

# **Annual Report and Financial Statements**

## **for the Year Ended 31 March 2011**

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**Veolia Water Central Ltd**

(Registered Number: 2546950)



# Veolia Water Central Limited

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# **Veolia Water Central Limited**

## **Chairman's Statement**

I am pleased to present the Statutory Accounts for the year ended 31 March 2011.

Our mission is to provide the best sustainable water services for our customers.

Over the last 12 months our teams have worked hard to realise this mission, striving to achieve continuous improvement across our business.

This resulted in a strong operational performance that included exceeding the leakage target set by Ofwat; achieving the lowest number of water quality compliance failures in the Company's history; reducing written complaints by 36% and lowering unwanted telephone contact by 20%.

During the year, we replaced 145km of water mains which will improve the performance of our water network.

Since 2008 we have placed the health and safety of our teams and the public at the top of our priorities. Whilst we have seen improvements in some performance metrics, namely a decline in accident rates and the frequency of reportable accidents, our overall Company performance needs to improve.

Throughout the year we achieved a high standard of customer service, occasionally in challenging circumstances. In June and July we faced exceptionally high demand for our water due to the hot weather. In December, during the harsh weather, we experienced three times more bursts than normal. During these periods, our teams worked very hard to repair bursts and minimise any unplanned interruptions to customers' supplies.

The year also saw three large unplanned supply interruptions to our water network. These incidents have highlighted our vulnerability to the high-impact but low-likelihood operational risks inherent in operating our mains network. We will use our experience this year to review our capital maintenance plans for the remainder of this price control period and in future business planning in order to reduce these risk.

Our financial performance in 2010/11 was strong, with annual turnover rising to £239.6m (2010: £234.4m), driven by the RPI uplift and higher customer demand.

Our operating costs fell to £186.5m (2010: £191.8m) despite leakage control measures incurring £5.3m of additional expenditure and restructuring costs being £1.3m higher than the previous year.

A number of other factors including: lower depreciation of £13.8m due to an exceptional write down of £13.8m of assets as part of a revaluation of assets; lower energy costs of £2.5m because of lower wholesale electricity prices; efficiencies and process improvements; and a lower bad debt charge following improvements in collection rates also contributed to the reduction in costs.

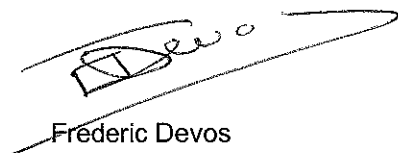
We incurred a loss of £1.0m on the sale of properties (2010: £10.7m profit – this figure included a small but high-market-value plot of land at St Georges Hill, Surrey).

Interest costs increased to £19.9m (2010: £16.4m) because of a full year's charge for a loan from Veolia Environment Europe Services (VEES) that was only in place for three months of 2009/10. Our overall profit for the year was £18.8m (2010: £28.1m).

# **Veolia Water Central Limited**

## **Chairman's Statement (continued)**

On behalf of the Board, I would like to thank all our people for their hard work and achievements in a year of continued uncertainty and change. I would also like to express my appreciation for the loyal service and significant accomplishments of David Alexander, Jeff Bishop, Richard Brimble and Jean Claude Banon, who all resigned from the Board during the course of the year.

A handwritten signature in black ink, appearing to read 'Devos', with a long horizontal stroke extending to the right.

Frederic Devos  
Chairman  
29 June 2011

# Veolia Water Central Limited

## Directors

### **F Devos (Chairman)**

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

### **R A Bienfait (Managing Director)**

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

### **D W Alexander (until 2 December 2010)**

David Alexander is British and served as Managing Director between 2000 and 2005. He resigned as director on 2 December 2010.

### **J C Banon (until 31 December 2010)**

Jean Claude Banon is French and was appointed a director in 1994. He resigned as director on 31 December 2010.

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

Jeff Bishop is British and was appointed Operations Director in 2002. He resigned on 8 June 2010 to take up another role within the Veolia Water UK group.

### **R J Brimble (Customer Relations Director until 7 July 2010)**

Richard Brimble is British and was appointed Customer Relations Director in 2008. He resigned on 7 July 2010 to take up another role within the Veolia Water UK group

### **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 General Secretary of Veolia Transdev.

### **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 in 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.

# **Veolia Water Central Limited**

## **Board Committees, Executives and Advisers**

### **Audit Committee**

Dr N W Summerton (Chairman)  
Baroness Buscombe  
F Woolf  
M Butcher

### **Executive Management Committee**

R A Bienfait (Chairman)  
F Devos  
N Paterson  
A Dench  
M Rowlatt  
S Martin  
G Chalkley  
V Muldoon  
T Monod

### **Remuneration and Employment Committee**

F Devos (Chairman)  
Dr N W Summerton

Membership of the Remuneration and Employment Committee was amended during the year.

### **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

# **Veolia Water Central Limited**

## **Report of the Directors**

### **Introduction**

The directors present their report and the audited statutory financial statements for the year ended 31 March 2011.

### **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 5.

### **Going concern**

The company has adequate resources to meet its current operational and financial obligations, and the directors have a reasonable expectation that this will continue for the foreseeable future. This assessment is based on the consideration of the company's budgeted cash flows and long term forecasts and related assumptions, available debt facilities and support of the wider Veolia group. For this reason, the directors 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 laws 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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions, 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

# **Veolia Water Central Limited**

## **Report to the Directors (continued)**

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 top quality sustainable water services for business and household consumers.

#### **Business objectives**

We want our Company to be the best water company in the industry, being a sustainable top quartile performer from 2013 and a showcase of excellence. We believe that succeeding this ambition will be beneficial to our customers, other stakeholders and Veolia Water UK.

Underpinning our vision, we have six goals. These are:

##### **Customers & Understanding**

Deliver an exceptional water service to our customers in their local communities. Understand the needs of our customers and the community and fulfil their expectations so that our customers only contact us to seek our help and advice, buy additional services or notify us of a change in their circumstances

##### **Technology & Creativity**

Develop our technological and innovative capabilities so that we can confidently deploy our creative ideas where:

- a) the potential of our people can be released
- b) we improve the lives of those in the community we serve and
- c) we create efficiencies and new sources of profitable revenue

##### **Failure & Feedback**

Develop an environment where every member of the team can contribute and identify feedback that helps us all understand, learn and take action to improve the team and the organisation

##### **Measure & Improve**

Design and employ consistent reporting systems which provide meaningful information concerning the current and predictive performance of our business in order that we maintain appropriate records and make timely decisions

##### **People & Potential**

Ensure a safe and healthy team-based environment which allows our teams to improve their capabilities and our people the opportunity to make the most of their potential

##### **Design & Process**

Design the company around the high level business processes and the needs of our customers; building agility, flexibility, teamwork and the opportunity to learn and improve

To measure performance in achieving this vision, we have established key performance targets. Achievement of these targets, per quarter, results in a bonus at the end of the year for all staff. In calendar year 2010 we measured five key targets and in 2011 we have introduced three additional targets. Our ultimate aim is to achieve improved performance in:-

- Health and safety
- Water quality
- Unplanned interruptions to supply
- Written complaints
- Leakage



# Veolia Water Central Limited

## Report to the Directors (continued)

- Unwanted contact
- Customer experience
- Profitability

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'. RPI for 2010/11 is 0.3% (2009/10: 3.0%) and 'k' for 2010/11 is 1.4% (2009/10: 0.4%)

The Water Act 2003 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 proposals 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:

- 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. Risks are reviewed and discussed at the Executive Management Committee (EMC). A key aim is to foster a culture in which staff throughout the business manage all risks as part of their management of day to day operations. The Audit Committee reviews the EMC's work on risk management and reports to the board on significant risks.

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

- risks associated with change and more specifically impact on people, from restructuring
- ability to meet the leakage target

# Veolia Water Central Limited

## Report to the Directors (continued)

- whether the efficiency target 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.

### Operational performance during the year ended 31 March 2011

- we installed 8,144 meters taking the proportion for domestic metered supplies to 40.8%
- we more than met our leakage target, achieving 181.5 MI/d against a target of 185.0 MI/d
- we reduced customer telephone contact by 5.5%
- written complaints reduced by 36% and unwanted telephone contacts by 20%
- we renewed 145km (1%) of mains network compared with 126km/year in the determination
- the number of metered customers who received a bill based on an actual meter reading was 99.6%
- we maintained high quality drinking water, the test pass rate being 99.98%

A consistent set of Health and Safety standards are deployed across all contractors working on the capital and opex programmes. These standards are robustly monitored by project managers who conduct monthly audits which are 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 performance for the benefit of society and the environment.

### 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 by our regulators. We will seek to grow our non-regulated business where appropriate.

### Financial performance for the year ended 31 March 2011

#### *Turnover*

Turnover of £239.6m (2010: £234.4m) increased by £5.2m. The main drivers of the increase were higher RPI & K (£3.9m) and higher customer demand.

#### *Operating expenditure*

Operating expenditure has decreased by £5.3m to £186.5m (2010: £191.8m). The largest component of the decrease in operating expenditure for the current year is depreciation which has decreased by £13.8m and is explained below. The adverse weather conditions experienced in December and January led to increased costs (£5.3m) due to the higher number of burst mains than usual and their severity. There has also been a reduction of £2.5m of energy costs over and above those incurred in the previous period. Efficiencies have been made, resulting in lowering costs in management and finance, customer services

# Veolia Water Central Limited

## Report to the Directors (continued)

and operations through process improvement and better communication. There has been a reduction in the bad debt provision due to better collection rates despite the uncertain economic climate.

### *Depreciation*

Depreciation has decreased by £13.8m to £30.2m (2010: £44.0m). The prior year figure included an amount of £13.4m recognised as part of the regearing and revaluation exercise.

### *Disposal of fixed assets*

Income from disposals was £11.7m lower than in the previous period. Losses on sale of properties in the year were £1.0m whilst 2010 saw a profit of 10.7m mainly due to the sale of a small but high market value plot of land in Surrey.

### *Financial returns*

As a result of the above changes, profit for the year ended 31 March 2011 is £21.3m (2010: £28.1m) a decrease of £6.8m.

### *Cash flow*

There was a net cash outflow in the year of £0.1m, a small change on the previous year when there was a net inflow of £0.3m.

Net debt decreased to £455.0m at the end of March 2011 compared to £461.6m at the end of March 2010.

### *Capital expenditure*

Expenditure for the year before contributions was £72.6m.

Whilst gross expenditure for both mains renewals and above ground assets exceeded the regulatory target, this was offset by contributions from developers.

### *Pensions*

In July 2010, the government announced that it would, in future, use the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) as the basis for determining the statutory minimum percentage increase for revaluation and indexation of pensions paid from private sector occupational pension schemes. The CPI basis has therefore been used for the calculation of pension scheme related amounts as indicated in Note 23, with the change being treated as an actuarial gain in the benefit obligation reconciliation, and resulting in a significant decrease in the overall obligation at 31 March 2011.

### *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, Veolia Water Central Finance PLC (formerly 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.

# Veolia Water Central Limited

## Report to the Directors (continued)

### *Capital finance*

The £200m 22-year bond, issued by Veolia Water Central Finance PLC (formerly Three Valleys Water Finance PLC) in 2004 at just below 6%, is part financing our capital programme for the current five year period.

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.

A £100m revolving credit facility is also available. Our financial ratios demonstrate Veolia Water Central's good credit quality. The balance sheet remains strong, with debt at around 58% of regulatory capital value, a considerable margin below that of some water companies.

### *Dividend policy*

Our dividend policy is primarily based on maintaining a specific level of gearing (no more than 65%). 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 as required.

The directors have declared and paid the following dividends during the year ended 31 March 2011:

#### **Ordinary dividends:**

	£000
Interim – paid July 2010	15,400
Interim – paid December 2010	19,482
	<hr/>
	34,882
	<hr/>

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.

# **Veolia Water Central Limited**

## **Report to the Directors (continued)**

### **Employees**

We consult and inform employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings and the intranet. We constantly discuss 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.

### **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**

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.

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.

The charitable contributions made by the company during the year were £590,281 (2010: £26,000), 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
- educate young people about water and sustainability issues
- assist customers who have serious financial difficulties in paying their water bills

In February 2011 a donation of £550,000 was paid to the Veolia Water Trust (formerly Three Valleys Water Trust). This trust seeks to assist customers whom it deems need help with their water debts. The company has committed to donate £2.5m to the Trust in the five years to March 2014.

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 37 (2010: 18).

# **Veolia Water Central Limited**

## **Report to the Directors (continued)**

### **Post balance sheet events**

No significant post balance sheet events have taken place. However, the premises formerly occupied by Veolia Water Central in Bushey, Hertfordshire is held for sale and completion of the sale is anticipated on 30 June 2011. The selling price will be £9.9m.

### **Disclosure of information to 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.

### **Auditors**

In accordance with Section 485 of the Companies Act 2006, a resolution to re-appoint the auditors, Ernst & Young LLP, will be proposed at the annual general meeting.

By order of the Board



T J W Monod  
Company Secretary  
29 June 2011

# **Veolia Water Central Limited**

## **Corporate Governance Report**

### **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 directors bring independent judgement to bear on all matters including issues of strategy, performance, resources and standards of conduct. Appointments to the Board reflect the decision 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. 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.

### **Board composition and independence**

At the end of the reporting year the Board comprised one executive and six 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.

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. While Dr Summerton has been a member of the Board for over 10 years, he is not a shareholder in the company or its parents and has no other paid position with Veolia except being an independent non-executive director of one of the sister regulated companies. He maintains his independence as a commentator and consultant on water matters.

The non-executive directors meet and maintain regular contact between Board meetings as appropriate. They have monthly teleconferences with the Managing Director and Secretary to discuss current business.

### **Board processes**

The Board has established three 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.

### **Audit Committee**

The Audit Committee comprises three independent non-executive directors and a representative of the shareholder and meets at least four times a year. The Board is satisfied that collectively the members have the appropriate knowledge and experience to be expected of an audit committee of a company of this type. The Committee is chaired by Dr. Neil Summerton. The Managing Director, Director of Finance & Regulation, 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 and give a true and fair representation of the company's financial position.

# **Veolia Water Central Limited**

## **Corporate Governance Report (continued)**

The Committee meets with the company's reporter and external auditors and reviews the information to be provided in the annual 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 begin, in the course of their work 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. It also approves in advance the activities and resources of internal audit and its effectiveness.

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. It also considers and advises the Board on the policies and procedures for controlling and managing risks throughout the company and supervises actions to define, assess, control and limit risk.

The Committee each year evaluates its performance by means of a questionnaire covering the range of its responsibilities and procedures.

### **Executive Management Committee**

The Executive Management Committee comprises the Managing Director and his management team together with certain shareholder representatives. Membership is shown on page 6. The Committee meets regularly (normally monthly) and is responsible to the Board for managing the business from day to day in an efficient, economical and effective manner. It is responsible for implementing Board decisions and for those matters delegated to it by the Board under defined terms of reference.

### **Remuneration and Employment Committee**

The Committee operates under defined terms of reference and advises the Board on the appointment of Board members, the level of fees to be paid to non-executive Directors and the remuneration and terms and conditions of senior executives of the Company. The Committee comprises the Chairman and one independent non-executive director. This balance reflects the company's status as a wholly owned subsidiary.

### **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.



# Veolia Water Central Limited

## Corporate Governance Report (continued)

### Attendance at meetings for year ended 31 March 2011

	Board	Audit Committee	Executive Management Committee	Remuneration & Employment Committee
Number of meetings in the year	5	4	14	1
David Alexander	4*	-	-	-
Jean Claude Banon	2*	-	-	-
Richard Bienfait	5	-	14	-
Jeff Bishop	1*	-	1*	-
Richard Brimble	2*	-	3*	-
Baroness Buscombe	5	3	-	-
Philippe Guitard	3	-	-	-
Olivier Grunberg	2	-	-	-
Dr. Neil Summerton	5	4	-	1
Fiona Woolf	5	4	-	-
Frédéric Devos	5	-	3	1

"-" 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. As a term of its licence, however, the company acts as through this combined code does apply to it. 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 provides assurance against material mis-statement or loss. 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.

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.

A whistle blowing 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.

# Veolia Water Central Limited

## Corporate Governance Report (continued)

The Executive Management Committee considers the management of both risks already identified and emerging and expected risks, in order to integrate fully the consideration of risk into the overall management of the business. The Committee is advised by specialists as necessary. The Audit Committee considers reports from the Executive Management Committee on risk and reports to the Board as necessary. Risks figure as necessary, in the monthly discussions between the independent non-executive directors and the Managing Director and Secretary.

By order of the Board



T J W Monod  
Company Secretary  
29 June 2011

# Veolia Water Central Limited

## Remuneration Report

### 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 interest and also the wider interest 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*

F Devos  
O Grunberg  
P Guitard

J C Banon & D W Alexander were non-executive directors but resigned during the course of the year.

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. 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 (Part year; now no longer an Executive Director)
R Brimble	Customer Relations Director (Part year; now no longer an Executive Director)

# Veolia Water Central Limited

## Remuneration Report (continued)

The salary of the managing director is currently set and paid by Veolia Water UK PLC and subsequently recharged to Veolia Water Central Limited, on a time proportional basis. The salary of the other executive directors was 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 2010 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
- **Attaining 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 were 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 = 50% of Maximum
- Achievement of five individual pre-set objectives = 25% of Maximum
- Achievement of Five Zeros throughout the year = 25% of Maximum

# Veolia Water Central Limited

## Remuneration Report (continued)

Notice periods are as follows:

	From the executive to the company	From the company to the executive
R A Bienfait*	6 months	6 months

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

### Directors' emoluments

Directors' emoluments for the year to date were £252k (2010: £943k). Full details are provided within note 5 on page 34.

### Directors' interests

There are no disclosable interests under the Companies Act 2006.

Shares held in Veolia Environnement SA are not disclosed in accordance with SI 1985/802

By order of the Board



T J W Monod  
Company Secretary  
29 June 2011

# **Independent Auditor's report to the members of Veolia Water Central Limited**

We have audited the financial statements of Veolia Water Central Limited for the year ended 31 March 2011 which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses 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 pages 7 and 8, 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 mis-statement, 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. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material mis-statements or inconsistencies we consider the implications for our report.

## **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 2011 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 Report of the Directors 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 Report 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 (continued)**

### **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.

Ernst & Young LLP

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

1 July 2011

# Veolia Water Central Limited

## Profit and loss account for the year ended 31 March 2011 (Registered Number 2546950)

	Note	2011 £000	2010 £000
<b>Turnover</b>	2	<b>239,647</b>	234,373
<b>Cost of sales</b>		<b>(154,277)</b>	(160,537)
<b>Gross profit</b>		<b>85,370</b>	73,836
Customer services and administrative expenses		<b>(40,209)</b>	(39,700)
Other operating income	3	<b>7,942</b>	8,447
<b>Operating profit</b>	4	<b>53,103</b>	42,583
(Loss)/profit on disposal of fixed assets		(976)	10,672
<b>Profit on ordinary activities before interest and taxation</b>		<b>52,127</b>	53,255
Interest receivable	6	<b>129</b>	1
Interest payable and finance charges	7	<b>(19,871)</b>	(16,390)
Other finance charges	8	<b>(1,978)</b>	(2,862)
<b>Profit on ordinary activities before taxation</b>		<b>30,407</b>	34,004
Tax on profit on ordinary activities	9	<b>(9,155)</b>	(5,945)
<b>Profit on ordinary activities after taxation and for the financial year</b>		<b>21,252</b>	28,059

All profits of the company are from continuing operations.

### Note of historical profits and losses

For the year ended 31 March	2011 £000	2010 £000
Reported profit on ordinary activities before taxation	30,407	34,004
Realisation of property revaluation gains of previous years	1,780	-
Difference between historical cost depreciation charge and the actual depreciation charge of the year calculated on the revalued amount	-	13,369
<b>Historical cost profit on ordinary activities before taxation</b>	<b>32,187</b>	<b>47,373</b>
<b>Historical cost profit for the year retained after taxation</b>	<b>23,032</b>	<b>41,428</b>



# Veolia Water Central Limited

## Statement of total recognised gains and losses for the year ended 31 March 2011 (Registered Number 2546950)

	Note	2011 £000	2010 £000
Profit for the financial year	20	<b>21,252</b>	28,059
Surplus on revaluation of tangible fixed assets	20	-	380,571
Issue of bonus shares	20	-	(251,830)
Actuarial gain/(loss) recognised in the pension schemes	20	<b>13,675</b>	(28,622)
Deferred tax movement relating to actuarial gain/(loss)	20	<b>(4,872)</b>	8,014
<b>Total recognised gains for the year</b>	20	<b>30,055</b>	136,191

# Veolia Water Central Limited

## Balance sheet

as at 31 March 2011

(Registered Number 2546950)

	Note	2011 £000	2010 £000
<b>Fixed assets</b>			
Intangible assets	11	6,678	6,678
Tangible assets	11	913,847	924,827
Investment	12	50	50
		<b>920,575</b>	<b>931,555</b>
<b>Current assets</b>			
Stocks	13	851	596
Debtors	14	54,042	55,253
Cash at bank and in hand		1,439	1,154
		<b>56,332</b>	<b>57,003</b>
<b>Creditors - amounts falling due within one year</b>	15	<b>(143,486)</b>	<b>(144,139)</b>
<b>Net current liabilities</b>		<b>(87,154)</b>	<b>(87,136)</b>
<b>Total assets less current liabilities</b>		<b>833,421</b>	<b>844,419</b>
<b>Creditors - amounts falling due after more than one year</b>	16	<b>(425,324)</b>	<b>(421,721)</b>
<b>Provisions for liabilities</b>	17	<b>(42,653)</b>	<b>(41,085)</b>
<b>Net assets excluding pension liability</b>		<b>365,444</b>	<b>381,613</b>
<b>Net pension liability</b>	23	<b>(21,389)</b>	<b>(32,732)</b>
<b>Net assets including pension liability</b>		<b>344,055</b>	<b>348,881</b>
<b>Capital and reserves</b>			
Called up share capital	18	26,506	26,506
Other reserves	19	126,961	128,741
Profit and loss account	19	190,588	193,634
<b>Shareholders' funds</b>	20	<b>344,055</b>	<b>348,881</b>

The statutory financial statements on pages 24 to 52 have been approved by the Board of Directors and were signed on 29 June 2011 on its behalf by:



Frederic Devos  
Chairman



Richard Bienfait  
Managing Director

# Veolia Water Central Limited

## Cash flow statement for the year ended 31 March 2011 (Registered Number 2546950)

	Note	2011 £000	2010 £000
<b>Net cash inflow from operating activities</b>	a	<b>129,857</b>	112,905
<b>Returns on investments and servicing of finance</b>			
Interest received		126	1
Interest paid		(19,480)	(15,895)
Interest element of finance lease payments		(400)	(460)
Net cash outflow from returns on investments and servicing of finance		(19,754)	(16,354)
<b>Taxation</b>		<b>(8,734)</b>	(10,156)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets		(71,878)	(82,686)
Capital contributions		6,575	6,589
Proceeds on disposal of tangible fixed assets		5,363	12,429
Net cash outflow from capital expenditure and financial investment		(59,940)	(63,668)
<b>Equity dividends paid to shareholders</b>		<b>(34,882)</b>	(190,733)
<b>Net cash inflow/(outflow) before financing</b>		<b>6,547</b>	(168,006)
<b>Financing</b>			
Capital element of finance lease payments		(1,384)	(1,290)
Loan from subsidiary		134	126
Loan from parent company		(10,733)	(32,477)
Loan from other group undertaking		6,239	201,278
Financing of assets operated by other parties		(856)	693
Decrease in other long term financial liabilities – repurchase of debentures		(2)	(1)
Net cash (outflow)/inflow from financing		(6,602)	168,329
<b>(Decrease)/Increase in net cash</b>	b/c	<b>(55)</b>	323

# Veolia Water Central Limited

## Notes to the cash flow statement

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

	2011 £000	2010 £000
Operating profit	53,103	42,583
Depreciation of tangible fixed assets	70,700	82,498
Amortisation of deferred credit	(329)	(329)
Increase in stocks	(255)	15
(Increase) in debtors	(1,057)	(7,378)
Increase/(decrease) in provisions	510	(42)
Increase/(decrease) in creditors	12,046	(5,779)
(Increase)/decrease in pension liability	(4,861)	1,337
Net cash inflow from operating activities	129,857	112,905

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

	2011 £000	2010 £000
(Decrease)/Increase in cash in the year	(55)	323
Cash inflow/(outflow) from increase in debt and finance leasing	6,602	(168,329)
Movement in net debt in the year	6,547	(168,006)
Net debt at the beginning of the year	(461,554)	(293,548)
Net debt at the end of the year	(455,007)	(461,554)

### c Analysis of net debt

	At 1 April 2010 £000	Cash Flow £000	Non Cash Flow £000	At 31 March 2011 £000
<b>Net cash</b>				
Bank	1,154	(55)	-	1,099
	1,154	(55)	-	1,099
<b>Debt</b>				
Loan from subsidiary financed by bond issue	(196,441)	-	(134)	(196,575)
Deposit with parent company	2,267	(2,267)	-	-
Loan from other group undertakings	(201,278)	(6,239)	-	(207,517)
Loan from parent company	(45,000)	13,000	-	(32,000)
Debentures	(34)	2	-	(32)
Finance leases (including sale and leaseback)	(4,459)	1,384	-	(3,075)
Financing of assets used by Veolia Water Central and operated by other parties	(17,763)	856	-	(16,907)
	(462,708)	6,736	(134)	(456,106)
<b>Net debt</b>	(461,554)	6,681	(134)	(455,007)

# **Veolia Water Central Limited**

## **Notes to the financial statements for the year ended 31 March 2011**

### **1 Statement of accounting policies**

#### **Basis of preparation**

These financial statements have been prepared on the going concern basis, under the historical cost convention, as modified by the revaluation of certain tangible fixed assets described below, and in accordance with the Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410), which forms part of the Companies Act 2006, and applicable UK accounting standards, except for the treatment of certain grants and contributions, described below, and non-amortisation of goodwill.

The accounts for Veolia Water Central Limited and its wholly owned subsidiary, Veolia Water Central Finance PLC (formerly 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 have been recognised in respect of share based payments in the years ended 31 March 2011 and 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.

#### **Use of estimates**

The preparation of accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from those estimates.

#### **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.

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 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 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, 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 the 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	

# **Veolia Water Central Limited**

## **Notes to the financial statements for the year ended 31 March 2011 (continued)**

### **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.

### **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.

# **Veolia Water Central Limited**

## **Notes to the financial statements for the year ended 31 March 2011 (continued)**

### **Basis of Preparation**

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.

### **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.



# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 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.

	2011 £000	2010 £000
Turnover by class is analysed below:		
Unmeasured supplies	124,469	123,571
Measured supplies	114,853	110,226
Chargeable services	325	576
	<b>239,647</b>	<b>234,373</b>

### 3 Other operating income

	2011 £000	2010 £000
Commission, rentals & other non-appointed income	<b>7,942</b>	8,447

### 4 Operating profit

	2011 £000	2010 £000
Operating profit is stated after charging/(crediting):		
Purchase of bulk water and water supplied under statutory entitlement	1,560	1,334
Water abstraction	4,881	4,512
Business rates	11,788	11,193
Chargeable services direct expenditure	750	1,215
Depreciation of infrastructure assets	40,511	38,463
Depreciation of tangible fixed assets - owned	29,239	29,398
Depreciation of tangible fixed assets - leased	950	1,268
Accelerated depreciation arising from revaluation	-	13,369
Research and development	222	297
Auditor's remuneration - audit	78	141
Auditor's remuneration - regulatory returns and non-statutory audit	116	94
Hire of equipment	780	589
Operating lease rentals – Land and Buildings	1,547	1,547
Operating lease rentals - other	98	75
Amortisation of deferred credit	(329)	(329)

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

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 5 Employees and directors

	2011 £000	2010 £000
Staff costs (including directors) consist of:		
Wages and salaries	23,285	26,053
Social security costs	1,985	2,080
Defined benefit pension costs (note 23)	3,819	2,216
Defined contribution pension costs	344	355
Other pension costs	454	236
Net settlement (credit)/charge (note 23)	(363)	3,522
	<b>29,524</b>	<b>34,462</b>

	2011 Number	2010 Number
The average number of employees (including directors) during the year was as follows:		
Operations	354	425
Customer service	343	288
Administration	51	120
	<b>748</b>	<b>833</b>

### Directors' emoluments

	2011 Salary and fees £000	2011 Benefits in kind £000	2011 Bonus £000	2011 Total £000	2010 Total £000
<b>Non-executives</b>					
Sir Alan Thomas	-	-	-	-	128
D W Alexander	19	-	-	19	25
J C Banon	25	-	-	25	25
Baroness Buscombe	25	-	-	25	25
Dr N W Summerton	25	-	-	25	25
F Woolf	25	-	-	25	25
F Devos	25	-	-	25	25
O Grunberg	25	-	-	25	25
P Guitard	25	-	-	25	25
<b>Executives</b>					
J A Bishop	22	3	-	25	153
A P Smith	-	-	-	-	304
R Brimble	31	2	-	33	158
	<b>247</b>	<b>5</b>	<b>-</b>	<b>252</b>	<b>943</b>

During the year pensions paid to non-executive directors amounted to £92k (2010: £91k).  
No directors exercised share options during the year.

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

The emoluments of R Bienfait were paid during the year by Veolia Water UK Plc, the company's parent undertaking, which has recharged an amount of £225k £(2010: £nil) to the company.

The sole director accruing retirement benefits under the money purchase pension scheme resigned from the Board during the year. The company contributions paid to money purchase pension schemes amounted to £6k (2010: £23k).

### Pensions (defined benefits)

	Accumulated total accrued pension at 31 March 2010			Increase in accrued pension during year			Accumulated total accrued pension at 31 March 2011	
	£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*	49	958	-	7	(45)	(9)	49	956

\*Mr J Bishop ceased to be a director on 8 June 2010. The value of the pension at 31 March 2011 is therefore based on pension accrued up to 8 June 2010.

There is no lump sum accrued for the highest paid director. The highest paid director does not participate in the group defined benefit schemes.

### 6 Interest receivable

	2011 £000	2010 £000
Other interest	129	1
	<b>129</b>	<b>1</b>

### 7 Interest payable and finance charges

	2011 £000	2010 £000
Interest payable to other group undertaking	6,427	2,194
Interest payable to parent company	380	635
Financing costs of assets used by Veolia Water Central and operated by other parties	743	1,148
Finance lease charges	353	460
Debenture interest	1	1
Interest payable to subsidiary in respect of bond issue	11,884	11,876
Other interest	83	76
	<b>19,871</b>	<b>16,390</b>

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 8 Other finance (charges)/income

	2011 £000	2010 £000
Expected return on pension scheme	12,307	10,503
Interest on pension scheme liabilities	(14,285)	(13,365)
	<b>(1,978)</b>	<b>(2,862)</b>

### 9 Tax on profit on ordinary activities

	2011 £000	2010 £000
<b>Current taxation</b>		
Current tax on profit of the year	8,654	12,263
Adjustment in respect of prior years	(900)	(3,002)
Current taxation	7,754	9,261
<b>Deferred taxation</b>		
Origination and reversal of timing differences	1,842	(2,870)
Effect of decreased tax rate on closing liability/change in tax law	-	-
Adjustment in respect of prior years	553	1,775
(Increase)/decrease in discounting	6,126	(2,221)
Impact of change in tax rate	(7,120)	-
Deferred tax charge for the year	1,401	(3,316)
Tax on profit on ordinary activities	9,155	5,945
<b>Current taxation reconciliation</b>		
Profit on ordinary activities before taxation	30,407	34,004
Theoretical tax at UK corporation tax rate of 28% (2010: 28%)	8,514	9,521
Effects of:		
Adjustment to tax in respect of prior years	(900)	(3,002)
Accelerated capital allowances	(343)	2,084
Pension cost charge in excess of pension cost relief	-	800
Other short term timing differences	(691)	(14)
Other timing differences	(808)	-
Permanent differences	1,982	(128)
Actual current taxation charge	7,754	9,261

The tax credit relating to losses on disposal of fixed assets amounts to £273,000 (2010: charge of £2,988,000).

Factors that may affect future tax charges:

A change in the UK main corporation tax rate from 28% to 27% was substantively enacted on 20 July 2010 and became effective from 1 April 2011. Further reductions in the UK corporation tax rate were announced in the March 2011 Budget, including an additional decrease in the main corporation tax rate to 26% effective from 1 April 2011. As a result the relevant deferred tax balances have been re-measured.

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

The further reductions from 26%, which are expected to be enacted separately each year, propose to reduce the rate by 1% per annum to 23% by 1 April 2014. The changes had not been substantively enacted at the balance sheet date and, therefore, are not recognised in these financial statements.

Changes to the UK capital allowance regime will also 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 at a similar level to the current year.

2011 £000	2010 £000
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Tax on recognised gains and losses not included in the profit and loss account (note 19):

UK corporation tax rate of 28% (2010: 28%)

Other deferred tax movements relating to pension schemes	4,872	(8,014)
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### 10 Dividends on equity shares

2011 £000	2010 £000
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Ordinary:

First interim paid of 5.81p per share (2010: 7.15p)	15,400	18,955
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Second interim paid of 7.35p per share (2010: 64.81p)	19,482	171,778
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<b>34,882</b>	<b>190,733</b>
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### 11 Fixed assets

#### Intangible assets

Positive goodwill £000
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Cost at 1 April 2010 and 31 March 2011	6,678
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Amortisation at 1 April 2010 and 31 March 2011	-
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Net book value at 31 March 2010 and 31 March 2011	<b>6,678</b>
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# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 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 2010	238,146	870,828	465,754	42,101	27,889	1,644,718
Additions at cost	3,186	32,835	18,023	(543)	19,134	72,635
Transfers to complete	2,635	-	21,631	2,280	(26,546)	-
Capital contributions	-	(6,575)	-	-	-	(6,575)
Disposals	(7,812)	(531)	-	(198)	-	(8,541)
At 31 March 2011	<b>236,155</b>	<b>896,557</b>	<b>505,408</b>	<b>43,640</b>	<b>20,477</b>	<b>1,702,237</b>
<b>Depreciation</b>						
At 1 April 2010	52,647	348,165	286,560	32,519	-	719,891
Charge for the year	6,435	40,511	20,263	3,491	-	70,700
Disposals	(1,482)	(531)	-	(188)	-	(2,201)
At 31 March 2011	<b>57,600</b>	<b>388,145</b>	<b>306,823</b>	<b>35,822</b>	<b>-</b>	<b>788,390</b>
<b>Net book value</b>						
At 31 March 2011	<b>178,555</b>	<b>508,412</b>	<b>198,585</b>	<b>7,818</b>	<b>20,477</b>	<b>913,847</b>
At 31 March 2010	185,499	522,663	179,194	9,582	27,889	924,827

Finance leases have been arranged for assets included above at 31 March 2011 as follows:

Cost	8,419	23,165	63,874	4,834	-	100,292
Depreciation	(7,469)	(10,656)	(61,966)	(4,834)	-	(84,925)
Net book value	950	12,509	1,908	-	-	15,367

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

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

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 £138,601k (2010: £132,026k) in order to give a true and fair view.

All land and buildings are held as freehold.

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

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 concluded that the most reliable valuation method to determine the current value for the tangible fixed assets of a UK water company was a two 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 were incorporated into the financial statements with the resulting revaluation adjustments 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 £1,321.6m (2010: £1,264.1m).

### 12 Investment

	2011 £000	2010 £000
Investment in subsidiary undertaking	50	50

The company has an investment of £50,000 in 100% of the £1 ordinary shares of a subsidiary company, Veolia Water Central Finance PLC (formerly Three Valleys Water Finance PLC). The principal activity of Veolia Water Central Finance PLC is to raise finance for the company. It made neither a profit nor loss in 2011 (2010: Nil).

### 13 Stocks

	2011 £000	2010 £000
Raw materials and consumables	851	596

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 14 Debtors

	2011 £000	2010 £000
<b>Due within one year</b>		
Trade debtors and customers' water charges	18,084	16,127
Deposit with parent company	-	2,267
Accrual for unbilled metered customers	27,423	26,182
Amounts due from fellow subsidiaries	2,985	3,963
Other debtors	3,253	2,409
Prepayments and accrued income	2,297	4,305
	<b>54,042</b>	<b>55,253</b>

Deposits with the parent company relates to overnight cash pooling.

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

	2011 £000	2010 £000
Net obligations under finance leases (note 22)	1,484	1,384
Financing of assets used by Veolia Water Central and operated by other parties (note 22)	1,318	1,220
Amounts due to fellow subsidiaries	10,771	4,690
Amounts due to parent company	339	-
Loan from parent company	32,000	45,000
Payments received in advance	33,753	31,855
Trade creditors	8,400	3,380
Inter-company interest payable	8,402	8,402
Corporation tax	4,580	5,560
Taxation and social security	882	860
Other creditors	5,476	8,632
Capital accruals	22,157	22,934
Other accruals and deferred income	13,924	10,222
	<b>143,486</b>	<b>144,139</b>

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

	2011 £000	2010 £000
Net obligations under finance leases (note 22)	1,591	3,075
Financing of assets used by Veolia Water Central and operated by other parties (note 22)	15,589	16,543
Deferred credit – contributions to surface assets	4,020	4,349
Loan from subsidiary company financed by bond issue	196,575	196,441
Loan from other group undertakings	207,517	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	20	23
5.25% irredeemable stock	1	1
	<b>425,324</b>	<b>421,721</b>



# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

During the year the company repurchased for cancellation £2,300 nominal irredeemable outstanding debenture stock (2010: £766).

The loan from the subsidiary company relates to a loan from Veolia Water Central Finance PLC (formerly Three Valleys Water Finance PLC). This represents the net proceeds of a bond issue made by Veolia Water Central Finance PLC and then lent to the company. On 13 July 2004 Veolia Water Central 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 Veolia Water Central 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 Veolia Water Central 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 £201.3m loan at an interest rate of 2% above GBP LIBOR 3m rates which mature 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 2010	(39,520)	(1,070)	(494)	(41,085)
Charged to the profit and loss account	(1,059)	(152)	(947)	(2,158)
Utilised in the year	-	-	589	589
At 31 March 2011	<b>(40,579)</b>	<b>(1,222)</b>	<b>(852)</b>	<b>(42,653)</b>

#### Deferred tax (see note 9)

	2011 £000	2010 £000
Accelerated capital allowances	<b>88,081</b>	93,821
Other timing differences	<b>(1,573)</b>	(2,246)
Undiscounted provision for deferred tax	<b>86,508</b>	91,575
Discount	<b>(45,929)</b>	(52,055)
Discounted provision for deferred tax	<b>40,579</b>	39,520
Deferred tax asset on pension liability (see note 23)	<b>(7,515)</b>	(12,730)
Provision at the end of the year including deferred tax on pension liability	<b>33,064</b>	26,790

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### Deferred tax asset relating to pension liability

	2011 £000	2010 £000
At 1 April 2010	12,730	3,539
Deferred tax (credit)/charge to the profit and loss account	(343)	1,176
Deferred tax (credit)/charge to the statement of total recognised gains and losses:		
- on actuarial (loss)/gain	(4,872)	8,015
At 31 March 2011	7,515	12,730

The deferred tax asset of £7,515,000 (2010: £12,730,000) 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 include £0.5m covering the risk of remedy to the buyer of St George's Hill land due to an encroachment issue and £0.4m for the charitable trust.

## 18 Share capital

	2011 £000	2010 £000
<b>Allotted, called up and fully paid share capital</b>		
Ordinary shared of £0.10 each	26,506	26,506

During the prior 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.

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 19 Reserves

	Revaluation reserve £'000	Share premium account £000	Capital redemption reserve £000	Profit and loss account £000	Total £000
At 1 April 2010	128,741	-	-	193,634	322,375
Actuarial gain recognised in the pension scheme	-	-	-	13,675	13,675
Realisation of property revaluation gains of previous years	(1,780)	-	-	1,780	-
Deferred tax arising thereon	-	-	-	(4,872)	(4,872)
Profit for the financial year	-	-	-	21,252	21,252
Dividends paid	-	-	-	(34,882)	(34,882)
At 31 March 2011	<b>126,961</b>	-	-	<b>190,588</b>	<b>317,549</b>

### 20 Reconciliation of movements in shareholders' funds

	2011 £000	2010 £000
Profit for the financial year	<b>21,252</b>	28,059
Surplus on revaluation of tangible fixed assets	-	380,571
Issue of bonus shares	-	(251,830)
Other recognised gains/(losses) in year (shown in STRGL)	<b>13,675</b>	(28,623)
Tax arising thereon	<b>(4,872)</b>	8,014
Total gains recognised for the year	<b>30,055</b>	136,191
Dividend paid	<b>(34,882)</b>	(190,733)
Capital reduction	-	238,551
Movement in called up and fully paid share capital	-	13,278
Net addition to shareholders' funds	<b>(4,827)</b>	197,288
Opening equity shareholders' funds	<b>348,881</b>	151,593
Closing equity shareholders' funds	<b>344,055</b>	348,881

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (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 £18,298,998 (2010: £14,329,000).

### 22 Commitments under finance and operating leases

	2011 £000	2010 £000
<b>Maturity of debt:</b>		
Finance leases		
In one year or less, or on demand	1,484	1,384
In more than one year but not more than two years	1,591	1,484
In more than two years but not more than five years	-	1,591
In more than five years	-	-
Net obligations due	<b>3,075</b>	4,459
	2011 £000	2010 £000
Financing of assets operated by third parties		
In one year or less, or on demand	1,318	1,220
In more than one year but not more than two years	819	1,285
In more than two years but not more than five years	2,548	2,391
In more than five years	12,222	12,867
Net obligations due	<b>16,907</b>	17,763

### Operating leases

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

	2011 Land and buildings £000	2011 Other £000	2010 Land and buildings £000	2010 Other £000
Operating leases which expire				
Within one year	-	98	-	75
In two to five years	-	863	-	885
After five years	1,547	-	1,547	-
	<b>1,547</b>	<b>961</b>	1,547	960

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### 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 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%. A valuation as at 31 December 2010 will be available by the end of 2011.

Contributions to the plan over the year ended 31 March 2011 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 (2010: £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.

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%. A valuation as at 31 December 2010 will be available by the end of 2011.

Contributions to the Veolia UK Pension Plan over the period ended 31 March 2011 were paid by members in accordance with the rules of the plan and by the company at 37.8% of the pensionable salary.

The contributions expected to be paid in the year from the balance sheet date are £2.4m (2010: £2.8m).

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### Non Executive Directors Pension Plan

A provision of £720,000 (2010: £751,000) was recognised at year end in respect of unfunded pension obligations to former employees and non executive directors of the company.

### Transfer between divisional schemes

On 1 October 2009 and 1 January 2010, 68 employees transferred employment from Veolia Water Central Limited to Veolia Water Shared Services Limited (42 and 26 employees for phases 1b and 1c respectively). 11 and 31 of these employees respectively are members of the final salary divisions of the VWSCPP and VUKPP schemes. The transferring members' benefits for service accrued from the date of transfer are provided by the corresponding Veolia Water UK Plc divisions of the VWSP and VUKPP plans.

All 42 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 on 31 May 2010. The transfers resulted in settlement credits of £0.1m and £0.3m 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 plan, the following financial assumptions have been used:

	2011	2010	2009
Discount rate	<b>5.5% pa</b>	5.65% pa	7.1% pa
Salary growth	<b>4.9% pa</b>	5.05% pa	4.7% pa
RPI	<b>3.4% pa</b>	3.55% pa	3.2% pa
CPI*	<b>2.9% pa</b>	-	-
VWSCPP pension-in payment increases	<b>2.9% pa</b>	3.55% pa	3.2% pa
VUKPP pension-in payment increases	<b>3.4% pa</b>	3.55% pa	3.2% pa
VWSCPP – Life expectancy for a male pensioner age 65 (yrs)	<b>22.8</b>	21.8	21.8
VWSCPP – Life expectancy for a male non-pensioner age 65 (yrs)	<b>25.8</b>	24.9	24.9
VUKPP – Life expectancy for a male pensioner age 65 (yrs)	<b>23.0</b>	22.6	22.6
VUKPP – Life expectancy for a male non-pensioner age 65 (yrs)	<b>26.7</b>	25.8	25.8

\*The impact of statutory increases is now being linked to the movement in CPI rather than RPI based on legal advice received by the Trustees for, as follows:

- VWSCPP – the change applies to deferred revaluation and pension increases in payment
- VUKPP – the change applies to deferred revaluation only

Deferred pensions are revalued to retirement age in line with the CPI assumption of 2.9% per annum 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 2011 was £4.2m (2010: £2.6m).

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

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

	VWSCPP at 31 March 2011		VUKPP at 31 March 2011		VWSCPP at 31 March 2010		VUKPP at 31 March 2010	
	Value £m	Long term rate of return expected (% pa)	Value £m	Long term rate of return expected (% pa)	Value £m	Long term rate of return expected (% pa)	Value £m	Long term rate of return expected (% pa)
Equities	<b>79.7</b>	<b>7.85</b>	<b>11.0</b>	<b>7.85</b>	83.9	8.0	10.4	8.0
Bonds	<b>59.8</b>	<b>5.55</b>	<b>3.7</b>	<b>5.55</b>	60.0	5.5	3.4	5.5
Gilts/ cash	<b>59.8</b>	<b>4.35</b>	<b>3.7</b>	<b>4.35</b>	<u>56.0</u>	4.5	<u>3.4</u>	4.5
Fair value of assets	<b><u>199.3</u></b>		<b><u>18.4</u></b>		<u>199.9</u>		<u>17.2</u>	

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

	Year ended 31 March 2011	Year ended 31 March 2010	Year ended 31 March 2009	15 months to 31 March 2008	Year ended 31 December 2006
Defined benefit obligation (£m)	<b>222.6</b>	237.6	182.1	214.6	206.7
Plan assets (£m)	<b>199.3</b>	199.9	172.2	193.7	201.1
Surplus/(deficit) (£m)	<b>(23.3)</b>	(37.7)	(9.9)	(20.9)	(5.6)
Difference between expected and actual return on plan assets:					
Percentage of plan assets	<b>1%</b>	17%	(20%)	(8%)	1%
Experience gains/(losses) on plan liabilities:					
Percentage of plan liabilities	<b>0%</b>	0%	0%	0%	0%

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

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

	Year ended 31 March 2011	Year ended 31 March 2010	Year ended 31 March 2009	15 months to 31 March 2008	Year ended 31 December 2006
Defined benefit obligation (£m)	<b>23.2</b>	24.2	14.2	17.7	15.9
Plan assets (£m)	<b>18.4</b>	17.2	12.2	13.9	12.1
(Deficit)/surplus (£m)	<b>(4.8)</b>	(7.0)	(2.0)	(3.8)	(3.8)
Difference between expected and actual return on plan assets:					
Percentage of plan assets	<b>(2%)</b>	24%	(41%)	(7%)	5%
Experience gains/(losses) on plan liabilities:					
Percentage of plan liabilities	<b>0%</b>	0%	4%	0%	(2%)

Reconciliation of present value of scheme liabilities:

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
<b>At 1 April 2009</b>	182,118	14,211	691	197,020
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 by scheme participants	571	279	-	850
<b>At 31 March 2010</b>	237,613	24,245	751	262,609
Current service cost	2,474	1,345	-	3,819
Interest cost	12,975	1,270	40	14,285
Settlement	(5,210)	(2,887)	-	(8,097)
Actuarial loss	(15,373)	(606)	21	(15,958)
Benefits paid	(10,359)	(345)	(92)	(10,796)
Contributions by scheme participants	525	233	-	758
<b>At 31 March 2011</b>	<b>222,645</b>	<b>23,255</b>	<b>720</b>	<b>246,620</b>



# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

### Reconciliation of fair value of scheme assets

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
At 1 April 2009	172,165	12,215	-	184,380
Contributions paid by employer	1,471	2,837	-	4,308
Contributions by scheme participants	571	279	-	850
Expected return on scheme assets	9,690	813	-	10,503
Settlement	(8,114)	(2,863)	-	(10,977)
Actuarial gain	34,727	4,047	-	38,774
Benefits paid	(10,573)	(118)	-	(10,691)
At 31 March 2010	199,937	17,210	-	217,147
Contributions paid by employer	5,742	2,484	-	8,226
Contributions by scheme participants	525	233	-	758
Expected return on scheme assets	11,206	1,101	-	12,307
Settlement	(5,117)	(2,617)	-	(7,734)
Actuarial gain/(loss)	(2,646)	362	-	(2,284)
Benefits paid	(10,359)	(345)	-	(10,704)
<b>At 31 March 2011</b>	<b>199,288</b>	<b>18,428</b>	<b>-</b>	<b>217,716</b>
Pension liability before deferred tax	37,676	7,035	750	45,461
Related deferred tax	(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>
Pension liability before deferred tax	23,357	4,827	720	28,904
Related deferred tax	(6,073)	(1,255)	(187)	(7,515)
<b>Net pension liability at 31 March 2011</b>	<b>17,284</b>	<b>3,572</b>	<b>533</b>	<b>21,389</b>

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 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
Total charge	6,686	1,868	46	8,600
<b>For year ended 31 March 2011</b>				
Current service cost	2,474	1,345	-	3,819
Expected return on scheme assets	(11,206)	(1,101)	-	(12,307)
Interest on pension scheme liabilities	12,975	1,270	40	14,285
Net settlement credit	(93)	(270)	-	(363)
<b>Total charge</b>	<b>4,150</b>	<b>1,244</b>	<b>40</b>	<b>5,434</b>

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

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

	VWSCPP £000	VUKPP £000	NED PP £000	Total £000
<b>For year ended 31 March 2010</b>				
Actuarial gains/(losses) on scheme assets	34,727	4,047	-	38,774
Actuarial gains/(losses) on scheme liabilities	(57,235)	(10,055)	(106)	(67,396)
Total charge	(22,508)	(6,008)	(106)	(28,622)
Deferred tax arising thereon	6,302	1,682	30	8,014
Charge after deferred tax	(16,206)	(4,326)	(76)	(20,608)
<b>For year ended 31 March 2011</b>				
Actuarial gains/(losses) on scheme assets	(2,646)	362	-	(2,284)
Actuarial gains/(losses) on scheme liabilities	15,373	606	(21)	15,958
Total credit/(charge)	12,727	968	(21)	13,675
Deferred tax arising thereon	(4,532)	(345)	5	(4,872)
<b>Credit/(charge) after deferred tax</b>	<b>8,195</b>	<b>623</b>	<b>(16)</b>	<b>8,803</b>

## 24 Ultimate parent company, controlling party 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 in paragraph 3(c) of FRS 8: Related Party Transactions not to disclose transactions with other group companies which meet the criteria that all subsidiary undertakings which are party to the transactions are wholly owned by the ultimate controlling parent.

Copies of the group financial statements of Veolia Water UK PLC may be obtained from the Company Secretary, Veolia Water UK PLC, Fifth 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.

## 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 period 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.

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

The Company finances its operations through a mixture of retained profits, bank borrowings and borrowings from the subsidiary 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 short-term borrowings from the immediate parent company.

Further disclosures are included in notes 16 and 22.

### Financial assets: excluding debtors within one year

The company has nil (2010: £2.3m) held on deposit with its parent company.

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

The company has a £32.0m (2010: £45.0m) loan from its parent company.

The company has an overdraft of £0.3m (2010: Nil) from its parent company

The interest rate profile of the company's financial liabilities excluding non-debt current liabilities and deferred credits at 31 March 2011 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
<b>31 March 2011</b>	<b>456,106</b>	<b>210,593</b>	<b>245,513</b>	<b>-</b>
31 March 2010	464,975	205,737	259,238	-

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 2.73%.

As at	Weighted average interest rate %	Fixed rate financial liabilities	
		Weighted average period for which rate is fixed*	Weighted average period until maturity
		Years	Years
<b>31 March 2011</b>			
- Loan from subsidiary	<b>6.0</b>	<b>15</b>	<b>15</b>
- Loan from parent	<b>1.0</b>	<b>0.1</b>	<b>0.1</b>
- Other	<b>5.5</b>	<b>14</b>	<b>14</b>
<b>31 March 2010</b>			
- Loan from subsidiary	6.0	16	16
- Loan from parent	0.9	0.1	0.1
- Other	7.2	9	9

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

# Veolia Water Central Limited

## Notes to the financial statements for the year ended 31 March 2011 (continued)

The maturity profile for the company's financial liabilities at 31 March 2011 was as follows:

	2011 £000	2010 £000
In one year or less or on demand (bank overdrafts and obligations under finance leases)	34,802	47,604
In more than one year but not more than two years	2,410	2,769
In more than two years but not more than five years	2,548	3,982
In more than five years	416,346	410,620
	<b>456,106</b>	<b>464,975</b>

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.

The company has various undrawn committed borrowing facilities. The facilities available at 31 March 2011 in respect of which all conditions precedent had been met were as follows:

	2011 £000	2010 £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 confirmed its intention to continue to support the company.

The Company has taken advantage of the exemption of FRS 29 *Financial Instruments: Disclosures* and has not disclosed information required by that standard, as the Group's consolidated financial statements, in which the Company is included, provide equivalent disclosures.

### 26 Post balance sheet events

No significant post balance sheet event has taken place. However, the premises formerly occupied by Veolia Water Central in Bushey, Hertfordshire is held for sale and completion of this sale is anticipated on 30 June 2011. The selling price will be £9.9m.

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# Veolia Water Central Limited

## Financial Statistics for the year ended 31 March 2011

Profit and Loss accounts	Year ended 31 March 2011 £000	Year ended 31 March 2010 £000	Year ended 31 March 2009 £000	15 months to 31 March 2008 £000	Restated Year ended 31 December 2006 £000
<b>Turnover</b>	<b>239,647</b>	234,373	228,912	274,817	211,244
Net operating profit	<b>53,103</b>	42,583	59,964	77,455	55,759
Profit before taxation	<b>30,407</b>	34,004	45,001	66,018	45,010
<b>Retained profit/(loss) for period</b>	<b>(13,630)</b>	(162,675)	(15,838)	20,823	(1,264)
Profit and Loss account at 1 April/1 January	<b>193,634</b>	81,643	92,394	84,862	85,172
Transfer (from)/to reserves	<b>(3,046)</b>	111,991	(10,751)	7,532	(310)
<b>Profit and Loss account at 31 March/Dec</b>	<b>190,588</b>	193,634	81,643	92,394	84,862
<b>Basic and diluted earnings per share</b>	<b>161.0p</b>	212.0p	184.0p	419.3p	229.7p

Balance Sheets	31 March 2011 £000	31 March 2010 £000	31 March 2009 £000	31 March 2008 £000	Restated 31 December 2006 £000
<b>Fixed assets</b>	<b>920,575</b>	931,555	555,095	537,648	489,468
<b>Current assets</b>					
Stocks and work in progress	<b>851</b>	596	611	552	432
Debtors	<b>54,042</b>	55,253	49,897	48,982	60,602
Cash in bank and at hand	<b>1,439</b>	1,154	831	2,260	1,074
	<b>56,332</b>	57,003	51,339	51,794	62,108
<b>Creditors - amounts falling due within one year</b>					
Other creditors	<b>(143,486)</b>	(144,139)	(181,189)	(148,338)	(118,541)
<b>Net current liabilities</b>	<b>(87,154)</b>	(87,136)	(129,850)	(96,544)	(56,433)
<b>Total assets less current liabilities</b>	<b>833,421</b>	844,419	425,245	441,104	433,035
<b>Creditors - amounts falling due after more than one year</b>	<b>(489,366)</b>	(495,538)	(273,652)	(278,760)	(278,223)
<b>Net assets</b>	<b>344,055</b>	348,881	151,593	162,344	154,812
<b>Capital and reserves</b>					
Called up share capital	<b>26,506</b>	26,506	13,228	13,228	13,228
Profit and Loss account	<b>190,588</b>	193,634	81,643	92,394	84,862
Share Premium	-	-	51,222	51,222	51,222
Other Reserves	<b>126,961</b>	128,741	-	-	-
Capital redemption reserve	-	-	5,500	5,500	5,500
	<b>344,055</b>	348,881	151,593	162,344	154,812

**VEOLIA WATER CENTRAL LIMITED**

REGULATORY FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

# Veolia Water Central Limited

## Operating and Financial Review

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 2011 for the total business as disclosed on pages 70 to 73.

### Mission

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

### Business objectives

We want our Company to be the best water company in the industry, being a sustainable top quartile performer from 2013 and a showcase of excellence. We believe that succeeding this ambition will be beneficial to our customers, other stakeholders and Veolia Water UK.

Underpinning our vision, we have six goals. These are:

#### Customers & Understanding

Deliver an exceptional water service to our customers in their local communities. Understand the needs of our customers and the community and fulfil their expectations so that our customers only contact us to seek our help and advice, buy additional services or notify us of a change in their circumstances

#### Technology & Creativity

Develop our technological and innovative capabilities so that we can confidently deploy our creative ideas where:

- a) the potential of our people can be released
- b) we improve the lives of those in the community we serve and
- c) we create efficiencies and new sources of profitable revenue

#### Failure & Feedback

Develop an environment where every member of the team can contribute and identify feedback that helps us all understand, learn and take action to improve the team and the organisation

#### Measure & Improve

Design and employ consistent reporting systems which provide meaningful information concerning the current and predictive performance of our business in order that we maintain appropriate records and make timely decisions

#### People & Potential

Ensure a safe and healthy team-based environment which allows our teams to improve their capabilities and our people the opportunity to make the most of their potential

#### Design & Process

Design the company around the high level business processes and the needs of our customers; building agility, flexibility, teamwork and the opportunity to learn and improve

To measure performance in achieving this vision, we have established key performance targets. Achievement of these targets, per quarter, results in a bonus at the end of the year for all staff. In calendar year 2010 we measured five key targets and in 2011 we have introduced three new targets. Our ultimate aim is to achieve improved performance in:-

- Health and safety
- Water quality
- Unplanned interruptions to supply
- Written complaints
- Leakage
- Unwanted contact
- Customer experience
- Profitability

# **Veolia Water Central Limited**

## **Operating and Financial Review (continued)**

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 (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:

- 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. We train our staff and urge them continually to work safely. Following a comprehensive review of our health and safety performance we have changed 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.

The health and safety of the public who may be affected by our operations is of equal importance. In addition to training we continually remind our staff of the need to work safely within the community. We also work closely with the police, local authorities, crime prevention groups and the media to tackle the nuisance caused by bogus callers.



# **Veolia Water Central Limited**

## **Operating and Financial Review (continued)**

We continued the programme of increasing awareness for all of safety issues. The number of reportable incidents (RIDDORs) fell to 7 in 2010/11 (9 in 2009/10); the number of near misses reported increased by 30%. The number of days lost to sickness, accident and ill health fell to 6,383 days (7,506 in 2010). We continue 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. During the year our staff received training in technical, managerial and health and safety skills and awareness. We carried out 909 training events at a cost of £383k. This focused training helps to ensure that staff are competent and motivated towards meeting company objectives.

For the second year in succession all employees received a bonus for achieving company targets. We continue to operate a flexible working scheme, Workwise, which aims to meet the changing demands of our employees.

As a responsible business the company is committed to managing its impact on the environment. 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 improvements in fuel consumption.

The Education Service has communicated water efficiency and wider sustainability messages to over 170,000 adults and schoolchildren since it was founded in 1998. It welcomes in the region of 200 schools to its classroom and outdoor facilities at Bushey each year, while the outreach scheme sees Education Service teaching staff visiting schools in the company's supply area. The educational activities help to raise awareness of the environment and the need to save water in children from four years of age.

As a responsible local business which cares about the communities it serves as well as the surrounding environment, we support environmental projects and voluntary and charitable organisations within our community. We know that donations both large and small can make a real and lasting difference to the organisations that receive them.

The company set up a Community Investment Fund of £30k in 2010 and invited applications for funding from organisations within our supply area which support projects in the areas of child welfare and education, social inclusion, support for the natural environment, and improving the quality of life for the disadvantaged. Nearly 40 charities received a grant, some receiving a maximum of £2,500 to help their cause. For 2011 we have increased the fund to £50k.

A monthly 'Time to Give Friday' is another way that staff collect money for local charities. In 2010, 12 charities received a total of £10,225.

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.

The company donated £545,000 at the end of March 2009 to establish an independent charity, Veolia Water Trust (formerly Three Valleys Water Trust). This body seeks to assist customers whom it deems to need help with their water debts. The company made a further contribution of £550,000 to the Trust in 2010/11 and is committed to donate a total of £2.5m in the five years to March 2014.

### **Risk and Uncertainty**

The company has a formal and continuous process for identifying, evaluating and managing the key risks faced. Risks are reviewed and discussed at the Executive Management Committee (EMC). A key aim is to foster a culture in which staff throughout the business manage all risks appropriately integrated with the day to day operations.

# Veolia Water Central Limited

## Operating and Financial Review (continued)

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

- risks associated with change and more specifically impact on people, from restructuring.
- ability to meet the leakage target
- whether the efficiency target 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 8,144 meters taking the proportion for domestic metered supplies to 40.8%
- We renewed 145km (1%) of mains network in the first year of the AMP period
- We reduced customer telephone contact by 5.5%
- Written contact reduced by 6.2% to 248,888
- We maintained high quality drinking water, the test pass rate being 99.98%.
- We beat our leakage target, achieving leakage of 181.5MI/d against a target of 185.0 MI/d
- Written complaints reduced by 36% and unwanted telephone contact by 20%.
- The number of metered customer who received a bill based on an actual meter reading was 99.6%.
- 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.

### 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*

	2007/08	2008/09	2009/10	2010/11
Ofwat overall performance assessment (OPA)				
OPA score (out of 288)	279	283	285	N/A
Ranking (out of 21 companies)	6	8	4	N/A

This measure was calculated by Ofwat for the water industry and the results published each autumn. It measured the company's quality of overall service provided to customers and the results were taken into account when setting prices. The OPA for the five years 2004/05 to 2008/09 was reflected in the 2009 price review. 2010 was the last time Ofwat published OPA. The OPA sought to assess a broad range of services provided to customers.

# Veolia Water Central Limited

## Operating and Financial Review (continued)

The key areas were:

- water supply (water pressure, interruptions to supply, and drinking water quality)
- Security of supply (leakage, hosepipe bans and security of supply index)
- 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 ( 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 is evaluating our business through the Service Incentive Mechanism (SIM). This is a change from the previous mechanism which was 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 are measured in terms of lines busy/abandoned calls, unwanted telephone contacts, written complaints, escalated written complaints and complaints investigated by Consumer Council for Water (CCW). It is worth noting, that again this year we have managed to resolve all customer complaints with no referrals to the CCW for adjudication. In addition, a qualitative survey is carried out each quarter to measure our customers' satisfaction of contacts that we have resolved. As tracked by the survey over the full year, Veolia Water Central appeared 9<sup>th</sup> overall in the national league table. Good progress was made on the quantitative measures with an annual score of 198 compared to a company target of 220 (beating target by 10%).

Our focus upon continuous improvement to the customer experience positions us well for 2011-12, as SIM is fully deployed throughout the industry with financial rewards and penalties.

### Leakage

	2007/08	2008/09	2009/10	2010/11
Leakage levels relative to the annual target (target shown in brackets) [new target]	145 (145)	142 (145)	143 (145)	182 [185]

Our new annual leakage target for AMP5 was set by Ofwat as part of the periodic review process in 2009 and the increase reflects a change in the way we assess leakage. The level of leakage reported by the company is calculated in accordance with Ofwat's guidelines and is reviewed by Ofwat's reporter.

Having narrowly missed our leakage target for year 2009/10 following three successful years of achieving the target it was important that the target for 2010/11 was achieved. We encountered our third consecutive severe winter with December having the coldest average temperatures since 1910 giving rise to a leakage breakout higher than previously experienced. A winter plan was already in force but we increased our efforts substantially to arrest this breakout of leakage and bring us back to target. Our actions enabled us to achieve the target and in doing so record the lowest end of reporting year leakage figure by a considerable margin.

### Water Quality

	2007/08	2008/09	2009/10	2010/11
Deliver water that meets quality standards (Operational Performance Index) (%)	99.94	99.94	99.98	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

# Veolia Water Central Limited

## Operating and Financial Review (continued)

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 2010/11 was to score at least 99.96% for the OPI; the actual performance was 99.98%.

### *Pollution*

	2007/08	2008/09	2009/10	2010/11
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*

	2007/08	2008/09	2009/10	2010/11
Number of meters installed	30,351	28,247	18,838	8,144

This measure reports the number of meters installed in the year under the optional metering scheme. 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.

### *Regulatory Obligations - serviceability*

	2007/08	2008/09	2009/10	2010/11
Serviceability - infrastructure	Marginal	Marginal	Marginal	*
non-infrastructure	Stable	Marginal	Marginal	*
* 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 who 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*

	2007/08	2008/09	2009/10	2010/11
Length of main renewed (km)	155	135	93	145

Ofwat require us to have a "stable" infrastructure and to thereby improve on the current "marginal" assessment. The lead indicator is bursts and the company assumption, as confirmed in the Final Determination, to achieve stability, is to renew 655km of mains during AMP5 (131km/yr). We renewed 145km, the increased length making up for a shortfall in renewal for AMP4. The burst rate for 2010/11 fell for the second consecutive year despite the coldest December since 1910.

# Veolia Water Central Limited

## Operating and Financial Review (continued)

### *Improve our Reputation*

	2007/08	2008/09	2009/10	2010/11
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 2010/11 we were not convicted of any offences.

During the year we secured two convictions for offences committed by third parties that compromised the quality of water supplied to our customers.

### *Health and safety*

	2007/08	2008/09	2009/10	2010/11
RIDDOR incidents - rate per 1000 employees	9.71	6.62	9.59	9.52

During 2010/11 there was a small decrease in the number of RIDDOR reportable accidents. The majority of these accidents were caused by employees slipping, tripping or falling. This type of accident was the focus of the annual Veolia Water safety week in 2010 which included a poster and flyer campaign, an awareness road show and a DVD presentation featuring an employee who sustained serious injuries as a result of a trip and fall accident. The number of slip, trip and fall accidents has reduced following this intervention. Health and safety performance, including a discussion of every accident reported, is reviewed at the monthly Executive Management Committee. The company is committed to the aim of causing no harm by its activities and this remains a key performance target.

### *Customer satisfaction*

	2007/08	2008/09	2009/10	2010/11
Customer satisfaction survey (1-5, the higher the score the better)	4.5	4.6	4.6	4.3

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.

## 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.

	2007/08	2008/09	2009/10	2010/11
Return on capital (%)	7.3	6.1	7.0	*
* 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).

# Veolia Water Central Limited

## Operating and Financial Review (continued)

	2007/08	2008/09	2009/10	2010/11
Cost of operations and capital maintenance per property billed (£)	140	145	153	164

\* 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 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.

### Turnover

Our turnover increased in the year by £6.0m from £235.3m to £241.3m. This increase can be analysed as follows:

	2007/08 £m	2008/09 £m	2009/10 £m	2010/11 £m
Prior year	212.8	224.3	230.0	235.3
Effect of RPI + 'k' (a)	10.2	8.1	8.0	3.9
Higher/(lower) customer demand (b)	(0.5)	(1.0)	(0.9)	2.2
New connections (c)	1.2	0.9	0.9	1.5
Other (d)	0.6	(2.3)	(2.7)	(1.6)
Current year	<u>224.3</u>	<u>230.0</u>	<u>235.3</u>	<u>241.3</u>

- (a) Increase in RPI + 'k' is driven by RPI increases of 0.3% (2009/10: 3.0%) and 'k' of 1.4% (2009/10: 0.4%).
- (b) We experienced an increase in measured consumption due mainly to the dry weather conditions seen in the earlier part of the year.
- (c) We had 8,106 new domestic properties this year generating an additional £1.5m 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 2010/11 arising from investigations around specific customers.

For the current 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.

# Veolia Water Central Limited

## Operating and Financial Review (continued)

### Financial Performance (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 £2.6m during the year.

	2007/08	2008/09	2009/10	2010/11
	£m	£m	£m	£m
Prior year	105.4	111.4	116.2	119.0
Energy (a)	0.7	0.9	3.4	(3.5)
Bulk Import	(1.2)	0.1	0.3	-
Network Repair (b)	1.5	(0.7)	(1.5)	0.4
Bad debts (c)	2.5	0.3	(3.3)	(0.2)
Customer Service	1.2	0.1	1.0	-
Insurance (d)	-	(0.5)	1.3	0.7
'Atypical' (e)	0.8	0.9	1.1	4.7
Other (f)	0.5	3.7	0.5	4.7
	<u>111.4</u>	<u>116.2</u>	<u>119.0</u>	<u>125.8</u>
Current year	<u>111.4</u>	<u>116.2</u>	<u>119.0</u>	<u>125.8</u>

a) Lower energy costs of £3.5m compared to the previous year benefiting from a significantly lower market price. The market price has since risen and is above the determination price

b) Higher traffic management costs of £0.4m following the reintroduced permit scheme.

c) Improvement in cash collection rate resulting in a lower charge of £0.2m. Bad debts have slightly improved despite a challenging economic environment.

d) The increase in insurance costs of £0.7m as a result of higher premiums and a rise in the uninsured losses.

e) The movement on 'Atypical' costs between 2009/10 and 2010/11 predominantly relates to the income due to the conclusion of the River Ver and Bromate dispute, offset by the leakage initiative during the last quarter of 2010/11. Further costs were incurred relating to a provision for the major bursts in Barnet and Caddington to cover claimed from National Grid, a company restructuring and rebuilding of a customer's property due to multiple burst mains.

f) Other costs include; £2.6m higher human resources and information technology costs, reflecting a decision to invest more in the training and development of our people, and inflationary pressures to operate our IT infrastructure, Increase in Local Authority Rates of £0.7m and other increases of £1.4m.

#### Depreciation and Infrastructure Renewals Charge

The infrastructure renewals charge increased by £2.0m in the year to £40.5m reflecting the higher current and planned volumes of work on the network.

Historic depreciation was £13.8m lower than 2009/10.



# **Veolia Water Central Limited**

## **Operating and Financial Review (continued)**

### **Financial Performance (continued)**

#### **Profit Before Tax**

The losses on disposal of fixed assets in the year to March 2011 were £1.0m, compared with a profit of £10.7m in 2009/10. This contributed to an overall fall in profit before tax of £3.6m for the total business.

The company's financing costs have increased by £2.5m over last years levels despite a reduction of £0.9m in pension financing. This overall increase was driven by interest costs for a loan which was taken out in October of 2009 and therefore a full years interest charge was not incurred in 2009/10.

#### **Debtors**

Trade debtors increased by £2.0m in the year reflecting higher tariffs due to RPI and the 'k' factor. The accrual for unbilled measured consumption rose from £26.2m to £27.4m reflecting the increased number of metered customers and higher tariffs. Bad debts have stabilised despite a continuingly challenging economic environment.

#### **Cash Flow**

Net cash inflow before financing for the total business for 2011 was £6.5m (2010/11: outflow £168.0m). The main driver for this swing in cash flows was the decrease in dividends paid in 2010/11 of £155.9m to £34.9m (£190.7m 2009/10). Other influencing factors include a decrease of £7.1m on disposal proceeds, a £10.8m reduction on purchase of fixed assets, an increase in cash flow from operating activities to £129.9m (£112.9m 2009/10). Net debt decreased to £455.0m (£461.6m 2009/10).

Net debt to RCV fell from 61% in 2010 to 58% in 2011 reflecting the continued balance sheet strength and credit quality of the company.

#### **Capital Expenditure**

Capital expenditure including infrastructure renewal expense decreased from £86.7m in 2010 to £72.6m in 2011. Expenditure on mains and other infrastructure assets was £32.8m. A total of 145km of mains were renewed in the year 2010/11.

#### **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, Veolia Water Central Finance PLC (formerly 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.



# Veolia Water Central Limited

## Operating and Financial Review (continued)

### Financial Performance (continued)

#### Capital Finance

The company, through its subsidiary Veolia Water Central Finance PLC (formerly Three Valleys Water Finance PLC), issued in 2004 a £200m 22 year bond with a coupon of 5.875%.

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 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.

A £100m revolving credit facility is also available. Our financial ratios demonstrate Veolia Water Central's good credit quality. The balance sheet remains strong, with debt at around 58% of regulatory capital value.

#### 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 the company has paid the following dividends during the year ended 31 March 2011:

Ordinary dividends:	£000
Interim – paid June 2010	15,400
Interim – paid October 2010	19,482
	<hr/>
	34,882
	<hr/>

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

# **Veolia Water Central Limited**

## **Operating and Financial Review (continued)**

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

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 29 June 2011, the directors of Veolia Water Central Limited ("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  
29 June 2011

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

In addition to their responsibilities to prepare financial statements in accordance with Companies Act 1985, 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 1985 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**

We have audited the Regulatory Accounts of Veolia Water Central Limited for the year ended 31 March 2011 on pages 70 to 90 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.

These Regulatory Accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the Statement of Accounting Policies.

This report is made, on terms that have been agreed, solely to the Company and 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 and sewerage undertaker under the Water Industry Act 1991. 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 Condition F 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.

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

As explained more fully in the Statement of Directors' Responsibilities set out on page 67, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## **Scope of the audit of the Regulatory Accounts**

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts sufficient to give reasonable assurance that the Regulatory Accounts 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 Regulatory Accounts. In addition, we read all the financial and non-financial information in the regulatory accounts to identify material inconsistencies with the audited Regulatory Accounts. If we become aware of any apparent misstatements or inconsistencies, we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, 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 International Standards on Auditing (UK & Ireland).

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

## **Opinion on Regulatory Accounts**

In our opinion, the Regulatory Accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 80 to 82, the state of the Company's affairs at 31 March 2011 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies.

## **Basis of preparation**

Without modifying our opinion, we draw attention to the fact that 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 and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 70 to 73 have been drawn up in accordance with Regulatory Accounting Guideline 3.06, in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 74.

## **Opinion on other matters prescribed by Condition F**

Under the terms of our contract, we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts.

## **Other matters**

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 such assessment.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2011 on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our 'statutory audit') was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 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 audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

*Ernst & Young LLP*

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

*1 July 2011*

# Veolia Water Central Limited

## Historical cost profit and loss account for the year ended 31 March 2011

	Note	Appointed £000	2011 Non-Appointed £000	Total £000	Appointed £000	2010 Non-Appointed £000	Total £000
<b>Turnover</b>	<b>2</b>	<b>241,349</b>	<b>-</b>	<b>241,349</b>	235,298	-	235,298
Operating costs		(164,476)	(1,523)	(165,999)	(155,612)	(1,516)	(157,128)
Historical Cost Depreciation		(30,189)	-	(30,189)	(44,035)	-	(44,035)
Operating income		(53)	-	(53)	11,447	-	11,447
Operating profit/(loss)		46,631	(1,523)	45,108	47,098	(1,516)	45,582
Other income		-	7,020	7,020	3	7,670	7,673
Interest		(21,716)	(5)	(21,721)	(19,246)	(5)	(19,251)
<b>Profit on ordinary activities before taxation</b>		<b>24,915</b>	<b>5,492</b>	<b>30,407</b>	27,855	6,149	34,004
Taxation		(6,216)	(1,538)	(7,754)	(7,539)	(1,722)	(9,261)
Current tax		(1,401)	-	(1,401)	3,316	-	3,316
Deferred tax							
<b>Profit for the financial year</b>		<b>17,298</b>	<b>3,954</b>	<b>21,252</b>	23,632	4,427	28,059
Dividends		(30,928)	(3,954)	(34,882)	(186,306)	(4,427)	(190,733)
<b>Loss transferred to reserves</b>		<b>(13,630)</b>	<b>-</b>	<b>(13,630)</b>	(162,674)	-	(162,674)

## Veolia Water Central Limited

### Historical cost statement of total recognised gains and losses for the year ended 31 March 2011

	2011 £000	2010 £000
Profit for the financial year	17,298	23,633
Actuarial gains/(losses) in the pension scheme	13,675	(28,622)
Deferred tax arising thereon	(4,872)	8,014
Other gains and losses	-	128,742
<b>Total gains recognised since last report</b>	<b>26,101</b>	<b>131,767</b>

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.

# Veolia Water Central Limited

## Historical cost balance sheet as at 31 March 2011

	Appointed £000	2011 Non- appointed £000	Total £000	Appointed £000	2010 Non- appointed £000	Total £000
<b>Fixed assets</b>						
Tangible assets	911,603	-	911,603	919,797	-	919,797
Investments	50	-	50	50	-	50
<b>Total fixed assets</b>	<b>911,653</b>	<b>-</b>	<b>911,653</b>	<b>919,847</b>	<b>-</b>	<b>919,847</b>
<b>Current assets</b>						
Stocks & work in progress	851	-	851	596	-	596
Debtors	53,421	621	54,042	52,187	798	52,985
Cash	-	5,774	5,774	-	7,817	7,817
Short term deposits	-	-	-	2,268	-	2,268
Infrastructure renewal prepayments	2,244	-	2,244	5,031	-	5,031
<b>Total current assets</b>	<b>56,516</b>	<b>6,395</b>	<b>62,911</b>	<b>60,082</b>	<b>8,615</b>	<b>68,697</b>
<b>Creditors – amounts falling due within one year</b>						
Overdrafts	(4,336)	-	(4,336)	(6,663)	-	(6,663)
Infrastructure renewals accrual	-	-	-	-	-	-
Creditors	(99,677)	(4,427)	(104,104)	(84,519)	(6,457)	(90,976)
Borrowings	(34,802)	-	(34,802)	(47,604)	-	(47,604)
Corporation tax payable	(2,612)	(1,968)	(4,580)	(3,402)	(2,158)	(5,560)
<b>Total Creditors</b>	<b>(141,427)</b>	<b>(6,395)</b>	<b>(147,822)</b>	<b>(142,188)</b>	<b>(8,615)</b>	<b>(150,803)</b>
<b>Net current liabilities</b>	<b>(84,911)</b>	<b>-</b>	<b>(84,911)</b>	<b>(82,106)</b>	<b>-</b>	<b>(82,106)</b>
<b>Total assets less current liabilities</b>	<b>826,742</b>	<b>-</b>	<b>826,742</b>	<b>837,741</b>	<b>-</b>	<b>837,741</b>
<b>Creditors - amounts falling due after more than one year</b>						
Borrowings	(421,304)	-	(421,304)	(417,372)	-	(417,372)
Other Creditors	-	-	-	-	-	-
<b>Total creditors</b>	<b>(421,304)</b>	<b>-</b>	<b>(421,304)</b>	<b>(417,372)</b>	<b>-</b>	<b>(417,372)</b>
<b>Provisions for liabilities and charges</b>						
Deferred tax	(40,579)	-	(40,579)	(39,520)	-	(39,520)
Deferred income	(4,019)	-	(4,019)	(4,349)	-	(4,349)
Post employment asset/(liabilities)	(21,389)	-	(21,389)	(32,732)	-	(32,732)
Other provisions	(2,074)	-	(2,074)	(1,564)	-	(1,564)
<b>Net Assets Employed</b>	<b>337,377</b>	<b>-</b>	<b>337,377</b>	<b>342,203</b>	<b>-</b>	<b>342,203</b>
<b>Capital and reserves</b>						
Called up share capital	26,506	-	26,506	26,506	-	26,506
Other Reserves	422,235	-	422,235	424,015	-	424,015
Profit and Loss account	(111,364)	-	(111,364)	(108,318)	-	(108,318)
<b>Equity shareholders' funds</b>	<b>337,377</b>	<b>-</b>	<b>337,377</b>	<b>342,243</b>	<b>-</b>	<b>342,243</b>



# **Veolia Water Central Limited**

## **Historical cost balance sheet as at 31 March 2011 (continued)**

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 £2.2m less (2010: £5.0m 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.

# Veolia Water Central Limited

## Reconciliation between statutory accounts and regulatory accounts as at 31 March 2011

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>			
<b>Operating Profit</b>	53.1	46.6	Statutory accounts include other operating income (£6.5m) but exclude loss on disposal of fixed assets (£1.0m)
<b>Profit before Tax</b>	30.4	24.9	Non appointed profit before tax is £5.5m
<b><u>Balance Sheet</u></b>			
<b>Tangible Fixed Assets (Net Book Value)</b>	913.8	911.6	In the statutory accounts the tangible fixed assets figure includes the infrastructure renewal prepayment. For regulatory accounting figures Ofwat requests this amount of £2.2m is not included
<b>Debtors</b>	54.0	54.0	
<b>Deferred Income - grants and contributions</b>	N/A	(4.0)	Amount relates to deferred credit for contributions to surface assets of £4.0m and has been classified within other creditors in the statutory accounts

# Veolia Water Central Limited

## Current cost profit and loss account for appointed business for the year ended 31 March 2011

	Note	2011 £000	2010 £000
<b>Turnover</b>	2	<b>241,349</b>	235,298
Current cost operating costs		<b>(206,722)</b>	(193,185)
Other operating (cost)/income	2	<b>(16,409)</b>	9,987
Working capital adjustment		<b>1,935</b>	1,759
<b>Current cost operating profit</b>	4	<b>20,153</b>	53,859
Other income		-	3
Net interest		<b>(21,716)</b>	(19,246)
Financing adjustment		<b>14,608</b>	14,438
<b>Current cost profit before taxation</b>		<b>13,045</b>	48,964
Taxation:			
Current tax		<b>(6,216)</b>	(7,539)
Deferred tax		<b>(1,401)</b>	3,316
<b>Current cost profit on ordinary activities</b>		<b>5,428</b>	44,741
<b>Current cost profit attributable to shareholders</b>		<b>5,428</b>	44,741
Dividends		<b>(30,928)</b>	(186,306)
<b>Current cost loss retained</b>	3	<b>(25,500)</b>	(141,565)

## Veolia Water Central Limited

### Current cost statement of total recognised gains and losses for the year ended 31 March 2011

	2011 £000	2010 £000
Profit for the financial year	5,428	44,741
Actuarial gain/(loss) recognised in the pension scheme	13,675	(28,623)
Deferred tax arising thereon	(4,872)	8,014
<b>Total gains recognised since last report</b>	<b>14,231</b>	<b>24,132</b>

# Veolia Water Central Limited

## Current cost balance sheet for appointed business as at 31 March 2011

	Note	2011 £000	2010 £000
<b>Fixed assets</b>			
Tangible assets	5	7,328,360	4,063,487
Third party contributions since 1989/90		(189,846)	(174,430)
Working capital	6	(46,649)	(31,171)
Short term deposits		-	2,268
Overdrafts		(4,336)	(6,663)
Infrastructure renewal prepayment		2,244	5,031
<b>Net operating assets</b>		<b>7,089,773</b>	<b>3,858,520</b>
<b>Non Operating Assets</b>			
Borrowings		(34,802)	(47,604)
Non-trade debtors		5,617	5,573
Non-trade creditors due within one year		(4,373)	(6,138)
Investment – other		50	50
Corporation tax payable		(2,612)	(3,402)
Total non operating assets and liabilities		(36,120)	(51,521)
<b>Creditors: amounts falling due after more than one year</b>			
Borrowings		(421,304)	(417,372)
Total creditors falling due after more than one year		(421,304)	(417,372)
<b>Provisions for liabilities and charges:</b>			
Deferred tax		(40,579)	(39,520)
Post employment liabilities		(21,389)	(32,732)
Other provisions		(2,074)	(1,564))
Total provisions		(64,042)	(73,816)
<b>Net assets employed</b>		<b>6,568,307</b>	<b>3,315,811</b>
<b>Capital and reserves</b>			
Called up share capital		26,506	26,506
Profit and loss reserve	3	(190,327)	(173,630)
Current cost reserve		6,688,683	3,419,491
Other reserves		43,445	43,444
<b>Total capital employed</b>		<b>6,568,307</b>	<b>3,315,811</b>

# Veolia Water Central Limited

## Current cost statement of cash flows for the year ended 31 March 2011

	Note	Appointed £000	2011 Non- appointed £000	Total £000	Appointed £000	2010 Non- appointed £000	Total £000
<b>Net cash inflow from operating activities</b>	a	<b>121,584</b>	<b>7,350</b>	<b>128,934</b>	107,491	4,639	112,130
<b>Returns on investments and servicing of finance</b>							
Interest received		126	-	126	1	-	1
Interest paid		(19,475)	(5)	(19,480)	(15,890)	(5)	(15,895)
Interest element of finance leases		(400)	-	(400)	(460)	-	(460)
Net cash outflow from returns on investments and servicing of finance		(19,749)	(5)	(19,754)	(16,349)	(5)	(16,354)
<b>Taxation</b>							
Corporation tax paid		(7,012)	(1,722)	(8,734)	(8,416)	(1,740)	(10,156)
Net cash outflow from taxation paid		(7,012)	(1,722)	(8,734)	(8,416)	(1,740)	(10,156)
<b>Capital expenditure and financial investment</b>							
Purchase of fixed assets		(34,153)	-	(34,153)	(45,155)	-	(45,155)
Capital contributions		6,575	-	6,575	6,589	-	6,589
Infrastructure renewals expenditure		(37,725)	-	(37,725)	(37,531)	-	(37,531)
Proceeds on disposal of fixed assets		6,286	-	6,286	13,204	-	13,204
Purchase of investment		-	-	-	-	-	-
Net cash taken over from investment		-	-	-	-	-	-
Net cash outflow from capital expenditure and financial investment		(59,017)	-	(59,017)	(62,893)	-	(62,893)
<b>Equity dividends paid</b>		<b>(30,928)</b>	<b>(3,954)</b>	<b>(34,882)</b>	(186,306)	(4,427)	(190,733)
Net cash inflow/(outflow) before financing and management of liquid resources		<b>4,878</b>	<b>1,669</b>	<b>6,547</b>	(166,473)	(1,533)	(168,006)
<b>Financing</b>							
Capital element of finance lease repaid		(1,384)	-	(1,384)	(1,290)	-	(1,290)
Loan from subsidiary		134	-	134	126	-	126
Loan from group undertaking		6,239	-	6,239	201,278	-	201,278
Loan from parent company		2,267	-	2,267	(34,500)	-	(34,500)
Deposit with parent company		(13,000)	-	(13,000)	2,023	-	2,023
Financing of assets operated by other parties		(856)	-	(856)	693	-	693
Decrease in other long term financial liabilities		(2)	-	(2)	(1)	-	(1)
Net cash (outflow)/inflow from financing		(6,602)	-	(6,602)	168,329	-	168,329
<b>(Decrease)/increase in cash</b>	b/c	<b>(1,724)</b>	<b>1,669</b>	<b>(55)</b>	1,856	(1,533)	323

# Veolia Water Central Limited

## Notes to the current cost statement of cash flows

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

	2011 £000	2010 £000
Current cost operating profit	20,153	53,859
Working capital adjustment	(1,935)	(1,759)
Movement in working capital	16,255	(12,438)
Receipt from other income	-	3
Current cost depreciation	41,917	37,244
Current cost loss/(profit) on sale of fixed assets	16,409	(9,987)
Infrastructure renewals charge	40,511	38,463
Other non-cash profit and loss Items	(11,726)	2,106
Net cash flow from operating activities	121,584	107,491

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

	2011 £000	2010 £000
(Decrease)/increase in cash in the period	(1,724)	1,856
Cash outflow/(inflow) from movement in debt and lease financing	6,602	(168,329)
Movement in net debt in the period	4,878	(166,473)
Net debt at the beginning of the period	(471,096)	(304,623)
Net debt at the end of the period	(466,218)	(471,096)

### c Analysis of net debt

	At 31 March 2010 £000	Cash Flow £000	Non Cash Flow £000	At 31 March 2011 £000
Net cash:				
Bank overdraft	(8,388)	(1,724)	-	(10,112)
	(8,388)	(1,724)	-	(10,112)
Debt:				
Bond issued by subsidiary	(196,441)	-	(134)	(196,575)
Deposit with parent company	2,267	(2,267)	-	-
Loan	(45,000)	13,000	-	(32,000)
Debentures	(34)	2	-	(32)
Finance leases	(4,459)	1,384	-	(3,075)
Financing of assets used by Veolia Water Central and operated by other parties	(17,763)	856	-	(16,907)
Loan from group undertaking	(201,278)	(6,239)	-	(207,517)
	(462,708)	6,736	(134)	(456,106)
Net debt	(471,096)	5,012	(134)	(466,218)

# **Veolia Water Central Limited**

## **Notes to the current cost financial information**

### **1 Statement of accounting policies**

#### **Basis of current cost accounting**

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

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.

Veolia Water Central classify unoccupied council/housing association properties as “occupied” if they are empty for less than 26 weeks for short term situations such as refurbishment or change of tenancy. These properties are billed in full and then a percentage is deducted from the amount owed in recognition that some properties will have been empty. Where properties are unoccupied for more than 26 weeks, the agreement with the council/housing association provides that the local authority will notify us so that the property can be formally recorded as “empty” on our billing system and, therefore, will not be billed.

The company no longer raise bills addressed to “The occupier” and these accounts are made void where there is no consumption. Our assumption is that these properties are not occupied. We make further enquiries and when we receive information that the property has become occupied the status of the account will be amended, the customer’s name applied to the account and billing will commence. Where enquiries give us reason to believe that the property is inhabited but we have been unable to obtain the customer’s name we then issue a bill in the name of the occupier.

In each of the above cases, if a bill is sent, we would recognise it within turnover.

#### **Acquisition of North Surrey Water Ltd**

On 1 October 2000 Veolia Water Central Limited 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 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 2008. The asset valuation arising from this exercise is included in this year’s accounts producing an adjustment of £2.9bn to the value of the current cost assets and is reflected in the AMP/SIR adjustment in note 7.

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.



# **Veolia Water Central Limited**

## **Notes to the current cost financial information (continued)**

### **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. 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 unchanged from last year, that is we maintain a level of gearing that ensures there is sufficient headroom to satisfy our borrowing covenants. The dividend depends upon the success of the company in generating cash flows in the reporting period. The policy distributes earnings equal to the amount necessary to maintain Net Debt to RCV at the targeted gearing ratio, and allows the company to have the flexibility to adjust the target gearing level from time to time as required.

### **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.

### **Directors Remuneration**

The salary of the managing director is currently set and paid by Veolia Water UK PLC and subsequently recharged to Veolia Water Central Limited, on a time proportional basis. The salary of the other executive directors was 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

# Veolia Water Central Limited

## Notes to the current cost financial information (continued)

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 2010 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
- **Attaining 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 were 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 = 50% of Maximum
- Achievement of five individual pre-set objectives = 25% of Maximum
- Achievement of Five Zeros throughout the year = 25% of Maximum

# Veolia Water Central Limited

## Notes to the current cost financial information (continued)

### 2 Analysis of turnover and operating income

	2011 £000	2010 £000
Turnover:		
Unmeasured	125,652	124,199
Measured	105,095	99,409
Large user and special agreement	8,092	8,650
Non-potable large user and special agreement	101	72
Rechargeable works	325	576
Bulk supplies	2,040	2,340
Other appointed business – third party	44	52
	<b>241,349</b>	<b>235,298</b>
Operating loss:		
Current cost (loss)/profit on disposal of fixed assets	<b>(16,409)</b>	9,987
Working capital adjustment	<b>1,935</b>	1,759

### 3 General reserve - current cost

	2011 £000
At 31 March 2010	<b>(173,630)</b>
Transfer from profit and loss account for appointed business	<b>(25,500)</b>
Statement of recognised gains and losses	<b>8,803</b>
At 31 March 2011	<b>(190,327)</b>

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

	2011 £000	2010 £000
Total historical cost operating profit	46,631	47,098
Current cost depreciation and amortisation of deferred credit	<b>(41,917)</b>	(37,741)
Historic cost deferred credit	<b>(329)</b>	(329)
Historical cost depreciation	30,189	44,036
Current cost adjustment on disposal of fixed assets	<b>(16,356)</b>	(1,460)
Working capital adjustment	1,935	1,759
Current cost operating profit	<b>20,153</b>	53,859

# Veolia Water Central Limited

## 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 2010	917,288	104,884	3,598,670	72,740	-	4,693,582
AMP/SIR adjustment	2,460,062	-	642,336	21,094	-	3,123,492
RPI adjustment	180,574	5,608	226,751	5,017	-	417,950
Additions	22,684	-	9,300	2,926	-	34,910
Disposals	(22,663)	-	-	(341)	-	(23,004)
<b>At 31 March 2011</b>	<b>3,557,945</b>	<b>110,492</b>	<b>4,477,057</b>	<b>101,436</b>	<b>-</b>	<b>8,246,930</b>
<b>Depreciation</b>						
At 1 April 2010	522,473	54,492	-	53,130	-	630,095
AMP/SIR adjustment	183,885	-	-	18,012	-	201,897
RPI adjustment	37,766	2,913	-	3,804	-	44,483
Disposals	-	-	-	(308)	-	(308)
Charge for the year	35,797	2,238	-	4,368	-	42,403
<b>At 31 March 2011</b>	<b>779,921</b>	<b>59,643</b>	<b>-</b>	<b>79,006</b>	<b>-</b>	<b>918,570</b>
<b>Net book value</b>						
<b>At 31 March 2011</b>	<b>2,778,024</b>	<b>50,849</b>	<b>4,477,057</b>	<b>22,430</b>	<b>-</b>	<b>7,328,360</b>
<b>At 31 March 2010</b>	<b>394,814</b>	<b>50,392</b>	<b>3,598,670</b>	<b>19,610</b>	<b>-</b>	<b>4,063,487</b>

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

### 6 Working capital

	2011 £000	2010 £000
Stocks	851	596
Trade debtors – measured household	3,089	1,770
– unmeasured household	6,255	4,645
– measured non-household	8,008	7,097
– unmeasured non-household	194	235
– other	538	2,379
Measured income accrual	27,423	26,182
Prepayments and other debtors	2,297	4,305
Trade creditors	(8,400)	(3,380)
Deferred income – customer advance receipts	(23,188)	(22,007)
Capital creditors	(22,157)	(22,934)
Accruals and other creditors	(41,559)	(30,060)
	<b>(46,649)</b>	<b>(31,171)</b>

# Veolia Water Central Limited

## Notes to the current cost financial information (continued)

### 7 Movement on current cost reserve

	2011 £000	2010 £000
Balance at 1 April	3,419,491	3,270,047
AMP/SIR adjustment	2,921,595	-
RPI adjustments:-		
Fixed assets	373,467	172,719
Working capital	(1,935)	(1,759)
Financing adjustment	(14,609)	(14,348)
Grants and third party contributions	(9,326)	(7,168)
Balance at 31 March 2011	<u>6,688,683</u>	<u>3,419,491</u>

### 8 Net Debt Analysis

	Fixed Rate	Floating rate	Total
Less than one year	33,318	1,484	34,802
Between one and two years	819	1,592	2,411
Between two and five years	2,548	-	2,548
Between five and twenty years	208,796	207,517	416,313
In more than twenty years	32	-	32
<b>Borrowings (excluding preference shares)</b>	<b>245,513</b>	<b>210,593</b>	<b>456,106</b>
Preference share capital			-
Total borrowings			<u>456,106</u>
Cash			10,112
Short term deposits			-
<b>Net Debt</b>			<u><u>466,218</u></u>

# Veolia Water Central Limited

## Notes to the current cost financial information (continued)

### 9 Regulatory capital value

	2011 £000
Opening RCV for the year	808,438
Capital expenditure	38,281
Infrastructure renewals expenditure	37,356
Infrastructure renewals charge	(40,981)
Grants and contributions	(1,884)
Depreciation	(41,941)
Out performance of regulatory assumptions (5 years in arrears)	(7,637)
Closing RCV carried forward	791,632
Average regulatory capital value	742,968

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 2011 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 2010/11 £'000
<b>Veolia Water UK PLC</b>	Management and technical support	5,084	No Market	4,225
<b>Veolia Water Shared Services Limited</b>	Support Services	25,846	No Market	20,828
<b>Veolia Environmental Services (UK) PLC</b>	Waste Water Disposal	801,946	Market Tested	122

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

# **Veolia Water Central Limited**

## **Notes to the current cost financial information (continued)**

### **11 Transactions with associated companies (continued)**

In the year 2004/05 Veolia Water Central Limited took out a loan of £200.0m through a wholly owned subsidiary, Veolia Water Central Finance PLC (formerly Three Valleys Water Finance PLC). These funds enabled all loans from Veolia Water Capital Funds Ltd at that time to be repaid.

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 2011 there was a £32.0m loan from Veolia Water Capital Funds Ltd and an overdraft balance with them of £0.3m.(2010: Nil).

All surplus funds are placed on overnight deposit with Veolia Water Capital Funds Ltd at rates linked to the market. On 31 March 2011 the overnight deposit was Nil.(2010: £2.3m).

# Veolia Water Central Limited

## 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	4,285	10,284	14,569
Power	12,871	2,313	15,184
Hired and contracted services	1,691	16,620	18,311
Associated companies	122	414	536
Materials and consumables	2,668	1,548	4,216
Service charges EA	4,596	-	4,596
Bulk supply imports and water supplied under statutory entitlement	1,594	-	1,594
Other direct costs	843	1,747	2,590
<i>Total direct costs</i>	28,670	32,926	61,596
General and support expenditure	6,301	11,133	17,434
<i>Functional expenditure</i>	34,971	44,059	79,030
Customer services	-	-	20,444
Scientific services	-	-	4,659
Other business activities	-	-	1,674
<i>Total business activities</i>	-	-	26,777
Local Authority rates	-	-	11,691
Doubtful debts	-	-	3,773
Exceptional items	-	-	-
<i>Total operating expenditure less third party services</i>	-	-	121,271
Third party services - operating expenditure	-	-	3,023
<i>Total operating expenditure</i>	-	-	124,294
<b>Capital maintenance</b>			
Infrastructure renewals charge	-	40,511	40,511
Current cost depreciation – service activities	34,967	2,629	37,596
Current cost depreciation – business activities	-	-	-
Amortisation of deferred credits	-	-	(486)
Business activities current cost depreciation (non-allocated)	-	-	4,348
<i>Capital maintenance less third party services</i>	-	-	81,969
Third party services – depreciation	-	-	459
<i>Total capital maintenance</i>	-	-	82,428
<b>Total operating costs</b>	-	-	<b>206,722</b>
<b>Reactive and planned maintenance (included in operating expenditure)</b>			
Reactive and planned maintenance infrastructure	-	29,721	29,721
Reactive and planned maintenance non-infrastructure	5,911	-	5,911



# Veolia Water Central Limited

## Rolling Summary of the current cost profit and loss account for the appointed business

	Year ended 31 March 2011 £000	Restated Year ended 31 March 2010 £000	Restated Year ended 31 March 2009 £000	Restated 15 month period to 31 March 2008 £000	Restated Year ended 31 March 2007 £000
Turnover	<b>241,349</b>	246,965	241,384	235,450	223,331
Current cost operating costs	<b>(206,722)</b>	(203,021)	(193,296)	(186,499)	(173,978)
Other operating income	<b>(16,409)</b>	10,482	621	4,200	-
Working capital adjustment	<b>1,935</b>	1,846	(252)	2,319	2,069
	<b>20,153</b>	56,272	48,457	55,470	51,422
Other income	-	4	463	220	6
Net interest	<b>(21,716)</b>	(20,201)	(16,356)	(12,013)	(12,011)
Financing adjustment	<b>14,608</b>	13,524	(1,189)	11,334	11,893
<b>Current cost profit before taxation</b>	<b>13,045</b>	49,599	31,375	55,011	51,310
Taxation	<b>(7,617)</b>	(4,360)	(19,855)	(2,126)	(15,198)
<b>Current cost profit attributable to shareholders</b>	<b>5,428</b>	45,239	11,520	52,885	36,112
Dividends	<b>(30,928)</b>	(195,359)	(37,482)	(32,410)	(28,804)
<b>Current cost (loss)/profit retained</b>	<b>(25,500)</b>	<b>(150,120)</b>	<b>(25,962)</b>	<b>20,475</b>	<b>7,308</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.

# Veolia Water Central Limited

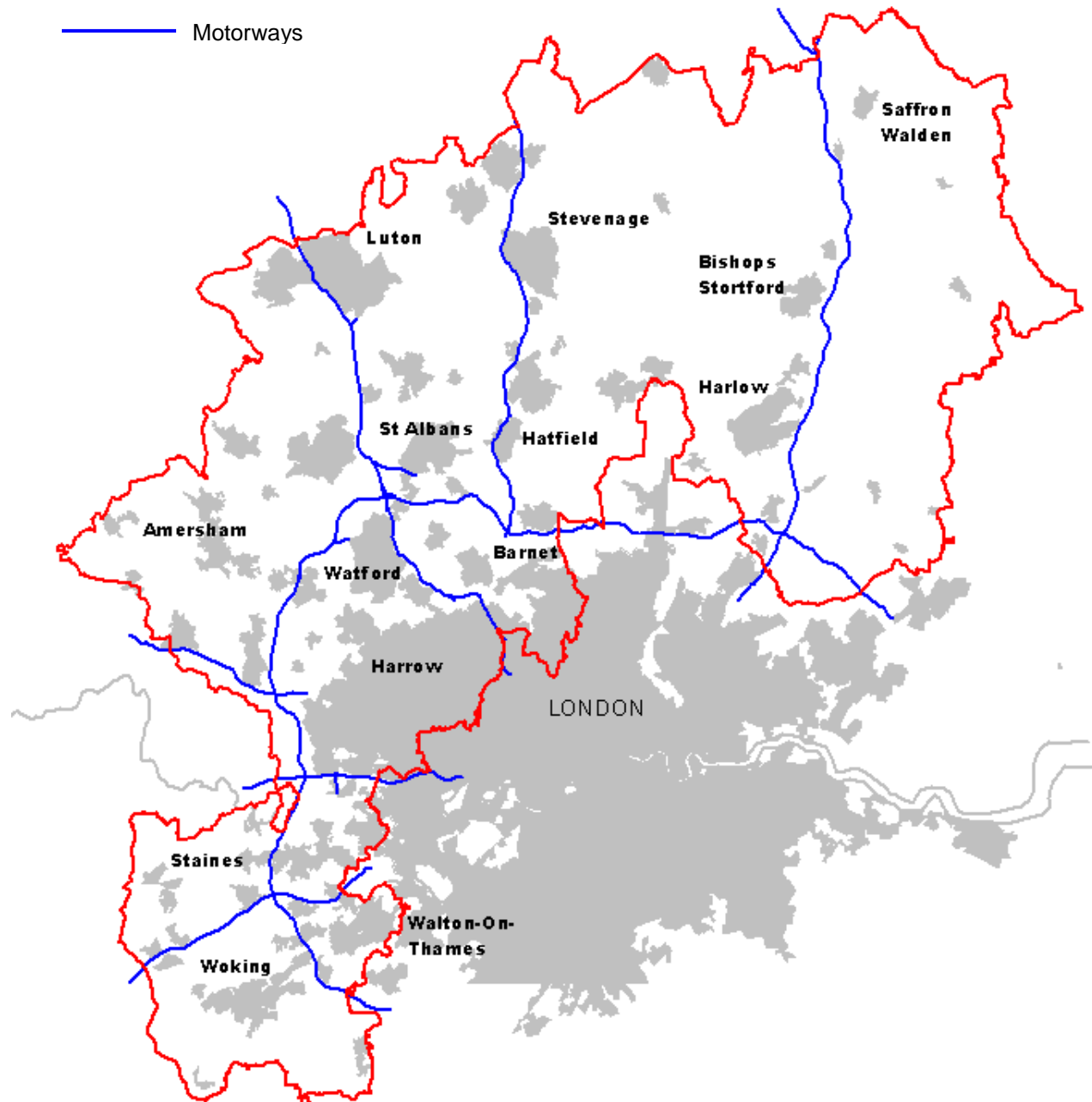
## Rolling Summary of the current cost balance sheet for the appointed business

	At 31 March 2011 £000	Restated At 31 March 2010 £000	Restated At 31 March 2009 £000	Restated 15 month period 31 March 2008 £000	Restated At 31 March 2007 £000
Tangible fixed assets	<b>7,328,360</b>	4,280,747	4,090,072	4,086,198	3,895,958
Third party contributions since 1989/90	<b>(189,846)</b>	(183,757)	(169,752)	(162,555)	(148,114)
Working capital	<b>(46,649)</b>	(32,839)	(41,678)	(63,422)	(61,278)
<b>Net operating assets</b>	<b>7,091,865</b>	4,064,151	3,878,642	3,860,221	3,686,566
Cash and investments	<b>(39,456)</b>	(53,010)	(85,886)	(32,012)	9,057
Non-trade debtors	<b>5,617</b>	5,872	5,101	4,569	3,257
Non-trade creditors	<b>(4,373)</b>	(6,466)	(7,995)	(3,201)	(3,206)
Creditors due after one year	<b>(421,304)</b>	(439,689)	(228,189)	(230,173)	(232,783)
Provisions	<b>(23,463)</b>	(36,130)	(11,279)	(21,798)	(4,722)
Deferred tax provision	<b>(40,579)</b>	(41,633)	(43,888)	(36,428)	(46,505)
<b>Net assets employed</b>	<b>6,568,307</b>	<b>3,493,095</b>	<b>3,506,506</b>	<b>3,541,178</b>	<b>3,411,664</b>
Called up share capital	<b>26,506</b>	27,923	13,935	13,935	13,935
Share premium reserved	-	-	53,961	53,961	53,961
Profit and loss account	<b>(190,327)</b>	(182,913)	(12,069)	8,622	7,820
Current cost reserve	<b>6,688,683</b>	3,602,318	3,444,885	3,458,866	3,330,154
Capital redemption reserve	<b>43,445</b>	45,767	5,794	5,794	5,794
<b>Total capital employed</b>	<b>6,568,307</b>	<b>3,493,095</b>	<b>3,506,506</b>	<b>3,541,178</b>	<b>3,411,664</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.

# Veolia Water Central Limited

## Area of Supply



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