NORTHUMBRIAN WATER LIMITED

REGULATORY FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2006

Registered no: 2366703

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CONDITION F REGULATORY FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2006

CONTENTS

DIRECTORS' REPORT
For the year ended 31 March 2006

The directors present their report and the audited regulatory financial statements for the year ended 31 March 2006.

Results and dividends

The company's profit after taxation for the year ended 31 March 2006 amounts to £96.6m (2005: £97.7m). The directors recommend a final ordinary dividend amounting to £36.9m (2005: £25.7m) which, together with the interim dividend of £36.9m (2005: £41.9m), makes a total for the year of £73.8m (2005: £67.6m).

During the year the company implemented FRS 21,"Events after the Balance Sheet Date". Dividends are now recognised in the financial statements in the year in which they are paid or, in the case of a final dividend, when approved by the shareholders. As such the amount of £62.6m recognised in the 2006 financial statements, as described in note 9, is made up of the 2005 proposed dividend at 31 March 2005 and the 2006 interim dividend, which have both been paid in the year ended 31 March 2006. Accordingly the balance sheet for 2005 has been restated to reflect this change in accounting policy.

Principal activities and review of business

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

The company maintained its high standards on water and waste water compliance and continued to perform well on most of Ofwat's customer service standards. As with last year, the only shortcoming related to sewer flooding where intense summer storms caused the company's performance to slip on this measure.

Turnover increased from £504.3m in 2004/05 to £550.5m for the year to 31 March 2006. This increase is mainly due to the application of new regulatory pricing which resulted in an average price increase to tariff income of 9.95% in April 2005. This price increase included an uplift for RPI of 3.45%.

Operating costs, excluding capital maintenance costs, have increased from £218.5m to £228.5m, principally reflecting the impact of inflation plus increases in market prices for power and increased pension contributions following an actuarial review of the pension scheme. These increases have been partially offset by efficiency savings. Operating costs for the appointed business in 2005/06 are £0.1m lower than those estimated in the 2004 final determination for the year.

Capital maintenance costs have increased from £94.5m to £97.3m, reflecting additional depreciation charges arising from the commissioning of new assets.

Net interest payable increased by £8.8m from £68.9m in 2004/05 to £77.7m in 2005/06. The increase is due partly to one-off benefits which arose in 2004/05 relating to the release of an interest rate hedge (£4.3m) and interest on sums recovered in respect of prior year tax claims (£1.9m). Additional interest has been incurred due to an increase in the average net debt from £1,445m in 2004/05 to £1,487m in 2005/06.

Key Performance Indicators (KPIs)

The NWL group of companies (note 11) uses many performance indicators, both financial and non-financial, to monitor its progress, many of which are combined into a balanced scorecard that is used to calculate employees' bonuses.

a) Financial performance against KPIs

KPI	Target	Performance	
		Current year	Previous year
Gearing to RCV	<70%[(1)]	66%	68%
Cash interest cover	>3.0x	3.3x	3.4x
Cash flow to net debt	>13%	17%	17%

(1) Less than 65% for the appointed business.

Gearing decreased to 66% for the NWL group and to 58% (2005: 59%) for the appointed business.

DIRECTORS' REPORT (continued)

Key Performance Indicators (continued)

The future focus of the company continues to be improving efficiency levels and driving down operating costs, whilst maintaining high standards of customer service and compliance 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, which will be made more challenging by further increases in energy prices.

b) Performance against non-financial KPIs

	Performance	
Target	Current year	Previous year
Customer service standards	See narrative below	
Customer satisfaction - overall service - value for money	 91% 83%	 88% 74%
Drinking water quality	99.9%	99.9%
Environmental performance	100%	100%

The company maintained its high level of service, continuing to achieve greater than 99.9% compliance with drinking water regulations, 100% compliance with Look Up Table (LUT) effluent consents, and a star rating on most Director General (DG) measures. The only shortcoming related to DG5, which measures performance on sewer flooding. Due to intense summer storms, the company's performance slipped on this measure. Whether such storms are rare events, unlikely to recur in the near future, or reflect changed weather patterns associated with climate change, remains to be seen.

Customer satisfaction surveys showed sustained customer satisfaction and perceived value for money.

Financial statements preparation and going concern

The directors consider 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 2006/07 and the forecast for the following three years. 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. The company maintains a programme of research and development activities appropriate to its operations and incurred costs of research and development in the year of £2.3m (2005: £5.0m).

Company payment policy

The company's policy is to agree and adhere to payment terms with suppliers when agreeing the terms of each transaction, also ensuring that suppliers are made aware of, and comply with, the terms of payment. The year end trade creditors expressed as a number of days of purchases made during the year is 18 days (2005: 27 days).

Fixed assets

Freehold land and buildings are carried in the financial statements at historical cost with a net book value of £57.9m (2005: £59.4m). In the opinion of the directors, at 31 March 2006, there is no significant difference between the net book value and market value of property capable of disposal within the foreseeable future. Note 10 gives more details of the fixed asset movements during the year.

DIRECTORS' REPORT (continued)

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 business. The strategy of the company 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.

During the year, the company issued two guaranteed Index Linked Eurobonds through its subsidiary Northumbrian Water Finance plc, £150m of Eurobonds were issued in September 2005, maturing in July 2036, and a further £60m of Eurobonds were issued in January 2006, maturing in January 2041. Since the year end, two further guaranteed Index Linked Eurobonds have been issued: £100m maturing in July 2049 and £100m maturing in July 2053.

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 ("NWG" or "the Group"). The strategy aims to is to assess the ongoing capital requirement of the company and raise funding on a timely basis, taking advantage of any favourable market opportunities.

The Treasury department of NWG 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 NWG, whose board reviews and agrees policies for managing each of these risks. These are summarised below. The treasury activities of the company are conducted in accordance with these policies.

Liquidity risk

As regards day to day liquidity, the company is responsible for cash management and has sufficient committed facilities to cover 18 months forecast cash outflow. The Group'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. The Group's policy is to keep a minimum 60 per cent of its borrowings at fixed rates of interest. At 31 March 2006, 80% (2005: 88%) of the borrowings of the Group were at fixed rates of interest. At 31 March 2006, the Group had £275.0m available in standby committed bank facilities.

Foreign currency risk

The Group's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered immediately on recognition. At 31 March 2006, the company had no currency exposures (2005: nil).

Market price risk

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

DIRECTORS' REPORT (continued)

Directors

The directors who served during the year were as follows:

Professor Sir F G T Holliday CBE (retiring July 2006)
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

A G Balls
Independent Non-Executive Director

A M Frew
Independent Non-Executive Director

A J Scott-Barrett
Independent Non-Executive Director – appointed 1 November 2005

Sir D Wanless
Non-Executive Director – appointed 1 January 2006

Sir A P Brown
Non-Executive Director – appointed 1 January 2006

R K Lepin
Non-Executive Director – appointed 1 January 2006

M A B Nègre
Non-Executive Director – appointed 1 January 2006

J M Williams
Non-Executive Director – appointed 1 January 2006

R R Allan
Independent Non-Executive Director – retired 28 July 2005

B Guirkinger
Non-Executive Director – resigned 28 April 2005

C Cros
Non-Executive Director – resigned 28 April 2005

DIRECTORS' REPORT (continued)

Employees and employment policies

Equal Opportunities
The company operates an equal opportunity policy, incorporated into NWG's 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
Throughout the year, the company continued to communicate effectively with its employees. Publications such as Watermark, Hel'eau and Low down have ensured consistent delivery of business and employee messages. In support of this, both informal and formal links are used to inform the communication process to ensure a constant and open flow of information and equal representation.

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.

Share Incentive Plan
The directors believe that employee investment strengthens the ties between its employees and NWG by enabling employees to participate more closely in the Group's economic performance.

In January 2004, NWG launched its Share Incentive Plan (SIP). All UK based employees of the Group are eligible to participate in the SIP. The SIP enables Group 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 Group has in place Director's and Officers' insurance and, on 28 November 2005, entered into a deed of indemnity to grant the director's of the Group and its subsidiaries further protection against liability to third parties.

Pensions

Information about the pension schemes operated by the Group is contained in note 27 to the financial statements.

DIRECTORS' REPORT (continued)

Charitable and political contributions
During the year, the company made charitable donations of £122,411 (2005: £89,369) and political donations of £3,857 (2005: £1,497).

It is the Group'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 Group 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 Group companies. Approval will be sought from Group shareholders at its forthcoming AGM to permit the Group and the company to make political donations as defined in PPERA 2000 up to a maximum of £20,000 in the 15 month period commencing on the date of the AGM or until the date of the 2007 AGM whichever is sooner. 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 period**
	£
Labour	2,785
Liberal Democrats	484
Conservative	588
Total	**3,857**

These payments covered attendance of employees and guests at regional breakfast meetings and dinners and at a party conference fringe event, which gave employees opportunities to engage with stakeholder groups and to heighten awareness within the political arena of key industry issues and matters affecting the Group. The value of donations made to each party reflects the representation of political parties in the company's areas of supply rather than the party in Government.

Environment policy
NWL is committed to preventing pollution, minimising its adverse environmental impacts, in the context of its activities as a water supply and sewerage undertaker, and promoting positive environmental outcomes. This is demonstrated through research to promote and deliver innovative solutions, together with a continuing commitment to improve its environmental performance across all its activities. This includes asset design, construction, operation and disposal, focusing specifically on air and climate systems, the water environment, resource and raw material use, waste, conservation of biodiversity and heritage and local communities.

Sustainable development policy
NWL aims to use resources efficiently and procure materials, goods and commodities on the basis of their environmental, social and economic impacts. At the same time, NWL will work to reduce, where possible, the amount of wastes generated and reuse or recycle by-products. It will also protect and enhance biological diversity, ecological systems and cultural heritage.

Future developments
Ofwat's review of the company's price limits in its final determination in 2004 sets the framework for the five years to 2010. The determination included assumptions on operating and capital efficiencies, as follows:

- annual average operating efficiency improvements of 1.2% for water and 2.0% for sewerage;
- overall capital maintenance efficiency improvements of 3.6% for water and 3.9% for sewerage (for the full five year period); and
- overall capital enhancement improvements of 14.8% for water and 14.6% for sewerage (for the full five year period).

Price limits allowed in 2005/06 increased by 6.5% before inflation and for the next four years the increases above inflation are 3.7%, 3.2%, 1.0% and 0.6%.

Financial performance for the appointed business has been broadly in line with Ofwat's assumptions this year, but the cost of power and abstraction charges is rising significantly above the rate of inflation. In this context, Ofwat's efficiency assumptions for future operating costs will be challenging.

DIRECTORS' REPORT (continued)

Investment aspects
Over the five years to 2010, the company will invest around £1 billion. This will include maintenance of its existing assets as well as further improvements to the quality of drinking water, sewerage assets, discharges to the environment, and levels of service provided to customers.

The company is increasing its investment to maintain its above ground sewerage assets. These have been assessed by Ofwat as 'deteriorating' but the increased capital maintenance investment will achieve and maintain a 'stable' performance. The company will also continue to invest in new and improved sewage treatment works, to meet the discharge standards required for the protection of environments designated as 'sensitive' and the requirements of the EU Freshwater Fish Directive, and in improvements to unsatisfactory sewage overflows and in reducing odours from a number of its sewage treatment works.

The extent and impact of flooding from sewers is a concern to the company, its customers and CCWater. The allowance in price limits for this service improvement will not eradicate the problem, but it will mean that the worst cases can be addressed on the basis of priorities agreed with Ofwat and CCWater.

The planning application to enlarge Abberton reservoir in Essex is due to be submitted in 2006 and, provided the planning process proceeds smoothly, construction will begin in 2010. When it is filled in 2014, the capacity of the enlarged reservoir will be some 60% greater than it is today.

The company has almost completed its 20 year mains rehabilitation programme and has now started its mains flushing programme to reduce the incidence of discoloured water. Investment at three water treatment works to provide additional protection against pesticides is well underway.

Future trends and factors
There are a number of known changes, both short term and longer term, that may have an impact on the future development, performance and position of the company including:

- the introduction of new UK and EU legislation (such as the Traffic Management Bill and Water Framework Directive), the deadlines in existing legislation (such as the lower lead in drinking water requirement in 2013) and proposals for future legislation (such as the proposal for water and sewerage companies to adopt private sewers);
- the impact of changes in population and industry levels, particularly with the development of the Thames Gateway area on the demand for, and supply of, water; and
- the impact of climate change, particularly where it relates to the increased incidence of flooding and changes in rainfall patterns.

Directors' declaration
In accordance with the Companies Audit, Investigations and Enterprise Act 2004, as far as each director is aware, there is no relevant audit information of which the company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

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.

DIRECTORS' REPORT (continued)

Statement of Directors' responsibilities
Company law requires the directors to prepare the Annual Report and the financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice.

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

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

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

BY ORDER OF THE BOARD

M Parker

Company Secretary

12 July 2006

HISTORICAL COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2006

	Note	2006 Appointed business	2006 Non-appointed business	2006 Aggregated basis	2005 Appointed business	2005 Non-appointed business	2005 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
Turnover	2	532.0	18.5	550.5	487.7	16.6	504.3
Operating costs	3(a)	(222.3)	(6.2)	(228.5)	(214.2)	(4.3)	(218.5)
Capital maintenance costs	3(b)	(96.8)	(0.5)	(97.3)	(94.1)	(0.4)	(94.5)
Total operating costs		(319.1)	(6.7)	(325.8)	(308.3)	(4.7)	(313.0)
OPERATING PROFIT		212.9	11.8	224.7	179.4	11.9	191.3
Net interest (payable) / receivable	4	(87.8)	10.1	(77.7)	(82.2)	13.3	(68.9)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	3(c)	125.1	21.9	147.0	97.2	25.2	122.4
Taxation	8(a)	(46.1)	(4.3)	(50.4)	(19.2)	(5.5)	(24.7)
PROFIT FOR THE FINANCIAL YEAR		79.0	17.6	96.6	78.0	19.7	97.7

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2006

There are no recognised gains and losses other than the profit attributable to shareholders of the company of £96.6m in the year ended 31 March 2006 and the profit of £97.7m in the year ended 31 March 2005.

In addition the effect of implementing FRS 21 is that an amount of £25.7m, previously included within creditors as a proposed divided at 31 March 2005, has been added back to the profit and loss reserve at 31 March 2005.

HISTORICAL COST BALANCE SHEET
At 31 March 2006

	Note	2006 Appointed business	2006 Non-appointed business	2006 Aggregated basis	2005 (restated) Appointed business	2005 (restated) Non-appointed business	2005 (restated) Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	10	2,612.3	99.0	2,711.3	2,497.6	98.9	2,596.5
Investments	11	-	160.6	160.6	-	160.6	160.6
		2,612.3	259.6	2,871.9	2,497.6	259.5	2,757.1
CURRENT ASSETS							
Stocks	12	2.6	0.2	2.8	2.9	0.1	3.0
Debtors due in less than one year	13	98.9	3.9	102.8	95.5	3.2	98.7
Debtors due in more than one year	14	3.6	-	3.6	-	-	-
Investments	15	57.7	-	57.7	-	-	-
Cash at bank and in hand		-	7.1	7.1	-	4.2	4.2
		162.8	11.2	174.0	98.4	7.5	105.9
CREDITORS Amounts falling due within one year	16	(181.1)	(5.9)	(187.0)	(234.4)	(7.5)	(241.9)
NET CURRENT (LIABILITIES) / ASSETS		(18.3)	5.3	(13.0)	(136.0)	-	(136.0)
TOTAL ASSETS LESS CURRENT LIABILITIES		2,594.0	264.9	2,858.9	2,361.6	259.5	2,621.1
CREDITORS: Amounts falling due after more than one year	17	(1,540.3)	-	(1,540.3)	(1,362.9)	-	(1,362.9)
PROVISIONS FOR LIABILITIES AND CHARGES	22	(190.7)	(9.3)	(200.0)	(166.8)	(8.2)	(175.0)
ACCRUALS AND DEFERRED INCOME	23	(54.9)	(199.0)	(253.9)	(46.4)	(206.1)	(252.5)
		(1,785.9)	(208.3)	(1,994.2)	(1,576.1)	(214.3)	(1,790.4)
NET ASSETS		808.1	56.6	864.7	785.5	45.2	830.7
CAPITAL AND RESERVES							
Called up share capital	24	92.1	30.6	122.7	92.1	30.6	122.7
Profit and loss account	25	716.0	26.0	742.0	693.4	14.6	708.0
EQUITY SHAREHOLDERS' FUNDS	25	808.1	56.6	864.7	785.5	45.2	830.7

Approved on behalf of the board

J A Cuthbert

C M Green
12 July 2006

NOTES TO THE HISTORICAL COST FINANCIAL STATEMENTS
For the year ended 31 March 2006

1. STATEMENT OF ACCOUNTING POLICIES

In accordance with Condition F of "the Instrument", these financial statements have been prepared to show separately a profit and loss account and a statement of assets and liabilities for each of:

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

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. The company is exempt by virtue of section 228 of the Companies Act 1985 from the requirement to prepare group financial statements, as it is included in the group financial statements of Northumbrian Water Group plc. These financial statements therefore present information about the individual company and not about its group.

(b) Prior year adjustment

The company has adopted FRS 21 'Events after the Balance Sheet Date' in these financial statements. Dividends are now accrued where an obligation exists at the balance sheet date. Consequently, dividends which the company approves in a general meeting after the balance sheet date are no longer accrued, but are required to be disclosed in the notes to the financial statements (see notes 9, 16 and 25). The prior year comparative figures have been restated to reflect the dividends paid in that year, in accordance with the first year adoption requirements of FRS 21.

(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.

(d) Cash flow statement

The directors have taken advantage of the exemption in Financial Reporting Standard No.1 (revised) and have not included a cash flow statement on the grounds that the company is wholly owned and its ultimate parent company publishes a consolidated cash flow statement.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(e) 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 company has 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 has 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 2005 and 31 March 2006 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 (2006 difference: £3.0m).

(ii) Other assets

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

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

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

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

(iii) Assets in the course of construction

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

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(f) 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 (2006 difference: £1.1m).

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.

(g) 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.

(h) 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.

(i) 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.

(j) 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 based on tax rates and laws enacted or substantively enacted at the balance sheet date.

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

As permitted by FRS 19, the company has 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)

(k) 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.

(l) Research and development

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

(m) Investments

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

(n) 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.

(o) Liquid resources

Liquid resources comprise external deposits**.**

(p) 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 comprise:

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Materials and consumables	14.0	0.9	14.9	14.2	0.6	14.8
Other external charges	53.8	2.9	56.7	53.1	1.4	54.5
Manpower costs (note 7(a))	80.4	1.5	81.9	72.4	1.1	73.5
Other operating charges	96.1	0.9	97.0	93.5	1.2	94.7
Own work capitalised	(22.0)	-	(22.0)	(19.0)	-	(19.0)
	222.3	6.2	228.5	214.2	4.3	218.5

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

(b) Capital maintenance costs (including profit or loss on disposal) comprise:

	2006			2005		
	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	61.0	0.4	61.4	56.2	0.4	56.6
Tangible fixed assets held under finance leases	3.9	-	3.9	2.9	-	2.9
Infrastructure renewals expenditure (note 22)	35.6	-	35.6	38.1	-	38.1
Infrastructure renewals accrued (note 22)	0.3	0.1	0.4	(2.9)	0.1	(2.8)
Amortisation of capital grants and contributions	(2.4)	-	(2.4)	(2.1)	(0.1)	(2.2)
(Profit) / loss on disposal of fixed assets	(1.6)	-	(1.6)	1.9	-	1.9
	96.8	0.5	97.3	94.1	0.4	94.5

(c) Profit on ordinary activities before taxation:

	2006			2005 (restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Profit on ordinary activities before taxation is stated after charging:						
Auditors remuneration:						
Audit fees	0.2	-	0.2	0.2	-	0.2
Non audit fees	0.1	-	0.1	0.1	-	0.1
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	2.3	-	2.3	5.0	-	5.0
Directors' emoluments (note 5)	1.0	-	1.0	1.2	-	1.2

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

(c) Profit on ordinary activities before taxation (continued)

Auditors' remuneration for the regulatory audit amounted to £15,405 (2005: £15,000). Fees of £26,702 and £12,324 (2005: £26,000 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 £91,917(2005: £91,000).

4. NET INTEREST PAYABLE / (RECEIVABLE)

Net interest payable / (receivable) comprises:

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Interest payable:						
Bank loans and overdrafts	19.7	-	19.7	23.0	0.3	23.3
Group loans	66.4	-	66.4	57.6	-	57.6
Debenture stock interest	0.5	-	0.5	1.0	-	1.0
Financing charges payable under finance leases	3.0	-	3.0	3.0	-	3.0
Total interest payable	89.6	-	89.6	84.6	0.3	84.9
Group interest receivable	-	(9.9)	(9.9)	(0.1)	(8.7)	(8.8)
Other interest receivable	(1.8)	(0.2)	(2.0)	(2.3)	(4.9)	(7.2)
Net interest payable	87.8	(10.1)	77.7	82.2	(13.3)	68.9

5. DIRECTORS' EMOLUMENTS AND INTERESTS

(a) Directors' remuneration

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

	2006	2005 restated
	£'000	£'000
Emoluments (including benefits in kind)	991.3	906.6

For those directors holding office with both NWL and NWG, costs are apportioned between the companies. This note reflects only the proportion of costs charged to NWL. The prior year has been restated to reflect this.

Four of the directors at 31 March 2006 were members of a defined benefit pension scheme where the company makes contributions towards the cost (2005: 4).

The directors who held office at 31 March 2006 had no interest in the shares of the company.

5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

(a) Directors' remuneration (continued)

The directors who held office as at 31 March 2006 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 2005	Amount of debentures held as at 31 March 2006
John Arthur Cuthbert	8.625% bonds 28/6/06	40,000	40,000
Christopher Michael Green	8.625% bonds 28/6/06	25,000	25,000

The directors who held office as at 31 March 2006 had the following interests in the Ordinary 10p shares of NWG:

Name of Director	Class of Shares	Number of shares held as at 1 April 2005 or subsequent date of appointment	Number of shares held as at 31 March 2006
†Sir A P Brown	Ordinary 10p	43,000	43,000
J A Cuthbert	Ordinary 10p	100,000	100,000
C M Green	Ordinary 10p	65,000	65,000
Sir F G T Holliday	Ordinary 10p	8,700	8,700
A C Jones	Ordinary 10p	4,433	4,433
†M A B Nègre	Ordinary 10p	190,000	190,000
†Sir D Wanless	Ordinary 10p	30,000	30,000
†J M Williams	Ordinary 10p	6,000	6,000

†Appointed on 1 January 2006.

The directors who held office as at 31 March 2006 held the following interests in the Ordinary 10p 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 2005	Number of shares held as at 31 March 2006
J A Cuthbert	Ordinary 10p	1,716	2,780
C M Green	Ordinary 10p	1,716	2,780
A C Jones	Ordinary 10p	1,716	2,780

The directors who held office as at 31 March 2006 held the following conditional interests in Ordinary 10p shares of the Group, awarded in accordance with the terms of its Long Term Incentive Plan:

Name of Director	Award date	Awards held at the start of the year or subsequent date of appointment	Awarded during the year	Awards vested/lapsed during the year	Awards held as at 31 March 2006
J A Cuthbert	27.1.04(1)	85,603	-	-	85,603
	22.12.04(2)	67,001	-	-	67,001
	9.12.05(3)	-	75,903	-	75,903
Totals		152,604	75,903	-	228,507
C M Green	27.1.04(1)	56,618	-	-	56,618
	22.12.04(2)	44,221	-	-	44,221
	9.12.05(3)	-	50,602	-	50,602
Totals		100,839	50,602	-	151,441
A C Jones	27.1.04(1)	22,463	-	-	22,463
	22.12.04(2)	20,100	-	-	30,100
	9.12.05(3)	-	26,506	-	26,506
Totals		42,563	26,506	-	69,069
G Neave	27.1.04(1)	40,000	-	-	40,000
	22.12.04(2)	25,125	-	-	25,125
	9.12.05(3)	-	32,530	-	32,530
Totals		65,125	32,530	-	97,655

5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

(a) Directors' remuneration (continued)

Notes

1) 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) 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) The market value of the shares on the date of the award was 249.16 pence per share. The three year performance period runs from 1 October 2005 to 30 September 2008.

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 the three year period compared with the TSR of a group of other water companies (in respect of 70% of the shares awarded) and, for the awards made in 2004, with the FTSE 250 Total Return Index (in respect of 30% of the shares awarded) and, for the awards made in 2005, with a FTSE 250 comparator group (in respect of 30% of the shares awarded). For further information, please refer to the Directors' Remuneration Report in the NWG accounts and to note 5(c)(iv) below.

As at 31 March 2006, 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 5(a) include the following in respect of the highest paid director:

	2006	2005 restated
	£'000	£'000
Emoluments (including benefits in kind)	278.5	250.8

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 March 2006 was £125,900 (2005: £108,687).

(c) Directors' pay and standards of performance

The following statement on Directos' remuneration is a requirement for the regulatory accounts in accordance with the Water Act 2003. This information is not required for statutory reporting purposes.

(i) Basic Salaries and Benefits

The basic salaries payable to directors of NWL are not directly linked to standards of performance in connection with the carrying out of functions of a "relevant undertaker". However, Executive directors' basic salaries and benefits are reviewed annually by the Company's Remuneration Committee, taking into account the overall performance of the company, advice from New Bridge Street Consultants on market comparators and individual performance. Benefits include membership of a defined benefit pension scheme (see below), car allowance and healthcare.

(ii) Bonus

The bonus arrangements for directors of NWL for 2005/06 were linked to NWL's predicted performance in the Overall Performance Assessment (OPA), as well as the other measures described below. The arrangements were approved for 2005/06 by the Company's Remuneration Committee on 17 July 2005, having taken advice from New Bridge Street Consultants.

The directors were entitled to bonuses of up to 70% of salary, relating to four components, as follows:

- up to 40% related to the profit before tax performance of NWG;
- up to 5% related to NWL's predicted current year performance against industry performance taken from the latest published OPA results. The scale for calculating the 2005/06 bonus was 388-413 points, which was the reported industry performance for 2004/05;
- up to 5% related to time lost through sickness, calculated on a linear scale around the published target for the company of 3%; and
- up to 20% related to personal targets.

5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

(c) Directors' pay and standards of performance (continued)

(ii) Bonus (continued)

The potential 5% bonus in respect of predicted OPA performance is considered to be linked to NWL's performance as a "relevant undertaker". The Remuneration Committee confirmed on 24 May that no bonus would be payable against this measure as the impact of sewer flooding offset improvements in other areas to give a forecast score of 369 against a minimum target of 388 points.

Of the personal targets, only those of Mr Neave and Mr Jones included targets directly linked to NWL's performance as a "relevant undertaker". Mr Neave's targets included three relating to achievement in Ofwat's Levels of Service Measures, the predicted OPA score and reducing customer complaints. Mr Neave had five further targets which related to other aspects of business performance which were assessed by the Remuneration Committee. Of the 20% available in respect of personal targets, Mr Neave was awarded 15%.

Mr Jones' personal targets included three relating to the development of a revised Access Code and Indicative Prices, work with the new Reporter and development of Water Quality Compliance procedures. He had six further personal targets. Taking account of overall performance against his personal targets, the Remuneration committee awarded Mr Jones 17.5% out of the 20% available in respect of personal targets.

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

(iii) Pension

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

(iv) Long Term Incentive Plan (LTIP)

Under the LTIP, executive directors may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in NWG.

A conclusion of the remuneration review that took place during 2005/06 was that the LTIP remained the most appropriate equity incentive plan, particularly in light of NWG's dividend policy. The Committee agreed that total shareholder return (TSR) performance conditions remained the best performance measure to ensure that executives are rewarded fairly for value created for NWG's investors. However, changes were made to the structure of the TSR condition, which are more consistent with best practice.

Summary of LTIP

LTIP awards made 27 January 2004 and 22 December 2004

Maximum award	75% of salary permitted. Actual grants to executive directors were over shares worth 40% of salary.
Performance conditions	Comparison of TSR with two comparator groups over three years: (1) 70% of award depends on NWG's TSR performance against other listed water companies: AWG plc, Bristol Water plc, East Surrey Holdings plc, Kelda Group plc, Pennon Group plc, Severn Trent plc and United Utilities plc; and (2) 30% of award depends on NWG's TSR performance against the FTSE 250 Index, excluding investment trusts.
Vesting schedules	(1) 30% vests at median performance with sliding scale based on ranking to 100% if NWG tops the group. Where NWG's TSR performance is below the median performance of the comparator group, none of that element of the award will vest. (2) 30% vests if NWG's TSR equals the FTSE 250 Index, increasing to 100% if NWG's TSR out-performs the Index by at least 6%. Where NWG's TSR performance is less than that of the Index, none of that element of the award will vest.

5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

(c) Directors' pay and standards of performance (continued)

(iv) Long Term Incentive Plan (LTIP) (continued)
LTIP award made 9 December 2005 and policy for future awards

Maximum award	75% of salary permitted. Actual grants to executive directors were over shares worth 70% of salary.
Performance conditions	As above.
Vesting schedules	(1) As above, but between median and upper quartile, the vesting will be calculated on a straight line basis comparing NWG's TSR to that of the median and upper quartile positions, rather than ranking. (2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where NWG's TSR performance is below the median, none of that element of the award will vest.

In addition, awards will only vest if the Committee is satisfied that NWG's TSR performance is consistent with the underlying business performance of NWG.

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

At its meeting on 24 November 2005, the Remuneration Committee agreed to make conditional awards to Mr Cuthbert and Mr Green with a value equal to 70% of base salaries, and to Mr Neave and Mr Jones with a value equal to 60% of base salaries. The level of the awards was previously agreed in principle by the Committee, following detailed advice from New Bridge Street Consultants. The awards were made on 9 December 2005. The higher level of awards to Mr Cuthbert and Mr Green recognises their additional roles as executive directors of NWG.

(v) Contribution to Remuneration by NWG
NWG contributes 30% of the cost of the basic salaries, benefits, bonus and pension of Mr Cuthbert and Mr Green. NWG also contributes 50% of the cost of basic salary and benefits of the Chairman. All costs of the LTIP and SIP arrangements, for directors and all employees, are borne by NWG.

(vi) Consideration of Ofwat Reports by Remuneration Committee
In assessing overall performance the Remuneration Committee take into account the company's position in the Ofwat reports. The relevant performance data published by Ofwat is also used by Mr Cuthbert to assess Mr Neave's and Mr Jones' performance and this informs the bonus recommendation put to the Committee.

(vii) Future Targets
For 2006/07, the OPA element of bonus continues to apply. Again, Mr Neave and Mr Jones have personal targets which relate to NWL's performance as a "relevant undertaker". In Mr Neave's case this relates to achievement in the OPA. Mr Jones' relevant target relates to the management of changes to the regulatory framework.

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

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

	2006			2005		
	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	49.0	1.3	50.3	45.6	0.9	46.5
Social security costs	4.1	0.1	4.2	4.2	0.1	4.3
Other pension costs	5.7	0.1	5.8	4.2	0.1	4.3
	58.8	1.5	60.3	54.0	1.1	55.1
Costs charged to capital schemes and infrastructure renewals:						
Wages and salaries	18.0	-	18.0	15.6	-	15.6
Social security costs	1.5	-	1.5	1.4	-	1.4
Other pension costs	2.1	-	2.1	1.4	-	1.4
	21.6	-	21.6	18.4	-	18.4
Total employee costs	80.4	1.5	81.9	72.4	1.1	73.5

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

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	No.	No.	No.	No.	No.	No.
Average during the year	2,488	53	2,541	2,427	48	2,475
Total at 31 March	2,497	56	2,553	2,478	51	2,529

8. TAXATION

(a) Analysis of charge in the year:

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
Current tax:				£'m	£'m	£'m
UK corporation tax on profits for the year at 30%	15.6	-	15.6	3.0	-	3.0
Adjustments in respect of prior years	(0.6)	-	(0.6)	3.1	-	3.1
Payable in respect of group relief for the current year at 30%	6.3	4.0	10.3	2.0	5.1	7.1
Adjustments in respect of prior years	1.2	(0.7)	0.5	-	-	-
Total current tax	22.5	3.3	25.8	8.1	5.1	13.2
Deferred tax:						
Origination and reversal of timing differences in the year	16.6	0.5	17.1	25.0	0.6	25.6
Adjustment in respect of prior years	0.7	-	0.7	(4.1)	-	(4.1)
	17.3	0.5	17.8	20.9	0.6	21.5
Increase/(decrease) due to discount	6.3	0.5	6.8	(9.8)	(0.2)	(10.0)
Total deferred tax	23.6	1.0	24.6	11.1	0.4	11.5
Tax on profit on ordinary activities	46.1	4.3	50.4	19.2	5.5	24.7

The appointed business has provisionally claimed tax losses from fellow subsidiaries in the current year of £19.6m (2005: £5.4m) for which payment will be made at the rate of 30%.

The non-appointed business has provisionally claimed tax losses from fellow subsidiaries in the current year of £13.4m (2005: £17.2m) for which payment will be made at the rate of 30%.

Post-tax yields on UK government gilts have fallen during the year such that the total discount on deferred tax has reduced (note 22).

8. TAXATION (continued)

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

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

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Profit on ordinary activities before tax	125.1	21.9	147.0	97.2	25.2	122.4
Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%)	37.5	6.6	44.1	29.2	7.5	36.7
Effects of:						
Expenses not deductible for tax purposes	0.4	-	0.4	0.3	-	0.3
Non-taxable income	(0.4)	(2.1)	(2.5)	(0.5)	(1.9)	(2.4)
Depreciation in respect of non-qualifying items	1.0	-	1.0	1.0	0.1	1.1
Capital allowances in excess of depreciation	(14.8)	(0.5)	(15.3)	(18.9)	(0.6)	(19.5)
Other timing differences	(1.8)	-	(1.8)	(6.1)	-	(6.1)
Adjustments in respect of prior years	0.6	(0.7)	(0.1)	3.1	-	3.1
Transfer pricing adjustments	(0.4)	-	(0.4)	(0.4)	-	(0.4)
Balancing payment payable	0.4	-	0.4	0.4	-	0.4
Current tax charge	22.5	3.3	25.8	8.1	5.1	13.2

(c) Factors that may affect future tax charges:

The company expects to continue to incur high levels of capital expenditure and to be able to claim capital allowances in excess of depreciation for the remainder of the current regulatory period. The annual excess is expected to reduce, resulting in increased current tax charges, as tax deductions for deferred revenue expenditure move to a depreciation basis (as set out in HM Revenue and Customs' Tax Bulletin 53).

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

	2006			2005 (restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Equity:						
Dividends paid:						
Final paid for the year ended 31 March 2005 of 20.95p (12 months to 31 December 2003: 34.41p) per share on an aggregated basis	23.0	2.7	25.7	39.1	3.1	42.2
Final paid for 3 months ended 31 March 2004 of 17.21p per share on an aggregated basis	-	-	-	19.6	1.5	21.1
Interim paid of 30.07p (2005: 34.16p) per share on an aggregated basis	33.4	3.5	36.9	41.0	0.9	41.9
Total dividends paid in the year	56.4	6.2	62.6	99.7	5.5	105.2
Dividends proposed:						
Final for year ended 31 March 2006 of 30.07p (year ended 31 March 2005: 20.95p) per share on an aggregated basis	33.4	3.5	36.9	23.0	2.7	25.7

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.

10. TANGIBLE FIXED ASSETS

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 £126.7m (2005: £123.8m) in order to give a true and fair view (note 1(f)).

	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 2005	86.4	1,171.2	1,651.6	134.2	61.8	3,105.2
Additions	-	-	-	-	183.5	183.5
Schemes commissioned	0.7	57.2	103.0	11.5	(172.4)	-
Reclassifications	(1.2)	8.0	16.0	(23.0)	-	(0.2)
Disposals	(0.2)	-	(0.5)	0.1	-	(0.6)
Grants and contributions	-	(15.2)	-	-	12.3	(2.9)
At 31 March 2006	85.7	1,221.2	1,770.1	122.8	85.2	3,285.0
Depreciation:						
At 1 April 2005	27.0	-	397.5	84.2	-	508.7
Provision for year	1.4	-	58.8	5.2	-	65.4
Disposals	(0.6)	-	0.3	(0.1)	-	(0.4)
At 31 March 2006	27.8	-	456.6	89.3	-	573.7
Net book value:						
At 31 March 2006	57.9	1,221.2	1,313.5	33.5	85.2	2,711.3
At 31 March 2005	59.4	1,171.2	1,254.1	50.0	61.8	2,596.5
Leased assets included above:						
Net book value						
At 31 March 2006	-	2.2	24.0	-	-	26.2
At 31 March 2005	-	2.2	25.9	0.3	-	28.4

11. FIXED ASSET INVESTMENTS

	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Loans to group companies:			
At 1 April 2005 and 31 March 2006	-	160.6	160.6

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

12. STOCKS

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Raw materials and consumables	2.6	0.2	2.8	2.9	0.1	3.0

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

13. DEBTORS DUE IN LESS THAN ONE YEAR

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Trade debtors	47.5	0.9	48.4	51.6	0.5	52.1
Amounts owed by other group companies	2.2	2.0	4.2	2.6	2.1	4.7
Other debtors	6.5	0.1	6.6	6.3	0.2	6.5
Prepayments and accrued income	42.7	0.9	43.6	35.0	0.4	35.4
	98.9	3.9	102.8	95.5	3.2	98.7

Trade debtors are shown net of bills raised in advance.

14. DEBTORS DUE MORE THAN ONE YEAR

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Interest rate hedge	3.6	-	3.6	-	-	-

15. INVESTMENTS

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Treasury deposits with group company	57.7	-	57.7	-	-	-

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2006			2005 (restated)		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	4.5	-	4.5	4.5	-	4.5
Bank overdraft	5.2	-	5.2	2.1	-	2.1
Loans (note 18)	29.2	-	29.2	18.9	-	18.9
Debenture stock (note 19)	-	-	-	5.7	-	5.7
Trade creditors	7.4	0.3	7.7	9.8	0.4	10.2
Amounts owed to other group companies	13.1	2.0	15.1	108.4	2.6	111.0
Taxation and social security	1.7	-	1.7	1.1	-	1.1
Corporation tax	9.7	-	9.7	1.1	-	1.1
Receipts in advance	18.7	-	18.7	17.6	-	17.6
Other creditors	11.1	0.1	11.2	12.1	0.1	12.2
Accruals and deferred income	82.7	1.3	84.0	57.1	0.4	57.5
Inter business balance	(2.2)	2.2	-	(4.0)	4.0	-
	181.1	5.9	187.0	234.4	7.5	241.9

Accruals and deferred income includes accruals related to capital projects of £33.2m (2005: £27.5m). Amounts owed to other group companies includes amounts related to capital projects of £nil (2005: £3.9m).

Included in amounts owed to other group companies is £10.1m (appointed business £8.1m (2005: £4.5m), non-appointed business £2.0m (2005: £2.6m)) payable in respect of tax losses surrendered by fellow subsidiaries. Also included in amounts owed to other group companies is £nil (2005: £71.5m) relating to loans repayable within one year (note 21).

The restatement of the prior year relates to the adjustment under FRS 21 of £25.7m in respect of dividends payable.

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

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	56.7	-	56.7	57.3	-	57.3
Loans (note 18)	276.0	-	276.0	305.2	-	305.2
Debenture stock (note 19)	-	-	-	3.5	-	3.5
Amounts owed to other group companies (note 21)	1,207.3	-	1,207.3	996.2	-	996.2
Other creditors	0.3	-	0.3	0.7	-	0.7
	1,540.3	-	1,540.3	1,362.9	-	1,362.9

18. LOANS

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
External loans are repayable as follows:						
Within one year (note 16)	29.2	-	29.2	18.9	-	18.9
Between one and two years	20.0	-	20.0	29.2	-	29.2
Between two and five years	131.2	-	131.2	133.6	-	133.6
After five years	124.8	-	124.8	142.4	-	142.4
	305.2	-	305.2	324.1	-	324.1

Loans wholly repayable by instalments repayable within 5 years amount to £6.3m (2005: £14.9m). Loans repayable by instalments not wholly repayable within 5 years amount to £208.9m (2005: £219.2m) and bear interest rates in the range of 4.74% to 8.55% of which £84.2m (2005: £76.8m) falls due in less than 5 years and £124.7m (2005: £142.4m) 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 (2005: £90.0m) and bear interest at rates in the range of 4.70 and 4.77%.

19. DEBENTURE STOCKS

	2006	2005
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Debenture stocks are repayable as follows:		
In less than one year:	-	5.7
Between one and two years	-	3.5
At 31 March	-	9.2

Apart from £9,672 of irredeemable debentures, all other debentures were repaid during the year.

20. OBLIGATIONS UNDER FINANCE LEASES

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

	2006	2005
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Amounts due:		
Within one year	4.5	4.5
Between one and two years	4.3	4.0
Between two and five years	13.3	12.1
After five years	58.0	62.3
	80.1	82.9
Less:		
Finance charge allocated to future periods	(18.9)	(21.1)
	61.2	61.8
Disclosed as due:		
Within one year (note 16)	4.5	4.5
After more than one year (note 17)	56.7	57.3
	61.2	61.8

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 £80.1m (2005: £82.5m).

21. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	2006	2005
	Appointed and aggregated basis	Appointed and aggregated basis
	£'m	£'m
Within one year	-	71.5
After five years	1,207.3	996.2
	1,207.3	1,067.7

On 31 March 2006, NWF was substituted as issuer for NSL in relation to £350.0m guaranteed Eurobonds maturing in February 2023 with an annual coupon of 6.875%. This substitution took effect following agreement reached at a bondholders meeting held on 31 March 2006. £200.0m Guaranteed Eurobonds were issued in February 1998 and a further £150.0m Guaranteed Eurobonds were issued in September 2001, maturing 6 February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the company who received the issue proceeds by way of inter-company loans of £194.2m and £156.2m respectively. Finance costs allocated during the year amounted to £0.2m (2005: £0.3m). Amortisation of loan issue receipts during the year amounted to £0.3m (2005: £0.2m). Finance costs incurred for the substitution of NWF as issuer amounted to £0.3m.

NWF issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by the company who received the issue proceeds by way of an inter-company loan. Amortisation of loan receipts during the year amounted to £0.1m (2005: £0.1m).

NWF issued £250.0m Guaranteed Eurobonds during December 2002, maturing April 2033, with an annual coupon of 5.625%. NWF 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 the company who received the issue proceeds by way of an inter-company loan. Finance costs allocated during the year amounted to £0.2m (2005: £0.1m).

21. AMOUNTS DUE TO OTHER GROUP COMPANIES (continued)

NWF issued £150.0m Guaranteed Index Linked Eurobonds in September 2005, maturing July 2036, with a real coupon of 2.033%. The issue was guaranteed by the company who received the issue proceeds by way of an inter-company loan. Indexation accretion during the year amounted to £2.6m.

NWF issued £60.0m Guaranteed Index Linked Eurobonds in January 2006, maturing January 2041, with a real coupon of 1.6274%. The issue was guaranteed by the company who received the issue proceeds by way of an inter-company loan. Indexation accretion during the year amounted to £0.1m.

22. PROVISIONS FOR LIABILITIES AND CHARGES

	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Infrastructure renewals:			
At 1 April 2005	3.9	1.5	5.4
Transferred from profit and loss account	35.9	0.1	36.0
Utilised during the year (note 3(b))	(35.6)	-	(35.6)
At 31 March 2006	4.2	1.6	5.8
Deferred tax :			
As at 1 April 2005	159.5	6.7	166.2
Movement in the year (note 8(a))	23.6	1.0	24.6
At 31 March 2006 (see below)	183.1	7.7	190.8
Severance provision:			
As at 1 April 2005	0.4	-	0.4
Released unused to profit and loss account	(0.4)	-	(0.4)
At 31 March 2006	-	-	-
Pension provision for former directors:			
As at 1 April 2005	3.0	-	3.0
Transferred from profit and loss account	0.7	-	0.7
Utilised during the year	(0.3)	-	(0.3)
At 31 March 2006	3.4	-	3.4
Provisions for liabilities and charges	190.7	9.3	200.0

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 £3.4m represents the full future amounts payable, based on an actuarial assessment, for which the company is directly liable.

22. PROVISIONS FOR LIABILITIES AND CHARGES (continued)

The provision for deferred tax as at 31 March 2006 comprises:

	2006		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Accelerated capital allowances	458.9	18.6	477.5
Other timing differences	(19.2)	(0.6)	(19.8)
Undiscounted provision for deferred tax	439.7	18.0	457.7
Discount	(256.6)	(10.3)	(266.9)
Discounted provision for deferred tax	183.1	7.7	190.8

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

	2005		
	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Accelerated capital allowances	443.4	18.1	461.5
Other timing differences	(21.0)	(0.6)	(21.6)
Undiscounted provision for deferred tax	422.4	17.5	439.9
Discount	(262.9)	(10.8)	(273.7)
Discounted provision for deferred tax	159.5	6.7	166.2

23. ACCRUALS AND DEFERRED INCOME

	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m
Non infrastructure capital grants and contributions:			
At 1 April 2005	46.4	0.5	46.9
Additions	11.1	-	11.1
Amortised during the year	(2.6)	-	(2.6)
At 31 March 2006	54.9	0.5	55.4
Sale proceeds – Kielder securitisation:			
At 1 April 2005	-	205.6	205.6
Amortised during the year	-	(7.1)	(7.1)
At 31 March 2006	-	198.5	198.5
Accruals and deferred income	54.9	199.0	253.9

24. CALLED UP SHARE CAPITAL

	2006			2005		
	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 (2005: 122,650,000)	92.1	30.6	122.7	92.1	30.6	122.7

	2006			2005		
	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 (2005: 122,650,000)	92.1	30.6	122.7	92.1	30.6	122.7

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

	Profit and loss account			Total shareholders' funds		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
At 31 March 2004 as previously stated	656.3	(4.1)	652.2	748.4	26.5	774.9
Prior year adjustment	58.8	4.5	63.3	58.8	4.5	63.3
At 31 March 2004 restated	715.1	0.4	715.5	807.2	31.0	838.2
Profit for the year	78.0	19.7	97.7	78.0	19.7	97.7
Dividends as restated (note 9)	(99.7)	(5.5)	(105.2)	(99.7)	(5.5)	(105.2)
At 31 March 2005 restated	693.4	14.6	708.0	785.5	45.2	830.7
Profit for the year	79.0	17.6	96.6	79.0	17.6	96.6
Dividends paid (note 9)	(56.4)	(6.2)	(62.6)	(56.4)	(6.2)	(62.6)
As at 31 March 2006	716.0	26.0	742.0	808.1	56.6	864.7

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(e) and 1(f). If the statutory accounting treatment had been applied to the regulatory financial statements, the retained profits would have been increased.

As stated in note 1b, reserves have been restated in respect of FRS 21 to remove dividends declared but not paid in the year.

26. COMMITMENTS

(a) Capital expenditure:

	2006			2005		
	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Expenditure contracted for	96.8	-	96.8	82.4	-	82.4

(b) Lease commitments:

The company 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:-

	2006			2005		
	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	0.5	-	0.5
	0.6	-	0.6	0.6	-	0.6

	2006			2005		
	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	-	-	-	0.1	-	0.1
	-	-	-	0.2	-	0.2

27. PENSIONS

The Group operates a defined benefit pension scheme providing benefits based on final pensionable remuneration to 2,351 active members at 31 March 2006. The Scheme, the Northumbrian Water Pension Scheme (NWPS), comprises four unitised sub-funds - WPS, Northumbrian Water (North), Northumbrian Water (South) and MIS.

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

The most recent actuarial valuation of the NWPS was at 31 December 2004. At that date the market value of assets amounted to £520m. The valuation also took account of debt on the employer payments in respect of the withdrawal of two participating employers and added £10m to the asset value. The 2004 valuation disclosed that the combined value of the assets represented 97.6% of the value of the accrued liabilities.

27. PENSIONS (continued)

The following table sets out the contribution rates recommended in the NWPS actuary's draft valuation summary:

Section	WPS	North	South	MIS
Members' contributions	6%	5%	5%	5%/6%
Employer's contributions	29.1%	23.1%	2.6%	73%

The recommended employer contribution rate was assessed using the Projected Unit Method and the following actuarial assumptions:

Investment Return	
-Pre Retirement	6.2%
-Post Retirement	5.3%
Pay Increases	3.75%
Pension Increases	3.0%
Price Inflation	3.0%

The Group responded to the recommendations with an alternative proposal to make capital injections of £36.1m by April 2006 and £23.3m by April 2007. The capital injections would cover:

- employers contributions, and the strain on the fund arising from ill-heath retirements, for the 5 years commencing 1 January 2006 and
- employee contributions for members electing to participate in a salary sacrifice arrangement effective for the period from 1 April 2006 to 31 December 2010.

For the period 1 January 2006 to 31 March 2006, all members continued to pay contributions to the NWPS. Members electing not to join the salary sacrifice arrangement continue to pay contributions to the NWPS from 1 April 2006. In addition, the employers have agreed to pay any savings in employer national insurance contributions arising from this arrangement into the NWPS and this amounts to £0.3m p.a.

The employers' proposals were accepted by the NWPS Trustee.

The contributions paid to the NWPS in the year by the company totalled £14.8m, which includes £7.0m made as an advance payment.

The Group also contributes to a defined contribution scheme, the Northumbrian Water Group Personal Pension Plan (NWGPPP). Members and employers contribute 3% and 6% of salary respectively. The NWGPPP is provided by an insurance company and members have their own individual policy. There were 258 contributing members throughout the Group at 31 March 2006. The contributions paid to the NWGPPP in the year by the company totalled £0.1m. The outstanding company contributions to be paid over to the NWGPPP at 31 March 2006 totalled £nil (2005: £nil).

In accordance with FRS 17, the company accounts for its contributions to the relevant sub-funds of the NWPS 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 NWPS on a consistent and reasonable basis.

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

A qualified actuary, using revised assumptions consistent with the requirements of FRS 17, has updated the actuarial valuation described above at 31 December 2004. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions at 31 March:

	Group		
	2006 %	2005 %	2004 %
Pay increases	3.6	3.9	4.0
Pension increases	2.9	2.9	3.0
Price inflation	2.9	2.9	3.0
Discount rate	4.9	5.4	5.5

27. PENSIONS (continued)

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

	Long term expected rate of return 2006	2006	Long term expected rate of return 2005	2005	Long term expected rate of return 2004	2004
	%	£'m	%	£'m	%	£'m
Equities	7.2	452.5	7.7	373.9	6.8	335.4
Corporate bonds	4.9	48.4	5.4	39.7	5.5	37.7
Government bonds	4.2	60.5	4.7	45.2	4.8	41.8
Property	5.7	67.3	6.2	55.5	5.8	47.5
Cash	4.5	34.4	4.7	12.3	4.0	12.7
Total fair value of assets		663.1		526.6		475.1
Present value of liabilities		(663.5)		(600.2)		(565.7)
Deficit		(0.4)		(73.6)		(90.6)
Related deferred tax asset		0.1		22.1		27.2
Net pension liability		(0.3)		(51.5)		(63.4)

Analysis of the amount that would have been charged to operating profit under FRS 17:

	2006	2005
	£'m	£'m
Current service cost	12.0	11.8
Curtailments and settlements	0.3	1.2
Total operating charge	12.3	13.0

Analysis of the amount that would have been credited to net finance income under FRS 17:

	2006	2005
	£'m	£'m
Expected return on assets	36.7	29.9
Interest on liabilities	(32.3)	(31.1)
Net credit / (charge)	4.4	(1.2)

Analysis of the actuarial gain that would have been recognised in the statement of total recognised gains and losses:

	2006	2005
	£'m	£'m
Experience gains and losses arising on the liabilities	34.0	(4.4)
Changes in assumptions underlying the present value of the liabilities	(68.3)	-
Total experience gains and losses arising on liabilities	(34.3)	(4.4)
Actual return less expected return on assets	86.8	28.5
	52.5	24.1

Analysis of movement in deficit during the year:

	2006	2005
	£'m	£'m
Deficit at 1 April	(73.6)	(90.6)
Current service cost	(12.0)	(11.8)
Total other finance income	-	0.5
Actuarial gain	52.5	24.1
Impact of curtailments and settlements	(0.3)	(1.2)
Other	-	(0.9)
Net return	4.4	(1.2)
Contributions	28.6	7.5
Deficit at 31 March	(0.4)	(73.6)

27. PENSIONS (continued)

History of experience gains and losses:

	Year to 31.3.2006	Year to 31.3.2005	15 months to 31.3.2004	Year to 31.12.2002
Difference between the expected and actual return on assets:				
Amount (£m)	86.8	28.5	30.4	67.1
Percentage of assets	13.1%	5.4%	6.4%	17.3%
Total experience gains and losses on liabilities:				
Amount (£m)	(34.3)	(4.4)	8.0	(52.1)
Percentage of the present value of liabilities	(5.1%)	(0.7%)	1.4%	(1.2%)
Total actuarial gain recognised in the statement of total recognised gains and losses:	52.5	24.1	37.6	(141.8)
Amount (£m)	7.9%	4.0%	6.7%	(30.5%)
Percentage of the present value of liabilities				

28. 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.

29. 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.

30. 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 only 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.

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

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

	March 2006 Infrastructure Assets
	£'m
Cost	
At 31 March 2006 per Regulatory Financial Statements	1,221.2
Adjustments to opening balance	307.4
Infrastructure renewals expenditure capitalised in the year	43.6
Infrastructure grants and contributions netted off in the year	15.2
Infrastructure disposals in the year	(12.1)
Cost at 31 March 2006 per Statutory Financial Statements	1,573.3
Depreciation	
At 31 March 2006 per Regulatory Financial Statements	-
Adjustment to opening balance	177.9
Depreciation charge for infrastructure renewals expenditure	32.9
Infrastructure provision adjustment	0.9
Infrastructure disposals in the year	(12.1)
At 31 March 2006 per Statutory Financial Statements	199.6
Net book Value	
At 31 March 2006 per Regulatory Financial Statements	1,221.2
Adjustment relating to infrastructure grants and contributions	125.6
Adjustment for reclassifications	7.1
Adjustment for infrastructure renewals accounting	(5.8)
Adjustment in respect of Section 19 "overlap" – note 1(e)((i))	27.6
At 31 March 2006 per Statutory Financial Statements	1,375.7
Provisions and Liabilities – infrastructure renewals	
At 31 March 2006 per Regulatory Financial Statements	5.8
Less infrastructure renewals accrual	(5.8)
At 31 March 2006 per Statutory Financial Statements	-
Deferred tax	
At 31 March 2006 per Regulatory Financial Statements	190.8
Adjustment relating to infrastructure grants and contributions	3.6
Adjustment relating to Section 19 "overlap"	6.9
At 31 March 2006 per Statutory Financial Statements	201.3
Accruals and deferred income	
At 31 March 2006 per Regulatory Financial Statements	55.4
Adjustment relating to infrastructure grants and contributions	128.2
Adjustment relating amortisation of infrastructure income	(8.8)
At 31 March 2006 per Statutory Financial Statements	174.8
Profit and loss for the year	
Year ended 31 March 2006 per Regulatory Financial Statements	96.6
Adjustment relating to Section 19 "overlap" – note 1(e)((i))	3.0
Adjustment relating to amortisation of infrastructure income	1.1
Difference in deferred tax charge	(4.2)
Year ended 31 March 2006 per Statutory Financial Statements	96.5

CURRENT COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2006

	Note	2006 £'m	2005 £'m
Turnover	2	532.0	487.7
Current cost operating costs	3	(222.4)	(212.1)
Capital maintenance costs	3	(141.4)	(136.4)
Profit on sale of fixed assets	2	1.6	-
CURRENT COST OPERATING PROFIT		169.8	139.2
Working capital adjustment	2	1.7	2.3
CURRENT COST OPERATING PROFIT		171.5	141.5
Net interest payable		(87.8)	(82.2)
Financing adjustment		37.6	47.3
CURRENT COST PROFIT BEFORE TAXATION		121.3	106.6
Taxation:			
Current tax		(22.5)	(8.1)
Deferred tax		(23.6)	(11.1)
CURRENT COST PROFIT ATTRIBUTABLE TO SHAREHOLDERS		75.2	87.4

All note references to the summary current cost financial statements on pages 38 to 40 refer to the notes to the current cost accounts.

CURRENT COST BALANCE SHEET
At 31 March 2006

	Note	2006	2005 restated
		£'m	£'m
FIXED ASSETS			
Tangible fixed assets	4	12,075.6	11,818.7
Third party contributions since 1989/90		(86.9)	(76.6)
		11,988.7	11,742.1
Working capital	5	(14.2)	(73.8)
NET OPERATING ASSETS		11,974.5	11,668.3
Non trade debtors		12.3	8.9
Non trade creditors due within one year		(20.6)	(78.5)
Creditors due after more than one year		(1,540.3)	(1,359.4)
Provisions for liabilities and charges – deferred tax		(183.1)	(159.5)
Provisions for liabilities and charges – other		(3.4)	(3.4)
NET ASSETS EMPLOYED		10,239.4	10,076.4
CAPITAL AND RESERVES			
Called up share capital		92.1	92.1
Profit and loss account	6	432.7	413.9
Current cost reserve	7	9,714.6	9,570.4
TOTAL CAPITAL AND RESERVES		10,239.4	10,076.4

CURRENT COST CASH FLOW STATEMENT
For the year ended 31 March 2006

	Note	2006 Appointed business	2006 Non-appointed business	2006 Aggregated basis	2005 Appointed business	2005 Non-appointed business	2005 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
NET CASH INFLOW/(OUTFLOW) FROM CONTINUING OPERATING ACTIVITIES	8	299.4	3.5	302.9	265.8	(0.2)	265.6
Returns on investments and servicing of finance							
Interest received		1.6	10.1	11.7	3.0	16.0	19.0
Interest paid		(85.6)	-	(85.6)	(80.9)	(0.5)	(81.4)
Interest element of finance lease rentals		(2.3)	-	(2.3)	(0.6)	-	(0.6)
Net cash (outflow) / inflow from returns on investments and servicing of finance		(86.3)	10.1	(76.2)	(78.5)	15.5	(63.0)
Taxation							
United Kingdom corporation tax (paid) / received		(10.4)	(3.9)	(14.3)	0.5	(4.0)	(3.5)
Net cash (outflow) / inflow from taxation		(10.4)	(3.9)	(14.3)	0.5	(4.0)	(3.5)
Capital expenditure and financial investment							
Purchase of tangible fixed assets		(187.2)	(0.6)	(187.8)	(157.2)	(2.5)	(159.7)
Infrastructure renewals expenditure		(35.6)	-	(35.6)	(38.1)	-	(38.1)
Sale of tangible fixed assets		2.0	-	2.0	1.6	-	1.6
Sale of income rights		-	-	-	-	212.1	212.1
Loan to immediate parent company		-	-	-	-	(160.6)	(160.6)
Grants, contributions and connection charges		21.6	-	21.6	21.2	-	21.2
Net cash (outflow) / inflow from capital expenditure and financial investment		(199.2)	(0.6)	(199.8)	(172.5)	49.0	(123.5)
Equity dividend paid		(56.4)	(6.2)	(62.6)	(99.7)	(5.5)	(105.2)
CASH (OUTFLOW) / INFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(52.9)	2.9	(50.0)	(84.4)	54.8	(29.6)
Management of liquid resources							
Purchase of short term deposits		(1,054.4)	-	(1,054.4)	(21.4)	-	(21.4)
Sale of short term deposits		996.7	-	996.7	21.4	-	21.4
Net cash outflow from management of liquid resources	9	(57.7)	-	(57.7)	-	-	-
Financing							
New loans		210.0	-	210.0	171.5	-	171.5
Debenture repayments		(9.2)	-	(9.2)	(5.0)	-	(5.0)
Loan repayments		(90.4)	-	(90.4)	(85.1)	(46.0)	(131.1)
Capital element of finance lease rental payments		(2.9)	-	(2.9)	(4.0)	-	(4.0)
Net cash inflow / (outflow) from financing		107.5	-	107.5	77.4	(46.0)	31.4
(DECREASE)/INCREASE IN CASH IN THE YEAR	9	(3.1)	2.9	(0.2)	(7.0)	8.8	1.8

NOTES TO THE CURRENT COST FINANCIAL INFORMATION
For the year ended 31 March 2006

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 Licence.

(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.

(f) Dividends

The company has adopted FRS 21 “Events after the Balance Sheet Date”. Consequently dividends are only accrued where an obligation exists at the balance sheet date. Dividends approved after the balance sheet date are no longer accrued. The prior year comparative figures have been restated to reflect the dividends paid in that year along with restatement of the five year rolling summaries (note 12).

2. TURNOVER

	2006			2005		
	Water services	Sewerage services	Appointed business	Water services	Sewerage services	Appointed business
	£'m	£'m	£'m	£'m	£'m	£'m
Measured	85.2	60.7	145.9	80.0	51.8	131.8
Unmeasured	175.3	143.4	318.7	162.5	134.9	297.4
Trade effluent	-	2.4	2.4	-	3.0	3.0
Large user revenues	35.4	10.9	46.3	20.4	7.4	27.8
Other sources	0.9	1.0	1.9	1.6	1.2	2.8
Third party services	2.9	13.9	16.8	11.4	13.5	24.9
Total turnover	299.7	232.3	532.0	275.9	211.8	487.7
Operating income:						
Current cost profit / (loss) on disposal of fixed assets	1.4	0.2	1.6	0.6	(0.6)	-
Working capital adjustment	1.0	0.7	1.7	1.3	1.0	2.3

3. OPERATING COSTS

2006

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	8.1	8.0	**16.1**	3.6	3.3	3.6	6.9	**10.5**			
Power	3.9	6.8	**10.7**	2.2	5.5	3.6	9.1	**11.3**			
Hired & contracted services	1.6	5.2	**6.8**	1.8	1.0	7.7	8.7	**10.5**			
Associated companies	-	0.2	**0.2**	-	-	0.2	0.2	**0.2**			
Materials and consumables	6.5	1.0	**7.5**	0.1	0.7	1.8	2.5	**2.6**			
Service charges (EA)	18.0	-	**18.0**	1.4	1.3	-	1.3	**2.7**			
Bulk supply imports	1.0	-	**1.0**	-	-	-	-	**-**			
Other direct costs	0.3	3.2	**3.5**	1.1	0.2	0.1	0.3	**1.4**			
Total direct costs	39.4	24.4	**63.8**	10.2	12.0	17.0	29.0	**39.2**	13.7	8.9	1.6
General and support expenditure	10.9	12.7	**23.6**	3.9	6.4	4.3	10.7	**14.6**	5.8	0.8	0.1
Functional expenditure	50.3	37.1	**87.4**	14.1	18.4	21.3	39.7	**53.8**	**19.5**	**9.7**	**1.7**
Business analysis			**20.8**					**10.1**			
Total business activities c/fwd			**108.2**					**63.9**			

3. OPERATING COSTS (continued)

2006

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			**108.2**					**63.9**
Rates			**15.4**					**5.2**
Doubtful debts			**6.2**					**6.2**
Total opex less third party services			**129.8**					**75.3**
Third party services – opex			**10.7**					**6.6**
Total operating expenditure			**140.5**					**81.9**
Capital costs								
Infrastructure renewal expenditure	1.2	23.4	**24.6**	7.4	-	-	-	**7.4**
Movement in infrastructure renewals accrual/prepayment	-	0.5	**0.5**	3.4	-	-	-	**3.4**
Current cost depreciation (allocated)	27.5	13.8	**41.3**	5.8	32.7	13.0	45.7	**51.5**
Amortisation of deferred credits			**(1.6)**					**(0.8)**
Business activities current cost depreciation (non allocated)			**9.9**					**5.2**
Total capital maintenance			**74.7**					**66.7**
Total operating costs			**215.2**					**148.6**
CCA (MEA) values								
Service activities			**5,912.1**					**6,093.3**
Business activities			**53.4**					**16.8**
Service totals			**5,965.5**					**6,110.1**

3. OPERATING COSTS (continued)

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**
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**

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 2005	1,493.7	44.3	5,034.3	128.4	6,700.7
AMP adjustment	(106.7)	4.2	-	(3.9)	(106.4)
RPI Adjustment	34.3	1.1	119.6	1.7	156.7
Disposals	(0.6)	-	-	-	(0.6)
Additions	44.7	2.4	35.9	8.4	91.4
At 31 March 2006	1,465.4	52.0	5,189.8	134.6	6,841.8
Depreciation:					
At 1 April 2005	721.2	21.7	-	71.9	814.8
AMP adjustment	(5.7)	(0.4)	-	(2.3)	(8.4)
RPI Adjustment	17.6	0.5	-	1.0	19.1
Disposals	(0.4)	-	-	-	(0.4)
Charge for year	39.0	1.6	-	10.6	51.2
At 31 March 2006	771.7	23.4	-	81.2	876.3
Net Book Value at 31 March 2006	693.7	28.6	5,189.8	53.4	5,965.5
Net Book Value at 31 March 2005	772.5	22.6	5,034.3	56.5	5,885.9

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 2005	1,649.8	28.6	4,882.2	45.7	6,606.3
AMP adjustment	0.2	2.5	-	(4.2)	(1.5)
RPI Adjustment	38.7	0.7	116.2	0.9	156.5
Disposals	-	-	-	-	-
Additions	49.8	0.9	33.3	4.3	88.3
At 31 March 2006	1,738.5	32.7	5,031.7	46.7	6,849.6
Depreciation:					
At 1 April 2005	634.0	14.1	-	25.4	673.5
AMP adjustment	(4.7)	(0.2)	-	(1.5)	(6.4)
RPI Adjustment	14.8	0.3	-	0.6	15.7
Disposals	-	-	-	-	-
Charge for year	50.3	1.0	-	5.4	56.7
At 31 March 2006	694.4	15.2	-	29.9	739.5
Net Book Value at 31 March 2006	1,044.1	17.5	5,031.7	16.8	6,110.1
Net Book Value at 31 March 2005	1,015.8	14.5	4,882.2	20.3	5,932.8

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 2005	3,143.5	72.9	9,916.5	174.1	13,307.0
AMP adjustment	(106.5)	6.7	-	(8.1)	(107.9)
RPI Adjustment	73.0	1.8	235.8	2.6	313.2
Disposals	(0.6)	-	-	-	(0.6)
Additions	94.5	3.3	69.2	12.7	179.7
At 31 March 2006	3,203.9	84.7	10,221.5	181.3	13,691.4
Depreciation:					
At 1 April 2005	1,355.2	35.8	-	97.3	1,488.3
AMP adjustment	(10.4)	(0.6)	-	(3.8)	(14.8)
RPI Adjustment	32.4	0.8	-	1.6	34.8
Disposals	(0.4)	-	-	-	(0.4)
Charge for year	89.3	2.6	-	16.0	107.9
At 31 March 2006	1,466.1	38.6	-	111.1	1,615.8
Net Book Value at 31 March 2006	1,737.8	46.1	10,221.5	70.2	12,075.6
Net Book Value at 31 March 2005	1,788.3	37.1	9,916.5	76.8	11,818.7

The opening cost balances in the statements above are based on the indexed MEA valuation, which was undertaken for the company's final business plan submission to Ofwat in April 2004, plus additions in the fixed asset register since March 2003. The AMP adjustment of £107.9m removes some duplication of assets appearing in both the MEAV and the subsequent fixed asset additions.

The accumulated depreciation has been adjusted by £14.8m through the AMP adjustment line to reflect revisions to the depreciation charge arising as a result of re-analysis of assets commissioned over the past five years to a more detailed level.

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

5. WORKING CAPITAL

	2006	2005
	£'m	£'m
Stocks	2.6	2.9
Trade debtors	47.5	51.6
Working cash balances	52.5	(2.1)
Trade creditors	(7.4)	(9.8)
Short term capital creditors	(33.1)	(31.4)
Infrastructure renewals (accruals)	(4.2)	(3.9)
Other trade accruals	(49.6)	(52.7)
Trade payments in advance	42.7	35.0
Payroll related taxes and DSS contributions	(1.7)	(1.1)
Other creditors due in less than one year	(63.5)	(62.3)
At 31 March	(14.2)	(73.8)

6. PROFIT AND LOSS ACCOUNT

	£'m
At 31 March 2004 as previously stated	367.4
Prior year adjustment in respect of dividends	58.8
At 31 March 2004 as restated	426.2
Profit for the year	87.4
Dividends paid as restated	(99.7)
At 31 March 2005 restated	413.9
Profit for the year	75.2
Dividends paid	(56.4)
At 31 March 2006	432.7

7. MOVEMENT ON CURRENT COST RESERVE

	2006	2005
	£'m	£'m
At 1 April	9,570.4	9,136.2
AMP adjustment	(93.1)	120.4
RPI Adjustments:		
Fixed assets	278.4	365.6
Working capital	(1.7)	(2.3)
Financing	(37.6)	(47.3)
Grants and third party contributions	(1.8)	(2.2)
At 31 March	9,714.6	9,570.4

8. RECONCILIATION OF CURRENT COST OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES FOR THE APPOINTED BUSINESS

	2006	2005
	£'m	£'m
Current cost operating profit	171.5	141.5
Working capital adjustment	(1.7)	(2.3)
Change in stocks	0.3	0.1
Current cost depreciation	107.9	101.2
Current cost profit on sale of assets	(1.6)	-
Increase in debtors and prepaid expenses	(6.8)	(6.7)
Increase in creditors and accrued expenses	(3.5)	(0.2)
Infrastructure renewals expenditure	35.6	38.1
Movement in provisions	0.3	(3.8)
Effect of other deferrals and accruals on operating activity cash flow	(2.6)	(2.1)
Net cash flow from operating activities	299.4	265.8

9. ANALYSIS OF NET DEBT

	At 1 April 2005	Cash flow	Other non cash changes	At 31 March 2006
	£'m	£'m	£'m	£'m
Cash in hand and at bank	(2.1)	(3.1)	-	(5.2)
Loans due after one year	(1,304.9)	(205.1)	26.7	(1,483.3)
Loans due within one year	(96.1)	96.1	(29.1)	(29.1)
Finance leases	(61.8)	2.9	(2.3)	(61.2)
Current asset investment	-	57.7	-	57.7
Total	(1,464.9)	(51.5)	(4.7)	(1,521.1)

SECTION C – CURRENT COST FINANCIAL INFORMATION FOR THE APPOINTED BUSINESS ONLY

10. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

Associate	Service	December 2005 or March 2006 Turnover	Terms of Supply	2005/06 Value
		£'m		£'m
Analytical & Environmental Services Limited	Rental of laboratories and service charges	13.5	Negotiated	0.6
Vehicle Lease and Service Limited	Rental of garage and service charges	11.9	Negotiated	0.1

Services supplied to the appointee by associated companies:

Associate	Service	December 2005 or March 2006 Turnover	Terms of Supply	2005/06 Value
		£'m		£'m
Analytical & Environmental Services Limited	Courier service	13.5	Competitive letting	0.1
Analytical & Environmental Services Limited	Sampling, analysis & cleaning	13.5	No market	8.4
Entec UK Limited	Engineering & environmental consultancy	45.2	Competitive letting	4.0
Entec UK Limited	Engineering & environmental consultancy	45.2	Other market testing	0.5
Fastflow Pipeline Services Limited	Mains renewals, sewer repairs	17.9	Competitive letting	4.3
Suez SA	Technical assistance, research, development & innovation	28,349.0	No market	0.2
Three Rivers Insurance Company Limited	Public liability insurance (deductible infill policy)	0.5	No market	0.5
Vehicle Lease and Service Limited	Vehicle maintenance and capital finance charge	11.9	Competitive letting	4.4

11. ROLLING SUMMARY: CURRENT COST PROFIT AND LOSS ACCOUNT

	2001/02	2002/03	2003/04	2004/05	2005/06
	£'m	£'m	£'m	£'m	£'m
Turnover	469.2	459.0	461.4	500.4	532.0
Current cost operating costs	(327.2)	(347.5)	(353.1)	(357.6)	(362.2)
Exceptional items	-	(4.8)	(1.1)	-	-
Working capital adjustment	0.5	0.5	(1.8)	2.4	1.7
Current cost operating profit	142.5	107.2	105.4	145.2	171.5
Net interest	(74.9)	(76.3)	(84.9)	(84.3)	(87.8)
Financing adjustment	16.7	43.5	42.1	48.5	37.6
Current cost profit before taxation	84.3	74.4	62.6	109.4	121.3
Taxation	14.3	(20.6)	12.3	(19.7)	(46.1)
Current cost profit on ordinary activities	98.6	53.8	74.9	89.7	75.2

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

12. ROLLING SUMMARY: CURRENT COST BALANCE SHEET

	31 March 2002 restated	31 March 2003 restated	31 March 2004 restated	31 March 2005 restated	31 March 2006
	£'m	£'m	£'m	£'m	£'m
Tangible fixed assets	12,672.2	12,757.2	11,913.7	12,097.8	12,075.6
Third party contributions since 89/90	(65.6)	(67.4)	(73.6)	(78.4)	(86.9)
Working capital	(18.1)	75.7	(77.2)	(75.5)	(14.2)
Net operating assets	12,588.5	12,765.5	11,762.9	11,943.9	11,974.5
Investments	99.9	96.8	-	-	-
Non trade debtors	8.4	9.0	25.8	9.1	12.3
Non trade creditors	(37.0)	(40.7)	(65.6)	(80.4)	(20.6)
Creditors due after > 1 year	(1,371.2)	(1,536.0)	(1,363.4)	(1,391.5)	(1,540.3)
Provisions for liabilities and charges	(144.8)	(176.5)	(161.3)	(166.7)	(186.5)
Net assets employed	11,143.8	11,118.1	10,198.4	10,314.4	10,239.4
Called up share capital	103.0	99.9	97.2	94.3	92.1
Profit and loss account	510.7	469.6	447.0	423.0	432.7
Current cost reserve	10,530.1	10,548.6	9,654.2	9,797.1	9,714.6
Total capital and reserves	11,102.8	11,118.1	10,198.4	10,314.4	10,239.4

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.
The above balance sheets have been restated to reflect the adoption of FRS 21 in the year (note 1f).

13. REGULATORY CAPITAL VALUE AT 2005/2006 PRICES

	2005/2006
	£'m
Opening regulatory capital value	2,526.4
Capital expenditure (excluding IRE)	213.6
Infrastructure renewals expenditure	33.7
Infrastructure renewals charge	(35.7)
Grants and contributions	(10.2)
Current cost depreciation	(101.6)
Out-performance Adjustment	(1.9)
Closing regulatory capital value	2,624.3
Average year regulatory capital value	2,550.2

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

The numbers included above are taken from the Ofwat publication "Future Water and Sewerage Charges 2005-10 Final Determinations" published in December 2004 and are consistent with the publications RD07/05 and RD08/06.

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.

STATEMENT OF DIRECTORS' RESPONSIBILITIES
For the year ended 31 March 2006

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

12 July 2006

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY 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 2006 which comprise

- the regulatory historical cost financial statements (Section B) , itself comprising the historical cost profit and loss account, the regulatory historical cost balance sheet, the statement of total recognised gains and losses and related 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 and non appointed businesses and the related notes to the current cost financial information numbered 1 to 13.

This report is made, on terms that have been agreed, solely to the company and the Water Services Regulation Authority ("the WSRA") 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 and sewerage 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 WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligations under the company's Instrument of Appointment to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the WSRA, for our audit work, for 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), Regulatory Accounting Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline 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 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. There are differences between United Kingdom Generally Accepted Accounting Principles ("UK GAAP") and the basis of preparation of information provided in the regulatory financial statements because the Regulatory Accounting Guidelines 1.03, 2.03, 3.05 and 4.02 specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared on the basis of UK GAAP may 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 WSRA, the directors and auditors

The nature, form and content of regulatory financial statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly, we make no 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 are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the regulatory financial statements in accordance with International Standards on auditing (UK and Ireland), 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'.

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF NORTHUMBRIAN WATER LIMITED (continued)

Respective responsibilities of the WSRA, the directors and auditors (continued)

We report our opinion as to whether the regulatory historical cost 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 Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost financial information (Section C) have been properly prepared in accordance with Regulatory Accounting Guidelines 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 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 Guidelines 1.03, 2.03, 3.05, and 4.02.

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 International Standards on auditing (UK and Ireland), 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 WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under 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 as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given in note 31 to the historical cost financial statements.

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF NORTHUMBRIAN WATER LIMITED (continued)

Opinion

In our opinion, the regulatory financial statements of the company for the year ended 31 March 2006 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 and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines 1.03, 2.03, 3.05 and 4.02 issued by the WSRA, 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 2006 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 the 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 and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guidelines 1.03, 2.03, 3.05 and 4.02 issued by the WSRA;

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 Guidelines 2.03, 3.05 and 4.02 issued by the WSRA;

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

Ernst & Young LLP
Registered auditors
Newcastle upon Tyne
12 July, 2006