

**FINANCIAL STATEMENTS**  
**NORTHUMBRIAN WATER LIMITED**  
**FOR THE YEAR ENDED 31 DECEMBER 2002**

Registered no: 2366703

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

# **FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2002**

<b>CONTENTS</b>	<b>Page</b>
Directors' report	1
Independent auditors' report to the shareholders of Northumbrian Water Limited	6
Group profit and loss account	7
Group statement of total recognised gains and losses	7
Group balance sheet	8
Company balance sheet	9
Group cash flow statement	10
Notes to the financial statements	12

## **DIRECTORS' REPORT**

### **For the year ended 31 December 2002**

The directors present their report and the audited financial statements for the year ended 31 December 2002.

#### **Results and dividends**

The group's profit after taxation for the year ended 31 December 2002 amounts to £90.9m (2001 as restated: £83.6m). The directors propose a final dividend on the ordinary shares of the company of £43.9m (2001: £42.1m) which, together with the interim dividend of £43.9m (2001: £42.0m), makes a total for the year of £87.8m (2001: £84.1m).

The prior year accounts have been restated following the implementation of FRS19 as described in note 2.

The group comprises the company Northumbrian Water Limited and its subsidiaries as detailed in note 12.

#### **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.

For the third 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 2002. The company was the only water and sewerage business in England and Wales to achieve the highest standard in each of Ofwat's customer service measures. The company also achieved the highest score in Ofwat's overall performance assessment which covers a wider range of non financial performance measures.

Turnover has increased by £3.1m compared to the prior year, mainly due to the impact of inflation based price increases in April 2001 (3.2%) and April 2002 (0.9%). These price increases resulted in income growth of £4.7m, which has been partially offset by lower water consumption by industrial customers (£2.6m). Growth in non-appointed activities also contributed an additional £1.0m income in 2002.

Operating costs have reduced by £2.5m from the prior year, largely reflecting the impact of additional operating efficiencies, partially offset by new additions to the cost base.

The capital maintenance costs show an increase of £4.0m on the prior year, reflecting the additional depreciation arising from the assets commissioned in the year.

Net interest payable increased by £1.0m on the prior year, although this included the benefit of a £50.0m interest swap which the company unwound in November resulting in a one off gain of £2.1m. The underlying interest charge increased by £3.1m, despite the benefit of very low variable interest rates during the year, reflecting the increase in the company's net debt of £122.4m in the year due mainly to the ongoing capital investment expenditure.

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 2003 and the business plan forecasts for the period from 2003 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 year of £5.5m (2001: £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. The year end trade creditors expressed as a number of days of purchases made during the year is 28 days (2001: 28 days).

### **Fixed assets**

Freehold land and buildings are carried in the accounts at historical cost with a net book value of £62.1m (2001: £100.3m). In the opinion of the directors, at 31 December 2002, there is no significant difference between the net book value and market value of property capable of disposal within the foreseeable future. Note 11 gives more details of the fixed asset movements during the year.

### **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.

The company has recently taken advantage of the prevailing lower interest rates, and the favourable level of interest shown by the sterling bond market in water companies, to issue a new sterling bond dated 2033 for £250.0m. The issue was completed in December 2002, at a very favourable interest rate of 5.625%, thereby securing prefunding for further capital investment obligations.

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

### **Directors**

The directors who served during the year were as follows:

Professor Sir F G T Holliday CBE (67)  
Non-Executive Chairman

J A Cuthbert (50)  
Executive Managing Director

C M Green (48)  
Executive Director

A Chaigneau (52)  
Non-Executive Director

R R Allan (68)  
Non-Executive Director

G Neave (47)  
Executive Director – appointed 31 January 2002

A G Balls (59)  
Non-Executive Director – appointed 1 April 2002

A M Frew (45)  
Non-Executive Director – appointed 1 April 2002

B Guirkinger (50)  
Non-Executive Director – appointed 25 July 2002

J F Petry (48)  
Non-Executive Director – appointed 14 October 2002

P Babin (45)  
Resigned 25 July 2002

Sir J D R Bradbeer OBE (71)  
Resigned 31 March 2002

J A Haynes (72)  
Resigned 31 March 2002

Directors' interests are disclosed in note 6 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 ultimate parent company, Suez S.A.

#### Communication

Communication with staff is achieved through the company's corporate newspaper 'Hel'eau' 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

The company has invited employees to join an employee investment scheme which is offered by the parent company, Suez S.A.

The present scheme, called SPRING, consists of two elements giving employees a choice of two different types of investment, or a combination of both. They can invest in a fund, SPRING Classic, which holds Suez S.A. shares which have been purchased at a discount, and/or, they can invest in a company, SPRING Multiple, which also holds Suez S.A. shares.

The SPRING Multiple investment guarantees the employee the return on their initial investment but gives the opportunity to increase their share in any growth in the value of the ultimate parent company's shares through the existence of a matched investment by Credit Agricole Indosuez.

The Directors believe that employee investment is a valuable method of strengthening the ties between the company employees and Suez S.A. by providing the opportunity for employees to participate more closely in the parent company's economic performance and results. To encourage participation in the plan the company made a discretionary contribution of up to £100 for all employees investing in SPRING Classic.

### **Pensions**

Information about the pension schemes operated by the group is contained in note 28 to the financial statements.

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

### **Charitable and Political Contributions**

During the year the company made charitable donations of £55,100 (2001: £60,659). The company made no donations to any political party during the year (2001: £nil).

### **Auditors**

In 2002, Arthur Andersen resigned as auditors. The shareholders, by written resolution, appointed Ernst & Young LLP as auditors to fill the vacancy arising.

### **Statement of 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 2002. 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.

BY ORDER OF THE BOARD

M Parker  
Company Secretary

10<sup>th</sup> April 2003

## **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 2002 which comprise the group profit and loss account, group statement of total recognised gains and losses, group balance sheet, company balance sheet, group cash flow statement, notes to the cash flow statement and the related notes numbered 1 to 30. These financial statements have been prepared under the accounting policies set out therein.

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

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

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

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 judgements 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 2002 and of the group's profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP  
Registered Auditor  
Newcastle-upon-Tyne

10<sup>th</sup> April 2003

**GROUP PROFIT AND LOSS ACCOUNT**  
**For the year ended 31 December 2002**

	Note	December 2002	December 2001 (as restated)
		£'m	£'m
Turnover	3	439.2	436.1
Operating costs	4(a)	(196.2)	(198.7)
Capital maintenance costs	4(b)	(81.4)	(77.4)
<b>OPERATING PROFIT</b>		<b>161.6</b>	<b>160.0</b>
Net interest payable	5	(68.6)	(67.6)
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>	4(c)	<b>93.0</b>	<b>92.4</b>
Taxation	9(a)	(2.1)	(8.8)
<b>PROFIT FOR THE FINANCIAL YEAR</b>		<b>90.9</b>	<b>83.6</b>
Dividends	10	(87.8)	(84.1)
<b>PROFIT/(LOSS) RETAINED FOR THE YEAR</b>	25	<b>3.1</b>	<b>(0.5)</b>

All activities are continuing.

**GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES**  
**For the year ended 31 December 2002**

	December 2002	December 2001 (as restated)
	£'m	£'m
Total recognised gains in the period	90.9	83.6
Prior year adjustment (note 2 )	(153.5)	-
Total gains and losses recognised since last annual report and financial statements	<b>(62.6)</b>	<b>83.6</b>

## GROUP BALANCE SHEET

At 31 December 2002

	Note	December 2002 <u>£'m</u>	December 2001 (as restated) <u>£'m</u>
<b>FIXED ASSETS</b>			
Tangible assets	11	2,483.7	2,358.2
<b>CURRENT ASSETS</b>			
Stocks	13	2.8	2.7
Debtors	14	104.5	85.8
Investments	15	120.1	240.5
Cash at bank and in hand		3.5	1.9
		<u>230.9</u>	<u>330.9</u>
<b>CREDITORS</b>			
Amounts falling due within one year	16	(224.6)	(408.7)
		<u>6.3</u>	<u>(77.8)</u>
<b>NET CURRENT ASSETS/(LIABILITIES)</b>			
		<u>2,490.0</u>	<u>2,280.4</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
		<u>2,490.0</u>	<u>2,280.4</u>
<b>CREDITORS: Amounts falling due after more than one year</b>			
	17	(1,327.4)	(1,136.2)
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>			
	22	(174.2)	(167.5)
<b>ACCRUALS AND DEFERRED INCOME</b>			
	23	(128.2)	(119.6)
		<u>(1,629.8)</u>	<u>(1,423.3)</u>
<b>NET ASSETS</b>			
		<u><u>860.2</u></u>	<u><u>857.1</u></u>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	24	122.7	122.7
Profit and loss account	25	737.5	734.4
		<u>860.2</u>	<u>857.1</u>
<b>EQUITY SHAREHOLDERS' FUNDS</b>			
	26	<u><u>860.2</u></u>	<u><u>857.1</u></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

10<sup>th</sup> April 2003

## COMPANY BALANCE SHEET

At 31 December 2002

	Note	December 2002	December 2001 (as restated)
		£'m	£'m
<b>FIXED ASSETS</b>			
Tangible assets	11	2,483.7	2,358.2
Investments	12	89.4	89.4
		<u>2,573.1</u>	<u>2,447.6</u>
<b>CURRENT ASSETS</b>			
Stocks	13	2.8	2.7
Debtors	14	104.5	85.8
Investments	15	120.1	240.5
Cash at bank and in hand		3.5	1.9
		<u>230.9</u>	<u>330.9</u>
<b>CREDITORS</b>			
Amounts falling due within one year	16	(224.6)	(408.7)
<b>NET CURRENT ASSETS/(LIABILITIES)</b>		<u>6.3</u>	<u>(77.8)</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>2,579.4</u>	<u>2,369.8</u>
<b>CREDITORS: Amounts falling due after more than one year</b>	17	(1,416.8)	(1,225.6)
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>	22	(174.2)	(167.5)
<b>ACCRUALS AND DEFERRED INCOME</b>	23	(128.2)	(119.6)
		<u>(1,719.2)</u>	<u>(1,512.7)</u>
<b>NET ASSETS</b>		<u>860.2</u>	<u>857.1</u>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	24	122.7	122.7
Profit and loss account	25	737.5	734.4
<b>EQUITY SHAREHOLDERS' FUNDS</b>	26	<u>860.2</u>	<u>857.1</u>

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

Approved on behalf of the board

J A Cuthbert

C M Green

10<sup>th</sup> April 2003

**GROUP CASH FLOW STATEMENT**  
**For the year ended 31 December 2002**

	Note	December 2002	December 2001
		£'m	£'m
NET CASH INFLOW FROM OPERATING ACTIVITIES	a	232.9	241.1
<b>Return on investments and servicing of finance</b>			
Interest received		6.1	0.9
Interest paid		(70.8)	(66.0)
Interest element of finance lease rentals		(1.6)	(1.7)
Net cash outflow from returns on investments and servicing of finance		(66.3)	(66.8)
<b>Taxation</b>			
United Kingdom corporation tax paid		(6.8)	(9.9)
Net cash outflow from taxation		(6.8)	(9.9)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets		(203.2)	(191.2)
Sale of tangible fixed assets		0.7	0.8
Grants, contributions and connection charges		11.6	7.3
Net cash outflow from capital expenditure and financial investment		(190.9)	(183.1)
<b>Equity dividends paid</b>		(86.0)	(82.2)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(117.1)	(100.9)
<b>Management of liquid resources</b>			
Purchase of short term deposits		(843.4)	(320.3)
Sale of short term deposits		963.7	80.0
Net cash inflow/(outflow) from management of liquid resources	b	120.3	(240.3)
<b>Financing</b>			
New loans		327.7	457.6
Debenture repayments		(8.0)	-
Loan repayments		(318.1)	(108.1)
Capital element of finance lease rental payments		(3.2)	(3.7)
Net cash (outflow)/inflow from financing	b	(1.6)	345.8
INCREASE IN CASH IN THE YEAR	b	1.6	4.6

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 2002

### a RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	Note	December 2002	December 2001
		£'m	£'m
Operating profit		161.6	160.0
Depreciation of tangible fixed assets	4(b)	82.0	78.0
Amortisation of capital grants	4(c)	(3.0)	(3.6)
Profit on sale of fixed assets	4(b)	(0.6)	(0.6)
Increase in stock		(0.1)	(0.5)
(Increase)/decrease in debtors		(13.8)	8.8
Increase/(decrease) in creditors		8.5	(0.3)
Decrease in restructuring provision		(1.7)	(0.7)
		232.9	241.1

The operating cash flows are all from continuing operations.

### b ANALYSIS AND RECONCILIATION OF NET DEBT

	1 January 2002	Cash flow	Other non- cash changes	31 December 2002
	£'m	£'m	£'m	£'m
Cash at bank and in hand	1.9	1.6	-	3.5
Debt due after 1 year	(1,082.0)	(207.0)	18.5	(1,270.5)
Debt due within 1 year	(206.6)	205.4	(18.4)	(19.6)
Finance leases	(56.9)	3.2	(5.4)	(59.1)
	(1,345.5)	1.6	(5.3)	(1,349.2)
Current asset investments	240.3	(120.3)	-	120.0
Net debt	(1,103.3)	(117.1)	(5.3)	(1,225.7)

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

	December 2002	December 2001
	£'m	£'m
Increase in cash in the year	1.6	4.6
Cash outflow/(inflow) from decrease/(increase) in debt and lease financing	1.6	(345.8)
Cash (inflow)/outflow from (decrease)/increase in liquid resources	(120.3)	240.3
Change in net debt resulting from cash flows	(117.1)	(100.9)
Finance costs incurred during the year	0.1	(0.2)
Finance lease interest capitalised	(1.0)	(1.0)
Finance lease non cash movement	(4.4)	(2.2)
Movement in net debt in year	(122.4)	(104.3)
Net debt at 1 January 2002	(1,103.3)	(999.0)
Net debt at 31 December 2002	(1,225.7)	(1,103.3)

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2002

### 1. STATEMENT OF ACCOUNTING POLICIES

These financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the principal accounting policies is set out below. These have been applied consistently throughout the current and preceding years, with the exception of FRS19 which is described 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. Costs include external and internal costs to bring the asset into use.

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) **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 to the profit and loss account over the expected useful economic lives of the qualifying assets. Specifically in the case of infrastructure assets, the expected useful economic lives have been determined by reference to the physical replacement cycle of these assets.

(f) **Hire purchase and leasing**

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

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

(g) **Stocks**

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

(h) **Pension costs**

The company is a member of the Northumbrian Lyonnaise Pension Scheme which is a multi employer scheme and the assets cannot be apportioned to individual companies. Accordingly, these financial statements account for pension costs as a defined contribution scheme and charges are made as incurred.

The company also operates a defined contribution scheme. The costs are charged to the profit and loss account in the year they are incurred.

(i) **Taxation**

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

Financial Reporting Standard No. 19, "Deferred taxation" ("FRS19"), has been adopted in the period. In previous periods deferred tax was dealt with under Statement of Standard Accounting Practice 15 and, by adopting a partial provision approach, no provision was made in the financial statements. Under FRS19 full provision for deferred tax is required for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation.

As permitted by FRS19 the company has decided to adopt a policy of discounting deferred tax assets and liabilities to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained at the balance sheet date on government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

As a consequence of the change in accounting policy, the balance sheet has been restated to show a deferred tax liability at 31 December 2001 of £153.5m and the profit and loss account has

been restated to show a deferred tax charge for the year ended 31 December 2001 of £7.7m, as described in note 2. Profit for the current year has been reduced by £8.4m as a result of the change

## 1. STATEMENT OF ACCOUNTING POLICIES (continued)

- (i) **Taxation (continued)**  
in accounting policy. The balance sheet shows a deferred tax liability at 31 December 2002 of £161.9m
- (j) **Foreign currency**  
All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the date of transaction. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange gains or losses are recognised in the profit and loss account in the period incurred.
- (k) **Research and development**  
Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.
- (l) **Investments**  
Fixed asset investments are stated at their purchase cost, less provision for diminution in value.
- (m) **Derivative Financial Instruments**  
The company utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments.

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

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

Forward exchange contracts are valued at the 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.

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

## 2. PRIOR YEAR ADJUSTMENT

As set out in note 1(i) above the company has changed its accounting policy for deferred tax by adopting FRS 19. As a result the comparatives have been restated as follows:

### (a) Group profit and loss account

	<u>Taxation</u>	<u>Profit for the financial year</u>
	£'m	£'m
Year ended 31 December 2001 as previously reported	(1.1)	91.3

Prior year adjustment	<u>(7.7)</u>	<u>(7.7)</u>
Year ended 31 December 2001 as restated	<u>(8.8)</u>	<u>83.6</u>

The brought forward reserves for 2001 have been restated by £145.8m.

## 2. PRIOR YEAR ADJUSTMENT (continued)

### (b) Group balance sheet

	Provisions for liabilities and charges – Deferred tax £'m	Profit and loss reserve £'m
As at 31 December 2001 as previously reported	-	887.9
Prior year adjustment	<u>153.5</u>	<u>(153.5)</u>
As at 31 December 2001 as restated	<u>153.5</u>	<u>734.4</u>

## 3. TURNOVER

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

## 4. OPERATING COSTS, CAPITAL MAINTENANCE COSTS AND PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

### (a) Operating costs comprise:

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Materials and consumables	13.2	13.3
Other external charges	47.3	46.5
Manpower costs (note 8a)	63.3	60.8
Other operating charges	89.3	92.6
Own work capitalised	<u>(16.9)</u>	<u>(14.5)</u>
	<u>196.2</u>	<u>198.7</u>

### (b) Capital maintenance costs comprise:

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Depreciation:		
Non-infrastructure assets	48.7	46.0
Non-infrastructure assets held under finance leases	4.4	3.3
Infrastructure assets	28.9	28.7
Profit on disposal of fixed assets	<u>(0.6)</u>	<u>(0.6)</u>
	<u>81.4</u>	<u>77.4</u>



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

(c) Profit on ordinary activities before taxation:

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Profit on ordinary activities before taxation is stated after crediting:		
Amortisation of capital grants (note 23)	3.0	3.6
And after charging:		
Operating leases: Plant and machinery	0.2	0.9
Other assets	0.8	0.9
Costs of research and development	5.5	5.3
Directors' emoluments (note 6)	0.7	0.8

Auditors' remuneration for the statutory audit amounted to £66,000 (2001: £66,500). There were no fees for non-audit services (2001: £nil).

#### 5. NET INTEREST PAYABLE

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	69.2	63.8
Debenture stock interest	2.6	2.3
Financing charges payable under finance leases	2.8	2.8
Total interest payable	74.6	68.9
Interest receivable	(6.0)	(1.3)
Net interest payable	68.6	67.6

## 6. DIRECTORS' EMOLUMENTS AND INTERESTS

Directors' remuneration

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

	<u>December 2002</u>	<u>December 2001</u>
	£'000	£'000
Emoluments (including benefits in kind)	<u>728.5</u>	<u>769.0</u>

Highest paid director

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

	<u>December 2002</u>	<u>December 2001</u>
	£'000	£'000
Emoluments (including benefits in kind)	<u>239.3</u>	<u>214.2</u>

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 December 2002 was £64,558 (31 December 2001: £78,990). In addition to the pension, there is a tax-free lump sum at normal pension date of which the accrued entitlement at 31 December 2002 was nil (31 December 2001: £236,970).

Three of the directors at 31 December 2002 were members of a defined benefit pension scheme where the company makes contributions towards the cost (2001: 2).

The directors who held office at 31 December 2002 had no interest in the shares of the company.

In accordance with the Companies (Disclosure of Directors' Interests) (Exemptions) Regulations 1985, the company is no longer required to be notified of and to report on Directors' interests in its ultimate parent company. This is due to the company becoming wholly owned by its ultimate parent company during the financial year to 31 December 2002, which is a company incorporated outside of Great Britain.

## 7. TRANSACTIONS WITH DIRECTORS AND OFFICERS

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

## 8. EMPLOYEE INFORMATION

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

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Costs charged to the profit and loss account:		
Wages and salaries	41.5	41.8
Social security costs	3.2	3.2
Other pension costs	3.2	3.2
	<u>47.9</u>	<u>48.2</u>
Costs charged to capital schemes:		
Wages and salaries	13.3	11.0
Social security costs	1.1	0.8
Other pension costs	1.0	0.8
	<u>15.4</u>	<u>12.6</u>
Total employee costs	<u>63.3</u>	<u>60.8</u>

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

	<u>December 2002</u>	<u>December 2001</u>
	Number	Number
Average during the year	<u>2,259</u>	<u>2,185</u>
Total at 31 December	<u>2,320</u>	<u>2,220</u>

## 9. TAXATION

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

	December 2002	December 2001
	£'m	£'m
Current tax:		
UK corporation tax on profits for the year at 30%	1.5	2.2
Adjustments in respect of prior years	(9.1)	(4.2)
Payable in respect of group relief for the current year at 30%	6.2	3.1
Adjustments in respect of prior years	(4.9)	-
Total current tax (credit)/charge (note 9b)	<u>(6.3)</u>	<u>1.1</u>
Deferred tax:		
Origination and reversal of timing differences in the year	22.6	24.5
Adjustments in respect of prior years	9.5	4.3
	<u>32.1</u>	<u>28.8</u>
Increase in discount	(23.7)	(21.1)
Total deferred tax (note 22)	<u>8.4</u>	<u>7.7</u>
Tax on profit on ordinary activities	<u><u>2.1</u></u>	<u><u>8.8</u></u>

The company has provisionally claimed tax losses from fellow subsidiaries in the current year of £20.7m (2001: £10.1m) for which payment will be made at the rate of 30%.

### (b) Factors affecting the tax charge/(credit) for the financial year:

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30%) (2001: 30%). The differences are explained below:

	December 2002	December 2001
	£'m	£'m
Profit on ordinary activities before tax	<u>93.0</u>	<u>92.4</u>
Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%) (2001 30%)	27.9	27.7
Effects of:		
Expenses not deductible for tax purposes	1.3	1.0
Depreciation in respect of non-qualifying items	1.1	1.1
Capital allowances in excess of depreciation	(25.2)	(23.4)
Other timing differences	2.6	(1.1)
Adjustment to tax charge in respect of previous years	(14.0)	(4.2)
Current tax (credit) / charge (note 9a)	<u><u>(6.3)</u></u>	<u><u>1.1</u></u>

## 9. TAXATION (continued)

### (c) Factors that may affect future tax charges:

The company expects to continue to incur high levels of capital expenditure and accordingly it expects to be able to claim capital allowances in excess of depreciation at a similar level to the current year.

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

## 10. DIVIDENDS

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Equity:		
Interim paid of 35.81p (2001: 34.23p) per share on an aggregated basis	43.9	42.0
Final proposed of 35.81p (2001: 34.31p) per share on an aggregated basis	43.9	42.1
	<u>87.8</u>	<u>84.1</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.

## 11. 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 2002	120.6	1,208.9	1,253.4	119.8	124.6	2,827.3
Additions	-	-	-	-	207.5	207.5
Schemes commissioned	0.6	76.1	112.7	6.1	(195.5)	-
Reclassifications	(39.4)	37.6	27.1	(32.5)	6.8	(0.4)
Disposals	-	(16.9)	-	(0.8)	-	(17.7)
At 31 December 2002	81.8	1,305.7	1,393.2	92.6	143.4	3,016.7
Depreciation:						
At 1 January 2002	20.3	137.2	253.2	58.4	-	469.1
Provision for year	0.7	28.9	46.5	5.9	-	82.0
Reclassifications	(1.3)	-	0.5	0.3	-	(0.5)
Disposals	-	(16.9)	-	(0.7)	-	(17.6)
At 31 December 2002	19.7	149.2	300.2	63.9	-	533.0
Net book value:						
At 31 December 2002	62.1	1,156.5	1,093.0	28.7	143.4	2,483.7
At 31 December 2001	100.3	1,071.7	1,000.2	61.4	124.6	2,358.2
Leased assets included above:						
Net book value						
At 31 December 2002	-	2.2	25.4	4.5	-	32.1
At 31 December 2001	-	2.2	27.9	1.9	-	32.0

## 12. FIXED ASSET INVESTMENT - COMPANY

	December 2002	December 2001
	£'m	£'m
At 1 January and 31 December	<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 the ordinary shares of 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 equates to a 100% holding in the ordinary shares of Suffolk Water plc, 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.

The company has a wholly owned subsidiary undertaking, Northumbrian Water Finance plc, whose principal activity is to hold certain finance instruments on behalf of Northumbrian Water Ltd. This investment equates to a 100% holding in the ordinary shares of Northumbrian Water Finance plc.

## 13. STOCKS – GROUP AND COMPANY

	December 2002	December 2001
	£'m	£'m
Raw materials and consumables	<u>2.8</u>	<u>2.7</u>

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

## 14. DEBTORS – GROUP AND COMPANY

	December 2002	December 2001
	£'m	£'m
Trade debtors	52.1	54.4
Amounts owed by other group companies	2.4	3.4
Corporation tax repayable	5.7	-
Other debtors	7.1	5.7
Prepayments and accrued income	<u>37.2</u>	<u>22.3</u>
	<u>104.5</u>	<u>85.8</u>

Trade debtors are shown net of bills raised in advance. Included in amounts owed by other group companies is £nil (2001: £0.3m) in respect of advance corporation tax surrendered in prior years.

## 15. INVESTMENTS – GROUP AND COMPANY

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Short term deposits	120.0	240.3
Assets held for resale	0.1	0.2
	<u>120.1</u>	<u>240.5</u>

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

	<u>December 2002</u>		<u>December 2001</u>	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	3.2	3.2	3.7	3.7
Loans (note 18)	18.4	18.4	22.6	22.6
Debenture stock (note 19)	-	-	8.0	8.0
Trade creditors	2.8	2.8	3.2	3.2
Amounts owed to other group companies	36.6	40.7	204.5	205.5
Taxation and social security	1.4	1.4	1.6	1.6
Corporation tax	-	-	14.2	14.2
Other creditors	15.1	15.1	20.1	20.1
Receipts in advance	39.3	39.3	30.9	30.9
Dividend payable	43.9	43.9	42.1	42.1
Accruals and deferred income	63.9	59.8	57.8	56.8
	<u>224.6</u>	<u>224.6</u>	<u>408.7</u>	<u>408.7</u>

Accruals and deferred income includes accruals related to capital projects of £23.4m (2001: £24.0m). Amounts owed to other group companies include amounts related to capital projects of £3.8m (2001: £3.2m).

Included in amounts owed to other group companies is £9.2m (2001: £2.7m) payable in respect of tax losses surrendered from fellow group companies. Also included in amounts owed to other group companies is £1.2m (2001: £176.0m) relating to loans repayable within one year (note 21).

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

	December 2002		December 2001	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under hire purchase contracts and finance leases (note 20)	55.9	55.9	53.2	53.2
Loans (note 18)	904.5	357.1	596.5	295.5
Debenture stocks (note 19)	14.3	14.3	14.3	14.3
Amounts owed to other group companies (note 21)	351.7	988.5	471.2	861.6
Other creditors	1.0	1.0	1.0	1.0
	<u>1,327.4</u>	<u>1,416.8</u>	<u>1,136.2</u>	<u>1,225.6</u>

At 31 December 2002 the group and company had entered into the following interest swap arrangements: £15.0m (2001: £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%, £1.0m (2001: £2.9m) 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 (2001: £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.

## 18. LOANS

	December 2002		December 2001	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Loans are repayable as follows:				
Within one year (note 16)	18.4	18.4	22.6	22.6
Between one and two years	48.1	48.1	23.0	23.0
Between two and five years	53.0	53.0	94.8	94.8
After five years	803.4	256.0	478.7	177.7
	<u>922.9</u>	<u>375.5</u>	<u>619.1</u>	<u>318.1</u>

Loans wholly repayable by instalments repayable within 5 years amount to £23.4m (2001: £32.3m). Loans repayable by instalments not wholly repayable within 5 years amount to £247.1m (2001: £180.8m) and bear interest rates in the range of 4.94% to 8.55% of which £66.1m (2001: £78.0m) falls due in less than 5 years and £181.0m (2001: £102.8m) 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 (2001: £30.0) and bear interest at rates in the range of 3.96% and 7.95%.

Loans repayable otherwise than by instalments which fall due after more than 5 years amount to £622.4m (2001: £376.0m) and bear interest at rates in the range of 3.85% and 6.0%.

## **18. 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 of directors 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 and interest rate 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.

## 18. 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 2002 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	(922.9)	(135.5)	(787.4)	6.06	18.4	18.4	-
Debtentures	(14.3)	-	(14.3)	9.84	4.5	4.5	-
Internal loans	(352.9)	(1.2)	(351.7)	6.75	20.1	20.1	-
Finance leases	(59.1)	(52.1)	(7.0)	7.15	5.8	5.8	-
Total borrowings	(1,349.2)	(188.8)	(1,160.4)	6.32	12.2	12.2	-
Cash	3.5	3.5	-				-
Short term investments	120.0	120.0	-				-
Net borrowings	(1,225.7)	(65.3)	(1,160.4)				-

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	-
Debtentures	(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)				-

## 18. LOANS (continued)

Included within the external sterling loans of the group above are loans amounting to £21.3m (2001: £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 2002, the group had no currency exposures (2001: £nil).

### Borrowing facilities

The group had no undrawn committed borrowing facilities as at 31 December 2002 but had access to undrawn committed borrowing facilities available to ONDEO Services UK plc which, at 31 December 2002, amounted to £100.0m (2001:£125.0m).

### 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 2002:

	<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	(22.8)	(26.4)
Long term borrowings	(1,326.4)	(1,410.5)
Financial assets	123.5	123.5
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	<u>-</u>	<u>1.0</u>
As at 31 December 2002	<u>(1,225.7)</u>	<u>(1,312.4)</u>

## 18. 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 2001:

	<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	(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>

The fair values of the interest rate swaps and sterling denominated long term fixed rate debt with a book value of £913.3m (2001: £675.0m) 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

	Gains	Losses	Total net
	£'m	£'m	gains/losses
			£'m
Unrecognised gains and losses on hedges at 1 January 2002	2.1	0.4	1.7
Gains and losses arising in previous years that were recognised in 2002	<u>(0.9)</u>	<u>(0.4)</u>	<u>(0.5)</u>
Gains and losses arising before 1 January 2002 that were not recognised in 2002	1.2	0.0	1.2
Gains and losses arising in 2002 that were not recognised in 2002	<u>0.2</u>	<u>0.4</u>	<u>(0.2)</u>
Unrecognised gains and losses on hedges at 31 December 2002	<u><u>1.4</u></u>	<u><u>0.4</u></u>	<u><u>1.0</u></u>
Of which:			
Gains and losses expected to be recognised in 2003	0.7	0.4	0.3
Gains and losses expected to be recognised in 2004 or later	<u>0.7</u>	<u>-</u>	<u>0.7</u>

1.4      0.4      1.0

## 18. 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.

## 19. DEBENTURE STOCKS

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Debtenture stocks are repayable as follows:		
In less than one year:		
£1, 11.75% Redeemable 2002/04 (note 16)	<u>-</u>	<u>8.0</u>
Between one and two years		
£1, 12.0% Redeemable 2004	5.0	-
Between two and five years:		
£1, 12.0% Redeemable 2004	-	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>14.3</u>	<u>14.3</u>
At 31 December	<u>14.3</u>	<u>22.3</u>

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

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

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

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Amounts due:		
Within one year	3.2	3.7
Between one and two years	3.2	2.9
Between two and five years	8.9	9.2
After five years	68.9	75.5
	<u>84.2</u>	<u>91.3</u>
Less:		
Finance charge allocated to future periods	(25.1)	(34.4)
	<u>59.1</u>	<u>56.9</u>
Disclosed as due:		
Within one year (note 16)	3.2	3.7
After more than one year (note 17)	55.9	53.2
	<u>59.1</u>	<u>56.9</u>

## 21. AMOUNTS DUE TO OTHER GROUP COMPANIES

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

	<u>December 2002</u>		<u>December 2001</u>	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Within one year	1.2	1.2	176.0	176.0
Between one and two years	-	-	-	-
Between two and five years	-	-	-	-
After five years	351.7	988.5	471.2	861.6
	<u>352.9</u>	<u>989.7</u>	<u>647.2</u>	<u>1,037.6</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.

## **21. AMOUNTS DUE TO OTHER GROUP COMPANIES (continued)**

At 31 December 2001 £119.5m was owed to a fellow subsidiary, North East Water plc, in the form of an unsecured loan note repayable, at par. At that time there was no intention to repay and the loan was therefore classified as being due in five years or more. In December 2002, the company exercised its option to repay the loan note at any time, also at par.

£351.7m is owed to the immediate parent company, ONDEO Services UK plc. ONDEO Services UK plc issued £200.0m Guaranteed Eurobonds in February 1998 and issued a further £150.0m 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 £nil (2001: £0.2m).

£300.9m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £300.0m Guaranteed Eurobonds in 2001, 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. Amortised receipts in the year amounted to £0.1m (2001: £nil).

£246.5m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £250.0m Guaranteed Eurobonds during December 2002, maturing April 2033, with an annual coupon of 5.625%. The issue was guaranteed by Northumbrian Water Limited who received the issue proceeds by way of an inter-company loan.

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

	December 2002
	£'m
Reorganisation / restructuring provision:	
At 1 January	5.8
(Released to)/Transferred from profit and loss account	(0.4)
Transferred from pension provision	7.6
Utilised during the year	(0.7)
At 31 December	<u>12.3</u>
Pension provision:	
At 1 January	8.2
Released to profit and loss account	(0.6)
Transferred to reorganisation/restructuring provision	(7.6)
Utilised during the year	-
At 31 December	<u>-</u>
Deferred tax :	
At 1 January as previously reported	-
Prior year adjustment	153.5
At 1 January as restated	153.5
Movement in the year (note 9a)	8.4
At 31 December	<u>161.9</u>
Closing balance	<u><u>174.2</u></u>

The reorganisation and restructuring provision 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 1999 and earlier. Following the recommendation of the actuaries of the pension schemes in which the individuals concerned belong, the amount was paid in full in January 2003 with the approval of the trustees of the pension schemes.

The provision for deferred tax comprises:

	December 2002	December 2001 (as restated)
	£'m	£'m
Accelerated capital allowances	457.4	421.8
Other timing differences	(51.2)	(47.7)
Undiscounted provision for deferred tax	406.2	374.1
Discount	(244.3)	(220.6)
Discounted provision for deferred tax	<u>161.9</u>	<u>153.5</u>

**23. ACCRUALS AND DEFERRED INCOME – GROUP AND COMPANY**

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Capital grants and contributions:		
At 1 January	119.6	115.9
Additions	11.6	7.3
Amortised during the year	<u>(3.0)</u>	<u>(3.6)</u>
At 31 December	<u><u>128.2</u></u>	<u><u>119.6</u></u>

**24. CALLED UP SHARE CAPITAL – GROUP AND COMPANY**

	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2001: 122,650,000)	<u>122.7</u>	<u>122.7</u>
	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2001: 122,650,000)	<u>122.7</u>	<u>122.7</u>

**25. PROFIT AND LOSS ACCOUNT – GROUP AND COMPANY**

	<u>December 2002</u>
	£'m
At 1 January as previously reported	887.9
Prior year adjustment (note 2a)	<u>(153.5)</u>
At 1 January as restated	734.4
Retained profit for the year	<u>3.1</u>
At 31 December	<u><u>737.5</u></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 £90.9m (2001 - as restated: £83.6m) relates to the operations of the company.

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

	<u>December 2002</u>
	£'m
Opening equity shareholders' funds as previously reported	1,010.6
Prior year adjustment (note 2)	<u>(153.5)</u>
Opening equity shareholders' funds as restated	857.1
Profit for the financial year	90.9
Dividends	<u>(87.8)</u>
Closing equity shareholders' funds	<u><u>860.2</u></u>

**27. COMMITMENTS – GROUP AND COMPANY**

(a) Capital expenditure	<u>December 2002</u>	<u>December 2001</u>
	£'m	£'m
Expenditure contracted for	<u>67.0</u>	<u>91.0</u>

(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 2002</u>	<u>December 2001</u>
	£'m	£'m
Land and buildings:		
Leases which expire:		
Within one year	0.1	0.4
In five years or more	<u>0.6</u>	<u>0.2</u>
	<u>0.7</u>	<u>0.6</u>
Other:		
Leases which expire:		
Within one year	<u>-</u>	<u>0.5</u>

## 28. PENSIONS

ONDEO Services UK plc operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,345 employees. The Scheme, named the Northumbrian Lyonnaise Pension Scheme, comprises four unitised sub-funds – WPS, LUKPS (North), LUKPS (South) and MIS.

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

The most recent actuarial valuation of the Scheme was at 31 December 2001. At that date the market value of the assets amounted to £441.0m in aggregate (excluding MIS which was valued at approximately £20.0m). The 2001 valuation disclosed that the combined value of the assets represented 109% of the value of the accrued liabilities.

The following table sets out the contributions agreed based on the 31 December 2001 valuations:

<b>Section</b>	<b>WPS</b>	<b>North</b>	<b>South</b>	<b>MIS</b>
Members' contributions	6%	5%	5%	5%/6%
Employer's contributions	15.5%	10.5%	Nil	6%/7.2%

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

<b>Investment Return</b>	
- Pre Retirement	6.1%
- Post Retirement	5.7%
<b>Pay Increases</b>	3.5%
<b>Pension Increases</b>	2.5%
<b>Price Inflation</b>	2.5%

During the year the group made contributions amounting to £4.2m.

The next valuation will be carried out as at 31 December 2004. An independent qualified actuary performs the actuarial valuation.

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 deficit of £76.3m. Further details of this valuation can be found in the consolidated financial statements of the parent company. Note that the company paid over £13.2m on 2 January 2003 which reduced the deficit to £63.1m.

In addition, Ondeo Services UK plc operates the Northumbrian Water Group Personal Pension Plan which provides defined contribution benefits to 885 employees.

## **29. 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.

## **30. 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 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.