

**FINANCIAL STATEMENTS**  
**NORTHUMBRIAN WATER LIMITED**  
**FOR THE YEAR ENDED 31 DECEMBER 2001**

Registered no: 2366703

Registered office  
Northumbria House  
Abbey Road  
Pity Me  
Durham  
DH1 5FJ

**FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2001**

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## **DIRECTORS' REPORT**

### **For the year ended 31 December 2001**

The directors present their report and the audited financial statements for the year ended 31 December 2001.

#### **Results and dividends**

The group's profit after taxation for the year ended 31 December 2001 amounts to £91.3m (December 2000: £109.8m). The directors propose a final dividend on the ordinary shares of the company of £42.1m (December 2000: £40.2m) which, together with the interim dividend of £42.0m (December 2000: £36.8m), makes a total for the year of £84.1m (December 2000 £77.0m).

#### **Principal activities and review of the business**

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

The prior year comparative figures include the trading performance relating to the Essex and Suffolk region from 1 April 2000 to 31 December 2000, whilst the results for the year ended 31 December 2001 include a full year's trading for the Southern region. The results relating to Essex and Suffolk for the three months ending 31 March 2000 have therefore been included in note 31 to enable a like for like comparison to be made.

Turnover has been reduced by the impact of the price reductions, offset by inflation, which were required by Ofwat from April 2000. The reductions were 13.8% in the South and 19.4% in the North. The latter region had a further reduction of 2% in April 2001.

For the second year in succession, the company achieved the best performance in the water industry against the Ofwat customer service measures for the regulatory year ended 31 March 2001. In addition, the investment programme delivered the required obligations by 31 December 2000 and operating efficiencies were achieved as a result of further restructuring and the completion of the merger with Essex and Suffolk Water plc.

The operating costs show an increase on the prior year of £29.6m, mainly due to the exclusion of £13.9m costs relating to the Essex and Suffolk region for the first 3 months of 2000, and the full year impact in 2001 of the costs of operating the new secondary sewage treatment facilities required to meet the Urban Waste Water Treatment Directive. The cost increase also reflects the impact of other new costs including climate change levy, cryptosporidium monitoring and Section 74 claims, partially offset by efficiencies generated following the merger of the Northern and Southern businesses.

The capital maintenance costs also show an increase of £14.0m, reflecting the depreciation impact of the new assets which were commissioned in early 2001, and the exclusion of the depreciation costs for the Southern region in the first three months of 2000 (£2.5m).

The future focus of the company continues to be improving efficiency levels and driving down operating costs while maintaining high standards of customer service and developing the skills and effectiveness of its employees. Continuous improvement will be necessary to ensure the company is successful in the competitive market.

#### **Financial Statements Preparation and Going Concern**

The directors consider that it is appropriate to prepare the financial statements for the financial year on a going concern basis. The directors have arrived at their decision based on consideration of the company's detailed budget for 2002 and the five-year business plan for the period from 2001 to 2005. Their analysis included a review of the capital expenditure and investment plans, the anticipated funding requirements and facilities available, and the reasonableness of the underlying assumptions of both the budget and business plans.

## **DIRECTORS' REPORT (continued)**

### **Research and development**

The company places a high priority on research and technological innovation to serve the needs of customers. Research and development is now co-ordinated by a sister company, Northumbrian Lyonnaise Technology and Research Centre Limited, a specialist subsidiary, wholly owned by the company's immediate parent, which has links with other Suez S.A. group research organisations worldwide. The company incurred costs of research and development in the period of £5.3m (December 2000: £5.3m).

### **Northumbrian Water Limited payment policy**

The company's policy is to agree payment terms with suppliers when agreeing the terms of each transaction, also ensuring that suppliers are made aware of and abide by the terms of payment. During the year, Northumbrian Water and Essex and Suffolk Water merged their creditors ledgers. The year end trade creditors expressed as a number of days of purchases made during the year is 28 days (December 2000: 27 days for Northumbrian Water; 20 days for Essex and Suffolk Water).

### **Fixed assets**

Freehold land and buildings are carried in the accounts at historical cost with a net book value of £100.3m (December 2000: £57.3m). In the opinion of the directors, at 31 December 2001, there is no significant difference between the net book value and market value of property capable of disposal within the foreseeable future.

### **Financial review**

The level of capital expenditure that the company is obliged to incur is such that it cannot be wholly financed by internally generated sources. As a result, the company must rely upon raising additional finance on a regular basis, to be principally used to fund the long-term assets required in its regulated businesses. The strategy of ONDEO Services UK plc, of which the company is a subsidiary, is to finance such investment by raising medium to long term debt, to provide a balance sheet match with long term assets and to fix a major proportion of interest rates.

During the year the company has secured additional funding at attractive rates by the issue of a further £150m Eurobond from the parent company's existing 2023 bond and by the issue of a £300m Eurobond from a wholly owned subsidiary, Northumbrian Water Finance plc.

## **DIRECTORS' REPORT (continued)**

### **Directors**

The directors who served during the year were as follows:

Professor Sir F G T Holliday CBE (66)  
Non-Executive Chairman

P Babin (44)  
Non-Executive Director

Sir J D R Bradbeer OBE (70)  
Non-Executive Director

J A Cuthbert (49)  
Executive Managing Director  
(Appointed as Managing Director on 1 November 2001)

A Chaigneau (51)  
Non-Executive Director

J A Haynes (71)  
Non-Executive Director

R R Allan (67)  
Non-Executive Director

C M Green (47)  
Executive Director

A J Harding  
Resigned 1 November 2001

M A B Nègre  
Resigned 2 May 2001

Graham Neave (46) was appointed as an Executive Director of the company on 31 January 2002.

Directors' interests are disclosed in note 5 to the financial statements.

## **DIRECTORS' REPORT (continued)**

### **Employees and employment policies**

#### Equal Opportunities

The company operates an equal opportunity policy and promotes equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment than another. The company is a member of 'Opportunity Now', which demonstrates our commitment to equal opportunity, and has been awarded an 'Exemplars of Best Practice' certificate.

#### Disabled Employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

#### Training and Development

Training and development of employees is a priority of the company. This year employees from the company have again participated in the ONDEO Global Player Programme which was created to ensure that highly skilled and experienced staff are ready and available to meet the ongoing worldwide business needs of the company and its parent company, Suez S.A.

#### Communication

Communication with staff is achieved through the company's corporate newspaper 'WaterMark' and the increased use of the company's intranet facilities. Employees are regularly informed about matters concerning their interests and the financial and economic factors affecting the company. The company has also established its own communication mechanisms such as team briefings, electronic mail and notice boards. Further, the company receives Job News and an English version of 'Terre Bleue', Suez S.A.'s corporate magazine.

#### Health and Safety

Health and safety policies are maintained and implemented through the company's safety team. Employee health services are provided by the company's Medical Adviser. Most employees are members of a company wide corporate health care plan managed by CIGNA Healthcare.

#### Employee Investment Schemes

In the previous 4 years the company has operated employee investment schemes, the last being SPRING 2000. The Board of Directors believes that employee investment is a valuable method of strengthening the ties between its employees and Suez S.A. by providing the opportunity for employees to participate more closely in its economic performance and results. The company has committed itself to future biennial employee investment opportunities.

### **Pensions**

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

## **DIRECTORS' REPORT (continued)**

### **Charitable and Political Contributions**

During the year the company made charitable donations of £60,659 (December 2000: £56,794). The company made no donations to any political party during the year (December 2000: £nil).

### **Auditors**

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

### **Directors' responsibilities**

The directors are required by United Kingdom company law to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the company and of the group as at the end of the financial year and of the profit or loss of the group for that year.

The directors confirm that suitable accounting policies have been used and applied consistently, and reasonable, prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 December 2001. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis.

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

### **Auditors' responsibilities**

The auditors are responsible for forming an independent opinion on the financial statements presented by the directors, based on their audit, and reporting their opinion to shareholders. Company law also requires the auditors to report to shareholders if the following requirements are not met:

- that the company has maintained proper accounting records;
- that the financial statements are in agreement with the accounting records;
- that directors' emoluments and other transactions with the directors are properly disclosed in the financial statements; and
- that they have obtained all information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of their audit.

The auditors' opinion does not encompass the Directors' Report. However, the Companies Act requires the auditors to report to the shareholders if the matters contained in the Directors' Report are inconsistent with the financial statements.

BY ORDER OF THE BOARD

M Parker  
Company Secretary

28 March 2002

## **INDEPENDENT AUDITORS' REPORT**

### **To the shareholders of Northumbrian Water Limited:**

We have audited the financial statements of Northumbrian Water Limited for the year ended 31 December 2001 which comprise the profit and loss account, balance sheet and cash flow statement and the related notes numbered 1 to 31. These financial statements have been prepared under the accounting policies set out therein.

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

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards are set out in the Statement of directors' responsibilities. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

### **Basis of opinion**

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### **Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group at 31 December 2001 and of the group's profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

### **Arthur Andersen Chartered Accountants and Registered Auditors**

Pearl Assurance House  
7 New Bridge Street  
Newcastle upon Tyne  
NE1 8BQ

28 March 2002

**GROUP PROFIT AND LOSS ACCOUNT**  
**For the year ended 31 December 2001**

	Note	<u>December 2001</u>	<u>December 2000</u>
		£'m	£'m
Turnover	2	436.1	415.5
Operating costs	3(a)	(198.7)	(169.1)
Capital maintenance costs	3(b)	(77.4)	(63.4)
Exceptional operating costs	3(c)	-	(2.0)
<b>OPERATING PROFIT</b>		160.0	181.0
Net interest payable	4	<u>(67.6)</u>	<u>(58.3)</u>
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>	3(d)	92.4	122.7
Taxation	8	<u>(1.1)</u>	<u>(12.9)</u>
<b>PROFIT FOR THE FINANCIAL YEAR</b>		91.3	109.8
Dividends	9	<u>(84.1)</u>	<u>(77.0)</u>
<b>PROFIT RETAINED FOR THE YEAR</b>	24	<u>7.2</u>	<u>32.8</u>

All turnover and operating profit derive from continuing operations.

The movement on reserves is shown in note 24.

The group has no recognised gains or losses other than the profits above and therefore no separate statement of total recognised gains or losses has been presented.

The accompanying notes are an integral part of this consolidated profit and loss account.

## GROUP BALANCE SHEET

At 31 December 2001

	Note	December 2001	December 2000
		£'m	£'m
<b>FIXED ASSETS</b>			
Tangible assets	10	2,358.2	2,248.5
<b>CURRENT ASSETS</b>			
Stocks	12	2.7	2.2
Debtors	13	85.8	93.8
Investments	14	240.5	0.2
Cash at bank and in hand		1.9	-
		<u>330.9</u>	<u>96.2</u>
<b>CREDITORS</b>			
Amounts falling due within one year	15	(408.7)	(326.3)
		<u>(77.8)</u>	<u>(230.1)</u>
<b>NET CURRENT LIABILITIES</b>			
		<u>(77.8)</u>	<u>(230.1)</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
		2,280.4	2,018.4
<b>CREDITORS: Amounts falling due after more than one year</b>			
	16	(1,136.2)	(884.4)
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>			
	21	(14.0)	(14.7)
<b>ACCRUALS AND DEFERRED INCOME</b>			
	22	(119.6)	(115.9)
		<u>(1,269.8)</u>	<u>(1,015.0)</u>
<b>NET ASSETS</b>			
		<u>1,010.6</u>	<u>1,003.4</u>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	23	122.7	122.7
Profit and loss account	24	887.9	880.7
		<u>1,010.6</u>	<u>1,003.4</u>
<b>EQUITY SHAREHOLDERS' FUNDS</b>			
	25	<u>1,010.6</u>	<u>1,003.4</u>

The accompanying notes are an integral part of this consolidated balance sheet.

Approved on behalf of the board

J A Cuthbert

C M Green

28 March 2002

## COMPANY BALANCE SHEET

At 31 December 2001

	Note	December 2001	December 2000
		<u>£'m</u>	<u>£'m</u>
<b>FIXED ASSETS</b>			
Tangible assets	10	2,358.2	2,248.5
Investments	11	89.4	89.4
		<u>2,447.6</u>	<u>2,337.9</u>
<b>CURRENT ASSETS</b>			
Stocks	12	2.7	2.2
Debtors	13	85.8	93.8
Investments	14	240.5	0.2
Cash at bank and in hand		1.9	-
		<u>330.9</u>	<u>96.2</u>
<b>CREDITORS</b>			
Amounts falling due within one year	15	(408.7)	(326.3)
<b>NET CURRENT LIABILITIES</b>			
		<u>(77.8)</u>	<u>(230.1)</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
		<u>2,369.8</u>	<u>2,107.8</u>
<b>CREDITORS: Amounts falling due after more than one year</b>			
	16	(1,225.6)	(973.8)
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>			
	21	(14.0)	(14.7)
<b>ACCRUALS AND DEFERRED INCOME</b>			
	22	(119.6)	(115.9)
		<u>(1,359.2)</u>	<u>(1,104.4)</u>
<b>NET ASSETS</b>			
		<u>1,010.6</u>	<u>1,003.4</u>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	23	122.7	122.7
Profit and loss account	24	887.9	880.7
<b>EQUITY SHAREHOLDERS' FUNDS</b>			
	25	<u>1,010.6</u>	<u>1,003.4</u>

The accompanying notes are an integral part of this balance sheet.

Approved on behalf of the board

J A Cuthbert

C M Green

28 March 2002

**GROUP CASH FLOW STATEMENT**  
**For the year ended 31 December 2001**

	Note	December 2001	December 2000
		£'m	£'m
NET CASH INFLOW FROM OPERATING ACTIVITIES	a	241.1	230.2
<b>Return on investments and servicing of finance</b>			
Interest received		0.9	2.6
Interest paid		(66.0)	(50.3)
Interest element of finance lease rentals		(1.7)	(1.5)
Net cash outflow from returns on investments and servicing of finance		(66.8)	(49.2)
<b>Taxation</b>			
United Kingdom corporation tax paid		(9.9)	(28.4)
Net cash outflow from taxation		(9.9)	(28.4)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets		(191.2)	(248.2)
Sale of tangible fixed assets		0.8	1.0
Grants, contributions and connection charges		7.3	9.5
Purchase of business		-	(0.7)
Net cash outflow from capital expenditure and financial investment		(183.1)	(238.4)
<b>Equity dividends paid</b>		(82.2)	(78.9)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(100.9)	(164.7)
<b>Management of liquid resources</b>			
Purchase of short term deposits		(320.3)	(110.5)
Sale of short term deposits		80.0	189.7
Net cash (outflow) / inflow from management of liquid resources		(240.3)	79.2
<b>Financing</b>			
New loans		457.6	94.6
Loan repayments		(108.1)	(11.3)
Capital element of finance lease rental payments		(3.7)	(4.2)
Net cash inflow from financing		345.8	79.1
INCREASE / (DECREASE) IN CASH IN THE YEAR		4.6	(6.4)

The accompanying notes are an integral part of this consolidated cash flow statement.



**NOTES TO THE CASH FLOW STATEMENT**  
**For the year ended 31 December 2001**

**a RECONCILIATION OF OPERATING PROFIT TO CASH FLOWS**

	Note	December 2001	December 2000
		£'m	£'m
Operating profit		160.0	181.0
Depreciation of tangible fixed assets	3(b)	78.0	63.7
Amortisation of capital grants	3(d)	(3.6)	(3.3)
Profit on sale of fixed assets	3(b)	(0.6)	(0.3)
(Increase) / decrease in stock		(0.5)	1.4
Decrease in debtors		8.8	2.7
Decrease in creditors		(0.3)	(13.3)
Decrease in restructuring provision		(0.7)	(1.7)
Net cash inflow from operating activities		<u>241.1</u>	<u>230.2</u>

The operating cash flows are all from continuing operations.

**b ANALYSIS AND RECONCILIATION OF NET DEBT**

	1 January 2001	Cash flow	Other non- cash changes	31 December 2001
	£'m	£'m	£'m	£'m
Cash at bank and in hand	-	1.9	-	1.9
Overdrafts	(2.7)	2.7	-	-
	<u>(2.7)</u>	<u>4.6</u>	<u>-</u>	<u>1.9</u>
Debt due after 1 year	(830.8)	(457.6)	206.4	(1,082.0)
Debt due within 1 year	(108.1)	108.1	(206.6)	(206.6)
Finance leases	(57.4)	3.7	(3.2)	(56.9)
	<u>(996.3)</u>	<u>(345.8)</u>	<u>(3.4)</u>	<u>(1,345.5)</u>
Current asset investments	-	240.3	-	240.3
Net debt	<u>(999.0)</u>	<u>(100.9)</u>	<u>(3.4)</u>	<u>(1,103.3)</u>

**Reconciliation of cash flow movement to net debt:**

	December 2001	December 2000
	£'m	£'m
Increase / (decrease) in cash in the year	4.6	(6.4)
Cash inflow from increase in debt and lease financing	(345.8)	(79.1)
Cash inflow / (outflow) from reduction in liquid resources	240.3	(79.2)
Change in net debt resulting from cash flows	(100.9)	(164.7)
Finance costs incurred during the year	(0.2)	(0.2)
Finance lease interest capitalised	(1.0)	(2.1)
Finance lease non cash movement	(2.2)	(1.0)
Debt acquired from Essex and Suffolk Water plc	-	(106.9)
Debt issued to purchase the assets of Essex and Suffolk Water plc	-	(176.0)
Movement in net debt in year	(104.3)	(450.9)
Net debt at 1 January 2001	(999.0)	(548.1)
Net debt at 31 December 2001	<u>(1,103.3)</u>	<u>(999.0)</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2001

### 1 STATEMENT OF ACCOUNTING POLICIES

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

(a) **Basis of accounting**

The financial statements have been prepared under the historic cost convention on a going concern basis.

(b) **Basis of consolidation**

The consolidated financial statements include the company and its subsidiary undertakings. The results of subsidiaries and operations acquired during the year are included from the date of their acquisition. Intra-group sales and profits are eliminated fully on consolidation.

(c) **Turnover**

Turnover, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom.

(d) **Tangible fixed assets and depreciation**

Tangible fixed assets comprise:

(i) **Infrastructure assets**

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

Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operational capability of the network in accordance with defined standards of service, is treated as additions which are included at cost.

The depreciation charge for infrastructure assets is based on the company's independently certified asset management plan which has estimated the level of expenditure required over the next five years to maintain the operating capability of the network.

(ii) **Non-Infrastructure assets**

Other assets (including properties, overground plant and equipment) are included at cost less accumulated depreciation and where required provision for impairment. Additions are included at cost.

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

Freehold buildings	30 – 60 years
Operational structures, plant and machinery	4 – 80 years
Fixtures, fittings, tools and equipment	4 – 10 years

(iii) **Assets in the course of construction**

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

## 1. STATEMENT OF ACCOUNTING POLICIES (continued)

(e) **Government grants and contributions**

Revenue grants are credited to the profit and loss account when received.

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

(f) **Hire purchase and leasing**

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

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

(g) **Stocks**

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

(h) **Pension costs**

The cost of providing pension benefits is charged to the profit and loss account so as to spread the cost over the expected average service lives of employees. Differences between the amounts funded and amounts charged to the profit and loss account are treated as prepayments or accruals in the balance sheet.

(i) **Taxation**

The charge for current taxation is based on the profit for the year as adjusted for taxation purposes. Tax deferred or accelerated is accounted for in respect of all material timing differences to the extent that it is probable that a liability or asset will crystallise in the foreseeable future. Timing differences arise from the inclusion of items of income and expenditure in tax computations in periods different from those in which they are included in the accounts. Provision is made at the rate which is expected to apply when the liability or asset crystallises.

(j) **Foreign currency**

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

(k) **Research and development**

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

(l) **Investments**

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

## 1. STATEMENT OF ACCOUNTING POLICIES (continued)

### (m) Derivative Financial Instruments

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

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

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

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

## 2. TURNOVER

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

## 3. OPERATING COSTS, CAPITAL MAINTENANCE AND EXCEPTIONAL COSTS

(a) Operating costs comprise:

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Materials and consumables	13.3	11.1
Other external charges	46.5	26.5
Manpower costs (note 7a)	60.8	52.3
Other operating charges	92.6	92.4
Own work capitalised	(14.5)	(13.2)
	<u>198.7</u>	<u>169.1</u>

(b) Capital maintenance costs comprise:

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Depreciation:		
Non-infrastructure assets	46.0	29.9
Non-infrastructure assets held under finance leases	3.3	7.7
Infrastructure assets	28.7	26.1
Profit on disposal of fixed assets	(0.6)	(0.3)
	<u>77.4</u>	<u>63.4</u>

**3. OPERATING COSTS, CAPITAL MAINTENANCE  
AND EXCEPTIONAL COSTS (continued)**

(c) Exceptional operating costs comprise:

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Reorganisation/restructuring costs	-	2.0

The reorganisation/restructuring costs represent exceptional costs resulting from a new severance scheme which was introduced during 2000.

(d) Profit on ordinary activities before taxation

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Profit on ordinary activities before taxation is stated after crediting:		
Amortisation of capital grants (note 22)	3.6	3.3
And after charging:		
Operating leases: Plant and machinery	0.9	2.4
Costs of research and development	5.3	5.3
Directors' emoluments (note 5)	0.8	0.9

Auditors' remuneration for the statutory audit amounted to £66,500 (December 2000: £83,900). There were no fees for non-audit services (December 2000: £nil).

#### 4. NET INTEREST PAYABLE

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	63.8	55.0
Debenture stock interest	2.3	2.0
Financing charges payable under finance leases	2.8	3.5
	<u>68.9</u>	<u>60.5</u>
Total interest payable	68.9	60.5
Interest receivable	(1.3)	(2.2)
	<u>67.6</u>	<u>58.3</u>
Net interest payable	<u>67.6</u>	<u>58.3</u>

#### 5. DIRECTORS' EMOLUMENTS AND INTERESTS

Directors' remuneration

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

	<u>December 2001</u>	<u>December 2000</u>
	£'000	£'000
Emoluments (including benefits in kind)	<u>769.0</u>	<u>876.1</u>

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid director:

	<u>December 2001</u>	<u>December 2000</u>
	£'000	£'000
Emoluments (including benefits in kind)	<u>214.2</u>	<u>194.3</u>

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 December 2001 was £78,990 (31 December 2000: £56,031). In addition to the pension, there is a tax-free lump sum at normal pension date of which the accrued entitlement at 31 December 2001 was £236,970 (31 December 2000: £147,529).

Two of the directors at 31 December 2001 were members of a defined benefit pension scheme where the company makes contributions towards the cost (2000: 3).

The directors who held office at 31 December 2001 had no interest in the shares of the company.

## 5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

The directors who held office at 31 December 2001 had the following beneficial interests in the ordinary shares, other than share options, and debentures of the company's ultimate parent company, Suez S.A.:

Name of Director	Description of shares or debentures	31 December 2001	Start of period or subsequent date of appointment
P Babin	Ordinary Shares of €	2633	3067
J A Cuthbert	Ordinary Shares of €	3561	3561
Professor Sir F G T Holliday	Ordinary Shares of €	-	2000
C M Green	Ordinary Shares of €	2446	2446
A Chaigneau	Ordinary Shares of €	7742	9042

The directors who held office on 31 December 2001 held the following options over ordinary shares of € each in Suez S.A.:

Name of Director	Start of period or subsequent date of appointment	Granted/(Exercised) During the year	31 December 2001	Exercise Price
P Babin	17,500	-	17,500	€17.47
	20,000	-	20,000	€29.82
	22,500	-	22,500	€0.22
	32,500	-	32,500	€6.41
	-	40,000	40,000	€4.51
	92,500	40,000	132,500	
J A Cuthbert	6,000	(6,000)	-	€13.90
	11,000	-	11,000	€17.47
	11,500	-	11,500	€29.82
	12,500	-	12,500	€0.22
	13,000	-	13,000	€6.41
	-	14,000	14,000	€4.51
	54,000	8,000	62,000	
Professor Sir F G T Holliday	15,000	-	15,000	€17.47
	15,000	-	15,000	€29.82
	15,000	-	15,000	€0.22
	15,000	-	15,000	€6.41
	-	15,000	15,000	€4.51
	60,000	15,000	75,000	
C M Green	3,500	-	3,500	€17.47
	5,000	-	5,000	€29.82
	3,500	-	3,500	€0.22
	4,500	-	4,500	€6.41
	-	5,000	5,000	€4.51
	16,500	5,000	21,500	
A Chaigneau	5,000	(5,000)	-	€13.90
	17,500	-	17,500	€17.47
	20,000	-	20,000	€29.82
	25,000	-	25,000	€0.22
	30,000	-	30,000	€6.41
	-	35,000	35,000	€4.51
	97,500	30,000	127,500	



## 5. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

No options have lapsed during the year.

On 4 May 2001 Suez S.A. shareholders resolved to restructure that company's ordinary share capital by splitting each Suez S.A. Ordinary Share with a nominal value of €10 into five new shares with a nominal value of €2 each. The restructure took effect on 15 May 2001 and the Company's Register of Directors Interests in shares has been adjusted to reflect the change.

All options with an exercise price of €13.90 were granted on 24 July 1996 and are exercisable between 24 July 1998 and 24 July 2004.

All options with an exercise price of €17.47 were granted on 17 November 1997 and are exercisable between 17 November 2002 and 17 November 2005.

All options with an exercise price of €29.82 were granted on 16 November 1998 and are exercisable between 16 November 2003 and 16 November 2006.

All options with an exercise price of €30.22 were granted on 15 November 1999 and are exercisable between 15 November 2004 and 15 November 2007.

All options with an exercise price of €36.41 were granted on 28 November 2000 and are exercisable between 28 November 2004 and 28 November 2010.

All options with an exercise price of €34.51 were granted on 28 November 2001 and are exercisable between 28 November 2005 and 28 November 2011.

The highest and lowest prices of the Suez S.A. shares during the year were €38.75 and €30.70 respectively.

No Director holds any other interest required to be disclosed in accordance with Schedule 7 of the Companies Act 1985.

## 6. TRANSACTIONS WITH DIRECTORS AND OFFICERS

No transactions or arrangements which are disclosable under the provisions of the Companies Act 1985 have occurred during the year.

## 7. EMPLOYEE INFORMATION

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

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Costs charged to the profit and loss account:		
Wages and salaries	41.8	33.8
Social security costs	3.2	3.0
Other pension costs	3.2	2.8
	<u>48.2</u>	<u>39.6</u>
Costs charged to capital schemes:		
Wages and salaries	11.0	11.2
Social security costs	0.8	0.9
Other pension costs	0.8	0.6
	<u>12.6</u>	<u>12.7</u>

## 7. EMPLOYEE INFORMATION (continued)

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

	<u>December 2001</u>	<u>December 2000</u>
	Number	Number
Average during the year	<u>2,185</u>	<u>2,158</u>
Total at 31 December	<u>2,220</u>	<u>2,133</u>

## 8. TAXATION

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Tax on profit on ordinary activities		
United Kingdom corporation tax at 30% (December 2000: 30%)		
- current year	2.2	1.5
- prior years	(4.2)	0.1
Payable/(receivable) in respect of group relief		
- current year	3.1	11.4
- prior years	-	(0.1)
Tax charge	<u>1.1</u>	<u>12.9</u>

(a) The company has provisionally claimed tax losses from fellow subsidiaries in the current year of £10.1m (December 2000: £38.1m) for which payment will be made at the rate of 30%.

(b) No deferred taxation has been provided in the financial statements since timing differences at 31 December 2001 are not expected to reverse in the foreseeable future (December 2000: £nil). The effect of not providing for deferred taxation has been a reduction in the tax charge for the year of £24.5m (December 2000: £26.1m). The full potential amount of deferred taxation calculated at 30% (December 2000: 30%) on all timing differences is as follows:

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Accelerated capital allowances	394.3	368.3
Other timing differences	(19.8)	(21.0)
	<u>374.5</u>	<u>347.3</u>

## 9. DIVIDENDS

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Equity:		
Interim paid of 34.23p (December 2000: 29.99p) per share on an aggregated basis	42.0	36.8
Final proposed of 34.31p (December 2000: 32.76p) per share on an aggregated basis	42.1	40.2
	<u>84.1</u>	<u>77.0</u>

The directors have a policy which, unless circumstances dictate otherwise, aims to grow dividends on a slow but regular basis and which takes into account the principle of incentive based price cap regulation, including operating and investment performance. The company has maintained its policy of a steady 2% real growth per annum for the Appointed business dividend. Dividends from the Non-Appointed business are determined by the directors and are based on performance.

In accordance with the principle of incentive based price cap regulation, rewards to shareholders will reflect company performance against Ofwat targets, in particular operating and investment targets.

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

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

## 10. TANGIBLE FIXED ASSETS – GROUP AND COMPANY

	Freehold land and buildings	Infra- structure assets	Operational structures , plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 January 2001	74.2	1,160.4	986.0	67.4	367.3	2,655.3
Additions	-	-	-	-	187.9	187.9
Schemes commissioned	46.7	64.1	267.4	52.4	(430.6)	-
Disposals	(0.3)	(15.6)	-	-	-	(15.9)
At 31 December 2001	120.6	1,208.9	1,253.4	119.8	124.6	2,827.3
Depreciation:						
At 1 January 2001	16.9	124.1	214.8	51.0	-	406.8
Provision for year	3.5	28.7	38.4	7.4	-	78.0
Disposals	(0.1)	(15.6)	-	-	-	(15.7)
At 31 December 2001	20.3	137.2	253.2	58.4	-	469.1
Net book value:						
At 31 December 2001	100.3	1,071.7	1,000.2	61.4	124.6	2,358.2
At 31 December 2000	57.3	1,036.3	771.2	16.4	367.3	2,248.5
Leased assets included above:						
Net book value						
At 31 December 2001	-	2.2	27.9	1.9	-	32.0
At 31 December 2000	-	2.2	28.2	6.4	-	36.8

## 11. FIXED ASSET INVESTMENTS – COMPANY

	December 2001	December 2000
	£'m	£'m
Investment in Newcastle and Gateshead Water plc	47.2	47.2
Investment in Suffolk Water plc	42.2	42.2
	<u>89.4</u>	<u>89.4</u>

The company has a wholly owned subsidiary undertaking, Newcastle and Gateshead Water plc, whose principal activity is the holding of a loan note due from the company. This investment equates to a 100% holding in Newcastle and Gateshead Water plc of £40.7m, and a long-term loan investment of £6.5m. Included in the net assets of Newcastle and Gateshead Water plc is a loan note receivable from Northumbrian Water Limited of £47.2m. Both companies have agreed that no interest will be levied on the loan note. The results of this subsidiary have been consolidated in these financial statements.

The company has a wholly owned subsidiary undertaking in Suffolk Water plc, whose principal activity is the holding of a loan note due from the company. This investment is valued at £42.2m which equates to the net assets of that company. Both companies have agreed that no interest will be levied on the loan note. The results of this subsidiary have been consolidated in these financial statements.

## 12. STOCKS – GROUP AND COMPANY

	December 2001	December 2000
	£'m	£'m
Raw materials and consumables	2.7	2.2

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

## 13. DEBTORS – GROUP AND COMPANY

	December 2001	December 2000
	£'m	£'m
Trade debtors	54.4	56.3
Amounts owed by other group companies	3.4	6.8
Other debtors	5.7	5.3
Prepayments and accrued income	22.3	25.4
	<u>85.8</u>	<u>93.8</u>

Included in amounts owed by other group companies is £0.3m (2000: £nil) in respect of advance corporation tax surrendered in prior years.

## 14. INVESTMENTS – GROUP AND COMPANY

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Short term deposits	240.3	-
Assets held for resale	0.2	0.2
	<u>240.5</u>	<u>0.2</u>

## 15. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	<u>December 2001</u>		<u>December 2000</u>	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 19)	3.7	3.7	4.6	4.6
Bank overdraft	-	-	2.7	2.7
Loans (note 17)	22.6	22.6	13.5	13.5
Debenture stock (note 18)	8.0	8.0	-	-
Trade creditors	3.2	3.2	3.2	3.2
Amounts owed to other group companies	204.5	205.5	131.3	131.3
Taxation and social security	1.6	1.6	1.6	1.6
Corporation Tax	14.2	14.2	16.5	16.5
Other creditors	20.1	20.1	20.0	20.0
Receipts in Advance	30.9	30.9	32.7	32.7
Dividend payable	42.1	42.1	40.2	40.2
Accruals and deferred income	57.8	56.8	60.0	60.0
	<u>408.7</u>	<u>408.7</u>	<u>326.3</u>	<u>326.3</u>

Accruals and deferred income includes accruals related to capital projects of £24.0m (December 2000: £30.3m). Amounts owed to other group companies include amounts related to capital projects of £3.2m (December 2000: £2.4m).

Included in amounts owed to other group companies is £2.7m (December 2000: £8.9m) payable in respect of tax losses surrendered from fellow Group companies. Also included in amounts owed to other group companies is £176.0m (December 2000: £94.6m) relating to loans repayable within one year (note 20).

## 16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	December 2001		December 2000	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under hire purchase contracts and finance leases (note 19)	53.2	53.2	52.8	52.8
Loans (note 17)	596.5	295.5	318.2	318.2
Debenture stocks (note 18)	14.3	14.3	22.3	22.3
Amounts owed to other group companies (note 20)	471.2	861.6	490.3	579.7
Other creditors	1.0	1.0	0.8	0.8
	<u>1,136.2</u>	<u>1,225.6</u>	<u>884.4</u>	<u>973.8</u>

At 31 December 2001 the group and company had entered into the following interest swap arrangements: £15.0m (December 2000: £15.0m) over a ten year period commencing on 10 May 1994 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 9.00%, and £2.9m (December 2000: £4.7m) over a seven year period commencing on 16 December 1996 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 7.45%, and £25.0m (December 2000: £25.0m) over a three year period commencing on 7 December 2000 under which the group and company is required to pay interest at 5.61% and will receive interest at a rate linked to LIBOR, and £25.0m over a five year period commencing 23 May 1997 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 7.45%.

## 17. LOANS

	December 2001		December 2000	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Loans are repayable as follows:				
Within one year	22.6	22.6	13.5	13.5
Between one and two years	23.0	23.0	22.6	22.6
Between two and five years	94.8	94.8	84.0	84.0
After five years	478.7	177.7	211.6	211.6
	<u>619.1</u>	<u>318.1</u>	<u>331.7</u>	<u>331.7</u>

Loans repayable by instalments wholly repayable within 5 years amount to £32.3m (December 2000: £7.2m). Loans repayable by instalments not wholly repayable within 5 years amount to £180.8m (December 2000: £219.5m) and bear interest rates in the range of 6.02% to 8.55% of which £78.0m (December 2000: £97.9m) falls due in less than 5 years and £102.8m (December 2000: £121.6m) falls due after more than 5 years.

Loans repayable otherwise than by instalments which fall due in less than 5 years amount to £30.0m (December 2000: £15.0) and bear interest at rates in the range of 4.05% and 7.95%.

Loans repayable otherwise than by instalments which fall due after more than 5 years amount to £376.0m (December 2000: £90.0m) and bear interest at rates in the range of 3.9% and 6.0%.

## 17. LOANS (continued)

The level of capital expenditure which the company is obliged to incur is such that it cannot be wholly financed by internally generated sources. As a result, the company must rely upon raising additional finance on a regular basis to fund the long term assets required in its business. The company's strategy is to finance such investment by raising medium to long term debt, to provide a balance sheet match with long term assets and to fix a major proportion of interest rates.

### **Treasury operations**

The company's board is responsible for the financing strategy of the company which is determined within treasury policies set by the company's immediate parent company, ONDEO Services UK plc. The aim of this strategy is to assess the ongoing capital requirement of the company and to raise funding on a timely basis, taking advantage of any favourable market opportunities.

The Treasury department carries out treasury operations on behalf of the company. Surplus funds are invested based upon forecast requirements, in accordance with the treasury policy. On occasion, derivatives are used as part of this process, but the treasury policies prohibit their use for speculation.

### **Risks arising from company's financial instruments**

The main risks arising from the company's financial instruments are liquidity risk, interest rate risk and foreign currency risk. As noted above, the company's financing strategy is developed in accordance with the treasury policies of ONDEO Services UK plc, whose board reviews and agrees policies for managing each of these risks. These are summarised below. All Northumbrian Water Limited treasury activities are conducted in accordance with these policies.

#### **Liquidity risk**

As regards day to day liquidity, the company is responsible for cash management but is reliant upon the committed borrowing facilities available to ONDEO Services UK plc. ONDEO Services UK's policy is to have available standby committed bank borrowing facilities with a value of no less than £50m and with a bank agreement availability period of no less than 3 months.

#### **Interest rate risk**

The company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and floating rates of interest and, as noted above, on occasion uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. ONDEO Services UK's policy is to keep a minimum 50 per cent of its borrowings at fixed rates of interest.

#### **Foreign currency risk**

ONDEO Services UK's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered immediately on recognition.

## 17. LOANS (continued)

### Interest rate risk profile of financial assets and financial liabilities

The interest rates and currency profile of the net borrowings of the Group at 31 December 2001 were:

	Total net borrowings	Variable rate net borrowings	Fixed Rate Net Borrowings			Financial liabilities on which no interest is paid	
			Fixed rate borrowings	Weighted average interest rate	Weighted average period until maturity		
	£'m	£'m	£'m	%	Years	Years	£'m
Sterling borrowings:							
External loans	(619.1)	(90.8)	(528.3)	6.67	13.0	13.0	-
Debentures	(22.3)	-	(22.3)	10.53	4.5	4.5	-
Internal loans	(647.2)	(295.5)	(351.7)	6.75	21.1	21.1	-
Finance leases	(56.9)	(51.0)	(5.9)	9.6	6.0	6.0	-
Total borrowings	(1,345.5)	(437.3)	(908.2)	6.89	14.8	14.8	-
Cash	1.9	1.9	-				-
Short term investments	240.3	240.3	-				-
Net borrowings	(1,103.3)	(195.1)	(908.2)				-

The interest rates and currency profile of the net borrowings of the Group at 31 December 2000 were:

	Total net borrowings	Variable rate net borrowings	Fixed Rate Net Borrowings			Financial liabilities on which no interest is paid	
			Fixed rate borrowings	Weighted average interest rate	Weighted average period until maturity		
	£'m	£'m	£'m	%	Years	Years	£'m
Sterling borrowings:							
External loans	(331.7)	(92.5)	(239.2)	7.58	10.2	10.2	-
Debentures	(22.3)	-	(22.3)	10.46	5.5	5.5	-
Internal loans	(584.9)	(390.1)	(194.8)	6.99	22.1	22.1	-
Finance leases	(57.4)	(50.4)	(7.0)	10.47	4.0	4.0	-
Bank overdraft	(2.7)	(2.7)	-	-	-	-	-
Total borrowings	(999.0)	(535.7)	(463.3)	7.54	14.8	14.8	-
Short term investments	-	-	-				-
Net borrowings	(999.0)	(535.7)	(463.3)				-

## 17. LOANS (continued)

Included within the external sterling loans of the group above are loans amounting to £98.8m whose rates are fixed for a period of 5 to 7 years from their inception and which, under the terms of the respective loan agreements, can then either be repaid or rolled over for a similar period at a new fixed rate based upon prevailing market rates at that date. The weighted average period for which the rates on such loans are fixed has been taken as the same average period until maturity.

### Currency exposures

At 31 December 2001, the group had no currency exposures.

### Borrowing facilities

The group had no undrawn committed borrowing facilities as at 31 December 2001 but had access to undrawn committed borrowing facilities available to ONDEO Services UK plc which, at 31 December 2001, amounted to £125.0m.

The facilities available to ONDEO Services UK plc at 31 December 2001, in respect of which all conditions precedent have been met, were as follows:

	£'m
Expiring in one year or less	50.0
Expiring in more than one year but not more than two years	75.0
	<u>125.0</u>

### Fair values of financial assets and financial liabilities

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities of the group as at 31 December 2001:

	Book value	Fair value
	£'m	£'m
Primary financial instruments held or issued to finance the group's operations:		
Short - term financial liabilities and current portion of long-term borrowings	(210.3)	(215.6)
Long - term borrowings	(1,135.2)	(1,163.8)
Financial assets	242.2	242.2
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	-	1.7
As at 31 December 2001	<u>(1,103.3)</u>	<u>(1,135.5)</u>

## 17. LOANS (continued)

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities of the group as at 31 December 2000:

	<u>Book value</u>	<u>Fair value</u>
	£'m	£'m
Primary financial instruments held or issued to finance the group's operations:		
Short-term financial liabilities and current portion of long-term borrowings	(115.4)	(115.1)
Long-term borrowings	(883.6)	(909.6)
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	-	2.3
As at 31 December 2000	<u>(999.0)</u>	<u>(1,022.4)</u>

The fair values of the interest rate swaps and sterling denominated long term fixed rate debt with a book value of £675.0m (December 2000: £217.0m) have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

### Gains and losses on hedges

The company's board uses the ONDEO Services UK plc treasury function to enter into any necessary forward foreign currency contracts on the company's behalf to eliminate the currency exposures that arise on sales denominated in foreign currencies immediately those sales are transacted. The company also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

#### Group

	<u>Gains</u>	<u>Losses</u>	<u>Total net</u>
	£'m	£'m	gains/losses
			£'m
Unrecognised gains and losses on hedges at 1 January 2001	2.3	-	2.3
Gains and losses arising in previous years that were recognised in 2001	<u>1.0</u>	<u>0.1</u>	<u>0.9</u>
Gains and losses arising before 1 January 2001 that were not recognised in 2001	1.3	0.1	1.2
Gains and losses arising in 2001 that were not recognised in 2001	<u>0.8</u>	<u>0.3</u>	<u>0.5</u>
Unrecognised gains and losses on hedges at 31 December 2001	<u>2.1</u>	<u>0.4</u>	<u>1.7</u>
Of which:			
Gains and losses expected to be recognised in 2002	0.9	0.3	0.6
Gains and losses expected to be recognised in 2003 or later	<u>1.2</u>	<u>0.1</u>	<u>1.1</u>
	<u>2.1</u>	<u>0.4</u>	<u>1.7</u>

## 17. LOANS (continued)

### Market price risk

The company's exposure to market price risk principally comprises interest rate exposure.

The company's policy is to accept a degree of interest rate risk. On the basis of the company's analysis, it is estimated that a rise in interest rates would not have a material affect on its pre-tax profits.

## 18. DEBENTURE STOCKS

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Debenture stocks are repayable as follows:		
In less than one year:		
£1, 11.75% Redeemable 2002/04	<u>8.0</u>	<u>-</u>
Between two and five years:		
£1, 11.75% Redeemable 2002/04	-	8.0
£1, 12.0% Redeemable 2004	5.0	5.0
£1, 12.0% Redeemable 2005	2.0	2.0
£1, 11.2% Redeemable 2005/09	3.5	3.5
In five years or more:		
£1, 3.75% Redeemable 2012	0.3	0.3
£1, 4.25% Redeemable 2012	0.7	0.7
£1, 5.25% Redeemable 2012	0.7	0.7
£1, 3.5% Irredeemable	0.2	0.2
£1, 4.0% Irredeemable	0.8	0.8
£1, 5.0% Irredeemable	1.1	1.1
	<u>22.3</u>	<u>22.3</u>

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

## 19. OBLIGATIONS UNDER FINANCE LEASES – GROUP AND COMPANY

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

	December 2001	December 2000
	£'m	£'m
Amounts due:		
Within one year	3.7	4.6
Between one and two years	2.9	3.9
Between two and five years	9.2	7.8
After five years	75.5	78.2
	<u>91.3</u>	<u>94.5</u>
Less:		
Finance charge allocated to future periods	(34.4)	(37.1)
	<u>56.9</u>	<u>57.4</u>
Disclosed as due:		
Within one year (note 15)	3.7	4.6
After more than one year (note 16)	53.2	52.8
	<u>56.9</u>	<u>57.4</u>

## 20. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	December 2001		December 2000	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Within one year	176.0	176.0	94.6	94.6
Between one and two years	-	-	-	-
Between two and five years	-	-	-	-
After five years	471.2	861.6	490.3	579.7
	<u>647.2</u>	<u>1,037.6</u>	<u>584.9</u>	<u>674.3</u>

£47.2m is owed to a subsidiary undertaking of the group, Newcastle & Gateshead Water plc, in the form of an unsecured loan note repayable, at par, otherwise than by instalments and is subject to interest at an agreed rate of 0%. The company may exercise an option to repay the loan note at any time, also at par, subject to three months notice in writing. At present there is no intention to repay, therefore it has been classified as being due in five years or more.

£42.2m is owed to a subsidiary undertaking of the group, Suffolk Water plc, in the form of an unsecured loan note repayable, at par, otherwise than by instalments and is subject to interest at an agreed rate of 0%. The company may exercise an option to repay the loan note at anytime, also at par, subject to three months notice in writing. At present there is no intention to repay, therefore it has been classified as being due in five years or more.

## 20. AMOUNTS DUE TO OTHER GROUP COMPANIES (continued)

£119.5m is owed to a fellow subsidiary, North East Water plc, in the form of an unsecured loan note repayable, at par, otherwise than by instalments after more than 5 years and is subject to an interest rate linked to LIBOR. The company may exercise an option to repay the loan note at any time, also at par, subject to three months notice in writing. At present there is no intention to repay, therefore it has been classified as being due in five years or more.

£176.0m is owed to a fellow subsidiary, Essex and Suffolk Water plc, in the form of an unsecured loan note repayable at par. The company intends to exercise an option to repay the loan note, at par, in 2002.

£351.7m is owed to the immediate parent company, ONDEO Services UK plc. ONDEO Services UK plc issued £200m Guaranteed Eurobonds in February 1998 and issued a further £150m Guaranteed Eurobonds in September 2001, maturing 6 February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the company who received the issue proceeds by way of inter-company loans of £194.2m and £156.2m respectively. Finance costs allocated during the year amounted to £0.2m (December 2000: £0.2m).

£301.0m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £300.0m Guaranteed Eurobonds during the year, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by Northumbrian Water Limited who received the issue proceeds by way of an inter-company loan.

## 21. PROVISIONS FOR LIABILITIES AND CHARGES – GROUP AND COMPANY

	Reorganisation and restructuring provision	Pension provision	Total
	£'m	£'m	£'m
At 1 January 2001	5.8	8.9	14.7
Transferred from profit and loss account	0.4	-	0.4
Utilised during the year	(0.4)	(0.7)	(1.1)
At 31 December 2001	5.8	8.2	14.0

The reorganisation provision remaining at the end of the year incorporates outstanding pension contributions for staff who left the business on early retirement terms as part of voluntary severance schemes in 1998 and 1999 and outstanding severance and pension payments relating to the additional provision made in the year. The redundancy component of the provision will be paid within twelve months of the balance sheet date, and the pension augmentation component will be paid or amortised following the recommendations of the actuaries of the pension schemes in which the individuals concerned belong.

The pension provision represents amounts provided in respect of pension contributions for staff leaving the business as part of voluntary severance schemes prior to 1998. The company's actuary has assessed that the company is not required to make cash payments to fund these contributions. Accordingly the provision is being released over the average remaining service life of current employees.

## 22. ACCRUALS AND DEFERRED INCOME – GROUP AND COMPANY

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Capital grants and contributions:		
At 1 January	115.9	84.7
Transferred from Essex and Suffolk Water plc	-	25.0
Additions	7.3	9.5
Amortised during the year	<u>(3.6)</u>	<u>(3.3)</u>
At 31 December	<u>119.6</u>	<u>115.9</u>

## 23. CALLED UP SHARE CAPITAL – GROUP AND COMPANY

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (December 2000: 122,650,000)	<u>122.7</u>	<u>122.7</u>
	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (December 2000: 122,650,000)	<u>122.7</u>	<u>122.7</u>

## 24. PROFIT AND LOSS ACCOUNT – GROUP AND COMPANY

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
At 1 January	880.7	847.9
Profit retained for the year	<u>7.2</u>	<u>32.8</u>
At 31 December	<u>887.9</u>	<u>880.7</u>

As permitted by Section 230 of the Companies Act 1985, the company's profit and loss account has not been included in these financial statements. The profit for the financial year of £91.3m (December 2000: £109.8m) relates to the operations of the company.

**25. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS – GROUP AND COMPANY**

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Profit for the financial year	91.3	109.8
Dividends	(84.1)	(77.0)
	<hr/>	<hr/>
Net additions to equity shareholders' funds	7.2	32.8
Opening equity shareholders' funds	1,003.4	970.6
	<hr/>	<hr/>
Closing equity shareholders' funds	<u>1,010.6</u>	<u>1,003.4</u>

**26. COMMITMENTS AND CONTINGENT LIABILITIES – GROUP AND COMPANY**

(a) Capital expenditure	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Expenditure contracted for	91.0	36.8
	<hr/>	<hr/>

(b) Lease commitments:

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

	<u>December 2001</u>	<u>December 2000</u>
	£'m	£'m
Land and buildings:		
Leases which expire:		
Within one year	0.4	0.3
In five years or more	0.2	0.4
	<hr/>	<hr/>
	0.6	0.7
	<hr/>	<hr/>
Other:		
Leases which expire:		
Within one year	0.5	0.2
Between two and five years	-	0.8
	<hr/>	<hr/>
	0.5	1.0
	<hr/>	<hr/>

## 27. PENSIONS

ONDEO Services UK plc operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,304 employees. The Scheme, named the Northumbrian Lyonnaise Pension Scheme, comprises three unitised sections – the WPS section, LUKPS (North) section and LUKPS (South) section.

The assets of the Scheme are held separately from those of the ONDEO Services UK plc in independently administered funds.

The most recent actuarial valuation of the Scheme was at 31 December 1998. At that date the market value of the assets amounted to £416.2m in aggregate. The 1998 valuation disclosed that the combined value of the assets represented 114% of the value of the accrued liabilities.

The following table sets out the contributions agreed based on the 31 December 1998 valuations:

<b>Section</b>	<b>South</b>	<b>North</b>	<b>WPS</b>
Members' contributions	5%	5%	6%
Employer's contributions	Nil	6.3%	17.2%

The company contribution rate was assessed using the Projected Unit Method and the following actuarial assumptions: -

### **Investment Return**

- Pre Retirement	6.2%
- Post Retirement	5.7%

### **Pay Increases**

- for 5 years after valuation date	3.8%
- thereafter	4.3%

<b>Pension Increases</b>	2.8%
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<b>Price Inflation</b>	2.8%
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The next valuation will be carried out as at 31 December 2001.

Under the transitional provisions of FRS 17 "Retirement benefits" additional disclosures regarding the group defined benefit pension scheme are required. In accordance with FRS 17, the company will account for its contributions to the Scheme as if it were a defined contribution scheme because it is not possible to identify the company's share of the net assets and liabilities in the Scheme on a consistent and reasonable basis.

The latest actuarial valuation of the Scheme, prepared for the purposes of making the transitional disclosures in accordance with FRS 17 in the consolidated financial statements of the parent company, shows a surplus of £63.0m. Further details of this valuation can be found in the consolidated financial statements of the parent company.

ONDEO Services UK plc also participates in the Water Mirror Image Pension Scheme and the Employer's contribution has been assessed and paid in accordance with the advice of an independent actuary. This Scheme provides a defined benefit pension arrangement for 56 employees. The last actuarial valuation was carried out as at 31 March 2001. At that date the Scheme assets amounted to £21.8m and the assets represented 103% of the value of the accrued liabilities.

The Northumbrian Water Group Personal Pension Plan provides defined contribution benefits to 651 employees.

## **28. RELATED PARTY DISCLOSURES**

The company is a wholly owned subsidiary of ONDEO Services UK plc which produces publicly available financial statements which include the company. Consequently the company is exempt under the terms of Financial Reporting Standard No 8 "Related Party Disclosures" from disclosing transactions with other members of the group headed by ONDEO Services UK plc.

Transactions with other members of the group headed by Suez S.A. outside of the ONDEO Services UK Group, comprised purchases of £13.3m (December 2000: £25.4m) and sales of £1.6m (December 2000: £1.0m). As at 31 December 2001, the amount due to these companies was £3.1m (December 2000: £3.2m) and due from these companies was £1.2m (December 2000: £0.6m).

The companies with which Northumbrian Water Limited has had transactions during the year, included in the above balances, were as follows:

Macao Water Supply Company  
ONDEO Degremont  
ONDEO Nalco  
ONDEO Services S.A.  
Sita Holdings UK Limited  
Suez S.A.

## **29. ULTIMATE PARENT COMPANY**

The ultimate parent company and controlling party of the company is Suez S.A., incorporated in France. The largest group which consolidates the results of the company is Suez S.A. and copies of the consolidated accounts are available to the public from Suez S.A., 16 rue de la Ville l'Eveque, 75383, Paris, France.

The smallest group which consolidates the results of the company is that of which ONDEO Services UK plc (formerly Northumbrian Water Group plc) is the parent. Copies of the consolidated accounts may be obtained from ONDEO Services UK plc, Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ. ONDEO Services UK plc is registered in England and Wales.

## **30. BILLING ON BEHALF OF WATER AND SEWERAGE COMPANIES**

The Group bills and collects charges in respect of sewerage services in some of its area of supply on behalf of Anglian Water Services Limited and Thames Water Utilities Limited who are responsible for those services.

The Group receives commission income for those services, which is included in other operating income. Payments on account from customers due to Anglian Water Services and Thames Water Utilities Limited are included in creditors falling due within one year.

### 31. ACQUISITION

On 1 April 2000 the company acquired the trade and assets of Essex and Suffolk Water plc for a total consideration of £176.0m. The consideration was satisfied by the issue of a loan note for the full amount.

#### Profit and Loss Account

The profit and loss account for Essex and Suffolk Water plc for the period from 1 January 2000, the beginning of the company's financial year, to the date of acquisition, is as follows:

	3 months ended 31 March 2000
	£'m
Turnover	29.1
Operating costs	(13.9)
Capital maintenance costs	(2.5)
Operating profit	12.7
Net interest payable	(2.5)
Profit on ordinary activities before taxation	10.2
Tax on ordinary activities	(1.6)
Profit on ordinary activities after taxation	8.6

There were no recognised gains and losses for the three-month period to 31 March 2000 other than profit for the year.