

**VEOLIA WATER CENTRAL LIMITED  
(FORMERLY THREE VALLEYS WATER PLC)**  
(Registered Number 2546950)

**ANNUAL REPORT AND FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2010**



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# Chairman's Statement

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I am pleased to present the Statutory Accounts for the year ended 31 March 2010.

In my first year as Chairman, after my appointment on 10 September, I would like to thank all our staff for their hard work and achievements in a year of uncertainty and change. I also welcome Richard Bienfait as our new Managing Director from the 9 March 2010 and express my appreciation for the loyal service and significant accomplishments of our predecessors, Sir Alan Thomas and Andrew Smith.

Our priority remains to improve our customers' experience of us and the service which we give them. In the last year we have maintained or exceeded our targets for levels of service. We have reduced the number of complaints significantly and made it easier for customers both to contact us and pay via an improved website. We reduced customer telephone contact by 5.2% in the year and written contact by 14.1%.

2009/10 will be seen as a landmark year in the progress and development of the Company.

In April and May 2009 we successfully relocated over 650 staff from three previous sites to a single new office in Hatfield. This has begun to facilitate efficiencies and enhance customer service. We have now exchanged contracts on one of the former office sites and completion is expected in early August.

In July 2009 we changed our name to Veolia Water Central Limited (VWC) and at the same time changed status to a private company. We are part of the wider Veolia Water United Kingdom, Ireland and Northern Europe Group and will therefore leverage synergies and efficiencies from utilising Veolia Water's expertise and brand consistently across the Group, in order to improve the quality of service to customers.

For many years VWC has provided services to other companies in the Veolia UK Group. However, following Veolia Water UK's purchase of the non-regulated business of Thames Water in 2007 and its plans to double in size, we recognised that this arrangement would cease to be sustainable or efficient in the future. In the past year Veolia Water has established Veolia Water Shared Services Limited (VWSS), which is a separate company outside of the regulatory ring fence; it provides general support and administrative services to companies in the Veolia Water UK Group including VWC. This will enable us to capture efficiencies, economies of scale and to share best practice. We consulted closely with Ofwat about our plan for VWSS and its implementation. VWSS was created on 1 April 2009 and we have progressively transferred people from VWC to the new company. VWC now procure from VWSS services in water quality sampling and analysis, scientific and corporate responsibility, purchasing, communications and public relations, transactional finance, human resources, health and safety, legal, and IT.

During the year we conducted a review of the financial structure of the business and concluded that it would be in the best interests of customers and the company to reduce the level of equity and increase the level of debt finance to levels consistent with other companies in the industry. We completed the restructuring in October and now our debt to Regulated Asset Value ratio stands at 61%. We consulted with Ofwat so that they could take account of the changes in their Final Determination of prices for the benefit of customers.

Two years ago we began to develop a culture of health and safety that recognises that all accidents are preventable and no one should be harmed as a result of our activities. A fundamental part of this programme is to move from an attitude of 'accidents happen' to a team-based ethos that 'No one should get hurt'. All our staff are aware of our commitment and belief that we can achieve zero accidents. We have been successful in continuously improving our safety performance. Whilst the number of reportable accidents rose to nine in the year (2008-09: seven), the number of days lost due to sickness, accident and occupational ill health dropped significantly to 7,130 (2008-09: 8,285). This is a journey and we want to see continuing improvement in these figures.

We accepted the Final Determination from Ofwat in January 2010. The key challenge remains the ability of our assets to deliver sustainable service to customers. Ofwat determined that the serviceability of our assets was Marginal, applying a shortfall for our AMP4 performance; and required our assets to be Stable by June Return 2012. We are making good progress towards this objective: despite the worst winter for over 30 years, Ofwat's lead indicator of bursts fell by 10%. This reflects more accurate application of Ofwat's definitions and suggests that burst levels in earlier years have been overstated. All other indicators continue to show Stable.



## Chairman's Statement (continued)

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The AMP4 capital programme was completed with 87km of mains renewed bringing the total length to 638km in the AMP period. We delivered 98% of our AMP4 programme. The remaining 14km was completed by the end of May 2010.

We have made good progress in controlling leakage despite the very difficult conditions for several weeks over the winter. There is always an increase in the natural rate of rise of leakage over the winter period, but the weather last winter brought additional stress on the network. We committed additional teams to detect and repair leaks with the result that we have met our three year leakage target.

We have continued to maintain high quality drinking water with the test pass rate being 99.98% (2008-09: 99.99%).

In the year, the financial performance of the company showed continued improvement. Turnover of £234.4m (2009: £228.9m) increased by £5.5m. The main driver of the increase was the RPI uplift which offset lower customer demand especially in the commercial sector where the effects of the recession continue to be seen. Operating costs increased by £22.9m to £191.8m (2009: £168.9m) with the largest component of the increase being depreciation which has increased by £17.5m following the revaluation of our assets undertaken in the year and the completion of our AMP4 capital programme. Weather conditions in December and January led to increased costs due to the higher number of burst mains than usual. There has also been an additional £3.3m of energy costs over and above those incurred in the previous period due to the unprecedentedly-high global energy prices. However, efficiencies have been made, resulting in reductions in costs in management and finance, customer relations and operations through process improvement and improved communication. There has been a reduction in the bad debt provision due to better collection rates. Profits on sale of properties in the year were £10.7m (2009: £0.6m), which is £10.1m higher than in previous period. This is mainly due to the sale of a small but high-market-value plot of land at St Georges Hill, Surrey. Overall profit for the year therefore saw an increase of £3.8m to £28.1m (2009: £24.3m).

We have set five key areas for performance improvement, targeting: zero harm; zero water quality failures; zero complaints; zero interruptions to supply and zero variance to budget. These objectives are supported by an incentive scheme under which everyone in the business is rewarded on a quarterly basis on the same performance objectives. We are helping our people to work together, to look at matters from the customer's perspective and do what they have to do to satisfy their needs. The benefit that this has brought to customers is clear. We have improved our performance in all of the Levels of Service Indicators set by Ofwat. Thirty percent fewer customers have needed to write to us to complain. Five percent fewer customers have contacted us with billing queries and thirty percent fewer customers have suffered from unplanned or unwarned interruptions to supply. Almost 120,000 customers have used our website to pay their bill, find information or raise a query with us.

With the changes we have made in the year I am confident that we will not only satisfy the demands of our customers but improve performance and become more efficient in the process.



Frédéric Devos  
Chairman  
6 July 2010

## Directors

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### **F Devos (Chairman from 10 September 2009)**

Frederic Devos is French and was appointed a director in 2007. He was appointed Chairman on 10 September 2009. He is also the Chief Executive Officer of Veolia Water UK PLC and a director of Three Valleys Water Finance PLC, Veolia Environnement UK Ltd and of other Veolia Water UK PLC subsidiaries.

### **Sir Alan Thomas (Chairman until 31 July 2009)**

Sir Alan retired as Chairman and director of the Company on 31 July 2009 after almost 9 years of service.

### **R A Bienfait (Managing Director from 9 March 2010)**

Richard Bienfait is British and was appointed a director in 2006. He was appointed Managing Director on 9 March 2010. He is also a Director of Three Valleys Water Finance PLC, Finance Director of Veolia Water UK PLC and a director of a number of other Veolia Water UK PLC subsidiaries.

### **A P Smith (Managing Director until 9 March 2010)**

Andrew Smith served as Managing Director for 3 years until 9 March 2010 when he resigned to take up a post outside of the Veolia Water UK Group, after 15 years service in total.

### **D W Alexander**

David Alexander is British and has over 35 years experience in the water industry. He was Managing Director of Veolia Water UK PLC until 2007 when he resigned from this position, although remaining on the Board.

### **J C Banon**

Jean Claude Banon is French and is Veolia Environnement's representative with the European Institutions. He has been a director since 1994 and is also a director of Veolia Environnement UK Ltd and of other Veolia Water UK PLC subsidiaries.

### **J A Bishop (Operations Director until 8 June 2010)**

Jeff Bishop is British and was appointed a director in 2002. He has over 25 years experience in the water industry and was formerly Operations Director of South Staffordshire Water PLC. He resigned on 8 June to take up another role within the group.

### **R J Brimble (Customer Relations Director)**

Richard Brimble is British and was appointed director in 2008. He has 25 years customer relations senior management experience gained in a variety of industries. He was formerly Managing Director of Understanding and Learning, a change management company.

### **Baroness Buscombe**

Baroness Buscombe is British and was appointed a director in 2006. She is a barrister, a member of the House of Lords and has held a number of Shadow Ministerial positions. She is Chairman of the Press Complaints Commission.

### **P Guitard**

Philippe Guitard is French and was appointed a director in 2008. He is Executive Vice President Europe of Veolia Water SA.

### **O Grunberg**

Olivier Grunberg is French and was appointed a director in 2008. He is the Financial Director and Deputy Managing Director of Veolia Water SA.

## Directors (continued)

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### **Dr N W Summerton CB**

Neil Summerton is British and was appointed a director in 2000 having been a director of North Surrey Water Ltd from 1998 to 2000. He was appointed chairman of the Audit Committee on 24 September 2009. He is also a director of Veolia Water South East Ltd and from 1991 to 1997 was responsible for water policy at the Department of the Environment.

### **F Woolf CBE**

Fiona Woolf is British and was appointed a director in 2006. She is an Alderman in the City of London, a Member of the Competition Commission, a Consultant with CMS Cameron McKenna and a trustee of Raleigh International.

# Board Committees, Executives and Advisers

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## **Audit Committee**

Sir Alan Thomas (Chairman until 31 July 2009)  
Dr N W Summerton (Chairman from 24 September 2009)  
Baroness Buscombe  
F Woolf

## **Executive Management Committee**

A P Smith (Chairman until 9 March 2010)  
R A Bienfait (Chairman from 9 March 2010)  
J A Bishop (until 8 June 2010)  
R J Brimble  
F Devos

## **Remuneration and Employment Committee**

Sir Alan Thomas (Chairman until 31 July 2009)  
F Devos (Chairman from 10 September 2009)  
P Guitard  
A P Smith (until 9 March 2010)  
R A Bienfait (from 9 March 2010)  
Dr N W Summerton

## **Nomination Committee**

Sir Alan Thomas (Chairman until 31 July 2009)  
F Devos (Chairman from 10 September 2009)  
P Guitard  
Dr N W Summerton

## **Secretary and Registered Office**

T J W Monod  
Tamblin Way  
Hatfield  
Hertfordshire AL10 9EZ

## **Registered Auditors**

Ernst & Young LLP  
1 More London Place  
London SE1 2AF

# Report of the Directors (continued)

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## Introduction

The directors present their report and the audited statutory financial statements for the year ended 31 March 2010.

On 17 June 2009, the company passed a special resolution to re-register as a private company and change the company's name to Veolia Water Central Limited with effect from 1 July 2009. However, to maintain continuity for customers and others in the area which we serve, we traded as Veolia Water Three Valleys for the period to 17 March 2010 before fully embracing the new name of Veolia Water Central Limited.

## Principal activity

The principal activity of the company is the supply of water and related services to approximately three million people and businesses in an area of 3,738 square kilometres of Berkshire, Buckinghamshire, Hertfordshire, Bedfordshire, Essex, Surrey and several London Boroughs.

## Directors

The directors of the company, together with their periods of office and their biographical details, are shown on page 4.

## Going concern

After making enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in the statutory financial statements.

## Directors' qualifying third party indemnity provisions

The company has granted an indemnity to one or more of its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in Section 234 of the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

## Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable 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). Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business, and
- be responsible for the maintenance and integrity of the website on which the financial statements have been published.



## Report of the Directors (continued)

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The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.

### **Business review and financial performance**

The company's mission, business objectives and risk and uncertainty are as follows:

#### **Mission**

Our mission is to provide the best sustainable water services for business and consumers.

#### **Business objectives**

- Zero reportable accidents
- Zero interruptions to supply
- Zero written complaints
- Zero water quality failures
- Zero variance to budget at EBIT level

The company is a regulated business and has important obligations to three regulators: the Water Services Regulation Authority (Ofwat); the Environment Agency; and the Drinking Water Inspectorate. The business is effectively a regional monopoly and is subject to incentive-based economic regulation by Ofwat. Ofwat imposes caps on increases in customer prices, and seeks to reward efficiency and high standards of customer service, whilst penalising inefficiency and poor standards of customer service.

Instruments of appointment (licences) for the provision of water supply were awarded in 1989 and continue in force for an indefinite period subject to termination on 25 years notice with more immediate revocation in certain specific circumstances (such as, for example, a failure to comply with an enforcement order made by Ofwat).

Price limits are set by Ofwat every five years through a periodic review. The last review was completed in November 2009 and imposed price limits for the period 2010/11 to 2014/15. During a periodic review, Ofwat considers the scale of the company's capital investment programme, the cost of capital, operational and environmental obligations, and operating expenditure as well as assessing the scope to improve efficiency.

Ofwat determines price limits by reference to the company's income for the previous year, adjusting for inflation (headline RPI). This determination factor is known as 'k' and can be a positive or negative percentage value. The company's regulated tariff evolves annually by RPI and 'k'.

The Water Act 2003 has extended opportunities for competition in the water industry by introducing a new framework for the licensing of water supply. Since 1 December 2005, water supply licensees have been able to supply water outside their licensed areas to non-household users provided these users consume more than 50 megalitres per year.

The water industry is subject to substantial domestic and European Union legislation which imposes significant statutory obligations on the company concerning, among other factors, the quality of treated water supplied.

Environmental policy and proposal for legislation are the responsibility of the Secretary of State for the Environment, Food and Rural Affairs. The following bodies are responsible for applying legislative requirements to water companies:

## Report of the Directors (continued)

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- The Environment Agency, responsible for conserving and redistributing water resources and securing the proper use of those resources, including the licensing of water abstraction;
- The Drinking Water Inspectorate, which enforces drinking water quality standards, and
- Natural England which is responsible for the protection of designated sites for nature conservation

### **Risk and uncertainty**

The company has a formal and continuous process for identifying, evaluating and managing the key risks faced. The company has a Risk Management Committee that reports to the Audit Committee with the Board notified of all key risks. The Risk Management Committee meets to identify and assess important risks, to receive reports of processes on risk management from risk owners and the risk assurance department, to review internal controls and to determine programmes of work for the forthcoming period. A key aim is to foster a culture in which staff throughout the business manage all risks appropriately.

The main risks and uncertainties that the company has identified are:

- risks associated with Change and more specifically impact on People, from the Company restructuring and acquisitions
- in the context of the new AMP, the ability of the business to meet the new Ofwat target for Infrastructure Serviceability, within which the significant risk is whether bursts numbers can be brought below the reference level
- whether the efficiency target of 3.1% per annum set in the Final Determination can be achieved
- poor programme management and contractors' performance
- loss of IT systems
- widespread loss of water sources

Threats to health and safety are treated differently from other commercial risks and are given extra importance.

Each of the key risks has a 'risk owner' from the senior management team who is responsible for establishing appropriate controls to mitigate the risks as far as possible. In addition to these main risks, other identified risks are allocated to specific risk owners.

### *Performance during the year ended 31 March 2010*

- We installed 18,838 meters taking the proportion for domestic metered supplies to 37.4%
- We reduced customer telephone contact by 5.2%
- Written contact reduced by 14.1% to 267,401
- We renewed 93km (1%) of mains network bringing the total to 638km for the AMP period.
- We maintained the industry norm levels of the number of metered customers who receive a bill based on an actual meter reading
- We maintained high quality drinking water, the test pass rate being 99.98%.
- We maintained our good DG3 performance, exceeding our Monitoring Plan target of 0.17% with only 0.14% total properties.
- A consistent set of Health and Safety standards are deployed across all contractors working on the capital programme. These standards are robustly monitored by project managers who conduct monthly audits which is then reported to the Executive Management Committee,
- We continue to play a central part in contributing to Veolia Water UK's performance as one of the top ranking companies in the last annual 'Business in the Community Top 100 Companies that Count' survey, in association with The Sunday Times. In this survey Veolia Water UK retained its Platinum status which is external recognition of how we continuously improve our impact on society and the environment.

# Report of the Directors (continued)

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## Future developments

We manage the business in the long-term interests of customers, the public and the shareholder. At the same time we are looking to improve our short term measures of performance and to achieve the outputs expected from our regulators. We will seek to grow our non-regulated business where appropriate.

## Financial performance for the year ended 31 March 2010

### *Turnover*

Turnover of £234.4m (2009: £228.9m) increased by £5.5m. The main drivers of the increase are higher RPI (£7.9m) which was partially offset by lower customer demand.

### *Operating expenditure*

Operating expenditure has increased by £22.9m to £191.8m (2009: £168.9m). The largest component of the increase in operating expenditure for the current year is depreciation which has increased by £17.5m and is explained below. The adverse weather conditions experienced in December and January led to increased costs due to the higher number of burst mains than usual and their severity. There has also been an additional £3.3m of energy costs over and above those incurred in the previous period. However, there has been a reduction of costs in areas such as Management and Finance and a reduction in the bad debt provision due to better than anticipated collection rates.

### *Depreciation*

Depreciation has increased to £44.0m (2009: £26.5m). The increase of £17.5m is mainly due to the depreciation recognised as part of the re-gearing and revaluation exercise (£13.4m). The remainder is due to depreciation of new additions and equally significantly, as the AMP 4 programme has drawn to a close, items which were in the course of construction at March 2009 but are now being depreciated.

### *Disposal of fixed assets*

Profits on sale of properties in the year were £10.7m (2009: £0.6m), which is £10.1m higher than previous period. This is mainly due to the sale of a small but high market value plot of land at St Georges Hill, Surrey.

### *Financial returns*

As a result of the above changes, profit for the year ended 31 March 2010 is £28.1m (2009: £24.3m) an increase of £3.8m.

### *Cash flow*

There was a net cash inflow in the year of £0.3m, a small change on the previous year when there was a net outflow of £1.4m.

Net debt increased to £461.6m at the end of March 2010 compared to £293.5m at the end of March 2009. This is mainly due to the re-gearing that was completed on 29 October 2009 culminating in a new loan of £201.3m facilitating the part repayment of existing loans.

### *Capital expenditure*

Expenditure for the year before contributions was £86.7m.

Whilst gross expenditure for both mains renewals and above ground assets exceeded the regulatory target, this was offset by contributions from developers. Overall we are marginally under the AMP4 allowed expenditure.

## Report of the Directors (continued)

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### *Financial instruments*

The main risks arising from the company's financial instruments are interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks.

The company finances its operations through a mixture of retained profits, bank borrowings and borrowings from its subsidiary company, Three Valleys Water Finance PLC which in turn raises funds from the capital markets and borrowings from a group undertaking Veolia Environnement Europe Services. Treasury policies are agreed in conjunction with the parent company (including liquidity and interest rate risks). The company does not undertake speculative transactions. Interest rate exposure is managed by using a mixture of fixed and floating rate borrowings. Liquidity is managed by utilisation of a mixture of bank overdrafts and short-term borrowings from the immediate parent company.

For further details on financial instruments see note 25.

### *Capital finance*

The £200m 22-year bond, issued by Three Valleys Water Finance PLC in 2004 at just below 6%, is part financing our capital programme for the current five year period. A £100m revolving credit facility is also available. Our financial ratios demonstrate Veolia Water Centrals' good credit quality. The balance sheet remains strong, with debt at around 61% of regulatory capital value, a considerable margin below that of some water companies.

On 29 October 2009 Veolia Eau Compagnie Generale des Eaux issued a £201.3m loan at an interest rate of 2% above GBP LIBOR 3m rates which matures on 31 December 2024. The loan can be repaid at any time without penalty after giving 5 business days notice. On 1<sup>st</sup> April 2010 the loan was transferred to Veolia Environnement Europe Services under the same terms.

### *Change in gearing and accounting policy for fixed assets*

During the year the company changed its accounting policy for fixed assets by revaluing certain classes of fixed assets to market value in accordance with the fair value provisions of FRS 15 'Tangible fixed assets'. The increase in fair value of fixed assets resulted in a credit to a revaluation reserve of £251.8m at 30 October 2009. In accordance with section 551 of the Companies Act 2006, the Directors approved a scheme to allot bonus shares in the company out of the revaluation reserve.

On the same day the directors approved a capital reduction by reducing the share capital from £265,057,823 divided into 265,057,823 ordinary shares of £1 each to £26,505,782.30 divided into 265,057,823 ordinary shares of £0.10.

The amount of £51,222,333 standing to the credit of the share premium account of the Company was cancelled on the same day.

The amount of £5,500,000 standing to the credit of the Capital Redemption Reserve of the Company was also cancelled.

On 31 March 2010, the revaluation of fixed assets was updated to incorporate changes from the final determination issued to the company on 26 November 2009. The update to the revaluation resulted in a further credit to a revaluation reserve of £128.7m at 31 March 2010.

## Report of the Directors (continued)

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### *Dividend policy*

Our dividend policy is primarily based on maintaining a specific level of gearing. The scale of the dividend is dependent on the level of success of the company to generate cash flows in the reported period. The policy distributes earnings equal to the amount necessary to maintain Net Debt to RCV at the targeted gearing ratio allowing the company to have the flexibility to adjust the target gearing level from time to time if ever required.

The directors have declared and paid the following dividends during the year ended 31 March 2010:

Ordinary dividends:	<b>£000</b>
Interim – paid June 2009	18,955
Interim – paid October 2009	171,778
	<hr/>
	190,733
	<hr/>

During October we underwent a capital restructuring which was executed through a £201.3m loan from fellow group undertaking Veolia Eau Compagnie Générale des Eaux. As a result of the restructuring an extraordinary dividend was paid to Veolia Water Capital Funds Limited of £171.8m.

No final dividend is proposed.

### *Competition*

We welcome greater competition and customer choice because it spurs us to improve our customer experience and service so that we retain our customers' business. As well as competition in the market, we also welcome competition for the market. Our parent company, Veolia Water UK is following its strategy to grow its business and become the leading water company in the UK by competing for operating contracts. We contribute to this strategy by focusing on our customers, innovating, improving our performance so that we become a reference for Veolia Water, and when possible making our expertise available on a cost-allocated basis. Sister companies in the Veolia Water group also act to increase competition as the operators of the MOD Tidworth inset appointment and as Water Supply Licence holders.

This year we negotiated terms for a bulk supply agreement with a new entrant which would allow the entrant to develop green field inset appointments within, or on the borders of, our supply area. We stand ready to negotiate and conclude similar agreements with other, interested new entrants but to date have only received one approach.

### **Employees**

Following the formation of Veolia Water Shared Services Ltd, 278 employees were transferred out of Veolia Water Central Ltd to enable the creation of a stand alone shared service operation.

We consult and inform employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings and the intranet. We are discussing with our Trade Unions ways to enhance and improve our communications and consultation channels.

The company gives full consideration to applications from disabled persons where the candidate's particular aptitudes and abilities are consistent with the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Employees who become disabled whilst employed by the company are actively encouraged to find appropriate employment within the business.

Several initiatives were also introduced with the aim of improving the health and well-being of our employees.



## Report of the Directors (continued)

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### Research and development activities

The development and application of new techniques and technology is an important part of the company's activities.

The company participates in the Veolia Water UK group research programme. The company also continues to participate in a research programme operated by UK Water Industry Research Limited.

### Charitable and political contributions

The charitable contributions made by the company during the year were £26,000 (2009: £627,000), largely to water-related and local organisations which aim to:

- improve opportunities and create worthwhile experiences for the disadvantaged
- improve the quality of life of senior citizens and the vulnerable within our community and
- educate young people about water and sustainability issues
- assist customers who have serious financial difficulties in paying their water bills.

As the Trust was set up after the annual billing period, which occurs in February each year, it made fewer grants than expected and therefore no contribution was required during 2009/10 (2008/09 £545,000). However, the company has committed to donate £2.5m to the Trust over 5 years and a further contribution will be made during the second quarter of 2010/11.

As a responsible local business which cares about the communities we serve and looks after the environment around us, we have always supported environmental projects and voluntary/charitable organisations within our community. We know that donations both large and small can make a real and lasting difference to the organisations which receive them.

On 1 April 2010 we launched a Community Investment Fund, where community groups and charities within our water supply area can apply for a grant for specific projects.

The company has a policy of not making political contributions.

### Creditor payment policy

Our policy is to negotiate the terms of payment with suppliers when agreeing terms of business and to pay in accordance with contractual and other legal obligations. The payment policy applies to all payments to creditors for revenue and capital supplies of goods and services. The average number of creditor days is 18 (2009: 18).

### Post balance sheet events

The following significant post balance sheet events have taken place.

On 1 April 2010 the loan issued by Veolia Eau Compagnie Generale des Eaux on 29 October 2009 for £201.3m was transferred to Veolia Environnement Europe Services under the same terms.

The premises formerly occupied by Veolia Water Central Ltd on Bishops Rise in Hatfield, Hertfordshire are currently held for sale. The exchange of contracts took place during May with legal completion expected in August. The selling price will be £6.1m.

## Report of the Directors (continued)

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### Auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the company's auditor, each director has taken all the steps that he or she is obliged to take as a director in order to make himself or herself aware of any relevant audit information and to establish that the auditor is aware of that information.

The auditors Ernst & Young LLP have expressed their willingness to continue in office and a resolution to reappoint them will be proposed at the annual general meeting in accordance with Section 485 of the Companies Act 2006.

By order of the Board



**T J W Monod**  
*Company Secretary*  
6 July 2010

# Corporate Governance Report

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## Introduction

As required by its Instrument of Appointment, the company is governed having regard to the principles of good governance set out in the Combined Code on Corporate Governance (June 2008). The following is a summary of how the company applies those principles in practice in the context of its status as a wholly owned subsidiary.

## The Board

The Board meets at least four times a year. There were nine meetings in the year. A schedule of matters specifically reserved for consideration by the Board has been adopted and includes, in particular, approval of strategic plans and regulatory matters. The Board receives reports from the Audit Committee on the effectiveness of the company's internal controls.

A procedure has also been agreed to enable directors to obtain access to independent professional advice where they think it necessary to perform their duties. The directors bring independent judgement to bear on all matters including issues of strategy, performance, resources and standards of conduct.

Appointments to the Board take into account the views of the shareholder as the company is a wholly owned subsidiary. Certain Board members are also directors of other group companies. This enables them to bring wider experience to discussions at meetings and on other occasions. All directors declare their position when as individuals they have a possible conflict of interest.

All directors have access to the advice and services of the Secretary, who is responsible to the Board for ensuring that Board procedures are followed. The Secretary ensures that the Board and its committees are provided in good time with papers of sufficient quality to enable the directors to prepare for meetings and otherwise to discharge their duties effectively. The Secretary may only be removed by the Board as a whole. The Secretary is also responsible for ensuring that every director receives appropriate training, both on appointment and subsequently as necessary.

## Board composition and independence

At the end of the reporting year the Board comprised three executive and eight non-executive directors. Dr. Neil Summerton is the senior independent non-executive director. The roles of Chairman and Managing Director are separated and clearly defined although not set out in writing. Frederic Devos was appointed non-executive Chairman of the company in September 2009, following the retirement of Sir Alan Thomas.

The Board considers that Baroness Buscombe, Dr. Neil Summerton and Fiona Woolf are independent. They are of sufficient calibre and experience for their views to carry significant weight in Board decisions.

The non-executive directors meet and maintain contact between Board meetings as and when appropriate.

## Board processes

The Board has established four standing committees, operating within written and agreed terms of reference. Each committee is able to take independent advice on any matters being considered. Minutes of the committee meetings are circulated to all Board members. See page 6 for the membership of each committee.

# Corporate Governance Report (continued)

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## ***Audit Committee***

The Audit Committee comprises three independent non-executive directors and meets at least four times a year. The Committee is chaired by Dr. Neil Summerton. The executive directors, Director of Finance, Head of Internal Audit, external auditors and other parties are invited to attend meetings as appropriate.

The Committee is responsible to the Board for reviewing the effectiveness of the systems of internal control that safeguard the shareholder's investment and the company's assets. The review covers all controls, including financial, operational and compliance controls and risk policy and management.

The Committee also reviews the company's statutory annual financial statements and regulatory accounts before submission to the Board to ensure that the report and accounts meet the obligations of the directors, including that the report and accounts give a true and fair representation of the company's financial position.

The Committee meets with the company's reporter and external auditors and reviews the information to be provided in the June Return to Ofwat before submission to the Board to ensure that the information meets Ofwat's reporting requirements.

Discussions are held with the external auditors before audits commence, and when the work is completed, to establish the nature and scope of the audit work, its cost effectiveness, the auditors' independence and objectivity and the results of audit work.

The Committee keeps under review the level of audit fees, the appointment of the external auditors, and the nature and extent of other services provided by them, seeking to balance the maintenance of objectivity with value for money.

The Committee also reviews the activities, resources and effectiveness of the internal audit function.

The Committee is responsible for drawing the attention of the Board to, and advising on, any matters which should appropriately be decided by the Board as a whole.

The Committee also considers and determines, on behalf of the Board, the policies and procedures for controlling and managing risks throughout the company and supervises actions to define, assess, control and limit risk.

## ***Executive Management Committee***

The Executive Management Committee membership is shown on page 6. The Committee meets regularly (normally monthly) and its duties are to consider certain strategic, financial, legal and regulatory matters delegated by the Board.

## ***Remuneration and Employment Committee***

Full details of the Remuneration and Employment Committee are shown on page 19. Membership is shown on page 6. As the company is a wholly owned subsidiary, the Remuneration and Employment Committee includes the Managing Director and certain non executive directors who are not independent. It also includes one independent non-executive director.

## ***Nomination Committee***

The Nomination Committee membership is shown on page 6. The Committee's duties are from time to time to review the structure, size and composition of the Board and give consideration to succession planning, subject to Board approval.

## ***Evaluation of Board performance***

The performance of the Board, and its committees is evaluated both informally and, from time to time, formally by the Board and the company's shareholder to ensure that the company retains the right balance of skills to provide leadership and control.

## Corporate Governance Report (continued)

### Attendance at meetings for year ended 31 March 2010

	Board	Audit Committee	Executive Management Committee	Remuneration & Employment Committee	Nomination Committee
Number of meetings in the year	9	5	12	1	0
Sir Alan Thomas	3*	1*	-	0*	0*
David Alexander	5	-	-	-	-
Jean Claude Banon	7	-	-	-	-
Richard Bienfait	9	-	4	-	-
Jeff Bishop	8	-	11	-	-
Richard Brimble	6	-	8	-	-
Baroness Buscombe	8	4	-	-	-
Philippe Guitard	5	-	-	0	0
Olivier Grunberg	6	-	-	-	-
Andrew Smith	9*	-	11*	1*	-
Dr. Neil Summerton	9	5	-	1	0
Fiona Woolf	9	5	-	-	-
Frédéric Devos	9	-	8	1	0

"-" denotes non-membership of that committee.

"\*\*" denotes not a member for the whole year.

### Relationships with shareholders

The principles of the Combined Code relating to relationships with institutional shareholders and private investors do not apply as the company is a wholly owned subsidiary. Representatives of the only shareholder are on the Board which ensures effective communication.

### Internal control

The Board has overall responsibility for the company's systems of internal control and for reviewing the effectiveness of these systems, including financial, operational and compliance controls and risk management. The systems are designed to manage the risk of failure to achieve business objectives, (though it cannot be completely eliminated), and can provide only reasonable and not absolute assurance against material misstatement or loss.

A whistleblowing procedure is in place that supports the open culture that the company promotes in its dealings with members of staff and all people with whom it engages in its business activities. The procedure encourages members of staff to communicate their concerns about malpractice or misconduct in an open and honest manner without fear of any form of detriment to their employment or career prospects.

### Risk

A formal, continuous process for identifying, evaluating and managing the significant risks faced by the company has been in place throughout the year under review and up to the date of approval of the Report and Accounts.

A Risk Management Committee comprises members of the Executive Management Committee and some specialists. Its purpose is to ensure that risk management is applied across the business as a whole, and evaluate its effectiveness. During the year the committee has met six times to prioritise actions for managing significant risks, receive reports of progress on risk management from risk owners and the risk



## Corporate Governance Report (continued)

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assurance department, review internal controls, and identify and assess significant risks for the forthcoming year. The Risk Management Committee reports to the Audit Committee.

The company contributes to the compliance of Veolia Environnement SA with the US Sarbanes-Oxley Act, as is necessary under the terms of Veolia Environnement's listing on the New York Stock Exchange.

In addition, the Board approves the company's annual budget and annual capital expenditure budget and regularly reviews actual performance. There is a defined organisational structure with appropriate delegation of authorities to line management and all major transactions are reviewed and approved by the Board as a whole.

By order of the Board



**T J W Monod**  
*Company Secretary*  
6 July 2010

# Remuneration Report

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## Introduction

The Remuneration & Employment committee provides advice and guidance to the Board on the remuneration of executive directors and on the terms and conditions of senior executives. The committee seeks to operate in accordance with best practice and appropriate guidelines and members of the committee are therefore excluded from discussions regarding their own remuneration and conditions of employment. Where appropriate the committee has received support and guidance from Monks KPMG, remuneration consultants.

The Committee is as shown on page 6 and meets as and when required. As a minimum the committee meets at least once a year to review the performance over the preceding twelve months and to set an appropriate remuneration framework for the forthcoming twelve months. The company believes that the composition of the committee and its terms of reference ensure sensitivity to both the shareholder's interests and also the wider interests in ensuring that remuneration packages are sufficient to attract, motivate and retain executives whilst not exceeding what is required for this purpose.

## Non-executive directors

The current non-executive directors fall into two groups.

### *Group A*

Baroness Buscombe  
Dr N W Summerton  
F Woolf

### *Group B*

D W Alexander  
J C Banon  
F Devos  
O Grunberg  
P Guitard

The directors in Group A are considered to be independent. They are appointed by resolution of the Board and there is no further written contract relative to their services. They receive a fee in respect of their services which is not related to company performance and they are not in receipt of share options or long-term incentive plans. The non-executive directors fees are set taking into account the market rate for non-executive directors, with particular reference to the UK water industry, and to the general level of remuneration increases within the company. The fees are cross referenced to the annual survey conducted by Incomes Data Services of non-executive fees.

There are no specific termination payments for non-executive directors in Group A. They may be removed from the Board by resolution of the shareholder.

The independent non-executive directors do not have service contracts.

The directors in Group B are employees or, in the case of D W Alexander, a retired employee of companies within the Veolia Water group. They can be removed from the Board of Veolia Water Central Limited by resolution of the Board as the sole member of the company

## Executive directors

R Bienfait	Managing Director
J A Bishop	Operations Director
R Brimble	Customer Relations Director

## Remuneration Report (continued)

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The salary of the managing director is currently set and paid by Veolia Water UK Limited and subsequently recharged to Veolia Water Central Limited, on a time proportional basis. The salary of the other executive directors is set annually (based on the year ended 31 December) on the recommendation of the Remuneration and Employment Committee taking into account:

- The performance of the individual executive
- Progression within the executive's current position
- Relevant comparative market data on remuneration within comparative industries and organisations produced by Monks KPMG
- The general level of remuneration increases within the Veolia group

The company also provides private health care and a fully expensed company car. The remuneration committee reviews the wider benefit package of the executive directors annually to ensure that they remain in line with market norms and are sufficient to retain and motivate high quality executives.

The bonuses of these executives are set in accordance with a target related bonus scheme. The remuneration committee annually reviews both the absolute level of the bonus and the individual elements to ensure that it is meeting the requirements of the company.

At the end of the year the results were compared to the targets set and a non-pensionable bonus was awarded accordingly. Although the scheme aimed to provide a direct link between executive and company performance and bonus award, such an award was at the discretion of the remuneration committee. There was no long-term incentive plan. For the year ended 31 December 2009 bonuses were paid.

The company operates a bonus scheme for all employees based around three common factors. This ensures a consistent message across the business and gives a common focus.

The three factors are:

- **Achievement of the company EBIT and Free Cash target**
  - Ensures the Company is hitting its financial obligations
  - Ensures an element of affordability
  - Focuses on key financial measures
- **Achievement of five individual pre-set objectives**
  - The other targets are generic so this introduces personal contribution
  - These targets will be set at the start of the year by the MD.
- **Hitting targets taking the business towards the four common business goals**
  - The targets will not be achieved overnight so each target will progressively move us towards its goal
  - The measures are consistently used throughout the business creating a sense of solidarity and unity among the entire team
  - The measures for 2010 are centred around Accidents, Interruptions to Supply, Water Quality Failures and Customer Complaints.

For Executives the bonus is split evenly between the three measures as follows:

- Achievement of the company EBIT and Free Cash target = 33% of Maximum
- Achievement of five individual pre-set objectives = 33% of Maximum
- Achievement of Five Zeros throughout the year = 33% of Maximum

## Remuneration Report (continued)

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Notice periods are as follows:

	From the executive to the company	From the company to the executive
R A Bienfait*	6 months	6 months
J A Bishop	3 months	3 months
R Brimble	6 months	6 months

\* notice period within VWUK contract but applicable to VWC service

### Directors' emoluments

Directors' emoluments for the year were £943k (2009: £752k). Full details are provided within note 5 on page 33.

### Directors' interests

There are no disclosable interests under the Companies Act 2006.

By order of the Board



**T J W Monod**  
*Company Secretary*  
6 July 2010

# Independent Auditor's Report to the Members of Veolia Water Central Limited (formerly Three Valleys Water PLC)

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We have audited the financial statements of Veolia Water Central Limited (formerly Three Valleys Water PLC) for the year ended 31 March 2010 which comprises of the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

## **Respective responsibilities of directors and auditors**

As explained more fully in the Statement of directors' responsibilities set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

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

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and the information given in the Corporate Governance Statement set out on pages 15 to 18 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.



# Independent Auditor's Report to the Members of Veolia Water Central Limited (formerly Three Valleys Water PLC) (continued)

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

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

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



*Steven Dobson (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London*

6 July 2010

# Profit and Loss Account for the Year Ended 31 March 2010

Registered Number 2546950

	Note	2010 £000	2009 £000
<b>Turnover</b>	2	<b>234,373</b>	228,912
<b>Cost of sales</b>		<b>(160,537)</b>	(137,333)
<b>Gross profit</b>		<b>73,836</b>	91,579
Customer services and administrative expenses		<b>(39,700)</b>	(39,614)
Other operating income	3	<b>8,447</b>	7,999
<b>Operating profit</b>	4	<b>42,583</b>	59,964
Profit on disposal of fixed assets		<b>10,672</b>	625
<b>Profit on ordinary activities before interest and taxation</b>		<b>53,255</b>	60,589
Interest receivable	6	<b>1</b>	455
Interest payable and finance charges	7	<b>(16,390)</b>	(15,524)
Other finance (charges)	8	<b>(2,862)</b>	(519)
<b>Profit on ordinary activities before taxation</b>		<b>34,004</b>	45,001
Tax on profit on ordinary activities	9	<b>(5,945)</b>	(20,657)
<b>Profit on ordinary activities after taxation and for the financial year</b>		<b>28,059</b>	24,344

All profits of the company are from continuing operations.

There are no material differences between the profit on ordinary activities before taxation and the profit on ordinary activities after taxation for the financial year as stated above and their historical cost equivalents, except for the difference between the historic cost depreciation charge and the actual depreciation charge for the year calculated on the revalued amount of £13.4m.

## Statement of Total Recognised Gains and Losses for the Year Ended 31 March 2010

	Note	2010 £000	2009 £000
Profit for the financial year		<b>28,059</b>	24,344
Surplus on revaluation of tangible fixed assets	19	<b>380,571</b>	-
Issue of bonus shares	19	<b>(251,830)</b>	-
Actuarial (loss)/gain recognised in the pension schemes	19	<b>(28,622)</b>	7,049
Deferred tax movement relating to actuarial gain/(loss)	19	<b>8,014</b>	(1,974)
Share based payment		-	12
<b>Total recognised gains for the year</b>	20	<b>136,192</b>	29,431

## Balance Sheet at 31 March 2010

	Note	2010 £000	2009 £000
<b>Fixed assets</b>			
Intangible assets	11	6,678	6,678
Tangible assets	11	924,827	548,367
Investment	12	50	50
		<b>931,555</b>	555,095
<b>Current assets</b>			
Stocks	13	596	611
Debtors	14	55,253	49,897
Cash at bank and in hand		1,154	831
		<b>57,003</b>	51,339
<b>Creditors - amounts falling due within one year</b>	15	<b>(144,139)</b>	(181,189)
<b>Net current liabilities</b>		<b>(87,136)</b>	(129,850)
<b>Total assets less current liabilities</b>		<b>844,419</b>	425,245
<b>Creditors - amounts falling due after more than one year</b>	16	<b>(421,721)</b>	(221,284)
<b>Provisions for liabilities</b>	17	<b>(41,085)</b>	(43,267)
<b>Net assets excluding pension liability</b>		<b>381,613</b>	160,694
<b>Net pension liability</b>	23	<b>(32,732)</b>	(9,101)
<b>Net assets including pension liability</b>		<b>348,881</b>	151,593
<b>Capital and reserves</b>			
Called up share capital	18	26,506	13,228
Share premium account	19	-	51,222
Other reserves	19	128,741	-
Capital redemption reserve	19	-	5,500
Profit and loss account	19	193,634	81,643
<b>Shareholders' funds</b>	20	<b>348,881</b>	151,593

The statutory financial statements on pages 24 to 51 have been approved by the Board of Directors and were signed on 6 July 2010 on its behalf by:



**Frederic Devos**  
Chairman



**Richard Bienfait**  
Managing Director

# Cash Flow Statement for the Year Ended 31 March 2010

	Note	2010 £000	2009 £000
<b>Net cash inflow from operating activities</b>	a	<b>112,905</b>	109,080
<b>Returns on investments and servicing of finance</b>			
Interest received		1	455
Interest paid		(15,895)	(15,098)
Interest element of finance lease payments		(460)	(574)
Net cash outflow from returns on investments and servicing of finance		(16,354)	(15,217)
<b>Taxation</b>		<b>(10,156)</b>	(12,826)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets		(82,686)	(98,984)
Capital contributions		6,589	8,089
Proceeds on disposal of tangible fixed assets		12,429	650
Net cash outflow from capital expenditure and financial investment		(63,668)	(90,245)
<b>Equity dividends paid to shareholders</b>		<b>(190,733)</b>	(40,182)
<b>Net cash outflow before financing</b>		<b>(168,006)</b>	(49,390)
<b>Financing</b>			
Capital element of finance lease payments		(1,290)	(1,203)
Loan from subsidiary		126	119
Deposit with parent company		(32,477)	50,087
Loan from other group undertaking		201,278	-
Financing of assets operated by other parties		693	(1,039)
Decrease in other long term financial liabilities – repurchase of debentures		(1)	(4)
Net cash inflow from financing		168,329	47,960
<b>Increase/(Decrease) in net cash</b>	b/c	<b>323</b>	(1,430)



# Notes to the Cash Flow Statement

## a Reconciliation of operating profit to net cash inflow from operating activities

	2010 £000	2009 £000
Operating profit	42,583	59,964
Depreciation of tangible fixed assets	82,498	62,073
Amortisation of deferred credit	(329)	(257)
Increase in stocks	15	(60)
(Increase) in debtors	(7,378)	(5,002)
(Decrease) in provisions	(42)	(643)
Increase in creditors	(5,779)	(563)
Decrease/(Increase) in pension liability	1,337	(6,444)
Share based payments	-	12
Net cash inflow from operating activities	112,905	109,080

## b Reconciliation of net cash flow to movement in net debt

	2010 £000	2009 £000
Increase/(Decrease) in cash in the year	323	(1,430)
Cash outflow from increase in debt and finance leasing	(168,329)	(47,960)
Movement in net debt in the year	(168,006)	(49,390)
Net debt at the beginning of the year	(293,548)	(244,158)
Net debt at the end of the year	(461,554)	(293,548)

## c Analysis of net debt

	At 1 April 2009 £000	Cash Flow £000	Non Cash Flow £000	At 31 March 2010 £000
<b>Net cash</b>				
Bank	831	323	-	1,154
	831	323	-	1,154
<b>Debt</b>				
Loan from subsidiary financed by bond issue	(196,314)	-	(127)	(196,441)
Deposit with parent company	4,290	(2,023)	-	2,267
Loan from other group undertakings	-	(201,278)	-	(201,278)
Loan from parent company	(79,500)	34,500	-	(45,000)
Debentures	(35)	1	-	(34)
Finance leases (including sale and leaseback)	(5,749)	1,290	-	(4,459)
Financing of assets used by Veolia Water Central and operated by other parties	(17,071)	(692)	-	(17,763)
	(294,379)	(168,202)	(127)	(462,708)
<b>Net debt</b>	(293,548)	(167,879)	(127)	(461,554)

# Notes to the Financial Statements

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## 1 Statement of accounting policies

### Basis of preparation

These financial statements are prepared on the going concern basis, under the historical cost convention, as modified by the revaluation of certain tangible fixed assets and the treatment of certain grants and contributions, described below, and non-amortisation of goodwill and in accordance with the Companies Act 2006 and applicable accounting standards.

The accounts for Veolia Water Central Limited (formerly Three Valleys Water PLC) and its wholly owned subsidiary, Three Valleys Water Finance PLC, are not presented in consolidated format as Veolia Water Central Limited is itself a wholly owned subsidiary of Veolia Water Capital Funds Limited which in turn is a wholly owned subsidiary of Veolia Water UK PLC which is the parent undertaking of the smallest group to consolidate the statutory financial statements.

No transactions were recognised in respect of the share based payments for the year ended 31 March 2010 because the amounts were not material.

### Change of accounting policy

The company has adopted a policy of revaluing certain classes of fixed assets to market value, in accordance with the fair value provisions of FRS 15 'Tangible fixed assets'. This is a change from the previous policy, under which all fixed assets were stated at historic cost, except for the treatment of certain grants and contributions.

The impact on the financial statements of this change in accounting policy has been to:

- increase the net book value of land and buildings as at 31 March 2010 by £88.5m;
- recognise an exceptional charge against operating profit in respect of accelerated depreciation arising from revaluation of the fixed plant of £8.8m at 30 October 2009 and £4.5m at 31 March 2010. This depreciation reflects the difference for all assets where the fair value of the asset as determined by the revaluation as at the relevant dates were below the net book value prior to the revaluation;
- the impact of the above is a net increase in the value of property, plant and equipment of £292.0m (see note 11). This has been booked as an increase on cost or valuation of £292.0m;
- recognise a credit of £380.6m against the revaluation reserve, representing the revaluation adjustment of £380.6m.

Management consider that restatement of the prior year comparatives to reflect the impact of this change in accounting policy would be impractical to perform and would hinder the understanding of the users of the accounts. No such restatement has therefore been provided.

### Bad debt provisioning

The bad debt provision is calculated by applying a range of different percentages to debt of different ages. These percentages also vary between 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 debt provision is sensitive to the specific percentages applied.

### Revenue recognition

Revenue is recognised in accordance with FRS 5 'reporting the substance of transactions' in the period in which it is earned. The company does not recognise revenue where payment is received in advance. However, payments made in the previous period in respect of the current period will be recorded as revenue in the current period. In accordance with Application Note G of FRS 5, the company does not recognise revenue where historic evidence indicates that the company will probably never be able to

## Notes to the Financial Statements (continued)

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collect the revenue billed. Where relevant, this includes an estimate of the sales value of water supplied to customers between the date of the last meter reading and the period end together with unbilled waste water charges, exclusive of value added tax.

### **Tangible fixed assets and depreciation**

FRS 15 requires fixed assets which are carried at revalued amounts to be shown at their current value at the balance sheet date. To achieve this all the tangible fixed assets are subject to a full valuation every five years with an interim valuation carried out in the third year of this cycle.

Tangible fixed assets comprise:

Infrastructure assets - mains and associated underground pipe-work.

Other assets - land and buildings, operational structures, fixed plant, vehicles and mobile plant.

Infrastructure assets (being mains and associated underground pipe-work) comprise a network of systems. Expenditure on infrastructure assets, including renewals, is treated as an addition and included at cost after deducting grants and contributions.

The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on the company's independently certified asset management plan. Disposals of infrastructure assets are calculated based on the estimated lives of the assets before they are replaced.

Depreciation is provided on all other fixed assets except freehold land and is calculated to write off their cost over their estimated useful lives on a straight-line basis. Assets acquired under finance leases are depreciated over the shorter of their useful life or the lease term. The performance of assets is continually monitored and where impairment is identified, fixed assets are written down to recoverable amount. Tangible fixed assets are reviewed for impairment at the end of each reporting period when the estimated remaining useful economic life of the assets exceeds 50 years. Information on the condition of assets is also provided to the Regulator every five years as part of the price review mechanism.

The estimated useful lives of these assets are:

Buildings	40 - 60 years
Operational structures	15 - 100 years
Fixed plant - Short life	3 - 10 years
- Other	10 - 30 years
Vehicles and mobile plant	3 - 10 years
Land is not depreciated	

### **Capital contributions**

Infrastructure charges received in respect of connections to the mains network are allocated to fixed assets, surface and infrastructure, in accordance with the basis on which the charges are calculated.

Grants and contributions receivable relating to infrastructure assets have been deducted from the cost of tangible fixed assets. This is not in accordance with Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410) which forms part of the Companies Act 2006, which requires tangible fixed assets to be shown at cost, and hence grants and contributions are accounted for as deferred income. This departure from the requirements of the Companies Act 2006 is, in the opinion of the directors, necessary for the non-statutory financial statements to show a true and fair view as, while a provision is made for depreciation of infrastructure assets, these assets have indefinite economic lives and therefore no basis exists on which to recognise grants and contributions in the profit and loss account. The effect of this treatment on the book value of tangible fixed assets is disclosed in note 11.

## Notes to the Financial Statements (continued)

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### Leased Assets

Assets financed by leasing are included in tangible fixed assets and the net obligation to pay future rentals is included within creditors. Instalments are apportioned between the finance element, which is charged to the profit and loss account as interest, and the capital element, which reduces the outstanding obligation for future instalments.

Rentals paid under an operating lease are charged against profits on a straight-line basis over the life of the lease.

### Fixed asset investments

Fixed asset investments are stated at cost less any provisions in respect of permanent diminution in value.

### Deferred taxation

Deferred tax is provided, except as noted below, on timing differences that have arisen but not reversed by the balance sheet date, where the timing differences result in an obligation to pay more tax, or a right to pay less tax, in the future. Timing differences arise because of differences between the treatment of certain items for accounting and taxation purposes.

In accordance with FRS 19, deferred tax is not provided on timing differences arising from:

- a revaluation gains on land and buildings, unless there is a binding agreement to sell them at the balance sheet date;
- b gains on the sale of non-monetary assets, where on the basis of all available evidence it is more likely than not that the taxable gain will be rolled over into replacement assets;
- c fair value adjustment gains to fixed assets and stock to uplift prices to those ruling when an acquisition is made.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Deferred tax is measured at the tax rates that are expected to apply in the periods when the timing differences are expected to reverse, based on tax rates and law enacted or substantively enacted at the balance sheet date.

Where law or accounting standards require gains and losses to be recognised in the statement of total recognised gains and losses, the related taxation is also taken directly to the statement of total recognised gains and losses in due course.

The company has adopted a policy of discounting deferred tax assets and liabilities to reflect the time value of money. Deferred tax assets and liabilities are discounted using a discount rate equivalent to the post tax yield that could be obtained at the balance sheet date on government bonds with similar maturity dates and currencies. The increase or decrease in the discount deducted in arriving at the deferred tax balance is included in the deferred tax charge or credit in the profit and loss account.

### Stocks and work in progress

Stocks are valued at the lower of cost or net realisable value after allowance for obsolete and slow moving items. In accordance with established practice in the water industry no value has been placed upon the water in reservoirs, mains or in the course of treatment. Work in progress for chargeable services is valued at cost.

### Research and development

The costs of research and development are written off in the period in which they are incurred.

## Notes to the Financial Statements (continued)

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### Pension costs

The company operates two pension schemes providing benefits based on final pensionable salary. These schemes closed to new members in April 1996 and September 2004. The assets of the scheme are held separately from those of the company.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term to the liability.

Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

The company also has an unfunded obligation to pay pensions to former non-executive directors. A provision in respect of the obligation is included within the net pension liability.

### Financial instruments

Income and expenditure arising on financial instruments is recognised on an accruals basis and credited or charged to the profit and loss in the financial period in which it arises.

### Goodwill and amortisation

Positive goodwill is the excess of the cost of the acquired entity over the aggregate of the fair values of that entity's identifiable assets and liabilities.

Goodwill relating to the acquisition of North Surrey Water Limited in the year ended 31 March 2001 amounting to £6.7m has been capitalised. The directors consider that this goodwill has an indefinite life and accordingly is not amortised but is subject to annual review for impairment. In estimating the useful economic life of goodwill arising, account has been taken of the nature of the business acquired and the stability of the industry. This is not in accordance with Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410) which forms part of the Companies Act which requires that all goodwill be amortised. The directors consider that this would not give a true and fair view of the profit for the year and that the economic measure of performance in any period is properly made by reference only to any impairment that may have arisen. The effect on the accounts of this departure amounts to £334,000 per annum over 20 years. Any impairment charge is included within operating profits.

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## 2 Turnover

Turnover represents income from the supply of water and other chargeable services exclusive of VAT arising wholly within the United Kingdom.

Turnover relating to unmeasured supplies comprises amounts due to the company for the accounting year.

	2010 £000	2009 £000
Turnover by class is analysed below:		
Unmeasured supplies	123,571	123,798
Measured supplies	110,226	104,507
Chargeable services	576	607
	<b>234,373</b>	<b>228,912</b>

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## Notes to the Financial Statements (continued)

### 3 Other operating income

	2010 £000	2009 £000
Commission, rentals & other non-appointed income	<b>8,447</b>	7,999

### 4 Operating profit

	2010 £000	2009 £000
Operating profit is stated after charging/(crediting):		
Purchase of bulk water and water supplied under statutory entitlement	<b>1,334</b>	1,574
Water abstraction	<b>4,512</b>	4,281
Business rates	<b>11,193</b>	10,698
Chargeable services direct expenditure	<b>1,215</b>	884
Depreciation of infrastructure assets	<b>38,463</b>	35,568
Depreciation of tangible fixed assets - owned	<b>29,398</b>	25,051
Depreciation of tangible fixed assets - leased	<b>1,268</b>	1,454
Accelerated depreciation arising from revaluation	<b>13,369</b>	-
Research and development	<b>297</b>	419
Auditor's remuneration - audit	<b>141</b>	99
Auditor's remuneration - regulatory returns and non-statutory audit	<b>94</b>	77
Auditor's remuneration - other	-	20
Hire of equipment	<b>589</b>	429
Operating lease rentals – Land and Buildings	<b>1,547</b>	1,547
Operating lease rentals - other	<b>75</b>	261
Amortisation of deferred credit	<b>(329)</b>	(257)

These items are included under customer service and administrative expenses in the profit and loss account.

### 5 Employees and directors

	2010 £000	2009 £000
Staff costs (including directors) consist of:		
Wages and salaries	<b>26,053</b>	32,842
Social security costs	<b>2,080</b>	2,820
Defined benefit pension costs (note 23)	<b>2,216</b>	4,075
Defined contribution pension costs	<b>355</b>	899
Other pension costs	<b>236</b>	-
Share based payment	-	12
Net settlement charge (note 23)	<b>3,522</b>	-
	<b>34,462</b>	40,648



## Notes to the Financial Statements (continued)

	2010 Number	2009 Number
The average number of employees (including directors) during the year was as follows:		
Operations	425	551
Customer service	288	278
Administration	120	217
	<b>833</b>	<b>1,046</b>

### Directors' emoluments

	2010 Salary and fees £000	2010 Benefits in kind £000	2010 Bonus £000	2010 Total £000	2009 Total £000
<b>Non-executives</b>					
Sir Alan Thomas	128			128	64
D W Alexander	25			25	31
J C Banon	25			25	25
Baroness Buscombe	25			25	25
C Roger-Lacan	-			-	4
M S Ross Collins	-			-	18
Dr N W Summerton	25			25	25
F Woolf	25			25	25
F Devos	25			25	31
O Grunberg	25			25	18
P Guitard	25			25	21
<b>Executives</b>					
J A Bishop	119	16	18	153	151
A P Smith	235		69	304	248
R Brimble	117	14	27	158	66
	<b>799</b>	<b>30</b>	<b>114</b>	<b>943</b>	<b>752</b>

During the year pensions paid to non-executive directors amounted to £91k (2009: £95k).  
No directors exercised share options during the year.

The number of directors accruing retirement benefits under the money purchase pension scheme was 1.  
The company contributions paid to money purchase pension schemes amounted to £23k (2009: £21k).

### Pensions (defined benefits)

	Accumulated total accrued pension at 31 March 2009		Increase in accrued pension during year				Accumulated total accrued pension at 31 March 2010	
	£000 p.a.	Transfer Value £000	Increase net of inflation £000 p.a.	Member contribution £000	Transfer value of increase (net of member contributions) £000	Total change in transfer value (net of member contributions) £000	£000 p.a.	Transfer Value £000
J A Bishop	45	1,001	4	7	69	(50)	49	958
A P Smith	21	351	11	9	86	(88)	32	272

## Notes to the Financial Statements (continued)

\* Part of the benefit was funded by fellow group company Veolia Water East Limited (formerly Tendring Hundred Water Services Limited) whom A P Smith left to join Veolia Water Central Limited on 1 May 2007.

Normal retirement age for J A Bishop and A P Smith is 60.

There were no benefits accrued under long term incentive plans during the year.

There is no lump sum accrued for the highest paid director. The company paid £47k into the defined benefit pension scheme for highest paid director.

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### 6 Interest receivable

	2010 £000	2009 £000
Interest receivable from parent company	-	207
Other interest	1	248
	<u>1</u>	<u>455</u>

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### 7 Interest payable and finance charges

	2010 £000	2009 £000
Interest payable to other group undertaking	2,194	-
Interest payable to parent company	635	1,981
Financing costs of assets used by Veolia Water Central and operated by other parties	1,148	1,191
Finance lease charges	460	552
Debenture interest	1	2
Interest payable to subsidiary in respect of bond issue	11,876	11,869
Other interest	76	(71)
	<u>16,390</u>	<u>15,524</u>

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### 8 Other finance (charges)/income

	2010 £000	2009 £000
Expected return on pension scheme	10,503	13,578
Interest on pension scheme liabilities	(13,365)	(14,097)
	<u>(2,862)</u>	<u>(519)</u>

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## Notes to the Financial Statements (continued)

### 9 Tax on profit on ordinary activities

	2010 £000	2009 £000
<b>Current taxation</b>		
Current tax on profit of the year	12,263	10,641
Adjustment in respect of prior years	(3,002)	1,274
Current taxation	9,261	11,915
<b>Deferred taxation</b>		
Origination and reversal of timing differences	(2,870)	3,986
Adjustment in respect of prior years	1,775	1,120
(Increase)/decrease in discounting	(2,221)	3,636
Deferred tax charge for the year	(3,316)	8,742
Tax on profit on ordinary activities	5,945	20,657
<b>Current taxation reconciliation</b>		
Profit on ordinary activities before taxation	34,004	45,001
Theoretical tax at UK corporation tax rate of 28% (2009: 28%)	9,521	12,600
Effects of:		
Adjustment to tax in respect of prior years	(3,002)	1,274
Accelerated capital allowances	2,084	(2,423)
Pension cost charge in excess of pension cost relief	800	(289)
Other short term timing differences	(14)	97
Permanent differences	(128)	656
Actual current taxation charge	9,261	11,915

The tax charge relating to profits on disposal of fixed assets amounts to £2,988,000 (2009: £175,000).

Factors that may affect future tax charges:

Changes to the UK capital allowance regime will impact the capital allowances the company can claim. Based on current capital investment plans the company expects to continue to be able to claim capital allowances in excess of depreciation in future years to similar levels to the current year.

In his budget of 22 June 2010, the Chancellor of the Exchequer announced Budget tax changes, which, if enacted in the proposed manner, will have a significant effect on the company's future tax position. As at 31 March 2010, the tax changes announced in the Budget were not yet regarded as 'substantively enacted' and as such, in accordance with accounting standards, the changes have not been reflected in the company's financial statements as at 31 March 2010.

The Budget proposed a decrease in the rate of UK corporation tax from 28% to 24% by 1% each year, from April 2011, which will be enacted annually. It is considered impractical to perform a quantification of the exact amount of the reduction on the company's deferred tax liability, due to the decrease in the tax rate to 24% over this period, at this stage. The rate change will also impact the amount of future cash tax payments to be made by the company.

The effect on the company of these proposed changes to the UK tax system will be reflected in the company's financial statements for the year ending 31 March 2011 once the proposals have been substantively enacted.

	2010 £000	2009 £000
Tax on recognised gains and losses not included in the profit and loss account (note 19):		
UK corporation tax rate of 28% (2009: 28%)		
Other deferred tax movements relating to pension schemes	(8,014)	1,974

## Notes to the Financial Statements (continued)

### 10 Dividends on equity shares

	2010 £000	2009 £000
Ordinary:		
First interim paid of 143.33p per share (2009: 159.07p)	18,955	21,041
Second interim paid of 648.07p per share (2009: 144.70p)	171,778	19,141
	<b>190,733</b>	<b>40,182</b>

### 11 Fixed assets

#### Intangible assets

	Positive goodwill £000
Cost at 1 April 2009 and 31 March 2010	6,678
Amortisation at 1 April 2009 and 31 March 2010	-
Net book value at 31 March 2009 and 31 March 2010	<b>6,678</b>

Positive goodwill arose on adoption of FRS 19, resulting in recognition of a deferred tax provision of £6,678,000 in North Surrey Water Limited, acquired in the year ended 31 March 2001.

#### Tangible assets

	Land, buildings and operational structures £000	Mains and other infrastructure assets £000	Fixed plant £000	Vehicles and mobile plant £000	Assets in the course of construction £000	Total £000
<b>Cost or valuation</b>						
At 1 April 2009	130,849	541,122	411,183	41,037	63,885	1,188,076
Additions at cost	4,359	44,916	19,890	2,073	15,495	86,733
Transfers to complete	14,404	-	34,681	2,406	(51,491)	-
Capital contributions	-	(6,589)	-	-	-	(6,589)
Surplus on revaluation	88,534	292,037	-	-	-	380,571
Disposals	-	(658)	-	(3,415)	-	(4,073)
At 31 March 2010	<b>238,146</b>	<b>870,828</b>	<b>465,754</b>	<b>42,101</b>	<b>27,889</b>	<b>1,644,718</b>
<b>Depreciation</b>						
At 1 April 2009	48,476	310,360	251,072	29,801	-	639,709
Charge for the year	4,171	38,463	22,119	4,376	-	69,129
Revaluation	-	-	13,369	-	-	13,369
Disposals	-	(658)	-	(1,658)	-	(2,316)
At 31 March 2010	<b>52,647</b>	<b>348,165</b>	<b>286,560</b>	<b>32,519</b>	<b>-</b>	<b>719,891</b>
<b>Net book value</b>						
At 31 March 2010	<b>185,499</b>	<b>522,663</b>	<b>179,194</b>	<b>9,582</b>	<b>27,889</b>	<b>924,827</b>
At 31 March 2009	82,373	230,762	160,111	11,236	63,885	548,367

## Notes to the Financial Statements (continued)

Finance leases have been arranged for assets included above at 31 March 2010 as follows:

Cost	<b>8,419</b>	<b>23,165</b>	<b>63,874</b>	<b>4,834</b>		<b>100,292</b>
Depreciation	<b>7,240</b>	<b>10,519</b>	<b>61,382</b>	<b>4,834</b>		<b>83,975</b>
Net book value	<b>1,179</b>	<b>12,646</b>	<b>2,492</b>	<b>-</b>		<b>16,317</b>

Finance leases have been arranged for assets included above at 31 March 2009 as follows:

Cost	8,419	23,165	63,874	4,834	-	100,292
Depreciation	7,007	10,382	60,484	4,834	-	82,707
Net book value	1,412	12,783	3,390	-	-	17,585

The net book value of mains and other infrastructure assets for the company is stated after the deduction of grants and contributions received since April 1990 amounting to £132,026k (2009: £125,437k) in order to give a true and fair view.

All land and buildings are held as freehold.

The company's tangible fixed assets were professionally valued at October 2009 and March 2010 by independent qualified valuers, PricewaterhouseCoopers LLP ('PwC'), a firm of independent chartered accountants. These valuations were performed in accordance with FRS 15 which requires that assets subject to a policy of revaluation should be carried at their current value. Current value is defined in FRS 15 as the lower of replacement cost and recoverable amount. The recoverable amount is further defined as the higher of Net Realisable Value ("NRV") and Value in Use ("VIU").

Having considered the above definitions of value, PwC have concluded that the most reliable valuation method to determine the current value for the tangible fixed assets of a UK water company is a 2 step approach:

- Step 1: Estimating the business VIU, using a discounted cash flow ("DCF") model to determine the business enterprise value, cross-checked against the Regulatory Capital Value ("RCV"), followed by
- Step 2: Allocating the VIU of the business (less relevant working capital balances, deferred tax liabilities and other adjustments) to individual classes of tangible fixed assets.

Such valuations have been incorporated into the financial statements and the resulting revaluation adjustments have been taken to the revaluation reserve. The revaluations during the year ended 31 March 2010 resulted in a net revaluation surplus of £128.7m (revaluation £380.6m less capital reduction £238.6 and share capital movement £13.3m). Deferred tax has not been provided on timing differences arising from the revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will be rolled over.

If the revalued assets were stated on a historical cost basis, the historic cost before depreciation would be £1,264.1m.

## 12 Investment

	2010 £000	2009 £000
Investment in subsidiary undertaking	<b>50</b>	50

## Notes to the Financial Statements (continued)

The company has an investment of £50,000 in 100% of the £1 ordinary shares of a subsidiary company, Three Valleys Water Finance PLC. The principal activity of Three Valleys Water Finance PLC is to raise finance for the company. It made neither a profit nor loss in 2010 (2009: Nil).

### 13 Stocks

	2010 £000	2009 £000
Raw materials and consumables	596	611

### 14 Debtors

	2010 £000	2009 £000
<b>Due within one year</b>		
Trade debtors and customers' water charges	16,127	11,703
Deposit with parent company	2,267	4,290
Unbilled accrual for metered customers	26,182	25,537
Amounts due from fellow subsidiaries	3,963	2,831
Other debtors	2,409	2,352
Prepayments and accrued income	4,305	3,184
	<b>55,253</b>	<b>49,897</b>

The deposit with the parent company relates to overnight cash pooling.

### 15 Creditors – amounts falling due within one year

	2010 £000	2009 £000
Net obligations under finance leases (note 22)	1,384	1,290
Financing of assets used by Veolia Water Central and operated by other parties (note 22)	1,220	1,273
Amounts due to fellow subsidiaries	4,690	3,236
Loan from parent company	45,000	79,500
Payments received in advance	31,855	30,479
Trade creditors	3,380	4,149
Inter-company interest payable	8,402	8,402
Corporation tax	5,560	6,455
Taxation and social security	860	1,237
Other creditors	8,632	9,242
Capital accruals	22,934	18,887
Other accruals and deferred income	10,222	17,039
	<b>144,139</b>	<b>181,189</b>



## Notes to the Financial Statements (continued)

### 16 Creditors – amounts falling due after more than one year

	2010 £000	2009 £000
Net obligations under finance leases (note 22)	3,075	4,459
Financing of assets used by Veolia Water Central and operated by other parties (note 22)	16,543	15,798
Deferred credit – contributions to surface assets	4,349	4,678
Loan from subsidiary company financed by bond issue	196,441	196,314
Loan from other group undertakings	201,278	-
4% irredeemable consolidated debenture stock	9	9
4% irredeemable debenture stock	1	1
4.25% irredeemable debenture stock	1	1
5% irredeemable debenture stock	23	23
5.25% irredeemable stock	1	1
	<b>421,721</b>	<b>221,284</b>

During the year the company repurchased for cancellation £766 nominal irredeemable outstanding debenture stock (2009: £3,735).

The loan from the subsidiary company relates to a loan from Three Valleys Water Finance PLC. This represents the net proceeds of a bond issue made by Three Valleys Water Finance PLC and then lent to the company. On 13 July 2004 Three Valleys Water Finance PLC issued a £200 million bond at an interest rate of 5.875% and repayable in July 2026. The company has unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by Three Valleys Water Finance PLC in respect of the £200 million bond. This guarantee constitutes direct, general and unconditional obligations of the company which will at all times rank at least pari passu with all other present and future unsecured obligations. The amount due by the company to Three Valleys Water Finance PLC also incurs interest at 5.875%.

The loan from other group undertakings relates to a loan from Veolia Eau Compagnie Generale des Eaux. On 29 October 2009 they issued a £201,278 loan at an interest rate of 2% above GBP LIBOR 3m rates which matures on 31 December 2024. The loan can be repaid at any time without penalty after giving Veolia Eau Compagnie des Eaux five business days notice. On 1 April 2010 the loan was transferred to Veolia Environnement Europe Services, under the same terms.

### 17 Provisions for liabilities

	Deferred tax £000	Insurance £000	Other £000	Total £000
At 1 April 2009	41,661	1,129	477	43,267
Charged to the profit and loss account	(2,141)	(59)	17	(2,182)
Utilised in the year	-	-	-	-
At 31 March 2010	<b>39,520</b>	<b>1,070</b>	<b>494</b>	<b>41,085</b>

## Notes to the Financial Statements (continued)

### Deferred tax (see note 9)

	2010 £000	2009 £000
Accelerated capital allowances	93,821	93,004
Other timing differences	(2,246)	(1,509)
Undiscounted provision for deferred tax	91,575	91,495
Discount	(52,055)	(49,834)
Discounted provision for deferred tax	39,520	41,661
Deferred tax asset on pension liability (see note 23)	(12,730)	(3,539)
Provision at the end of the year including deferred tax on pension liability	26,790	38,122

### Deferred tax asset relating to pension liability

	2010 £000	2009 £000
At 1 April	3,539	7,172
Deferred tax charge/(credit) to the profit and loss account	1,176	(1,659)
Deferred tax charge/(credit) to the statement of total recognised gains and losses:		
- on actuarial (loss)/gain	8,015	(1,974)
At 31 March	12,730	3,539

The deferred tax asset of £12,730,000 (2009: £3,539,000) has been deducted in arriving at the net pension liability on the balance sheet.

Factors that may affect future tax charges:

Based on current capital investment plans, the group expects to continue to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

Reference should also be made to note 9 regarding recently proposed changes to the UK tax system.

### Insurance

Insurance represents the amount of the company's liability in respect of excesses on individual claims. This is based upon data provided by loss adjusters to insurers on levels of reserve and is calculated on settlement experience. It is expected that this provision will be utilised within 24 months.

### Other provisions

Other provisions represents a provision of £0.3m covering the risk of remedy to the buyer of St George's Hill land due to an encroachment issue and a provision of £0.2m for the charitable trust.

## 18 Share capital

	2010 £000	2009 £000
<b>Allotted, called up and fully paid share capital</b>		
Ordinary shares of £1 each	-	13,228
Ordinary shared of £0.10 each	26,506	-

## Notes to the Financial Statements (continued)

During the year the directors approved a scheme to allot shares out of a revaluation reserve created by the revaluation of assets. At the same time the directors approved a capital reduction by reducing the share capital from £265,057,823 divided into 265,057,823 ordinary shares of £1 each to £26,505,782.30 divided into 265,057,823 ordinary shares of £0.10.

### 19 Reserves

	Revaluation reserve £'000	Share premium account £000	Capital redemption reserve £000	Profit and loss account £000	Total £000
At 1 April 2009	-	51,222	5,500	81,643	138,365
Actuarial loss recognised in the pension scheme	-	-	-	(28,622)	(28,622)
Movement in deferred tax relating to pension liability	-	-	-	8,014	8,014
Issue of bonus shares	(251,830)	-	-	-	(251,830)
Capital reduction	-	-	-	238,551	238,551
Cancellation of share premium account	-	(51,222)	-	51,222	-
Cancellation of capital redemption reserve	-	-	(5,500)	5,500	-
Revaluation in the year	380,571	-	-	-	380,571
Profit for the financial year	-	-	-	28,059	28,059
Dividends paid	-	-	-	(190,733)	(190,733)
At 31 March 2010	128,741	-	-	193,634	<b>322,375</b>

During the year the directors approved a scheme to allot shares out of a revaluation reserve created by the revaluation of assets. At the same time the directors approved a capital reduction by reducing the share capital from £265,057,823 divided into 265,057,823 ordinary shares of £1 each to £26,505,782.30 divided into 265,057,823 ordinary shares of £0.10. The amount of £51,222,333 standing to the credit of the share premium account of the Company was cancelled on the same day. The amount of £5,500,000 standing to the credit of the Capital Redemption Reserve of the Company was also cancelled.

### 20 Reconciliation of movements in shareholders' funds

	2010 £000	2009 £000
Profit for the financial year	<b>28,059</b>	24,344
Surplus on revaluation of tangible fixed assets	<b>380,571</b>	-
Issue of bonus shares	<b>(251,830)</b>	-
Other recognised gains/(losses) in year (shown in STRGL)	<b>(20,608)</b>	5,087
Total gains recognised for the year	<b>136,192</b>	29,431
Dividend paid	<b>(190,733)</b>	(40,182)
Capital reduction	<b>238,551</b>	-
Movement in called up and fully paid share capital	<b>13,278</b>	-
Net addition to shareholders' funds	<b>197,288</b>	(10,751)
Opening equity shareholders' funds	<b>151,593</b>	162,344
Closing equity shareholders' funds	<b>348,881</b>	151,593

## Notes to the Financial Statements (continued)

### 21 Capital commitments

The directors have authorised to undertake a programme of capital expenditure (including infrastructure renewals), of which the contracted element not provided for in the accounts amounts to £14,329,000 (2009: £21,800,000).

### 22 Commitments under finance and operating leases

	2010 £000	2009 £000
<b>Maturity of debt:</b>		
Finance leases		
In one year or less, or on demand	1,384	1,290
In more than one year but not more than two years	1,484	1,384
In more than two years but not more than five years	1,591	3,075
In more than five years	-	-
Net obligations due	<b>4,459</b>	5,749
	2010 £000	2009 £000
Financing of assets operated by third parties		
In one year or less, or on demand	1,220	1,273
In more than one year but not more than two years	1,285	1,268
In more than two years but not more than five years	2,391	2,595
In more than five years	12,867	11,935
Net obligations due	<b>17,763</b>	17,071

### Operating leases

The company had annual commitments under non-cancellable operating leases as follows:

	2010 Land and buildings £000	2010 Other £000	2009 Land and buildings £000	2009 Other £000
Operating leases which expire:				
Within one year	-	75	-	155
In two to five years	-	885	-	916
After five years	1,547	-	1,547	-

## Notes to the Financial Statements (continued)

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### 23 Pensions

#### Composition of the schemes:

The company operates two defined benefit pension schemes; one is the Veolia Water Supply Companies' Pension Plan and the other the Veolia UK Pension Plan.

#### Veolia Water Supply Companies' Pension Plan (VWSCPP)

Until 31 March 1996, the company was a member of The Water Companies' Association Pension Scheme, which provided benefits based on final pensionable pay. On 1 April 1996 the assets and liabilities of the General Utilities PLC subsidiaries which participated in the Water Companies' Association Scheme were transferred to a "mirror image" plan called Veolia Water Supply Companies Pension Plan which was closed to new members. This plan continues to provide benefits on a no less favourable basis than those previously provided for existing members of the scheme.

The assets of the plan are held separately to those of the company, being invested by independent fund managers.

The most recent triennial valuation of the plan for the company, determined by an independent qualified actuary, was at 31 December 2007. The valuation was made on the "attained age" funding method. The actuarial valuation made the following assumptions:

Rate of investment return	6.85% (pre-retirement), 5.35% (post-retirement)
Rate of increase in remuneration	4.8%
Rate of pension increase	3.3%

The valuation as at 31 December 2007 stated the market valuation of the plan to be £204m with a funding level of 93%.

Contributions to the plan over the year ended 31 March 2010 were paid by members in accordance with the rules of the plan and by the company of 40.9% of the pensionable salary.

The contributions expected to be paid in the year from the balance sheet date are £5.9m.

#### Veolia UK Pension Plan (VUKPP)

A new scheme was inaugurated as at 1 April 1996, the Générale des Eaux UK Retirement Benefits Scheme. This scheme was merged with the Générale des Eaux UK Pension Plan on 1 April 1998 to form the Veolia UK Pension Plan, which was open to all new staff and existing members. The scheme provides a selection of benefits based upon final pensionable pay or money purchase according to the members' wishes. The final salary section was closed to new members on 30 September 2004.

Contributions to the Veolia UK Pension Plan over the year ended 31 March 2010 were paid by members in accordance with the rules of the plan and by the company of 37.8% of pensionable salary.

The latest formal valuation of the plan for the company, determined by an independent qualified actuary, was at 31 December 2007. The valuation was made on the "attained age" funding method. The actuarial valuation made the following assumptions:

Rate of investment return	6.75% (pre-retirement), 5.25% (post retirement)
Rate of increase in remuneration	4.9%
Rate of pension increase	3.4%

The valuation as at 31 December 2007 stated the market valuation of the plan to be £14.9m with a funding level of 90%.

The contributions expected to be paid in the year from the balance sheet date are £2.8m.

## Notes to the Financial Statements (continued)

### Non Executive Directors Pension Plan

There is a provision of £751,000 (2009: £691,000) in respect of unfunded pension obligations to former employees and non executive directors of the company.

### Transfer between divisional schemes

On 1 April 2009, 92 members of the Veolia pension arrangements transferred employment from Veolia Water Central Limited to Veolia Water Shared Services Limited. 72 of the 92 are members of the final salary divisions of VWSCPP and VUKPP schemes. The transferring members' benefits for service accruing from 1 April 2009 were provided by the respective Veolia Water UK Plc divisions of the VWSPP and VUKPP plans.

All 72 members elected to transfer their accrued benefits in order to retain continuous pensionable service and the final salary link. The associated assets and liabilities in respect of the transferees were transferred to the Veolia Water UK Plc divisions as at 31 July 2009. The transfers resulted in settlement losses of £2,476,000 and £1,046,000 for the respective VWSCPP and VUKPP schemes.

### Principal Assumptions

The present values of pension liabilities are estimated by discounting pension commitments, including salary growth, at an AA corporate bond yield.

In calculating the liabilities of the plans, the following financial assumptions have been used:

	2010	2009	2008
Discount rate	5.65%pa	7.1%pa	6.1%pa
Salary growth	5.05%pa	4.7%pa	5.0%pa
RPI	3.55%pa	3.2%pa	3.5%pa
Pension-in payment increases	3.55%pa	3.2%pa	3.5%pa
VWSCPP - Life expectancy for a male pensioner age 65 (yrs)	21.8	21.8	21.8
VWSCPP - Life expectancy for a male non-pensioner age 65 (yrs)	24.9	24.9	24.9
VUKPP - Life expectancy for a male pensioner age 65 (yrs)	22.6	22.6	22.6
VUKPP - Life expectancy for a male non-pensioner age 65 (yrs)	25.8	25.8	25.8

Deferred pensions are re-valued to retirement age in line with the RPI assumption of 3.55% pa unless otherwise prescribed by statutory requirements or the plan rules.

The assets of the above plans are held separately to those of the company, being invested by independent fund managers.

The total pensions charge including the defined contributions scheme for the period ended 31 March 2010 was £2,600,000 (2009: £4,400,000).

### The assets of the scheme and the weighted average expected rate of return were:

	VWSCPP 2010		VUKPP 2010		VWSCPP 2009		VUKPP 2009	
	Value	Long term rate of return expected	Value	Long term rate of return expected	Value	Long term rate of return expected	Value	Long term rate of return expected
	£m	(% pa)	£m	(% pa)	£m	(% pa)	£m	(% pa)
Equities	83.9	8.0	10.4	8.0	70.6	7.5	9.8	7.5
Bonds	60.0	5.5	3.4	5.5	48.2	6.7	1.2	6.7
Gilts/cash	56.0	4.5	3.4	4.5	53.4	4.0	1.2	4.0
Fair value of assets	<u>199.9</u>		<u>17.2</u>		<u>172.2</u>		<u>12.2</u>	



## Notes to the Financial Statements (continued)

**VWSCPP - Amounts for current period and previous four periods are as follows:**

	Year ended 31 March 2010	Year ended 31 March 2009	15 months to 31 March 2008	Year ended 31 December 2006	Year ended 31 December 2005
Defined benefit obligation (£m)	237.6	182.1	214.6	206.7	202.7
Plan assets (£m)	199.9	172.2	193.7	201.1	193.5
Deficit (£m)	(37.7)	(9.9)	(20.9)	(5.6)	(9.2)
Experience gains and losses on scheme liabilities:					
Percentage of the present value of the scheme liabilities	0%	0%	0%	0%	(2%)
Experience gains and losses on scheme assets:					
Percentage of the scheme assets	17%	(20%)	(8%)	1%	7%

**VUKPP - Amounts for current period and previous four periods are as follows:**

	Year ended 31 March 2010	Year ended 31 March 2009	15 months to 31 March 2008	Year ended 31 December 2006	Year ended 31 December 2005
Defined benefit obligation	24.2	14.2	17.7	15.9	12.5
Plan assets	17.2	12.2	13.9	12.1	9.6
Surplus/(deficit)	(7.0)	(2.0)	(3.8)	(3.8)	(2.9)
Experience gains and losses on scheme liabilities:					
Percentage of the present value of the scheme liabilities	0%	4%	0%	(2%)	(0%)
Experience gains and losses on scheme assets:					
Percentage of the scheme assets	24%	(41%)	(7%)	5%	11%

## Notes to the Financial Statements (continued)

### Reconciliation of present value of scheme liabilities

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
At 1 April 2008	214,648	17,757	854	233,259
Current service cost	2,666	1,409	-	4,075
Interest cost	12,918	1,130	49	14,097
Actuarial gain	(39,407)	(6,165)	(117)	(45,689)
Benefits paid	(9,377)	(281)	(95)	(9,753)
Contributions paid by scheme participants	670	361	-	1,031
<b>At 31 March 2009</b>	<b>182,118</b>	<b>14,211</b>	<b>691</b>	<b>197,020</b>
Current service cost	1,535	681	-	2,216
Interest cost	12,365	954	46	13,365
Settlement	(5,638)	(1,817)	-	(7,455)
Actuarial loss	57,235	10,055	106	67,396
Benefits paid	(10,573)	(118)	(92)	(10,783)
Contributions paid by scheme participants	571	279	-	850
<b>At 31 March 2010</b>	<b>237,613</b>	<b>24,245</b>	<b>751</b>	<b>262,609</b>

### Reconciliation of fair value of scheme assets

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
At 1 April 2008	193,721	13,924	-	207,645
Contributions paid by employer	8,361	2,063	-	10,424
Contributions paid by scheme participants	670	361	-	1,031
Expected return on scheme assets	12,475	1,103	-	13,578
Actuarial loss	(33,685)	(4,955)	-	(38,640)
Benefits paid	(9,377)	(281)	-	(9,658)
<b>At 31 March 2009</b>	<b>172,165</b>	<b>12,215</b>	<b>-</b>	<b>184,380</b>
Contributions paid by employer	1,471	2,837	-	4,308
Contributions paid by scheme participants	571	279	-	850
Expected return on scheme assets	9,690	813	-	10,503
Settlement	(8,114)	(2,863)	-	(10,977)
Actuarial loss	34,727	4,047	-	38,774
Benefits paid	(10,573)	(118)	-	(10,691)
<b>At 31 March 2010</b>	<b>199,937</b>	<b>17,210</b>	<b>-</b>	<b>217,147</b>
Pension liability before deferred tax	9,953	1,996	690	12,640
Related deferred tax liability	(2,787)	(559)	(193)	(3,539)
<b>Net pension liability at 31 March 2009</b>	<b>7,166</b>	<b>1,437</b>	<b>497</b>	<b>9,101</b>
Pension liability before deferred tax	37,676	7,035	750	45,461
Related deferred tax liability	(10,549)	(1,970)	(210)	(12,729)
<b>Net pension liability at 31 March 2010</b>	<b>27,127</b>	<b>5,065</b>	<b>540</b>	<b>32,732</b>

## Notes to the Financial Statements (continued)

The amounts recognised in the profit and loss account are as follows

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
<b>For year ended 31 March 2009</b>				
Current service cost	2,666	1,409	-	4,075
Expected return on scheme assets	(12,475)	(1,103)	-	(13,578)
Interest on pension scheme liabilities	12,918	1,130	49	14,097
<b>Total charge</b>	<b>3,109</b>	<b>1,436</b>	<b>49</b>	<b>4,594</b>
<b>For year ended 31 March 2010</b>				
Current service cost	1,535	681	-	2,216
Expected return on scheme assets	(9,690)	(813)	-	(10,503)
Interest on pension scheme liabilities	12,365	954	46	13,365
Net Settlement Charge	2,476	1,046	-	3,522
<b>Total charge</b>	<b>6,686</b>	<b>1,868</b>	<b>46</b>	<b>8,600</b>

Total actuarial gains and losses recognised in the statement of total gains and losses

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
<b>For year ended 31 March 2009</b>				
Actuarial losses on scheme assets	(33,685)	(4,955)	-	(38,640)
Actuarial gains on scheme liabilities	39,407	6,165	117	45,689
<b>Total charge</b>	<b>5,722</b>	<b>1,210</b>	<b>117</b>	<b>7,049</b>
Deferred tax arising thereon				(1,974)
<b>Credit after deferred tax</b>				<b>5,075</b>
<b>For year ended 31 March 2010</b>				
Actuarial losses on scheme assets	34,727	4,047	-	38,774
Actuarial losses on scheme liabilities	(57,235)	(10,055)	(106)	(67,396)
<b>Total charge</b>	<b>(22,508)</b>	<b>(6,008)</b>	<b>(106)</b>	<b>(28,622)</b>
Deferred tax arising thereon				8,014
<b>Charge after deferred tax</b>				<b>(20,208)</b>

## Notes to the Financial Statements (continued)

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### 24 Ultimate parent company and related parties

The company is a wholly owned subsidiary of Veolia Water Capital Funds Limited which in turn is a wholly owned subsidiary of Veolia Water UK PLC.

Veolia Water UK PLC, a company registered in England & Wales, is the parent undertaking of the smallest group to consolidate the statutory financial statements of the company. Veolia Environnement SA, a company incorporated in France, is the parent undertaking of the largest group to consolidate these statutory financial statements and is the ultimate holding and controlling company.

The company has taken advantage of the exemption available due to being a wholly owned subsidiary under paragraph 3(c) of FRS 8: Related Party Transactions and has accordingly not disclosed transactions with other entities that are part of the group.

Copies of the group financial statements of Veolia Water UK PLC may be obtained from the Company Secretary, Veolia Water UK PLC, 5<sup>th</sup> Floor, Kings Place, 90 York Road, London, N1 9AG.

Copies of the accounts of Veolia Environnement SA may be obtained from the head office at 36 – 38 Avenue Kléber, 75116 Paris, France.

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### 25 Financial instruments and risk management

The company's financial instruments comprise borrowings, debentures, some cash and various items, such as trade debtors and trade creditors that arise directly from operations. The main purpose of these financial instruments is to raise finance for the company's operations.

It is, and has been throughout the year under review, the company's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

The company finances its operations through a mixture of retained profits, bank borrowings and borrowings from the subsidiary company and the parent company. Treasury policies are agreed in conjunction with the parent company (including liquidity and interest rate risks). The company does not undertake speculative transactions. Interest rate exposure is managed by using a mixture of fixed and floating rate borrowings. Liquidity is managed by utilisation of a mixture of bank overdrafts and borrowings from the immediate parent company. No change is expected in the immediate future.

Further disclosures are included in notes 16 and 22.

#### **Financial assets: excluding debtors within one year**

The company has £2.3m (2009: £4.3m) held on deposit with its parent company.

#### **Financial liabilities: excluding non-debt current liabilities**

The company has a £45.0m (2009: £79.5m) loan from its parent company.

## Notes to the Financial Statements (continued)

The interest rate profile of the company's financial liabilities excluding non-debt current liabilities and deferred credits at 31 March 2010 was as follows:

As at	Total £000	Floating rate financial liabilities £000	Fixed rate financial liabilities £000	Financial liabilities on which no interest is paid £000
31 March 2010	<b>464,975</b>	<b>205,737</b>	<b>259,238</b>	-
31 March 2009	298,669	5,749	292,920	-

Fixed rate liabilities represent the loan from subsidiary company, irredeemable debenture stock and the financing of assets used by Veolia Water Central and operated by other parties. The current interest rate on the floating rate financial liabilities is 7.25%.

As at	Fixed rate financial liabilities		
	Weighted average interest rate %	Weighted average period for which rate is fixed* Years	Weighted average period until maturity Years
<b>2010</b>			
- Loan from subsidiary	<b>6.0</b>	<b>16</b>	<b>16</b>
- Loan from parent	<b>0.9</b>	<b>0.1</b>	<b>0.1</b>
- Other	<b>7.2</b>	<b>35</b>	<b>35</b>
<b>2009</b>			
- Loan from subsidiary	6.0	17	17
- Loan from parent	1.5	0.1	0.1
- Other	6.9	25	25

\*This calculation excludes the irredeemable debenture stock where the interest rate is fixed in perpetuity (see note 16).

The maturity profile for the company's financial liabilities at 31 March 2010 was as follows:

	2010 £000	2009 £000
In one year or less or on demand (bank overdrafts and obligations under finance leases)	<b>47,604</b>	82,063
In more than one year but not more than two years	<b>2,769</b>	2,651
In more than two years but not more than five years	<b>3,982</b>	5,671
In more than five years	<b>410,620</b>	208,284
	<b>464,975</b>	298,669

All financial liabilities due after one year comprise obligations under finance leases, the financing of assets used by Veolia Water Central and operated by other parties and amounts due to the subsidiary company.

## Notes to the Financial Statements (continued)

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The company has various undrawn committed borrowing facilities. The facilities available at 31 March 2010 in respect of which all conditions precedent had been met were as follows:

	2010 £000	2009 £000
Expiring in one year or less	-	-
Expiring in more than one year but not more than two years	-	-
Expiring in more than two years	100,000	100,000
	<b>100,000</b>	<b>100,000</b>

### Fair values of financial assets and liabilities

Other than the fixed rate liability in respect of the financing of assets by Veolia Water Central operated by other parties, the fair values calculated by market interest rates of the financial instruments are not materially different from book values.

The short-term loan from the parent company is repayable on demand and therefore disclosed as a current liability. This loan is not expected to be called for repayment, and the parent company has indicated their intention to continue to support the company.

## 26 Post balance sheet events

The following significant post balance sheet events have taken place.

On 1 April 2010 the loan issued by Veolia Eau Compagnie Generale des Eaux on 29 October 2009 for £201.3m was transferred to Veolia Environnement Europe Services under the same terms. The premises formerly occupied by Veolia Water Central Ltd on Bishops Rise in Hatfield, Hertfordshire are currently held for sale. The exchange of contracts took place during May with legal completion expected in August. The selling price will be £6.1m.



## Financial Statistics for the Period Ended 31 March 2010

Profit and loss accounts	<i>Restated</i>				
	Yearended 31 March 2010 £000	Year ended 31 March 2009 £000	15 months to 31 March 2008	Year ended 31 December 2006 £000	Year ended 31 December 2005 £000
<b>Turnover</b>	<b>234,373</b>	228,912	274,817	211,244	198,996
Net operating profit	<b>42,583</b>	59,964	77,455	55,759	60,631
Profit before taxation	<b>34,004</b>	45,001	66,018	45,010	51,196
<b>Retained profit/(loss) for period</b>	<b>(162,675)</b>	(15,838)	20,823	(1,264)	(9,694)
Profit and loss account at 1 April/1 January	<b>81,643</b>	92,394	84,862	85,172	107,186
Transfer to/(from) reserves	<b>(183,283)</b>	(10,751)	7,532	(310)	(22,014)
<b>Profit and loss account at 31 March/Dec</b>	<b>(101,640)</b>	81,643	92,394	84,862	85,172
<b>Basic and diluted earnings per share</b>	<b>212.0p</b>	184.0p	419.3p	229.7p	275.9p

Balance sheets				<i>Restated</i>	<i>Restated</i>
	31 March 2010 £000	31 March 2009 £000	31 March 2008 £000	31 December 2006 £000	31 December 2005 £000
<b>Fixed assets</b>	<b>931,555</b>	555,095	537,648	489,468	470,032
<b>Current assets</b>					
Stocks and work in progress	<b>596</b>	611	552	432	602
Debtors	<b>55,253</b>	49,897	48,982	60,602	66,287
Cash in bank and at hand	<b>1,154</b>	831	2,260	1,074	2,357
	<b>57,003</b>	51,339	51,794	62,108	69,246
<b>Creditors - amounts falling due within one year</b>					
Other creditors	<b>(144,139)</b>	(181,189)	(148,338)	(118,541)	(101,681)
<b>Net current liabilities</b>	<b>(87,136)</b>	(129,850)	(96,544)	(56,433)	(32,435)
<b>Total assets less current liabilities</b>	<b>844,419</b>	425,245	441,104	433,035	437,597
<b>Creditors - amounts falling due after more than one year</b>	<b>(495,538)</b>	(273,652)	(278,760)	(278,223)	(282,430)
<b>Net assets</b>	<b>348,881</b>	151,593	162,344	154,812	155,167
<b>Capital and reserves</b>					
Called up share capital	<b>26,506</b>	13,228	13,228	13,228	13,228
Profit and loss account	<b>(101,640)</b>	81,643	92,394	84,862	85,217
Share premium	-	51,222	51,222	51,222	51,222
Other Reserves	<b>424,015</b>				
Capital redemption reserve	-	5,500	5,500	5,500	5,500
	<b>348,881</b>	151,593	162,344	154,812	155,167



**VEOLIA WATER CENTRAL LIMITED (FORMERLY THREE VALLEYS WATER PLC)**

REGULATORY FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2010

# Operating and Financial Review

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The Operating and Financial Review (OFR) has been prepared in accordance with the 'Reporting Statement of Best Practice on the OFR' issued by the Accounting Standards Board modified to include certain additional information as required by Regulatory Accounting Guideline 3. It covers the twelve month period to 31 March 2010 for the total business as disclosed on pages 69 to 72.

## Mission

Our mission is to provide the best sustainable water services for business and consumers.

## Business objectives

- Zero reportable accidents
- Zero interruptions to supply
- Zero written complaints
- Zero water quality failures
- Zero variance to budget at EBIT level

The company supplies water and related services to approximately three million people and businesses in an area of 3,738 square kilometres of Berkshire, Buckinghamshire, Hertfordshire, Bedfordshire, Essex, Surrey and several London Boroughs.

The company is a regulated business and has important obligations to three regulators: the Water Services Regulation Authority (Ofwat); the Environment Agency; and the Drinking Water Inspectorate. The business is effectively a regional monopoly and is subject to incentive-based economic regulation by Ofwat. Ofwat imposes caps on increases in customer prices, and seeks to reward efficiency and high standards of customer service, whilst penalising inefficiency and poor standards of customer service.

Instruments of appointment (licences) for the provision of water supply were awarded in 1989 and continue in force for an indefinite period subject to termination on 25 years notice with more immediate revocation in certain specific circumstances (such as, for example, a failure to comply with an enforcement order made by Ofwat).

Price limits are set by Ofwat every five years through a periodic review. The last review was completed in November 2009 and imposed price limits for the period 2010/11 to 2014/15. During a periodic review, Ofwat considers the scale of the company's capital investment programme, the cost of capital, operational and environmental obligations, and operating expenditure as well as assessing the scope to improve efficiency.

Ofwat determines price limits by reference to the company's income for the previous year, adjusting for inflation (headline RPI). This determination factor is known as 'k' and can be a positive or negative percentage value. The company's regulated tariff evolves annually by RPI and 'k'.

The Water Act 2003 has extended opportunities for competition in the water industry by introducing a new framework for the licensing of water supply. Since 1 December 2005, water supply licensees have been able to supply water outside their licensed areas to non-household users provided these users consume more than 50 megalitres per year.

The water industry is subject to substantial domestic and European Union legislation which imposes significant statutory obligations on the company concerning, among other factors, the quality of treated water supplied.

Environmental policy and proposal for legislation are the responsibility of the Secretary of State for the Environment, Food and Rural Affairs. The following bodies are responsible for applying legislative requirements to water companies:

## Operating and Financial Review (continued)

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- The Environment Agency, responsible for conserving and redistributing water resources and securing the proper use of those resources, including the licensing of water abstraction;
- the Drinking Water Inspectorate, which enforces drinking water quality standards, and
- Natural England which is responsible for the protection of designated sites for nature conservation.

### **Our People, Our Community and Our Environment**

The company aims to ensure that each employee or applicant for employment receives the same treatment irrespective of race, gender, disability, sexual orientation, religious beliefs, creed, marital or parental status. This extends through all company policies including recruitment.

The health and safety of our staff is paramount and we continually train and urge our staff about the need to work safely. Following a comprehensive review of our health and safety performance we set about changing our culture to one of “zero harm”. We believe that we can be successful only if everything we do is achieved without harm to our people, the environment or property.

Equally the health and safety of the public who may be affected by our operations are of importance and we continually train and remind our staff of our responsibility and the necessity of working safely within the community. The company also works closely with the police, local authorities, crime prevention groups and the media to tackle the nuisance caused by bogus callers.

Extensive training was conducted on technical, managerial and health and safety skills and awareness. We have continued the programme of increasing awareness for all executive directors and senior managers on health & safety issues. The number of RIDDOR incidents increased to 9 in 2009/10 (7 in 2008/09). The number of days lost to sickness, accident and ill health decreased to 7,130 days in 2009/10 (2008/09 8,285). The number of near misses reported increased but to a level still considerably below expectations. We have continued to provide driver assessment and training to all individuals who drive on company business.

Investing in our employees through training and development is a high priority. We have introduced a new personal development system to provide a more structured approach to learning and career development.

We carried out 402 training events at a cost of £430k. This focused training helps to ensure that staff are competent and motivated towards meeting company objectives.

A comprehensive company bonus scheme was introduced during the year with targets successfully met and payments made to all employees. Also a flexible working scheme, Workwise, was introduced to responsibly meet the changing demands of our employees.

The company's Water Community Support programme aims to make a real difference to real people's lives. By helping the right organisation at the right time the company helps existing charities and organisations to provide essential support directly to the community.

The company's Employee Community Sponsorship Programme continued during the year, helping staff actively involved in community programmes. A monthly dress down day is another way that staff collect money for local charities. The company is a strong supporter of WaterAid, the water industry's flagship charity, which aims to help in providing safe, clean water and sanitation to the world's poorest people.

As a responsible business the company is committed to managing its impact on the environment. The company seeks to contain the negative environmental impact of its activities to the practical minimum. The company is focusing its efforts on reducing the amount of energy consumed, reducing, reusing or recycling resources, reducing the amount of waste going to landfill and maintaining the improvement in fuel consumption.

The Education Centre has now helped more than 140,000 young water-wise environmental ambassadors since it opened in 1998 and welcomes near 200 schools to its classroom and outdoor facilities each year. This builds environmental awareness and the need to save water in children from four years old.

## Operating and Financial Review (continued)

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As a responsible local business which cares about the communities we serve as well as the environment around us, we have always supported environmental projects and voluntary/charitable organisations within our community. We know that donations both large and small can make a real and lasting difference to the organisations which receive them.

On 1 April 2010 we launched a Community Investment Fund, where community groups and charities within our water supply area can apply for a grant for specific projects.

A donation of £545,000 was paid at the end of March 2009 to a newly established independent charity, Three Valleys Water Trust. The Trust seeks to assist customers who it deems need help to escape from their water debts. As the Trust was set up after the annual billing period, which occurs in February each year, it made fewer grants than expected and therefore no contribution was required during 2009/10. However, the company has committed to donate £2.5m to the Trust over 5 years and a further contribution will be made to the Trust during the second quarter of 2010/11.

### Risk and Uncertainty

The company has a formal and continuous process for identifying, evaluating and managing the key risks faced. The company has a Risk Management Committee that reports to the Audit Committee with the Board notified of all key risks. The Risk Management Committee meets to identify and assess important risks, to receive reports of processes on risk management from risk owners and the risk assurance department, to review internal controls and to determine programmes of work for the forthcoming period. A key aim is to foster a culture in which staff throughout the business manage all risks appropriately.

The main risks and uncertainties that the company has identified are:

- risks associated with Change and more specifically impact on People, from the Company restructuring and acquisitions
- in the context of the new AMP, the ability of the business to meet the new Ofwat target for Infrastructure Serviceability, within which the significant risk is whether bursts numbers can be brought below the reference level
- whether the efficiency target of 3.1% per annum set in the Final Determination can be achieved.
- poor programme management and contractors' performance
- loss of IT systems
- widespread loss of water sources

Threats to health and safety are treated differently from other commercial risks and are given extra importance.

Each of the key risks has a 'risk owner' from the senior management team who is responsible for establishing appropriate controls to mitigate the risks as far as possible. In addition to these main risks, other identified risks are allocated to specific risk owners.

### Current Performance

The highlights of the year were:-

- We installed 18,838 meters taking the proportion for domestic metered supplies to 37.4%
- We renewed 93km (1%) of mains network bringing the total to 638km for the AMP period.
- with the help of these measures distribution input rose in 2009/10 to 829 MI/d from 825 MI/d in 2008/09
- We reduced customer telephone contact by 5.2%
- Written contact reduced by 14.1% to 267,401
- We maintained the industry norm levels of the number of metered customers who receive a bill based on an actual meter reading
- We maintained high quality drinking water, the test pass rate being 99.98%.

## Operating and Financial Review (continued)

- We maintained our good DG3 performance, exceeding our Monitoring Plan target of 0.17% with only 0.14% total properties.
- significant resource and effort was employed to improve customer service especially DG8 performance in the area of meter reading
- A consistent set of Health and Safety standards are deployed across all contractors working on the capital programme. These standards are robustly monitored by project managers who conduct monthly audits which is then reported to the Executive Management Committee,
- We continue to play a central part in contributing to Veolia Water UK's performance as one of the top ranking companies in the last annual 'Business in the Community Top 100 Companies that Count' survey, in association with The Sunday Times. In this survey Veolia Water UK retained its Platinum status which is external recognition of how we continuously improve our impact on society and the environment.

### Non-Financial Performance

The company has a system of targets and objectives that link to the priority objectives. Within these targets the key measures include:

#### *Excellent Customer Service*

	2006/07	2007/08	2008/09	2009/10
Ofwat overall performance assessment (OPA)				
OPA score (out of 288)	262	279	283	*
Ranking (out of 22 companies)	16	6	8	*
* to be published later this year				

This measure is calculated by Ofwat for the water industry and the results are published in the autumn. It measures the company's quality of overall service provided to customers and the results are taken into account when setting prices. The OPA for the six years 2004/05 to 2009/10 is reflected in the 2010 price review. The OPA seeks to assess a broad range of services provided to customers. The key areas are:

- water supply (water pressure, interruptions to supply, hosepipe ban and drinking water quality)
- customer service (written complaints, billing contacts, meter reading, telephone answering, telephone access, services to customers with special needs, supply pipe repair policies, debt and revenue policies, complaint handling, compensation and providing information to customers)
- environmental effect (leakage and pollution incidents)

The company's aim is to provide an excellent service to customers; and continuously to improve in each and every aspect of its service.

From the 1<sup>st</sup> April 2010, Ofwat will be evaluating our business through the Service Incentive Mechanism (SIM) This is a change from the current mechanism which is to evaluate the water company performance on the above Overall Performance Assessment (OPA). SIM measures both the quantitative and qualitative service that we provide to our customers and gives equal weighting to both customer billing and community activities. Companies will be measured in terms of lines busy/abandoned calls, unwanted telephone contacts, written complaints, escalated written complaints and complaints investigated by CC Water. In Addition, a qualitative survey will be carried out each quarter to measure our customers satisfaction of contacts that we have resolved.

#### *Leakage*

	2006/07	2007/08	2008/09	2009/10
Leakage levels relative to the annual target (target shown in brackets)	149 (150)	145 (145)	142 (145)	142 (145)

## Operating and Financial Review (continued)

The annual leakage targets for AMP4 were set by Ofwat as part of the periodic review process in 2004. The level of leakage reported by the company is calculated in accordance with Ofwat's guidelines and is reviewed by Ofwat's reporter.

Having met our yearly leakage targets since 2005-06, the past year proved extremely testing due to the most severe winter in 30 years. The prolonged low temperatures and snow covering caused leakage to rise significantly above expected levels for that time of year. We reacted immediately to the breakout of leakage and mobilised extra resources to detect and do necessary repairs aimed at bringing us back to target. The result however was that we closed 2009-10 with a leakage level of 143MI/d, higher than the 140MI/d target. We did however meet our three year average leakage target and the additional resource mobilised from January has enabled us to reduce leakage levels so that we are confident in meeting the target for 2010-11.

### *Water Quality*

	2006/07	2007/08	2008/09	2009/10
Deliver water that meets quality standards (Operational Performance Index) (%)	99.97	99.94	99.94	99.98

Water quality is based on compliance data for the 12 months to 31 December. The Operational Performance Index is the average of the 'mean zonal compliance' performance of six water quality parameters: turbidity, iron, manganese, aluminium, total Trihalomethanes and E coli; it is an important measure of the quality of the water supplied to customers. The individual results for each parameter are taken from the company's compliance sampling programme and are reported to the DWI. The calculation has been used as a performance measure since 1998 and it has not changed, although the Regulations that came into force in 2004 changed the size and number of the water supply zones and the number of samples taken. The company's target for 2009/10 was to score at least 99.96% for the OPI; the actual performance was 99.98%.

### *Pollution*

	2006/07	2007/08	2008/09	2009/10
Category 1 or 2 pollution incidents (number)	-	-	-	-

There are three categories of pollution incident defined by the Environment Agency, viz. categories 1, 2 and 3, broadly corresponding to 'major', 'significant' and 'minor' incidents respectively.

The company's target is to manage its operations such that the company has no Category 1 or 2 pollution incidents.

There have been no changes to the assessment criteria used by the Environment Agency over the period covered by this OFR.

### *Regulatory Obligations - metering*

	2006/07	2007/08	2008/09	2009/10
Number of meters installed	40,933	30,351	28,247	18,838

This measure reports the number of meters installed in the year under the optional and change of hands (compulsory) metering schemes. The data is extracted from the company's billing system as part of the preparation of the June Return and is reviewed by the company's reporter. The purpose of the measure is to track the company's metering rate against its regulatory target. The company continues to promote the benefits of metering through our billing booklet and website to encourage customers to opt for a meter.



## Operating and Financial Review (continued)

### *Regulatory Obligations - serviceability*

	2006/07	2007/08	2008/09	2009/10
Serviceability - infrastructure	Marginal	Marginal	Marginal	*
- non	Stable	Stable	Marginal	*
- infrastructure				
* to be published later this year				

Serviceability is an assessment of the capability of assets to provide the required level of service to customers and to safeguard the environment now and into the future. The 'service level requirement' is assessed by Ofwat which examines trends in both headline services and key asset performance indicators. This measure is important as, under its operating licence, the company is required to maintain its assets such that services to customers can be sustained over the long term. Ofwat seeks to set its price limits so as to allow for sufficient maintenance of these assets.

Assessments are made on a scale of (best to worst); improving, stable, marginal or deteriorating. The target is 'stable' for both infrastructure and non infrastructure assets. The company will continue to work with Ofwat to demonstrate progress in line with its Serviceability Action Plans for infrastructure and non infrastructure assets.

### *Regulatory Obligations – network renewal*

	2006/07	2007/08	2008/09	2009/10
Length of main renewed (km)	192	155	135	93

This measure enables the rate of renewal to be monitored against the target stipulated in Ofwat's determination, viz. to renew 652km of main in the five year period to 31 March 2010. The total output at March 31<sup>st</sup> 2010 was 638km with the balance for the AMP of 14km completed by the end of May 2010..

### *Improve our Reputation*

	2006/07	2007/08	2008/09	2009/10
Number of offences in year	-	2	3	-

As a water supplier serving the public, the reputation of the company is important. The company strives to work constructively and conscientiously with its regulators and to respond diligently to their instructions and targets. The Company aims to comply with legislation and regulations at all times. We are pleased to report that in 2009/10 we were not convicted of any offences.

During the year we brought 3 prosecutions and secured 29 convictions for offences committed by third parties that compromised the quality of water supplied to our customers.

### *Health and safety*

	2006/07	2007/08	2008/09	2009/10
RIDDOR incidents - rate per 1000 employees	14.81	9.71	6.62	9.59

The company invests heavily to ensure its employees are suitably trained and competent. During 2009 a key safety target of zero reportable accidents was introduced (as defined within HSE RIDDOR guidance). This is measured every three months for each calendar year. The safety target is one of five company targets for core activities. Health and safety performance is reported monthly to the Executive Management Committee (EMC) and at Board meetings. Every accident, regardless of severity is reported and reviewed by the EMC each month. Accidents are reported directly to the company safety team who collate data. It is also reported in the company's June Return and is reviewed by the company's reporter. The target is to reduce the rate to zero.

## Operating and Financial Review (continued)

### Customer satisfaction

	2007/08	2008/09	2009/10
Customer satisfaction survey (1-5, the higher the score the better)	4.5	4.6	4.6

The company also uses their own independent market research agency to research the attitudes of a sample of customers who have had dealings with the company in the previous three months. The customers in the research are asked a series of questions as part of a telephone survey. The survey is performed on a quarterly basis. The company's target is to maintain or better this score.

### Price Review PR09

We produced our business plan in April 2009 and subsequently accepted Ofwat's price determination at the end of January 2010. The price review project is now complete.

### Financial Performance

The company continues to report under UK GAAP. The accounting policies are set out in Note 1 to the Historical Cost Financial Statements. No new accounting standards have been adopted during the year.

	2006/07	2007/08	2008/09	2009/10
Return on capital (%)	7.1	7.3	6.1	*
* to be published later this year				

Return on Capital Employed measures the company's current cost operating profit as a percentage of its regulatory capital value. The return on capital calculation uses data from the financial statements. Regulatory capital values were reported by Ofwat as part of the 2004 price review and are updated each year to take account of inflation and the net new capital expenditure (after allowing for current cost depreciation) assumed at the price review. The company's target is to outperform Ofwat's allowed return on capital of 7.73% over the Asset Management Period (AMP).

	2006/07	2007/08	2008/09	2009/10
Cost of operations and capital maintenance per property billed (£)	171	140	145	*
* to be published later this year				

Operating and capital maintenance costs per property data measures the sum of the accounting costs for operating expenditure, infrastructure renewals charge and current cost depreciation, all divided by the number of billed properties. The result is the average accounting costs per property of operating and maintaining the water supply assets.

The company strives to be an efficient operator since this helps keep water bills for customers as low as possible. By monitoring its performance against the rest of the industry, the company can compare its position relative to the water industry in England and Wales.

The data is derived from Ofwat's annual report into unit costs and relative efficiency, published in December each year. This data is compiled by Ofwat from each water company's annual June Return.

The target is to manage operating and maintenance costs such that the company at least meets and, where possible, outperforms its profit target for the year. Its profit target is derived from internal budgeting and financial forecasting.

There have been no material changes to the calculation or the definitions of the underlying data used by Ofwat to construct this indicator over the period.

The outlook is that the average accounting costs per property are set to rise. In addition to continuing cost pressures, increased investment in asset maintenance will drive up depreciation charges.

## Operating and Financial Review (continued)

### Turnover

Turnover increased in the year by £5.3m from £230.0m to £235.3m, analysed as follows:

	2005/06 £m	2006/07 £m	2007/08 £m	2008/09 £m	2009/10 £m
Prior year	174.4	206.4	212.8	224.3	230.0
Effect of RPI + 'k' (a)	30.6	8.2	10.2	8.1	8.0
Lower customer demand (b)	(1.2)	(1.6)	(0.5)	(1.0)	(0.9)
New connections (c)	1.2	1.2	1.2	0.9	0.9
Other (d)	1.4	(1.4)	0.6	(2.3)	(2.7)
Current year	<u>206.4</u>	<u>212.8</u>	<u>224.3</u>	<u>230.0</u>	<u>235.3</u>

- (a) Increase in RPI + 'k' is driven by RPI increases of 3.00% (2009: 4.28%) and 'k' of 0.40% (2009: -0.60%).
- (b) There was a continued underlying fall in measured consumption in line with distribution input trends.
- (c) The company has just over 8000 new connections each year generating an additional £0.9m income over the previous year.
- (d) 'Other', includes the effect on turnover as a result of unmeasured customers switching to a measured supply, variations in the bulk export of water, variations in chargeable services work and back billing in 2009/10 arising from investigations with specific customers.

For the next five year period Ofwat has introduced a control mechanism, called the Revenue Correction Mechanism. The mechanism will enable both the Company and the Regulator to rebalance both shortfalls and outperformance of income.

## Operating and Financial Review (continued)

### Operating Expenditure

Operating costs represent cost of sales, plus customer services and administration expenses, after deducting depreciation and infrastructure renewals charges. Operating costs increased by £2.8m during the year.

	2005/06 £m	2006/07 £m	2007/08 £m	2008/09 £m	2009/10 £m
Prior year	89.6	91.3	105.4	111.4	116.2
Energy (a)	2.1	2.0	0.7	0.9	3.4
Bulk Import	(0.5)	1.0	(1.2)	0.1	0.3
Repairs of network (b)	0.1	4.2	1.5	(0.7)	(1.5)
Bad debts (c)	1.1	0.2	2.5	0.3	(3.3)
Customer service (d)	(0.1)	0.7	1.2	0.1	1.0
Insurance (e)	0.3	0.8	-	(0.5)	1.3
'Atypical' (f)	(3.4)	5.1	0.8	0.9	1.1
Other	2.1	0.1	0.5	3.7	0.5
	<u>91.3</u>	<u>105.4</u>	<u>111.4</u>	<u>116.2</u>	<u>119.0</u>
Current year					

- (a) The Company's energy cost base faced significant pressures due to the high prices in the energy market prices in 08/09 and locked into price to March 2010. The electricity wholesale market prices have dropped off from the 08/09 peak but the effect will not be realised until 2010/11.
- (b) The decrease in costs in relation to 2008/09 was due to the company employing a different contractor to carry out network repairs and cost of consequential damage being allocated to insurance.
- (c) The movement in bad debt reflects the better collection rates along with the beneficial impact of the Charitable Trust.
- (d) The primary reason for this movement relates to payments made during the year to contractors in respect of voids and missing properties activities during 2009/10. Additional costs attributable to customer services were also identified during the year.
- (e) The movement in insurance relates to the provision for outstanding claims relating to uninsured losses and the cost of consequential damage now being allocated to insurance.
- (f) The movement on 'Atypical' costs between 2008/09 and 2009/10 predominantly relates to the cost of site relocation, cost of rebranding and provision for risk of encroachment on the sale of land at St Georges Hill.

### Depreciation and Infrastructure Renewals Charge

The infrastructure renewals charge increased by £2.9m in the year to £38.5m reflecting the higher current and planned volumes of work on the network.

Historic depreciation was £17.5m higher than 2008/09.

### Profit Before Tax

The profits on disposal of fixed assets in the year to March 2010 were £10.7m, an increase of £10.1m on 2009. This contributed to an overall increase in profit before tax of £11.0m for the total business.

The company's financing costs have remained broadly the same, higher pension financing income was offset by the cost of higher levels of debt.

## Operating and Financial Review (continued)

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### Debtors

Trade debtors increased by £4.4m in the year reflecting higher tariffs due to RPI and the 'k' factor. The accrual for unbilled measured consumption rose from £25.5m to £26.2m reflecting the increased number of metered customers and higher tariffs. Bad debts have increased due to an increasingly difficult economic environment.

### Cash Flow

Net cash outflow before financing for the total business for 2010 was 168.0m (2009: outflow £49.4m). The main causes were: an increase in dividends to £190.7m (£40.2m 2008/09) offset by an increase of £11.8m on disposal proceeds, £16.3m reduction on purchase of fixed assets, an increase in cash flow from operating activities to £112.9m (£109.1m 2008/09). Net debt increased to £461.6m (£293.5m 2008/09).

Net debt to RCV rose from 38% in 2009 to 61% in 2010 reflecting the continued balance sheet strength and credit quality of the company.

### Capital Expenditure

Capital expenditure including infrastructure renewal expense decreased from £87.6m in 2009 to £86.7m in 2010. Expenditure on mains and other infrastructure assets was £1.4m higher than the prior year. A total of 93km of mains were renewed in the year 2009/10.

### Financial Instruments

The main treasury risks facing the company are interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks.

The company finances its operations through a mixture of retained profits, bank borrowings and borrowings from its subsidiary company, Three Valleys Water Finance PLC as well as from its parent company, Veolia Water Capital Funds Limited. The company does not undertake speculative transactions. Interest rate exposure is managed by using a mixture of fixed and floating rate borrowings. Liquidity is managed by utilisation of a mixture of borrowings from the immediate parent and long term borrowings from bond investors.

For further details on financial instruments see Note 25 of the statutory financial statements.

### Capital Finance

The company, through its subsidiary Three Valleys Water Finance PLC, issued in 2004 a £200m 22 year bond with a coupon of 5.875%. The company has arranged a revolving credit facility to finance in part its AMP4 capital programme. The company's balance sheet is very strong, with net debt at around 61% of regulatory capital value.

On 29 October 2009 Veolia Eau Compagnie Generale des Eaux issued a £201,278 loan at an interest rate of 2% above GBP LIBOR 3m rates which matures on 31 December 2024. The loan can be repaid at any time without penalty after giving Veolia Eau Compagnie des Eaux five business days notice. On 1<sup>st</sup> April 2010 the loan was transferred to Veolia Environnement Europe Services, under the same terms.

### Dividend Policy

Our dividend policy is primarily based on maintaining a specific level of gearing. The scale of the dividend is dependent on the level of success of the company to generate cash flows in the reported period. The policy distributes earnings equal to the amount necessary to maintain Net Debt to RCV at the targeted gearing ratio allowing the company to have the flexibility to adjust the target gearing level from time to time if ever required

## Operating and Financial Review (continued)

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The directors have declared and the company has paid the following dividends during the year ended 31 March 2010:

Ordinary dividends:	£000
Interim – paid June 2009	18,955
Interim – paid October 2009	171,778
	<hr/>
	190,733
	<hr/>

During October we underwent a capital restructuring which was executed through a £201.3m loan from fellow group undertaking Veolia Eau Compagnie Générale des Eaux. As a result of the restructuring an extraordinary dividend was paid to Veolia Water Capital Funds Limited of £171.8m.

No final dividend is proposed.

### Competition

We welcome greater competition and customer choice because it spurs us to improve our customer experience and service so that we retain our customers' business. As well as competition in the market, we also welcome competition for the market. Our parent company, Veolia Water UK is following its strategy to grow its business and become the leading water company in the UK by competing for operating contracts. We contribute to this strategy by focusing on our customers, innovating, improving our performance so that we become a reference for Veolia Water, and when possible making our expertise available on a cost-allocated basis. Sister companies in the Veolia Water group also act to increase competition as the operators of the MOD Tidworth inset appointment and as Water Supply Licence holders.

This year we negotiated terms for a bulk supply agreement with a new entrant which would allow the entrant to develop green field inset appointments within, or on the borders of, our supply area. We stand ready to negotiate and conclude similar agreements with other, interested new entrants but to date have only received one approach.

### Outlook

The company will continue to provide a reliable, sustainable and high quality service to present and future customers. We take a long term view which is consistent with the timeframes of our rolling licence (25 years), water resource plans (25 years) and the longevity of our network and some of our plant and equipment. We expect to invest significantly in our pipe network and renew mains which suffer from high and repeated bursts. We will continue to increase household meter penetration to encourage as many of our customers as possible to use water carefully and to restrain the growth in water demand.

The company published its Strategic Direction Statement in December 2007 which sets out in detail the company's strategic direction for the next 25 years. Our overall strategic intent is to:

- balance the supply of and demand for water in the medium and long term through managing demand and extending supply, a 'twin track approach'
- ensure that our assets are durable, strong and resilient to both social and environmental pressures
- continue to listen to our employees and customers, and understand and exceed our customer expectations of us.

These approaches underline the proposals in our draft Water Resources Management Plan published for consultation in April 2009.

The Operating and Financial Review contains forward looking statements that are subject to risk factors associated, amongst other things, with the economic, business and regulatory circumstances occurring from time to time in the markets in which the company operates. These and other factors could adversely or positively affect our customers and the financial and operational plans summarised above.

# Certificate of Compliance with Licence Condition F6A

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To: Water Services Regulation Authority  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

## **CERTIFICATE OF COMPLIANCE WITH LICENCE CONDITION F6A**

This is to certify that, at their meeting on 6 July 2010, the directors of Veolia Water Central Limited (Formerly Three Valleys Water Plc) ("the Appointee") resolved that in their opinion:

- the Appointee will have available to it 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
- the Appointee will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions; and
- 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 undertaker.

The first two statements are based on the net worth of the company as shown in the accounts and on the budget and the plan for the forthcoming year.

The opinion on contracts with associated companies is based on an examination of the contracts in question.

**T J W Monod**  
*Company Secretary*

6 July 2010

## **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

In addition to their responsibilities to prepare financial statements in accordance with Companies Act 2006, the directors are also responsible under Condition F of the Instrument of Appointment by the Secretary of State for the Environment, Transport and the Regions of the company as a water undertaker as amended by the variation and modifications dated 18 September 2000 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 (WSRA), to the Appointee from time to time;
- b preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, or as specified under the Variation and Modifications dated 18 September 2000, having regard also to the terms of guidelines notified by the WSRA 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 Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to these accounts;
- c preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by the WSRA from time to time or as specified under the Variation and Modifications dated 18 September 2000;
- d preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by the WSRA from time to time.



# Independent Auditors' Report to the Director General of Water Services ("the Regulator") and Directors of Veolia Water Central Limited

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## TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF VEOLIA WATER CENTRAL LIMITED (FORMERLY THREE VALLEYS WATER PLC)

We have audited the Regulatory Financial Statements ("regulatory accounts") of Veolia Water Central Limited (formerly Three Valleys Water plc) ("the Company") on pages 69 to 88 for the year ended 31 March 2010 which comprise

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements including the statement of accounting policies.

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 Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under the Water Industry Act 1991 (the Regulatory Licence). Our audit work has been undertaken so that we might state to the company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation 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 this report, or for the opinions we have formed.

### Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts 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 accounts because the Regulatory Accounting Guidelines 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 2006.

### Respective responsibilities of the WSRA, the directors and auditors

The nature, form and content of Regulatory Accounts 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 Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 65.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the "Basis of audit

# **Independent Auditors' Report to the Director General of Water Services ("the Regulator") and Directors of Veolia Water Central Limited (continued)**

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opinion", below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.06 (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 accounting statements on pages 74 to 88 have been properly prepared in accordance with Regulatory Accounting Guideline 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 Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06, and Regulatory Accounting Guideline 4.03.

We read the other information contained in the Regulatory Accounts, 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 Accounts. The other information comprises the operating and financial review, the notes on regulatory information, and the additional information required by the licence.

## **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 Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, 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 Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts 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 Accounts 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 accounts of the company (our "Statutory" audit) was made solely to the company's members, as a body, in accordance with sections 495, 496 and 497 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the company's members those matters we are required to state to them in a Statutory auditors' 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 accounting statements on pages 69 to 72 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 disappplied. 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 2006 is given on page 73.

# Independent Auditors' Report to the Director General of Water Services ("the Regulator") and Directors of Veolia Water Central Limited (continued)

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## Opinion

In our opinion the Regulatory Accounts of the company for the year ended 31 March 2010 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 79 and 80, the state of the company's affairs at 31 March 2010 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

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

- a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;
- b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting 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 accounting statements on pages 69 to 72 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 accounting statements on pages 74 to 88 have 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

Ernst & Young LLP  
London  
6 July 2010

## Historical Cost Profit and Loss Account for the Year Ended 31 March 2010

	Note	Appointed £000	2010 Non- Appointed £000	Total £000	Appointed £000	2009 Non- Appointed £000	Total £000
<b>Turnover</b>	2	<b>235,298</b>	-	<b>235,298</b>	<b>229,981</b>	-	<b>229,981</b>
Operating costs		(155,612)	(1,516)	(157,128)	(150,168)	(1,343)	(151,511)
Historical Cost Depreciation		(44,035)		(44,035)	(26,505)	-	(26,505)
Operating income		11,447	-	11,447	625	-	625
Operating profit/(loss)		47,098	(1,516)	45,582	53,933	(1,343)	52,590
Other income		3	7,670	7,673	441	7,558	7,999
Interest		(19,246)	(5)	(19,251)	(15,583)	(5)	(15,588)
<b>Profit on ordinary activities before taxation</b>		<b>27,855</b>	<b>6,149</b>	<b>34,004</b>	<b>38,791</b>	<b>6,210</b>	<b>45,001</b>
Taxation							
Current tax		(7,539)	(1,722)	(9,261)	(10,176)	(1,740)	(11,916)
Deferred tax		3,316	-	3,316	(8,742)	-	(8,742)
<b>Profit for the financial year</b>		<b>23,632</b>	<b>4,427</b>	<b>28,059</b>	<b>19,873</b>	<b>4,470</b>	<b>24,343</b>
Dividends		(186,306)	(4,427)	(190,733)	(35,712)	(4,470)	(40,182)
<b>(Loss)/profit transferred to reserves</b>		<b>(162,674)</b>	-	<b>(162,674)</b>	<b>(15,839)</b>	-	<b>(15,839)</b>

## Historical Cost Statement of Total Recognised Gains and Losses for the Year Ended 31 March 2010

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	2010 £000	2009 £000
Profit for the financial year	<b>23,633</b>	19,873
Actuarial gains/(losses) in the pension scheme	<b>(28,622)</b>	7,049
Deferred tax arising thereon	<b>8,014</b>	(1,974)
Share based payments	-	12
Other gains and losses	<b>128,742</b>	-
<b>Total gains recognised since last report</b>	<b>131,767</b>	24,960

It is not practicable to apportion the actuarial information and the restatement in respect of the share based payment liabilities between the appointed and non-appointed business.

## Historical Cost Balance Sheet as at 31 March 2010

	Appointed £000	2010 Non- appointed £000	Total £000	Appointed £000	2009 Non- appointed £000	Total £000
<b>Fixed assets</b>						
Tangible assets	919,797	-	919,797	542,404	-	542,404
Investments	50	-	50	50	-	50
<b>Total fixed assets</b>	<b>919,847</b>		<b>919,847</b>	<b>542,454</b>		<b>542,454</b>
<b>Current assets</b>						
Stocks & work in progress	596	-	596	611	-	611
Debtors	52,187	798	52,985	45,267	340	45,607
Cash	-	7,817	7,817	287	6,288	6,575
Short term deposits	2,268	-	2,268	4,290	-	4,290
Infrastructure renewal prepayments	5,031	-	5,031	5,963	-	5,963
<b>Total current assets</b>	<b>60,082</b>	<b>8,615</b>	<b>68,697</b>	<b>56,418</b>	<b>6,628</b>	<b>63,046</b>
<b>Creditors – amounts falling due within one year</b>						
Overdrafts	(6,663)	-	(6,663)	(5,743)	-	(5,743)
Infrastructure renewals accrual	-	-	-	-	-	-
Creditors	(84,519)	(6,457)	(90,976)	(88,187)	(4,485)	(92,672)
Borrowings	(47,604)	-	(47,604)	(82,063)	-	(82,063)
Corporation tax payable	(3,402)	(2,158)	(5,560)	(4,312)	(2,143)	(6,455)
<b>Total Creditors</b>	<b>142,188</b>	<b>(8,615)</b>	<b>(150,803)</b>	<b>(180,305)</b>	<b>(6,628)</b>	<b>(186,933)</b>
<b>Net current liabilities</b>	<b>(82,106)</b>	<b>-</b>	<b>(82,106)</b>	<b>(123,887)</b>	<b>-</b>	<b>(123,887)</b>
<b>Total assets less current liabilities</b>	<b>837,741</b>	<b>-</b>	<b>837,741</b>	<b>418,567</b>	<b>-</b>	<b>418,567</b>
<b>Creditors - amounts falling due after more than one year</b>						
Borrowings	(417,372)	-	(417,372)	(216,606)	-	(216,606)
Other Creditors	-	-	-	-	-	-
<b>Total creditors</b>	<b>(417,372)</b>	<b>-</b>	<b>(417,372)</b>	<b>(216,606)</b>	<b>-</b>	<b>(216,606)</b>
<b>Provisions for liabilities and charges</b>						
Deferred tax	(39,520)	-	(39,520)	(41,661)	-	(41,661)
Deferred income	(4,349)	-	(4,349)	(4,678)	-	(4,678)
Post employment asset/(liabilities)	(32,732)	-	(32,732)	(9,101)	-	(9,101)
Other provisions	(1,564)	-	(1,564)	(1,606)	-	(1,606)
<b>Net Assets Employed</b>	<b>342,203</b>	<b>-</b>	<b>342,203</b>	<b>144,915</b>	<b>-</b>	<b>144,915</b>
<b>Capital and reserves</b>						
Called up share capital	26,506	-	26,506	13,228	-	13,228
Share premium	-	-	-	51,222	-	51,222
Other Reserves	424,015	-	424,015			
Profit and loss account	(108,318)	-	(108,318)	74,965	-	74,965
Capital redemption reserve	-	-	-	5,500	-	5,500
<b>Equity shareholders' funds</b>	<b>342,203</b>	<b>-</b>	<b>342,203</b>	<b>144,915</b>	<b>-</b>	<b>144,915</b>

## Historical Cost Balance Sheet as at 31 March 2010 (continued)

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The treatment of infrastructure renewals prepayments within the regulatory accounts differs from that in the historical cost financial statements. Consequently tangible assets above are reported at £5.0m less (2009: £6.4m less) than in the historical cost financial statements with an addition to debtors of the same amount.

In the historical cost financial statements goodwill of £6.7m arose on the acquisition of North Surrey Water Limited on 1 October 2000. No goodwill arises in the regulatory accounts, as the acquisition has been accounted for as a merger.



# Reconciliation between Statutory Accounts and Regulatory Accounts as at 31 March 2010

In the preparation of its statutory accounts and profit and loss account, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS 15: Tangible Fixed Assets. However for the purposes of the Regulatory Accounts, the WSRA has requested that FRS 15 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. Reconciliation to the balance sheet is shown in the statutory accounts set out below:

	Statutory UK GAAP £m	Regulatory £m	
<b><u>Profit and Loss Account</u></b>			
Operating Profit	42.6	47.1	Statutory accounts include other operating income and non appointed business, but exclude profit on disposal of fixed assets. In regulatory accounts £10.7m gain on disposal is included in operating profit, but £8.4m for other income is excluded
Profit before Tax	34.0	27.9	Non appointed profit before tax is £6.1m
<b><u>Balance Sheet</u></b>			
Tangible Fixed Assets (Net Book Value)	924.8	919.8	In the statutory accounts the tangible fixed assets figure includes the infrastructure renewal prepayment. For regulatory accounting figures Ofwat requests this amount of £5.0m is not included
Debtors	55.3	53.0	The parent company debtor of £2.3m has been classified as a short term deposit in the regulatory accounts.
Deferred Income - grants and contributions	N/A	(4.3)	Amount relates to deferred credit for contributions to surface assets of £4.3m and has been classified within other creditors in the statutory accounts

## Current Cost Profit and Loss Account for the Year Ended 31 March 2010

	Note	2010 £000	2009 £000
<b>Turnover</b>	2	<b>235,298</b>	229,981
Current cost operating costs		<b>(193,185)</b>	(184,165)
Other operating income/(cost)	2	<b>9,987</b>	592
Working capital adjustment		<b>1,759</b>	(240)
<b>Current cost operating profit</b>	4	<b>53,859</b>	<b>46,168</b>
Other income		<b>3</b>	441
Net interest		<b>(19,246)</b>	(15,583)
Financing adjustment		<b>14,348</b>	(1,124)
<b>Current cost profit before taxation</b>		<b>48,964</b>	<b>29,902</b>
Taxation:			
Current tax		<b>(7,539)</b>	(10,176)
Deferred tax		<b>3,316</b>	(8,742)
<b>Current cost profit on ordinary activities</b>		<b>44,741</b>	<b>10,984</b>
<b>Current cost profit attributable to shareholders</b>		<b>44,741</b>	<b>10,984</b>
Dividends		<b>(186,306)</b>	(35,712)
<b>Current cost (loss)/profit retained</b>	3	<b>(141,565)</b>	<b>(24,728)</b>

## Current Cost Statement of Total Recognised Gains and Losses for the Year Ended 31 March 2010

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	2010 £000	2009 £000
Profit for the financial year	<b>44,741</b>	10,984
Actuarial gain/(loss) recognised in the pension scheme	<b>(28,623)</b>	7,049
Deferred tax arising thereon	<b>8,014</b>	(1,974)
Share based payments	-	12
<b>Total gains recognised since last report</b>	<b>24,132</b>	<b>16,071</b>

It is not practicable to apportion the actuarial information and restatement in respect of Share based payments between the appointed and non-appointed business.

# Current Cost Balance Sheet for Appointed Business as at 31 March 2010

	Note	2010 £000	2009 £000
<b>Fixed assets</b>			
Tangible assets	5	4,063,487	3,882,490
Third party contributions since 1989/90		(174,430)	(161,137)
Working capital	6	(31,171)	(39,563)
Cash		-	287
Short term deposits		2,268	4,290
Overdrafts		(6,663)	(5,743)
Infrastructure renewal prepayment		5,031	5,963
<b>Net operating assets</b>		<b>3,858,520</b>	<b>3,686,587</b>
<b>Non Operating Assets</b>			
Borrowings		(47,604)	(82,063)
Non-trade debtors		5,573	4,843
Non-trade creditors due within one year		(6,138)	(7,589)
Investment – other		50	50
Corporation tax payable		(3,402)	(4,312)
Total non operating assets and liabilities		(51,521)	(89,071)
<b>Creditors: amounts falling due after more than one year</b>			
Borrowings		(417,372)	(216,606)
Other Creditors		-	-
Total creditors falling due after more than one year		(417,372)	(216,606)
<b>Provisions for liabilities and charges:</b>			
Deferred tax		(39,520)	(41,661)
Post employment liabilities		(32,732)	(9,101)
Other provisions		(1,564)	(1,606)
Total provisions		(73,816)	(52,368)
<b>Net assets employed</b>		<b>3,315,811</b>	<b>3,328,542</b>
<b>Capital and reserves</b>			
Called up share capital		26,506	13,228
Share premium reserve		-	51,222
Profit and loss reserve	3	(173,630)	(11,456)
Current cost reserve		3,419,491	3,270,048
Other reserves		43,444	5,500
<b>Total capital employed</b>		<b>3,315,811</b>	<b>3,328,542</b>

## Current Cost Statement of Cash Flows for the Year Ended 31 March 2010

	Note	Appointed £000	2010 Non- appointed £000	Total £000	Appointed £000	2009 Non- appointed £000	Total £000
<b>Net cash inflow from operating activities</b>	a	<b>107,491</b>	<b>4,639</b>	<b>112,130</b>	<b>100,942</b>	<b>8,138</b>	<b>109,080</b>
<b>Returns on investments and servicing of finance</b>							
Interest received		1	-	1	455	-	455
Interest paid		(15,890)	(5)	(15,895)	(15,093)	(5)	(15,098)
Interest element of finance leases		(460)	-	(460)	(574)	-	(574)
Net cash outflow from returns on investments and servicing of finance		(16,349)	(5)	(16,354)	(15,212)	(5)	(15,217)
<b>Taxation</b>							
Corporation tax paid		(8,416)	(1,740)	(10,156)	(11,213)	(1,613)	(12,826)
Net cash outflow from taxation paid		(8,416)	(1,740)	(10,156)	(11,213)	(1,613)	(12,826)
<b>Capital expenditure and financial investment</b>							
Purchase of fixed assets		(45,155)	-	(45,155)	(64,720)	-	(64,720)
Capital contributions		6,589	-	6,589	8,089	-	8,089
Infrastructure renewals expenditure		(37,531)	-	(37,531)	(34,264)	-	(34,264)
Proceeds on disposal of fixed assets		13,204	-	13,204	650	-	650
Purchase of investment		-	-	-	-	-	-
Net cash taken over from investment		-	-	-	-	-	-
Net cash outflow from capital expenditure and financial investment		(62,893)	-	(62,893)	(90,245)	-	(90,245)
<b>Equity dividends paid</b>		<b>(186,306)</b>	<b>(4,427)</b>	<b>(190,733)</b>	<b>(35,712)</b>	<b>(4,470)</b>	<b>(40,182)</b>
Net cash (outflow)/inflow before financing and management of liquid resources		(166,473)	(1,533)	(168,006)	(51,440)	2,050	(49,390)
<b>Financing</b>							
Capital element of finance lease repaid		(1,290)	-	(1,290)	(1,203)	-	(1,203)
Loan from subsidiary		126	-	126	119	-	119
Loan from group undertaking		201,278	-	201,278	-	-	-
Loan from parent company		(34,500)	-	(34,500)	46,000	-	46,000
Deposit with parent company		2,023	-	2,023	4,087	-	4,087
Financing of assets operated by other parties		693	-	693	(1,039)	-	(1,039)
Decrease in other long term financial liabilities		(1)	-	(1)	(4)	-	(4)
Net cash inflow from financing		168,329	-	168,329	47,960	-	47,960
<b>Increase/(Decrease) in cash</b>	b/c	<b>1,856</b>	<b>(1,533)</b>	<b>323</b>	<b>(3,480)</b>	<b>2,050</b>	<b>(1,430)</b>

# Notes to the Current Cost Statement of Cash Flows

## a Reconciliation of current cost operating profit to net cash flow from operating activities

	2010 £000	2009 £000
Current cost operating profit	53,859	46,168
Working capital adjustment	(1,759)	240
Movement in working capital	(12,438)	(9,290)
Receipt from other income	3	441
Current cost depreciation	37,244	33,740
Current cost profit on sale of fixed assets	(9,987)	(592)
Infrastructure renewals charge	38,463	35,568
Other non-cash profit and loss Items	2,106	(5,333)
Net cash flow from operating activities	107,491	100,942

## b Reconciliation of net cash flow to movement in net debt

	2010 £000	2009 £000
Increase/(Decrease) in cash in the period	1,856	(3,480)
Cash outflow from movement in debt and lease financing	(168,329)	(47,960)
Movement in net debt in the period	(166,473)	(51,440)
Net debt at the beginning of the period	(304,623)	(253,183)
Net debt at the end of the period	(471,096)	(304,623)

## c Analysis of net debt

	At 31 March 2009 £000	Cash Flow £000	Non Cash Flow £000	At 31 March 2010 £000
Net cash:				
Bank overdraft	(10,244)	1,856	-	(8,388)
	(10,244)	1,856	-	(8,388)
Debt:				
Bond issued by subsidiary	(196,314)	-	(127)	(196,441)
Deposit with parent company	4,290	(2,023)	-	2,267
Loan	(79,500)	34,500	-	(45,000)
Debentures	(35)	1	-	(34)
Finance leases	(5,749)	1,290	-	(4,459)
Financing of assets used by Veolia Water Central and operated by other parties	(17,071)	(692)	-	(17,763)
Loan from group undertaking	-	(201,278)	-	(201,278)
	(294,379)	(168,202)	(127)	(462,708)
Net debt	(304,623)	(166,346)	(127)	(471,096)

# Notes to the Current Cost Financial Information

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## 1 Statement of accounting policies

### Basis of current cost accounting

These accounts have been prepared in accordance with relevant Regulatory Accounting Guidelines (RAGs).

The current cost accounts have been prepared for the appointed business of the company in accordance with guidance issued by the Water Services Regulation Authority for modified real terms financial statements 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, with the exception of certain assets acquired prior to 31 March 1990, the effective commencement of the new regulatory system.

There have been no changes to the IRC and CCD policies during the year.

The accounting policies used are the same as those adopted in the historical cost accounts, except as set out below.

### Revenue recognition

The regulatory accounts 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.

### Acquisition of North Surrey Water Ltd

On 1 October 2000 Veolia Water Central Limited (Formerly Three Valleys Water Plc) acquired the assets and liabilities of North Surrey Water Ltd. Details of the acquisition are given in the Statutory Accounts of Veolia Water Central Limited (Formerly Three Valleys Water Plc) for 31 March 2001. The acquisition was funded by the issue of share capital and debt. The additional debt taken on of £20,010,000 was added to the opening balance of long term creditors.

### Tangible fixed assets

An Asset Management Plan (AMP) survey was undertaken to produce Modern Equivalent Asset (MEA) values for all existing assets at 31 March 2003. The asset valuation arising from this exercise was included in the accounts for year ended 31 March 2005, and has been adjusted for inflation as measured by changes in the Retail Price Index (RPI) since that date.

Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost. Costs relating to increases in capacity or enhancements to the network are capitalised. No depreciation is charged on mains because the network is required to be maintained in perpetuity and therefore has no finite economic life.

The treatment in the current cost accounts differs from that in the historical cost accounts in relation to the disapplication of renewals accounting paragraphs of FRS 15 and FRS 12, as required by regulatory accounting guidelines. The non-compliance has no effect on the profit and loss account other than to reclassify infrastructure renewals charges as depreciation.

### Third party contributions

Infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

Infrastructure charges received in respect of connections to the mains network are allocated to fixed assets, surface and infrastructure, in accordance with the basis on which the charges are calculated.



## Notes to the Current Cost Financial Information (continued)

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Contributions receivable relating to infrastructure assets, which are not depreciated, have been deducted from the cost of tangible fixed assets in order to show a true and fair view.

### **Real financial capital maintenance adjustments**

These adjustments are made to historical cost profit in order to arrive at profit after maintenance of financial capital in real terms:

Depreciation adjustment - this is the difference between depreciation based on the current cost value of assets in these accounts and depreciation charged in arriving at historical cost profit.

Working capital adjustment - this is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors.

Financing adjustment - this is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

Disposal of fixed asset adjustment - per RAG1.02 - is calculated by applying the difference between the net book value of the current cost and the net book value of the historical cost of disposed assets, to the profit from disposal of fixed assets as shown in the historical cost accounts.

### **Dividend policy**

Our dividend policy is primarily based on maintaining a specific level of gearing. The scale of the dividend is dependent on the level of success of the company to generate cash flows in the reported period. The policy distributes earnings equal to the amount necessary to maintain Net Debt to RCV at the targeted gearing ratio, allowing the company to have the flexibility to adjust the target gearing level from time to time if ever required

We have paid a full year 2009/10 dividend of £190.7m.

### **Share based payment**

UITF Abstract 44, 'FRS 20 – Group and treasury share transactions', was early adopted for the 15 months period ended 31 March 2008. UITF Abstract 44 provides guidance on whether share-based transactions involving treasury shares or involving group entities (for example, options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent and group companies.

## Notes to the Current Cost Financial Information (continued)

### 2 Analysis of turnover and operating income

	2010 £000	2009 £000
Turnover:		
Unmeasured	124,199	124,598
Measured	99,409	94,387
Large user and special agreement	8,650	8,328
Non-potable large user and special agreement	72	57
Rechargeable works	576	607
Bulk supplies	2,340	1,950
Other appointed business – third party	52	54
	<b>235,298</b>	<b>229,981</b>
Operating loss:		
Current cost profit on disposal of fixed assets	9,987	592
Working capital adjustment	1,759	(240)

### 3 General reserve - current cost

	2010 £000
At 31 March 2009	(11,456)
Transfer from profit and loss account for appointed business	(141,565)
Statement of recognised gains and losses	(20,609)
At 31 March 2010	<b>(173,630)</b>

### 4 Reconciliation of historical cost operating profit to current cost operating profit for appointed business

	2010 £000	2009 £000
Total historical cost operating profit	47,098	53,933
Current cost depreciation and amortisation of deferred credit	(37,245)	(33,741)
Historic cost deferred credit	(329)	(257)
Historical cost depreciation	44,036	26,505
Current cost adjustment on disposal of fixed assets	(1,460)	(32)
Working capital adjustment	1,759	(240)
Current cost operating profit	<b>53,859</b>	<b>46,168</b>

## Notes to the Current Cost Financial Information (continued)

### 5 Current cost analysis of tangible fixed assets by type

	Specialised operational assets £000	Non- specialised operational assets £000	Infrastructure assets £000	Other tangible assets £000	Assets in the course of construction £000	Total £000
<b>Gross replacement cost</b>						
At 1 April 2009	842,297	100,417	3,438,325	71,201	-	4,452,240
AMP/SIR adjustment	-	-	-	-	-	-
RPI adjustment	37,472	4,467	152,959	3,167	-	198,065
Additions	37,519	-	7,386	4,297	-	49,203
Disposals	-	-	-	(5,925)	-	(5,925)
<b>At 31 March 2010</b>	<b>917,288</b>	<b>104,884</b>	<b>3,598,670</b>	<b>72,740</b>	<b>-</b>	<b>4,693,582</b>
<b>Depreciation</b>						
At 1 April 2009	471,018	50,047	-	48,685	-	569,750
AMP/SIR adjustment	-	-	-	-	-	-
RPI adjustment	20,954	2,226	-	2,166	-	25,346
Disposals	-	-	-	(2,709)	-	(2,709)
Charge for the year	30,501	2,219	-	4,988	-	37,708
<b>At 31 March 2010</b>	<b>522,473</b>	<b>54,492</b>	<b>-</b>	<b>53,130</b>	<b>-</b>	<b>630,095</b>
<b>Net book value</b>						
At 31 March 2010	<b>394,814</b>	<b>50,392</b>	<b>3,598,670</b>	<b>19,611</b>	<b>-</b>	<b>4,063,487</b>
At 31 March 2009	371,278	50,371	3,438,325	22,516	-	3,882,490

All tangible fixed assets are used in the water supply business.

### 6 Working capital

	2010 £000	2009 £000
Stocks	596	611
Trade debtors – measured household	1,770	1,590
– unmeasured household	4,645	3,667
– measured non-household	7,097	3,933
– unmeasured non-household	235	85
– other	2,379	2,428
Measured income accrual	26,182	25,537
Prepayments and other debtors	4,305	3,184
Trade creditors	(3,380)	(4,149)
Deferred income – customer advance receipts	(22,007)	(20,211)
Capital creditors	(22,934)	(18,887)
Accruals and other creditors	(30,060)	(37,351)
	<b>(31,171)</b>	<b>(39,563)</b>

## Notes to the Current Cost Financial Information (continued)

### 7 Movement on current cost reserve

	2010 £000	2009 £000
Balance at 1 April	3,270,047	3,283,320
AMP/SIR adjustment	-	-
RPI adjustments:-		
Fixed assets	172,719	(15,514)
Working capital	(1,759)	240
Financing adjustment	(14,348)	1,124
Grants and third party contributions	(7,168)	878
Balance at 31 March 2010	3,419,491	3,270,048

### 8 Net Debt Analysis

	Fixed Rate	Floating rate	Total
Less than one year	46,220	1,384	47,604
Between one and two years	1,285	1,484	2,769
Between two and five years	2,391	1,591	3,982
Between five and twenty years	209,308	201,278	410,586
In more than twenty years	34	-	34
Borrowings (excluding preference shares)	259,238	205,737	464,975
Preference share capital			-
Total borrowings			464,975
Cash			8,388
Short term deposits			(2,267)
Net Debt			471,096

## Notes to the Current Cost Financial Information (continued)

### 9 Regulatory capital value

	2010 £000
Opening RCV for the year	754,574
Capital expenditure	42,856
Infrastructure renewals expenditure	36,741
Infrastructure renewals charge	(32,402)
Grants and contributions	(6,536)
Depreciation	(36,332)
Out performance of regulatory assumptions (5 years in arrears)	2,404
	<hr/>
Closing RCV carried forward	761,305
	<hr/>
Average regulatory capital value	770,495
	<hr/>

The table shows the RCV used in setting the price limits for the period; the differences from the actual capital expenditure, depreciation and other items will not affect price limits in the current period. Capital efficiencies and the effects of construction price inflation will be taken into account in the calculation for the next periodic review.

### 10 Compliance with Condition K

Paragraph 3.1 of Condition K of the company's Instrument of Appointment requires the company to at all times ensure, so far as reasonably practicable, that if a special administration order were made, it would have available to it sufficient rights and assets (other than financial reserves) to enable a special administrator to manage the affairs, business and property of the appointed business of the company.

The company hereby certifies that at 31 March 2010 it was in compliance with paragraph 3.1 of Condition K.

### 11 Transactions with associated companies

To the best of their knowledge, the directors of the company declare that:

- All appropriate transactions with associated companies have been disclosed, and
- Transactions with associated companies are "at arms length with no cross-subsidy occurring"
- No directors have acted as both purchaser and supplier in any transaction with an associate company.

Company	Service	Turnover of Associate £'000	Terms of Supply	Value 2009/10 £'000
<b>Veolia Water UK PLC</b>	Management and technical support	4,296	No Market	3,667
<b>Veolia Water Shared Services Limited</b>	Support Services	16,664	No Market	13,079
<b>Dalkia Plc</b>	Facilities Management	76,597	Other Market Testing	168

In disclosing the above, the company has applied a materiality limit on transactions of £100,000.

## Notes to the Current Cost Financial Information (continued)

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In the year 2004/05 Veolia Water Central Limited (Formerly Three Valleys Water Plc) took out a loan of £200m through a wholly owned subsidiary, Three Valleys Water Finance PLC. These funds enabled all loans from Veolia Water Capital Funds Ltd to be repaid.

All surplus funds are placed on overnight deposit with Veolia Water Capital Funds Ltd at rates linked to the market. On 31 March 2010 the overnight deposit was £2.3m.

On 29 October 2009 Veolia Eau Compagnie Generale des Eaux issued a £201.3m loan at an interest rate of 2% above GBP LIBOR 3m rates which matures on 31 December 2024. The loan can be repaid at any time without penalty after giving 5 business days notice. On 1<sup>st</sup> April 2010 the loan was transferred to Veolia Environnement Europe Services under the same terms.

On 31 March 2010 there was a £45.0m loan from Veolia Water Capital Funds Ltd.

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## Licence Condition F – Paragraph 7

### Activity Cost Analysis for Appointed Business

The analysis of operating costs by activity has been compiled in accordance with Regulatory Accounting Guideline 4.01, issued by the Director General of Water Services. Where identifiable, costs have been allocated to direct costs and service areas. Where indirect costs exist, these have been allocated over service area in proportion to total direct costs.

	Resource & Treatment £000	Distribution £000	Water Supply Total £000
<b>Direct costs</b>			
Employment costs	4,234	8,765	12,999
Power	12,504	5,281	17,785
Hired and contracted services	1,764	13,222	14,986
Associated companies	-	139	139
Materials and consumables	2,997	767	3,764
Service charges EA	4,308	-	4,308
Bulk supply imports and water supplied under statutory entitlement	1,262	-	1,262
Other direct costs	134	3,520	3,654
<i>Total direct costs</i>	<i>27,203</i>	<i>31,694</i>	<i>58,897</i>
General and support expenditure	6,826	9,025	15,851
<i>Functional expenditure</i>	<i>34,029</i>	<i>40,719</i>	<i>74,748</i>
Customer services			17,676
Scientific services			5,290
Other business activities			1,752
<i>Total business activities</i>			<i>24,718</i>
Local Authority rates			11,011
Doubtful debts			3,952
Exceptional items			-
<i>Total operating expenditure less third party services</i>			<i>114,429</i>
Third party services - operating expenditure			3,049
<i>Total operating expenditure</i>			<i>117,478</i>
<b>Capital maintenance</b>			
Infrastructure renewals charge		38,463	38,463
Current cost depreciation – service activities	21,496	11,570	33,066
Current cost depreciation – business activities			
Amortisation of deferred credits			(463)
Business activities current cost depreciation (non-allocated)			4,198
<i>Capital maintenance less third party services</i>			<i>75,264</i>
Third party services – depreciation			443
<i>Total capital maintenance</i>			<i>75,707</i>
<b>Total operating costs</b>			<b>193,185</b>
<b>Reactive and planned maintenance (included in operating expenditure)</b>			
Reactive and planned maintenance infrastructure		23,307	23,307
Reactive and planned maintenance non-infrastructure	6,925		6,925



## Rolling Summary of the Current Cost Profit and Loss Account for the Appointed Business

	Year ended 31 March 2010 £000	<i>Restated</i> Year ended 31 March 2009 £000	<i>Restated</i> 15 month period to 31 March 2008 £000	<i>Restated</i> Year ended 31 March 2007 £000	<i>Restated</i> Year ended 31 March 2006 £000
Turnover	<b>235,298</b>	231,052	235,372	213,772	207,384
Current cost operating costs	<b>(193,185)</b>	(185,022)	(178,516)	(166,531)	(148,432)
Other operating income	<b>9,987</b>	595	4,020	(1,062)	851
Working capital adjustment	<b>1,759</b>	(241)	2,220	1,980	772
	<b>53,859</b>	46,383	53,097	48,159	60,575
Other income	<b>3</b>	443	211	5	25
Net interest	<b>(19,246)</b>	(15,656)	(11,499)	(11,497)	(11,834)
Financing adjustment	<b>14,348</b>	(1,138)	10,849	11,384	5,971
<b>Current cost profit before taxation</b>	<b>48,964</b>	<b>30,032</b>	<b>52,658</b>	<b>48,052</b>	<b>54,737</b>
Taxation	<b>(4,223)</b>	(19,006)	(2,036)	(14,547)	(14,695)
<b>Current cost profit attributable to shareholders</b>	<b>44,741</b>	11,027	50,622	33,505	40,042
Dividends	<b>(186,306)</b>	(35,878)	(31,023)	(27,571)	(28,257)
<b>Current cost profit/(loss) retained</b>	<b>(141,565)</b>	<b>(24,851)</b>	<b>19,599</b>	<b>5,933</b>	<b>11,785</b>

Prior years' figures have been adjusted for subsequent inflation using the indexation procedures prescribed by the Director General in his letter reference RD 5/01.

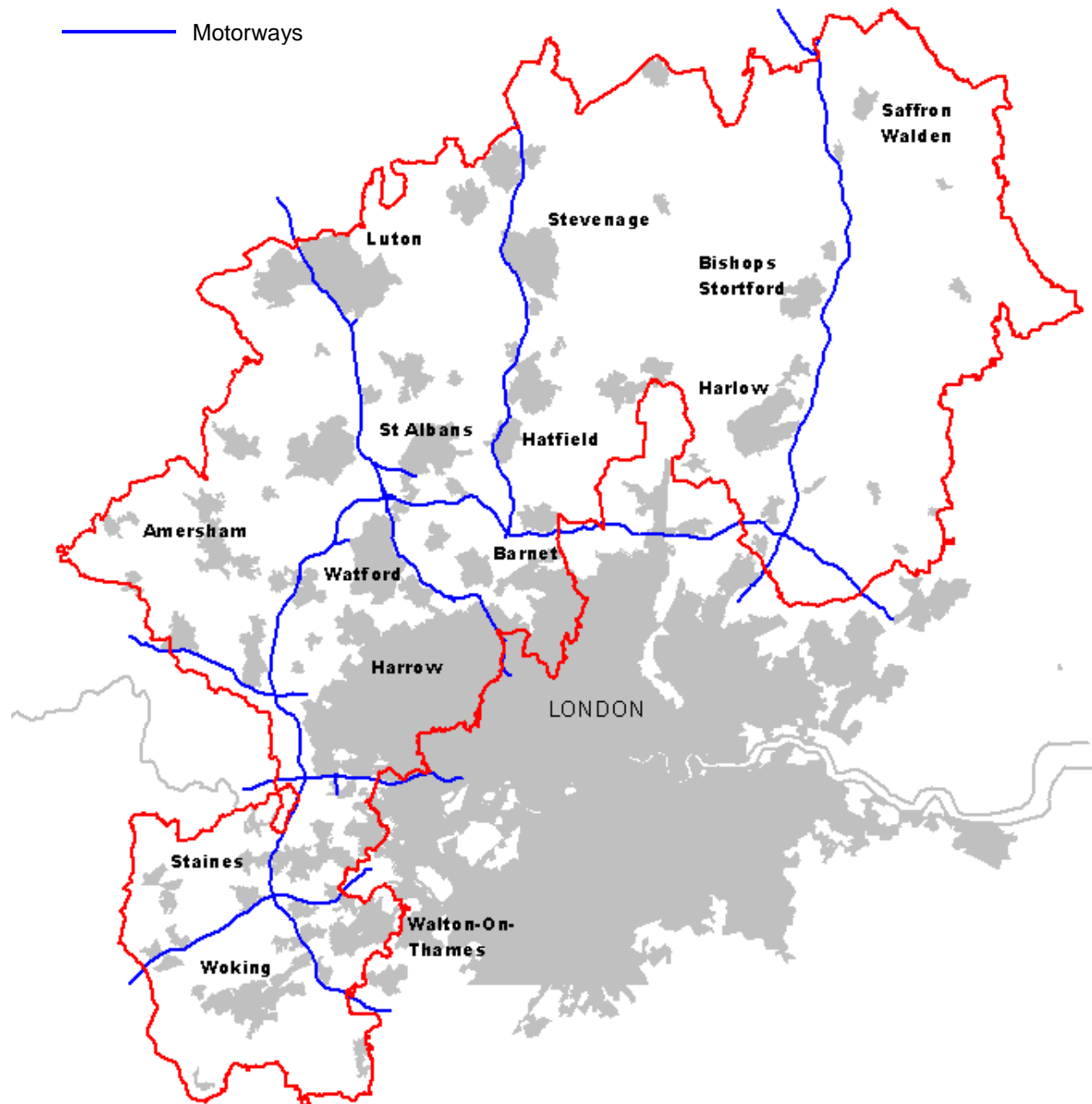
## Rolling Summary of the Current Cost Balance Sheet for the Appointed Business

		<i>Restated</i>	<i>Restated</i>	<i>Restated</i>	<i>Restated</i>
	At 31	At 31	15 month	At 31	At 31
	March	March	period 31	March	March
	2010	2009	2008	2007	2006
	£000	£000	£000	£000	£000
Tangible fixed assets	<b>4,063,487</b>	3,900,565	3,896,870	3,715,445	3,529,400
Third party contributions since 1989/90	<b>(174,431)</b>	(161,887)	(155,023)	(141,252)	(118,707)
Working capital	<b>(31,171)</b>	(39,747)	(60,483)	(58,439)	(17,324)
<b>Net operating assets</b>	<b>3,857,885</b>	3,698,931	3,681,363	3,515,754	3,393,369
Cash and investments	<b>(50,320)</b>	(81,907)	(30,528)	8,637	(3,535)
Non-trade debtors	<b>5,573</b>	4,865	4,357	3,106	3,342
Non-trade creditors	<b>(6,138)</b>	(7,624)	(3,053)	(3,057)	(16,424)
Creditors due after one year	<b>(417,372)</b>	(217,615)	(219,507)	(221,998)	(231,501)
Provisions	<b>(34,297)</b>	(10,759)	(20,788)	(4,503)	(5,075)
Deferred tax provision	<b>(39,520)</b>	(41,855)	(34,740)	(44,351)	(43,160)
Dividends payable	-	-	-	-	-
<b>Net assets employed</b>	<b>3,315,811</b>	<b>3,344,037</b>	<b>3,377,103</b>	<b>3,253,590</b>	<b>3,097,018</b>
Called up share capital	<b>26,506</b>	13,289	13,289	13,289	13,290
Share premium reserved	-	51,461	51,460	51,460	51,460
Profit and loss account	<b>(173,630)</b>	(11,509)	8,222	7,458	869
Current cost reserve	<b>3,419,491</b>	3,285,271	3,298,605	3,175,857	3,025,872
Capital redemption reserve	<b>43,444</b>	5,526	5,526	5,526	5,526
<b>Total capital employed</b>	<b>3,315,811</b>	<b>3,344,037</b>	<b>3,377,103</b>	<b>3,253,590</b>	<b>3,097,018</b>

Prior years' figures have been adjusted for subsequent inflation using the indexation procedures prescribed by the Director General in his letter reference RD 5/01.

## Area of Supply

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