13.3
SITA	Waste disposal	7,726.0	Competitive letting	0.1
Suez SA	Group research and development costs	27,595.0	No market	6.3
Vehicle Lease and Service Limited	Maintenance and capital finance charge	12.1	Competitive letting	5.4

10. ROLLING SUMMARY: CURRENT COST PROFIT AND LOSS ACCOUNT

	2000/01	2001/02	2002/03	2003/04	2004/05
	£'m	£'m	£'m	£'m	£'m
Turnover	448.0	457.3	447.4	449.7	487.7
Current cost operating costs	(313.7)	(318.9)	(338.7)	(344.1)	(348.5)
Exceptional items	(2.1)	-	(4.7)	(1.1)	-
Working capital adjustment	0.5	0.5	0.5	(1.8)	2.3
Current cost operating profit	132.7	138.9	104.5	102.7	141.5
Net interest	(70.9)	(73.0)	(74.4)	(82.7)	(82.2)
Financing adjustment	26.4	16.3	42.4	41.0	47.3
Current cost profit before taxation	88.2	82.2	72.5	61.0	106.6
Taxation	(50.7)	13.9	(20.1)	12.0	(19.2)
Current cost profit on ordinary activities	37.5	96.1	52.4	73.0	87.4
Dividends	(71.5)	(78.8)	(79.5)	(101.1)	(63.9)
Current cost (loss) / profit retained	(34.0)	17.3	(27.1)	(28.1)	23.5

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.

11. ROLLING SUMMARY: CURRENT COST BALANCE SHEET

	31 March 2001	31 March 2002	31 March 2003	31 March 2004	31 March 2005
	£'m	£'m	£'m	£'m	£'m
Tangible fixed assets	12,106.4	12,379.8	12,462.8	11,638.8	11,818.7
Third party contributions since 89/90	(63.7)	(64.1)	(65.8)	(71.9)	(76.6)
Working capital	(43.5)	(17.7)	74.0	(75.4)	(73.8)
Net operating assets	11,999.2	12,298.0	12,471.0	11,491.5	11,668.3
Investments	98.9	97.6	94.6	-	-
Non trade debtors	13.5	8.2	8.8	25.2	8.9
Non trade creditors	(187.3)	(36.1)	(39.8)	(64.1)	(78.5)
Creditors due after > 1 year	(1076.8)	(1,339.6)	(1,500.6)	(1,331.9)	(1,359.4)
Provisions for liabilities and charges	(157.7)	(141.5)	(172.4)	(157.6)	(162.9)
Dividends payable	(37.9)	(40.1)	(39.7)	(60.7)	(23.0)
Net assets employed	10,651.9	10,846.5	10,821.9	9,902.4	10,053.4
Called up share capital	101.9	100.6	97.6	95.0	92.1
Profit and loss account	451.4	462.9	422.2	379.2	390.9
Current cost reserve	10,098.6	10,283.0	10,302.1	9,428.2	9,570.4
Total capital and reserves	10,651.9	10,846.5	10,821.9	9,902.4	10,053.4

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.

12. REGULATORY CAPITAL VALUE AT 2004/2005 PRICES

	2004/2005
	£'m
Opening regulatory capital value	2,392.0
Capital expenditure (excluding IRE)	151.0
Infrastructure renewals expenditure	35.0
Infrastructure renewals charge	(30.0)
Grants and contributions	(7.0)
Current cost depreciation	(83.0)
Out-performance of regulatory assumptions (5 years in arrears)	(48.0)
Closing regulatory capital value	2,410.0
Average year regulatory capital value	2,372.0

The table shows the regulatory capital value used by Ofwat in setting the price limits for 2004/2005.

The numbers included above are taken from the Ofwat publication RD05/04 'Regulatory Capital Values 2003-04'. As part of the 2004 Periodic Review, a further £58.0m was added for COPI indexation and logging up & down, to give an opening value for 2005/06 as per RD07/05 of £2,468m (2004/05 year end prices).

Differences between the above figures and actual capital expenditure, infrastructure renewals expenditure, infrastructure renewals charge, grants and contributions and current cost depreciation will not affect the price limits set for the period 2005-10. They will be taken into account in the calculation of outperformance adjustments at the next Periodic Review in 2009.

The year average regulatory capital value is in the average year price base, all other figures are in the year end price base.

STATEMENT OF DIRECTORS' RESPONSIBILITIES
For the year ended 31 March 2005

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

8 July 2005

INDEPENDENT AUDITORS' REPORT TO THE DIRECTOR GENERAL OF WATER SERVICES AND DIRECTORS OF NORTHUMBRIAN WATER LIMITED

We have audited the Regulatory Financial Statements of Northumbrian Water Limited ("the company") for the year ended 31 March 2005 which comprise the regulatory historic cost financial statements (Section B) , itself comprising the group regulatory historical cost profit and loss account, the the company historical cost profit and loss account, the group regulatory historical cost balance sheet, the company regulatory historical cost balance sheet, the group regulatory historical cost cash flow statement, notes to the cash flow statement a and b and relates notes to the regulatory historical cost financial statements number 1 to 31, and the regulatory current cost financial information (Section C), itself comprising the regulatory current cost profit and loss account for appointed business, the regulatory current cost balance sheet for appointed business, the regulatory current cost cash flow statement for appointed business and the 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 Director General of Water Services (the Regulator) in order to meet the requirements of Condition F of the company's Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under the Water Industry Act 1991 ('the Regulatory Licence'). 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 assis t the company to meet its obligations under the Regulatory Licence 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 Condition F of the company's Instrument of Appointment as a water undertaker, the Regulatory Accounting Guidelines 1.03 (Guideline for accounting for current costs and regulatory capital values), 2.03 (Guideline for the classification of expenditure), 3.05 (Gu ideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets), 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' responsibilities for preparing the regulatory financial statements in accordance with the Regulatory Licence and the Regulatory Accounting Guidelines 1.03, 2.03, 3.05 and 4.02 issued by the Regulator are set out in the Statements of Directors' Responsibilities.

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, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guidelines 2.03, 3.05 and 4.02, and whether the regulatory current cost financial information (Section C) have been properly prepared in accordance with Regulatory Accounting Guidelines 1.03, 3.05 and 4.02. We also report to you if, in our opinion, the company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointees' accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, 2.03, 3.05, and 4.02. We also report if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Regulatory Financial Statements, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Financial Statements. The other information comprises the Directors' Report and Section D – Supplementary Information to the Financial Statements required by the Director General of Water Services.

Basis 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 appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the 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.

The regulatory historical cost financial statements (Section B) have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting has been applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. As a result, the provision for infrastructure renewals remains in provisions for liabilities and charges. The effect of this departure from Generally Accepted Accounting Principles is given in notes 1 and 31 to the historical cost financial statements.

Opinion

In our opinion, the regulatory financial statements of the company for the year ended 31 March 2005 fairly present in accordance with Condition F of the company's Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines 1.03, 2.03, 3.05 and 4.02 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 2005 on a regulatory historical cost and regulatory current cost basis, the regulatory historical cost and regulatory current cost profit for the year then ended and regulatory current cost cash flow for the year the 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 1.03, 2.03, 3.05 and 4.02 issued by the Regulator;

c) the regulatory historical cost financial statements (Section B) present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, 3.05 and 4.02 issued by the Regulator;

d) the regulatory current cost financial information has been properly prepared in accordance with Regulatory Accounting Guidelines 1.03, 3.05 and 4.02 issued by the Regulator.

Ernst & Young LLP
Registered auditors
Newcastle upon Tyne

8 July 2005