NORTHUMBRIAN WATER LIMITED

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2009

Registered no: 2366703

Registered office
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FINANCIAL STATEMENTS
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DIRECTORS' REPORT and OPERATING AND FINANCIAL REVIEW
For the year ended 31 March 2009

The directors present their annual report and operating and financial review and the audited financial statements for the year ended 31 March 2009.

Principal activities

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.

Directors

The directors who served during the year were as follows:

Sir D Wanless	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 Scientific Services Director
A G Balls	Independent Non-Executive Director
A M Frew	Independent Non-Executive Director
A J Scott-Barrett	Non-Executive Director
Dr S Lyster	Independent Non-Executive Director
Sir A P Brown	Non-Executive Director
M A B Nègre	Non-Executive Director
J M Williams	Non-Executive Director
C R Lamoureux	Non-Executive Director

BUSINESS OVERVIEW

Operating Environment

Northumbrian Water Limited (NWL or the Company) is one of the ten regulated water and sewerage businesses in England and Wales operating in the north east of England, where it trades as Northumbrian Water, and in the south east of England, where it trades as Essex & Suffolk Water. The Company's ultimate parent company is Northumbrian Water Group plc (NWG or the Group), a company listed on the UK Stock Exchange.

In the north east the business comprises the supply of both potable and raw water and the collection, treatment and disposal of sewage and sewage sludge to 2.6 million people. In this region there has been a gradual fall in overall water demand in recent decades as a consequence of a reduction in industrial demand for water. This trend is expected to continue for at least the next five years with a faster decline in the short term due to the impact of the economic recession. The north east compares well to the rest of the country as far as water resources are concerned and our major regional rivers can all be supported by Kielder reservoir. This provides very high security of supply for our customers.

In the south the business supplies potable water to 1.8 million people. This is a water scarce region that is forecast to experience further economic and population growth in the medium term. While this area has also seen a reduction in demand from heavy industry and the recession is likely to dampen housing growth in the near future, we have a current deficit, meaning supplies are not secure in a severe drought. Future growth will intensify the pressure on the balance between supply and demand. NWL is implementing long term plans to ensure the availability of water supplies to meet both current and future demand in a region where water

Operating Environment (continued)

resources are already constrained. The project to increase the capacity of Abberton reservoir near Colchester, which has recently obtained full planning approval, coupled with ongoing demand management measures, will secure supplies to the Essex area for the foreseeable future.

Regulatory environment

As a monopoly supplier of an essential public service, the UK water industry operates within a demanding regulatory environment.

The Water Services Regulation Authority (Ofwat) regulates prices and levels of customer service, while the Drinking Water Inspectorate (DWI) monitors drinking water quality and the Environment Agency (EA) covers environmental protection. Customers' interests are represented by the Consumer Council for Water (CCWater).

NWL aims to maintain good working relationships with its regulators and with regional organisations, such as local authorities, which have an interest in the services it provides and can influence the Company's business.

The 'Cave Review: competition and innovation in water markets' (Cave Review) published its final report in April 2009. Government has welcomed the report and intends to bring forward measures into the 'Flooding and Water Management Bill' in light of its recommendations. In our view, the vital test for any change must be 'Will it improve outcomes for customers?'. While the essential characteristics of the sector mean the scope for competition is likely to be less than in other utilities, we agree that there are opportunities to expand competition beyond its current very limited level. We remain to be convinced that retail business separation would bring benefits for customers. We welcome the emphasis in the report on measures to increase innovation.

Protecting supplies to customers is a high priority. We submitted our 'Water Safety Plan' to the DWI in October 2008 and this underpins our drinking water quality proposals.

We commenced Phase I of Operator Self Monitoring in April 2009. This involves NWL taking on responsibility for sampling and analysing the final effluent at sewage treatment works for compliance purposes. This task had previously been undertaken by the EA. The transfer is consistent with the Better Regulation principles and we expect it to result in a small cost saving. The second and final stage of the transfer will happen in January 2010.

We are pleased that the draft 'River Basin Management Plan' published by the EA for the rivers in our regions proposed an appropriate balance between challenging environmental targets and a clear evidence base for action. We support the emphasis on tackling diffuse pollution at source rather than end of pipe solutions.

NWL intends to increase the emphasis given to catchment management across its operating areas. This will help tackle emerging challenges from water soluble pesticides and also bring a range of other benefits in terms of habitat protection, biodiversity and carbon management.

DIRECTORS' REPORT and OPERATING AND FINANCIAL REVIEW (continued)

BUSINESS STRATEGY AND OBJECTIVES

Our mission

The NWG mission is to be the national leader in the provision of sustainable water and waste water services, and this is shared by NWL.

Strategic direction

Our strategy is to focus on our core competences of water and waste water management and, through that focus, to deliver value to all of our stakeholders. Our three priorities are:

to maintain our strong reputation and relationships by:
- delivering excellent service to customers;
- delivering regulatory outputs;
- creating shareholder value; and
- involving our main stakeholder groups.

to ensure a stable financial profile by:
- maximising revenue;
- delivering operational efficiency; and
- securing low cost long term funds.

to develop a culture of continuous improvement by:
- ensuring a focus on safety and rigorous risk management;
- encouraging employees to fulfil their potential;
- promoting a flexible and proactive attitude; and
- embracing a sustainable and responsible approach.

A clear framework

We have identified five key strategic themes. Four of these, People, Customer, Competitiveness and Environment, are important individually and also contribute to the fifth, Reputation. These themes underpin our drive for performance and delivery of our corporate objectives. The themes are mutually supportive and achieving the right balance between them is an essential part of our success.

People	We believe strongly that our people are the key to business success.
Customer	Customers are central to our thinking and our overriding objective is to properly understand and meet their needs.
Competitiveness	To grow our business and meet the challenges of a developing market we strive to be competitive in everything we do.
Environment	Our business is founded on water and environmental engineering and a great deal of what we do influences the environment. We seek to understand our impact on the environment and, also taking into account our impact on, and contribution to, the economy and communities in which we operate, aim always to deliver sustainable outputs from our activities.
Reputation	Our ability to develop our business will be influenced by our reputation. A good reputation is often the starting point for good stakeholder relationships on which business growth can be achieved.

By staying focused, motivated and innovative we are confident we will be able to continue to supply our customers with an excellent service at the right price and, by satisfying our customers, we provide a platform on which we will build, expand and develop our business.

Our corporate objectives are:
- to deliver industry leading customer service;
- to be the most efficient water company;
- to be recognised as a great company to work for;
- to be the company of choice for investors; and
- to protect and enhance the natural environment.

We also prepare a detailed medium term business plan and annual budget, which are reviewed and submitted to the Board for approval. Targets are set to measure performance and regular financial forecasts are made. Business plans and budgets include an assessment of the key risks and success factors facing each business unit. On a monthly basis, management compares the actual operational and financial performance of each business with plan and budget and this is reported to the Board.

FINANCIAL PERFORMANCE

We use a range of indicators to monitor performance. The definition, purpose and source of each KPI are shown on page 24. Performance against the financial KPIs is set out below:

KPI	**Target**	**Performance**	
		Current year	**Previous year**
Gearing to RCV – NWL group (note 11) (%)	<70	61	59
Gearing to RCV – Appointed business only (%)	<65	60	58
Cash interest cover (times)	>3.0	3.8	3.9
Cash flow to net debt (%)	>13	18	17

The calculation of gearing for the NWL group has been reviewed and net debt has been restated to include £159.0m (2008: £159.0m) in respect of an intra-group loan from NWL to Northumbrian Services Ltd. (NSL), which is repayable on demand, as the Company believes this is a better reflection of our net debt. This change results in gearing at 31 March 2008 being restated from 64% to 59% for NWL Group.

All financial KPIs remained better than the target for the year.

Financial results and dividends

The Company's profit and loss account and balance sheet are set out on pages 26 and 27. The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. The key accounting policies are summarised in note 1 to the statutory financial statements on pages 28 to 31 and these have been applied consistently throughout the current and preceding periods.

Profit after tax for the year was £129.3m (2008: £125.3m).

Turnover increased from £622.4m in 2007/08 to £641.2m for the year to 31 March 2009. This increase is mainly due to the application of the Retail Price Index (RPI) of 4.28% to water and sewerage charges, partially offset by a small overall reduction in demand for both water and sewerage services and a reduction in other services related to the housing market. The difficult economic climate continues to have an impact on industrial and commercial customers where volumes are down by c.4% compared to the prior year. The K factor allowed for 2008/09 in the 2004 final determination was 1.0%, however, NWL chose not to apply this increase.

Financial results and dividends (continued)

Operating costs, excluding capital maintenance costs, have increased from £250.8m in 2007/08 to £274.6m in 2008/09, principally reflecting the impact of inflation, increases in energy costs and bad debt charges. These increases have been partially offset by efficiencies including lower manpower costs following the changes made to our defined benefit pension scheme where, from 1 January 2008, the scheme was closed to new entrants, the benefit structure amended and employee contribution rates increased. Energy costs for 2008/09 are over 50% higher than both last year and the level assumed by the regulator at the last price review. Although energy prices have softened recently, we expect them to remain volatile for the future.

Capital maintenance costs have reduced from £118.5m in 2007/08 to £106.4m in 2008/09, reflecting a reduction in the infrastructure depreciation charge partially offset by increased depreciation arising from the commissioning of new assets. The Company updated its long-term investment plans as part of the periodic review process (PR09) and at 31 March 2008 was projecting a significant increase in infrastructure maintenance investment over the period to March 2020. However, following subsequent discussions with Ofwat, it was agreed that significant elements of the investment programme, specifically relating to sewer flooding and leakage, should be categorised as infrastructure enhancement and, therefore, not taken into account within the infrastructure depreciation charge. The charge for 2008/09 is, therefore, c.£13m lower than the charge for 2007/08.

Net interest payable increased from £75.9m in 2007/08 to £91.4m in 2008/09, an increase of £15.5m of which £14.3m related to non-cash elements, principally inflation on index linked bonds, a reduction in the expected return on pension assets and an increase in the interest cost of pension plan obligations.

In September 2008, the Company completed the final drawdown of £20.8m in relation to a £50m finance lease facility at a variable rate of interest linked to RPI. Rentals are due quarterly in advance with a final maturity of March 2043. In September 2008, the Company drew a new loan of £120m from the EIB at a fixed rate of 5.186%, repayable in instalments, with a final maturity date of September 2022.

During the year, projects to improve water treatment processes were completed at a number of sites. At Lartington, in County Durham, a new sludge treatment process was installed. Sludge from this facility is now recycled, increasing the recycled volumes of sludge from water treatment works to above 50%. Work to increase the output from Layer water treatment works in Essex, by 20%, was completed successfully, improving the resilience of supplies throughout the region.

A large diameter mains cleaning programme, which began in February 2007 and will be complete by 2011, will improve tap water quality to 500,000 customers in south east Northumberland, north Tyneside and the north of Newcastle. This work is progressing well and will make a significant contribution to the planned reduction in customer complaints.

Our plan to increase the capacity of the Abberton reservoir near Colchester by around 58% reached a key milestone in April 2009, with the granting of planning permission for the reservoir raising, pipelines and pumping stations. The EA is continuing to prepare the application to vary its licences at Denver and Blackdyke, in Norfolk, which, together with the enhanced transfer facilities and the enlarged reservoir, will secure water supplies for customers in one of the driest areas in the UK.

For the sewerage service significant investment was made at strategic works in Darlington, Sunderland and Browney (County Durham) and 20 schemes were completed to alleviate sewer flooding risk for 114 properties. We improved 102 combined sewer overflows, which will further improve rivers and water courses, enhance their visual appearance and reduce pollution incidents. A project is currently underway to introduce advanced sludge digestion at Bran Sands which will both reduce sludge volumes and energy usage.

The directors recommend a final ordinary dividend amounting to £42.5m (2008: £41.0m) which, together with the interim dividend of £42.9m (2008: £40.8m), makes a total for the year of £85.4m (2008: £81.8m). This continues the stated dividend policy for the appointed business of 1.9% real annual growth (see note 9 to the statutory financial statements).

DIRECTORS' REPORT and OPERATING AND FINANCIAL REVIEW (continued)

OPERATIONAL PERFORMANCE

Key Performance Indicators

In addition to the financial indicators shown on page 4, NWL also uses non-financial indicators throughout the business. Performance against these indicators is reviewed by the management team each month. The definition, purpose and source of the main KPIs are shown on pages 24 and 25.

North (N) South (S)		**Target 2009/10**	**Target 2008/09**	**Target achieved**	**Performance Current year**	**Performance Previous year**
Customer satisfaction						
Overall service (%)	N/S	90	90	x	88	89
Value for money (%)	N/S	85	85	x	84	83
Customer – levels of service						
Properties at risk of low pressure	N S	274 126	274 126	✓ ✓	271 40	181 60
Properties subject to unplanned interruption of 6 hours or more	N S	3,000 2,000	3,000 2,000	x x	8,278[1] 3,353[2]	3,318 3,405
Properties subject to hosepipe bans at any time during the year	N/S	0	0	✓	0	0
Properties subject to sewer flooding incidents (other causes)	N	150	150	x	286	290
Properties at risk of sewer flooding incidents (once in ten years)	N	44	61	x	189	125
Properties at risk of sewer flooding incidents (twice in ten years)	N	32	41	x	370	329
Billing contacts responded to (within five working days) (%)	N S	99.2 99.2	99.2 99.2	✓ ✓	99.2 99.6	99.3 99.6
Written complaints responded to (within ten working days) (%)	N S	99.8 99.8	99.8 99.8	✓ x	99.9 99.7	99.9 99.7
Bills based on meter readings (%)	N S	99.95 99.95	99.95 99.95	x ✓	99.90 99.95	99.80 99.96
All telephone lines busy (%)	N S	0.05 0.25	0.25 0.25	✓ ✓	0.07 0.06	0.03 0.00
Abandoned telephone calls (%)	N S	3.00 2.00	2.50 2.50	x ✓	3.43 1.95	2.85 3.27
Water						
DWI Mean Zonal Compliance (%)	N S	99.90 99.98	99.90 99.98	✓ ✓	99.92 99.99	99.94 99.99
DWI Operational Performance Index (%)	N S	99.65 99.98	99.65 99.98	✓ ✓	99.67 99.98	99.66 99.98
Distribution Maintenance Index (%)	N S	99.70 99.85	99.70 99.80	x ✓	99.52 99.96	99.47 99.96
Environment						
Sewage treatment works (%)	N	99.7	99.7	✓	100	98.4
Bathing waters Mandatory Standard (%)	N	100	100	✓	100	100
Pollution incidents	N	89	96	✓	94	119
Employees						
Employee turnover (rolling %)[3]	N/S	-	Industry ave. 10.4	-	6.4	7.4
Lost time reportable accidents (per 1,000 employees)	N/S	10[4]	5	x	6	6
Sickness absence (%)	N/S	2.85	2.85	x	2.94	3.25

Notes:
1. Performance affected by a major burst in Northumberland.
2. Performance affected by a major burst in Suffolk.
3. No target set, data for information.
4. Scope of target widened for 2009/10 to include all lost time accidents.

Key Performance Indicators (continued)

NWL carries out regular quarterly tracking surveys of domestic customers and, during the year, customer satisfaction levels remained very high, with 90% of customers satisfied or very satisfied with the service NWL provides and 87% feeling it provides value for money. CCWater has carried out its third annual survey for domestic customers on a number of key themes, including value for money. This year's survey again concluded that, of all water companies' customers, ours are the most satisfied with the fairness of charges and value for money. Understanding and meeting the needs of customers is at the heart of our strategy and NWL is committed to providing a high standard of customer service that meets those needs and those of our regulators.

Intense rainfall during localised summer storms caused extensive flooding during the year with 829 properties flooded internally, well above the long term average and second only to 2005/06 with 1,160 properties. Investment to reduce the risk of sewer flooding has been increased.

The quality of drinking water supplied by NWL remained excellent in 2008/09. All 33 bathing waters in NWL's area passed the EU Mandatory Standard and 20 of these also met the more demanding Guideline Standard, despite poor weather in the summer of 2008. All 158 (2008: 157) consented sewage treatment works met their required standards during the year.

NWL places great emphasis on health and safety and employees are actively encouraged to be involved in identifying and eliminating hazards in the workplace. This has resulted in a significant reduction in accidents over recent years. NWL's current level of sickness absence is 2.94% which is the lowest ever achieved and well below the norm for the sector.

FUTURE DEVELOPMENTS

Putting customers first

As in the prior year, we have only increased our prices for 2009/10 by inflation and have not used the real increase that Ofwat's price limits allow. This is the third consecutive year in which we have not implemented the maximum price increase. By 2010, we expect our combined water and sewerage bill in the north east to be one of the lowest in the country and, in our Essex and Suffolk regions, our water bills will compare favourably with other local suppliers.

We submitted our Final Business Plan, covering the period from April 2010 to March 2015, to Ofwat in April 2009 setting out the short term proposals to deliver our 25 year strategy published in 'Looking to the future'. Our significant investment programme will continue to deliver high levels of service to our customers and value to our stakeholders. However, within the investment programme, there is a change in emphasis from achieving new quality standards to maintaining the high standards already achieved. We will also be working to tackle the challenges posed by climate change, reducing our operational carbon emissions and improving the resilience of our assets. We believe we are well placed to deliver these objectives and propose raising prices by the minimum amount consistent with both maintaining safe and secure water supplies and our commitment to protect the environment.

Part A of the Final Business Plan is available on our websites at www.nwl.co.uk and www.eswater.co.uk
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Looking to the future

We consulted key stakeholders before publishing 'Looking to the future', our long term operational strategy for the next 25 years. We published different versions for each of our operational areas and they have been well received by a range of stakeholders. They are available on our websites.

In our strategy, we set out our long term aims for NWL alongside intermediate targets for the period to 2015 for the key areas of:
- customer satisfaction;
- water quality;
- availability of water;
- waste water services;
- sustainability, the environment and climate change;
- finance; and
- employees.

Our long term operational strategy was produced to help inform our plans for the period 2010-15. The strategy builds on our achievements of the past 20 years and re-affirms our commitment to long term planning and investment to deliver value to all our stakeholders.

We identified three key challenges for the future:
- sustaining and, where appropriate, improving services while keeping bills affordable;
- maintaining healthy and stable finances to ensure we can continue to borrow money to meet the investment needed in the business; and
- responding to climate change by further reducing greenhouse gas emissions and future-proofing our operations.

RISKS AND UNCERTAINTIES

The Company identifies and assesses the impact of risks to the business under five headings; environment, external, operations, finance and reputation. For each risk the likelihood and consequences are identified, management controls and frequency of monitoring are reported and the scale of the risk is assessed. The management team reviews the approach to risk management in detail every year and the Audit Committee considers the outcome of this review. The management team also reviews the significant risks every month and summary reports on these reviews are submitted to the NWL Board.

Financial risk

The financial ratios and financial results are described in the section headed Financial Performance. The management of financial risks relating to liquidity and treasury policies are covered below under Capital Structure.

The current pressures within the financial markets have been well documented and the credit crunch has resulted in reduced availability of certain types of finance (such as index linked bonds) and a significant increase in the cost of corporate debt. It is not clear how long current difficult market conditions will persist. However, NWL has sufficient funding in place to 2011 and, therefore, the effects on the Company are minimal.

The current economic climate is also having an impact on revenues, particularly those from industrial and commercial customers and those associated with the housing market. We continue to monitor the uncertain situation very carefully.

Regulatory risk

The key risk for the business is the outcome of PR09, the process by which Ofwat sets limits on the prices which NWL can charge customers for the five years from 1 April 2010. Ofwat will publish its draft determination in July 2009 and will consider representations before issuing its final determination in November 2009.

The Government published a consultation paper on the draft Flood and Water Management Bill in April 2009. The Bill includes measures to implement the recommendations of the 'Pitt Review: Lessons learned from the 2007 floods' (Pitt Review) on flooding as well as a range of other measures to tidy up aspects of water related legislation. The flooding measures primarily relate to local authorities and the Environment Agency but also have implications for water companies, particularly with regard to how they interact and cooperate with these bodies.

It is intended that the Bill will ultimately incorporate measures in response to the 'Cave Review' and the 'Walker Report' on charging and metering (published in June 2009). These measures will be added at a later date and will be subject to separate consultation.

The 'Cave Review' proposes a cautious step-by-step approach to the introduction of competition and envisages the main benefits arising from greater innovation. It proposes a number of regulatory changes including providing Ofwat with a duty to promote innovation and the incorporation of negotiated agreements involving customer representatives (eg CCWater) as part of future price reviews.

The most significant competition proposal, at least in the short term, is the legal separation of retail businesses. This will need to be considered in greater detail as part of a separate consultation. We remain to be convinced of the benefits of this proposal.

The Government has confirmed that it intends to proceed with the transfer of certain private drains and sewers into water company ownership by 2011, which would increase the sewerage network owned and maintained by NWL by about 60%. Further details on the transfer process are expected later in the year but this will be too late for the costs to be included in the PR09 price review. It is, therefore, likely that all sewerage companies will see an adjustment to price limits post 2010.

Another item of new legislation that will have a significant impact on the business, as and when the provisions are implemented by local authorities, is the Traffic Management Act which came into effect in April 2008.

Environmental, social and governance risks

There are two environmental, social or governance risks considered to be significant to the Company.

The first relates to the use of sewage sludge as a soil conditioner on agricultural land. If this disposal route was lost, the sector would need to find or develop alternative ways to re-use or dispose of its sewage sludge. This could mean higher capital and revenue costs to provide additional sludge processing facilities. The development of the 'Safe Sludge Matrix' and the proposed revision of the Sludge (Use in Agriculture) Regulations have reduced the immediate risk in this area. NWL is introducing advanced digestion to both reduce sludge volumes and the carbon impact of its activities and will retain a facility to dry sludge and produce pellets as a fuel replacement, as a viable alternative way of using sludge in the medium term.

The second is the potential for sewer flooding. As rainfall patterns become more variable and intense storms more frequent, localised heavy rainfall can result in sewers becoming overloaded. We welcome the focus on integrated flood management in Defra's strategic document 'Future Water' and in the 'Pitt Review' on recent flooding.

Affordability and customer debt

Although our average household bills are relatively low, affordability is an issue for NWL with income deprivation levels in the northern area the highest of all water and sewerage companies and in the southern area, close to the national average.

Providing our customers with a range of payment facilities and frequencies that suit their individual circumstances is a critical element of successful income collection and debt prevention. We ensure that customers are aware of options which help reduce charges and ease the establishment of payment arrangements.

Customers who deliberately avoid paying charges are actively pursued and we continue to work with Ofwat and Defra to seek changes to legislation to assist the industry to impose and collect charges.

Water resources

The way we retain, recycle and distribute our water resources is a central part of our business. While NWL has sufficient water resources in the north east, we believe it is still important to manage the demand for water so that it does not exceed levels that can be supplied in a sustainable way.

In our Essex and Suffolk areas, however, water resource availability is a key issue. We have been successful over many years in encouraging our customers to use less water and in keeping leakage at or below the economic level. Nonetheless, we need to continue to invest to achieve our aim of ensuring our customers have a safe, secure and reliable supply of water well into the future. In spring 2008, we published our draft 'Water Resources Management Plan' for consultation and, in January 2009, we produced a Statement of Response to the consultation and provided an updated draft of the plan to Defra. A final plan will be published once approval has been received.

In April 2009, Colchester Borough Council formally approved our application for planning permission for raising Abberton reservoir which will increase its capacity by 58%. This successful conclusion was the culmination of years of extensive work with environmental scientists, lawyers and planners to produce the environmental statement and supporting documentation submitted to the planning authorities. The one remaining part of the overall Abberton Scheme that requires permissions is the variation of abstraction licences at Denver and Blackdyke in Norfolk. Once this Scheme is in operation in 2014, it is unlikely we will need to develop major resources in Essex for the next 25 years.

We will continue to play a leading role in the industry on water efficiency measures and to encourage customers to use water wisely. We will work with other stakeholders to develop a coordinated strategy for reducing water use to sustainable levels.

In areas where water is scarce, water meters have a key role to play in reducing demand. We aim to achieve as near to universal metering as possible in Essex by 2020 and in Suffolk by 2023. On current policies it will take considerably longer to achieve full metering in the north east as there is no economic, environmental or social driver to move more quickly.

Changing weather patterns

The water cycle and the changing British weather has a direct influence on the provision of water and waste water services. Our employees are experienced in managing the effects of too much or too little rainfall, but changing weather patterns will present a growing challenge for the business.

We have carried out research into the likely impact of climate change on all our assets and water resources and this has been incorporated in our 'Climate Change Policy' as part of our corporate responsibility work. We will continue to do work in this area using the latest projections of the impacts of climate change soon to be published by the UK Climate Impacts Programme.

Employees

People are our key asset and if we are to continue to meet the needs of our customers, and to achieve our regulatory obligations, we need to continue to recruit and retain talented and skilled people as a leading employer in our regions. We will continue to offer all our employees terms and conditions at least commensurate with other major employers as well as appropriate training and development to support their career progression. This includes the comprehensive management development framework, graduate and apprentice programmes, as well as initiatives such as the NVQ programme which reach many employees.

CAPITAL STRUCTURE

Cash flows and liquidity

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.

The Company has substantial cash resources and undrawn committed bank facilities available to maintain general liquidity. Total cash and short term cash deposits available to meet the requirements of the business through to 2011 amounted to £166.2m.

Credit rating

The credit rating for NWL has remained consistent throughout the year at BBB+ stable (Fitch and Standard & Poors) and Baa1 stable (Moodys).

Treasury policies

The Board is responsible for the financing strategy of the Company which is determined within treasury policies set by NWG. The Group's treasury function carries out treasury operations on behalf of the Company and has the main purposes of assessing the ongoing capital requirement, maintaining short term liquidity and raising funding, taking advantage of any favourable market opportunities. 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

The Company is responsible for cash management and has sufficient committed facilities to cover 3 years forecast cash outflow. The Group's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0m and with a bank agreement availability period of no less than 3 months. At 31 March 2009, NWL had £75.0m (2008: £75.0m) available in standby committed bank facilities.

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 Company's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2009, 72% (2008: 63%) of the borrowings of the Company were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

Foreign currency risk

The 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 2009, the Company had no currency exposures (2008: 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.

CORPORATE RESPONSIBILITY

NWL is expected to provide a secure supply of water, a basic necessity for health, and to protect or enhance the environment when we return waste to it. However, our stakeholders also expect us to:

- behave fairly and responsibly;
- use resources wisely;
- improve quality of life; and
- contribute to economic development.

We take our corporate responsibilities seriously. Our aim of balancing economic, social and environmental priorities underpins all of our activities and is an integral part of the way we do business. We have significant resources in our assets, land and employees and believe we have a responsibility to use these resources for the benefit of our customers, our shareholders and the wider communities we serve.

The Managing Director is directly accountable to the NWL and NWG boards for both the environment and sustainable development policies. We have developed our own model to integrate corporate responsibility as an essential part of normal business practice in NWL. This model is published on our websites with links to our policy, action plan, key performance indicators, trend data and case studies for 25 key areas of our business.

The Corporate Responsibility Committee (CRC) is a subcommittee of the NWL board and comprises non-executive directors, management team members and senior managers from the business. The CRC maintains a strategic overview of corporate responsibility policies and issues. Within the business a Corporate Responsibility Management Group (CRMG) drives and manages our corporate responsibility programme both prioritising activity and facilitating reporting and monitoring. The CRMG is supported by two regional groups and by teams of community and environmental champions drawn from across the business to ensure communication and influence is as effective and widespread as possible. We also have specialist working groups responsible for investigating, advising on and driving change on specific projects, such as climate change, energy use, transport, waste and recycling.

CORPORATE RESPONSIBILITY (continued)

NWL supports the communities we serve in a number of different ways. As well as providing financial support and facilities, we encourage employees to volunteer their time, skills and expertise. These activities generally support projects that make the areas we serve better places in which to live, work or invest. The programme focuses on key themes throughout these communities but, increasingly, we are developing initiatives designed to tackle lasting and sustainable change in specific areas.

In April 2009, NWL received the Queen's Award for Enterprise in the category of Sustainable Development and the citation read:

"Northumbrian Water Limited receives the Award for its ongoing and impressive commitment to sustainability.

"It has actively striven to promote best practice within its sector and is committed to ongoing review and continuous improvement.

"With a commendable and ever improving environmental performance in place, it is, however, Northumbrian's extremely impressive social and economic initiatives which elevate it to the status of sector leaders.

"A diverse suite of programmes have been implemented, encompassing local procurement, strong apprenticeship programmes, individual up skilling and the continuous leverage of their spending power, employment and wider economic presence to ensure maximum benefit for local communities.

"Northumbrian's driving commitment to sustainability governance provides an example and benchmark across sectors, demonstrating that strong leadership and ambition can make a tangible difference to communities both local and more widely."

NWL was also named 'Utility Company of the Year' at the Utility Week Awards in December 2008. Steve Hobson, the Editor said:

"Last year for the first time we asked our panel of eminent judges to nominate and vote for the utility they felt deserved the accolade 'Utility Company of the Year'. The aim was to open this top category to companies that deserve such recognition but often don't enter awards for various reasons.

"Northumbrian Water was a worthy winner for the way it builds its business around customers and the community, principles that usually do not make headlines but show that a successful utility really does put customers at the heart of its business."

In addition to the awards outlined above we were:

- members of the FTSE4GoodIndex again;
- ranked by Business in the Community (BITC) as one of the top 100 'Companies for corporate responsibility' and as a Platinum ranked company. It also awarded the Company its Big Tick award for its impact on society and for being a healthy workplace;
- leading water company in Britain's Most Admired Companies survey;
- North East Call Centre of the Year in the 2008 contact centre awards;
- the employee engagement winner at North East of England Chartered Institute of Personnel Development HR&D awards; and
- the category winner of Culture for Success Large Employer Award for employee development, customer service, business growth and the contribution we have made to the community.

Over many years, we have donated at least 1% of our pre-tax profits (through cash, employee time and expertise, or use of our facilities) to projects which benefit the communities we serve. We reported this publicly as part of BITC's Per Cent Club standard and, although this ended in October 2007, we have maintained this commitment. The Company made charitable donations totalling £134,415 during the year.

Community support

Employees and volunteering
Currently 22% of employees participate in the 'Just an hour' volunteering scheme and last year gave over 6,500 hours to the community. Over 500 different organisations were given financial and in-kind support during the year. The 'Care for safety' scheme, which encourages employees to reduce accidents and associated lost time, has triggered payments totalling £52,655 for our nominated charities (Great North Air Ambulance Service, Mencap's Dilston College, RNLI, St Teresa's Hospice and East Anglia's Children's Hospices). Since it began over £250,000 has been raised for charity.

Education
Further to the launch of the 'Northumbrian Water GLOBE' programme, which saw us link up with the international environmental education initiative set up by Al Gore in 1996, we donated 85 fully automated weather stations and associated training to schools throughout the northern region, to collect weather data in areas where Meteorological Office coverage is poor. This data is now helping to increase understanding of the impact of climate change, and is a valuable curriculum tool.

The 'Northumbrian Water Schools Awards', now in their third year in the northern region, are designed to recognise and celebrate the achievements being made by our schools. They cover both community and curriculum based projects and honour whole schools, classes and individuals.

In our southern operating area, we support 'Cash for Schools' along with the Essex Chronicle. This recognises excellence, with a focus on environmental projects from primary and secondary schools, within the newspaper's distribution area.

A wide range of educational materials are available on our websites for children and teachers.

Partnerships

Water for health
NWL is at the forefront in the water industry in communicating the health benefits of drinking tap water. To date, over £244,000 has been provided for mains-fed water coolers in schools and around 600 have been supplied in nearly 300 schools. We also continue to promote bottle-free water coolers as a sustainable alternative to bottle-fed coolers.

We also support the Water UK and Unison led 'Water@work' initiative to encourage employers to ensure that employees have adequate access to drinking water.

Environmental
Key partnerships have been developed with NWL to help the conservation of biodiversity on our sites. Our contribution to the partnerships includes funding project officers and current partnerships include:

- Northumberland Wildlife Trust (Kielder and Bakethin);
- Durham Wildlife Trust;
- Essex Wildlife Trust (Hanningfield);
- Broads Authority (Lound and Trinity Broads); and
- Davy Down Trust.

Sustainable communities

We have a continuing commitment to support projects and organisations within the areas in which we work and contribute to the long term sustainability not only of our business, but also of the environment, society and communities we serve. Corporate responsibility is integral to how we do business and as part of this commitment we are working in different ways within our communities to promote lasting change.

We are working with partners to create models of sustainable change and also methods of evaluating their success, which can be replicated in other communities. The focus has been on health, education, economy and affordable housing as well as creating new ways to support areas helped by our chosen charity WaterAid.

Health

Healthworks has been open for nearly two years now after we reached an agreement with County Durham Primary Care Trust (PCT) granting them a 99 year lease on a redundant building at our Easington waterworks. We worked in partnership with the PCT, the District of Easington Council, the Neighbourhood Management Pathfinder and other stakeholders to develop services for the local community in an area where census records show one of the worst health records in the country.

Our commitment has gone beyond providing the building. There is a natural synergy between our own 'Water for health' campaign and the 'Healthy Living' agenda, so we devised new ways for NWL to work at a strategic level with the partners of the Healthworks to ensure the sustainability of the building and its facilities for the community. We contributed research, marketing and communications support to improve awareness of the centre and helped with events to promote healthy living, targeted at primary and secondary schools and day centres.

We sit on the steering group for Healthworks which achieved almost 10,000 visitors in its first year alone and now provides more than 30 health and community support services. It acts as a community focal point where service providers and community groups can come together to address issues that affect the quality of life in the local community. Facilities range from a juice bar to a gym and information kiosks, some of which can be used in a private setting with many more planned. Healthworks has been so successful that the plans for phase two have been brought forward and will include a GP walk-in surgery thus securing the future of Healthworks for the community.

As part of the support, we developed the 'Oceans of Fun' activity which is supported by sponsorship of 'Everyday Swim' an innovative swimming programme run by the Amateur Swimming Association to promote physical exercise and an arts programme run by Creative Partnerships to use arts-based activities to change children's attitudes to eating and drinking, supported by research from Durham University. Our contribution to the work of the Healthworks is a unique approach to tackling the poor long term health of the residents in Easington.

Sporting partnerships

NWL prides itself on being immersed in the community and working with a wide and diverse range of sporting partners is a natural extension of our 'Water for Health' campaign, which encourages people to lead a healthy lifestyle. Working with our sporting partners we support a diverse range of sports to get people active as well as educating them on healthy eating and good hydration.

Through our partnerships we reach over 55,000 children and adults annually. We provide:

- links and networks to enable sporting partners to get together to share ideas and resources;
- financial support of over £50,000 per annum which then levered over £80,000 from other sources;
- approximately 200 employee volunteer hours per annum;
- advice and marketing support on programme development;
- bottled tap water, sports bottles or mains-fed bottle-free coolers to reinforce the importance of drinking tap water to re-hydrate during sporting activities; and
- help with fundraising and raising the profile to attract additional investment.

Sporting partnerships (continued)

We can generate wider support for projects by adding our name and commitment to them and by encouraging others to get involved thus generating additional funding sources for projects. Our involvement acts as a key catalyst to raise confidence that projects present real opportunities for the private sector.

Education

NWL is lead sponsor for Castle View Enterprise Academy, a new and exciting independent school for 11-16 year olds serving the areas of Castletown, Town End Farm and Hylton Castle in Sunderland. The area contains some of the most deprived wards in the region and 61%-80% of the school catchment population is categorised as being 'struggling families'.

Castle View Enterprise Academy will offer a new approach to education and is one of three academies being created in Sunderland with the City Council as co-sponsor. It is a unique model under the 'Building Schools for the Future' programme. Our aim as lead sponsor is to create a centre of excellence with a clear focus on raising standards of academic performance and enabling every student to achieve their personal best in all areas of academy life within a safe, secure and stable environment. The project is now in its third year and we have committed time and resources to support the Principal of the Academy. The Managing Director chairs the Trust Board and employees have helped in the design, build and management arrangements. The Academy will open in September 2009 and the Company will use its business networks to complement the specialism which is business and enterprise.

WaterAid

NWL has continued to raise funds and awareness for the work of WaterAid which brings sustainable water and sanitation solutions as well as hygiene education to the poorest parts of Africa and Asia. The employee fundraising committee has raised more than £3 million, since 1997, with the help of the Company and last year focused its fundraising support on specific projects in Malawi and Burkina Faso.

Community Foundations

Community Foundations covering our areas of supply hold endowment funds totalling nearly £1m contributed by NWL over the last 17 years. These are long term investments with the income from the funds used to support community initiatives. Recipients are chosen by committees of our own employees (64 groups this year).

Climate change

The water industry is one of the largest users of energy in the UK and we aim to play a full part in support of Government's plans to reduce emissions. We have been working over recent years to reduce our carbon footprint while preparing ourselves for the future challenges of a change in climate and the weather events we may face as a consequence. We will shortly commence commissioning of an advanced anaerobic digestion plant at Bran Sands which, when operational, will provide 50% (c.4.7 MW) of the energy requirements of the site. A similar investment for our site at Howdon, on Tyneside, has been included in our Final Business Plan submission.

Detailed below are some of our projects to reduce our impact on climate change:

- limiting tertiary UV disinfection outside the bathing water season at five major works reduces energy consumption and carbon emissions with no detrimental effect on the marine environment;
- introducing anaerobic digestion, as part of our sludge strategy, will generate power at three smaller sites initially, and at two larger sites (Bran Sands will be complete in 2009 and Howdon is planned for the next five year investment period) increasing our total renewable energy to over 20%;
- generating our own renewable energy with hydroelectric plants at Kielder, Derwent, Lartington and Wear Valley reservoirs and biogas combined heat and power at Stressholme, Hexham and Aycliffe;
- contributing to a project in the North Pennines, which has 27% of England's peat-forming blanket bog which locks in carbon, preventing it being released into the atmosphere;

Climate change (continued)

- encouraging customers, through our 'Water is precious' campaign, to use water wisely and recognise that if they waste water, they also waste energy (a water carbon footprint calculator is now available for customers on our websites to emphasise this link); and
- introducing a new work management system which will improve customer service and efficient working, and will also significantly reduce mileage in our vehicles.

Through these projects we have reduced the amount of energy used by almost 9% over the last 5 years. We are continuing to develop our understanding of the potential impacts of a changing climate. The UK Climate Projections will be published later this year and we will be revisiting our assessment in light of the new science that emerges.

Our work to date includes:

- publishing our Water Resource Management Plan and our strategic direction statement 'Looking to the future' which include an assessment of climate change on water resource needs for the next 25 years;
- undertaking an assessment of the main threats to service provisions and continuity from flooding, in response to the floods seen elsewhere in 2007 and the subsequent "Pitt Review";
- aiming by 2013 to have completed, with relevant agencies, a major study on Tyneside to explore sustainable drainage options that take into account regional development and the impact of climate change (building on similar work carried out in Hartlepool as part of the Defra 'Making space for water scheme'); and
- working with experts to understand the potential impact on our assets and sharing information with the North East Climate Change Adaptation Study and Action Plan published on 1 May 2008.

RELATIONSHIPS

Employees and Employment Policies

NWL's key asset is its employees and one of its strengths is employee loyalty. Employee turnover is relatively low at 6.4%, well below the UK water industry average of 10.4%. NWL ensures its terms and conditions both attract and retain the best employees in the areas it serves. NWL employees also have access to a scheme which provides a wide range of benefits including childcare vouchers and discounted store vouchers. Currently 62% of employees participate in the scheme, up from 27% last year.

The active involvement and engagement of everyone across the business is an important part of delivering performance and NWL continues to formally seek the views of employees through an annual employee attitude survey. This year's survey was completed by 57% who gave their views on their working life, training, communications, managers and the Company. The results were reported back to all employees at workshops and employees participated in the development of action plans with their managers. Overall, employee satisfaction levels remain very high with over 77% of respondents stating they are proud to work for the Company and 71% telling us that NWL is a great organisation to work for.

The key employment policies in operation are outlined below.

<u>Equality and diversity</u>
The Company operates an equal opportunity policy and promotes equality of opportunity in recruitment and selection, terms and conditions of employment and 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, marital status, disability, race, ethnic or national origin, religion or sexual orientation. NWL monitors its workforce profile against the communities it operates in and aims to ensure it takes full advantage of the rich backgrounds and abilities of current and potential employees.

Employees and Employment Policies (continued)

We properly consider employment applications from people with disabilities and, where existing employees develop disabilities, it is our policy, wherever practicable, to support them through providing appropriate adjustments to their roles and/or effective redeployments. Our Occupational Health Physicians assist this process with professional medical advice.

Consultation and engagement

NWL engages with its employees through a variety of means, including formal consultation processes. The importance of an inclusive and engaging management style is fully recognised and, in 2008, the Company continued to develop in this area through over 120 workshops covering all our employees. The aim was to engage employees in a dialogue on improvements to our working practices and environment and seek their views on the areas that should be covered in our 2010-15 People Plan. In March 2009, the Chartered Institute of Personnel and Development presented NWL with the Employee Engagement Award in recognition of its proactive and inclusive employee engagement activities.

Training and Development

The Company trains and develops its employees to benefit both the Company and the individual. Annual appraisals are given high priority, as is the identification of training needs, in recognition of the importance of training and development in achieving the Company's goals and policies.

NWL introduced an extensive People Plan in 2007 in which it set out a programme to support and develop employees.

Everyone who joins NWL receives a personalised induction plan outlining their familiarisation and training programme for the first weeks of their employment. In addition they are invited to an induction day where they meet senior managers and are introduced to the Company and our approach to key areas including health and safety, terms and conditions, pensions and 'Just an hour'.

We are committed to the continuous development of occupational skills and signed the Government's 'Skills Pledge', committing to 90% of employees achieving the National Vocational Framework (NVQ) Level 2 standard by December 2009 and 95% as soon as possible thereafter.

An ambitious NVQ programme is being rolled out in our customer and operational areas. Funding has been secured from the Learning and Skills Council's 'Train to Gain' fund and also through Business Link. In December 2008, NWL was the first water and sewerage company in the UK to have all its 138 water treatment production operators meet the requirements of the 'Competent Operator Framework' and achieve a nationally recognised qualification, the NVQ Level 2 in Operating Process Plant.

Since the re-introduction of our apprenticeship scheme in September 2007 we have recruited 18 apprentices for the maintenance area across the business. In 2009, we plan to recruit nine new apprentices, including the first apprentice for our information services team. Candidates undertake a four year development programme and have excellent career prospects when they complete their apprenticeships being guaranteed employment on successful completion of their training.

Our Graduate Development Programme was re-launched in 2008, to provide potential leaders for the future. Candidates undertake a two year programme with three to six month placements in different parts of the business. In addition to a line manager they are also given a senior management mentor. Employment is guaranteed on successful completion of the programme. We recruited four graduates in 2008 and plan to recruit an additional four to start in 2009.

Employees and Employment Policies (continued)

One of the objectives of the People Plan is to develop leadership skills in current and potential managers. NWL continues to implement its Management Development Framework which is structured to cover the training needs of those who show the potential for management right through to development at director level. As part of this framework we are working in partnership with Newcastle Business School to provide qualifications from a Diploma to a Masters degree in leadership and management.

Employees' academic achievements were celebrated this year at our third annual skills awards. Attended by senior managers from around the business, and with guest speaker Kriss Akabusi, the events were again motivational and memorable.

Communication

The Company uses a wide range of communication methods including magazines, newsletters, intranet, notice boards and regular team meetings. 'Unplugged', the Group magazine, contains articles on activities and news from across the business, focusing on employees and their achievements. NWL issues all employees with a series of information booklets clearly explaining areas such as the Company's mission and values, terms, conditions and benefits of employment, occupational health and wellbeing programmes and People Plan objectives.

Disclosure (Whistleblowing)

The Company encourages open feedback and is committed to protecting employees who wish to voice concerns about behaviour or decisions that they believe to be illegal or unethical. The Audit Committee regularly reviews the Disclosure Policy.

Health and safety

A safe working environment is given a high priority in the business. The health and safety policy is maintained and implemented through the Company's health and safety team. Our emphasis on the importance of health and safety within NWL has resulted in major improvements to our safety record in recent years. This year we experienced six lost time reportable accidents per 1,000 employees, which is a 57% reduction over the previous five years. This has been accompanied by a further reduction in days lost through accidents.

We have established a medium term plan for taking health and safety forward in the business to 2014. We aim to further reduce the number of accidents by 10% each year and to reinforce the safety culture in the business.

NWL proactively supports and encourages employees to strive for high standards of health and wellbeing by providing a wide range of services, support and resources relating to occupational health, with the Group's medical advisor providing comprehensive occupational health services, general health promotion and stress management. NWL employees also have on and offsite access to specialist advice and treatment to support recovery from musculoskeletal disorders (MSD).

We continue to promote healthy eating, hydration and discourage smoking in our workforce and offer excellent health screening and medical insurance schemes. Around 1,700 employees have been through our health screening and fitness standards programmes, both of which now include lifestyle advice elements. In the first year we have reduced sickness absence due to MSD by just over 9%.

Employee Share Incentive Plan (SIP)

The directors believe that employee investment strengthens the ties between the Company's employees and the Group. More than a third of employees participate in the SIP, with an interest in 0.5% of the issued share capital. The scheme provides one free matching share for every three shares bought by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants. There are no performance conditions attached to the SIP but free shares not held in trust for at least 12 months are forfeited. Employees participating in the SIP are given the opportunity to exercise their voting rights through the Trustee of the SIP.

Customers

Our relationship with our customers is vital to the success of our business.

We keep our customers informed about our activities through leaflets sent out with bills and also through an annual magazine called 'Source'. Customers also have access via our websites at www.nwl.co.uk and www.eswater.co.uk to a range of information about our services and any supply issues.

Customers directly affected by our work receive prior notification explaining both the need for, and timing of, the work we intend to carry out. We also communicate more broadly with local communities through public meetings and written material explaining the impact of any work we are planning.

We carry out regular surveys and focus group research to understand our customers' needs, and their perceptions of our service and its value for money. Affordability and value for money are important to our customers and are, therefore, key issues for the business.

Our reputation for providing value for money and working to maintain high levels of customer satisfaction has undoubtedly helped achieve a positive response to our appeals to use water carefully.

NWL has longstanding relationships with its key industrial and commercial customers in the areas it serves. The north east, in particular, has a significant industrial base and existing customers and potential investors in the region value the availability of not only high quality potable and raw water but also access to reliable effluent treatment services.

Domestic customers

Understanding and meeting the needs of customers is at the heart of our strategy and NWL is committed to providing a high standard of customer service that meets those needs and those of our regulators. The introduction of our 'right first time every time' philosophy during 2008/09 was part of the re-launch of our customer care charter and a campaign to reinforce a strong customer service ethos across the business.

Ensuring we receive payment for the services we provide remains a priority and our ongoing focus on debt recovery inevitably generates contact from customers in arrears. In the current economic climate we expect the level of our debt recovery activity to increase.

During the year, CCWater introduced a new quality assessment process for complaint handling. We work very closely with CCWater and welcome feedback on our performance which helps to identify areas for further improvement to our high standards.

In a further reflection of our focus on customer service excellence, one of a number of awards for NWL this year was the North East Contact Centre of the Year 2008.

Business customers

The economic situation has had a significant impact on some business sectors which are important in our operating regions and NWL has been working closely with major customers in those sectors to mitigate the impact where possible. It has also taken the opportunity to work with potential new businesses in its regions and with the regional economic agencies to both secure existing and encourage new business.

Leisure customers

NWL is one of the founding members of Kielder Water & Forest Park Charitable Trust. This will replace the existing Kielder Partnership and seek to promote sustainable development, recreation, access and leisure, education, infrastructure and a range of other charitable purposes at Kielder and in the surrounding area. The Trust is seeking registration as a charity and will be chaired by John Cuthbert, Managing Director.

Customers (continued)

The development of Kielder Water & Forest Park is supported by the Northumberland Strategic Partnership, Government Office Northeast and One NorthEast. This year has seen the completion of a 27 mile lakeside multi-user track and water access points as well as the opening of an award winning observatory and a range of mountain biking tracks. The new website at www.visitkielder.com provides further details of all facilities.

NWL continues to develop its leisure facilities at all strategic sites, investing in fishing facilities, holiday accommodation and supporting 'Access for All'.

Quality

NWL has maintained its certification to the international quality standard ISO 9001:2000 and to the international environmental standard ISO 14001:2004 across all areas of the business, including operational sites and office based teams. The Company also achieved companywide certification to the international occupational health and safety management standard OHSAS 18001 in 2007.

Research and development

We run a programme of research and development linked to our core business operations. This includes the development of technical solutions for water and waste water management, collaborative research within the sector and through partnerships with academic and research organisations. During the year, the Company invested £1.8m (2008: £1.8m) in research and development.

Political contributions

We do not support any political party and we do not make what are commonly regarded as donations to any political party or other political organisations. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the Company and political parties and political organisations. These activities include attending Party Conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. The costs associated with these activities during 2008/09 were as follows (2008: £6,136):

Name of political party	**£**
Conservative	2,059
Labour	4,124
Liberal Democrats	1,012
Total	**7,195**

NWG shareholder authority to permit the Company to continue with these activities until the 2010 AGM will be sought at this year's AGM.

Company payment policy

The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. The Company's policy is to make payment not more than 30 days after receipt of a valid invoice, except as otherwise agreed. The ratio, expressed in days, between the amount invoiced by its suppliers during the year and the amount owed to its trade creditors at 31 March 2009, was 19 days (2008: 18 days).

Fixed assets

Freehold land and buildings are carried in the financial statements at historical cost with a net book value of £60.8m (2008: £60.7m). In the opinion of the directors, at 31 March 2009, 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.

Pensions

The Group operates both a defined benefit pension scheme, of which the Company is the principal member, which closed to new entrants on 31 December 2007, and an occupational defined contribution arrangement which began on 1 January 2008.

The surplus (under FRS 17) of the defined benefit scheme of £90.4m, at 31 March 2008, has moved to a deficit of £119.4m at 31 March 2009. This is mainly due to the fall in the market value of the scheme's assets since March 2008 and a reduction in the discount rate assumption to 6.1% (March 2008: 6.8%) to better match the average duration of the schemes liabilities.

Further information about the pension schemes operated by the Company is contained in note 26 to the financial statements.

Directors' remuneration

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

Indemnification of directors

The Group has in place directors' and officers' insurance and, on 28 November 2005, entered into a deed of indemnity to grant the directors of the Group and its subsidiaries further protection against liability to third parties, subject to the conditions set out in the Companies Act 1985. Such qualifying third party indemnity provision remains in force at the date of approving the directors' report.

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 2009/10 and the fact that the Company has put in place substantial pre-funding to meet the capital investment programme to 2011.

Directors' declaration

As required under Section 234ZA of the Companies Act 1985, so 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.

Statement of Directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and 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, hence, for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

Martin Parker
Company Secretary
9 July 2009

APPENDIX TO THE DIRECTORS' REPORT and OPERATING AND FINANCIAL REVIEW

DEFINITION OF KEY PERFORMANCE INDICATORS

Financial KPIs

Gearing to RCV

Definition and calculation: The ratio of net debt (including loans to other group companies) to Regulatory Capital Value (RCV). The RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews based on its view of the cost of capital.
Purpose: The RCV generates most of the revenue stream of the Company and regulatory gearing is an important factor in credit ratings.
Source of underlying data: The RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to five years ahead, based on its last price determination. Net debt is calculated from the balance sheet in the audited financial statements.

Regulatory gearing

Definition and calculation: The ratio of NWL appointed business net debt to RCV. The RCV represents the total capital value of the appointed water and sewerage business on which Ofwat allows a rate of return at price reviews based on its view of the cost of capital.
Purpose: The RCV generates most of the revenue stream of the Company and regulatory gearing is an important factor in credit ratings.
Source of underlying data: The RCV is calculated by Ofwat and published each year. Ofwat also publishes anticipated values up to five years ahead, based on its last price determination. Net debt is disclosed in the audited regulatory accounts.

Cash interest cover

Definition and calculation: Cash generated from operations less tax divided by net interest paid.
Purpose: Measures the ability of the Company to service its debt.
Source of underlying data: Audited financial statements.

Cash flow to net debt

Definition and calculation: Cash generated from operations less tax paid divided by net debt.
Purpose: Indicates the Company's ability to reduce debt in the absence of need for additional investment, without resorting to asset disposal.
Source of underlying data: Audited financial statements.

Non-financial KPIs

CUSTOMER

Customer – levels of service

Definition and calculation: Customer service standards are established by Ofwat and calculated using source data in the Company.
Purpose: To monitor customer service performance of NWL.
Source of underlying data: Information collected by the Company and submitted to Ofwat. It is independently certified.

Customer satisfaction

Definition and calculation: Domestic customers' satisfaction with overall service and overall value for money, expressed as satisfaction averaged over the surveys carried out during the year. Average satisfaction is based on a scale of 1 to 10 using the score of 6 and above as satisfied. Net scores are used to show true satisfaction by taking into consideration those who are dissatisfied who score between 1 and 3.
Purpose: To enable tracking of perception of reputation, service and value for money over time.
Source of underlying data: Independent surveys of 500 customers (300 north, 200 south) chosen at random, but representative of the customer base, carried out each quarter – a total of 2,000 customers.

APPENDIX TO THE DIRECTORS' REPORT and OPERATING AND FINANCIAL REVIEW (continued)

Non-financial KPIs (continued)

WATER

Drinking water quality

Definition and calculation: Compliance with drinking water regulations as monitored by the DWI.
Purpose: To monitor drinking water quality.
Source of underlying data: Samples recorded by NWL and audited by the DWI.

Leakage

Definition and calculation: Total leakage from the water network (including customer pipes).
Purpose: To monitor compliance with Ofwat leakage targets.
Source of underlying data: Information recorded by NWL and audited by Ofwat.

ENVIRONMENT

Sewage treatment works

Definition and calculation: Percentage of population equivalent served by non-compliant works failing Look Up Tables' consents.
Purpose: To monitor the performance of NWL's sewage treatment works and their impact on the environment.
Source of underlying data: Information recorded by NWL and the EA and reported on by the latter.

Bathing waters Mandatory Standard

Definition and calculation: Percentage of bathing waters complying with Mandatory Standards.
Purpose: To monitor the impact of NWL's coastal treatment works on the environment.
Source of underlying data: Information recorded and reported by the EA.

Pollution incidents

Definition and calculation: Number of category 1, 2 and 3 pollution incidents in the calendar year as defined by the EA.
Purpose: To monitor the performance of NWL's sewerage system and its impact on the environment.
Source of underlying data: Information recorded and reported to Ofwat by the EA.

EMPLOYEE

Lost time reportable accidents

Definition and calculation: Injury accidents that are reported to the Health & Safety Executive as required by the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995. Calculated as number of accidents reported in financial year per 1,000 employees.
Purpose: To monitor the safety performance of NWL over time.
Source of underlying data: Completed NWL accident/incident report forms. Employee numbers provided by the human resources department.

Sickness absence

Definition and calculation: Sickness absence days as a percentage of total working days multiplied by the end of month headcount.
Purpose: To track and trend sickness absence levels across the organisation.
Source of underlying data: Sicknotes, return to work interviews and weekly returns by managers.

Employee turnover

Definition and calculation: Number of leavers within the year as a percentage of average headcount.
Purpose: To track the employee turnover within the business to ensure that it is within benchmark data.
Source of underlying data: Current employees' details are held within the human resources management system – reports show leavers against headcount.

PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2009

	Note	2009	2008
		£'m	£'m
Turnover	2	641.2	622.4
Operating costs	3(a)	(274.6)	(250.8)
Capital maintenance costs	3(b)	(106.4)	(118.5)
Total operating costs		(381.0)	(369.3)
OPERATING PROFIT		260.2	253.1
Net interest payable	4	(91.4)	(75.9)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	3(c)	168.8	177.2
Taxation	8(a)	(39.5)	(51.9)
PROFIT FOR THE FINANCIAL YEAR	24	129.3	125.3

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2009

	Note	2009	2008
		£'m	£'m
Profit for the financial year		129.3	125.3
Reversal of pension prepayment		-	(22.4)
Recognition of pension asset and actuarial (loss) / gain in the year	26	(207.8)	70.1
Deferred tax related to pension adjustments	26	58.2	(13.4)
Total recognised gains and losses relating to the year		(20.3)	159.6

BALANCE SHEET
at 31 March 2009

	Note	2009	2008
		£'m	£'m
FIXED ASSETS			
Tangible assets	10	3,268.7	3,135.0
Investments	11	160.9	160.8
		3,429.6	3,295.8
CURRENT ASSETS			
Stocks	12	2.7	2.7
Debtors due in less than one year	13	122.8	116.7
Debtors due in more than one year	14	3.3	3.4
Investments	15	159.4	183.1
Cash at bank and in hand		6.8	6.9
		295.0	312.8
CREDITORS			
Amounts falling due within one year	16	(178.2)	(255.4)
NET CURRENT ASSETS		116.8	57.4
TOTAL ASSETS LESS CURRENT LIABILITIES		3,546.4	3,353.2
CREDITORS: Amounts falling due after more than one year	17	(1,925.4)	(1,781.1)
PROVISIONS FOR LIABILITIES AND CHARGES	21	(222.5)	(220.4)
ACCRUALS AND DEFERRED INCOME	22	(388.8)	(389.3)
		(2,536.7)	(2,390.8)
NET ASSETS EXCLUDING PENSION LIABILITY / ASSET		1,009.7	962.4
Pension (liability) / asset	26	(86.0)	65.1
NET ASSETS INCLUDING PENSION LIABILITY / ASSET		923.7	1,027.5
CAPITAL AND RESERVES			
Called up share capital	23	122.7	122.7
Profit and loss account	24	801.0	904.8
EQUITY SHAREHOLDERS' FUNDS	24	923.7	1,027.5

Approved on behalf of the board

J A Cuthbert

C M Green
9 July 2009

NOTES TO THE STATUTORY FINANCIAL STATEMENTS
for the year ended 31 March 2009

1. STATEMENT OF ACCOUNTING POLICIES

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

(a) Basis of accounting
The financial statements have been prepared under the historical cost convention on a 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) Turnover
Turnover, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom.

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

(d) Tangible fixed assets and depreciation
Tangible fixed assets comprise:

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

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

The Section 19 quality programme addresses water discolouration problems caused by iron pipes, either through relining these pipes or replacing them where relining is not possible. “Overlap” expenditure 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 classified as capital in nature and is included under infrastructure assets in the fixed asset note.

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

(ii) Non-infrastructure assets
Other assets are included at cost less accumulated depreciation and, where required, provision for impairment. Additions are included at cost.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation (continued)
(ii) Non-infrastructure assets (continued)

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

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

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

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

(e) Grants and contributions
Revenue grants are credited to the profit and loss account when received.

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

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

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

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

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

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

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

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(i) Taxation

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

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

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

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

(j) Foreign currency

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

(k) Research and development

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

(l) Fixed Asset Investments

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

(m) Derivative financial instruments

The Company utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments.

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

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

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

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

(n) Liquid resources

Liquid resources comprise external deposits and cash.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(o) Bad debt provisioning

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

(p) Share based payments

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by an external valuer using the Monte-Carlo simulation model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Group (market conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired, management's best estimate of the achievement or otherwise of non-market conditions and the number of equity instruments that will ultimately vest or in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

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:

	2009	2008
	£'m	£'m
Materials and consumables	18.6	17.7
Other external charges	81.0	74.7
Net manpower costs (note 7)	94.6	99.7
Other operating charges	107.4	84.9
Own work capitalised	(27.0)	(26.2)
	274.6	250.8

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

(b) Capital maintenance costs comprise:

	2009	2008
	£'m	£'m
Depreciation:		
Non-infrastructure assets	69.9	69.2
Non-infrastructure assets held under finance leases	4.0	3.6
Infrastructure assets	38.1	51.2
Amortisation of capital grants and contributions	(4.4)	(4.2)
Profit on disposal of fixed assets	(1.2)	(1.3)
	106.4	118.5

(c) Profit on ordinary activities before taxation:

	2009	2008
	£'m	£'m
Profit on ordinary activities before taxation is stated after charging:		
Operating leases: Plant and machinery	0.3	0.1
Other assets	1.3	1.0
Costs of research and development	1.8	1.8
Directors' emoluments (note 5)	1.0	1.1

Auditors' remuneration in respect of the statutory audit amounted to £106,983 (2008: £98,897). Auditors' remuneration for the regulatory audit amounted to £17,930 (2008: £16,575). Fees of £14,785 and £15,799 (2008: £13,667 and £14,605) were also incurred in the auditing of RAG 5 information and the June Return respectively. The remuneration to auditors for non-audit services is disclosed on a consolidated basis in the group financial statements of the ultimate parent company.

4. NET INTEREST PAYABLE

	2009	2008
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	22.6	22.9
Group loans	92.7	86.4
Financing charges payable under finance leases	4.7	2.4
Total interest payable	120.0	111.7
Interest receivable:		
Group interest	(22.7)	(22.2)
External interest	(0.1)	(0.4)
Total interest receivable	(22.8)	(22.6)
Other finance income relating to pension scheme (note 26)	(5.8)	(13.2)
Net interest payable	91.4	75.9

5. DIRECTORS' EMOLUMENTS

(a) Directors' remuneration

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

	2009	2008
	£'000	£'000
Emoluments (including benefits in kind)	996.6	1,100.4

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.

Four of the directors at 31 March 2009 were members of a defined benefit pension scheme where the Company makes contributions towards the cost (2008: 4).

The directors who held office as at 31 March 2009 held the following conditional interests in the ordinary 10p shares of the Group, awarded in accordance with the terms of its Long Term Incentive Plan (LTIP):

Name of Director	Award date	Awards held at the start of the year	Awarded during the year	Awards lapsed during the year	Awards vested during the year	Awards held as at 31 March 2009
J A Cuthbert	9.12.05[1]	75,903	-	53,359	22,544[2]	**-**
	21.12.06[3]	66,721	-	-	-	**66,721**
	13.12.07[4]	79,230	-	-	-	**79,230**
	15.12.08[5]	-	103,100	-	-	**103,100**
Totals		221,854	103,100	53,359	22,544	**249,051**
C M Green	9.12.05[1]	50,602	-	35,573	15,029[2]	**-**
	21.12.06[3]	49,423	-	-	-	**49,423**
	13.12.07[4]	61,620	-	-	-	**61,620**
	15.12.08[5]	-	78,650	-	-	**78,650**
Totals		161,645	78,650	35,573	15,029	**189,693**
A C Jones	9.12.05[1]	26,506	-	18,633	7,873[2]	**-**
	21.12.06[3]	25,899	-	-	-	**25,899**
	13.12.07[4]	22,450	-	-	-	**22,450**
	15.12.08[5]	-	28,850	-	-	**28,850**
Totals		74,855	28,850	18,633	7,873	**77,199**
G Neave	9.12.05[1]	32,530	-	22,868	9,662[2]	**-**
	21.12.06[3]	32,374	-	-	-	**32,374**
	13.12.07[4]	27,470	-	-	-	**27,470**
	15.12.08[5]	-	34,800	-	-	**34,800**
Totals		92,374	34,800	22,868	9,662	**94,644**

5. DIRECTORS' EMOLUMENTS (continued)

(a) Directors' remuneration (continued)

Notes:

1. The market value of the shares on the date of the award was 252.00 pence per share. The three year performance period ran from 1 October 2005 to 30 September 2008.
2. Shares vested on 9 December 2008 and the closing price on that date was 245.75 pence per share.
3. The market value of the shares on the date of the award was 302.75 pence per share. The three year performance period runs from 1 October 2006 to 30 September 2009.
4. The market value of the shares on the date of the award was 334.00 pence per share. The three year performance period runs from 1 October 2007 to 30 September 2010.
5. The market value of the shares on the date of the award was 251.50 pence per share. The three year performance period runs from 1 October 2008 to 30 September 2011.
6. The cost of conditional awards is charged to the profit and loss account over the three year performance period to which they relate after taking account of the probability of performance criteria being met. In the year, £0.4m was charged to the profit and loss account (2008: £0.5m).
7. Details of the performance conditions are shown in Note 11 (iv) of the Regulatory Accounts.
8. The market price of the shares on 31 March 2009 was 218.25 pence per share. During the year, the highest market price was 352.31 pence per share and the lowest market price was 206.75 pence per share.
9. Aggregate gross gains made by directors on exercise of awards at date of vesting was £135,428 (2008: £390,362).
10. Some or all of the shares will vest only if specified performance targets are achieved during the three year performance period. For further information, please refer to the Directors' Remuneration Report in the NWG accounts and to note 11 to the Regulatory Accounts.

The directors who held office as at 31 March 2009 held the following interests in the ordinary 10p shares of the Group, purchased and held in accordance with the terms of the Share Incentive Plan:

Name of Director	Number of shares held as at 1 April 2008	Number of shares held as at 31 March 2009
J A Cuthbert	4,176	4,785
C M Green	4,176	4,785
A C Jones	4,176	4,785
G Neave	590	590

(b) Highest paid director

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

	2009	2008
	£'000	£'000
Emoluments (including benefits in kind)	248.5	282.4

The accrued pension entitlement under the Company's defined benefit scheme of the highest paid director at 31 March 2009 was £163,400 (2008: £141,700).

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

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

	2009	2008
	£'m	£'m
Gross costs charged to the profit and loss account:		
Wages and salaries	60.9	58.0
Social security costs	5.0	4.9
Other pension costs	7.8	12.4
	73.7	75.3
Costs recharged to other group companies:		
Wages and salaries	2.0	1.2
Social security costs	0.1	0.1
Other pension costs	0.3	0.2
	2.4	1.5
Net costs charged to the profit and loss account:		
Wages and salaries	58.9	56.8
Social security costs	4.9	4.8
Other pension costs	7.5	12.2
	71.3	73.8
Costs charged to capital schemes:		
Wages and salaries	19.2	19.9
Social security costs	1.6	1.7
Other pension costs	2.5	4.3
	23.3	25.9
Total net employee costs	94.6	99.7

The average monthly number of employees on the payroll during the financial year was 2,942 (2008: 2,890) and the total at the year end was 2,966 (2008: 2,917).

8. TAXATION

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

	2009	2008
	£'m	£'m
Current tax:		
UK corporation tax on profits for the year at 28% (2008:30%)	33.0	28.2
Adjustments in respect of prior years	(1.1)	(2.7)
Payable in respect of group relief for the current year at 28% (2008:30%)	5.7	8.1
Adjustments in respect of prior years	-	0.3
Total current tax charge (note 8b)	37.6	33.9
Deferred tax:		
Reduction due to opening tax rate change	-	(32.9)
Decrease in discount arising from above rate change	-	15.4
Net reduction in opening deferred tax	-	(17.5)
Movement in the year at 28% (2008: 30%):		
Change in tax law re industrial buildings allowances	-	(37.2)
Origination and reversal of timing differences in the year	8.4	11.6
Adjustments in respect of prior periods	1.1	1.0
	9.5	(24.6)
(Increase)/decrease in discount arising from current year movements	(7.6)	60.1
Movement in the year	1.9	35.5
Total deferred tax (note 21)	1.9	18.0
Tax on profit on ordinary activities	39.5	51.9

Tax losses have provisionally been claimed from other group companies in the current year of £17.1m (2008: £25.7m) for which payment will be made at the rate of 28% (2008:30%).

The rate of UK corporation tax was reduced from 30% to 28% by the 2007 Finance Act with effect from 1 April 2008. As a result, deferred tax was restated at 1 April 2007 at the rate at which timing differences are expected to reverse.

The Finance Act 2007 also contains provisions preventing any clawback of industrial buildings allowances arising on a disposal of relevant assets. In accordance with FRS 19 deferred tax in respect of timing differences relating to those assets was released in 2007/08 and industrial building allowances claimed and related depreciation have been dealt with in the reconciliation of the current tax charge as permanent differences (see note 8b).

Discount has decreased due to the removal of timing differences relating to industrial buildings as well as falls in the post-tax yields on UK government gilts during the year.

8. TAXATION (continued)

(b) Reconciliation of the current tax charge:

	2009	2008
	£'m	£'m
Profit on ordinary activities before tax	168.8	177.2
Profit on ordinary activities multiplied by standard rate of UK corporation tax 28% (2008: 30%)	47.3	53.2
Effects at 28% (2008: 30%) of:		
Expenses not deductible for tax purposes	0.3	(0.2)
Non-taxable income	(2.1)	(2.4)
Depreciation in respect of non-qualifying items	4.8	5.0
Industrial buildings allowances claimed in the year	(4.8)	(6.9)
Capital allowances in excess of depreciation	(10.6)	(10.7)
FRS17 pension deficit / (surplus)	0.5	(6.1)
Other timing differences	1.7	4.4
Refinancing of infrastructure assets	1.6	-
Adjustments in respect of prior years	(1.1)	(2.4)
Transfer pricing adjustments	(0.9)	(0.4)
Balancing payment payable	0.9	0.4
Total current tax charge (note 8a)	37.6	33.9

(c) Factors that may affect future tax charges:

The Company expects to continue to incur high levels of capital expenditure and, accordingly, it expects to be able to claim capital allowances in excess of depreciation for the remainder of the current regulatory review period.

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

9. DIVIDENDS

	2009	2008
	£'m	£'m
Equity:		
Dividends paid:		
Final paid for the year ended 31 March 2008 of 33.41p (year ended 31 March 2007: 31.62p) per share on an aggregated basis	41.0	38.8
Interim paid of 34.96p (2008: 33.25p) per share on an aggregated basis	42.9	40.8
Total dividends paid in the year	83.9	79.6
Dividends proposed:		
Final proposed for year ended 31 March 2009 of 34.64p (year ended 31 March 2008: 33.41p) per share on an aggregated basis	42.5	41.0

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

The Company has maintained its policy of steady real growth of 1.9% per annum for the appointed business dividend and also re-based the dividend in line with Ofwat's assumptions for dividends in the 2004 final determination. Dividends from the non-appointed business are determined by the directors and are based on performance.

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

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

10. TANGIBLE FIXED ASSETS

	Freehold land and buildings	Infra-structure assets	Operational structures, plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 April 2008	92.6	1,781.3	1,957.7	137.8	152.2	4,121.6
Additions	-	-	-	-	245.7	245.7
Schemes commissioned	2.0	117.6	96.6	5.5	(221.7)	-
Disposals	-	(15.4)	(11.1)	-	-	(26.5)
At 31 March 2009	94.6	1,883.5	2,043.2	143.3	176.2	4,340.8
Depreciation:						
At 1 April 2008	31.9	275.1	573.9	105.7	-	986.6
Charge for year	1.9	38.1	63.9	8.1	-	112.0
Disposals	-	(15.4)	(11.1)	-	-	(26.5)
At 31 March 2009	33.8	297.8	626.7	113.8	-	1,072.1
Net book value:						
At 31 March 2009	60.8	1,585.7	1,416.5	29.5	176.2	3,268.7
At 31 March 2008	60.7	1,506.2	1,383.8	32.1	152.2	3,135.0
Leased assets included above:						
Net book value:						
At 31 March 2009	-	48.3	24.1	-	-	72.4
At 31 March 2008	-	28.4	23.7	-	-	52.1

11. FIXED ASSET INVESTMENTS

	Loans to Group Companies
	£'m
At 1 April 2008	160.8
Capitalised interest	0.1
At 31 March 2009	160.9

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

In May 2004 NWL made a loan of £1.5m to Bakethin Holdings Limited, a quasi subsidiary company, maturing in January 2034**.** The interest on the loan is capitalised and at 31 March 2009 was £1.9m (2008: £1.8m).

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

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

12. STOCKS

	2009	2008
	£'m	£'m
Raw materials and consumables	2.7	2.7

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

13. DEBTORS DUE IN LESS THAN ONE YEAR

	2009	2008
	£'m	£'m
Trade debtors	63.0	61.7
Amounts owed by other group companies	8.1	8.2
Other debtors	5.7	1.8
Prepayments and accrued income	46.0	45.0
	122.8	116.7

Trade debtors are shown net of bills raised in advance.

14. DEBTORS DUE IN MORE THAN ONE YEAR

	2009	2008
	£'m	£'m
Interest rate hedge	3.3	3.4

15. INVESTMENTS

	2009	2008
	£'m	£'m
Short term deposits with NSL	159.4	183.1

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2009	2008
	£'m	£'m
Obligations under finance leases (note 19)	6.8	6.1
Loans (note 18)	19.1	94.6
Trade creditors	6.6	5.8
Amounts owed to other group companies	12.0	15.4
Taxation and social security	2.1	2.0
Corporation tax	6.1	3.7
Other creditors	12.4	10.8
Receipts in advance	17.3	18.2
Accruals and deferred income	95.8	98.8
	178.2	255.4

Accruals and deferred income includes accruals related to capital projects of £37.9m (2008: £41.2m).

Included in amounts owed to other group companies is £10.3m (2008: £11.2m) payable in respect of tax losses surrendered from fellow group companies.

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

	2009	2008
	£'m	£'m
Obligations under hire purchase contracts and finance leases (note 19)	104.8	83.6
Loans (note 18)	362.3	261.4
Amounts owed to other group companies (note 20)	1,458.2	1,435.8
Other creditors	0.1	0.3
	1,925.4	1,781.1

18. LOANS

	2009	2008
	£'m	£'m
Loans are repayable as follows:		
Within one year (note 16)	19.1	94.6
Between one and two years	17.6	19.1
Between two and five years	125.6	98.0
After five years	219.1	144.3
	381.4	356.0

Loans wholly repayable within 5 years amount to £67.4m (2008: £152.5m).

Loans not wholly repayable within 5 years amount to £314.0m (2008: £203.5m) and bear interest rates in the range 5.16% to 7.27%.

19. OBLIGATIONS UNDER FINANCE LEASES

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

	2009	2008
	£'m	£'m
Amounts due:		
Within one year	6.8	6.1
Between one and two years	6.4	5.4
Between two and five years	16.8	13.7
After five years	160.0	123.8
	190.0	149.0
Less:		
Finance charge allocated to future periods	(78.4)	(59.3)
	111.6	89.7
Disclosed as due:		
Within one year (note 16)	6.8	6.1
After more than one year (note 17)	104.8	83.6
	111.6	89.7

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 £190.0m (2008: £149.0m).

20. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	2009	2008
	£'m	£'m
After five years	1,458.2	1,435.8

NWF issued £200.0m and £150.0m Guaranteed Eurobonds in February 1998 and September 2001 respectively, maturing February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £194.2m and £163.2m respectively. Finance costs allocated during the year amounted to £0.2m (2008: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2008: £0.3m).

NWF issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £301.0m. Amortisation of loan receipts during the year amounted to £0.1m (2008: £0.1m).

NWF issued £250.0m and £100.0m Guaranteed Eurobonds in December 2002 and December 2004, maturing April 2033 with an annual coupon of 5.625%. Both issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £246.6m and £100.8m respectively. Finance costs allocated during the year amounted to £0.2m (2008: £0.2m).

NWF issued £150.0m Guaranteed Index Linked Eurobonds in September 2005, maturing July 2036, with a real coupon of 2.033%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £150.0m. Indexation accretion during the year amounted to £8.2m (2008: £6.0m).

NWF issued £60.0m Guaranteed Index Linked Eurobonds in January 2006, maturing January 2041, with a real coupon of 1.6274%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £60.0m. Indexation accretion during the year amounted to £3.2m (2008: £2.4m).

NWF issued two £100.0m Guaranteed Index Linked Eurobonds in June 2006 with real coupons of 1.7118% and 1.7484% and with maturities of 2049 and 2053 respectively. Both issues were guaranteed by the Company who received the issue proceeds by way of two inter-company loans of £100.0m. Indexation accretion during the year amounted to £10.8m (2008: £7.9m).

21. PROVISIONS FOR LIABILITIES AND CHARGES

	£'m
Pension provision for former directors:	
At 1 April 2008	3.0
Utilised during the year	(0.3)
At 31 March 2009	2.7
Deferred tax :	
At 1 April 2008	217.4
Movement in the year (note 8a)	1.9
Movement relating to pensions (note 26)	0.5
At 31 March 2009	219.8
Provisions for liabilities and charges	222.5

The pension provision for former directors relates to pensions payable to former directors of water-only companies which have since merged with the Company. The provision of £2.7m represents the full future amounts payable, based on an actuarial assessment, for which the Company is directly liable.

The provision for deferred tax comprises:

	2009	2008
	£'m	£'m
Accelerated capital allowances	495.5	483.8
Other timing differences	(61.2)	(59.5)
Undiscounted provision for deferred tax	434.3	424.3
Discount	(214.5)	(206.9)
Discounted provision for deferred tax	219.8	217.4

22. ACCRUALS AND DEFERRED INCOME

	Gilt lock	Capital grants and contributions	Proceeds from Kielder securitisation	Total
	£'m	£'m	£'m	£'m
At 1 April 2008	0.5	204.4	184.4	389.3
Additions	-	11.2	-	11.2
Amortised / transferred during the year	-	(4.6)	(7.1)	(11.7)
At 31 March 2009	0.5	211.0	177.3	388.8

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

In 2006/07, the Company entered into a hedging instrument in order to protect the Company against movement in real interest rates prior to the launch of the two £100 million index linked bonds issued in June 2006. The bonds were priced on 24 May 2006 and the hedging instrument was liquidated on the same day resulting in a gain of £0.5m. This income is amortised to the profit and loss account of the Company over the life of the bonds.

23. CALLED UP SHARE CAPITAL

	2009	2008
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2008: 122,650,000)	122.7	122.7

	2009	2008
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2008: 122,650,000)	122.7	122.7

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

	Profit and loss account	Total share-holders' funds
	£'m	£'m
At 31 March 2008	904.8	1,027.5
Profit for the year	129.3	129.3
Share based payment	0.4	0.4
Actuarial loss on pension liability in the year (note 26)	(207.8)	(207.8)
Deferred tax related to actuarial loss on pension liability in the year (note 26)	58.2	58.2
Dividends paid (note 9)	(83.9)	(83.9)
At 31 March 2009	801.0	923.7

25. COMMITMENTS

(a) Capital expenditure:

	2009	2008
	£'m	£'m
Expenditure contracted for but not provided for	168.8	166.8

(b) Lease commitments:

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

	2009	2008
	£'m	£'m
Land and buildings:		
Leases which expire:		
After one year but not more than five	0.3	0.1
In five years or more	0.6	0.6
	0.9	0.7

	2009	2008
	£'m	£'m
Other:		
Leases which expire:		
Within one year	-	0.1
Between two and five years	0.1	-
	0.1	0.1

26. PENSIONS

NWL participates in the Group defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 2,169 active members at 31 March 2009 (2008: 2,391).

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 2007. At that date the value of assets amounted to £732.3 million and the funding level was 106.1%.

The future service contribution rate jointly payable by members and the employers from 31 December 2007 was 22.6% of pensionable salaries. Members' contributions are 7.3% on average with the employers paying 15.3%.

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

Investment Return:	
Pre-retirement	6.1%
Post-retirement	5.2%
Pay Increases	3.65%
Pension Increases	3.4%
Price Inflation	3.4%

Following the 2004 actuarial valuation the employers had prepaid contributions to the scheme up to 31 December 2010. The scheme actuary recommended that regular contributions should recommence from 1 January 2011.

26. PENSIONS (continued)

The scheme also has a defined contribution section which had 310 active members at 31 March 2009 (2008: 219). Members can choose to contribute either 3%, 4% or 5% of salary, with employers contributing 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Company in the year totalled £0.4m (2008: £nil).

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

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

A qualified actuary, using revised assumptions that are consistent with the requirements of FRS 17, has updated the actuarial valuation described above as at 31 March 2009. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions :	2009 %	2008 %
Pay increases[1]	4.0	4.5
Pension increases	3.0	3.5
Price inflation	3.0	3.5
Discount rate	6.1	6.8
Mortality assumptions[2,3]	PCMA/PCFA00	PMA/PFA00
- Life expectancy for a member aged 60 – female (years)	-	28.0
- Life expectancy for a member aged 60 – male (years)	-	25.2
- Life expectancy for a member aged 65 – female (years)	22.9	28.0
- Life expectancy for a member aged 65 – male (years)	20.6	25.2

1. including promotional salary scale
2. 115% of PCMA/PCFA00 and PMA/PFA00
3. PCMA/PCFA00 and PMA/PFA00 (year of birth with medium cohort improvements).

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

	Long term expected rate of return 2009	2009	Long term expected rate of return 2008	2008
	%	£'m	%	£'m
Equities	7.2	369.0	7.5	457.1
Corporate bonds	6.1	38.9	6.8	51.6
Government bonds	4.2	50.0	4.5	66.1
Property	5.7	58.7	6.0	76.3
Cash	4.0	1.8	5.3	15.6
Loan to Scheme from NSL	2.0	(39.8)	-	-
Total fair value of assets		478.6		666.7
Present value of liabilities		(598.0)		(576.3)
(Deficit) / surplus		(119.4)		90.4
Related deferred tax [1]		33.4		(25.3)
Net pension (liability) / asset		(86.0)		65.1

1. The movement in deferred tax of £58.7m comprises £58.2m relating to the actuarial loss in the year, which is recognised in the statement of total recognised gains and losses, and £0.5m relating to other items, which is recognised in the deferred tax provision in the balance sheet (note 21).

26. PENSIONS (continued)

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

	2009	2008
	£'m	£'m
Current service cost	9.6	15.3
Past service cost	0.3	0.4
Recognised in operating costs in arriving at operating profit	9.9	15.7

	2009	2008
	£'m	£'m
Interest cost on plan obligations	38.5	35.2
Expected return on plan assets	(44.3)	(48.4)
Recognised in net interest payable (note 4)	(5.8)	(13.2)

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

	2009	2008
	£'m	£'m
Net actuarial (loss) / gain	(207.8)	27.2
Cumulative amounts recognised since adopting the standard	(81.6)	126.2

History of experience gains and losses:

	2009	2008	2007	2006	2005
Fair value of assets	478.6	666.7	710.8	659.8	523.8
Present value of defined benefit obligation	(598.0)	(576.3)	(668.1)	(663.5)	(600.2)
(Deficit) / surplus	(119.4)	90.4	42.7	(3.7)	(76.4)
Experience adjustments arising on plan assets	(205.3)	(93.4)	0.6	87.1	25.6
Experience adjustments arising on plan liabilities	18.7	0.6	1.7	34.0	(4.4)

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

	2009	2008
	£'m	£'m
Present value at 1 April	576.3	668.1
Current service cost	9.6	15.3
Past service cost	0.3	0.4
Interest cost	38.5	35.2
Contributions by plan participants	0.1	0.1
Actuarial gains on obligations	2.5	(120.6)
Benefits paid	(29.3)	(22.2)
Present value at 31 March	598.0	576.3

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

	2009	2008
	£'m	£'m
At 1 April	666.7	710.8
Expected return on plan assets	44.3	48.4
Actuarial (losses)/gains on plan assets	(205.3)	(93.4)
Contributions by employer	2.1	23.0
Contributions by plan participants	0.1	0.1
Benefits paid	(29.3)	(22.2)
At 31 March	478.6	666.7

26. PENSIONS (continued)

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

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

A reduction in the net discount rate will increase the assessed value of liabilities, as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have an opposite effect of similar magnitude. The overall effect of a change in the net discount rate of 0.1% would change the liabilities by around £11.6 million.

There is also uncertainty around life expectancy for the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

The disclosures have been prepared using the mortality assumptions adopted for the 2007 formal valuation, detailed earlier in this note. The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around 2.9%.

27. SHARE INCENTIVE PLANS

(a) Long Term Incentive Plan (LTIP)
Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Group. Further details of the LTIP can be found in the directors' remuneration report on pages 33 and 34.

The following table illustrates the movements in conditional share awards during the year.

	March 2009 Number	March 2008 Number
Outstanding at 1 April	1,103,069	1,114,715
Granted during the year	462,700	364,370
Forfeited/lapsed during the year	(270,480)	(102,606)
Exercised	(105,255)	(273,410)
Outstanding at 31 March	1,190,034	1,103,069
Exercisable at 31 March	9,023	4,062

The weighted average exercise price throughout the year was £nil (2008: £nil). The fair value of conditional share awards granted during the year was £0.1m (2008: £0.1m).

The weighted average share price at the date of exercise for the conditional share awards is 248.08 pence (2008: 343.34 pence).

For the conditional awards outstanding as at 31 March 2009, the weighted average remaining contractual life is 1.8 years (2008: 1.7 years).

27. SHARE INCENTIVE PLANS (continued)

The fair value of conditional share awards granted was estimated using the Monte-Carlo model. The significant inputs to the model were as follows:

	March 2009	March 2008
Dividend yield	4.9%	3.5%
Expected share price volatility	28%	24%
Share price at award	251.50p	334.00p
Expected FTSE 250 index volatility	23%	13%
Risk free interest rate %	2.6%	4.6%
Expected life of option (years)	3	3

The expected life of these options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

(b) Share Incentive Plan (SIP)
The Group SIP scheme provides one free matching share for every three shares purchased by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants.

The following table illustrates the movements in conditional share awards during the year for the Group scheme. The costs of the scheme are apportioned to the participating subsidiary companies and the Company reports only the relevant proportion of scheme cost.

	March 2009 Number	March 2008 Number
Outstanding at 1 April	97,876	115,219
Granted during the year	119,922	100,721
Forfeited during the year	(2,861)	(3,647)
Exercised	(97,250)	(114,417)
Outstanding at 31 March	117,687	97,876

28. RELATED PARTY DISCLOSURES

The Company is a wholly owned subsidiary of Northumbrian Water Group plc which produces publicly available financial statements which include the Company. Consequently the Company is exempt under the terms of FRS 8 "Related Party Disclosures" from disclosing transactions with other members of the group headed by NWG.

29. ULTIMATE PARENT COMPANY

Northumbrian Water Group plc, 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NORTHUMBRIAN WATER LIMITED

We have audited the Company's financial statements for the year ended 31 March 2009 which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, Balance Sheet and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' Report and Operating and Financial Review is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report and Operating and Financial Review and the Appendix to the Directors' Report and Operating and Financial Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the 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 financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2009 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report and Operating and Financial Review is consistent with the financial statements.

Ernst & Young LLP
Registered Auditor
Newcastle upon Tyne
10 July 2009

HISTORICAL COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2009

	Note	2009 Appointed business	2009 Non-appointed business	2009 Aggregated basis	2008 Appointed business	2008 Non-appointed business	2008 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
Turnover	2	614.4	26.1	640.5	595.3	27.1	622.4
Operating costs		(302.3)	(12.9)	(315.2)	(291.7)	(13.5)	(305.2)
Historical cost depreciation		(70.4)	(0.6)	(71.0)	(69.2)	(0.7)	(69.9)
Operating income		1.1	-	1.1	1.3	-	1.3
OPERATING PROFIT	A	242.8	12.6	255.4	235.7	12.9	248.6
Net interest (payable) / receivable		(101.9)	10.5	(91.4)	(86.6)	10.6	(76.0)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		140.9	23.1	164.0	149.1	23.5	172.6
Taxation – current		(32.9)	(4.7)	(37.6)	(29.5)	(4.3)	(33.8)
– deferred	A	23.4	0.1	23.5	(17.5)	6.0	(11.5)
PROFIT FOR THE FINANCIAL YEAR		131.4	18.5	149.9	102.1	25.2	127.3
Dividends		(76.9)	(7.0)	(83.9)	(72.6)	(7.0)	(79.6)
RETAINED PROFIT FOR THE YEAR		54.5	11.5	66.0	29.5	18.2	47.7

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 2009

	2009 Appointed business	2009 Non-appointed business	2009 Aggregated basis	2008 Appointed business	2008 Non-appointed business	2008 Aggregated basis
	£'m	£'m	£'m	£'m	£'m	£'m
Profit for the financial year	131.4	18.5	149.9	102.1	25.2	127.3
Pension prepayment reclassification	-	-	-	(21.9)	(0.6)	(22.5)
Recognition of pension asset and actuarial gain in the year	(202.5)	(3.4)	(205.9)	68.2	1.2	69.4
Deferred tax related to pension adjustments	56.6	1.0	57.6	(12.9)	(0.2)	(13.1)
Total recognised gains and losses relating to the year	(14.5)	16.1	1.6	135.5	25.6	161.1

HISTORICAL COST BALANCE SHEET
At 31 March 2009

		2009			2008		
	Note	Appointed business	Non-appointed business	Aggregated basis	Appointed business	Non-appointed business	Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
FIXED ASSETS							
Tangible assets	A	2,985.6	99.9	3,085.5	2,858.9	100.0	2,958.9
Investments – loans to group companies		-	160.9	160.9	-	160.8	160.8
TOTAL FIXED ASSETS		2,985.6	260.8	3,246.4	2,858.9	260.8	3,119.7
CURRENT ASSETS							
Stocks		2.4	0.3	2.7	2.5	0.3	2.8
Debtors	A	128.1	(2.0)	126.1	118.3	1.7	120.0
Cash		-	26.8	26.8	-	18.6	18.6
Short term deposits		159.4	-	159.4	183.1	-	183.1
TOTAL CURRENT ASSETS		289.9	25.1	315.0	303.9	20.6	324.5
CREDITORS: Amounts falling due within one year							
Overdrafts		(20.0)	-	(20.0)	(11.7)	-	(11.7)
Infrastructure renewals accrual		(24.6)	(1.9)	(26.5)	(20.2)	(1.8)	(22.0)
Creditors		(137.3)	(8.6)	(145.9)	(142.5)	(8.6)	(151.1)
Borrowings		(25.9)	-	(25.9)	(100.7)	-	(100.7)
Corporation tax payable		(6.1)	-	(6.1)	(3.6)	-	(3.6)
TOTAL CREDITORS		(213.9)	(10.5)	(224.4)	(278.7)	(10.4)	(289.1)
NET CURRENT ASSETS		76.0	14.6	90.6	25.2	10.2	35.4
TOTAL ASSETS LESS CURRENT LIABILITIES		3,061.6	275.4	3,337.0	2,884.1	271.0	3,155.1
CREDITORS: Amounts falling due after more than one year							
Borrowings		(1,925.3)	-	(1,925.3)	(1,780.8)	-	(1,780.8)
Other creditors		(0.1)	-	(0.1)	(0.3)	-	(0.3)
TOTAL CREDITORS		(1,925.4)	-	(1,925.4)	(1,781.1)	-	(1,781.1)
PROVISIONS FOR LIABILITIES AND CHARGES							
Deferred tax provision	A	(171.5)	(1.6)	(173.1)	(194.3)	(1.7)	(196.0)
Deferred income – grants and contributions	A	(56.5)	(0.5)	(57.0)	(56.7)	(0.5)	(57.2)
Post employment (liability) / asset	A	(83.8)	(1.4)	(85.2)	63.4	1.1	64.5
Other provisions		(2.7)	-	(2.7)	(3.0)	-	(3.0)
Other deferred income		(0.5)	(177.3)	(177.8)	(0.5)	(184.4)	(184.9)
NET ASSETS EMPLOYED		821.2	94.6	915.8	911.9	85.5	997.4
CAPITAL AND RESERVES							
Called up share capital		92.1	30.6	122.7	92.1	30.6	122.7
Profit and loss account		729.1	64.0	793.1	819.8	54.9	874.7
CAPITAL AND RESERVES		821.2	94.6	915.8	911.9	85.5	997.4

Approved on behalf of the board

J A Cuthbert C M Green
9 July 2009

(A) RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS
For the year ended 31 March 2009

In preparing its statutory accounts, the Company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS15: Tangible Fixed Assets. However, for the purpose of the regulatory accounts, Ofwat has requested that FRSI5 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. In addition, the WSRA has decided to depart from UK GAAP and disapply the provisions of Note G of FRS.5, which states the turnover should not include amounts that the company does not expect to collect. A reconciliation between the statutory and historical cost regulatory accounts is set out below:

	Statutory UK GAAP	Regulatory	Explanation of difference
	£'m	£'m	
PROFIT AND LOSS ACCOUNT			
Turnover	641.2	640.5	Statutory accounts include provision for revenue recognition of £0.7m in accordance with Note G of FRS5, which is disapplied for regulatory purposes (see note 1(c)).
Operating Profit	260.2	255.4	Adjustments mainly relating to Section 19 "overlap" (£3.2m) (see note 1(a)(i)) and amortisation of infrastructure income (£1.5m)(see note 1(a)(ii)).
Deferred tax charge / (credit)	1.9	(23.5)	Adjustments relating to amortisation of infrastructure income (£0.4m), Section 19 "overlap" (£0.9m) post employment liability (£0.1m) and discount (£24.0m).
BALANCE SHEET			
Tangible fixed assets (net book value)	3,268.7	3,085.5	Adjustments relating to – infrastructure grants and contributions netted off (£172.3m), Section 19 "overlap" (£37.3m) and infrastructure renewals provision (£26.4m).
Provisions for liabilities and charges – deferred tax	219.8	173.1	Adjustments relating to amortisation of infrastructure income (£5.1m), Section 19 "overlap" (£10.5m) and discount (£31.1m).
Deferred income – grants and contributions	211.0	57.0	Adjustments relating to gross up (£172.3m) and amortisation (£18.3m) of infrastructure grants and contributions.
Post employment liability	86.0	85.2	Adjustment relating to additional charge in statutory accounts for VLS pension scheme (£0.8m).

The non-appointed debtor balance shows a net credit of £2.0m as it includes an amount of £7.1m owed to the appointed business. The aggregated debtor balance therefore agrees to the statutory accounts.

CURRENT COST PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2009

	Note	2009 £'m	2008 £'m
Turnover	2	614.4	595.3
Current cost operating costs	3	(429.8)	(416.6)
Operating income	2	1.2	1.6
Working capital adjustment	2	-	(0.5)
CURRENT COST OPERATING PROFIT		185.8	179.8
Net interest payable		(101.9)	(86.6)
Financing adjustment		(4.8)	46.2
CURRENT COST PROFIT BEFORE TAXATION		79.1	139.4
Taxation:			
Current tax		(32.9)	(29.5)
Deferred tax		23.4	(17.5)
CURRENT COST PROFIT ATTRIBUTABLE TO SHAREHOLDERS		69.6	92.4
Dividends		(76.9)	(72.6)
CURRENT COST (LOSS) / PROFIT RETAINED		(7.3)	19.8

All note references to the summary current cost financial statements on pages 55 to 57 refer to the notes to the current cost accounts.

CURRENT COST BALANCE SHEET
At 31 March 2009

	Note	2009	2008
		£'m	£'m
FIXED ASSETS			
Tangible assets	4	13,404.7	13,360.7
Third party contributions since 1989/90		(96.2)	(96.7)
		13,308.5	13,264.0
Working capital	5	22.8	12.1
Short term deposits		159.4	183.1
Overdraft		(20.0)	(11.7)
Infrastructure renewals accrual		(24.6)	(20.2)
NET OPERATING ASSETS		13,446.1	13,427.3
NON OPERATING ASSETS AND LIABILITES			
Borrowings		(25.9)	(100.7)
Non-trade debtors		7.4	3.8
Non-trade creditors due within one year		(37.0)	(37.6)
Corporation tax payable		(6.1)	(3.6)
Total non-operating liabilities		(61.6)	(138.1)
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
Borrowings		(1,925.3)	(1,780.8)
Other creditors		(0.1)	(0.3)
Total creditors due after more than one year		(1,925.4)	(1,781.1)
PROVISIONS FOR LIABILITIES AND CHARGES			
Deferred tax provision		(171.5)	(194.3)
Post employment (liability)/asset		(83.8)	63.4
Other provisions		(2.7)	(3.0)
Total provisions		(258.0)	(133.9)
NET ASSETS		11,201.1	11,374.2
CAPITAL AND RESERVES			
Called up share capital		92.1	92.1
Profit and loss account		392.5	545.1
Current cost reserve	6	10,716.5	10,737.0
TOTAL CAPITAL AND RESERVES		11,201.1	11,374.2

CURRENT COST CASH FLOW STATEMENT
For the year ended 31 March 2009

	Note	2009 Appointed business	2009 Non-appointed business	2009 Aggregated basis	2008 Appointed business	2008 Non-appointed business	2008 Aggregated basis
		£'m	£'m	£'m	£'m	£'m	£'m
NET CASH FLOW FROM OPERATING ACTIVITIES	7	354.2	10.5	364.7	333.0	14.6	347.6
Returns on investments and servicing of finance							
Interest received		9.3	10.3	19.6	14.0	10.1	24.1
Interest paid		(93.9)	-	(93.9)	(94.1)	-	(94.1)
Interest in finance lease rentals		(4.5)	-	(4.5)	(3.6)	-	(3.6)
Net cash flow from returns on investments and servicing of finance		(89.1)	10.3	(78.8)	(83.7)	10.1	(73.6)
Taxation paid		(31.2)	(4.9)	(36.1)	(29.0)	(4.6)	(33.6)
Capital expenditure and financial investment							
Gross cost of purchase of fixed assets		(207.3)	(0.9)	(208.2)	(222.2)	(1.2)	(223.4)
Receipt of grants and contributions		10.9	0.2	11.1	24.8	-	24.8
Infrastructure renewals expenditure		(36.8)	-	(36.8)	(34.9)	-	(34.9)
Disposal of fixed assets		1.1	-	1.1	1.6	0.3	1.9
Net cash outflow from investing activities		(232.1)	(0.7)	(232.8)	(230.7)	(0.9)	(231.6)
Equity dividend paid		(76.9)	(7.0)	(83.9)	(72.6)	(7.0)	(79.6)
Management of liquid resources							
Net cash flow from management of liquid resources		23.7	-	23.7	70.8	-	70.8
NET CASH FLOW BEFORE FINANCING		(51.4)	8.2	(43.2)	(12.2)	12.2	-
Financing							
Capital element in finance lease rentals		(3.1)	-	(3.1)	(3.2)	-	(3.2)
New bank loans		140.8	-	140.8	29.1	-	29.1
Repayment of bank loans & debentures		(94.6)	-	(94.6)	(20.0)	-	(20.0)
Net cash inflow from financing		43.1	-	43.1	5.9	-	5.9
(DECREASE)/INCREASE IN CASH		(8.3)	8.2	(0.1)	(6.3)	12.2	5.9

NOTES TO THE REGULATORY FINANCIAL STATEMENTS
For the year ended 31 March 2009

1. STATEMENT OF REGULATORY ACCOUNTING POLICIES

(a) Historical cost information

The financial statements have been prepared in accordance with regulatory accounting guidelines (RAGs) published by Ofwat.

The accounting policies set out on pages 28 to 31 apply to the historical cost regulatory financial information, with the exception of:

- capital grants and contributions to infrastructure assets which is not in accordance with the Companies Act 1985 (as described in (ii) below).
- infrastructure renewals accounting which, in accordance with RAG 3.06, has been accounted for in accordance with RAG 2.03, Classification of Infrastructure Expenditure". RAG 2.03 is not in accordance with FRS 12, "Provisions, Contingent Liabilities and Contingent Assets" and FRS 15, "Tangible Fixed Assets" as described in section (i) below.
- recognition of income relating to energy generation as described in section 1(c) below.

(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 3.06 the Company has not applied FRS 12, "Provisions, Contingent Liabilities and Contingent Assets" and FRS 15, 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 FRS 12 it is not permitted to recognise a provision for the costs of renewals expenditure. Adoption of FRS 12, taken together with FRS 15, would require:

- restatement of the cost and accumulated depreciation of infrastructure fixed assets to reflect infrastructure renewals expenditure, depreciation and retirement of assets since renewals accounting was first adopted. Accordingly, infrastructure renewals provisions and prepayments at years ended 31 March 2008 and 31 March 2009 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 those pipes or replacing them where relining is not possible. The "overlap" represents the extra cost of replacing pipes rather than relining them where their structural condition is insufficient to withstand the relining process. Such expenditure is included in the infrastructure renewals charge in the regulatory 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.

1. STATEMENT OF REGULATORY ACCOUNTING POLICIES (continued)

(a) Historical cost information (continued)

(ii) 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 3.06. 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 (a). The statutory financial statements reflect grants and contributions as deferred income and amortise them to profit and loss account over the expected useful economic lives of the assets, resulting in a higher operating profit in the statutory financial statements.

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

(b) Current cost information

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 Ofwat for modified real time financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance in the context of assets which are valued at their current cost value to the business.

(i) 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.

- **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.

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

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

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

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

1. STATEMENT OF REGULATORY ACCOUNTING POLICIES (continued)

(b) Current cost information (continued)

(ii) Real financial capital maintenance adjustments

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

(iii) 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.

(iv) 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.

(c) Turnover recognition

The revenue recognition policy is the same in the regulatory and statutory accounts, with the exception of income relating to energy generation. As required by Ofwat in their reporting guidance for the 2009 Annual Return, income relating to energy generation, which is recorded as turnover in the statutory accounts, is recorded as negative operating expenditure in the regulatory accounts.

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

All water and sewerage charges billed to customers are recognised as income at the time they are billed and apportioned over the period to which they relate. For consumption by measured customers which has not yet been billed an accrual is estimated.

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

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

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

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

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

2. ANALYSIS OF TURNOVER AND OPERATING INCOME FOR THE APPOINTED BUSINESS

	2009			2008		
	Water services	Sewerage services	Appointed business	Water services	Sewerage services	Appointed business
	£'m	£'m	£'m	£'m	£'m	£'m
Unmeasured household	185.9	151.1	337.0	183.5	146.4	329.9
Unmeasured non-household	2.5	2.7	5.2	2.8	2.4	5.2
Measured household	65.6	30.1	95.7	57.7	26.1	83.8
Measured non-household	54.3	55.5	109.8	53.4	53.1	106.5
Trade effluent	-	2.7	2.7	-	2.7	2.7
Large user and special agreement	24.7	24.4	49.1	25.2	25.7	50.9
Non-potable large user and special agreement	9.8	-	9.8	10.6	-	10.6
Rechargeable works	1.2	0.2	1.4	0.6	-	0.6
Bulk supplies/inter-company payments	0.5	-	0.5	0.7	-	0.7
Other appointed business (third party)	1.6	0.2	1.8	2.8	0.3	3.1
Other sources	1.0	0.4	1.4	0.6	0.7	1.3
Total turnover	347.1	267.3	614.4	337.9	257.4	595.3
Operating income:						
Current cost profit on disposal of fixed assets	1.1	0.1	1.2	1.2	0.4	1.6
Working capital adjustment	-	-	-	(0.3)	(0.2)	(0.5)

3. OPERATING COSTS

	Water services			Sewerage services			
	Resources & treatment	Distribution	**Water services subtotal**	Sewerage	Sewage treatment	Sludge treatment & disposal	**Sewerage service subtotal**
	£'m	£'m	**£'m**	£'m	£'m	£'m	**£'m**
Direct Costs							
Employment costs	8.9	9.0	**17.9**	3.5	4.2	2.5	**10.2**
Power	8.0	8.6	**16.6**	4.1	9.3	2.8	**16.2**
Hired & contracted services	1.3	6.6	**7.9**	2.4	0.7	8.5	**11.6**
Materials and consumables	7.6	1.1	**8.7**	0.1	0.8	2.0	**2.9**
Service charges (EA)	19.7	-	**19.7**	1.1	1.5	-	**2.6**
Bulk supply imports	1.9	-	**1.9**	-	-	-	-
Other direct costs	0.3	2.7	**3.0**	1.2	0.1	0.1	**1.4**
Total direct costs	47.7	28.0	**75.7**	12.4	16.6	15.9	**44.9**
General and support expenditure	11.6	14.3	**25.9**	4.4	8.6	5.0	**18.0**
Total functional expenditure	59.3	42.3	**101.6**	16.8	25.2	20.9	**62.9**
Business analysis							
Customer services			**15.3**				**7.2**
Scientific services			**7.4**				**3.7**
Other business activities			**1.9**				**1.0**
Business activities sub-total			**24.6**				**11.9**
Local authority rates			**16.8**				**6.9**
Doubtful debts			**9.5**				**8.2**
Total opex less third party services			**152.5**				**89.9**
Third party services – opex			**12.0**				**6.7**
Total operating expenditure			**164.5**				**96.6**
Capital maintenance							
Infrastructure renewals charge	-	30.0	**30.0**	11.2	-	-	**11.2**
Current cost depreciation – service activities	31.8	17.6	**49.4**	7.1	45.2	12.6	**64.9**
– business activities			**10.6**				**5.6**
Amortisation of grants			**(1.1)**				**(1.9)**
Total capital maintenance			**88.9**				**79.8**
Total operating costs			**253.4**				**176.4**
CCA (MEA) Values							
Service activities			**6,585.8**				**6,648.4**
Business activities			**118.4**				**52.1**
Total			**6,704.2**				**6,700.5**

4. TANGIBLE FIXED ASSETS

Water services	Specialised operational assets	Non-specialised properties	Infrastructure assets	Other tangible assets	Total
	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:					
At 1 April 2008	1,630.1	57.6	5,679.1	184.6	7,551.4
AMP adjustment	9.9	-	(9.0)	(2.8)	(1.9)
RPI adjustment	(6.3)	(0.2)	(22.2)	(0.5)	(29.2)
Disposals	-	-	-	-	-
Additions	35.9	3.5	26.5	17.7	83.6
At 31 March 2009	1,669.6	60.9	5,674.4	199.0	7,603.9
Depreciation:					
At 1 April 2008	752.5	29.9	-	80.2	862.6
AMP adjustment	(9.5)	-	-	(9.9)	(19.4)
RPI adjustment	(3.1)	(0.1)	-	(0.2)	(3.4)
Disposals	-	-	-	-	-
Charge for year	38.2	11.2	-	10.5	59.9
At 31 March 2009	778.1	41.0	-	80.6	899.7
Net book value at 31 March 2009	891.5	19.9	5,674.4	118.4	6,704.2
Net book value at 31 March 2008	877.6	27.7	5,679.1	104.4	6,688.8

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 2008	1,848.0	47.8	5,493.4	75.6	7,464.8
AMP adjustment	3.9	-	(1.7)	(3.3)	(1.1)
RPI adjustment	(7.0)	(0.2)	(21.7)	(0.2)	(29.1)
Disposals	-	-	-	-	-
Additions	72.5	1.9	31.7	10.3	116.4
At 31 March 2009	1,917.4	49.5	5,501.7	82.4	7,551.0
Depreciation:					
At 1 April 2008	739.1	23.8	-	30.0	792.9
AMP adjustment	(4.6)	-	-	(5.3)	(9.9)
RPI adjustment	(2.9)	(0.1)	-	(0.1)	(3.1)
Disposals	-	-	-	-	-
Charge for year	58.9	6.0	-	5.7	70.6
At 31 March 2009	790.5	29.7	-	30.3	850.5
Net book value at 31 March 2009	1,126.9	19.8	5,501.7	52.1	6,700.5
Net book value at 31 March 2008	1,108.9	24.0	5,493.4	45.6	6,671.9

4. TANGIBLE FIXED ASSETS (continued)

Total	Specialised operational assets	Non-specialised properties	Infrastructure assets	Other tangible assets	Total
	£'m	£'m	£'m	£'m	£'m
Gross Replacement Cost:					
At 1 April 2008	3,478.1	105.4	11,172.5	260.2	15,016.2
AMP adjustment	13.8	-	(10.7)	(6.1)	(3.0)
RPI adjustment	(13.3)	(0.4)	(43.9)	(0.7)	(58.3)
Disposals	-	-	-	-	-
Additions	108.4	5.4	58.2	28.0	200.0
At 31 March 2009	3,587.0	110.4	11,176.1	281.4	15,154.9
Depreciation:					
At 1 April 2008	1,491.6	53.7	-	110.2	1,655.5
AMP adjustment	(14.1)	-	-	(15.2)	(29.3)
RPI adjustment	(6.0)	(0.2)	-	(0.3)	(6.5)
Disposals	-	-	-	-	-
Charge for year	97.1	17.2	-	16.2	130.5
At 31 March 2009	1,568.6	70.7	-	110.9	1,750.2
Net book value at 31 March 2009	2,018.4	39.7	11,176.1	170.5	13,404.7
Net book value at 31 March 2008	1,986.5	51.7	11,172.5	150.0	13,360.7

Additions in the current cost fixed asset statements are shown net of infrastructure grants.

5. WORKING CAPITAL

	2009	2008
	£'m	£'m
Stocks	2.4	2.5
Trade debtors:		
- measured household	12.0	11.1
- unmeasured household	33.0	29.5
- measured non-household	10.4	10.1
- unmeasured non-household	0.6	0.3
- other	4.8	7.8
Measured income accrual	37.2	36.4
Prepayments and other debtors	22.7	19.3
Trade creditors	(6.4)	(5.6)
Deferred income – customer advance receipts	(13.4)	(13.9)
Capital creditors	(37.8)	(41.0)
Accruals and other creditors	(42.7)	(44.4)
Total working capital	22.8	12.1

6. MOVEMENT ON CURRENT COST RESERVE

	2009	2008
	£'m	£'m
At 1 April	10,737.0	10,221.8
AMP adjustment	26.2	80.3
RPI adjustments:		
- fixed assets	(51.8)	484.0
- working capital	-	0.5
- financing	4.8	(46.2)
- grants and third party contributions	0.3	(3.4)
At 31 March	10,716.5	10,737.0

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

	2009	2008
	£'m	£'m
Current cost operating profit	185.8	179.8
Working capital adjustment	-	0.5
Movement in working capital	(7.5)	5.3
Current cost depreciation	127.6	124.9
Current cost profit on sale of fixed assets	(1.2)	(1.6)
Infrastructure renewals charge	41.2	54.4
Other non-cash profit and loss items	8.3	(30.3)
Net cash flow from operating activities	354.2	333.0

8. ANALYSIS OF NET DEBT FOR THE APPOINTED BUSINESS

	Interest rate risk profile			
	Fixed rate	Floating rate	Index linked	Total
	£'m	£'m	£'m	£'m
Maturity profile:				
Less than one year	19.2	2.5	-	21.7
Between one and two years	17.3	2.5	-	19.8
Between two and five years	72.4	46.8	-	119.2
Between five and twenty years	880.6	57.1	-	937.7
In more than twenty years	344.8	46.0	462.0	852.8
Total borrowings	1,334.3	154.9	462.0	1,951.2
Overdraft				20.0
Short term deposits				(159.4)
Net debt at 31 March 2009				1,811.8

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Services supplied by the appointee to associated companies:

		December 2008 or March 2009		2008/09
Associate	Service	Turnover	Terms of Supply	Value
		£'m		£'m
Vehicle Lease and Service Limited (VLS)	Rental of garage and service charges	12.9	Negotiated	0.1

Services supplied to the appointee by associated companies:

		December 2008 or March 2009		2008/09
Associate	Service	Turnover	Terms of Supply	Value
		£'m		£'m
Northumbrian Water Group plc	Holding company charges	5.5	No market	0.5
Three Rivers Insurance Company Limited	Public liability insurance (deductible infill policy)	0.4	No market	0.4
Vehicle Lease and Service Limited	Vehicle maintenance and capital finance charge	12.9	Competitive letting	7.4

Information in relation to allocations and apportionments

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

Turnover is separately recorded between water services and sewerage services and no apportionment has been necessary. Operating costs have been allocated between water and sewerage services in accordance with the guidance set out in Regulatory Accounting Guideline No 4.03.

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 5.04.

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

Amounts borrowed by the appointee from associated companies

The Company has loans amounting to £1,458.2m due to NWF, a subsidiary company. Details of these loans and the associated guarantees are provided in note 20 of the statutory financial statements.

The Company acquires vehicles from VLS, an associated company, on a finance lease basis. During the year, new finance leases of £3.9m were entered into and capital repayments of £2.8m were made. The year end finance lease creditor was £8.4m. All leases are at a fixed interest rate of 6%.

Amounts lent by the appointee to associated companies

NWL had short-term deposits amounting to £159.4m with NSL at the year end, representing surplus cash invested via the Group's treasury function.

9. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES (continued)

Guarantees or other forms of security

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

Dividends paid and proposed

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

	£'m
Dividends paid:	
Final paid for the year ended 31 March 2008	37.5
Interim paid for the year ended 31 March 2009	39.4
Total dividends paid in the year	76.9
Dividends proposed:	
Final proposed for year ended 31 March 2009	39.0

The dividends for the year, comprising the interim dividend of £39.4m and the final dividend of £39.0m, total £78.4m (2008: £74.8m). This continues the stated dividend policy of 1.9% real annual growth.

Omission of right

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

Waivers

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

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

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

10. REGULATORY CAPITAL VALUE AT 2008/09 PRICES

	2008/09
	£'m
Opening regulatory capital value	2,964.8
Infrastructure renewals expenditure (IRE)	35.5
Capital expenditure (excluding IRE)	163.8
Infrastructure renewals charge	(39.3)
Grants and contributions	(10.5)
Current cost depreciation	(114.7)
Outperformance adjustment	(2.0)
Closing regulatory capital value	2,997.6
Average year regulatory capital value	3,030.9

Note the average year 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 publication RD07/08.

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.

11. STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

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

The directors' remuneration policy is set by NWL's Remuneration Committee (the Remuneration Committee) in conjunction with the Remuneration Committee of the Company's ultimate parent company, Northumbrian Water Group plc (the Committee) and NWG's appointed recruitment consultants, Hewitt New Bridge Street (HNBS). The remuneration policy is as follows:

- that the setting of base salaries is largely influenced by individual contributions and internal relativities rather than external comparators (although for 2009/10 the Committee has been influenced by general economic conditions);
- that the annual bonus plan recognises the interests of all of NWG's stakeholders (shareholders, customers and employees) rather than being focused solely on profit; and
- management shares in the longer term value created for NWG's investors, but equity incentive schemes should only reward if there is clear outperformance of the market and other relevant companies.

During the year the Committee:

- agreed bonuses for 2008/09;
- agreed salaries for 2009/10;
- determined the vesting percentage to be applied to the LTIP awards made on 9 December 2005, which vested on 9 December 2008;
- granted LTIP awards on 15 December 2008 (to vest in December 2011); and
- set performance targets for executive directors and senior managers.

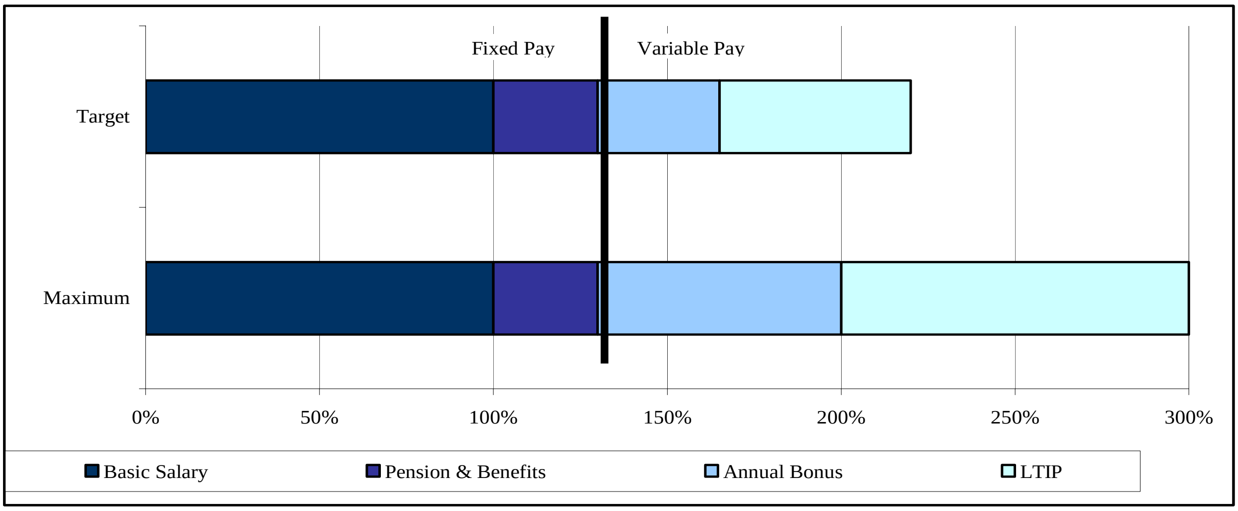
11.STATEMENT ON DIRECTORS' PAY AND STANDARDS OF PERFORMANCE (continued)

Elements of remuneration

The remuneration of the executive directors comprises:

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

In addition to reviewing each constituent element, the Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure and quantum. The chart below shows the composition of the Managing Director's remuneration (as a percentage of basic salary) both at "target" and "maximum" levels of performance. Maximum performance assumes the achievement of maximum bonus and full vesting of LTIP awards.



The table below shows the remuneration paid by NWL to directors during the year. 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.

	Basic pay	Bonus	Other benefits	Fees	Total remuneration
	£'000	£'000	£'000	£'000	£'000
Sir D Wanless	-	-	-	78.8	78.8
J A Cuthbert	206.5	36.1	5.9	-	248.5
C M Green	157.5	27.6	6.6	-	191.7
A C Jones	137.5	30.9	9.4	-	177.8
G Neave	166.0	29.1	10.2	-	205.3
A G Balls	-	-	-	31.5	31.5
A M Frew	-	-	-	31.5	31.5
Dr S Lyster	-	-	-	31.5	31.5
Total remuneration	667.5	123.7	32.1	173.3	996.6

(i) Executive directors: basic salary and benefits

Basic salary is the only pensionable element of the executive directors' remuneration package. The basic salaries payable to directors of NWL are not directly linked to standards of performance in connection with the carrying out of functions of a "relevant undertaker". Basic salary is reviewed annually based on individual contributions and internal relativities. The committee also has regard to market practice in other quoted water companies and similar sized companies more generally. The basic salaries of NWG executive directors have not been increased for 2009/10 in recognition of the fact that RPI at the date of the review was zero. All other employees have been awarded a 3%

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

(i) Executive directors: basic salary and benefits (continued)
increase in basic pay for 2009/10. Benefits provided to the executive directors include membership of a defined benefit pension scheme, car allowance and healthcare.

(ii) Annual bonus
The bonus arrangements for executive directors of NWL for 2008/09 were linked to NWL's predicted performance in the Overall Performance Assessment (OPA), as well as the other measures described below.

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 2008/09 bonus was 341-419 points, which was the reported industry performance for 2007/08;
- up to 5% related to time lost through sickness. The actual sickness absence rate was 2.94% and bonus is calculated on a linear scale between 2.6% and 3.1% with a published target for the Company of 2.85%; and
- up to 20% related to personal targets.

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 27 May that 1% would be payable against this measure reflecting the forecast score of 356 against a range between 341 and 419 points. The Remuneration Committee also confirmed that 1.5% would be payable in respect of time lost through sickness.

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 related to management of the PR09 process, the continued development of employee relations to improve performance, to ensuring that NWL is a high performer in the industry for levels of service, reputation and efficiency, to quantification and delivery of the investment programme and to increasing efficiency. Of the 20% available in respect of personal targets, Mr Neave was awarded 15%.

Mr Jones' personal targets included management of the PR09 process, work on the integration of the Scientific Services business and the Water Safety Plan, health and safety and business continuity. Taking account of overall performance against his personal targets, the Remuneration Committee awarded Mr Jones the full 20% available in respect of personal targets.

Mr Cuthbert's personal targets related principally to management of the PR09 process, maintaining key financial ratios and measures, ensuring that good relationships are maintained with major investors, the investment programme, cost efficiency and succession planning. Mr Green's personal targets were focused mainly on management of the PR09 process, the maintenance of key financial ratios and measures, relationships with major investors and analysts, addressing Ofwat's proposals for accounting separation, the investment programme and cost efficiency. Of the 20% available in respect of personal targets, Mr Cuthbert and Mr Green were each awarded 15%.

Taking account of performance against personal targets and the OPA, PBT and lost time performance, bonuses equal to the percentages of basic salary indicated were approved for payment to Mr Cuthbert of 17.5%, Mr Green of 17.5%, Mr Neave of 17.5% and Mr Jones of 22.5%.

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.

The Remuneration Committee considered whether or not any portion of annual bonus should be deferred but its conclusion was that this was not appropriate at this time.

(iii) Pension
Directors participate in a defined benefit pension scheme which is not linked to NWL's performance as a "relevant undertaker". The executive directors' pensions were modified with effect from 1 January 2008, in line with the changes proposed for the pension scheme as a whole, and the executive pension arrangements were closed to new entrants on that date.

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

(iv) Long Term Incentive Plan

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

Details of the levels of award and performance conditions are shown in the table below.

Summary of LTIP awards and performance conditions

LTIP AWARD MADE 9 DECEMBER 2005	
Maximum award	75% of salary permitted. Actual grants to executive directors related to shares worth up to 70% of salary.
Performance conditions	Comparison of TSR with two comparator groups over three years: (1) 70% of award depends on the Company's TSR performance against other listed water companies: AWG plc, Bristol Water Group 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 the Company's TSR performance against the FTSE 250 Index, excluding investment trusts. East Surrey Holdings plc de-listed on 28 October 2005, Bristol Water Group plc de-listed on 18 May 2006, AWG plc de-listed on 21 December 2006 and Kelda Group de-listed on 12 February 2008. These companies have been left in the comparator group for the purpose of the awards and their performance was frozen on the date each company de-listed. This means that a constant TSR has been applied at each date after the de-listing.
Vesting schedules	(1) 30% vests at median performance and 100% if the Company tops the group. Between median and upper quartile, the vesting will be calculated on a straight line basis comparing the Company's TSR to that of the median and upper quartile positions. Where the Company's TSR performance is below the median, none of that element of the award will vest. (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 the Company's TSR performance is below the median, none of that element of the award will vest.
LTIP AWARD MADE 21 DECEMBER 2006	
Maximum award	75% of salary permitted. Actual grants to executive directors related to shares worth up to 70% of salary.
Performance conditions	(1) 50% of award depends on NWL's return on capital employed relative to that of the other water and sewerage companies of England and Wales. (2) 50% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts.
Vesting schedules	(1) 30% vests at median performance. At upper quartile or above, all of that half of the award will vest. Between median and upper quartile, straight line pro-rating will apply. Where the return on capital employed performance is below the median, none of this element of the award will vest. (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 the Company's TSR performance is below the median, none of this element of the award will vest.
LTIP AWARD MADE 13 DECEMBER 2007 AND FUTURE AWARDS	
Maximum award	100% of salary permitted and actual grants to executive directors related to shares worth up to 100% of salary.
Performance conditions and vesting schedules	As per LTIP award made 21 December 2006.

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

(iv) Long Term Incentive Plan (continued)

The Committee, with advice from HNBS, has reviewed the LTIP and is still of the view that it remains the most appropriate equity incentive plan, particularly in the light of NWG's dividend policy. Total shareholder return (TSR) remains an appropriate measure because it ensures that executives are rewarded fairly for value created for NWG's investors.

For the awards granted on 15 December 2008 the three years to be reviewed are 2008/09, 2009/10 and 2010/11. Over the three year performance period, the return on capital employed will be calculated on a compounded annualised return basis.

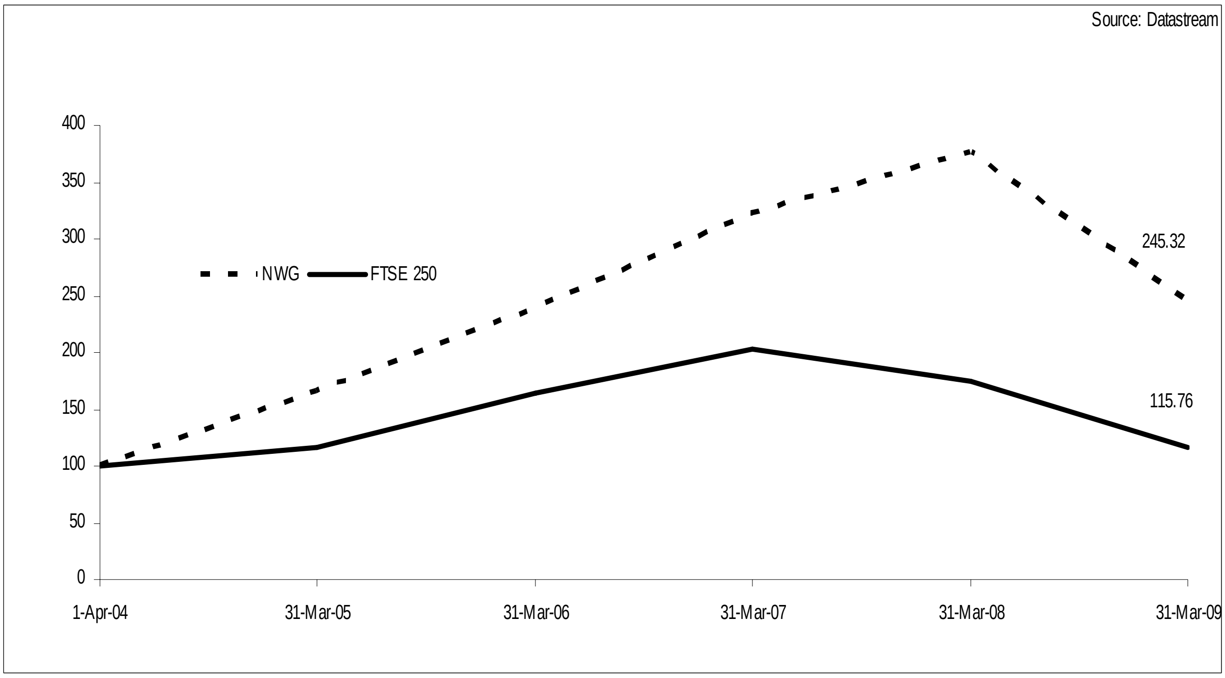
In addition, awards will only vest if the Committee is satisfied that NWG's TSR performance is consistent with the underlying business performance of NWG. An independent firm is engaged by the Committee to calculate the TSRs and to assess the extent to which the performance conditions have been met, so that the process is rigorous and transparent.

In the event of a change of control, the Committee would determine the extent to which the performance conditions had been met and the proportion of the performance period that had elapsed in deciding whether or not any vesting of awards would take place.

The LTIP award granted on 9 December 2005 became available to vest on 9 December 2008. The Committee instructed PricewaterhouseCoopers (PwC) to assess the level of vesting of this award. PwC reported that 29.7% of the award was available to vest (being 99% of the award relating to NWG's TSR performance against the FTSE 250 Index and 0% of the award relating to NWG's TSR performance against the other listed water companies). Prior to vesting, the Committee satisfied itself that the recorded TSR performance was a genuine reflection of NWG's underlying performance. Details of the number of awards which lapsed and those which were exercised by the directors of the Company are shown in the table on page 33.

Performance graph

The graph below shows a comparison between the TSR for NWG's shares for the five year period to 31 March 2009, and the TSR for the companies comprising the FTSE 250 Index (excluding investment trusts) over the same period. This index has been selected as NWG is a constituent of the FTSE 250.



Note:
This graph shows the value, by 31 March 2009, of £100 invested in Northumbrian Water Group plc on 1 April 2004 compared with the value of £100 invested in the FTSE 250 Index (excluding investment trusts) over the same period.

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

(iv) Long Term Incentive Plan (continued)

At its meeting on 19 November 2008, the Committee agreed to make conditional awards to Mr Cuthbert and Mr Green with a value equal to 88% of base salaries, and to Mr Neave and Mr Jones with a value equal to 53% of base salaries. The level of the awards was previously agreed in principle by the Committee, following detailed advice from HNBS. The awards were made on 15 December 2008. 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 Remuneration Committee.

(vii) Future Targets

For 2009/10, all four executive directors have personal targets which relate to NWL's performance as a "relevant undertaker". Their targets, in summary, relate to:

Mr Cuthbert: managing PR09; maintaining financial ratios; maintaining relationships with investors; succession planning; delivery of the investment programme and implementing cost efficiencies.

Mr Green: managing PR09; maintaining financial ratios; maintaining good relationships with investors; addressing Ofwat's proposals for accounting separation and competition; delivery of the investment programme and implementing cost efficiencies.

Mr Neave: managing PR09; realising the benefits of the Work Management Programme; ensuring that NWL is a high performer in the industry for levels of service, reputation, safety and efficiency; delivery of the investment programme and implementing cost efficiencies.

Mr Jones: managing PR09; business planning and implementing efficiency improvements within Scientific Services; business continuity and health and safety.

DIRECTORS' RESPONSIBILITIES AND DECLARATIONS
For the year ended 31 March 2009

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

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

RING FENCING

The directors confirm that, as at 31 March 2009, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment by which the Appointee had available to it sufficient rights and assets to enable a special administrator to manage the affairs, business and property of the Appointee, should a special administrative order be made.

OFWAT INSTRUMENT OF APPOINTMENT – CONDITION F6A.2A CERTIFICATE
(FINANCIAL & MANAGEMENT RESOURCES TO CARRY OUT THE APPOINTED BUSINESS)

The directors of Northumbrian Water Limited confirm that, in their opinion, the Appointee will:

- have sufficient financial resources and facilities to enable it to carry out for at least the next 12 months the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and
- for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.

The directors of Northumbrian Water Limited confirm that, in their opinion, all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

In providing this certificate, the Directors have taken into account the 2004 Final Determination, Company performance during 2008/09, prospects for the period up to 2010 and the fact that the Company has put in place substantial pre-funding to meet the capital investment programme to 2011.

ON BEHALF OF THE BOARD

M Parker
Company Secretary

9 July 2009

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 2009 which comprise

- the regulatory historical cost financial information, itself comprising the regulatory historical cost profit and loss account, the regulatory historical cost statement of total recognised gains and losses, the regulatory historical cost balance sheet, the reconciliation between statutory accounts and historical cost regulatory accounts and the related note to the regulatory historical cost financial information numbered 1(a), and
- the regulatory current cost financial information, 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 and the related notes to the current cost financial information numbered 1(b) to 11.

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 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets), and the accounting policies set out in note 1(a) to the historical cost financial information and note 1(b) to the current cost financial information and in the case of the historical cost financial information under the historical cost convention.

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 1.04, 2.03, 3.06 and 4.03 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 wholly 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 the 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 Accounting Guidelines 1.04, 2.03, 3.06 and 4.03 are set out in the Statements 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)

We report our opinion as to whether the regulatory historical cost financial information 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 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost financial information has been properly prepared in accordance with Regulatory Accounting Guidelines 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03. 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 1.04, 2.03, 3.06 and 4.03.

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 Operating and Financial Review and the Appendix to the Directors' Report and Operating and Financial Review.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the regulatory financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of regulatory financial statements are determined by the 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 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 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 the reconciliation between the statutory financial statements and the regulatory 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 2009 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 1.04, 2.03, 3.06 and 4.03 issued by the WSRA, and the accounting policies set out in note 1(a) to the historical cost financial information and note 1(b) to the current cost financial information, the state of the Company's affairs at 31 March 2009 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 of Appointment;
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 Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
c) the regulatory historical cost financial information 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, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
d) the regulatory current cost financial information has been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

Ernst & Young LLP
Registered auditors
Newcastle upon Tyne

10 July, 2009