



Preliminary results
for the year ending 31 March 2010

Foreword to the Preliminary Results Announcement

Basis of preparation

The following announcement of preliminary results includes information which has been extracted directly from the audited Glas Cymru Cyfyngedig Annual Report and Accounts for the year ended 31 March 2010. It does not include the Directors' Report, the Corporate Governance Statement or the 2010 Remuneration Report.

The independent Auditors' Report set out on pages 15 and 16 refers to the Glas Cymru Cyfyngedig Annual Report and Accounts as a whole. It therefore also covers procedures carried out on the Directors' Report, the Corporate Governance Statement and the 2010 Remuneration Report, which are excluded from this Preliminary Announcement.

Chairman's Statement

As Glas Cymru approaches its tenth anniversary it is a pleasure to be able to report another year of solid progress for Welsh Water, with real improvements in a number of key areas supported by a record investment for the longer term. Since this has been the final year of one of the industry's recurring five-year regulatory cycles and also my last Chairman's statement, it is a fitting time to stand back and assess what Glas Cymru's very special structure has achieved since we acquired Welsh Water in May 2001.

I believe that we have come a long way in that time and have established that 'not-for-profit' ownership of a long term industry providing an essential public service can work and work well. Under Glas Cymru's ownership Welsh Water is now financially secure and has delivered a step change improvement in performance for our customers in terms of bills, service standards and the quality of their environment. The Company is well placed to tackle the significant challenges it now faces following Ofwat's price determination that will see average household bills in the region £30 lower in real terms in five years' time than they were last year.

Ten years ago Welsh Water had the highest water bill in the industry and the second highest sewerage bill, something that our customers found difficult to understand in such a wet part of the country. This year our water bill is below the industry average and our sewerage bill is closer to the industry average – an achievement that has been possible only because of Welsh Water's sector-leading record of cost reduction that also made possible an annual 'customer dividend' that has been unique in the industry.

Financing efficiency has been one of our most important successes, and is the key to ensuring that the public service we provide is affordable. Under Glas Cymru's ownership we have created financial reserves of over £1 billion by reducing gearing from 93% at the acquisition of the company in 2001 to 71% today, funded 'customer dividends' of more than £150 million and achieved the best credit ratings in the sector. With 60% of our total borrowings being index-linked, interest costs last year fell by a third and a £140 million index-linked bond issue in March 2010 put the Company in a strong liquidity position with its capital expenditure requirements for the next regulatory period now largely pre-funded.

But financing efficiency is only part of the picture. In the regulated water industry much of what matters to customers and to the environment can be measured, compared and judged. Welsh Water was one of the poorest performers on this basket of measures 10 years ago, but by 2005 had improved to the best in the industry. In the years since 2005 we have suffered some setbacks, but we have been determined to rectify any shortfalls and to invest whatever is necessary to restore Welsh Water's position as a consistently leading water company on all the measures that matter for customers and for the environment.

I am delighted that Bob Ayling will be taking over as Chairman following this year's AGM. I would like to take this opportunity to thank my colleagues on the Board for all the support they have given me as Chairman over the years and for their continuing dedication to and enthusiasm for the Company and what we have set out to achieve. This commitment is exemplified by Dame Deirdre Hine who is also standing down as a Non-Executive Director at this year's AGM, after nearly 10 years on the board. Deirdre has been chair of our Quality and Environment Committee throughout that period and her contribution to the Board has been immense.

I must also thank the Members of the Company, who perform such an important corporate governance role, and who have brought the right mix of support and informed challenge to their task throughout.

Finally, I would like to thank all the staff who work so hard for Welsh Water, whether they are employed directly by the Company or not. It is a great team that always goes the extra mile and I am confident that it will again rise to the challenges that lie ahead and that Welsh Water and its customers will prosper as a result.

Lord Burns

Chairman - Glas Cymru Cyfyngedig

4 June 2010

Managing Director's Report

The past year has been an important one for Welsh Water: the conclusion of Ofwat's five-yearly price review has set significant challenges for us, and we have had to take difficult decisions on the future shape of the business in order to meet them. At the same time we can report another year of solid progress, including record capital investment, all designed to improve our service to customers, to safeguard the environment, and to bring our performance up to the high level to which the whole team aspires.

Performance

Our most important responsibility is safe drinking water. Overall compliance with water quality standards in 2009 remained very high at 99.95%, and there were fewer water quality incidents in 2009 although still more than the average for the water sector. To improve the reliability of our water supply network we have accelerated £200 million of investment to refurbish and upgrade 24 water treatment works, with priority given to those, mostly in North Wales, that previously have relied on single stage treatment of high quality source waters.

Schemes totalling £83 million at Cwellyn, Harlech and Penybont in North Wales and at Crai, Cwmbran and Talybont in South Wales, were completed during the year. Pending completion of this major improvement programme, we also installed additional ultra violet treatment at 24 sites to protect against the risk to public health posed by cryptosporidium in particular.

Wales, with only 15% of the British coastline, secured a record 50 Blue Flag awards – more than a third of the total awarded to all of the UK - for the 2010 summer season, and all 81 designated bathing beaches in Wales passed the mandatory European standard for coastal water quality. In addition, a record 48 Green Coast awards for rural beaches were secured. Wales also continues to have some of the highest quality rivers in the UK with more than 90% being classed by the Environment Agency as having good or very good chemical and biological water quality.

On the wastewater side compliance with discharge consents at our wastewater treatment works slipped to 99.9%, from 100% in 2008, and there were nine serious pollution incidents caused by asset breakdown, compared with just three in the previous year but 17 in the year before that. Getting back to sector-leading performance on environmental protection, which Welsh Water has achieved in the past, is a high priority.

Our relatively strong water resource position was reinforced during the year by the completion of a £7 million scheme in Anglesey to link two supply zones thereby further reducing the risk of shortages during droughts. Alongside water efficiency, managing leakage is important to ensure that we are able to maintain supplies during droughts and last year we again achieved Ofwat's leakage reduction target despite a doubling of the number of bursts following the freezing weather at the start of 2010.

Customer satisfaction, as measured by quarterly tracking research, reached a record high, with 83% of customers saying they were satisfied with the overall service provided by Welsh Water. This high standing was confirmed by Ofwat's independent research into customer satisfaction, with Welsh Water ranked as the second highest of the ten water and sewerage companies.

Against this encouraging picture, we still have more complaints than average about discoloured tap water. Moreover, we judge that more than half of the contacts we received last year from our customers could have been avoided - and one of the most important benefits we will secure from our £100 million IT modernisation programme will be to equip our customer facing staff with the information they need to deliver outstanding

customer service. A key element of this programme is the establishment of a new operational control centre at St Mellons near Cardiff which will open towards the end of 2010.

Last year the number of sewer flooding incidents fell by nearly 20%, from 392 to 317. We know that the very worst customer service failing is flooding from overloaded or blocked sewers and during the year we completed 92 schemes to reduce the risk of internal and external sewer flooding for over 460 properties, cutting the “at risk” register to 250. Over the last five years we have invested £59 million on upgrading our sewer network reducing the risk of repeat flooding for over 1,200 properties. The Consumer Council for Water uses “Leading Edge Tables” to identify areas of good practice and last year Welsh Water came top for the level of service it provides when dealing with a problem caused by flooding from a public sewer.

Value for money

As our Chairman states, Welsh Water has made great strides in reducing bills to something much closer to the average across England and Wales. Sector-leading cost reduction and financing efficiency has allowed us to sustain an annual ‘customer dividend’ that is unique in the industry. Last year the ‘customer dividend’ reduced each bill by £22 and brought the total sum returned to our customers in this way to more than £150 million.

Affordability has been at the heart of our plans since the start and it is very clear to us that many of our customers face real hardship in paying their water bill, particularly in the current economic climate. So, we have developed a unique range of customer assistance tariffs which, together with our Customer Assistance Fund, have helped 27,000 customers to afford their water bill.

The Ofwat price review has set some very challenging targets for us for the next five years. While our plans for £1.3 billion of capital investment were largely endorsed, we have been set the demanding target of reducing our controllable operating costs by 20%. As a result, the average household customer’s bill will fall in real terms over the next five years. With bills falling, and in order to marshal our financial resources in what is still a very difficult economic environment, the Board has decided to postpone any further ‘customer dividends’ until it is once again prudent to do so.

Outsourcing strategy

Since Glas Cymru acquired Welsh Water in 2001, we have employed an outsourcing strategy to ensure that our customers get the best value for money from a competitive marketplace for each element of the value chain. To date, around 85% of our costs have been covered by outsourcing arrangements.

Our key contracts with United Utilities and Kelda for the operation of Welsh Water’s water and wastewater assets provided for a ‘price and performance review’ to coincide with Ofwat’s Final Determination of price limits for the next five years. After an exhaustive process, we were not able to agree terms that were acceptable to United Utilities and Kelda while satisfying us that we could reach our targets for both cost reduction and improved customer service. As a result, the contracts with both United Utilities and Kelda were terminated by agreement with effect from 1 April 2010 and 1 May 2010 respectively and nearly 1,600 staff transferred to the direct employment of Welsh Water in accordance with TUPE legislation.

United Utilities since 2001 and Kelda Water Services since 2005 have made an enormous contribution to improving the performance and especially the efficiency of Welsh Water. The business is in better shape to tackle the new challenges ahead than it would have been but for this important contribution from both companies.

Despite bringing the asset operations under the direct control of Welsh Water, some 60% of annual operating and capital expenditure will remain subject to competitive tender, still the highest percentage in our sector.

Looking ahead

The challenge of reducing our costs, while continuing to improve our service to customers and ensuring a high degree of sustainable protection for the environment, will be testing. But I am confident that the commitment of our newly unified team, together with our commercial partners, will rise to the challenge. The way in which our staff right across the business have responded to the significant challenges that arose during the year is remarkable. Their continuing commitment and enthusiasm is the key to our success in serving our customers and to looking after this long term and important industry for future generations.

Finally, I would like to add my particular thanks to two people: to Dame Deirdre Hine for her leadership of our Quality and Environment Committee, combining great wisdom and insight as well as calm authority on all matters and, in particular, those to do with public health and, of course, to Lord Burns for his unflagging leadership, support, guidance and inspiration over the last decade. Glas Cymru would not have come into being without his insight and commitment. We are all in his debt and my thanks to him are profound.

The past year has been an important one for Welsh Water: the conclusion of Ofwat's five-yearly price review has set significant challenges for us, and we have had to take difficult decisions on the future shape of the business in order to meet them. At the same time we can report another year of solid progress, including record capital investment, all designed to improve our service to customers, to safeguard the environment, and to bring our performance up to the high level to which the whole team aspires.

*Nigel Annett
Managing Director
4 June 2010*

Key Performance Measures

	Monitoring plan target ³	Previous performance 2008-09	Actual performance 2009-10	At or better than previous year
Water Quality				
Overall water quality compliance 'at the tap' ^{1 c}	n/a	99.9%	99.9%	√
Bacteriological compliance 'at the tap' ^c	n/a	99.8%	99.8%	√
Iron compliance 'at the tap' ^c	99.1%	99.4%	99.3%	X
Operational Performance Index ^c	n/a	99.9%	99.8%	X
Operational Performance Index (TIM) ^{2 c}	n/a	99.8%	99.7%	X
Environmental				
Leakage m3/km/day	7.5	7.2	7.1	√
Number of 'category 1 and 2' pollution incidents ^c	n/a	3	9	X
Number of 'category 3' pollution incidents ^c	n/a	230	311	X
Wastewater treatment works complying with 'look up' table ^c	n/a	100%	99.9%	X
Sewage sludge recycled satisfactorily ^c	100%	100%	100%	√
'Mandatory' coastal bathing water compliance ^c	100%	99%	100%	√
'Guideline' coastal bathing water compliance ^c	'Stable'	77%	91%	√
Customer Service				
Properties 'at risk' of receiving low pressure	242	197	194	√
Properties affected by unplanned water supply interruptions lasting more than 6 hours	1,080	894	477	√
Properties 'at risk' of sewer flooding	308	265	250	√
Properties flooded due to hydraulic overload	67	106	73	√
Properties flooded due to other causes	120	186	198	X
Billing enquiries answered within 5 days	100%	100%	100%	√
Written complaints answered within 10 days	99.9%	99.3%	99.6%	√
Number of written complaints received	n/a	12,486	13,313	X
Customer meters read within year	99.9%	99.9%	99.9%	√
Telephone calls abandoned	1.3%	4.4%	2.1%	√
Telephone calls receiving engaged tone	0%	0.04%	0.9%	X
Call handling satisfaction (score out of 5)	n/a	4.65	4.72	√

¹ This measure is based on 'Mean Zonal Compliance'

² Incorporates performance against turbidity, iron and manganese

^c Calendar year 2009, all other figures are for the year ended 31 March 2010

³ The Monitoring Plan sets out the targets agreed with regulators at the Regulatory Price Review in 2004 and covers the five year period to 31 March 2010

Financial Review

While Glas Cymru has not been immune to the impact of the recent economic recession, we have delivered a sound financial performance during the year to 31 March 2010 and continued our important investment to improve drinking water quality and the environment. However, achievement of Ofwat's Final Determination for 2010 to 2015 is a big challenge and, as a result, we are making a major change to our business operations.

Appointed revenue has grown due to regulatory price increases which support our extensive capital investment and the delivery of better customer service, after taking into account the 'customer dividend' of £22 per customer. Operational expenditure (before exceptional items) has fallen due to lower power costs partly offset by an increase in the bad debt charge.

Capital investment in our regulated water and wastewater operations including infrastructure renewals expenditure ('IRE') amounted to £361 million during the year. This is 2% higher than last year, and represents a record level of investment spend for Glas Cymru.

Revenue

Glas Cymru's turnover in the year to 31 March 2010 was £688 million (2009: £657 million), an increase of 4.7% on last year. This increase primarily reflects the price increase of 5.4%, however our 'customer dividend' policy means that our total charges were some £28 million lower than if we had applied the full price increase determined by Ofwat (2009: £27 million lower). Additional revenue from new customers has been offset by household customers switching to metered charging.

Our unique range of customer assistance tariffs has continued to help support customers who have difficulty paying their bills; by 31 March 2010 some 27,000 customers were benefiting from one of these tariffs.

Operational expenditure

Glas Cymru's total operational costs (excluding IRE and depreciation, and before exceptional items) were £266 million (2009: £267 million), lower power costs being offset by an increase in the provision for bad debts.

In the years to 31 March 2010, around two thirds of operational costs related to outsourced service contracts. The major contracts were with United Utilities Operating Services ('UUOS', for the operation of the water network and the wastewater network in North Wales) and with Kelda Water Services ('KWS', for the operation of the wastewater network in South Wales and Herefordshire). These contracts included a target cost mechanism aimed at enhancing operating efficiency to the end of the AMP4 regulatory period in 2010.

All water and sewerage companies need to draw on significant energy resources, particularly for water treatment and pumping processes, and Welsh Water – with its network spread across Wales' undulating topography – is no exception. This year we have experienced reductions in energy prices which have seen power costs fall by around 20% to £35 million (2009: £43 million).

Customer debt recovery remains a high priority for Welsh Water and our billing and income contract partner, Veolia Water. In a challenging economic environment, in which water companies have no sanction to disconnect supplies to non-paying domestic customers, cash collection has continued to be challenging. The bad debt charge for the year of £22 million (2009: £19 million) represents around 3% of annual turnover (2009: 3%), and reflects an increase in the provision based on a review of historical collections and having regard to the deterioration experienced, particularly during the first half of the year.

IRE has fallen by some 24% on the prior year, the lower charge reflecting the completion of the Section 19 programme which has resulted in the refurbishment of 1,800km of trunk mains over the course of the 5 years to March 2010.

Exceptional operational expenditure

On 9 February 2010 it was announced that Welsh Water was to undertake the biggest restructuring of the company since it was bought by Glas Cymru and became a 'not-for-profit' company – to meet the toughest efficiency targets the company has ever faced.

The price limits for the next 5 years, set last November by Ofwat, will allow Welsh Water to invest £1.2 billion in water quality and other improvements. But Welsh Water must also reduce its day-to-day operating costs by some 20% to enable the average household bill to fall by £30 before inflation.

Since 2001, UUOS and then also KWS have helped us to cut our operating costs by more than any other water and sewerage company in the regulated water industry in England and Wales. But in order to deliver the price reductions required over the next five years we must make a further step change in our cost efficiency.

Over the past year we have had lengthy discussions with UUOS and KWS through the five-yearly price and performance review of the contracts we undertook with both companies. We recognise and appreciate the considerable efforts made by both companies to meet our requirements. However, it did not prove possible to reach agreement with either company in relation to the terms for a continuation of those contracts for a further five years.

In light of this, we reached agreement with both UUOS and KWS that their staff would transfer to Welsh Water. On 1 April 2010 1,093 UUOS employees transferred, followed by 476 KWS employees on 1 May 2010.

We have also announced, as part of the drive to cut our operating costs by 20%, a phased reduction, over the next five years, of around 300 in the number of people required to deliver water and wastewater services to Welsh Water's customers. We are working closely with staff and our trade union colleagues and intend to achieve this through a combination of retirements, natural staff turnover and voluntary severance.

Included in the 2009-10 results are exceptional items totalling £30 million. These provide for the costs of terminating the United Utilities and Kelda Water Services contracts and for the estimated severance pay and pension top-up required to achieve our planned headcount reduction. These are necessary enabling costs which will help us to create the efficiencies required to meet Ofwat's challenging target.

Financing costs

Net interest payable (excluding loss on derivatives) of £98m is £68m lower than last year; the impact of lower interest rates has been combined with an indexation credit in respect of the group's index-linked bonds (calculated using July 2008 to July 2009 RPI). The average cost of debt during the period was 3.7% (2009: 6.6%).

In response to the crisis in the banking markets, the company tightened its criteria for investing cash deposits such that maximum deposits with any single counterparty were reduced and the maximum term limited to 3 months. Consequently, the average interest receivable rate has fallen from 3.9% to 0.4% and remains below the average 3 month LIBOR over the same period (which fell from 4.4% to 0.8%).

Glas Cymru has a number of swap contracts and, while these are effective commercial hedges, they do not qualify for hedge accounting under IAS 39. Although there is no impact on cash flows, there is significant volatility in the income statement and fair value losses in 2009-10 amounted to £15 million (2009: £87 million). This has resulted in a total liability of £173 million in the balance sheet but, assuming that the swaps are held to maturity, this will ultimately reduce to nil.

Profit before taxation and 'customer dividend'

Excluding fair value movements and exceptional items, the profit before tax was £107 million (2009: loss before tax of £11 million). This profit was made after funding the 'customer dividend' of £22 for all customers receiving both water and wastewater services, at a total of £28 million (2009: £21 per customer, totalling £27 million). Since 2003, 'customer dividends' have totalled some £152 million.

Taxation

The taxation credit for the year of £2 million comprises a current year deferred tax charge of £16 million, offset by a prior year tax credit of £18 million. The prior year tax credit is principally due to the agreement of tax allowances on the company's water mains refurbishment programme. The group has tax trading losses carried forward of approximately £288 million, which the group believes should be sufficient to eliminate tax on trading profits in the five years ending 31 March 2015, subject to any changes in tax law.

Liquidity

Glas Cymru aims to offer a secure, low risk investment to long-term investors. By building and maintaining a strong financial position, we intend to keep our borrowing costs low, enabling us to finance future investment in the business efficiently, whilst retaining the scope to return money to our customers and keep bills affordable.

The company had strong liquidity as at 31 March 2010 - cash balances of £249 million, together with an undrawn European Investment Bank ('EIB') facility of £75 million and undrawn revolving credit facilities of £345 million. The cash balances include the proceeds of the £140 million index-linked bond issue on 31 March 2010. On 7 May 2010, in view of the very high level of available liquidity (£669 million), the level of undrawn revolving credit facilities was reduced to £100 million and on 3 June 2010 the group agreed to repurchase £113 million of Class C1 bonds following a tender offer to bond holders. The amount repurchased represents a take-up rate of 90% and settlement will be made in cash on 7 June 2010.

Gearing and financial reserves

On Glas Cymru's acquisition of Welsh Water in May 2001, gearing stood at 93%. Since then, its financial position has improved steadily, such that gearing had fallen to 71% as at 31 March 2010 and 'financial reserves' (RCV less net debt) were almost £1.1 billion.

Credit ratings and bond spreads

The strong credit quality of the business is reflected in credit ratings which are now the highest in the water sector, despite a very challenging Final Determination. On 8 March 2010 Standard & Poor's placed Glas' ratings on negative outlook, reflecting their assessment of the potential impact of Ofwat's Final Determination following the 2009 Price Review.

There has been a significant downward reduction in the spread differential to Government gilts during the year across the water sector, reflecting an easing of the difficult credit conditions over the last year. Glas bonds continue to trade at spread differentials generally below those of equivalent water sector bonds of similar maturities.

Debt financing and interest rate management

Despite difficult conditions in the borrowing and capital markets, on 31 March 2010 Glas Cymru issued £140m of 2048 index-linked series B bonds. A further £35 million of funding, provided by KfW bank, was drawn on 15 December 2009.

To protect Glas Cymru's high credit quality, the Board has always adopted prudent financial policies, predominantly covering the fixing of interest rates and the investment of cash balances. Glas Cymru's policy is to minimise its exposure to movements in market rates, with a minimum of 85% of its liabilities being fixed rate, index-linked to the UK Retail Price Index ('RPI') or matched by cash balances. The Board considers that linking debt to UK RPI inflation is particularly appropriate, as Welsh Water's revenues and Regulatory Capital Value are also linked to RPI through the regulatory system operated by Ofwat. Implementation of the policies is

delegated to a small team of specialists which operates to ensure that Welsh Water meets the requirements of its licence, and therefore undertakes no speculative trading. As at 31 March 2010, approximately 60% of gross debt was index-linked via bonds and derivatives (2009: 58%).

The expected maturity of the outstanding fixed rate and index-linked bonds ranges from 2011 to 2057, with not more than 20% falling due in any 2 year period, in accordance with our refinancing policy.

Capital investment

Glas Cymru's strong financial position has been built up over the last 8 years, and provides a stable base from which it can respond positively to the challenges of the recent economic recession and drive forward its largest ever capital programme. Over £1.5 billion has been invested since April 2005, bringing sustained improvements to customer service, drinking water quality and the environment.

Total capital expenditure by Welsh Water during the year (including IRE) was a record £361 million (2009: £355 million), bringing the total expenditure over the 5 year AMP4 period to £1,521 million. Welsh Water works with an alliance of capital investment partners to deliver the investment programme at the best value for money for customers. Welsh Water is planning to invest some £1.2 billion over the next AMP period which will run from 2010 to 2015.

Looking ahead

The Board's policy is to reduce gearing to around 70%, and maintain it at around this level. A key part of our strategy is to minimise customer bills in the long term, and the Board judges that this level of gearing will enable the company to efficiently fund the AMP5 investment programme.

Ofwat has set us an efficiency target of a reduction of some 20 per cent in our day to day running costs. In addition to the headcount reduction, we will do this by exploiting our recent large investment in new technology, by eliminating the profit element, overhead and contract management costs of the previously outsourced services, and by investing in "green energy" and processes to reduce power costs. This involves considerable expenditure by the company and forms part of our planned £1.2 billion investment programme to improve services over the next five years.

In the face of these major changes, our priority will remain the essential task of guaranteeing safe and reliable services for all our customers, as well as safeguarding the environment.

Disclaimer

This report contains certain forward looking statements with respect to the future business prospects and the strategies of the Glas Cymru Group. These statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward looking statements. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

Managing Risk

Glas Cymru cannot diversify into non-core activities, but otherwise we face the same risks as any other company in the UK utility sector.

It is a key principle of our business model that Glas Cymru cannot diversify into activities unrelated to the water and sewerage business in the region served by Welsh Water. This ensures we cannot be distracted from the single purpose for which Glas Cymru was established and also serves to contain the range of risks that we face. Many of the risk factors affecting the Company are business risks which can be mitigated by ensuring that appropriate controls are in place. However, the Company is affected by many risks outside our control which could have a material effect on our long-term performance. No company is insulated from the impact of economic recession, climate change or of a changing regulatory environment. The most important risks facing Welsh Water are described below.

Business Operations Changes

Following the decision to end arrangements for the outsourcing of the day-to-day operation and maintenance of our network of water and sewerage assets, the proportion of annual operating and capital expenditure that will be undertaken by service partners working for Welsh Water under contract through competitive tender has been significantly reduced. However, significant outsourced contracts remain in place for the design and construction of major capital investment schemes, for ICT and for customer contact and billing.

The above change was the Board's response to meeting the challenges set by a very tough price review. The move to these new arrangements involved a period of additional uncertainty and risk, and arrangements were put in place to ensure that public health, staff safety, customer service and environmental performance standards did not fall. This included detailed and audited transition project plans and governance, and the successful closure of the previously outsourced contracts which enabled the TUPE transfer of staff to be completed for United Utilities Operating Services Limited and Kelda Water Services Wales Limited on 1 April 2010 and 1 May 2010, respectively. There was limited additional risk associated with the management of business systems and data as operating partners had always used Welsh Water's core systems and processes.

Regulatory risk

Regulatory risk can arise from Ofwat's price control determinations, from the requirement to comply with Ofwat's extensive data requirements and more generally from changes in the regulatory environment. The changing nature of regulatory risk was illustrated in the 2009 regulatory price review in which Welsh Water was subject to a shortfall adjustment of £12 million for failing, by only a small margin, one of the asset serviceability standards set retrospectively by Ofwat for 2005-10. In the period 2010-15 Ofwat will assess the water industry against 20 standards of serviceability.

Ofwat's Final Determination of price limits for the period 2010-15 is one of the most challenging Welsh Water has been set since privatisation – and we have the toughest efficiency targets in the sector. Furthermore, Ofwat's cost assumptions for the sector are based on benign economic conditions in which, for example, power prices and bad debts are no higher than they were in 2008-09. Welsh Water aims to achieve this cost reduction by:

- exploiting recent large investment in new technology
- eliminating duplication in management
- investing in green energy processes to reduce power costs,
- a phased reduction over the next five years of around 300 in the number of staff required to deliver water and wastewater services, to be achieved by a combination of retirement, natural staff turnover and voluntary severance.

The net effect of the price review is that the Company's financial plans will be subject to greater uncertainty and so the company has decided to pursue a prudent approach to issues such as the "customer dividend" until that uncertainty is resolved.

One significant regulatory risk was removed in December 2009 when the European Court of Justice determined that stretches of the northeast Irish Sea would not be designated as 'sensitive waters' under the Urban

Wastewater Treatment Directive. This means that Welsh Water will not have to extend coastal wastewater treatment works, avoiding the need for significant investment.

A number of other regulatory risks remain. The expected transfer of private sewers to Welsh Water will increase our sewer network by more than 70%, and we judge that the condition of these private sewers is poor - below the standard of assets that the industry is generally required to operate. The Welsh Assembly Government has indicated that this transfer will take place sometime after April 2011.

The Environment Agency has indicated that Welsh Water should plan for major reductions in the volumes of water we abstract from a number of rivers, mostly in South Wales, in order to comply with the EU Habitats Directive. These potential changes to our obligations, which together could require a very large increase in investment expenditure, are not included in our investment programme for 2010-15 and, if confirmed, may fall to be funded through an 'interim determination' of price limits or 'logged up' to be taken into account at a subsequent price review.

Welsh Water has to provide extensive data to regulators each year in respect of all aspects of our business. Failure to provide reliable, accurate and complete data would trigger regulatory sanctions and fines, and all regulatory data is subject to significant independent scrutiny and due diligence. In 2008, our process of data collation and verification was accredited to ISO 9001:2000, and this accreditation has been retained with an extended scope of service.

Ofwat has a duty to promote competition where it judges it to be in the best interests of customers, and in 2009 judicial clarification was given on an important point of principle following Ofwat's grant of an inset appointment – the appointment of a new company to supply water and sewerage services to a specific area - to a new entrant in the water industry.

Ofwat's proposal that the industry accounts for each element in the 'value chain' separately, as a possible precursor to legal separation of distinct activities, would require changes to the current legal framework. The Welsh Assembly Government has indicated it will consult on the conclusions of the Cave Review of competition in water markets. Some of the Review's conclusions would, if adopted, lead to a change in the structure of the industry and have serious implications for the Company. The competitive market in Wales is currently limited to business customers using more than 250 megalitres of water per annum (50 megalitres in England) - of which Welsh Water has some 120 customers who account for around 4% of total turnover.

Operational risk

We have reassessed operational risk following the experience of the last few years where we have experienced more extreme patterns of weather, particularly storms and periods of prolonged freezing conditions. Wales is currently one of the least constrained parts of the UK in terms of water resources (subject to the regulatory risk to abstraction licence review, referred to above), but customers in our region are not immune from the effects of periods of drought.

More generally, operational risk is varied and may include:

- the impact of major operational incidents on public health, environmental quality or customer service, whether arising from equipment failure, from natural events - such as 'acts of God' or more extreme weather events as a possible consequence of climate change
- changes in environmental, consumer protection and public health and safety law and regulation, which typically require ever higher standards of performance
- the health and safety risk associated with the operation of a large and complicated network of water and sewerage assets
- the risk of losing and failing to recruit key people in Welsh Water to ensure we have the competencies and experience needed to meet our long-term obligations
- the changes associated with our programme of IT-enabled change which is upgrading old IT systems and introducing simplified and more robust business processes.

The Board has approved policies and operational strategies to mitigate each of the risks to the reputation, operating results and financial position of Welsh Water. Business risk is also mitigated by the availability and

terms of insurance - covering property, business interruption, public liability, environmental pollution and employer's liability.

Financial risk

Welsh Water is exposed to a number of financial risks, many of which are heightened at a time of economic recession. These include:

- revenue risk, such as a reduction in metered demand and the loss of large business customers
- the collection of customer charges and non-recovery of customer debt
- external cost pressures, such as changes in the price of chemicals or power pricing
- deflation and the impact on both revenues and regulatory asset value from a negative Retail Prices Index
- access to capital markets while the business needs to finance a continuing large capital investment programme and to refinance some existing debts.

The overall financial risk is that Glas Cymru may not be able to finance the operating and capital investment obligations of Welsh Water, which continue to be financed from cash flow from operations – in other words, customers' bills - and the raising of finance from the capital markets. Under our funding arrangements we are required to ensure that the business has sufficient committed facilities available to meet at least 12 months anticipated net cash requirement.

Financial risk is mitigated in three ways:

- the group's financial position at 31 March 2010 shows a significant balance of cash and undrawn borrowing facilities available, which gives the business a high degree of liquidity
- following the successful £140 million bond issue in March 2010, Welsh Water has funding for its investment programme for substantially the whole of the next five-year regulatory period
- the impact of deflation is mitigated by the high proportion of index-linked debt issued by the Company.

Independent auditors' report to the members of Glas Cymru Cyfyngedig

We have audited the group and parent company financial statements (the "financial statements") of Glas Cymru Cyfyngedig for the year ended 31 March 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Reserves, the Consolidated and Parent Company Balance Sheets, the Consolidated Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

The directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2010 and of the group's profit and group's and parent company's cash flows for the year then ended
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

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

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

Other matters

The directors have requested, (because the company applies Listing Rules 9.8.6R 5 and 6 of the Financial Services Authority as if it were a listed company), that we review the parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review by the Listing Rules of the Financial Services Authority. We have nothing to report in respect of this review.

At the request of the directors, we have also audited the Directors' Remuneration Report that is described as having been audited. In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

*Stephen W Harrison (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cardiff
4 June 2010*

Consolidated Income Statement for the year ended 31 March 2010

	Note	2010 £m	2009 £m
Revenue		688.2	657.2
Operating costs:			
- Operational expenditure			
Before exceptional items	3	(265.7)	(266.9)
Exceptional items	4	<u>(29.5)</u>	<u>-</u>
		(295.2)	(266.9)
- Infrastructure renewals expenditure	3	(77.3)	(101.1)
- Depreciation and amortisation	3	(139.5)	(133.5)
- Loss on disposal of fixed assets	3	(0.4)	(0.8)
Operating profit analysed as:			
Operating profit before exceptional items		205.3	154.9
Exceptional items		<u>(29.5)</u>	<u>-</u>
Operating profit		<u>175.8</u>	<u>154.9</u>
Financing costs:			
- Interest payable and similar charges	5a	(101.3)	(174.3)
- Interest receivable	5a	3.4	8.6
- Fair value losses on derivative financial instruments	5b	<u>(15.0)</u>	<u>(86.5)</u>
		(112.9)	(252.2)
Profit/(loss) before taxation	3	62.9	(97.3)
Taxation credit/(charge)	6	1.9	(5.6)
Profit/(loss) for the year		<u>64.8</u>	<u>(102.9)</u>

Underlying profit/(loss) for the year (Profit/(loss) before exceptional items, taxation and fair value adjustments)		
	2010 £m	2009 £m
Profit/(loss) before taxation per Income Statement	62.9	(97.3)
Add back:		
- Exceptional items (see note 4)	29.5	-
- Fair value losses on derivative financial statements (see note 5b)	15.0	86.5
Underlying profit/(loss) for the year (before exceptional items, taxation and fair value adjustments)	107.4	(10.8)

Consolidated Statement of Comprehensive Income for the year ended 31 March 2010

	Note	2010 £m	2009 £m
Profit/(loss) for the year		64.8	(102.9)
Actuarial loss recognised in the pension scheme	21	(1.5)	(10.4)
Movement on deferred tax asset relating to pension scheme	6	-	2.9
Total comprehensive income/(expenditure) for the year		<u>63.3</u>	<u>(110.4)</u>

Consolidated Statement of Changes in Reserves for the year ended 31 March 2010

	2010 £m	2009 £m
Reserves at 1 April	(152.1)	(41.7)
Total comprehensive income/(expenditure) for the year	63.3	(110.4)
Reserves at 31 March	<u>(88.8)</u>	<u>(152.1)</u>

There were no changes in reserves of the parent company during the year (2009: none).

Consolidated Balance Sheet as at 31 March 2010

	Note	2010 £m	2009 £m
Assets			
Non-current assets			
Property, plant and equipment	8	3,103.9	2,980.0
Intangible assets	9	60.1	46.2
Investments	10a	-	-
Financial assets:			
- derivative financial instruments	15	0.8	-
		<u>3,164.8</u>	<u>3,026.2</u>
Current assets			
Trade and other receivables	11	114.0	102.2
Financial assets:			
- derivative financial instruments	15	4.4	26.0
Cash and cash equivalents	12	248.7	139.3
		<u>367.1</u>	<u>267.5</u>
Liabilities			
Current liabilities			
Trade and other payables	13	(130.5)	(129.5)
Financial liabilities:			
- borrowings	14	(150.2)	(20.0)
- derivative financial instruments	15	(36.0)	(2.1)
Provisions	17	(14.8)	-
		<u>(331.5)</u>	<u>(151.6)</u>
Net current assets		35.6	115.9
Non-current liabilities			
Trade and other payables	13	(2.3)	(3.0)
Financial liabilities:			
- borrowings	14	(2,761.8)	(2,739.7)
- derivative financial instruments	15	(141.9)	(181.7)
Retirement benefit obligations	21	(8.0)	(7.8)
Provisions	17	(22.6)	(9.2)
		<u>(2,936.6)</u>	<u>(2,941.4)</u>
Net assets before deferred tax		263.8	200.7
Deferred tax - net	7	(352.6)	(352.8)
Net liabilities		<u>(88.8)</u>	<u>(152.1)</u>
Deficit		<u>(88.8)</u>	<u>(152.1)</u>

The financial statements on pages 17 to 54 were approved by the Board of directors on 4 June 2010 and were signed on its behalf by:

N C Annett
Managing Director

C A Jones
Finance Director

Parent Company Balance Sheet as at 31 March 2010

	Note	2010 £m	2009 £m
Assets			
Non-current assets			
Investment in subsidiaries	10b	-	-
Trade and other receivables	11b	<u>3.4</u>	<u>3.4</u>
		3.4	3.4
Current assets			
Cash and cash equivalents	12	<u>0.1</u>	<u>0.1</u>
		0.1	0.1
Liabilities			
Current liabilities			
Trade and other payables	13	<u>(3.5)</u>	<u>(3.5)</u>
		(3.5)	(3.5)
Net assets			
		<u>-</u>	<u>-</u>
Reserves			
Retained earnings		<u>-</u>	<u>-</u>
Total reserves		<u>-</u>	<u>-</u>

The financial statements on pages 17 to 54 were approved by the Board of directors on 4 June 2010 and were signed on its behalf by:

N C Annett
Managing Director

C A Jones
Finance Director

Consolidated Cash Flow Statement for the year ended 31 March 2010

	Note	2010 £m	2009 £m
Cash flows from operating activities			
Cash generated from operations	18a	330.6	309.1
Interest received		3.5	9.8
Interest paid	18b	(116.1)	(129.4)
Net cash inflow from operating activities		218.0	189.5
Cash flows from investing activities			
Purchase of property, plant and equipment		(281.4)	(257.0)
Grants and contributions received		12.3	13.6
Costs of sale of property, plant and equipment		(0.4)	(0.8)
Net cash used in investing activities		(269.5)	(244.2)
Net cash outflow before financing activities		(51.5)	(54.7)
Cash flows from financing activities			
Long term loans and finance leases received		35.0	85.0
Bond issue proceeds		139.3	-
Revolving credit facility and term loan repayments		(4.4)	(4.4)
Capital element of finance lease payments		(8.6)	(10.4)
Other loan repayments		(0.4)	(0.3)
Net cash generated from financing activities		160.9	69.9
Increase in net cash	19	109.4	15.2
Net cash at 1 April		139.3	124.1
Net cash at 31 March	12	248.7	139.3

The parent company had no cash flows during the year (2009: none).

1. Accounting policies, financing risk management and accounting estimates

Basis of Preparation

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and those parts of the Companies Act 2006 applicable to reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial instruments to fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

In the current year, Glas Cymru has applied the following Interpretations which are or have become effective:

IFRS 7	Financial Instruments – Disclosures (amendment)
IFRS 8	Operating Segments (revision)
IAS 1	Presentation of Financial Statements (revision)
IAS 23	Borrowing Costs (revision)
IAS 27	Consolidated and Separate Financial Statements (revision)
IAS 32	Financial Instruments: Presentation (revision)
IAS 39	Financial Instruments: Recognition and Measurement (revision)

Except as noted under “Changes of accounting policy” below in respect of IAS 23, the application of these Interpretations has no material effect on the preparation or presentation of the results or financial position for the current or prior accounting periods, and accordingly no prior period adjustment has been required.

At the date of approval of these financial statements, the following Standards and Interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

IAS 1	Presentation of Financial Statements (revision)
IAS 27	Consolidated and Separate Financial Statements (revision)
IAS 38	Intangible Assets (revision)
IFRIC 18	Transfers of Assets from Customers

The application of IFRIC 18, effective for Glas Cymru’s financial statements for the year ending 31 March 2011, will require the recognition of income in the financial statements when a property developer lays a pipe to connect a new development to the network and transfers the asset to the water company for no charge. Such assets will be recorded at their fair value on the balance sheet with the credit recognised immediately as revenue, on the basis that once the company has connected the development to the network there is no further obligation arising for the company.

The presentational impact of the other Standards and Interpretations is being assessed, but the directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the group.

Change of accounting policy

During the year, a revision to IAS 23, “Borrowing costs” became applicable. The revision removes the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale, and Glas Cymru is therefore required to capitalise borrowing costs as part of the cost of such assets (see “Property, plant and equipment” below). In respect of the year ended 31 March 2010, £6.1m of borrowing costs have been capitalised and will be amortised over the useful economic lives of the related assets. The revision to IAS 23 has been applied prospectively from 1 April 2009 and no adjustment is required to prior periods.

Basis of consolidation

The consolidated financial statements include the financial statements of the company and all of its subsidiaries. The results of companies and businesses acquired during the year are dealt with in the consolidated financial statements from the date of acquisition. Intra-group transactions and profits are eliminated on consolidation.

Accounting policies for the year ended 31 March 2010

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been applied consistently to all the years presented, except as noted above under "Change of accounting policy".

Revenue recognition

Revenue represents the income receivable in the ordinary course of business for services provided, excluding value added tax. Where services have been provided, but for which no invoice has been raised at the year-end, an estimate of the value is included in revenue. See the critical accounting estimates section for further details.

Revenue recognised reflects the actual charges levied on customers in the year. The difference between the actual revenue and the level of revenue that could have resulted had the full Ofwat-allowed level of charges been levied is referred to as a 'customer dividend'.

Property, plant and equipment

Property, plant and equipment are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs and, in respect of capital projects commenced after 1 April 2009, borrowing costs in accordance with IAS 23.

Property, plant and equipment comprise:

- a) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls); and
- b) Other assets (including properties, overground operational structures and equipment, and fixtures and fittings).

The carrying value of assets is reviewed for impairment if circumstances dictate that the carrying value may not be recoverable. Asset lives and residual values are reviewed annually.

1) Infrastructure assets

Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas, reflecting the way the group operates its wastewater activities.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is treated as additions, which are included at cost. Expenditure incurred in repairing and maintaining the operating capability of individual infrastructure components, "infrastructure renewals expenditure", is expensed in the year in which the expenditure is incurred.

The depreciation charge for infrastructure assets is determined for each component of the network and is based on each component's cost, estimated residual value and the expected remaining average useful life. The useful average economic lives of the infrastructure components range principally from 60 to 150 years.

2) Other assets

Other assets are depreciated on a straight line basis over their estimated useful economic lives, which are as follows:

Freehold buildings	60 years
Leasehold properties	over the lease period
Operational structures	10 – 80 years
Fixed plant	8 – 40 years
Vehicles, mobile plant, equipment and computer hardware & software	3 – 16 years

Assets in the course of construction are not depreciated until commissioned.

Intangible assets

Intangible assets, which comprise principally computer software and system developments, are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs but excluding interest.

The carrying values of intangible assets are reviewed for impairment if circumstances dictate the carrying value may not be recovered.

Intangible assets are amortised on a straight line basis over their estimated useful economic lives, which range between 3 and 15 years. These asset lives are reviewed annually.

Leased assets

Where assets are financed by leasing arrangements, which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are capitalised and included in "property, plant and equipment" with the corresponding liability to the lessor included within "financial liabilities – borrowings". Leasing payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor with the finance charge being recognised over the period of the lease based on its implicit rate so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Grants and customer contributions

Grants and customer contributions in respect of expenditure on property, plant and equipment have been offset against fixed assets.

Grants in respect of revenue expenditure are credited to the Income Statement over the same period as the related expenditure is incurred.

Capital expenditure programme incentive payments

The group's agreements with its construction partners involved in delivering capital expenditure programmes incorporate incentive bonuses payable after completion of the programmes. The cost of fixed asset additions includes an accrual for incentive bonuses earned to date, relating to projects substantially completed at the year-end, where the likelihood of making the incentive payment is considered probable. Amounts recoverable from contract partners relating to targets not being achieved are only recognised on completed projects.

Target cost contracts

The group maintains target cost contracts with its main operating partners. The group's policy in respect of pain/gain share receivables/payables arising from these contracts is to recognise gain payables over the period to which the charge relates, and pain receivables as income only when final agreement with the relevant service partner has been achieved.

Trade receivables and their impairment

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost less provision for impairment. They are first assessed individually for impairment, or collectively where the receivables are not individually significant. Where there is no objective evidence of impairment for an individual receivable, it is included in a group of receivables with similar credit risk characteristics and these are assessed collectively for impairment based on their ageing. Movements in the provision for impairment are recorded in the income statement.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition and typically include cash in hand and deposits with banks or other financial institutions, less any overdrafts.

Pension costs

i) Defined benefit scheme

A majority of the group's employees belongs to the group's defined benefit pension scheme, which is funded by both employer's and employees' contributions. Actuarial valuations of the scheme are carried out at intervals of not more than three years. Contribution rates are based on the advice of a professionally qualified actuary.

The net asset or liability recognised in the balance sheet represents the present value of the defined benefit obligations less the fair value of the plan's assets.

The group's defined benefit scheme service cost, being the increase in the present value of the liabilities expected to arise from employee service in the period, is included in operating costs. The expected return on scheme assets and interest on scheme liabilities are included in financing costs in the income statement. Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the Statement of Comprehensive Income.

ii) Defined contribution scheme

The group also operates a defined contribution scheme for those employees who are not members of the defined benefit scheme. Obligations for contributions to the scheme are recognised as an expense in the Income Statement in the period in which they arise.

Financial liabilities

Debt is initially measured at fair value, which is the amount of the net proceeds after deduction of directly attributable issue costs, with subsequent measurement at amortised cost. Debt issue costs are recognised in the income statement over the expected term of such instruments at a constant rate on the carrying amount.

Financial assets

Financial assets represent held to maturity investments that are non-derivative, with fixed or determinable payments and fixed maturities of over three months at the date of acquisition, which the group intends to hold until maturity.

Derivative financial instruments

Derivative instruments utilised by the group are interest rate and inflation swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the group.

Derivatives are recognised initially and subsequently re-measured at fair value (based on market price data from relevant counterparties).

During the year to 31 March 2010, none of the group's derivatives qualified for hedge accounting under IAS 39 (2009: none). These instruments are carried at fair value with changes in fair value being recognised immediately in the income statement.

Deferred taxation

Deferred corporation tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised in respect of all temporary differences. Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and tax losses, to the extent that they are regarded as recoverable. They are regarded as recoverable where, on the basis of available evidence, there will be suitable taxable profits against which the future reversal of the underlying temporary differences can be deducted. The carrying value of the amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all, or part, of the asset to be utilised.

Deferred corporation tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on the tax rates that have been substantially enacted at the balance sheet date (2010 and 2009: 28%).

Provisions

Provision is made for all known and estimated liabilities of the group where there is a present obligation and it is probable that a transfer of economic benefits will be required to settle the obligation.

In the case of leases, where properties are no longer occupied by the group, provision is made for the liabilities that are expected to arise in respect of rental payments and dilapidations, prior to disposal or termination of the lease.

Where the group receives claims that are either not covered by insurance or where there is an element of the claim for which insurance cover is not available, a provision is made for the expected future liabilities.

Exceptional Items

Exceptional items are those significant items which are disclosed separately by virtue of their size and/or nature to enable a full understanding of the group's financial performance.

Financing risk management objectives and policies

Treasury activities are managed within a formal set of treasury policies and objectives, which are reviewed regularly and approved by the Board. The policy specifically prohibits any transactions of a speculative nature and the use of complex financial instruments. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may only be changed with the consent of Dŵr Cymru Cyfyngedig's security trustee (the "Security Trustee"). The risk is further mitigated by limiting exposure to any one counterparty. Financial instruments, which principally include listed bonds, finance leases, bank loan facilities and derivatives, are used to raise finance and manage risk from our operations.

Credit risk

The group has a prudent policy for investing cash and short term bank deposits ("cash investments"). Counterparties for cash investments must meet minimum short term and/or long term credit ratings as published by Standard & Poor's ("S&P"), Moody's Investor Service Limited ("Moody's") and Fitch Ratings Limited ("Fitch"). The minimum short term rating, for cash deposits of up to one year, is A1/P1/F1 and the minimum long term rating, for cash deposits over one year, is A+/A3/A+ each for S&P, Moody's and Fitch respectively. The Board reviews counterparties annually for cash investments and the credit limit assigned to each.

The group has continued to follow a cautious policy for investing cash deposits as a response to the situation in the banking market. In consequence, all new cash investments must meet the minimum long term rating and have a maximum investment period of three months. The maximum cash investment with a single counterparty was £142m (2009: £69m).

Interest rate risk

The group hedges at least 85% of its total outstanding financial liabilities, including finance leases, into either index-linked or fixed rate obligations. For this purpose floating rate interest liabilities are hedged through a combination of derivative instruments and cash balances. The regulatory framework under which revenues and the regulatory asset value are indexed also exposes the group to inflation risk. Subject to market constraints and Board approval, the group therefore may seek to raise new debt through index-linked instruments or to enter into appropriate hedging transactions.

The group analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. Of total borrowings of £2,912m as at 31 March 2010 (2009: £2,760m), only £30m related to floating rate debt (2009: £156m). The group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2010, 99% (2009: 94%) of the group's gross debt was at fixed or index-linked ("RPI") rates of interest after taking into account interest rate and RPI swaps. The "hedges" established to manage interest rate risks are economic in nature, but do not satisfy the specific requirements of IAS 39 in order to be treated as hedges for accounting purposes. Accordingly, all movements in the fair value of derivative financial instruments are reflected in the income statement. This has resulted in a total liability of £173 million in the balance sheet at 31 March 2010 (2009: £158 million) but, assuming that the swaps are held to maturity, this will ultimately reduce to nil.

Power price hedges

The company enters into contracts which fix the price of a proportion of future power purchases in order to reduce the impact of power price variances. The company has forward-purchased approximately a third of the estimated power requirement of the business over the regulatory period from 1 April 2010 to 31 March 2015. These contracts neither qualify as financial instruments under IAS 39 nor as onerous contracts under IAS 37 and, consequently, are not included in the financial statements until the contracts are effective.

Refinancing risk

Refinancing risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of currencies, instruments, type and maturities. Our policy is to ensure that the maturity profile does not impose an excessive strain on our ability to repay loans. Under this policy, no more than 20% of the principal of group borrowings of £2,912m can fall due in any 24 month period.

Liquidity risk

We maintain committed banking facilities in order to provide flexibility in the management of the group's liquidity.

Under the Common Terms Agreement which governs the group's obligations to its bond holders and other financial creditors, the group is required to have cash available to fund operations for a duration of 18 months. As at 31 March 2010, the group had committed undrawn borrowing facilities of £420m (2009: £420m) and cash and cash equivalents (excluding debt service payments account) of £238m (2009: £124m). On 15 April 2010 the group drew down the £75m balance of its EIB facility, and on 7 May 2010 reduced its undrawn revolving credit facilities to £100m following the Board's conclusion that these were surplus to requirements.

There is also a special liquidity facility of £150m; this is required in order to meet certain interest and other obligations that cannot be funded through operating cashflow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants.

Capital risk management

The group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail Prices Index and determined by Ofwat.

The Board considers that it is in the best long-term interests of Welsh Water's customers to continue to reduce the level of gearing, with a view to achieving further reductions in its cost of finance. The Board intends ultimately to reduce gearing to around 70% and to maintain it at that level, but recognises that the recent economic recession will prevent this in the short term.

In respect of the risks detailed above, further quantitative disclosures are provided in note 16.

Critical accounting estimates

The preparation of financial statements which conform to generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

Provision for impairment of trade receivables

Individual impairment losses on customer debts are calculated based on an individual assessment of the cash flows that are expected. Collective impairment losses on receivables with similar credit risk are calculated using a statistical model. The key assumption in the model is the probability of a failure to recover amounts when they fall into arrears. The probability of failing to recover is determined by past experience, adjusted for changes in external factors. The accuracy of the impairment calculation would therefore be affected by unexpected changes to the economic situation, and to changes in customer behaviour. To the extent that the failure to recover debts in arrears alters by 5%, the provision for impairment would increase or decrease by £3.4 million (2009: £5.0 million).

Pension benefits

The present value of the pension obligations is dependent on the actuarial calculation, which includes a number of assumptions. These assumptions include the discount rate, which is used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the Group considers market yields of high quality corporate bonds, denominated in sterling, that have times to maturity approximating the terms of the pension liability. Were this discount rate to reduce or increase by 0.1%, the carrying value of the pension obligations as at 31 March 2010 would increase or reduce by £1.1 million (2009: £0.7 million). Subsequent to the year-end, it is likely that the size of the pension scheme will increase significantly as employees transferring into Welsh Water become eligible to transfer their existing pensions into the DCWW Pension Scheme (see subsequent events note 27). This will increase the sensitivity of the balance sheet obligation to changes in the discount rate.

Measured income accrual

Revenue includes an accrual for unbilled charges at the year-end. The accrual is estimated using a defined methodology based upon the weighted average water consumption by tariff, which is calculated using historical billing information adjusted for changes in external factors, such as weather. A 5% change in actual consumption from that estimated would have the effect of increasing or decreasing the accrual by £2.3 million (2009: £2.3 million).

2. Segmental information

The directors consider that there is only one reporting segment, being the operation of water and sewerage business in the UK. Therefore the disclosures for the primary segment have already been given in these financial statements. The secondary reporting format is geographical analysis by origin and destination. As the group has only domestic activities there is only one geographical segment; therefore, the disclosures for the secondary segment have also already been given in these financial statements.

The parent company's business is solely to act as a holding company and therefore it operates in a single segment.

3. Profit/(loss) before taxation

The following items have been included in arriving at the profit/(loss) before taxation:

	Before exceptional items 2010 £m	Group Exceptional items (note 4) 2010 £m	Total 2010 £m	Total 2009 £m
Operating charges from outsourced activities				
- Operating services agreements	131.2	(5.0)	126.2	138.4
- Customer services agreement	18.7	-	18.7	19.5
- Laboratories and analytical services	6.6	-	6.6	6.7
- Other contracts	14.1	-	14.1	14.2
- Contract termination costs	-	10.8	10.8	-
- Restructuring and rationalisation	-	15.4	15.4	-
	170.6	21.2	191.8	178.8
Employee costs (note 20)				
- Wages and salaries	10.7	-	10.7	10.7
- Social security	1.1	-	1.1	1.0
- Pension costs (excluding actuarial loss)	1.7	-	1.7	1.0
- Restructuring and rationalisation	-	7.2	7.2	-
	13.5	7.2	20.7	12.7
Research and development expenditure	0.5	-	0.5	0.5
Trade receivables impairment	22.3	-	22.3	18.8
Rates	26.9	-	26.9	25.5
Environment Agency charges	15.1	-	15.1	14.9
Fees payable to auditors	0.2	-	0.2	0.2
Staff costs capitalised	(5.9)	-	(5.9)	(5.7)
Other operating charges	22.5	1.1	23.6	21.2
Total operational expenditure	265.7	29.5	295.2	266.9
Infrastructure renewals expenditure	77.3	-	77.3	101.1
Depreciation and amortisation				
- Owned assets	91.2	-	91.2	89.1
- Under finance leases	40.6	-	40.6	40.7
- Amortisation of intangible assets	7.7	-	7.7	3.7
	139.5	-	139.5	133.5
Loss on disposal of fixed assets	0.4	-	0.4	0.8
	482.9	29.5	512.4	502.3

Services provided by the group's auditor

During the year, the group obtained the following services from the group's auditor:

	Group	
	2010	2009
	£'000	£'000
Non-discretionary audit fees		
Statutory audit of parent company and consolidated financial statements	11	11
Statutory audit of subsidiary companies	77	75
Total statutory audit fees	88	86
Review of interim financial statements	22	21
Regulatory audit services pursuant to legislation	39	33
Review of draft business plan (required by Ofwat)	-	81
Total audit fees	149	221
Other services		
Tax advisory services	5	10
Services relating to bond prospectus update and bond issue	25	-
Other	10	2
Total other services	40	12
Total cost of services provided by the group's auditor	189	233

Regulatory audit services include audit work on the Regulatory Accounts, June Return and Principal Statement. In addition to the above services, PricewaterhouseCoopers LLP acted as auditor to the DCWW Pension Scheme. The appointment of auditors to the pension scheme and the fees paid in respect of the audit are agreed by the trustees of the scheme, who act independently from the management of the group. The fees paid in respect of audit services to the pension scheme during the year were £11,000 (2009: £13,000).

The Board has adopted a formal policy with respect to services received from external auditors. The external auditor will not be used for internal audit services and all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee.

4. Exceptional restructuring costs

On 9 February 2010 Glas Cymru announced its intention to restructure Welsh Water following the decision to bring back in house the operational activities which had been outsourced (for further information, see Operating and Financial Review). Restructuring costs of £29.5m are considered exceptional by nature and are disclosed separately in note 3 to the financial statements. These include the costs of terminating the outsourced contracts along with the estimated restructuring costs associated with a reduction in the headcount by some 300. Contract termination costs include agreed payments in lieu of the profit element for year 6 and early agreement of an adjustment reflecting year 5 performance. It is not anticipated that any further significant expenditure will be incurred in relation to the restructuring of the business.

5. Financing costs

a) Net interest before fair value losses on derivative financial instruments

	Group	
	2010	2009
	£m	£m
Interest payable on bonds	(84.9)	(86.1)
Indexation on index-linked bonds	9.5	(41.4)
Interest payable on finance leases	(18.4)	(37.1)
Other loan interest	(10.9)	(7.4)
Other interest payable and finance costs	(2.4)	(2.5)
Net interest (charge)/credit on pension scheme liabilities	(0.3)	0.2
Capitalisation of borrowing costs under IAS 23 (2010: 3.8%, 2009: nil)	6.1	-
Interest payable	<u>(101.3)</u>	<u>(174.3)</u>
Interest receivable	3.4	8.6
Net interest payable before fair value adjustments	<u>(97.9)</u>	<u>(165.7)</u>

Between July 2008 and July 2009 the Retail Prices Index fell by 1.5% producing an indexation 'credit' on the groups index-linked bonds (July 2007 to July 2008: rise of 5.0%).

b) Fair value losses on derivative financial instruments

Derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IAS 39. Consequently, the group's interest rate and index-linked swaps are fair valued at each balance sheet date with the net loss or gain disclosed in the income statement. Over the life of these swaps, if held to maturity, these fair value adjustments will reverse and reduce to zero. (See note 15 in respect of derivative financial instruments held on the balance sheet.)

	Group	
	2010	2009
	£m	£m
Fair value gains/(losses) on interest rate swaps	9.5	(28.3)
Fair value losses on index-linked swaps	(24.5)	(58.2)
Total fair value losses on derivative financial instruments	<u>(15.0)</u>	<u>(86.5)</u>
Deferred tax effect at 28% (2009: 28%) of fair value losses	4.2	24.2
Net of tax impact of fair value losses	<u>(10.8)</u>	<u>(62.3)</u>

6. Taxation credit/(charge)

Analysis of credit/(charge) in the year

	Group	
	2010	2009
	£m	£m
Current tax		
- Adjustment in respect of prior years	1.7	-
Deferred tax		
- Current year movements	(15.8)	30.3
- Adjustment in respect of prior years	16.0	4.0
- Effect of abolition of Industrial Buildings Allowances	-	(37.0)
	0.2	(2.7)
Taxation credit/(charge)	1.9	(2.7)
Analysed as:		
Credit/(charge) to Income Statement	1.9	(5.6)
Credit to Statement of Comprehensive Income	-	2.9
	1.9	(2.7)

The £16m deferred tax adjustment in respect of prior years relates to the agreement with HMRC of retrospective capital allowances claims.

The effective rate of tax for the year is lower (2009: higher) than the standard rate of corporation tax in the UK (2010: and 2009: 28%). The differences are explained below:

	Group	
	2010	2009
	£m	£m
Profit/(loss) before tax	62.9	(97.3)
Profit/(loss) before tax multiplied by the corporation tax rate in the UK of 28% (2009: 28%)	17.6	(27.2)
Effect of:		
- Adjustments in respect of prior years	(17.7)	(4.0)
- Other permanent differences	(1.8)	(0.2)
- Effect of abolition of Industrial Buildings Allowances	-	37.0
- Movement on deferred tax asset relating to pension scheme	-	(2.9)
Total taxation (credit)/charge	(1.9)	2.7

7. Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 28% (2009: 28%).

The movement in the deferred tax provision is as shown below:

	Group	
	2010	2009
	£m	£m
At 1 April	352.8	350.1
(Credit)/Charge to Income Statement	(0.2)	5.6
Credit to Statement of Comprehensive Income	-	(2.9)
At 31 March	<u>352.6</u>	<u>352.8</u>

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered. Under the current tax regime, trading tax losses carried forward will be available to offset trading profits in future periods.

	Group	
	2010	2009
	£m	£m
Effect of:		
Tax allowances in excess of depreciation	454.4	443.7
Capital gains rolled over	41.6	41.6
Deferred tax on tax losses carried forward	(82.5)	(80.1)
Deferred tax on losses on derivative financial instruments	(48.9)	(44.7)
Pensions	(2.2)	(2.2)
Other tax differences	(9.8)	(5.5)
Provision for deferred tax	<u>352.6</u>	<u>352.8</u>

The company has no deferred tax balance.

8. Property, plant and equipment

Group

Current year	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2009	34.4	1,513.1	2,383.4	226.2	4,157.1
Additions net of grants and contributions	-	32.9	222.2	1.3	256.4
At 31 March 2010	34.4	1,546.0	2,605.6	227.5	4,413.5
Accumulated depreciation					
At 1 April 2009	16.8	131.2	859.4	169.7	1,177.1
Charge for the year	0.5	33.8	83.2	15.0	132.5
At 31 March 2010	17.3	165.0	942.6	184.7	1,309.6
Net book value					
At 31 March 2010	17.1	1,381.0	1,663.0	42.8	3,103.9

The net book value of property, plant and equipment includes £155.5m in respect of assets in the course of construction (2009: £160.9m).

The net book value of property, plant and equipment includes £6.1m of borrowing costs capitalised in accordance with IAS 23 (2009: nil), of which £6.1m were additions in the year (2009: nil).

Prior year	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2008	33.0	1,457.4	2,232.5	222.9	3,945.8
Additions net of grants and contributions	1.4	55.7	150.9	67.4	275.4
Disposals	-	-	-	(64.1)	(64.1)
At 31 March 2009	34.4	1,513.1	2,383.4	226.2	4,157.1
Accumulated depreciation					
At 1 April 2008	16.3	98.8	772.9	164.4	1,052.4
Charge for the year	0.5	32.4	86.5	10.5	129.9
Released on disposal	-	-	-	(5.2)	(5.2)
At 31 March 2009	16.8	131.2	859.4	169.7	1,177.1
Net book value					
At 31 March 2009	17.6	1,381.9	1,524.0	56.5	2,980.0

Assets held under finance leases

Included within the above are assets held under finance leases, analysed as below:

Group

Current year	Infrastructure assets £m	Operational assets £m	Total £m
Cost			
At 1 April 2009 and at 31 March 2010	611.8	658.1	1,269.9
Accumulated depreciation			
At 1 April 2009	51.6	220.5	272.1
Charge for the year	7.7	32.9	40.6
At 31 March 2010	59.3	253.4	312.7
Net book value			
At 31 March 2010	552.5	404.7	957.2
Prior year			
Cost			
At 1 April 2008	611.8	598.1	1,209.9
Additions	-	60.0	60.0
At 31 March 2009	611.8	658.1	1,269.9
Accumulated depreciation			
At 1 April 2008	43.9	187.5	231.4
Charge for the year	7.7	33.0	40.7
At 31 March 2009	51.6	220.5	272.1
Net book value			
At 31 March 2009	560.2	437.6	997.8

The parent company owns no property, plant or equipment.

9. Intangible assets

Intangible assets comprise computer software and related system developments.

Group

	Cost £m	Amortisation £m	Net book value £m
Current year			
At 1 April 2009	101.5	(55.3)	46.2
Additions	21.6	(7.7)	13.9
Disposals	(6.5)	6.5	-
At 31 March 2010	116.6	(56.5)	60.1
Prior year			
At 1 April 2008	76.7	(51.6)	25.1
Additions	24.8	(3.7)	21.1
At 31 March 2009	101.5	(55.3)	46.2

The net book value of intangible assets includes £34.2m in respect of assets in the course of construction (2009: £18.1m). The majority of this relates to assets which will have an estimated life of around 20 years once commissioned.

The parent company owns no intangible fixed assets.

10. Fixed asset investments

(a) Group

	2010 £m	2009 £m
Cost and net book value		
At 1 April and 31 March	-	-

Equity of less than 10% is held in the following unlisted company:

	Principal activity	Country of incorporation	Holding
Water Research Centre (1989) plc	Water research	England and Wales	'B' Ordinary Shares of £1

In addition, the group holds 5% Convertible Unsecured Loan Stock 2014 at a cost of £23,326 in Water Research Centre (1989) plc.

(b) Parent Company

The company has a £1 investment in Glas Cymru (Securities) Cyfyngedig and has indirect investments in the following subsidiary undertakings:

	Principal activity	Country of incorporation	Holding
Dŵr Cymru (Holdings) Limited	Holding company	England and Wales	100%
Dŵr Cymru Cyfyngedig	Water and sewerage	England and Wales	100%
Dŵr Cymru (Financing) Limited	Raising finance	Cayman Islands	100%
Welsh Water Utilities Finance plc	Raising finance	England and Wales	100%

11. Trade and other receivables

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
(a) Amounts falling due within one year:				
Trade receivables	86.0	109.4	-	-
Provision for impairment of receivables	(44.2)	(70.6)	-	-
Trade receivables - net	41.8	38.8	-	-
Prepayments and accrued income	62.1	62.0	-	-
Corporation tax	1.7	-	-	-
Other receivables	8.4	1.4	-	-
	114.0	102.2	-	-
(b) Amounts falling due after more than one year:				
Amounts owed by group undertakings	-	-	3.4	3.4
	-	-	3.4	3.4
Total trade and other receivables	114.0	102.2	3.4	3.4

All non-current receivables are due within five years from the balance sheet date.

As at 31 March 2010, based on a review of historical collection rates it was considered that £44.2m of trade receivables were impaired and these have therefore been provided for (2009: £70.6m). The impaired receivables relate mainly to measured and unmeasured water supply debtors.

The ageing of receivables was as follows:

Current year	Total	Provided for	Net
Trade receivables	£m	£m	£m
Under one month	18.4	(3.6)	14.8
Between one and six months	22.6	(10.3)	12.3
Between six months and one year	19.0	(9.2)	9.8
Between one and two years	16.1	(12.0)	4.1
Between two and three years	9.6	(8.8)	0.8
Over three years	0.3	(0.3)	-
	86.0	(44.2)	41.8
Prior year	Total	Provided for	Net
Trade receivables	£m	£m	£m
Under one month	10.1	(3.4)	6.7
Between one and six months	18.0	(8.2)	9.8
Between six months and one year	21.4	(7.2)	14.2
Between one and two years	21.9	(16.3)	5.6
Between two and three years	15.9	(13.6)	2.3
Over three years	22.1	(21.9)	0.2
	109.4	(70.6)	38.8

Movements in the provision for impairment of trade receivables are as follows:

	2010	2009
	£m	£m
At 1 April	70.6	58.8
Charge to Income Statement	21.6	18.1
Receivables written off during the year as uncollectable	(48.0)	(6.3)
At 31 March	44.2	70.6

The creation and release of provision for impaired receivables have been included in operational expenditure.

The other classes within trade and other receivables do not contain impaired assets. All trade and other receivables are denominated in sterling.

During the year the group has written off £48.0m of debt which had been provided for in full (2009: £6.3m).

12. Cash and cash equivalents

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
Cash at bank and in hand	3.7	3.0	0.1	0.1
Short-term deposits	245.0	136.3	-	-
	248.7	139.3	0.1	0.1

The effective interest rate on short-term deposits as at 31 March 2010 was 0.6% (2009: 0.6%) and these deposits have an average maturity of 9 days (2009: 8 days). All cash and cash equivalents were held in sterling.

13. Trade and other payables

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
Current				
Trade payables	21.5	28.2	-	-
Capital payables	56.5	53.4	-	-
Amounts due to group undertakings	-	-	3.5	3.5
Other taxation and social security	0.5	0.4	-	-
Accruals and deferred income	52.0	47.5	-	-
	130.5	129.5	3.5	3.5
Non-current				
Deferred income	2.3	3.0	-	-

14. Financial liabilities – borrowings

	Group	
	2010	2009
Current	£m	£m
Interest accruals	5.9	6.9
Bonds	125.0	-
Unamortised bond premium	0.6	0.5
Unamortised bond issue costs	(0.4)	(0.7)
European Investment Bank loans	8.9	4.4
Local authority loans	0.3	0.3
Finance lease obligations	9.9	8.6
	150.2	20.0

	Group	
	2010	2009
Non-current	£m	£m
Interest accruals	38.0	35.0
Bonds	1,670.0	1,664.5
Unamortised bond premium	11.2	11.8
Unamortised bond issue costs	(5.9)	(4.2)
KfW Bank loan	35.0	-
European Investment Bank loans	138.0	146.8
Local authority loans	1.9	2.3
Finance lease obligations	873.6	883.5
	2,761.8	2,739.7

The parent company has no borrowings.

A security package was granted by Dŵr Cymru Cyfyngedig (DCC), as part of the group's bond programme for the benefit of holders of senior bonds, finance lessors and other senior financial creditors.

The obligations of DCC are guaranteed by the company, Glas Cymru (Securities) Cyfyngedig and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:

- i) a first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence; and
- ii) a fixed and floating security given by the guarantors referred to above which are accrued on each of these companies' assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

The group's Class A Bonds of £895.9m (2009: £902.3m) benefit from a guarantee from MBIA UK Insurance Limited ("MBIA"). MBIA's credit rating has been reduced to B3 and BBB+ by Moody's and S&P respectively, and is no longer rated by Fitch. The credit rating of the Class A bonds has therefore defaulted to the higher underlying rating of these bonds, of A3/A/A from Moody's, S&P and Fitch respectively. The underlying rating reflects the standalone credit quality of these bonds without the benefit of the MBIA guarantee, and is the same as the credit ratings of the group's Class B bonds of £759.1m (2009: £637.2m).

15. Derivative financial instruments

Derivative financial instruments are held for economic hedging purposes. However, they do not qualify as accounting hedges under IAS 39 and movements in their fair value are taken to the Income Statement (see note 3b). The fair values of all derivative financial instruments held by the group are the result of mark-to-market pricing by the issuing counterparties and as such fall within level 1 of the fair value hierarchy set out in IFRS 7.

Group - 2010

	Fair values	
	Assets £m	Liabilities £m
Current		
Index-linked swaps	4.4	(24.4)
Interest rate swaps	-	(11.6)
	4.4	(36.0)
Non-current		
Index-linked swaps	-	(105.5)
Interest rate swaps	0.8	(36.4)
	0.8	(141.9)
Total	5.2	(177.9)

Group - 2009

	Fair values	
	Assets £m	Liabilities £m
Current		
Index-linked swaps	18.6	(1.4)
Interest rate swaps	7.4	(0.7)
	26.0	(2.1)
Non-current		
Index-linked swaps	-	(119.7)
Interest rate swaps	-	(62.0)
	-	(181.7)
Total	26.0	(183.8)

In accordance with IAS 39, 'Financial instruments: Recognition and Measurement', the group has reviewed all contracts for embedded derivatives that are required to be accounted for separately if they do not meet certain requirements set out in the standard. The group has no such embedded derivatives as per IAS 39.

The parent company has no derivative financial instruments or embedded derivatives.

Interest rate swaps

At 31 March 2010 an interest rate swap fixes the interest rate on £192m (2009: £192m) of floating rate liabilities held by the group. The maturity date of the swap is 31 March 2031 and the quarterly fixed interest rate is 5.67%. In addition, £56m (2009: £nil) of finance lease liabilities have been swapped from a floating to a fixed rate of 3.57% until March 2017. The notional amount of the swap is £54m (2009: £nil).

£534 million (2009: £563m) of finance lease liabilities are converted from 3 month to 12 month floating for a period of one year; the swaps expire on 31 March 2011. These swaps are matched against the same liabilities as £534m of the finance lease index-linked swaps noted below.

Index-linked swaps

Finance lease swaps

The index-linked swaps have the effect of index-linking the interest rate on £692m (2009: £617m) of finance lease liabilities by reference to the Retail Prices Index ("RPI").

The notional amount of the swaps as at 31 March 2010 is £636 million (2009: £563m), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2010. The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases.

The principal terms are as follows:

Notional amount	£636m (amortising)
Average swap maturity	23 years
Average interest rate	1.58% (fixed) plus RPI

Bond swap

The index-linked swaps have the effect of index-linking the interest rate on £100m of fixed rate bonds by reference to the RPI.

The principal terms are as follows:

Indexed notional amount	£109.4m
Swap maturity	47 years
Interest rate	1.35% (indexed by RPI)

16. Financial risk management

The policies of the group in respect of financial risk management are included in the accounting policies note on page 26. The numerical financial instrument disclosures as required by IFRS 7 are set out below.

a) Interest rate risk

The effective interest rates at the balance sheet dates were as follows:

	2010	2009
Assets:		
Cash and cash equivalents	0.6%	0.6%
Liabilities:		
Bonds	5.2%	5.6%
European Investment Bank loans	2.4%	2.1%
Local authority loans	4.9%	5.3%
Finance lease obligations	1.6%	5.1%

Trade and other receivables and payables are non interest-bearing.

The effective interest rates ignore the effect of the interest rate and index-linked swaps set out in note 15. They also exclude the indexation charge applicable to the index-linked bonds.

b) Liquidity risk

Group - 2010	Within 1	1 - 2 years	2 - 5 years	> 5 years	Total
	year				
	£m	£m	£m	£m	£m
Assets:					
Cash and cash equivalents	248.7	-	-	-	248.7
Trade and other receivables	112.4	-	-	-	112.4
	361.1	-	-	-	361.1
Liabilities:					
Bonds	125.6	0.6	1.8	1,678.8	1,806.8
KfW Bank loan	-	-	11.7	23.3	35.0
European Investment Bank loans	8.9	13.5	42.9	81.6	146.9
Local authority loans	0.3	0.3	1.0	0.6	2.2
Finance lease obligations	9.9	11.9	91.8	769.9	883.5
Trade and other payables	130.5	0.5	1.5	0.3	132.8
	275.2	26.8	150.7	2,554.5	3,007.2
Group - 2009	Within 1	1 - 2 years	2 - 5 years	> 5 years	Total
	year				
	£m	£m	£m	£m	£m
Assets:					
Cash and cash equivalents	139.3	-	-	-	139.3
Trade and other receivables	102.2	-	-	-	102.2
	241.5	-	-	-	241.5
Liabilities:					
Bonds	0.5	125.6	1.8	1,548.9	1,676.8
European Investment Bank loans	4.4	8.9	40.4	97.5	151.2
Local authority loans	0.3	0.3	1.0	1.0	2.6
Finance lease obligations	8.6	9.9	51.1	822.5	892.1
Trade and other payables	129.5	0.3	0.3	2.4	132.5
	143.3	145.0	94.6	2,472.3	2,855.2

As at 31 March 2010, the bonds maturing within 1 year represent £125 million of subordinated bonds with an expected maturity date of 31 March 2011. If these bonds are not redeemed on or before 31 March 2011, the interest rate will change from a fixed rate of 8.174% to a floating 3 month LIBOR interest rate plus a margin of 5.75%. On 3 June 2010 the company agreed to repurchase £113 million of Class C1 bonds following a tender offer to bond holders. The amount repurchased represents a take-up rate of 90% and settlement will be made in cash on 7 June 2010.

The minimum lease payments under finance leases fall due as follows:

	2010 £m	2009 £m
Gross finance lease liabilities		
Within one year	22.2	30.9
Between two and five years	232.3	175.9
After five years	<u>1,164.5</u>	<u>1,165.5</u>
	1,419.0	1,372.3
Future interest	<u>(535.5)</u>	<u>(480.2)</u>
Net finance lease liabilities	<u>883.5</u>	<u>892.1</u>
Net finance lease liabilities are repayable as follows:		
Within one year (note 14)	<u>9.9</u>	<u>8.6</u>
Between two and five years	103.7	61.1
After five years	<u>769.9</u>	<u>822.4</u>
Total over one year (note 14)	<u>873.6</u>	<u>883.5</u>

c) Fair values

The fair values of the group's derivative financial instruments are set out in note 15. The following table summarises the fair value and book value of the group's bonds.

	2010		2009	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bonds (note 14)	1,806.8	2,036.9	1,676.8	<u>1,603.0</u>

The fair values of all other financial instruments are equal to the book values.

d) Borrowing facilities

As at 31 March 2010, the group had available undrawn committed borrowing facilities of £420m expiring as set out below, in respect of which all conditions precedent had been met (2009: £420m).

	2010 £'000	2009 £'000
Expiring in less than 1 year:		
- term loan facility	75,000	-
Expiring in more than 1 year:		
- revolving credit facilities	345,000	345,000
- term loan facility	-	75,000
	<u>345,000</u>	<u>420,000</u>
	<u>420,000</u>	<u>420,000</u>

Dŵr Cymru (Financing) Limited also has a special liquidity facility of £150 million, which it is required to maintain in order to meet certain group interest and other obligations that cannot be funded through operating cashflow of the group, in the event of a standstill being declared by the Security Trustee. A standstill would arise in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. No such covenant defaults have arisen during the year. Dŵr Cymru Cyfyngedig also has a £20 million overdraft facility. Both of these facilities are renewable on an annual basis. All of the above facilities, including the liquidity facility, are at floating rates of interest.

In view of the strong liquidity position, £245m of revolving credit facilities were cancelled on 7 May 2010.

e) Capital risk management

Gearing ratios

	2010	2009
	£m	£m
Total borrowings	(2,912)	(2,759)
Less: cash and cash equivalents	249	139
Net debt	(2,663)	(2,620)
RCV	3,737	3,626
Total capital	1,074	1,006
Less: unamortised bond costs	(6)	(5)
Total capital per bond covenants	1,068	1,001
Gearing ratio	71%	72%

As set out on page 29, the group monitors its capital structure based on a regulatory gearing ratio which compares its net debt to the Ofwat-determined RCV.

17. Provisions

Group	Restructuring provision £m	Dilapidations provision £m	Uninsured loss provision £m	Total £m
At 1 April 2009	-	1.4	7.8	9.2
Charged to income statement	28.4	0.8	0.7	29.9
Utilised in year	-	-	(1.7)	(1.7)
At 31 March 2010	28.4	2.2	6.8	37.4
Split as:				
Amounts to be utilised within one year	12.9	0.2	1.7	14.8
Amounts to be utilised after more than one year	15.5	2.0	5.1	22.6
At 31 March 2010	28.4	2.2	6.8	37.4

As at 31 March 2009, all provisions were expected to be utilised after more than one year.

The parent company has no provisions at 31 March 2010 (2009: nil).

Restructuring provision

This provides for the costs of terminating the outsourced contracts along with the estimated restructuring costs associated with a reduction in the headcount by some 300 (see note 4).

Dilapidations provision

This provision relates to estimated dilapidation costs, which will be incurred over the next two years.

Provision for uninsured losses

This provision is in respect of uninsured losses and instances where insurance does not cover a deductible amount. The utilisation period of these liabilities is uncertain due to the nature of claims, but is estimated to be within five years.

18. Net cash inflow from operating activities

a) Cash generated from operations

Reconciliation of operating profit to cash generated from operations:

	Group	
	2010	2009
	£m	£m
Operating profit	175.8	154.9
Adjustments for:		
- Depreciation and amortisation	139.5	133.5
- Loss on disposal of fixed assets	0.4	0.8
- Changes in working capital:		
(Increase)/decrease in trade and other receivables	(10.1)	11.1
(Decrease)/increase in trade and other payables	(2.1)	8.1
Pension contributions in excess of operating costs	(1.1)	-
Increase in provisions	28.2	0.7
	<u>14.9</u>	<u>19.9</u>
Cash generated from operations	<u>330.6</u>	<u>309.1</u>

b) Interest paid

	Group	
	2010	2009
	£m	£m
Interest payable per income statement	101.3	174.3
Less non-cash items:		
- Indexation on index-linked bonds	9.5	(41.4)
- Amortisation of bond issue costs	0.6	(0.7)
- Interest (charge)/credit on pension scheme liabilities	(0.2)	0.2
- Amortisation of bond issue premium	0.7	0.5
- Effect of capitalisation under IAS 23	6.1	-
- Decrease in prepayments	-	(3.7)
- (Increase)/decrease in accruals	(1.9)	0.2
	<u>14.8</u>	<u>(44.9)</u>
Interest paid	<u>116.1</u>	<u>129.4</u>

19. Analysis and reconciliation of net debt

a) Net debt at the balance sheet date may be analysed as:

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
Cash and cash equivalents	248.7	139.3	0.1	0.1
Debt due after one year	(1,850.2)	(1,821.2)	-	-
Debt due within one year	(134.4)	(4.5)	-	-
Finance leases	(883.5)	(892.1)	-	-
Accrued interest	(43.9)	(41.9)	-	-
	(2,912.0)	(2,759.7)	-	-
Net debt	(2,663.3)	(2,620.4)	0.1	0.1

b) The movement in net debt during the period may be summarised as:

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
Net debt at start of year	(2,620.4)	(2,524.4)	0.1	0.1
Increase in net cash	109.4	15.2	-	-
Increase in debt	(160.9)	(69.9)	-	-
Increase in net debt arising from cash flows	(51.5)	(54.7)	-	-
Movement in accrued interest	(2.0)	0.2	-	-
Indexation of index-linked debt	9.5	(41.4)	-	-
Other non-cash movements	1.1	(0.1)	-	-
Movement in net debt during the year	(42.9)	(96.0)	-	-
Net debt at end of year	(2,663.3)	(2,620.4)	0.1	0.1

20. Employees and directors

a) Staff costs for the group during the year

	2010	2009
	£m	£m
Wages and salaries	10.7	10.7
Social security costs	1.1	1.0
Other pension costs	1.7	1.0
	13.5	12.7

Of the above, £5.9 million (2009: £5.7 million) has been charged to capital.

Average monthly number of people (including executive directors) employed by the group	2010	2009
	Number	Number

Regulated water and sewerage activities	200	187
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Some 1,600 employees who worked on the previously outsourced operational contracts have transferred to Welsh Water via TUPE arrangements post year-end (see note 27).

b) Parent company

The parent company had no employees (2009: nil) in the year. Full details of the directors' remuneration are included in the Directors' Remuneration Report, which forms part of these Financial Statements.

21. Pension commitments

The group operates a funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service), the DCWW Pension Scheme. The assets of the scheme are held in a separate trustee-administered fund.

The DCWW Pension Scheme was closed to new members from 31 December 2005 and a new defined contribution scheme, the Dŵr Cymru Defined Contribution Scheme, was introduced from 1 January 2006.

Subsequent to the end of the year, on 1 April 2010 1,093 United Utilities Operational Services ('UUOS') employees transferred to Welsh Water, followed by 476 Kelda Water Services ('KWS') employees on 1 May 2010. Around 1,000 UUOS and KWS employees transferring to Welsh Water are entitled to transfer their existing defined benefit pensions into the DCWW Pension Scheme. In aggregate the transfer is likely to be fully-funded on an actuarial basis, although this result is uncertain and the assumptions used may differ from the calculation under IAS 19.

Assuming that all 1,000 members transfer their pensions into the DCWW Pension Scheme, this would increase scheme assets as at 31 March 2010 by around £177m. Assuming that all members commute the maximum possible pension for cash at retirement, the IAS 19 liability as at the same date would be broadly similar. Scheme membership would increase from around 150 to a total of around 1,150 members.

In the event that the IAS 19 valuation varies from the funded actuarial valuation at the date of transfer, any differences will be taken to the income statement for the year to 31 March 2011.

See also subsequent events note 27.

Total pension costs in the year were as follows:

	2010	2009
	£'000	£'000
Defined contribution scheme	273	122
Defined benefit scheme - excluding actuarial loss	1,287	927
	1,560	1,049
Net actuarial loss recognised in year	1,512	10,400
	3,072	11,449

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2009 by Robert Davies of Quantum Advisory, an independent, professionally qualified actuary, using the attained age method. This valuation has been updated as at 31 March 2010 and the principal assumptions made by the actuaries were:

	2010	2009
Discount rate	5.6%	6.2%
Inflation assumption	3.5%	2.7%
Rate of increase in pensionable salaries	4.5%	3.7%
Rate of increase in pensions in payment	3.3%	2.7%
Post retirement mortality (life expectancy):		
- Current pensioners aged 65 - males	87.0 years	87.0 years
- Current pensioners aged 65 - females	89.9 years	89.9 years
- Future pensioners aged 65 (currently aged 45) - males	88.1 years	88.1 years
- Future pensioners aged 65 (currently aged 45) - females	90.9 years	90.9 years

Post retirement mortality assumptions are based on those in published actuarial tables "PA92", relevant to members' year of birth with medium cohort adjustments.

The major categories of plan assets, as a percentage of total assets and the expected long-term rates of return thereon, were as follows:

	2010		2009	
	Expected return	% of total assets	Expected return	% of total assets
Equities	7.5%	60.5%	8.0%	59.0%
Bonds	5.0%	39.2%	5.0%	39.8%
Other	3.0%	0.3%	3.0%	1.2%

The amounts recognised in the Income Statement are as follows:

	2010	2009
	£'000	£'000
Current service cost (excluding member contributions)	852	878
Past service cost	151	151
Effect of curtailments or settlements	-	99
Total included within staff costs	1,003	1,128
Interest cost	2,538	2,353
Expected return on plan assets	(2,254)	(2,554)
Total included within interest payable and similar charges	284	(201)
Total recognised in the Income Statement	1,287	927

Note that the defined contribution scheme charge of £273,000 (2009: £122,000) has also been included within staff costs.

The amounts recognised in the Statement of Comprehensive Income are as follows:

	2010	2009
	£'000	£'000
Actuarial gain/(loss) on plan assets	9,977	(9,301)
Actuarial loss on defined benefit obligation	(11,489)	(1,099)
Total recognised in the Statement of Comprehensive Income	(1,512)	(10,400)

The total recognised in the Balance Sheet is made up as follows:

	2010	2009
	£'000	£'000
Present value of funded obligations	(55,171)	(40,577)
Plus unrecognised prior service costs	375	526
Fair value of plan assets	46,773	32,283
Net liability recognised in the Balance Sheet	(8,023)	(7,768)

Changes in the present value of the defined benefit obligation are as follows:

	2010	2009
	£'000	£'000
At 1 April	40,577	37,416
Current service cost (including member contributions)	1,209	1,241
Interest cost	2,538	2,353
Benefits paid (net of transfers in)	(642)	(919)
Settlement	-	(613)
Actuarial loss	11,489	1,099
At 31 March	55,171	40,577

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

	2010	2009
	£'000	£'000
At 1 April	32,283	38,786
Expected return on plan assets	2,254	2,554
Contributions (including member contributions)	2,901	1,875
Benefits paid (net of transfers in)	(642)	(919)
Settlement	-	(712)
Actuarial gain/(loss) on plan assets	9,977	(9,301)
At 31 March	46,773	32,283

Analysis of the movement in the amount recognised on the balance sheet:

	2010	2009
	£'000	£'000
At 1 April	7,768	(2,047)
Total charge to Income Statement	1,287	927
Total charge to Statement of Comprehensive Income	1,512	10,400
Contributions paid (excluding member contributions)	(2,544)	(1,512)
At 31 March	8,023	7,768

	2010	2009	2008	2007	2006
Experience adjustments arising on scheme assets:					
Amount (£m)	10.0	(9.3)	(4.7)	(0.2)	3.5
Percentage of scheme assets	21%	(29%)	(12%)	(1%)	11%
Experience adjustments arising on scheme liabilities:					
Amount (£m)	11.5	(1.1)	8.0	(0.7)	(2.0)
Percentage of the present value of scheme liabilities	21%	(3%)	22%	(2%)	(5%)
Present value of scheme liabilities (£m)	54.8	40.1	36.8	41.0	37.2
Fair value of scheme assets (£m)	46.8	32.3	38.8	35.5	30.6
(Deficit)/surplus (£m)	(8.0)	(7.8)	2.0	(5.5)	(6.6)

The contributions paid in the year to 31 March 2010 include a special contribution of £1.1m (2009: £nil). The contribution expected to be paid during the financial year ended 31 March 2011 amounts to £4.1m (based on scheme membership as at 31 March 2010).

22. Capital and other financial commitments

The group's business plan at 31 March 2010 shows net capital expenditure and infrastructure renewals expenditure of £252m (2009: £350m) during the next financial year. While only a portion of this amount has been formally contracted for, the group is effectively committed to the total as part of its overall capital expenditure programme approved by its regulator.

23. Related party transactions

In accordance with the exemption afforded by IAS 24 there is no disclosure in the consolidated financial statements of transactions with entities that are part of the Glas Cymru Cyfyngedig group.

24. Status of the company

The company is limited by guarantee and does not have any share capital. In the event of the company being wound up, the liability of the members is limited to £1 each.

25. Directors' and officers' loans and transactions

No loans or credit transactions with any directors, officers or connected persons existed during the year or were outstanding at the balance sheet date.

26. Elan Valley Trust Fund

In 1984 Welsh Water Authority entered into a conditional sale and purchase agreement with Severn Trent Water Authority for the sale of the aqueduct and associated works by which the bulk supply to Severn Trent reservoirs is conveyed.

The sum of £31.7m, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Welsh Water Authority, whilst preserving the capital value of the fund in real terms. Welsh Water Authority's interest in this fund was vested in Dŵr Cymru Cyfyngedig under the provisions of the Water Act 1989.

The assets of the fund are not included in these financial statements.

Interest receivable includes £2.6m (2009 £2.3m) in respect of distributions from the Elan Valley Trust Fund.

27. Subsequent events

On 9 February 2010 Welsh Water announced its intention to restructure the business by terminating the outsourced operational contracts with United Utilities Operational Services ('UUOS') and Kelda Water Services ('KWS') and by implementing a phased headcount reduction of around 300 people.

Subsequent to the end of the year, negotiations relating to the termination of the contracts have been finalised, and on 1 April 2010 1,093 UUOS employees transferred to Welsh Water, followed by 476 KWS employees on 1 May 2010.

Around 1,000 UUOS and KWS employees transferring to Welsh Water are entitled to transfer their existing defined benefit pensions into the DCWW Pension Scheme. In aggregate the transfer is likely to be fully-funded on an actuarial basis, although this result is uncertain and the assumptions used may differ from the calculation under IAS 19.

Assuming that all 1,000 members transfer their pensions into the DCWW Pension Scheme, this would increase scheme assets as at 31 March 2010 by around £177m. Assuming that all members commute the maximum possible pension for cash at retirement, the IAS 19 liability as at the same date would be broadly similar.

In the event that the IAS 19 valuation varies from the funded actuarial valuation at the date of transfer, any differences will be taken to the income statement for the year to 31 March 2011.

The financial statements contain exceptional items of £29.5m relating to the costs of terminating the contracts and reorganising the business (see notes 3 and 4).