

Anglian Water Services Limited
Annual Report and Accounts 2006



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Group publications

AWG Plc
Annual Report
and Accounts 2006

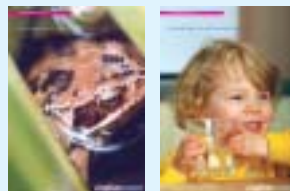


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The waste water treatment process creates methane, a renewable fuel, which is stored in large tanks. The front cover photograph shows one of those tanks near Cambridge.

Environment Report 2006
Drinking Water Quality Report 2005



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Disability and Discrimination Act

AWG Plc shareholder communications are also available on audio tape, in braille and in large print versions.

Please call 0870 606 0382 or textphone 0870 600 3950.

performance review

Anglian Water Services Limited

Anglian Water Services Limited is part of AWG Plc. The company operates on an arm's-length basis from other companies within AWG Plc. The financial results for 2006 are presented for the company only and therefore exclude the results of Anglian Water Services Financing Plc (AWSF).

The financial results have been prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP).

operating results

The company profit and loss account as presented on page 9 is summarised in Table 1 below:

Table 1	2006	2005	Movement
	£m	restated £m	
Turnover	865.7	796.8	8.6
Operating profit	359.6	329.4	9.2
Net interest payable and other finance charges	(62.5)	(63.9)	(2.2)
Profit before tax	297.1	265.5	11.9
Taxation	(50.2)	(9.5)	428.4
Profit after tax	246.9	256.0	(3.6)
Dividends	(305.7)	(233.6)	30.9
Retained profit	(58.8)	22.4	(362.5)

In order to aid understanding of the accounts, a pro forma profit and loss account is provided in Table 2 below. In this profit and loss account, the interest receivable by the company from Anglian Water Services Holdings Ltd (see note 5 on page 19) and the inter-company dividend paid (see note 8 on page 20) by the company and retained within the Anglian Water Services Financing group (see Directors' report on page 6) of £240.7 million (2005: £193.6 million), have been eliminated.

Table 2	2006	2005	Movement
	£m	restated £m	
Turnover	865.7	796.8	8.6
Operating profit	359.6	329.4	9.2
Net interest payable and other finance charges	(255.6)	(257.0)	(0.5)
Profit before tax	104.0	72.4	43.6
Taxation	(50.2)	(9.5)	428.4
Profit after tax	53.8	62.9	(14.5)
Dividends	(65.0)	(40.0)	62.5
Retained profit	(11.2)	22.9	(148.9)

Turnover increased by 8.6 per cent as a result of the regulatory pricing formula (including a factor K¹ of 3.8 per cent), together with higher than normal revenues due to the effect of the dry weather in the early part of the summer in 2005. This net increase in revenue of £68.9 million, together with the realisation of cost efficiencies, contributed to an increase in operating profit of 9.2 per cent (£30.2 million).

Operating expenditure for the year (excluding depreciation) increased by 4.5 per cent to £314.4 million (2005: £301.0 million). This was due to upward cost pressures from wage inflation, power, rates and the incremental running costs of new capital projects. These costs were mitigated by savings generated from the manpower reduction programme at the start of the year, as well as other efficiency initiatives. Overall, operating expenditure as a percentage of turnover decreased slightly from 37.8 per cent to 36.3 per cent.

The reduction in manpower costs and other identified initiatives will generate a significant proportion of the total operating efficiency savings required to be delivered over AMP4 (see glossary of terms on page 64).

Taxation costs increased from £9.5 million in 2005 to £50.2 million in 2006. This was due to an increase in current tax related to changes in tax legislation plus movements in discount rates (see note 7(a)) giving rise to an increased deferred tax charge.

Gross capital expenditure for the year was £293.6 million, £76.5 million of which was delivered by a Capital Alliance of six partner companies working in close co-operation with the company. During the year, the company successfully delivered the regulatory obligations for year one of the new five-year asset management plan.

Net interest payable and other finance charges per Table 2 (excluding interest receivable on an inter-company loan, see note 5 on page 19) reduced from £257.0 million in 2005 to £255.6 million in 2006, reflecting the impact of re-financing completed over the past twelve months.

financial needs and resources

At 31 March 2006 the company had net borrowings of £3,537.3 million, a decrease of £380.6 million over the prior year. Net borrowings are a mixture of fixed, index linked and variable rate debt of £4,038.8 million and cash and deposits of £501.5 million. The decreased net borrowings comprise a net decrease of £300.4 million in loans and associated costs and a net increase of £80.2 million in cash and deposits.

The business generated a net cash inflow from operating activities of £528.8 million in 2006 (2005: £534.5 million). The company, through its financing subsidiary AWSF, took advantage of the very strong market conditions that existed in the debt capital markets to raise £402 million (before debt issue costs) early in the current year at historically attractive levels. This provides a good start to funding the capital expenditure programme for AMP4 and the refinancing of debt instruments which expire in the period. In addition, as a part of its ongoing debt management strategy, the company has refinanced its existing floating rate note issues in line with the terms of the individual issues.

¹ see glossary of terms on page 64.

performance review continued

shareholder's return

Dividends of £305.7 million (2005: £233.6 million) have been declared and paid at 35.55 pence per share (2005: 27.16 pence per share).

Of the above, £240.7 million (2005: £193.6 million) is payable to Anglian Water Services Holdings Limited in order for it to service the interest payable to the company on the inter-company loan of £1,609.1 million and £65.0 million (2005: £40.0 million) is payable outside the Anglian Water Services Financing group (see Directors' report on page 6). The dividend payable outside the Anglian Water Services Financing group equates to 7.56 pence per share (2005: 4.65 pence per share).

liquidity

The company's objective is to maintain flexibility, diversification and continuity of funding through access to different markets and debt instruments. At 31 March 2006 the company held cash, deposits and current asset investments of £501.5 million (2005: £421.3 million) and had undrawn committed facilities of £225.0 million (2005: £225.0 million). These resources are maintained to ensure liquidity and the continuation of the company's investment programme. The maturity profile of the company's borrowings is set out in note 15 on pages 24 to 28 of the accounts.

In addition, the company has access to £333.0 million of liquidity facilities (2005: £333.0 million), consisting of £257.0 million to finance debt service costs and £76.0 million to finance operating expenditure and maintenance capital expenditure in the event that the company was in default on its debt obligations and had insufficient liquidity. All facilities are accessed under a loan agreement between the company, AWSF and Deutsche Trustee Company Ltd (as Agent and Trustee for itself and each of the Finance Parties to the Global Secured Medium Term Note Programme) dated 30 July 2002. This agreement guarantees that any facilities drawn by AWSF will be passed directly on to the company upon utilisation of the facility.

interest rates

The company's policy, as agreed by the board, is to achieve an optimum mix of funding at indexed (to RPI), fixed and floating rates of interest. At the year-end, taking into account interest rate swaps, 43.3 per cent (2005: 30.0 per cent) of the company's borrowings were at rates indexed to RPI, 48.2 per cent (2005: 57.9 per cent) were at fixed rates and 8.5 per cent (2005: 12.1 per cent) were at floating rates. This includes the use of interest rate swaps to manage the company's exposure to interest rate fluctuations. The increase in index linked borrowings reflects the issuance of £402 million of index linked debt in April 2006.

See note 15 on pages 24 to 28 for further details.

credit risk

The company's main credit risk is in relation to trade debtors and is managed by regular review of problem accounts. Due to the statutory requirement to provide service, credit checks are not generally performed but the risk is spread over a large number of low value customer accounts.

service quality

The company's previously strong performance within Ofwat's (see glossary on page 64) measure of the water industry's Overall Performance Assessment (OPA) is expected to be impacted this year by non-compliance of its wastewater operations in part of the region and as a result of two major bursts in sewerage pipelines.

Steps have been taken to address the reasons for the non-compliance that will affect this year's score.

The overall score for the previous year 2004/5 was 408, ranking the company joint third. The 2005/6 performance will be published later in the year.

The company is committed to providing its customers with a high level of service and a consistent supply of wholesome drinking water. This is demonstrated by excellent compliance with the water quality standards in the Drinking Water Regulations in 2005 (these are measured on a calendar year basis). Drinking water quality remained high throughout the year, with an overall mean zonal compliance of 99.96 per cent for 2005 (2004: 99.95 per cent). Overall microbiological compliance remained high with 99.93 per cent of samples in 2005 complying with mandatory standards.

The company carries out continuous monitoring at treatment works and other key sites to complement the extensive laboratory sampling and analysis.

All water companies have a duty to inform the Drinking Water Regulator of any events that have affected, or are likely to affect, drinking water quality. The Regulator then assesses the information provided to determine whether the event is significant or not. If it is deemed significant then it is classified as an incident and enforcement action against the company concerned may also be considered. Of the events notified by the company to the Drinking Water Regulator in 2005, only a small number were classified as incidents.

water resources

The company has met its leakage target for 2005/6 as agreed with Ofwat. The target is set at the economic level of leakage; the point at which it would cost more to make further reductions than to produce the water from another source.

At six cubic metres per kilometre of water main per day or 110 litres per property per day, Anglian Water's leakage performance is one of the best in the UK. In 2004/5, the UK industry average leakage was reported at 11 cubic metres per kilometre of water main per day or 151 litres per property per day.

More than 100 people are employed in proactive leakage detection. More than 19,000 leakage repair jobs were completed in 2005/6 at a cost of more than £10 million.

regulation

The company's activities are regulated by the Water Industry Act 1991 (which consolidated that part of the Water Act 1989 relating to water supply and sewerage) and the conditions of an Instrument of Appointment (the licence) granted to the company by the Secretary of State for the Environment on 1 September 1989.

With certain exceptions, the regulatory provisions do not apply to business activities which are not connected with the carrying out of the water and sewerage functions. These business activities are referred to as non-appointed business (see note 3 on page 45).

On 1 April 2006 the role of the Director General of Ofwat was replaced by a new board structure, which will now take responsibility for the economic regulation of the water and sewerage industry in England and Wales. Although it will continue to be known as Ofwat, the statutory name was changed to the Water Services Regulation Authority (WSRA).

Under Condition F of the licence the company is obliged to provide the WSRA with additional accounting information to that contained in the statutory financial statements. This information is presented in the regulatory accounts on pages 40 to 64.

Between 2005 and 2010, Ofwat assumed capital investment for the company of a further £1.5 billion (at 2002/3 prices), in addition to the £4.6 billion that it has invested since privatisation in 1989. Approximately half of the £1.5 billion investment will be spent on the capital maintenance programme.

Ofwat's final determination (see glossary of terms on page 64), issued on 2 December 2004, resulted in the company having the lowest price increase of any water and wastewater company in England and Wales. It also set a number of challenging efficiency targets.

In response to the efficiency targets and known additional cost pressures from increases in energy costs, bad debt and pensions, the management team has put in place the framework and detailed plans to address these challenges.

As a first step, the company carried out a restructuring programme in 2004/5 financial year, which resulted in savings of £10 million per annum in operating costs, beginning in the financial year 2005/6. Further efficiency savings will come from a range of projects, principally the implementation of a centralised operational management centre, the management of energy purchasing and usage, a four-year agreement on pay and pension costs and programmes to reduce customer bad debt.

risks

pensions

The company has adopted Financial Reporting Standard 17 'Retirement benefits' (FRS 17) in the current year. The impact of this on the financial statements is discussed on page 14.

The company closed its defined benefit (final salary) pension scheme to new employees in 2002. Employees have subsequently been offered the opportunity to join a defined contribution scheme.

The defined benefit scheme remains a financial risk, however, with continued exposure to investment interest, inflation and mortality risks.

An in-depth review of the pension arrangements was carried out, focusing on controlling and reducing costs through the current regulatory period, while maintaining core pension provisions for employees. Proposals were developed and agreed with trustees following extensive consultation with employees, for whom the defined benefit scheme is valued highly. That package of changes takes effect in 2006 and leaves the defined benefit accrual intact, and achieves the aims of the review through a four-year pay deal and changes to early retirement terms for future service.

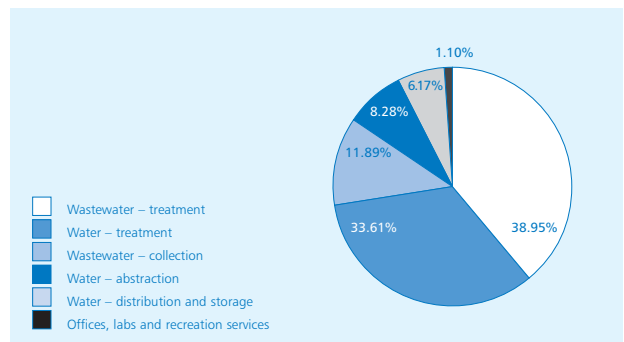
The improvement in the value of scheme assets together with scheme changes have helped to reduce the company's FRS 17 deficit from £103.0 million in 2005 to £35.1 million in 2006 (both net of deferred tax).

The company is working closely with the Trustees, the in-house treasury team and its advisers to develop solutions for managing investment and interest risks.

energy costs

Energy represents a key risk to the company's operating efficiency. The company is one of the largest energy users in the East Anglian region. In 2005/6, energy expenditure represented 13 per cent of total operating costs (£39.8 million).

In total, the company used 736 Gigawatt hours (GWh) in 2005/6, or 0.2 per cent of total electricity usage in the UK.



The above chart demonstrates energy consumption by the key processes. Water and wastewater pumping are significant elements due to the flat nature of the region. In addition energy is used to operate 1,075 wastewater treatment works and 138 water treatment works.

performance review continued

The company's electricity prices are on a rising trend and increased 24 per cent in 2005/6. Electricity costs for the company are anticipated to continue to increase over the current regulatory period.

The company's energy costs are currently hedged until October 2007. One contract, to procure energy through to October 2007, is from entirely renewable sources and represents two per cent of Anglian Water's energy demand.

Reducing energy consumption is an imperative for the company, for both economic and environmental reasons.

In 2005/6, the company strengthened its existing energy team, which is tasked with identifying and reducing controllable energy usage and promoting the need for energy efficiency throughout the company. The target for 2006/7 is to save at least 30 GWh per year.

The energy team is also investigating opportunities to increase the proportion of self-generated energy from renewable sources such as wind and combined heat and power (CHP) on wastewater treatment works.

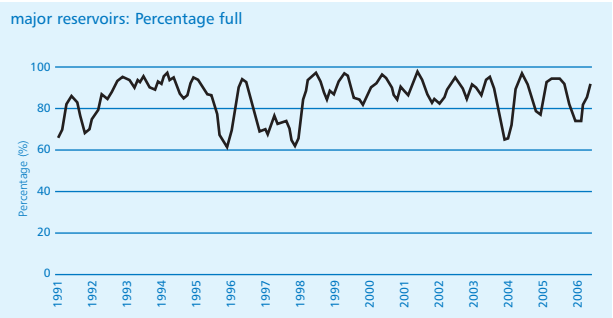
In 2005/6 the company generated 11 GWh of renewable energy from its CHP engines. These saved 4,975 tonnes of carbon and delivered over £1.1 million of benefits through offsetting power bought from the grid and from the sale of Renewable Obligation Certificates. Plans are in place to increase the amount of renewable power generated to achieve 70 GWh per year by 2010 through the further development of CHP and wind initiatives.

supply and demand

The company operates in the driest part of the country. A combination of national and regional economic growth is expected to lead to an increase in household demand, often on a very localised basis.

In 2005/6, the company's region received 92 per cent of its long-term average rainfall. The period November to March was noticeably drier, with only 65 per cent of long-term average rainfall. As at March 2006, overall regional water resources remained close to normal ranges, although groundwater levels in the drier southern area of the region were below average for the time of year.

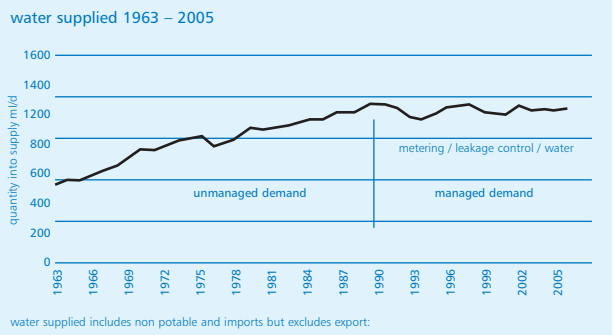
The potential deficit in the availability of water resources was mitigated through effective planning and investment in water storage and supply systems. One example of this was through expenditure on increased pumping; reinforcing the network and scheduling maintenance work to minimise the impact of water resources.



Following a dry winter in which groundwater levels in much of the South of England did not recharge sufficiently, 2005/6 saw a number of other water companies invoke hosepipe bans and apply for powers to restrict non-essential use of water.

For the majority of the companies affected, this was the second successive winter of low rainfall; depleting already stretched supplies.

The company takes a twin-track approach to balancing supplies with demand through investment in demand management alongside resource development: effective leakage control, combined with increased household metering help manage demand. More than half of the region's residents now use a meter, with around 40,000 more added each year. All new homes now have meters installed as standard.



As part of its long-term water resource planning, the company has been making preparations to extract more water from Rutland Water, its largest reservoir. The company has typically used only three-quarters of its available amount. As part of its plan to use its full potential, the company has consulted with local residents and statutory organisations regarding the extension of the reservoir's water treatment works.

Part of the consultation has been to explain how the company intends to extract more water from the reservoir while minimising the impact on the wildlife at this internationally important Special Protection Area (SPA).

Mindful of the potential consequences of climate change and Government plans for continued regional growth, the company is developing long-term plans to manage increased demand, one aspect of which is to raise customer awareness of the issues and the need to be 'waterwise'.

sewage sludge (biosolids)

Sewage sludge is a by-product of wastewater treatment. The safe and sustainable management of sludge, or biosolids as it is known when it is treated for use in agriculture, remains a key issue for the company and the industry as a whole.

The company uses a number of methods for managing sludge, the most important of which is recycling it to land. Around 90 per cent of treated biosolids is used as a high-quality fertiliser on agricultural land. If legislation or demand changed, removing agricultural land as an option, it would pose a substantial challenge to the industry. The company, therefore, maintains the highest standards within the current operation and continuously researches alternative treatment and management methods.

At present the company does not believe that there is any reason to expect a significant detrimental change in legislation. The treatment of sludge, and the recycling of the biosolids, are both highly regulated processes and are undertaken in accordance with strict quality guideline procedures. Both the UK Government and the EU Commission support this method of managing sludge.

The company continues to work, at a national and European level, with the water industry, the Government and regulators, to ensure the understanding and confidence of stakeholders in the safe and sustainable practice of recycling is maintained and improved.

environmental incidents

One of the company's key objectives is to minimise the impact of its operations on the environment. Unfortunately, given the scale of the company's operations, covering an area of 27,500 square kilometres, there can be instances of failure.

During the financial year 2005/6 the Environment Agency brought six court actions against the company for pollution incidents. The company was acquitted in one case but pleaded guilty in the other five.

Fines from the five convictions totalled £44,500 (2004/5: £61,500). The company works closely with the Environment Agency to learn the lessons from such unfortunate incidents and to strive to prevent any further incidents from occurring.

climate change

Climate change will directly affect the company. The company is currently investigating the impacts that this will have on the supply of drinking water and the collection and treatment of wastewater in the region.

The key implications for the company are:

- requirement for increased winter raw water storage
- supply infrastructure improvements – peak demand resilience
- impact on infrastructure – temporary or permanent asset loss due to flooding, sea level rise and coastal realignment
- resource competition – environmental/economic pressure to share water
- requirement to adapt design standards eg sewer capacity

The company recognises the serious nature of the challenges that it faces and has developed a strategy identifying the implications and required actions, both in terms of mitigation and adaptation.

The company is keen to play an active role in tackling the issues of climate change and in preparing our business for the inevitable requirements of adaptation.

Water Framework Directive

The Water Framework Directive (WFD) is the most substantial piece of EC water legislation to date. The WFD (2000/60/EC) came into force in December 2000 and became law in December 2003.

The main objectives of the WFD are to:

- enhance the status and prevent further deterioration of aquatic ecosystems and associated wetlands – there is a requirement for nearly all inland and coastal waters to achieve good status by 2015
- promote the sustainable use of water
- reduce pollution of water, especially by 'priority' and 'priority hazardous' substances
- lessen the effects of floods and droughts
- rationalise and update existing water legislation and introduce a co-ordinated approach to water management based on the concept of river basin planning.

The water industry has a contribution to make in achieving the WFD objectives. However, this contribution must be fair and proportionate with that of other sectors, ie the polluter pays principle should be followed. The contribution must also be sustainable in the long term and based on sound science.

The Company is working closely with the Environment Agency, other key regulators and Water UK on the implementation of the WFD to ensure that the benefits of the WFD are realised in a sustainable manner with all sectors contributing appropriately and equitably.

Any new obligations on the water industry that are contributions/measures towards meeting WFD objectives, will be funded through the Periodic Review (see glossary of terms on page 64) process (using appropriate change mechanisms where WFD timescales are not compatible with the company's business planning process).

directors' report

The Directors present their report and the audited financial statements of Anglian Water Services Limited (the company) for the year ended 31 March 2006.

The company serves the people of the Anglian Water region, an area stretching from the Humber to the Thames estuary and from Northamptonshire to the east coast, as well as customers in the Hartlepool Water region. The company aims to provide a high quality, cost-effective service to all customers, whilst ensuring compliance with environmental and public health standards.

The company provides water and wastewater services under licence from the Government. The quality of its service and the prices the company is able to charge its customers are regulated by Ofwat (see Regulation section on page 3). The company's customer base is increasing as the population grows. More than 200,000 new houses are expected to be built in the region over the next 10 years.

Common Terms Agreement

The company has a Common Terms Agreement (CTA) with its debt investors.

The CTA sets out the terms and conditions of the company's borrowing and the ongoing management of its Global Secured Medium Term Note (GSMTN) programme. The CTA also sets out the financial and non-financial covenants that must be complied with in relation to the GSMTN.

Under the CTA the following companies are collectively known as the Anglian Water Services Financing group (AWSFG):

- Anglian Water Services Holdings Limited
- Anglian Water Services Overseas Holdings Limited
- Anglian Water Services Limited
- Anglian Water Services Financing Plc

business review

Details are included in the performance review on pages 1 to 5.

corporate governance

The corporate governance measures put in place at the time of the financial restructuring in 2002 are designed to ensure that the company has the means to conduct its regulated business separately from other companies within the AWG Plc group, and that all dealings between other companies within the AWG Plc group and the company are on an arm's length basis.

The company is required to maintain at least three independent Non-Executive Directors, except for periods where a temporary vacancy exists. Further, the board of Directors may be comprised of Directors who are also Directors of other AWG Plc group companies, provided that the Executive Directors in this category do not constitute a majority of the Executive Directors. The constitutional documents of each company within the AWSFG provide that all conflicts of interest of Directors must be disclosed and that no Director may vote on any contracts or arrangement between the company and any other AWG Plc group company if he/she is also a Director of the AWG Plc group company.

The processes for identifying, evaluating and managing the significant risks to the company and the company's internal control systems are regularly reviewed by the Audit Committee which reports its findings for consideration by the board.

The Audit Committee is comprised of Non-Executive Directors and has written terms of reference. The terms of reference deal clearly with the committee's authority and duties.

The processes used by the committee to carry out its review include:

- the review of plans prepared by internal and external auditors
- the review of reports arising from the work of the Risk Management Committee on the effectiveness of risk management
- discussions with management on significant risk areas and
- the review of significant issues highlighted by the Executive Directors, internal and external auditors.

financial instruments disclosures

Details are included on page 2 of the performance review and in note 15 of the financial statements.

principal activities

The company provides more than one billion litres of drinking water to 4.2 million customers every day. The water comes from a variety of sources: reservoirs, underground reserves (aquifers) and extraction from rivers.

The company receives approximately 950 million litres of wastewater per day from 5.4 million customers, including 1.2 million customers who receive their water from other companies. The wastewater is treated to a high standard and returned to the environment via rivers or coastal outlets. The organic waste is treated, dried and used in agriculture as a natural fertiliser.

results and dividends

The profit and loss account on page 9 shows the company's results, dividends and profit for the year.

health and safety

The health and safety of staff, contractors and the public is paramount. There is nothing so important that employees cannot take the time to do it safely and the commitment to health and safety is enshrined in the company's Safety First – Second Nature philosophy.

The company has an effective Occupational Health and Safety (OH&S) management system in place, which continues to drive improvements in this area. In order to further strengthen this, and to provide external validation, it is actively seeking Occupational Health and Safety Assessment Series (OHSAS) 18001 accreditation (the internationally recognised quality award for OH&S).

The company continued to show improvement in the two key metrics used to assess OH&S performance: Accident Frequency Rate (number of accidents per 100,000 hours worked) reduced from 0.42 to 0.39, and Sickness Absence (number of days lost per person) reduced from 8.26 days to 7.30 days.

In recognition of the very high standards that the company has demonstrated over the past two years, the company has been awarded a prestigious Royal Society for the Prevention of Accidents (RoSPA) Silver Award in 2006.

Seeking continuous improvement in its OH&S performance, the company has again set stringent targets for the year ahead and has a comprehensive action plan in place to meet them.

The company has operational procedures for each business area. These procedures take account of good management practice and specific business, statutory and legal requirements. Business heads are charged with the implementation of these procedures within their respective units.

directors and Directors' interests

The current Directors of Anglian Water Services Limited are listed below:

Jonson Cox – Chief Executive and Chairman

Peter Simpson – Executive Director

David Hipple – Executive Director

Chris Newsome – Executive Director

Jean Spencer – Executive Director

Scott Longhurst – Non-Executive Director

Robert Napier – Independent Non-Executive Director

John Watkinson – Independent Non-Executive Director

All of the Directors served throughout the year except for John Watkinson, who was appointed as an Independent Non-Executive Director on 12 May 2005. Roger Whitcomb resigned as an Independent Non-Executive Director on 26 April 2006.

Details of the Directors' interests in the shares of AWG Plc, and in options over such shares, are shown in note 24 on pages 36 and 37.

charitable and political donations

During the year the company made a payment of £1.0 million (2005: £1.0 million) to the Anglian Water Trust Fund. This amount is included as an operating cost for statutory and regulatory accounts.

The AWG Community Investment Programme, which is predominantly based on employees' participation in community activities during working hours, saw 348 employees joining up for the *give me five* matching hours scheme.

The *give me five* scheme allows employees to take up to 30 hours a year of work time, matched by their own time, to get involved in community activities. The company's proviso is that participation also contributes to personal development objectives.

Financially through charitable donations, educational, regeneration and recreation projects the company contributed £0.1 million (2005: £0.1 million) to other charitable causes.

No political donations were made during the year.

research and development

The company has a continuing policy of undertaking market-focused research and development on process plant, biosolids treatment and other water and wastewater-related matters.

employees

Employees are kept informed of changes in the business and general financial and economic factors influencing the company. This is done through a systematic approach to employee communication through regular briefings, presentations, electronic mailings and the wide circulation of the AWG employee magazine. The company's intranet is also widely used as a source of information.

The company values the views of its employees and consults with them and their representatives on a regular basis about matters that may affect them.

The company has an Ethics Policy, which informs all employees on the company's approach to a range of ethical issues. Procedures are in place to deal with allegations of misconduct, harassment, bullying and other inappropriate behaviour.

The company also has a series of family friendly policies including such initiatives as flexible working hours, home working, sabbaticals and career breaks.

A Sharesave Scheme and a Sharebuy Plan are in place to encourage participation in the AWG Plc group's performance.

The company values diversity within its workforce and has put in place procedures to ensure that it is an equal opportunities employer. All job applications from disabled persons are fully and fairly considered, having regard to the aptitudes and abilities of the applicant. In the event of disability, every effort is made to ensure that employment continues and appropriate training is given. Career development and promotion of disabled people is, as far as possible, identical to that of other employees.

policy on the payment of creditors

It is the company's policy to provide suppliers of goods and services with a statement of general conditions of contract. This document is available from the company's Supply Chain Management department. In general, regional purchasing agreements are in place with preferred suppliers and the terms will apply to all transactions. The company abides by the terms of payment. The company's average creditor payment period at 31 March 2006 was 35 days (2005: 35 days).

directors' disclosures to auditors

In the case of each of the persons who are Directors at the time when the report is approved under Section 234a of the Companies Act 1985 the following applies:

- a) so far as the Director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- b) he/she has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

directors' report **continued**

auditors

Under Section 386 of the Companies Act 1985, Anglian Water Services Limited has an elective resolution in place to dispense with the need to appoint auditors annually. PricewaterhouseCoopers LLP will continue to act as auditors of the company.

Annual General Meeting

Pursuant to Section 366A of the Companies Act 1985, Anglian Water Services Limited has dispensed with the obligation to hold an Annual General Meeting and pursuant to Section 252 the company has dispensed with the requirement to lay the annual report and accounts before the company in general meeting.

By order of the board

Patrick Firth
Joint Company Secretary
30 May 2006

Registered Office: Anglian House,
Ambury Road, Huntington,
Cambridgeshire PE29 3NZ
Registered in England and Wales No. 2366656

statement of Directors' responsibilities

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and of the profit for that period. The Directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The Directors confirm that suitable accounting policies have been used and applied consistently (with the exception of changes arising on the adoption of new accounting standards in the year) as set out in note 1 to the financial statements (Accounting policies). They also confirm that reasonable and prudent judgments and estimates have been made in preparing the financial statements for the year ended 31 March 2006 and the applicable accounting standards have been followed.

The Directors are responsible for ensuring that the annual report and accounts are published and where they are published on the Internet, for maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the Internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements.

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

profit and loss account for the year ended 31 March

Notes	2006 £m	2005 restated £m
2	865.7	796.8
3	(314.4)	(301.0)
3	(191.7)	(166.4)
3	(506.1)	(467.4)
4	359.6	329.4
5	(62.4)	(60.9)
6	(0.1)	(3.0)
	297.1	265.5
7	(50.2)	(9.5)
	246.9	256.0
8	(305.7)	(233.6)
	(58.8)	22.4

The notes on pages 14 to 38 form part of these financial statements.

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 17 'Retirement benefits', FRS 20 'Share-based payment' and FRS 21 'Events after the balance sheet date' (see note 1(a)).

There was no difference between both the profit on ordinary activities before taxation and the profit for the financial year stated above, and their historical cost equivalents.

statement of total recognised gains and losses for the year ended 31 March

Notes	2006 £m	2005 restated £m
Profit on ordinary activities after taxation	246.9	256.0
19,22 Actuarial gains recognised in the pension scheme	88.0	18.4
18,22 Movement on deferred tax relating to the actuarial gain in the pension scheme	(26.5)	(5.6)
18,22 Deferred tax on share-based payments	3.8	–
Total recognised gains and losses for the year before prior year adjustment	312.2	268.8
22 Prior year adjustment in respect of adoption of FRS 17 (Retirement Benefits) (see note 1(a))	(142.9)	
Total recognised gains and losses since last annual report	169.3	

balance sheet

at 31 March

Notes		2006 £m	2005 restated £m
	Fixed assets		
10	Tangible assets	3,992.9	3,911.4
11	Investments	1,609.2	1,609.2
		<u>5,602.1</u>	<u>5,520.6</u>
	Current assets		
12	Stocks	10.6	6.9
13	Debtors	169.6	591.5
	Investments – money market deposits	–	22.5
	Cash at bank and in hand (including short-term deposits)	501.5	398.8
		<u>681.7</u>	<u>1,019.7</u>
	Creditors: amounts falling due within one year		
14,15	Short-term borrowings	(202.4)	(88.1)
14	Other creditors	(383.2)	(303.5)
		<u>(585.6)</u>	<u>(391.6)</u>
	Net current assets	<u>96.1</u>	<u>628.1</u>
	Total assets less current liabilities	<u>5,698.2</u>	<u>6,148.7</u>
	Creditors: amounts falling due after more than one year		
15	Loans and other borrowings	(3,836.4)	(4,251.1)
16	Other creditors	(102.6)	(98.4)
		<u>(3,939.0)</u>	<u>(4,349.5)</u>
17	Provisions for liabilities and charges	<u>(139.2)</u>	<u>(117.8)</u>
19	Defined benefit pension liabilities	<u>(35.1)</u>	<u>(103.0)</u>
	Net assets	<u>1,584.9</u>	<u>1,578.4</u>
	Capital and reserves		
21	Called up share capital	860.0	860.0
22	Profit and loss account	724.9	718.4
23	Total shareholder's funds (all equity)	<u>1,584.9</u>	<u>1,578.4</u>

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 17 'Retirement benefits', FRS 20 'Share-based payment' and FRS 21 'Events after the balance sheet date' (see note 1(a)).

The notes on pages 14 to 38 form part of these financial statements.

The financial statements were approved by the board on 30 May 2006 and signed on its behalf by:

Peter Simpson
Chief Operating Officer

David Hipple
Finance Director

cash flow statement

for the year ended 31 March

Notes	2006 £m	2005 restated £m
(a) Net cash inflow from operating activities	528.8	534.5
Returns on investments and servicing of finance		
Interest received	266.9	212.9
Interest paid	(244.7)	(231.4)
(d) Finance costs capitalised	–	(0.3)
Interest element of finance lease rental payments	(6.4)	(8.0)
Net cash inflow/(outflow) for returns on investments and servicing of finance	15.8	(26.8)
Taxation		
Corporation tax paid	(2.0)	(0.8)
Payments to other AWG Plc group undertakings	(5.4)	–
	(7.4)	(0.8)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(264.0)	(290.9)
Grants and contributions received	24.1	26.9
Disposal of tangible fixed assets	2.0	1.1
Net cash outflow for capital expenditure and financial investment	(237.9)	(262.9)
Acquisitions and disposals		
Receipt from sale of fixed asset investment	–	0.1
Net cash inflow for acquisitions and disposals	–	0.1
Equity dividends paid	(305.7)	(233.6)
Net cash (outflow)/inflow before management of liquid resources and financing	(6.4)	10.5
(c) Management of liquid resources		
(d) Increase in short-term deposits and investments	(87.1)	(105.1)
Financing		
(d) Increase in loans	399.9	–
(d) Repayment of amounts borrowed	(292.8)	(3.3)
(d) Capital element of finance lease rental payments	(20.5)	(17.3)
Net cash inflow/(outflow) from financing	86.6	(20.6)
(d) Decrease in cash	(6.9)	(115.2)

The notes on page 13 form part of this cash flow statement.

notes to the cash flow statement

	2006 £m	2005 restated £m
(a) Reconciliation of operating profit to net cash inflow from operating activities		
Operating profit	359.6	329.4
Depreciation (net of amortisation of deferred grants and contributions)	191.7	166.4
Profit on disposal of fixed assets	(1.8)	(0.8)
Other non-cash movements	(6.2)	(25.0)
Net movement on provisions	0.8	4.6
	<u>544.1</u>	<u>474.6</u>
Working capital:		
Increase in stocks	(3.7)	(0.3)
(Increase)/Decrease in debtors	(21.0)	45.2
Increase in creditors	9.4	15.0
	<u>(15.3)</u>	<u>59.9</u>
Net cash inflow from operating activities	<u>528.8</u>	<u>534.5</u>

	1 April 2005 £m	Cash flows £m	Non-cash movements £m	31 March 2006 £m
(b) Analysis of net debt				
Cash	47.2	(6.9)	–	40.3
Deposits and investments	374.1	87.1	–	461.2
Debt due within one year	(88.1)	88.1	(202.4)	(202.4)
Debt due after one year	<u>(4,251.1)</u>	<u>223.6</u>	<u>191.1</u>	<u>(3,836.4)</u>
	<u>(3,917.9)</u>	<u>391.9</u>	<u>(11.3)</u>	<u>(3,537.3)</u>

Non-cash movements comprise indexation of index linked loan stock, indexation of Retail Price Index (RPI) swaps, transfers between categories of debt, repayments made by Anglian Water Services Financing Plc, amortisation of discounts and expenses relating to debt issues and amortisation of 'mark to market' adjustments. Included within deposits and investments above are £461.2 million (2005: £351.6 million) of short-term deposits maturing within three months, which are included in the heading 'cash at bank and in hand' in the balance sheet.

- (c) **Management of liquid resources**
This comprises movements in short-term deposits which have maturity dates of up to one year.

	2006 £m	2005 £m
(d) Movement in net debt		
At beginning of year	(3,917.9)	(3,491.2)
Decrease in cash	(6.9)	(115.2)
Increase in short-term deposits and investments	87.1	105.1
Increase in loans	(399.9)	–
Repayment of amounts borrowed	292.8	3.3
Repayment/(new borrowings) made on behalf of company by Anglian Water Services Financing Plc	398.3	(398.3)
Movement in inter-company account with Anglian Water Services Financing Plc	35.5	–
Finance costs capitalised	–	0.3
Amortisation of discounts and expenses relating to debt issues and 'mark to market' adjustments	(0.9)	(1.2)
Indexation of loan stock and RPI swaps	(45.9)	(38.0)
Capital element of finance lease rental payments	20.5	17.3
At end of year	<u>(3,537.3)</u>	<u>(3,917.9)</u>

Cash held by Anglian Water Services Financing Plc of £398.3 million at 31 March 2005 was used to repay debt in the year ended 31 March 2006.

notes to the financial statements

1 Accounting policies

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards and with the Companies Act 1985, except as disclosed in note 1(e) below as relating to grants and contributions.

The following principal accounting policies and estimation techniques have been consistently applied to the financial statements as stated except for the changes relating to FRS 17, FRS 20, FRS 21 and FRS 25.

(a) Change in accounting policies

The company has adopted FRS 17 'Retirement benefits', FRS 20 'Share-based payment', FRS 21 'Events after the balance sheet date', and the presentation requirements of FRS 25 'Financial instruments: disclosure and presentation' in these financial statements. The adoption of these standards represents a change in accounting policy and the comparative figures have been restated accordingly.

It is impracticable to show the impact of adopting FRS 17 figures in the current year as no SSAP 24 figures are available for 2006. The effect of the adoption of FRS 17 on 2005 results was to increase staff costs by £9.6 million, decrease the tax charge by £2.9 million, decrease profit for the year by £6.7 million and increase total recognised gains and losses by £12.8 million.

The adoption of FRS 20 has resulted in a current year charge of £0.9 million to operating costs and a credit of £3.8 million through the statement of total recognised gains and losses. There was a £0.3 million impact on 2005 results.

The effect of the change in accounting policy to adopt FRS 21 was to recognise the final proposed dividend for the year ended 31 March 2005 of £77.6 million in the current year. The final dividend for the current year of £35 million which was declared on 18 May 2006 will be recognised in the following year (ending 31 March 2007), as it does not meet the definition of a liability as at 31 March 2006.

The adoption of the presentational requirements of FRS 25 had no impact on the results for 2006 or 2005.

(b) Group accounts not prepared

The company is exempt under Section 228 of the Companies Act 1985 from the requirement to prepare group financial statements and to deliver them to the Registrar of Companies. The financial statements, therefore, present information about the company as an individual undertaking and not about its group. The company is included within the consolidated financial statements of AWG Plc, the company's ultimate parent undertaking, which is incorporated in England and Wales.

(c) Turnover

Turnover represents the income receivable (excluding Value Added Tax) in the ordinary course of business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured income.

The measured income accrual is an estimation of the amount of main water and wastewater charges unbilled at the year-end. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical billing information. The calculation is sensitive to estimated consumption for domestic customers (a fall of 1 cubic metre in average annual consumption will reduce turnover by approximately £1.0 million).

(d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

(i) Infrastructure assets

Infrastructure assets comprise a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls. Investment expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with defined standards of service is treated as an addition and recorded at cost along with related capital grants and contributions.

The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on the company's independently certified Asset Management Plan.

(ii) Other assets

Other assets comprise land and non-operational buildings, operational assets (comprising sites used for water and wastewater treatment, pumping or storage where not classified as infrastructure) and vehicles, plant and equipment, and are included at cost less accumulated depreciation. Cost includes own work capitalised comprising the direct costs of materials, labour and applicable overheads. Interest costs are not capitalised.

Freehold land is not depreciated, nor are assets in the course of construction until commissioned. Depreciation of other assets is calculated at rates expected to write off cost less the estimated residual value of the relevant assets on a straight line basis over their estimated economic lives, which are primarily as follows:

Operational assets	30-80 years
Buildings	30-60 years
Fixed plant	12-40 years
Vehicles, mobile plant and equipment	3-10 years

Fixed assets are assessed for impairment in accordance with Financial Reporting Standard (FRS) 11 'Impairment of fixed assets and goodwill', if an appropriate trigger arises.

(e) Grants and contributions

Grants and contributions for capital expenditure include government grants, infrastructure charges, connection charges, sewer adoption fees and other contributions from third parties.

Grants and contributions to capital expenditure, other than those relating to infrastructure assets, are credited to a deferral account within creditors and are released to the profit and loss account evenly over the expected useful life of the relevant asset in accordance with the provisions of the Companies Act 1985.

Grants and contributions to capital expenditure on infrastructure assets are deducted from the costs of these assets. This policy is not in accordance with Schedule 4 of the Companies Act 1985, which requires grants and contributions to be shown as deferred income, but has been adopted in order to show a true and fair view as, in the opinion of the Directors, while a provision is made for depreciation of infrastructure assets, these assets have no determinable finite economic life and hence no basis exists on which to recognise such contributions as deferred income. The financial effect of this departure is disclosed in note 10.

Revenue grants and contributions are credited to the profit and loss account in the year to which they apply. In particular, commuted lump sums received in advance for water and sewer requisitions are credited to a deferral account within creditors and are released to the profit and loss account in proportion to the year to which they apply.

notes to the financial statements *continued*

1 Accounting policies *continued*

(f) **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 treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor, and the finance costs being written off to the profit and loss account over the primary period of the lease. The assets are depreciated over the shorter of their estimated useful lives and the lease period. All other leases are regarded as operating leases. Rental costs arising under operating leases are expensed over the term of the lease.

(g) **Investments**

Investments held as fixed assets are stated at cost less any provision for impairment.

(h) **Stocks**

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence.

(i) **Pension costs**

Defined Benefit Scheme

For the defined benefit scheme, pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liabilities. The increase in the present value of the liabilities of the company's defined benefit pension scheme expected to arise from employee service in the period is charged to operating profit. The expected return on the scheme's assets and the increase during the year in the present value of the scheme's liabilities arising from the passage of time are included in other finance charges. Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

Pension schemes' surpluses, to the extent that they are considered recoverable, or deficits are recognised in full and presented on the face of the balance sheet net of the related deferred tax.

Defined Contribution Scheme

The cost of the defined contribution scheme is charged to the profit and loss account in the year in respect of which the contributions become payable.

(j) **Research and development**

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

(k) **Foreign currencies**

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transactions or, if hedged forward, at the rate of exchange under the related forward currency contract. Assets and liabilities denominated in foreign currencies are translated into sterling at the financial year-end exchange rates or, if hedged forward, at the rate of exchange under the related forward currency contract.

- (l) **Deferred taxation**
 Deferred taxation is provided on timing differences, arising from the different treatment for accounts and taxation purposes of events and transactions recognised in the financial statements of the current and previous years. Deferred taxation is calculated at the rates at which it is estimated that taxation will arise. The deferred taxation balances are discounted using the post tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred taxation assets and liabilities. For assets with a life in excess of 30 years, an average rate based on bonds with a life up to 49 years has been used as no other quoted rates are available.
- Deferred taxation is not provided in respect of timing differences arising from the sale or revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will be rolled over.
- Deferred taxation assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits against which the deferred tax asset can be recoverable in future periods.
- Calculation of deferred tax on infrastructure assets:**
 Infrastructure assets effectively have an unlimited life and a notional depreciation charge, the infrastructure renewal charge (IRC), is offset against the gross network asset value (see note 1(d)). For the purposes of estimating the deferred tax liability in relation to infrastructure assets, the useful life over which the underlying differences reverse is estimated by deflating the current cost based IRC to an appropriate deemed historic cost based depreciation charge.
- (m) **Bad debts**
 The bad debt provision is calculated based on applying expected recovery rates, based on actual historical cash collection performance, to an aged debt profile.
- (n) **Related party transactions**
 The company has taken advantage of the exemption not to disclose transactions with other members of the AWG Plc group under FRS 8 'Related party disclosures' as it is a wholly-owned subsidiary.
- (o) **Financial instruments**
 Derivative instruments are used for hedging purposes in line with the company's risk management policy and no trading in financial instruments is undertaken. Loans and other borrowings are recorded using the contracted rates implicit in the financial instruments used to hedge the company's exposure to fluctuations in currency rates. Similarly, interest is charged to the profit and loss account based on the contracted interest rates.
- (p) **Capitalisation of finance costs**
 Costs that are incurred directly in connection with the issue of a capital instrument are capitalised and amortised at a constant rate over the life of the underlying instrument.
- (q) **Provisions**
 Provisions are recognised when the company has a present obligation for a past event, for which it is probable that a transfer of economic benefits will be required and a reliable estimate can be made of the amount of the obligation.
- Provisions of a long-term nature are discounted to reflect the time value of money in the estimated period over which the provision will be utilised. A risk-free rate of discount has been used.
- (r) **Redundancy costs**
 Redundancy costs are charged to the profit and loss account in the period in which the company both becomes irrevocably committed to incurring the costs and has raised a valid expectation with, and announced the main features of the programme to, affected employees or their representatives.
- (s) **Onerous lease costs**
 Provision is made for the expected future costs of property and other leases to the extent that these costs are not expected to be of future benefit to the business, net of any recoveries from sub leases.
- (t) **Share based remuneration**
 For grants made under the AWG Plc group's share based remuneration scheme, amounts that reflect the fair value of options awarded as at the time of grant are charged to the profit and loss account. The valuation of options utilises a binomial option pricing model which forms the basis for the charge from AWG Plc for the company's element of the charge under these schemes.
- (u) **Dividends**
 Dividends are recognised as a liability in the period in which they are approved. Interim dividends are recognised in the period in which they are paid.

notes to the financial statements *continued*

2 Segmental analysis

The Directors believe that the whole of the company's activities constitute a single class of business.

The company's turnover is wholly generated from within the United Kingdom (UK).

3 Operating costs

	2006	2005
	£m	restated £m
Operating costs before depreciation:		
Raw materials and consumables	25.7	26.9
Other operating costs	222.6	188.1
Staff costs (see note 9)	111.9	125.7
Own work capitalised	(45.0)	(39.9)
Contribution to Anglian Water Trust Fund	1.0	1.0
Profit on sale of fixed assets	(1.8)	(0.8)
Total operating costs before depreciation	<u>314.4</u>	<u>301.0</u>
Depreciation of tangible fixed assets	199.7	171.9
Amortisation of deferred grants and contributions	(8.0)	(5.5)
Depreciation net of amortisation of deferred grants and contributions	<u>191.7</u>	<u>166.4</u>
Total operating costs	<u>506.1</u>	<u>467.4</u>

The profit on sale of fixed assets relates to various sales of surplus land and assets.

4 Operating profit

	2006	2005
	£m	£m
Operating profit is stated after charging:		
Fees paid to the auditors:		
– for statutory audit services	0.1	0.1
– for regulatory audit services	0.1	0.1
– total audit services	<u>0.2</u>	<u>0.2</u>
– for other assurance services	0.1	0.1
Total fees paid to the auditors	<u>0.3</u>	<u>0.3</u>
Hire of plant and machinery	1.1	1.5
Other operating lease costs	8.7	9.6
Research and development expenditure	1.1	1.3

The fees paid to auditors for other assurance work largely relates to work undertaken on the Periodic Review 2004 and the Global Secured Medium Term Note Programme.

5 Interest payable (net)

	2006	2005 restated
	£m	£m
Other loans including financing expenses	1.6	5.9
Finance leases	6.1	7.9
Interest payable to Anglian Water Services Financing Limited	289.3	260.2
	297.0	274.0
Interest receivable from Anglian Water Services Holdings Limited	(193.1)	(193.1)
Other interest receivable	(41.5)	(20.0)
Total interest payable (net)	62.4	60.9

6 Other finance charges

	2006	2005 restated
	£m	£m
Unwinding of discount on coupon enhancement provision (see note 17)	0.7	0.5
Unwinding of discount on onerous lease obligation provision (see note 17)	0.2	0.2
Defined benefit pension scheme (see note 19(c))	(0.8)	2.3
	0.1	3.0

7 Taxation

	2006	2005 restated
	£m	£m
(a) Analysis of tax charge in the year		
Current tax:		
UK Corporation Tax	22.6	1.8
Adjustments in respect of previous periods	1.0	–
Total current tax charge (see note 7(b))	23.6	1.8
Deferred tax:		
Charge for timing differences arising in year	11.5	20.6
Impact of discounting on deferred tax liability	(9.6)	(5.1)
Impact of decrease in discount rates	20.9	2.1
Discounted effect of movements in Advance Corporation Tax (ACT)	5.0	(5.9)
Adjustments in respect of previous periods	(1.2)	(4.0)
Total deferred tax charge	26.6	7.7
Total tax charge on profit on ordinary activities	50.2	9.5

The post-tax yield to maturity on UK Government bonds is used to discount the gross deferred tax liability of the company. Movements in the discount rates gave rise to a charge of £20.9 million (2005: charge of £2.1 million) in the year. If all UK gilt rates moved by 0.25 per cent a change in the tax charge of between £10.0 million to £15.0 million would occur.

The current tax charge includes a charge of £12.0 million from another AWG Plc group undertaking for the utilisation of ACT.

It has been agreed that the company will not pay for tax losses surrendered to it by Anglian Water Services Holdings Limited.

notes to the financial statements *continued***7 Taxation continued****(b) Factors affecting tax charge for the period**

The tax assessed for the year is lower than the standard rate of Corporation Tax in the UK (30 per cent). The differences are explained below:

	2006 £m	2005 restated £m
Profit on ordinary activities before tax	297.1	265.5
Profit on ordinary activities at the standard UK rate of Corporation Tax (30 per cent)	89.1	79.7
Effects of:		
Items not deductible for tax purposes	(0.5)	(0.9)
Group relief utilised	(55.2)	(57.1)
Accounting for depreciation not eligible for tax purposes	0.7	0.7
Capital allowances for the year in excess of depreciation	(11.9)	(13.8)
Short-term timing differences	0.4	(6.8)
Adjustments to tax charge in respect of previous period	1.0	–
Current tax charge for the year (see note 7(a))	<u>23.6</u>	<u>1.8</u>

8 Dividends

	2006 £m	2005 restated £m
Ordinary:		
2005 Final paid	30.0	10.0
2006 Interim paid	35.0	30.0
Dividend paid by the company and retained within the Anglian Water Services Financing group	240.7	193.6
	<u>305.7</u>	<u>233.6</u>

A dividend of £240.7 million (2005: £193.6 million) was paid to Anglian Water Services Holdings Limited, a parent undertaking, in order for it to service the interest payable to the company on the inter-company loan of £1,609.1 million (see note 11).

The directors have proposed a final dividend for the year ended 31 March 2006 of 4.07 pence per share, that is a total of £35.0 million. This dividend has not been accounted for within the current year financial statements as it has been approved and paid subsequent to the year end.

9 Employee information and Directors' emoluments

	2006 £m	2005 restated £m
(a) Employee information		
Staff costs:		
Wages and salaries	86.1	96.3
Social security costs	8.0	7.7
Pension costs (see note 19)	16.9	21.4
Cost of employee share schemes	0.9	0.3
	<u>111.9</u>	<u>125.7</u>

Staff costs for the year ended 31 March 2006 include £45.0 million (2005: £37.3 million) of costs that have been capitalised as 'own work capitalised' and redundancy costs of £1.3 million (£0.5 million of wages and salaries and £0.8 million of pension costs) relating wholly to a reorganisation undertaken by the company (2005: £11.4 million of which £6.2 million represented wages and salaries and £5.2 million represented pension costs).

	2006	2005
Average number of full-time equivalent persons employed:		
Number employed	3,322	3,376
	2006 £000	2005 £000
(b) Directors' emoluments		
Aggregate emoluments	1,373	1,618

Aggregate emoluments of the Directors comprise salaries, taxable benefits and amounts payable under incentive schemes. The emoluments of the highest paid Director in 2006 were £408 thousand (2005: £362 thousand). Details of the emoluments of the Directors of the company who are also Directors of AWG Plc are given in that company's accounts. Retirement benefits are accruing to two Directors (2005: two Directors) under a defined benefit scheme.

10 Tangible fixed assets

	Land and Buildings £m	Infra- structure assets £m	Operational assets £m	Vehicles, plant & equipment £m	Assets under construction £m	Total £m
Cost						
At 1 April 2005	27.6	2,334.2	2,903.3	648.8	197.2	6,111.1
Additions	–	–	–	–	293.6	293.6
Transfers on commissioning	1.5	96.8	122.8	29.5	(250.6)	–
Disposals	(0.1)	–	(0.1)	(59.4)	(0.1)	(59.7)
At 31 March 2006	29.0	2,431.0	3,026.0	618.9	240.1	6,345.0
Grants and contributions						
At 1 April 2005	–	(176.9)	–	–	(1.5)	(178.4)
Additions	–	(12.0)	–	–	(0.2)	(12.2)
At 31 March 2006	–	(188.9)	–	–	(1.7)	(190.6)
Depreciation						
At 1 April 2005	(2.0)	(484.3)	(1,043.0)	(492.0)	–	(2,021.3)
Charge for the year	(0.2)	(50.8)	(98.4)	(50.3)	–	(199.7)
Disposals	–	–	0.1	59.4	–	59.5
At 31 March 2006	(2.2)	(535.1)	(1,141.3)	(482.9)	–	(2,161.5)
Net book amount						
At 31 March 2006	26.8	1,707.0	1,884.7	136.0	238.4	3,992.9
At 31 March 2005	25.6	1,673.0	1,860.3	156.8	195.7	3,911.4

notes to the financial statements *continued*

10 Tangible fixed assets *continued*

Tangible fixed assets at 31 March 2006 include land of £17.7 million (2005: £17.0 million) which is not subject to depreciation. The company's interests in land and buildings are almost entirely freehold.

The net book amount of tangible fixed assets held under finance leases at 31 March 2006 was £114.2 million (2005: £124.9 million). Depreciation charged on assets held under finance leases during the year ended 31 March 2006 amounted to £10.7 million (2005: £11.5 million).

Capital commitments

The company has a substantial long-term investment programme which includes expenditure to meet regulatory requirements, shortfalls in performance and condition and to provide for new demand and growth. The commitments shown below reflect the value outstanding of orders placed at 31 March 2006.

	2006 £m	2005 £m
Contracted for but not provided in the financial statements	113.6	71.6

11 Fixed asset investments

	2006 £m	2005 £m
Shares at cost in participating interests	0.1	0.1
Loan to Anglian Water Services Holdings Limited	1,609.1	1,609.1
	<u>1,609.2</u>	<u>1,609.2</u>

The loan of £1,609.1 million, made by the company to Anglian Water Services Holdings Limited, is repayable on the later of 30 July 2038 and another date being the next interest payment date following a date which is two years and one day after the final maturity date of the longest dated bond issued from time to time by Anglian Water Services Financing Plc. Interest on the loan is calculated at 12 per cent per annum. Anglian Water Services Financing Plc, whose principal activity is that of a financing company, is the sole subsidiary of the company. It is 100 per cent owned, and is registered, incorporated and operating in the UK at 31 March 2006.

12 Stocks

	2006 £m	2005 £m
Raw materials and consumables	10.6	6.9

The current replacement value of stocks does not materially exceed the historical costs stated above.

13 Debtors

	2006	2005 restated
	£m	£m
Amounts falling due within one year		
Trade debtors	119.1	75.4
Amounts owed by other AWG Plc group undertakings	–	464.7
Other debtors	18.2	8.2
Prepayments and accrued income	32.3	43.2
	169.6	591.5

Prepayments and accrued income as at 31 March 2006 includes water and wastewater income not yet billed of £26.1 million (2005: £37.5 million).

Amounts received in advance from unmeasured customers have been reclassified in the current year from trade debtors to receipts in advance. If the reclassification was adjusted in the 2005 results debtors and receipts in advance would increase by £33.5 million.

14 Creditors: amounts falling due within one year

	2006	2005 restated
	£m	£m
Amounts owed to Anglian Water Services Financing Plc-current portion of long-term loans	178.5	67.6
Obligations under finance leases	23.9	20.5
Short-term borrowings (see note 15)	202.4	88.1
Trade creditors	107.5	87.4
Amounts owed to other AWG Plc group undertakings	113.0	85.7
Receipts in advance	104.4	72.6
Corporation tax	41.6	25.4
Other taxation and social security	3.4	3.2
Deferred grants and contributions	7.7	7.2
Accruals	5.6	22.0
Other creditors	383.2	303.5

Receipts in advance includes £81.7 million (2005: £52.6 million) relating to amounts received from customers for water and wastewater charges in respect of the following year.

notes to the financial statements *continued*

15 Loans, other borrowings and financial instruments

	2006 £m	2005 £m
Loans and other borrowings		
£150 million 8.25% fixed rate 2006 (a), (b)	150.0	150.0
£150 million 'mark to market' adjustment (d)	2.0	5.1
£100 million 5.5% index linked 2008 (a), (b), (f)	162.7	158.4
£100 million 12.375% fixed rate 2014 (a), (b)	100.0	100.0
£250 million 5.837% fixed rate 2022 (a), (b)	246.7	246.5
£200 million 6.875% fixed rate 2023 (a), (b)	199.9	199.9
£200 million 6.625% fixed rate 2029 (a), (b)	199.9	199.9
£246 million 6.293% fixed rate 2030 (a), (b)	243.6	243.5
£275 million 7.882% fixed rate 2012/2037 (a), (b), (c)	272.7	272.3
£250 million 5.25% fixed rate 2015 (a), (b)	249.4	249.7
£150 million 5.5% fixed rate 2017/2040 (a), (b), (c)	148.3	148.3
£150 million 4.125% index linked 2020 (a), (b), (f)	174.5	169.8
£75 million 3.666% index linked 2024 (a), (b), (f)	82.5	80.2
£200 million 3.07% index linked 2032 (a), (b), (f)	218.4	212.3
£60 million 3.07% index linked 2032 (a), (b), (f)	65.6	63.7
£50 million LIBOR plus 1.2% floating rate 2007/2012 (a), (b), (c)	–	49.9
£180 million LIBOR plus 1.25% floating rate 2009/2014 (a), (b), (c)	–	179.5
£100 million LIBOR plus 2.8% floating rate 2010/2037 (a), (b), (c)	–	99.6
Finance leases (b)	116.4	136.8
Other fixed rate loans	0.1	0.1
£150 million index linked swap 2024 (a), (e)	16.1	11.7
£175 million index linked swap 2030 (a), (e)	18.7	13.6
£258 million index linked swap 2013 (a), (e)	18.8	10.9
€350 million 5.375% fixed rate 2009 (a), (b)	229.2	229.2
€650 million 4.625% fixed rate 2013 (a), (b)	452.5	452.2
€115 million EURIBOR plus 2.8% floating rate 2010/2037 (a), (b), (c)	–	73.7
US\$40 million 6.57% private placements 2005 (a), (b)	–	28.4
US\$4 million 7.21% private placements 2006 (a)	0.3	1.0
US\$55 million 6.85% private placements 2006 (a)	–	35.8
US\$35 million 6.62% private placements 2006 (a), (b)	24.9	24.8
US\$400 million LIBOR plus 0.4% floating rate 2007 (a), (b)	–	253.5
US\$100 million 7.01% private placements 2008 (a), (b)	70.9	70.8
US\$25 million 7.07% private placements 2009 (a)	10.6	13.3
US\$25 million 'mark to market' adjustment (d)	0.4	0.5
US\$23 million 7.13% private placements 2009 (a), (b)	16.3	16.3
US\$195 million 7.23% private placements 2011 (a), (b)	138.1	138.0
£402 million 2.40% Index-Linked 2035 (a), (b), (f)	409.3	–
Total loans and other borrowings	4,038.8	4,339.2
Less amounts included in creditors falling due within one year	(202.4)	(88.1)
Loans and other borrowings due after more than one year	3,836.4	4,251.1

EURIBOR is the European Inter Bank Offer Rate. LIBOR is the London Inter Bank Offer Rate.

- (a) These loans are 'back-to-back' inter-group loans from Anglian Water Services Financing Plc to the company. Under the company / Anglian Water Services Financing Plc loan agreement, Anglian Water Services Financing Plc onlends an equal amount to the sterling equivalent of each bond to the company on identical terms. Therefore each individual 'back-to-back' inter-group loan has been separately disclosed. Anglian Water Services Financing Plc charges the company an annual management fee in respect of entering into the company / Anglian Water Services Financing Plc loan agreement.
- (b) These loans are shown net of issue costs. The issue costs are amortised at a constant rate based on the carrying amount of debt over the life of the underlying instruments.
- (c) Legal maturity of these instruments is the second of the years quoted. Coupon 'step-up' is in the first of the years quoted.

- (d) 'Mark to market' adjustments relate to back-to-back debt reassigned from AWG Group Limited to Anglian Water Services Financing Plc in July 2002 at fair value rather than book value. The difference between the book value and fair value is being amortised at a constant rate based on the carrying amount of debt over the remainder of its life.
- (e) The company has entered into three index linked interest rate swap agreements. The values of the notional capital on these swaps are linked to movements in the Retail Price Index (RPI). The increase in the notional capital value is payable at the final maturity date of the swaps. The increase for the current year of £17.5 million (2005: £17.9 million) has been taken to the profit and loss account as part of interest payable.
- (f) The value of the capital and interest elements of the index linked loans are linked to movements in RPI. The total increase in the capital value of index linked loans during the year of £28.4 million (2005: £20.1 million) has been taken to the profit and loss account as part of interest payable.
- (g) Anglian Water Service Financing Plc has entered into swap agreements that convert its debt into either floating rate, fixed rate or index linked debt in accordance with the company's hedging policy (see page 2). The 'back-to-back' loans to the company are at the hedged rates.
- (h) Anglian Water Services Financing Plc has entered into two forward starting interest rate swaps commencing in 2007 and maturing in 2010 which have the effect of increasing the level of fixed rate debt for that period to a level consistent with the company's hedging policy.
- (i) Under a security agreement dated 30 July 2002 between Anglian Water Services Financing Plc, the company, Anglian Water Services Overseas Holdings Limited, Anglian Water Services Holdings Limited and Deutsche Trustee Company Limited (as Agent and Trustee for itself and each of the Finance Parties to the Global Secured Medium Term Note Programme) creates a fixed and floating charge over the assets of the company to the extent permissible under the Water Industry Act 1991. In addition there is a fixed charge over the issued share capital of Anglian Water Services Financing Plc, the company and Anglian Water Services Overseas Holdings Limited. At 31 March 2006 this charge applies to £4,038.8 million (2005: £4,339.2 million) of the debt listed above.

The current and long-term borrowings can be analysed as follows:

	2006		2005	
	Creditors < 1 year £m	Creditors > 1 year £m	Creditors < 1 year £m	Creditors > 1 year £m
Amounts owed to group undertakings ('back-to-back' inter-group loans)	180.0	3,761.4	70.7	4,150.7
Debt issue costs	(1.5)	(17.6)	(3.1)	(16.0)
Obligations under finance leases	23.9	92.5	20.5	116.3
Other loans	–	0.1	–	0.1
	<u>202.4</u>	<u>3,836.4</u>	<u>88.1</u>	<u>4,251.1</u>

	2006 £m	2005 £m
Maturity analysis of financial liabilities		
Less than one year	205.6	91.6
Between one and two years	31.2	205.3
Between two and five years	493.7	1,003.2
After five years	3,334.3	3,063.7
	<u>4,064.8</u>	<u>4,363.8</u>

Included above are amounts due under finance leases of £23.9 million (2005: £20.5 million) payable within one year, £27.2 million (2005: £23.8 million) payable between one and two years, £7.6 million (2005: £32.4 million) payable between two and five years and £57.7 million (2005: £60.1 million) payable after five years. The above maturity profile is determined by reference to the fixed dates on which the liability falls due.

In addition to loans and finance leases the above analysis includes other financial liabilities (including overdrafts, long-term creditors, accruals and provisions) totalling £26.0 million (2005: £24.6 million), of which £3.2 million falls due in less than one year (2005: £3.5 million). This analysis is net of issue costs totalling £19.1 million (2005: £19.1 million).

notes to the financial statements **continued**

15 Loans, other borrowings and financial instruments continued

	2006 £m	2005 £m
Borrowing facilities		
The company has the following unused committed borrowing facilities:		
Expiring within one year	333.0	333.0
Expiring between one and two years	–	–
Expiring between two and five years	225.0	–
Expiring in more than five years	–	225.0
	558.0	558.0

All facilities are accessed under a loan agreement between the company, AWSF and Deutsche Trustee Company Ltd (as Agent and Trustee for itself and each of the Finance Parties to the Global Secured Medium Term Note Programme) dated 30 July 2002. This agreement guarantees that any facilities drawn by AWSF will be passed directly on to the company upon utilisation of the facility.

Control of treasury

The Treasury team, which reports directly to the company's Finance Director, substantially manages the company financing, including debt, interest costs and foreign exchange. Treasury policy continues to be focused on the efficient and effective management of cash and financial resources within the company. The treasury function will actively endeavour to:

- ensure that lenders covenants are met
- secure funds through a balanced approach to financial markets and maturities
- manage interest rates to minimise financial exposures and minimise interest costs
- invest temporary surplus cash to best advantage at minimal financial risk
- maintain an excellent reputation with providers of finance and rating agencies
- promote management techniques and systems and
- enhance control of financial resources.

Management of financial risk

Financial risks faced by the company include funding, interest rate, contractual and currency risks. The board of the company regularly reviews these risks and has approved written policies covering treasury strategy and the use of financial instruments to manage risks. The last review was in March 2006 and treasury matters are reported to the board each month.

A Treasury Advisory Group (TAG), comprising the company Finance Director, the company Treasurer and a Non-Executive Director of the company, together with the same position holders of the ultimate shareholder AWG Plc, meets monthly with the specific remit of reviewing treasury matters.

The company aims to meet its funding requirements primarily through public bond markets, private placements, bank loans and finance leases. Surplus cash is invested in short-term bank deposits, commercial paper and AAA rated money funds.

The company, via its financing subsidiary AWSF, also enters into derivative transactions (principally currency and interest rate swaps) to manage the interest rate and currency risks arising from the treasury policy.

To ensure continued effectiveness and relevance, the board carries out a formal annual review of the treasury organisation and reporting.

Borrowing covenants

With the exception of asset-based funding, all the company's borrowings are raised by Anglian Water Services Financing Plc and guaranteed by the Anglian Water Services Financing group (see Directors' Report on page 6). The treasury function monitors compliance against all financial obligations and it is the company's policy to manage the balance sheet so as to ensure operation within covenanted restrictions.

Foreign currency

The company has currency exposures resulting from debt raised in currencies other than sterling and very small purchases in foreign currencies. The company uses a range of instruments to hedge such exposures. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets and profits.

Financial instruments disclosures

Short-term debtors and creditors have been excluded from this note except for the comments on currency exposures to the financial statements.

Currency exposures

The company has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

Fair value of financial assets and financial liabilities

	Book value £m	2006 Fair value £m	Book value £m	2005 Fair value £m
The fair value of the company's financial instruments at 31 March was:				
Cash at hand and in bank	501.5	501.5	398.8	398.8
Current asset investments	–	–	22.5	22.5
Short-term borrowings	(202.4)	(201.2)	(88.1)	(75.2)
Long-term borrowings	(3,782.8)	(4,269.3)	(4,214.9)	(4,477.4)
Interest rate swaps	–	(4.5)	–	(3.8)
Index-linked swaps	(53.6)	(139.3)	(36.2)	(92.9)
	(3,537.3)	(4,112.8)	(3,917.9)	(4,228.0)
Fixed asset investments	1,609.2	1,930.8	1,609.2	1,930.8
Provisions excluding deferred tax and pension obligations (see note 17)	(26.0)	(26.0)	(24.6)	(24.6)
	(1,954.1)	(2,208.0)	(2,333.3)	(2,321.8)

The fair value of loans and other borrowings represents the market value of publicly traded debt instruments or, if in respect of private debt, the cost which the company would incur if it elected to repay these borrowings before their maturity dates, calculated by discounting future cash flows at prevailing rates. In the fair value table above, the book values assigned to derivative instruments are separately analysed from the book values of the underlying loans.

In accordance with the company's accounting policy, long-term borrowings are recorded using the contracted rates implicit in the financial instruments used to hedge the company's exposure to fluctuations in currency and interest rates.

Interest is charged to the profit and loss account based on the contracted interest rates. To determine the fair value of interest rate swaps for inclusion in the above table, a calculation was made of the net gain or loss which would have arisen if these contracts had been terminated on 31 March 2006. The value at that date was determined by market interest rates, which fluctuate over time. The fair value of the company's fixed asset investments is calculated by discounting cash flows at prevailing rates reflecting the relative risks involved.

The fair value of the company's provisions and other financial liabilities has been estimated as not materially different from the book value.

	2006 Gains £m	2006 Losses £m	2006 Net £m	2005 Gains £m	2005 Losses £m	2005 Net £m
Unrecognised gains and losses on hedges						
Unrecognised at 1 April	–	(96.6)	(96.6)	–	(47.7)	(47.7)
Reversal of items unrecognised at 1 April	–	–	–	–	0.7	0.7
Recognised during the year	–	5.0	5.0	–	0.6	0.6
Arising during the year	–	(52.1)	(52.1)	–	(50.2)	(50.2)
Unrecognised at 31 March	–	(143.7)	(143.7)	–	(96.6)	(96.6)

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. The total net unrecognised loss of £143.7 million (2005: net loss £96.6 million) principally represents the opportunity cost of protecting the company interest charge against movements in interest rates at a time when interest rates were higher than at 31 March 2006.

Of the unrecognised gains and losses at 31 March 2006, a net gain of £0.5 million (2005: net gain of £0.3 million) is expected to be included in the profit and loss account for the year ended 31 March 2007 and the balance in future years.

notes to the financial statements *continued*

15 Loans, other borrowings and financial instruments continued

Currency and interest rate analysis of net financial assets/(liabilities) at 31 March 2006

	Total £m	Index linked £m	Floating rate £m	Fixed rate £m	Financial assets on which no interest is paid £m	Fixed rate weighted average interest rate %	Fixed rate weighted average years to maturity
Total borrowings (all sterling)	(4,038.8)	(1,748.7)	(344.0)	(1,946.1)	–	6.7	12.3
Cash, deposits and current asset investments (all sterling)	501.5	–	501.5	–	–		
Net debt	(3,537.3)	(1,748.7)	157.5	(1,946.1)	–		
Fixed asset investments	1,609.2	–	–	1,609.1	0.1		
Provisions	(26.0)	–	–	–	(26.0)		
Net financial liabilities	(1,954.1)	(1,748.7)	157.5	(337.0)	(25.9)		

Currency and interest rate analysis of net financial assets/(liabilities) at 31 March 2005

	Total £m	Index linked £m	Floating rate £m	Fixed rate £m	Financial assets on which no interest is paid £m	Fixed rate weighted average interest rate %	Fixed rate weighted average years to maturity
Total borrowings (all sterling)	(4,339.2)	(1,301.9)	(523.8)	(2,513.5)	–	6.9	10.7
Cash, deposits and current asset investments (all sterling)	421.3	–	421.3	–	–		
Net debt	(3,917.9)	(1,301.9)	(102.5)	(2,513.5)	–		
Fixed asset investments	1,609.2	–	–	1,609.1	0.1		
Provisions	(24.6)	–	–	–	(24.6)		
Net financial liabilities	(2,333.3)	(1,301.9)	(102.5)	(904.4)	(24.5)		

Floating rate cash and investments earn interest based on the London Inter Bank Bid rate (LIBID) for the relevant currency.
Floating rate borrowings incur interest based on LIBOR.

16 Other creditors falling due after more than one year

	2006 £m	2005 £m
Deferred grants and contributions	102.6	98.4

17 Provisions for liabilities and charges

	Onerous lease obligation £m	Coupon enhancement provision £m	Deferred tax restated £m	Total restated £m
At 1 April 2005	3.0	21.6	93.2	117.8
Charge to profit and loss account	1.1	3.5	23.8	28.4
Credit to reserves – share options (see note 22)	–	–	(3.8)	(3.8)
Unwinding of discount	0.2	0.7	–	0.9
Utilised in the year	(0.3)	(3.8)	–	(4.1)
At 31 March 2006	4.0	22.0	113.2	139.2

The onerous lease provision relates to office space vacated by the company as part of the cost cutting programme to achieve efficiency targets set by the Ofwat. The provision is discounted and is expected to be utilised over the next 16 years.

The coupon enhancement provision of £22.0 million relates to coupon enhancement and other related costs incurred on the transfer of debt from AWG Group Limited to Anglian Water Services Financing Plc at the end of the refinancing exercise in 2002. The provision relates to several instruments with varying maturity dates. It is expected to be utilised in varying amounts over the next 23 years and has been discounted.

The deferred tax charge to the profit and loss account represents the element of the £26.6 million (see note 7(a)) that is credited to the deferred tax liability in the balance sheet. The other £2.8 million is credited to the defined benefit pension liability.

The deferred tax provision and the effect of discounting is analysed in note 18.

18 Deferred taxation

The total tax charge or credit in the current year includes provisions for discounted deferred taxation. Consequently, changes in the medium-term and long-term interest rates used to discount deferred taxation assets and liabilities can affect the amount of deferred taxation charged or credited in the profit and loss account.

The deferred tax liability is stated net of Advance Corporation Tax (ACT) recoverable. If changes in the tax legislation were introduced which restricted the ability of companies to use ACT, this asset may no longer be recoverable and in this event, an additional tax charge would arise in the profit and loss account of £68.4 million.

	2006 £m	2005 restated £m
Accelerated capital allowances	754.2	745.1
Short-term timing differences	(19.4)	(13.0)
Surplus ACT asset	(137.0)	(149.8)
Undiscounted provision for deferred tax	597.8	582.3
Discount	(484.6)	(489.1)
Discounted provision for deferred tax	113.2	93.2
Deferred tax asset on pension liability (see note 19(b))	(15.0)	(44.3)
Total deferred tax included in the balance sheet	98.2	48.9
	£m	
At 1 April 2005 as previously reported	107.6	
Restated for FRS 17	(58.7)	
Restated balance at 1 April 2005	48.9	
Deferred tax charged to the profit and loss account (see note 7(a))	26.6	
Deferred tax charged to the statement of total recognised gains and losses	22.7	
At 31 March 2006	98.2	

notes to the financial statements *continued*

19 Pension commitments

Pension arrangements for the majority of the company's employees are of the funded defined benefit type through the AWG Pension Scheme (AWGPS). The company's actuary is Aon Consulting. The defined benefit arrangements are closed to new employees, who are eligible instead for entry to AWG's defined contribution schemes. For the AWGPS, as a closed scheme, under the projected unit method, the current service cost will increase as the members approach retirement. The administration and investment of the pension funds are maintained separately from the finances of the AWG Plc group.

The company also manages an unfunded pension arrangement which has been valued by independent actuaries to take account of the requirements of FRS 17 as at 31 March 2006. The provision for unfunded pension obligations relates to the cost of enhancements to the pension entitlements of former employees, over and above their entitlements in the company's pension schemes. The majority of these employees ceased their employment following redundancy programmes principally between 7 and 16 years ago. These pension enhancements are payable until the death of the employees (or their dependents), and payments are expected to be made over approximately 27 years.

In addition, the company operates a defined benefit scheme for the employees of the former Hartlepool Water Limited acquired on 1 April 2000 and a defined contribution scheme which commenced on 1 April 2002. The assets and liabilities of these arrangements are not material to the company and were excluded from the disclosures for 2004. In 2005 and the current year these disclosures have been included for completeness.

Contributions to defined contribution pension scheme in the year were £0.8 million (2005: £0.5 million).

a) financial assumptions

The valuation used has been based on the most recent full actuarial valuation for AWGPS carried out as at 1 April 2005 (summarised below), updated by independent actuaries to take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 March 2006. The company contributed 20.1 per cent of pensionable pay in the year and for the year ending 31 March 2007 the expected contribution rate is 14.9 per cent. In addition, the company paid £7.7 million in deficit reduction payments in the year.

The liabilities of the schemes have been valued using the projected unit method and using the following assumptions:

	2006 % pa	2005 % pa	2004 % pa
Discount rate	4.9	5.4	5.5
Inflation rate	2.8	2.8	2.9
Increase to deferred benefits during deferment	2.8	2.8	2.9
Increases to inflation related pensions in payment	2.8	2.8	2.9
General salary increases	2.8 ¹	3.8	4.4
Longevity at age 65 for current pensioners (years)			
Men	18.6	18.5	18.5
Women	21.5	21.4	21.4
Longevity at age 65 for future pensioners (years)			
Men	19.9	19.3	18.5
Women	22.8	22.2	21.4

¹ The salary increase assumption has been restated in 2006 to RPI for the remainder of the current AMP (see glossary of terms on page 64) which ends in 2009/10.

(b) market value of assets and expected rates of return

The long-term expected rate of return and the assets in the scheme relating to the company at 31 March 2006 are:

	Expected rate of return % pa	AWGPS	Unfunded pensions	Hartlepool	Total
		Fair value of scheme assets £m	Fair value of scheme assets £m	Fair value of scheme assets £m	Fair value of scheme assets £m
Equities	7.3	471.9	n/a	2.2	474.1
Corporate bonds	4.7	114.6	n/a	–	114.6
Gilts	4.3	78.0	n/a	8.6	86.6
Property	6.3	18.4	n/a	–	18.4
Other	4.4	14.5	n/a	–	14.5
Total assets		697.4	n/a	10.8	708.2
Fair value of scheme liabilities		(702.4)	(42.0)	(13.9)	(758.3)
Deficit in the scheme		(5.0)	(42.0)	(3.1)	(50.1)
Related deferred tax asset		1.5	12.6	0.9	15.0
Net pension liability		(3.5)	(29.4)	(2.2)	(35.1)

The long-term expected rate of return and the assets in the scheme relating to the company at 31 March 2005 were:

	Expected rate of return % pa	AWGPS	Unfunded pensions	Hartlepool	Total
		Fair value of scheme assets £m	Fair value of scheme assets £m	Fair value of scheme assets £m	Fair value of scheme assets £m
Equities	7.7	352.4	n/a	1.9	354.3
Corporate bonds	5.1	37.0	n/a	–	37.0
Gilts	4.7	132.1	n/a	7.9	140.0
Property	6.7	16.0	n/a	0.3	16.3
Other	4.8	41.2	n/a	0.1	41.3
Total assets		578.7	n/a	10.2	588.9
Fair value of scheme liabilities		(682.2)	(40.2)	(13.8)	(736.2)
Deficit in the scheme		(103.5)	(40.2)	(3.6)	(147.3)
Related deferred tax asset		31.1	12.1	1.1	44.3
Net pension liability		(72.4)	(28.1)	(2.5)	(103.0)

The long-term expected rate of return and the assets in the scheme relating to the company at 31 March 2004 were:

	Expected rate of return % pa	AWGPS	Unfunded pensions	Total
		Fair value of scheme assets £m	Fair value of scheme assets £m	Fair value of scheme assets £m
Equities	7.8	333.0	n/a	333.0
Corporate bonds	5.2	23.1	n/a	23.1
Gilts	4.8	113.6	n/a	113.6
Property	6.8	13.4	n/a	13.4
Other	4.0	32.1	n/a	32.1
Total assets		515.2	n/a	515.2
Fair value of scheme liabilities		(658.8)	(39.7)	(698.5)
Deficit in the scheme		(143.6)	(39.7)	(183.3)
Related deferred tax asset		43.4	11.9	55.3
Net pension liability		(100.2)	(27.8)	(128.0)

notes to the financial statements *continued*19 Pension commitments *continued*

(c) analysis of amount charged against profits

The group's pension expense for its defined benefit schemes, in accordance with FRS 17, is set out below.

	AWGGS £m	Unfunded pensions £m	Hartlepool £m	Total £m
2006 profit and loss account				
Current service cost	(15.0)	–	(0.3)	(15.3)
Past service cost	–	–	–	–
Charge to operating profit	(15.0)	–	(0.3)	(15.3)
Expected return on pension scheme assets	39.1	–	0.5	39.6
Interest on pension scheme liabilities	(36.0)	(2.1)	(0.7)	(38.8)
Amount credited/(charged) to other finance charges	3.1	(2.1)	(0.2)	0.8
Charge to profit on ordinary activities before taxation	(11.9)	(2.1)	(0.5)	(14.5)

	AWGGS £m	Unfunded pensions £m	Hartlepool £m	Total £m
2005 profit and loss account				
Current service cost	(15.3)	–	(0.4)	(15.7)
Past service cost	(1.9)	–	–	(1.9)
Charge to operating profit	(17.2)	–	(0.4)	(17.6)
Expected return on pension scheme assets	35.5	–	0.6	36.1
Interest on pension scheme liabilities	(35.7)	(2.1)	(0.6)	(38.4)
Amount charged to other finance charges	(0.2)	(2.1)	–	(2.3)
Charge to profit on ordinary activities before taxation	(17.4)	(2.1)	(0.4)	(19.9)

(d) analysis of the amount recognised in the statement of total recognised gains and losses

	AWGGS £m	Unfunded pensions £m	Hartlepool £m	Total £m
2006 statement of total recognised gains and losses				
Actual return on pension scheme assets less expected return	76.8	–	0.2	77.0
Experience gains and losses arising on the scheme liabilities	27.5	–	2.0	29.5
Changes in assumptions underlying the present value of the scheme liabilities	(14.9)	(2.0)	(1.6)	(18.5)
Gain/(loss) recognised	89.4	(2.0)	0.6	88.0
2005 statement of total recognised gains and losses				
Actual return on pension scheme assets less expected return	8.2	–	0.3	8.5
Experience gains and losses arising on the scheme liabilities	8.1	–	(4.2)	3.9
Changes in assumptions underlying the present value of the scheme liabilities	6.3	(0.6)	0.3	6.0
Gain/(loss) recognised	22.6	(0.6)	(3.6)	18.4

(e) movements in liability during year

	AWGPS £m	Unfunded pensions £m	Hartlepool £m	Total £m
2006 movement in scheme deficit (before related deferred tax asset)				
Deficit at 1 April 2005	(103.5)	(40.2)	(3.6)	(147.3)
Current service costs	(15.0)	–	(0.3)	(15.3)
Contributions	21.3	2.3	0.4	24.0
Bulk Transfers	(0.3)	–	–	(0.3)
Net interest	3.1	(2.1)	(0.2)	0.8
Actuarial gain/(loss)	89.4	(2.0)	0.6	88.0
Deficit at 31 March 2006	(5.0)	(42.0)	(3.1)	(50.1)

2005 movement in scheme deficit (before related deferred tax asset)

	AWGPS £m	Unfunded pensions £m	Hartlepool £m	Total £m
Deficit at 1 April 2004	(143.6)	(39.7)	–	(183.3)
Current service costs	(15.3)	–	(0.4)	(15.7)
Contributions	34.9	2.2	0.4	37.5
Past service costs	(1.9)	–	–	(1.9)
Net interest	(0.2)	(2.1)	–	(2.3)
Actuarial gain/(loss)	22.6	(0.6)	(3.6)	18.4
Deficit at 31 March 2005	(103.5)	(40.2)	(3.6)	(147.3)

(f) history of experience gains and losses

	AWGPS	Unfunded pensions	Hartlepool	Total
2006 details of experience gains and losses				
Difference between expected and actual returns on scheme assets:				
Amount (£ million)	76.8	–	0.2	77.0
Percentage of scheme assets	11.0%	–	1.9%	10.9%
Experience gains and losses on scheme liabilities:				
Amount (£ million)	27.5	–	2.0	29.5
Percentage of present value of scheme liabilities	3.9%	–	14.4%	3.9%
Amount in statement of total recognised gains and losses:				
Amount (£ million)	89.4	(2.0)	0.6	88.0
Percentage of present value of scheme liabilities	12.7%	(4.8%)	4.3%	11.6%

notes to the financial statements *continued*19 Pension commitments *continued*

	AWGPS	Unfunded pensions	Hartlepool	Total
2005 details of experience gains and losses				
Difference between expected and actual returns on scheme assets:				
Amount (£ million)	8.2	–	0.3	8.5
Percentage of scheme assets	1.4%	–	2.9%	1.4%
Experience gains and losses on scheme liabilities:				
Amount (£ million)	8.1	–	(4.2)	3.9
Percentage of present value of scheme liabilities	1.2%	–	(30.4%)	0.5%
Amount in group statement of total recognised gains and losses:				
Amount (£ million)	22.6	(0.6)	(3.6)	18.4
Percentage of present value of scheme liabilities	3.3%	(1.5%)	(26.1%)	2.5%
	AWGPS	Unfunded pensions	Total	
2004 details of experience gains and losses				
Difference between expected and actual returns on scheme assets:				
Amount (£ million)	75.5	–	75.5	
Percentage of scheme assets	14.7%	–	14.7%	
Experience gains and losses on scheme liabilities:				
Amount (£ million)	–	–	–	
Percentage of present value of scheme liabilities	–	–	–	
Amount in group statement of total recognised gains and losses:				
Amount (£ million)	53.3	(2.2)	51.1	
Percentage of present value of scheme liabilities	8.1%	(5.5%)	7.3%	
	AWGPS	Unfunded pensions	Total	
2003 details of experience gains and losses				
Difference between expected and actual returns on scheme assets:				
Amount (£ million)	(160.4)	–	(160.4)	
Percentage of scheme assets	(39.7%)	–	(39.7%)	
Experience gains and losses on scheme liabilities:				
Amount (£ million)	–	0.9	0.9	
Percentage of present value of scheme liabilities	–	2.4%	0.1%	
Amount in group statement of total recognised gains and losses:				
Amount (£ million)	(201.6)	(0.9)	(202.5)	
Percentage of present value of scheme liabilities	(33.6%)	(2.4%)	(31.8%)	

20 Commitments under operating leases

At 31 March 2006 the company had commitments to make payments during the next 12 months under non-cancellable operating leases which expire as follows:

	2006		2005	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	–	1.2	–	1.1
Between one and five years	0.2	4.3	0.1	4.1
After five years	2.7	–	2.8	1.2
	2.9	5.5	2.9	6.4

21 Share capital – equity shares

	2006 £m	2005 £m
Authorised		
Ordinary shares of £1 each	860.0	860.0
Allotted, issued and fully paid		
Ordinary shares of £1 each	860.0	860.0

22 Movement in shareholders' funds

	Share capital £m	Profit and loss account £m	Total £m
At 31 March 2005 as previously reported	860.0	783.7	1,643.7
Prior year adjustment (see below)	–	(65.3)	(65.3)
Opening shareholders' funds as restated	860.0	718.4	1,578.4
Actuarial gain on post-retirement liability	–	88.0	88.0
Deferred tax on actuarial gain	–	(26.5)	(26.5)
Deferred tax on share based payment	–	3.8	3.8
Profit after taxation	–	246.9	246.9
Dividends	–	(305.7)	(305.7)
At end of year	860.0	724.9	1,584.9

The profit and loss reserve includes £35.1 million (2005: £103.0 million) stated net after deferred taxation of £15.0 million (2005: £44.3 million) in respect of pension scheme liabilities.

The following adjustments have been made to opening shareholders' funds as a result of the adoption of FRS 17 and FRS 21.

	2005 £m	2004 £m
Post-retirement liability (net of deferred tax)	103.0	128.0
Reversal of SSAP 24 pension prepayment	81.0	53.5
Deferred tax on SSAP 24 pension prepayment	(21.5)	(13.0)
Reversal of unfunded pension provision	(26.7)	(26.5)
Deferred tax on unfunded pension provision	7.1	7.1
Prior year adjustment recognised in the statement of total recognised gains and losses	142.9	149.1
FRS 21 – reversal of prior year dividends	(77.6)	(58.1)
Total prior year adjustments	65.3	91.0

23 Reconciliation of movements in shareholders' funds

	2006 £m	2005 restated £m
Profit attributable to shareholders	246.9	256.0
Dividends	(305.7)	(233.6)
	(58.8)	22.4
Actuarial gains net of taxation	61.5	12.9
Deferred tax on share-based payment	3.8	–
Net increase in shareholders' funds	6.5	35.3
Opening shareholders' funds as previously stated	1,643.7	1,634.1
Prior year adjustment (see note 22)	(65.3)	(91.0)
Opening shareholders' funds as restated	1,578.4	1,543.1
Closing shareholders' funds	1,584.9	1,578.4

notes to the financial statements *continued*

24 Directors' interests

The beneficial interests in shares and options for Jonson Cox and Scott Longhurst, who are also Directors of AWG Plc, and their interest in the shares of AWG Plc can be found in the AWG Plc annual report and accounts 2006. The interests of the other Directors in the shares of AWG Plc and in options over such shares granted under that company's Share Schemes are set out below.

Beneficial and family interests in shares:

	1 April 2005 No. of shares	31 March 2006 No. of shares
Peter Simpson	3,031	4,917
David Hipple	–	1,564
Chris Newsome	–	790
Jean Spencer	–	1,125
Robert Napier	–	–
Roger Witcomb	–	–
John Watkinson	–	–

The figures include the following ordinary shares held in trust for Directors as the share element of the Annual Retained Bonus Scheme: Peter Simpson 1,652, David Hipple 1,330, Chris Newsome 556 and Jean Spencer 891. The figures also include the shares purchased and awarded under the AWG Plc Sharebuy Plan. For every two partnership shares purchased, the company also awards one matching share. Participants can also choose to reinvest any dividends earned on shares held in the plan. The first monthly purchase under this plan was made in April 2005. Details of partnership, matching and dividend shares are detailed below:

	1 April 2005	Partnership shares bought	Matching shares awarded	Dividend shares bought	31 March 2006
Peter Simpson	–	153	76	5	234
David Hipple	–	153	76	5	234
Chris Newsome	–	153	76	5	234
Jean Spencer	–	153	76	5	234

Long-term Incentive Plan (LTIP)

The following contingent interests were held under the 2004 AWG Plc Long-term Incentive Plan 2004:

	Holding at 1 April 2005*	No. of shares awarded	No. of shares lapsed	Holding at 31 March 2006
Peter Simpson	17,715	18,747	–	36,462
David Hipple	12,543	8,729	–	21,272
Chris Newsome	12,205	6,151	–	18,356
Jean Spencer	13,111	6,444	–	19,555

*or at date of appointment

The proportion of the LTIP shares awarded during the year ended 31 March 2005 that will vest is dependent on the company's performance relative to a comparator index of companies in terms of total shareholder return (TSR) over a three-year period. Valuation of these share awards was based on the total value of the shares awarded and an expectation of the number likely to vest based on statistical sampling.

The proportion of the LTIP shares awarded during the year ended 31 March 2006 that will vest depends 60 per cent on the company's performance relative to a comparator index of companies in terms of TSR and 40 per cent on its performance in terms of EPS over a three-year period. Valuation for the TSR element is as above and valuation for the EPS element is based on inputs into a binomial model.

The company is charged by AWG Plc an amount relating to the directors participating in the scheme. Full details of the scheme are given in the AWG plc annual report and accounts 2006

Executive share option scheme (ESOS)

Interests in the AWG Plc Executive Share Option Scheme are as follows:

	No. of options at 1 April 2005	No. of options granted	No. of options lapsed	No. of options at 31 March 2006
Peter Simpson	44,074	–	13,282	30,792
David Hipple	11,266	–	11,266	–

Options granted under the Executive Share Option Scheme are exercisable during a period commencing on the third anniversary and ending on the tenth anniversary of the date of grant, providing performance conditions are met.

The company is charged by AWG Plc an amount relating to the directors participating in the scheme. Full details of the scheme are given in the AWG plc annual report and accounts 2006

Interests in the AWG Plc Sharesave Scheme are as follows:

	No. of options at 1 April 2005*	No. of options granted	No. of options lapsed	No. of options at 31 March 2006
Peter Simpson	4,640	1,012	–	5,652
David Hipple	1,276	–	–	1,276
Chris Newsome	1,276	–	–	1,276
Jean Spencer	2,227	–	–	2,227

*or at date of appointment

Options granted under the Sharesave Scheme are exercisable within a period of six months after either the third, fifth or seventh anniversary of the date of the savings contract.

The date of grant and the option prices are set out below:

Sharesave Scheme

Date of grant	Option price
10 December 1997	£6.19
9 December 1998	£7.12
12 January 2000	£4.34
31 January 2001	£4.68
6 February 2002	£4.20
31 January 2003	£3.38
5 February 2004	£4.28
28 January 2005	£7.42
8 February 2006	£9.54

Executive Share Option Scheme

Date of grant	Option price
9 July 2002	£5.38
31 July 2003	£5.40
16 January 2004	£5.26

notes to the financial statements *continued*

25 Share based payments

The AWG Plc group operates a SAYE share option scheme for all employees to encourage participation in the AWG Plc group's results. The company is charged by AWG Plc an amount relating to the company's employees participating in the scheme. Options are exercisable at a price equal to the quoted market price of AWG Plc's shares on the date of grant less a discount of between 10 and 20 per cent. The options mature after either three years or five years and there is an exercise period of six months from when the share options become exercisable after which period the options lapse.

The weighted average share price at the date of exercise for share options exercised during the year was £9.87. The options outstanding at 31 March 2006 had a weighted average exercise price of £4.66 (2005: £4.11), and a weighted average remaining contractual life of 1.5 years (2005: 2.2 years). During the year options were granted on 8 February 2006. The aggregate of the estimated fair values of the options granted on those dates is £1.0 million.

The inputs into the binomial model that the group uses to value share options were:

	2006 3 year	2006 5 year	2005 3 year	2005 5 year
Share price at date of grant	1060p	1060p	824.5p	824.5p
Exercise price	954p	954p	742p	742p
Expected volatility	21.1%	24.5%	25.6%	30.9%
Expected life	3.5 years	5.5 years	3.5 years	5.5 years
Risk free rate	4.3%	4.3%	4.5%	4.5%
Expected dividend yield	4.6%	4.6%	6.1%	6.1%

Expected volatility was determined by calculating the historical volatility for a period up to the date of grant equal to the length of the expected life of the options.

Details of the movements in the total number of share options outstanding during the year are included within the annual report and accounts of AWG Plc.

26 Contingent liabilities

At 31 March 2006 £137.0 million (2005: £149.8 million) of Advance Corporation Tax (ACT) has been surrendered to the company by AWG Group Limited. As part of the financial restructuring in 2002, the company is required to pay AWG Group Limited on utilisation of ACT. A provision has not been recognised in the company accounts as it is uncertain whether the ACT will be utilised (ie it is not probable that a transfer of economic benefits will be required to settle the obligation) and it is not possible to make a reliable estimate of the amount of the obligation.

The company, as part of the Anglian Water Services Financing group (see Directors' report on page 6), guarantees unconditionally and irrevocably all the borrowings of Anglian Water Services Financing Plc, which at 31 March 2006 amounted to £3,948.6 million (2005: £4,166.8 million). The borrowings of Anglian Water Services Holdings Limited and Anglian Water Services Overseas Holdings Limited are also guaranteed unconditionally and irrevocably by the company. Excluding the £1,609.1 million loan made by the company to Anglian Water Services Holdings Limited, Anglian Water Services Holdings Limited and Anglian Water Services Overseas Holdings Limited had no outstanding indebtedness at 31 March 2006.

There are no other material contingent liabilities at 31 March 2006 for which provision has not been made in these financial statements.

27 Ultimate parent company

Anglian Water Services Overseas Holdings Limited, a company registered in the Cayman Islands, is the immediate parent company of the company.

AWG Plc, a company registered in England and Wales, is the parent company of the largest group to consolidate the accounts of the company. The Directors consider AWG Plc to be the ultimate parent company.

Copies of the accounts of AWG Plc, Anglian Water Services Holdings Limited and Anglian Water Services Financing Plc can be obtained from the Company Secretary, Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.

independent auditors' report

TO THE MEMBERS OF ANGLIAN WATER SERVICES LIMITED

We have audited the financial statements of Anglian Water Services Limited for the year ended 31 March 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown to or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Performance Review that is cross referred from the Business Review section of the Directors' Report. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report and the Performance Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

basis of audit opinion

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

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

opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006 and of its profit and cash flows for the year then ended.
- the financial statements have been properly prepared in accordance with the Companies Act 1985.
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

Birmingham

30 May 2006

regulatory accounts and required regulatory information

The regulatory accounts and required regulatory information on pages 42 to 61 are provided to comply with Condition F of the Instrument of Appointment of Anglian Water Services Limited as a water and sewerage undertaker under the Water Industry Act 1991.

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat.

There are differences between UK Generally Accepted Accounting Practice and the Regulatory Accounting Guidelines. Where different treatments are specified under each, the Regulatory Accounting Guidelines take precedence.

A glossary of regulatory terms is shown on page 64.

statement of Directors' responsibilities for regulatory information

Further to the requirements of company law, the Directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat.

This additionally requires the Directors to:

- confirm that, in their opinion, the company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months
- confirm that, in their opinion, the company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the company
- confirm that, in their opinion, the company has contracts with any associate company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the company's obligations as a water and sewerage undertaker
- report to Ofwat changes in the company's activities which may be material in relation to the company's ability to finance its regulated activities
- undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length and
- keep proper accounting records which comply with Condition F.

These responsibilities are additional to those already set out in the statutory financial statements.

notes on regulatory information

1 General

As discussed in the Directors' report in the statutory financial statements, the company's activities are regulated by the conditions of a licence granted to the company by the Secretary of State for the Environment. With certain exceptions, the regulatory provisions do not apply to business activities which are not connected with the carrying out of the water and sewerage function, these business activities are referred to as non-appointed business (see note 3 on page 45).

An analysis of the regulatory historical cost profit and loss account and regulatory historical cost balance sheet between appointed and non-appointed business is set out on pages 42 and 43. A current cost profit and loss account and current cost balance sheet are shown on pages 48 and 49. Other current cost disclosures appear on pages 50 to 61. Additional information required by the licence is shown on pages 44 to 47.

Under the Regulatory Accounting Guidelines the treatment of certain turnover and expenditure items differs from that disclosed in the statutory financial statements.

2 Protection of the regulated business

- (a) In the opinion of the Directors the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the regulated activities (including the investment programme necessary to fulfil its obligations under the Instrument of Appointment).
- (b) In the opinion of the Directors the company will, for at least the next 12 months, have available to it management resources and methods of planning and internal control which are sufficient to carry out the regulated activities (including the investment programme necessary to fulfil its obligations under the Instrument of Appointment).
- (c) In the opinion of the Directors all contracts entered into with any associate company include all necessary provisions and requirements concerning the standard of service to be supplied to the company to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

3 Arm's-length trading

In the opinion of the Directors, the company was in compliance with paragraph 3.1 of Condition F of the licence throughout the year.

regulatory historical cost profit and loss account for the year ended 31 March

	2006			Appointed restated £m	Non Appointed restated £m	2005 Total restated £m
	Appointed £m	Non Appointed £m	Total £m			
Turnover	856.7	9.0	865.7	789.6	7.2	796.8
Operating costs	(502.3)	(5.6)	(507.9)	(464.0)	(4.2)	(468.2)
Profit on sale of fixed assets	1.8	–	1.8	0.8	–	0.8
Operating Profit	356.2	3.4	359.6	326.4	3.0	329.4
Interest receivable	234.6	–	234.6	213.1	–	213.1
Interest payable	(297.1)	–	(297.1)	(277.0)	–	(277.0)
Profit on ordinary activities before taxation	293.7	3.4	297.1	262.5	3.0	265.5
Taxation:						
– current tax	(22.6)	(1.0)	(23.6)	(0.9)	(0.9)	(1.8)
– deferred tax	(26.6)	–	(26.6)	(7.7)	–	(7.7)
Profit on ordinary activities after taxation	244.5	2.4	246.9	253.9	2.1	256.0
Dividends	(301.2)	(4.5)	(305.7)	(230.7)	(2.9)	(233.6)
Movement in reserves	(56.7)	(2.1)	(58.8)	23.2	(0.8)	22.4

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 17 'Retirement benefits', FRS 20 'Share-based payment' and FRS 21 'Events after the balance sheet date'. See note 1(a) in the statutory financial statements on page 14.

regulatory historical cost balance sheet at 31 March

	2006		2005			
	Appointed £m	Non Appointed £m	Appointed restated £m	Non Appointed restated £m	Total restated £m	
Fixed Assets						
Tangible assets	3,956.6	–	3,956.6	3,867.3	–	3,867.3
Investments	1,609.2	–	1,609.2	1,609.2	–	1,609.2
	5,565.8	–	5,565.8	5,476.5	–	5,476.5
Current assets						
Stocks	10.6	–	10.6	6.9	–	6.9
Debtors	205.9	–	205.9	635.6	–	635.6
Investment – money market deposits	461.2	–	461.2	374.1	–	374.1
Cash at bank and in hand (including short term deposits)	39.3	1.0	40.3	44.2	3.0	47.2
	717.0	1.0	718.0	1,060.8	3.0	1,063.8
Creditors: amounts falling due within one year						
Short-term borrowings	(202.4)	–	(202.4)	(88.1)	–	(88.1)
Other creditors	(382.2)	(1.0)	(383.2)	(302.6)	(0.9)	(303.5)
	(584.6)	(1.0)	(585.6)	(390.7)	(0.9)	(391.6)
Net current assets	132.4	–	132.4	670.1	2.1	672.2
Total assets less current liabilities	5,698.2	–	5,698.2	6,146.6	2.1	6,148.7
Creditors: amounts falling due after more than one year						
Loans and other borrowings	(3,836.4)	–	(3,836.4)	(4,251.1)	–	(4,251.1)
Deferred income	(102.6)	–	(102.6)	(98.4)	–	(98.4)
	(3,939.0)	–	(3,939.0)	(4,349.5)	–	(4,349.5)
Provisions for liabilities and charges						
Deferred Tax	(113.2)	–	(113.2)	(93.2)	–	(93.2)
Other provisions	(26.0)	–	(26.0)	(24.6)	–	(24.6)
	(139.2)	–	(139.2)	(117.8)	–	(117.8)
Defined Benefit pension liabilities	(35.1)	–	(35.1)	(103.0)	–	(103.0)
Net assets	1,584.9	–	1,584.9	1,576.3	2.1	1,578.4
Capital and reserves						
Called up equity share capital	860.0	–	860.0	860.0	–	860.0
Profit and loss account	724.9	–	724.9	716.3	2.1	718.4
Total shareholder's funds (all equity)	1,584.9	–	1,584.9	1,576.3	2.1	1,578.4

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 17 'Retirement benefits', FRS 20 'Share-based payment' and FRS 21 'Events after the balance sheet date'. See note 1(a) in the statutory financial statements on page 14.

additional information required by the licence

1 Accounting policies

The accounting policies are set out in the statutory financial statements, except that, as noted on page 41, under the Regulatory Accounting Guidelines certain turnover and expenditure items are treated differently in the regulatory accounts. In addition, infrastructure renewals accounting has been retained in the regulatory accounts in accordance with Ofwat's requirements.

Cumulative infrastructure renewals expenditure, net of depreciation, has been included within debtors in the regulatory historical cost balance sheet in accordance with Regulatory Accounting Guideline 3.05. This represents a departure from the accounting policy adopted in the company's statutory financial statements and Financial Reporting Standard (FRS) 15, which require this amount to be included within fixed assets.

2 Link between Directors' pay and standards of performance

Directors pay comprises a package of base salary together with performance bonuses. Base salary is set by an AWG remuneration committee advised by independent consultants. Under the performance bonus scheme 60 per cent of the total available bonus relates to the company's overall performance and 40 per cent to personal performance. For the year ended 31 March 2006 the results for the year (financial and non-financial) resulted in the following performance assessment against targets:-

	%
Financial performance	50.0
Capital delivery index	20.0
Overall performance assessment (OPA)	0.0
Levels of service (LOS)	7.5
	<u>77.5%</u>

Financial and capital delivery targets were met in full. Against the targets set the company partly met its Levels of Service objectives and did not meet its OPA target. The component of the bonus relating to personal performance reflects on individuals achievement of personal targets set for the year.

Bonuses paid to directors are as follows:

	£000
P Simpson	108.0
D Hipple	62.2
J Spencer	53.9
C Newsome	50.4

For 2006/07 a similar arrangement exists but with a higher weighting being attributed to the OPA component of the basket of measures.

The element which relates to company performance is made up as follows:-

	%
Financial Performance	50.0
Capital delivery index	20.0
Overall performance assessment	15.0
Levels of service	15.0
	<u>100%</u>

Stretching targets are set for the Company's performance against these four metrics. These targets are set at the beginning of the year.

The financial performance element covers a number of targets in respect of profitability, costs and cash flow. The capital delivery index is a basket of measures which reflects the performance of the capital programme and covers amounts of work completed, regulatory and other outputs delivered, and efficiencies justified. The element attributable to OPA measures the company's performance on Ofwat's OPA league table. This is an effective way of measuring and rewarding performance on this series of metrics that cover customer service and water and wastewater quality and compliance. The levels of service measure is an internal measure of the effectiveness of the company in completing jobs against the time scales given to customers.

The same approach and weightings are applied in calculating a team bonus for all of the Company's employees.

3 Information in relation to allocations and apportionments between the appointed and any other business or activity of the appointee or associated company

The non-appointed business relates mainly to legal searches to locate utility infrastructure, recreation, leisure and the provision of consultancy services. The North Tees water supply agreement to the Huntsman Petrochemical site, which is not in the Anglian Water area, has also been treated as non-appointed business.

A proportion of the operating costs relating to these activities is directly incurred and does not require allocation. Other relevant costs have been allocated according to time spent on these activities.

4 Allocation to principal service

- (a) Operating costs are incurred directly by specific service and have not required allocation. Indirect costs are allocated on either a causal link basis or according to local managers' assessments. The allocation to principal service of the charge for infrastructure renewals is based on the Asset Management Plan (AMP).
- (b) Capital costs, and hence the related depreciation charges, are incurred directly by specific service and have not required allocation.

5 Information in respect of transactions with any other business or activity of the appointee or any associated company

To the best of the Directors' knowledge, all appropriate transactions with associated companies have been disclosed in notes (a) to (g) below.

(a) Borrowings or sums lent

On 30 July 2002 £1,609.1 million was lent by the company to Anglian Water Services Holdings Limited. No other sums were lent by the appointee to associated companies at 31 March 2006.

Sums borrowed by the appointee from Anglian Water Services Financing Plc, its financing subsidiary, were:

Type of loan	Principal amount £m	Repayment date	Interest rate %
Fixed rate	100.0	2014	12.375
Fixed rate	200.0	2023	6.875
Fixed rate	200.0	2029	6.625
Fixed rate	150.0	2006	8.25
'Mark to market' adjustments on £150.0m loan (1)	2.0	2006	–
Fixed rate	250.0	2022	5.837
Fixed rate	246.0	2030	6.293
Fixed rate (5)	275.0	2012/2037	7.882
Fixed rate	229.2	2009	5.375
Fixed rate	453.3	2013	4.625
Fixed rate	10.6	2009	7.07
'Mark to market' adjustments on £13.3m loan (1)	0.4	2009	–
Fixed rate	0.3	2006	7.21
Fixed rate	24.9	2006	6.62
Fixed rate	71.0	2008	7.01
Fixed rate	16.3	2009	7.13
Fixed rate	138.5	2011	7.23
Fixed rate	250.0	2015	5.25
Fixed rate (5)	150.0	2017/2040	5.5
Index linked (2)	162.7	2008	5.5
Index linked (2)	174.6	2020	4.125
Index linked (2)	221.8	2032	3.07
Index linked (2)	66.6	2032	3.07
Index linked (2)	411.4	2035	2.4
Index linked (2)	83.2	2024	3.666
£150m index linked swap (3), (4)	16.1	2024	–
£175m index linked swap (3), (4)	18.7	2030	–
£258m index linked swap (3), (4)	18.8	2013	–
	<u>3,941.4</u>		

EURIBOR is the European Inter Bank Offer Rate. LIBOR is the London Inter Bank Offer Rate.

additional information required by the licence **continued**

5 Information in respect of transactions with any other business or activity of the appointee or any associated company continued

- (1) As part of a financial restructuring of the company in 2002, back-to-back loans to the company from AWG Group Limited were reassigned from AWG Group Limited to Anglian Water Services Financing Plc. The 'mark to market' adjustments relate to the reassignment of these loans at fair value rather than book value. The difference between the book value and fair value is being amortised at a constant rate on the carrying amount of the debt over the remainder of its life.
- (2) The value of the capital and interest elements of the index linked debt are linked to movements in the Retail Price Index (RPI).
- (3) The company, through its financing subsidiary (AWSF), has entered into swap agreements that convert its debt into either floating rate debt or index linked debt in accordance with the company's hedging policy.
- (4) The values of the notional capital on these index linked swaps are linked to movements in RPI. The increase in the notional capital value is payable at the final maturity date of the swaps.
- (5) Legal maturity of these instruments is the second of the years quoted. Coupon 'step-up' is in the first of the years quoted.

(b) Dividends payable

A dividend of £301.2 million is payable for the year (2005: £230.7 million). Of this dividend, £240.7 million (2005: £193.6 million) is ultimately payable to Anglian Water Services Holdings Limited, a parent undertaking, in order for it to service the interest payable to the company on the inter-company loan of £1,609.1 million (see note 5 (a) on page 45).

(c) Guarantees / securities

The company, as part of the Anglian Water Services Financing group (see Directors' report on page 6), guarantees unconditionally and irrevocably all the borrowings of Anglian Water Services Financing Plc, its wholly owned subsidiary, which at 31 March 2006 amounted to £3,948.6 million (2005: £4,166.8 million). The borrowings of Anglian Water Services Holdings Limited and Anglian Water Services Overseas Holdings Limited are also guaranteed unconditionally and irrevocably by the company. Excluding the £1,609 million loan made by the company to Anglian Water Services Holdings Limited, Anglian Water Services Holdings Limited and Anglian Water Services Overseas Holdings Limited had no outstanding indebtedness at 31 March 2006 (2005: nil).

(d) Supply of services

Recharges by the appointee to associated companies:

Nature of transaction	Company	Terms of supply	Value £m
Payroll services	AWG Central Services Limited	Actual costs	0.2
Legal services	AWG Central Services Limited	Actual costs	0.5
HR services	AWG Central Services Limited	Actual costs	0.2

Services supplied to the appointee by associated companies:

Nature of transaction	Company	Turnover of associated company £m	Terms of supply	Value £m
Pension administration	AWG Central Services Limited	32.6	Negotiated	0.1
Rental of office accommodation	AWG Central Services Limited	32.6	Space apportionment	0.6
Directors' costs	AWG Central Services Limited	32.6	Time apportionment	0.4
Insurance	AWG Central Services Limited	32.6	Negotiated	0.3
Engineering and construction	Morrison Utility Services Limited	385.9	Competitive tendering	9.0
Taxation services	AWG Central Services Limited	32.6	Negotiated	0.2
Internal audit services	AWG Central Services Limited	32.6	Negotiated	0.3
External audit services	AWG Central Services Limited	32.6	Pass through	0.2
Rental of office accommodation	Ambury Developments Limited	2.8	Negotiated	0.1
Engineering, construction and fabrication	Purac Limited	39.6	Competitive tendering	0.7
Facilities management services	Morrison Facilities Services Limited	153.9	Other market testing	0.1
Other	n/a	n/a	n/a	0.3
				12.3*

* This total includes amounts of £7.9 million that were capitalised by the appointed business.

Not included above are non-trade transactions of £0.8 million, recharged as a pass through cost, with AWG Central Services Limited. In addition £5.4 million was paid to AWG Group Limited to settle a corporation tax recharge and £0.3 million was paid to settle the company's element of a PAYE audit.

(e) **Charitable and political donations**

During the year the company made a payment of £1.0 million (2005: £1.0 million) to the Anglian Water Trust Fund. This was treated as an operating cost in the financial statements.

Financially through charitable donations, educational, regeneration and recreation projects, the company contributed £0.1 million (2005: £0.1 million) to other charitable causes.

No political donations were made during the year.

(f) **Omissions of rights**

No material omissions took place during the year.

(g) **Waivers**

There were no material waivers during the year.

current cost profit and loss account for the appointed business for the year ended 31 March

Notes	2006	2005
	Appointed £m	Appointed restated £m
2 Turnover	856.7	789.6
4 Current cost operating costs	(581.5)	(545.9)
3 Operating income	0.3	0.6
	275.5	244.3
1(e),3 Working capital adjustment	(17.9)	(13.2)
	257.6	231.1
Current cost operating profit		
Other income		
Interest receivable	234.6	213.1
Interest payable	(297.1)	(277.0)
1(e) Financing adjustment	69.5	76.6
	264.6	243.8
Current cost profit before taxation		
Current tax	(22.6)	(0.9)
Deferred tax	(26.6)	(7.7)
	215.4	235.2
Current cost profit attributable to shareholder		
Dividends	(301.2)	(230.7)
	(85.8)	4.5
7 Current cost (loss) / profit		

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 17 'Retirement benefits', FRS 20 'Share-based payments' and FRS 21 'Events after the balance sheet date'.

The notes on pages 51 to 58 form part of these current cost financial statements.

current cost balance sheet for the appointed business at 31 March

Notes	2006 Appointed	2005 Appointed restated
	£m	£m
Assets employed		
5	20,937.5	20,435.8
	(682.5)	(650.2)
	20,255.0	19,785.6
6	326.0	756.9
	20,581.0	20,542.5
	1,609.2	1,609.2
	18.2	8.2
	(202.4)	(88.1)
	(3,836.4)	(4,251.1)
	(113.2)	(93.2)
	(61.3)	(127.6)
	17,995.1	17,599.9
Financed by		
	860.0	860.0
7	85.3	105.8
8	17,049.8	16,634.1
	17,995.1	17,599.9

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 17 'Retirement benefits', FRS 20 'Share-based payments' and FRS 21 'Events after the balance sheet date'.

The notes on pages 51 to 58 form part of these current cost financial statements.

The financial statements were approved by the board on 30 May 2006 and signed on its behalf by:

Peter Simpson
Chief Operating Officer

David Hipple
Finance Director

current cost cash flow statement for the year ended 31 March

Notes	2006		2005			
	Appointed £m	Non Appointed £m	Total £m	Appointed restated £m	Non Appointed £m	Total restated £m
9(a) Net cash inflow from operating activities	525.4	3.4	528.8	531.5	3.0	534.5
Return on investments and servicing of finance						
Interest received	266.9	–	266.9	212.9	–	212.9
Interest paid	(244.7)	–	(244.7)	(231.4)	–	(231.4)
Finance costs capitalised	–	–	–	(0.3)	–	(0.3)
Interest element of finance lease rental payments	(6.4)	–	(6.4)	(8.0)	–	(8.0)
Net cash inflow/(outflow) for returns on investments and servicing of finance	15.8	–	15.8	(26.8)	–	(26.8)
Taxation						
Corporation tax paid	(1.1)	(0.9)	(2.0)	1.2	(2.0)	(0.8)
Payments to other AWG Plc group undertakings	(5.4)	–	(5.4)	–	–	–
	(6.5)	(0.9)	(7.4)	1.2	(2.0)	(0.8)
Capital expenditure and financial investment						
Gross cost of purchase of fixed assets	(220.8)	–	(220.8)	(253.9)	–	(253.9)
Grants and contributions received	24.1	–	24.1	26.9	–	26.9
Infrastructure renewals expenditure	(43.2)	–	(43.2)	(37.0)	–	(37.0)
Disposal of tangible fixed assets	2.0	–	2.0	1.1	–	1.1
Net cash outflow for capital expenditure and financial investment	(237.9)	–	(237.9)	(262.9)	–	(262.9)
Acquisitions and disposals	–	–	–	0.1	–	0.1
Equity dividend paid	(301.2)	(4.5)	(305.7)	(230.7)	(2.9)	(233.6)
Management of liquid resources						
Increase in short-term deposits and investments	(87.1)	–	(87.1)	(105.1)	–	(105.1)
Net cash outflow before financing	(91.5)	(2.0)	(93.5)	(92.7)	(1.9)	(94.6)
Financing						
Increase in loans	399.9	–	399.9	–	–	–
Repayments of amounts borrowed	(292.8)	–	(292.8)	(3.3)	–	(3.3)
Capital element of finance lease payments	(20.5)	–	(20.5)	(17.3)	–	(17.3)
Net cash inflow/(outflow) from financing	86.6	–	86.6	(20.6)	–	(20.6)
Decrease in cash	(4.9)	(2.0)	(6.9)	(113.3)	(1.9)	(115.2)

notes to the current cost financial statements

1 Accounting policies

(a) general

These financial statements have been prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat for modified real terms financial statements suitable for regulation in the water industry.

They measure profitability on the basis of real financial capital maintenance, in the context of assets which are valued at their current cost value to the business.

The regulatory accounts are separate from the statutory financial statements of the company. There are differences between the United Kingdom Generally Accepted Accounting Practice (UK GAAP) and the basis of preparation of information provided in the regulatory accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed.

The accounting policies used are the same as those adopted in the statutory financial statements, except as set out below:

(b) tangible fixed assets

The assets have been valued in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values) on a modern equivalent asset (MEA) basis.

Depreciation is charged over the estimated remaining economic life of the asset. Infrastructure assets are not depreciated.

Additions during the year are taken at their historic cost values. Disposals are stated at the value of the replacement assets.

(i) land and buildings

Non-specialised operational properties are valued on the basis of open market value for existing use as part of the periodic Asset Management Plan (AMP) reviews and are expressed in real terms by indexation using the Retail Price Index (RPI) thereafter.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between periodic AMP reviews by adjusting for inflation as measured by changes in the RPI. The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below).

(ii) infrastructure assets

Mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost, on an MEA basis, determined principally on the basis of data provided by the AMP.

A process of continuing refinement of asset records is expected to produce adjustments to existing values when periodic reviews of the AMP take place. In the intervening years, values are restated to take account of changes in the general level of inflation, as measured by changes in the RPI over the year.

(iii) other fixed assets

All other fixed assets are valued periodically at depreciated replacement costs. Between periodic AMP reviews, values are restated for inflation as measured by changes in the RPI.

(iv) surplus land

Surplus land is valued at recoverable amount, taking into account that part of any proceeds to be passed on to customers under Condition B of the licence.

(c) modern equivalent asset (MEA) valuation

A review of the MEA valuation and asset stock is undertaken as part of each five-year periodic review. The revised values arising from this review, once deemed effective by Ofwat, provide the basis for calculating the MEA in the current cost financial statements.

(d) grants and other third party contributions

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

notes to the current cost financial statements **continued**

(e) **real financial capital maintenance adjustments**

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

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

Disposal of fixed assets adjustment – the difference between the values of realised assets in these current cost financial statements and in the historical cost financial statements.

The depreciation adjustment is incorporated within operating costs in the profit and loss account. The disposal of fixed assets adjustment is incorporated within operating income in the profit and loss account.

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

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

2 **Turnover for the appointed business**

	2006			2005		
	Water service £m	Sewerage service £m	Total £m	Water service £m	Sewerage service £m	Total £m
Measured	183.2	253.9	437.1	149.4	232.9	382.3
Unmeasured	128.7	213.4	342.1	117.7	210.6	328.3
Trade effluent	–	7.2	7.2	–	7.0	7.0
Large user revenues	35.3	25.5	60.8	26.2	26.3	52.5
Third party services	6.8	1.7	8.5	13.0	1.6	14.6
Other sources	0.4	0.6	1.0	3.4	1.5	4.9
Total turnover	354.4	502.3	856.7	309.7	479.9	789.6

3 **Operating income and working capital adjustment for the appointed business**

	2006			2005		
	Water service £m	Sewerage service £m	Total £m	Water service £m	Sewerage service £m	Total £m
Current cost profit on disposal of fixed assets	0.2	0.1	0.3	0.3	0.3	0.6
Working capital adjustment	(8.9)	(9.0)	(17.9)	(6.6)	(6.6)	(13.2)

4 Analysis of operating costs and fixed asset net book values by service

2006

	Service analysis								Business activities		
	Water service			Sewerage service					Customer services	Scientific services	Other business activities
	Resources and treatment	Distribution	Water service subtotal	Sewerage treatment	Sludge treatment & disposal	Sewage T&D subtotal	Sewerage service subtotal	£m			
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Direct costs:											
Employment costs	6.1	7.2	13.3	10.5	17.9	6.8	24.7	35.2	10.7	5.6	1.3
Power	11.4	7.4	18.8	3.7	14.5	2.3	16.8	20.5	–	0.1	–
Hired and contracted services	3.7	11.4	15.1	4.8	8.3	15.7	24.0	28.8	8.9	1.9	2.2
Materials and consumables	3.8	1.2	5.0	1.4	6.2	6.7	12.9	14.3	0.3	0.7	–
Service charges	9.1	–	9.1	1.1	5.3	–	5.3	6.4	–	–	–
Bulk supply imports	0.7	–	0.7	–	–	–	–	–	–	–	–
Other direct costs	0.5	1.3	1.8	1.0	1.0	0.5	1.5	2.5	5.4	0.5	3.4
Total direct costs	35.3	28.5	63.8	22.5	53.2	32.0	85.2	107.7	25.3	8.8	6.9
General and support expenditure	8.3	7.8	16.1	5.6	12.3	9.3	21.6	27.2	0.1	0.3	0.1
Functional expenditure	43.6	36.3	79.9	28.1	65.5	41.3	106.8	134.9	25.4	9.1	7.0
Total business activities			20.4					21.1			
Rates			19.1					16.2			
Doubtful debts			6.9					9.2			
Total less third party services			126.3					181.4			
Third party services			2.4					0.5			
Total operating costs			128.7					181.9			
Capital costs:											
Infrastructure renewals expenditure	0.2	23.0	23.2	20.0	–	–	–	20.0			
Movement in infrastructure renewal accrual/prepayment	–	4.2	4.2	3.6	–	–	–	3.6			
Depreciation† (allocated)	48.1	17.9	66.0	26.1	108.9	10.1	119.0	145.1			
Amortisation of deferred credits			(4.4)					(3.8)			
Business activities depreciation† (non-allocated)			5.1					7.6			
Capital maintenance excluding third party services			94.1					172.5			
Third party services – capital maintenance			3.3					1.0			
Total capital maintenance			97.4					173.5			
Total operating costs⁽¹⁾			226.1					355.4			
Current cost accounting (modern equivalent asset) values											
Service activities	1,223.0	4,928.5	6,151.6	12,914.3	1,688.2	96.5	1,784.7	14,699.0			
Business activities			5.4					8.0			
Service totals			6,157.0					14,707.0			
Service assets for third parties			62.4					11.2			
Total			6,219.4					14,718.2			

† On a current cost basis.

(1) Included within total operating costs are reactive and planned maintenance expenditure on infrastructure assets of £13.9 million. This is split £10.3 million water distribution and £3.6 million sewerage.

notes to the current cost financial statements **continued**

4 Analysis of operating costs and fixed asset net book values by service continued

2005

	Service analysis								Business activities		
	Water service			Sewerage service					Customer services	Scientific services	Other business activities
	Resources and treatment	Distribution	Water service subtotal	Sewerage treatment	Sewage treatment & disposal	Sludge	Sewage T&D subtotal	Sewerage service subtotal			
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Direct costs:											
Employment costs (restated)	9.3	7.4	16.7	16.6	15.3	7.0	22.3	38.9	9.7	5.1	2.0
Power	6.7	6.2	12.9	1.8	8.2	2.3	10.5	12.3	–	0.1	–
Hired and contracted services	3.9	11.7	15.6	6.0	11.3	13.3	24.6	30.6	8.6	1.9	1.1
Materials and consumables	3.9	1.0	4.9	1.6	4.1	7.3	11.4	13.0	0.8	0.6	–
Service charges	7.7	–	7.7	1.0	5.1	–	5.1	6.1	–	–	–
Bulk supply imports	1.2	–	1.2	–	–	–	–	–	–	–	–
Other direct costs	0.2	0.3	0.5	0.4	0.9	0.3	1.2	1.6	4.8	0.2	1.6
Total direct costs	32.9	26.6	59.5	27.4	44.9	30.2	75.1	102.5	23.9	7.9	4.7
General and support expenditure	10.7	7.6	18.3	7.1	12.0	7.4	19.4	26.5	3.4	0.9	0.8
Functional expenditure	43.6	34.2	77.8	34.5	56.9	37.6	94.5	129.0	27.3	8.8	5.5
Total business activities			19.7					21.9			
Rates			16.5					14.1			
Doubtful debts			5.6					8.1			
Total less third party services			119.6					173.1			
Third party services			4.1					0.8			
Total operating costs			123.7					173.9			
Capital costs:											
Infrastructure renewals expenditure	0.1	19.2	19.3	17.7	–	–	–	17.7			
Movement in infrastructure renewal accrual/prepayment	–	(5.2)	(5.2)	(4.8)	–	–	–	(4.8)			
Depreciation [†] (allocated)	48.5	18.2	66.7	25.1	106.6	9.6	116.2	141.3			
Amortisation of deferred credits			(1.9)					(3.6)			
Business activities depreciation [†] (non-allocated)			5.9					8.8			
Capital maintenance excluding third party services			84.8					159.4			
Third party services – capital maintenance			3.2					0.9			
Total capital maintenance			88.0					160.3			
Total operating costs⁽¹⁾			211.7					334.2			
Current cost accounting (modern equivalent asset) values											
Service activities	1,191.2	4,782.5	5,973.7	12,602.9	1,664.0	94.4	1,758.4	14,361.3			
Business activities			9.8					14.9			
Service totals			5,983.5					14,376.2			
Service assets for third parties			64.2					11.9			
Total modern equivalent asset values			6,047.7					14,388.1			

† On a current cost basis.

(1) Included within total operating costs are reactive and planned maintenance expenditure on infrastructure assets of £12.9 million. This is split £8.4 million water distribution and £4.5 million sewerage.

5 Fixed assets

	Specialised operational assets £m	Non- specialised operational properties £m	Infra- structure assets £m	Other tangible assets £m	Total £m
(a) Fixed assets by type – water service					
Gross replacement cost					
At 1 April 2005	1,639.8	10.8	5,251.0	199.1	7,100.7
RPI adjustment	38.7	0.3	124.0	4.7	167.7
Disposals	(1.4)	–	–	(1.2)	(2.6)
Additions	53.6	0.2	31.5	19.0	104.3
At 31 March 2006	1,730.7	11.3	5,406.5	221.6	7,370.1
Depreciation					
At 1 April 2005	864.4	2.6	–	186.0	1,053.0
RPI adjustment	20.4	0.1	–	4.4	24.9
Disposals	(0.2)	–	–	(1.1)	(1.3)
Charge for the year	57.6	0.2	–	16.6	74.4
At 31 March 2006	942.2	2.9	–	205.9	1,151.0
Net book amount at 31 March 2006	788.5	8.4	5,406.5	15.7	6,219.1
Net book amount at 31 March 2005	775.4	8.2	5,251.0	13.1	6,047.7
(b) Fixed assets by type – sewerage service					
Gross replacement cost					
At 1 April 2005	4,693.8	12.9	12,044.4	262.1	17,013.2
RPI adjustment	110.9	0.3	284.5	6.2	401.9
Disposals	(0.4)	–	–	(1.7)	(2.1)
Additions	85.1	0.3	30.6	28.5	144.5
At 31 March 2006	4,889.4	13.5	12,359.5	295.1	17,557.5
Depreciation					
At 1 April 2005	2,366.6	3.0	–	255.5	2,625.1
RPI adjustment	55.9	0.1	–	6.0	62.0
Disposals	–	–	–	(1.7)	(1.7)
Charge for the year	126.2	0.1	–	27.4	153.7
At 31 March 2006	2,548.7	3.2	–	287.2	2,839.1
Net book amount at 31 March 2006	2,340.7	10.3	12,359.5	7.9	14,718.4
Net book amount at 31 March 2005	2,327.2	9.9	12,044.4	6.6	14,388.1
(c) Fixed assets by type – total					
Gross replacement cost					
At 1 April 2005	6,333.6	23.7	17,295.4	461.2	24,113.9
RPI adjustment	149.6	0.6	408.5	10.9	569.6
Disposals	(1.8)	–	–	(2.9)	(4.7)
Additions	138.7	0.5	62.1	47.5	248.8
At 31 March 2006	6,620.1	24.8	17,766.0	516.7	24,927.6
Depreciation					
At 1 April 2005	3,231.0	5.6	–	441.5	3,678.1
RPI adjustment	76.3	0.2	–	10.4	86.9
Disposals	(0.2)	–	–	(2.8)	(3.0)
Charge for the year	183.8	0.3	–	44.0	228.1
At 31 March 2006	3,490.9	6.1	–	493.1	3,990.1
Net book amount at 31 March 2006	3,129.2	18.7	17,766.0	23.6	20,937.5
Net book amount at 31 March 2005	3,102.6	18.1	17,295.4	19.7	20,435.8

notes to the current cost financial statements **continued**

- (d) In the preparation of its statutory financial statements, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as required by FRS 15 Tangible fixed assets. However, for the purposes of the regulatory financial statements, the Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the tangible fixed assets shown in the statutory financial statements is set out below:

Infrastructure
assets
£m

Cost

At 31 March 2006 per regulatory financial statements	17,766.0
Adjustment to opening balance at 31 March	(15,378.2)
Infrastructure renewals expenditure capitalised in the year	43.2
At 31 March 2006 per statutory financial statements	<u>2,431.0</u>

Grants and contributions

At 31 March 2006 per regulatory financial statements	–
Adjustment to opening balance at 31 March	(188.9)
At 31 March 2006 per statutory financial statements	<u>(188.9)</u>

Depreciation

At 31 March 2006 per regulatory financial statements	–
Adjustment to opening balance at 31 March	(484.3)
Depreciation charge for infrastructure renewal expenditure	(50.8)
At 31 March 2006 per statutory financial statements	<u>(535.1)</u>

Net book value

At 31 March 2006 per regulatory financial statements	17,766.0
Adjustment to opening balance at 31 March	(16,051.4)
Infrastructure renewals expenditure capitalised in the year	43.2
Depreciation charge for infrastructure renewal expenditure	(50.8)
At 31 March 2006 per statutory financial statements	<u>1,707.0</u>

Working capital

At 31 March 2006 per regulatory financial statements	36.3
Less infrastructure renewals prepayment	(36.3)
At 31 March 2006 per statutory financial statements	<u>–</u>

6 Working capital

	2006 £m	2005 £m
Cash	500.5	418.3
Stocks	10.6	6.9
Trade debtors	119.1	75.4
Trade creditors	(56.3)	(62.1)
Short-term capital creditors	(49.8)	(25.3)
Infrastructure renewals prepayment	36.3	44.1
Other trade accruals	(183.3)	(179.5)
Corporation tax	(39.9)	(24.5)
Payroll related taxes and social security contributions	(3.4)	(3.2)
Group trade (creditor)/debtor	(40.1)	463.6
Prepayments	32.3	43.2
Total working capital	326.0	756.9

Amounts received in advance from unmeasured customers have been reclassified in the current year from trade debtors to other trade accruals. If the reclassification was adjusted in the 2005 results debtors and other trade accruals would increase by £33.5 million.

7 Current cost profit and loss account

	2006 £m	2005 restated £m
At beginning of the year as previously reported	173.2	182.3
Prior year adjustment	(67.4)	(93.8)
At beginning of year restated	105.8	88.5
Retained (loss)/profit for the year	(85.8)	4.5
	20.0	93.0
Actuarial gains recognised in pension scheme	88.0	18.4
Movement on deferred tax relating to pension liability	(26.5)	(5.6)
Deferred tax on share based payments	3.8	–
At end of year	85.3	105.8

8 Current cost reserve

	2006 £m	2005 £m
At beginning of year	16,634.1	15,491.6
AMP adjustment (a)	–	592.7
RPI adjustments:		
Fixed assets	482.7	632.7
Working capital	17.9	13.2
Financing	(69.5)	(76.6)
Deferred grants and contributions	(15.4)	(19.5)
At end of year	17,049.8	16,634.1

- (a) In accordance with the company's accounting policy, current cost gross asset values and cumulative depreciation were reassessed at 31 March 2004 as part of the periodic review process. In accordance with the RD08/05 letter published by Ofwat the revised amounts were reflected in the regulatory accounts in 2005.

notes to the current cost financial statements **continued**

9 (a) Reconciliation of current cost operating profit to net cash inflow from operating activities for the appointed business

	2006 £m	2005 £m
Current cost operating profit	257.6	231.1
Working capital adjustment	17.9	13.2
Increase in stocks	(3.7)	(0.3)
Current cost depreciation	228.1	226.7
Current cost profit on sale of fixed assets	(0.3)	(0.6)
(Increase) / decrease in debtors and prepaid expenses	(21.0)	44.0
Increase / (decrease) in creditors and accrued expenses	13.5	(1.5)
Provision for Infrastructure renewals	51.0	27.0
Net movement in provisions	(9.5)	(2.6)
Amortisation of deferred grants and contributions	(8.2)	(5.5)
Net cash flow from operating activities	525.4	531.5

9 (b) Analysis of net debt

	1 April 2005 £m	Cash flows £m	Non-cash movements £m	31 March 2006 £m
Cash	44.2	(4.9)	–	39.3
Deposits and investments	374.1	87.1	–	461.2
Finance leases due within one year	(20.5)	20.5	(23.9)	(23.9)
Finance leases due after one year	(116.3)	–	23.8	(92.5)
Other debt due within one year	(67.6)	67.6	(178.5)	(178.5)
Other debt due after one year	(4,134.8)	223.6	167.3	(3,743.9)
	(3,920.9)	393.9	(11.3)	(3,538.3)

Cash held by Anglian Water Services Financing Plc of £398.3 million at 31 March 2005 was used to repay debt in the year ended 31 March 2006.

Non-cash movements comprise indexation of index linked loan stock, indexation of Retail Price Index (RPI) swaps, transfers between categories of debt, repayments made by Anglian Water Services Financing Plc, amortisation of discounts and expenses relating to debt issue costs and amortisation of 'mark to market' adjustments.

supplementary regulatory information incorporating the performance review

1 Regulatory capital value (RCV)

	2006 £m
Opening RCV for the year	4,490.5
Capital expenditure	254.9
Infrastructure renewals expenditure	52.2
Grant and contributions	(15.4)
Depreciation	(204.7)
Infrastructure renewals charge	(47.1)
Outperformance of regulatory assumptions (5 years in arrears)	(29.7)
Closing RCV for the year	4,500.7
Average RCV	4,452.0

RCV figures are extracted from those published by the Ofwat on 22 April 2005 in their RD07/05 letter at 2004/05 prices. These have been indexed upwards to 2005/06 prices using an RPI factor of 195.0 / 190.5 (RPI at 31 March 2006 / RPI at 31 March 2005) to give the current year figures in the table excluding average RCV. The average RCV is derived by indexing the average RCV published in RD07/05 by the RPI factor of 193.1 / 188.2 (average RPI for the year ended 31 March 2006 / average RPI for the year ended 31 March 2005).

2 Current cost profit and loss account for the appointed business

	2006 £m	2005 restated £m	2004 £m	2003 £m	2002 £m
Turnover	856.7	810.2	802.7	782.5	797.2
Operating costs	(581.5)	(560.1)	(545.5)	(564.6)	(555.3)
Operating income	0.3	0.6	0.3	0.3	2.0
Working capital adjustment	(17.9)	(13.5)	(3.4)	(9.7)	1.4
Current cost operating profit*	257.6	237.2	254.1	208.5	245.3
Other income	–	–	–	0.1	1.2
Interest payable (net)	(62.5)	(65.7)	(55.2)	(115.8)	(114.0)
Financing adjustment	69.5	78.6	54.2	69.0	24.3
Current cost profit attributable to shareholders	264.6	250.1	253.1	161.8	156.8
Taxation – current	(22.6)	(0.9)	24.5	(38.9)	31.8
Taxation – deferred	(26.6)	(7.9)	12.0	(21.6)	–
Dividends	215.4	241.3	289.6	101.3	188.6
Current cost (loss) / profit retained	(85.8)	4.6	27.5	659.3	188.6

* After historical exceptional charges in 2003 (£20.3 million) and 2002 (£31.6 million).

The comparative for 2005 has been restated for the adoption of FRS 17, FRS 20 and FRS 21 as disclosed in note 1(a) to the statutory accounts on page 14.

supplementary regulatory information incorporating the performance review **continued**

2 Current cost balance sheet for the appointed business

	2006	2005 restated	2004	2003	2002
	£m	£m	£m	£m	£m
Assets employed					
Fixed assets	20,937.5	20,918.5	20,261.6	20,232.6	20,212.5
Third party contributions since 31 March 1990	(682.5)	(665.6)	(643.6)	(630.4)	(619.1)
Working capital	326.0	774.8	434.4	132.1	321.6
Net operating assets	20,581.0	21,027.7	20,052.4	19,734.3	19,915.0
Cash and investments	1,609.2	1,647.2	1,700.0	1,744.4	0.2
Non-trade debtors	18.2	8.4	72.4	55.6	45.8
Dividends payable	–	–	(58.3)	(163.3)	(878.3)
Other non-trade creditors due within one year	(202.4)	(90.2)	(23.2)	(29.7)	(287.2)
Creditors due after one year	(3,836.4)	(4,351.5)	(4,120.4)	(3,727.5)	(1,916.1)
Provisions for liabilities and charges	(174.5)	(226.0)	(157.4)	(177.8)	(127.5)
Net assets employed	17,995.1	18,015.6	17,465.5	17,436.0	16,751.9
Financed by					
Called up share capital	860.0	880.3	908.5	932.2	961.0
Profit and loss account	85.3	108.3	192.6	169.5	(502.4)
Current cost reserves	17,049.8	17,027.0	16,364.4	16,334.3	16,293.3
Total capital and reserves	17,995.1	18,015.6	17,465.5	17,436.0	16,751.9
Exceptional charge	–	–	–	20.2	29.9

The financial information set out above for the four years ended 31 March 2005 is based on the audited current cost financial statements for those years, as adjusted to 2005/06 prices for changes in the Retail Price Index (RPI).

On 1 April 2002 the company acquired part of the business and certain assets and liabilities of Geodesys Limited. The trading results and balance sheet figures for the years ending 31 March 2006, 31 March 2005, 31 March 2004 and 31 March 2003 reflect this acquisition and are therefore not strictly comparable to previous years.

The comparative for 2005 has been restated for the adoption of FRS 17, FRS 20 and FRS 21 as disclosed in note 1(a) to the statutory accounts on page 14.

current cost five-year performance review

This review relates to the five-year profit and loss accounts and balance sheets on pages 59 and 60 prepared using current cost accounting principles and should be read in conjunction with the performance review on pages 1 to 5 of this document. The prior year figures are those reported in the regulatory accounts for that particular year and inflated to a common price base with figures reported in the current year. This is done by multiplying the prior year numbers by the Retail Price Index (RPI) at 31 March 2006 and dividing by the RPI at 31 March in the relevant prior year. All figures are therefore presented at a March 2006 price base.

Current cost operating costs comprise the operating costs of the appointed business plus current cost depreciation and the infrastructure renewals charge. The operating costs increased by £21.4 million between 2005 and 2006 principally due to additional cost pressures as described on page 1.

A commentary on the movements between 2005 and 2006 (not discussed on pages 1 to 5) is included below.

- (a) The working capital adjustment arises through the indexation of the 2005 balance sheet working capital by the RPI movement in the current year. This results in a credit to the balance sheet and an offsetting debit to the profit and loss of £17.9 million in the current year.
- (b) The financing adjustment was £69.5 million compared to £78.6 million in 2005 due to the indexation of the 2005 balance sheet net assets employed less net operating assets. Net assets employed are lower than net operating assets as net assets include the impact of long-term debt and dividends payable. This results in a credit balance sheet movement and an offsetting debit profit and loss account movement in the current year.
- (c) The decrease in working capital in the balance sheet of £448.8 million between 2005 and 2006 is due primarily to a debtor with AWSF of £400 million in the books of the company at the previous year end. This amount has now been repaid.

Over the five-year period the major notable movements are as follows:

- (i) From 2002 to 2003 there was a reduction in turnover of £14.7 million. This was due to the allowable K increase of 2.2 per cent being offset by negative consumption movements and refinements to the accrual consumption calculation. From 2003 to 2004 there was an increase of £20.2 million due to an allowable K of 2.5 per cent and £8 million of additional turnover generated as a result of additional demand from metered customers during the exceptionally dry summer of 2003. From 2004 to 2005 there was an allowable K increase of 2.5 offset by the higher opening base in 2004 due to the one-off dry summer impact. The movement between 2005 and 2006 is explained on page 1.
- (ii) Current cost operating costs comprise four elements, operating costs (excluding depreciation), current cost depreciation, the infrastructure renewals charge (IRC) and the amortisation of deferred grants and contributions. Over the five-year period, operating costs (excluding depreciation) started in 2002 at £324.3 million (in March 2006 prices) and ended at £310.6 million. The reduction is due to the 2002 costs including redundancy costs of £31.6 million offset by cost pressures and changes in the accounting treatment of pension costs with the introduction of FRS 17 (see note 1 (a) on page 14). Current cost depreciation increased over the five-year period from £207.5 million in 2002 to £228.1 million in 2006. This is in line with the historic cost depreciation (as adjusted for price inflation). The IRC also increased from £30.2 million in 2002 to £51.0 million in 2006. This is due to the increase in allowable capital maintenance for AMP 4 (see glossary of terms on page 64). There was also a small increase in deferred grants and contributions from £6.7 million in 2002 to £8.2 million in 2006.
- (iii) The interest charge shows a reduction in 2004 compared to 2003. This is due to an increase in underlying interest costs due to the full year effect of the financial restructuring completed in 2003 offset by the increased interest receivable relating to an inter-company loan with Anglian Water Services Holdings Limited. This loan was also put in place at the time of restructuring (see note 11 on page 22). The increase between 2004 and 2005 reflects the impact of additional borrowings made in 2005. The increase from 2005 to 2006 is discussed on page 1.
- (iv) In the 2002 tax charge there was a credit of £30.1 million due to accrual releases following the settlement of prior year tax assessments plus a negative deferred tax charge due to movements in discount rates. In 2003 there was a charge of £38.9 million on current tax, which was predominantly due to charging tax on the interest receivable of £140.6 million (discussed above). In 2004, following agreement that the company will not pay for the losses surrendered to it by Anglian Water Services Holdings Limited, most of this charge was reversed which gave rise to a credit. The 2005 charge reflected a more normal level of tax. The increase from 2005 to 2006 is discussed on page 1.

* Ofwat defines K as the amount by which a company can increase, or must decrease, its average charge above or below inflation each year to finance its services and meet its legal obligations. When inflation is included, this is commonly referred to as the 'price limit'.

independent auditors' report

TO THE WATER SERVICES REGULATION AUTHORITY AND THE DIRECTORS OF ANGLIAN WATER SERVICES LIMITED

We have audited the Regulatory Accounts of Anglian Water Services Limited (the Company) which comprise:

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account and the regulatory historical cost balance sheet; and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes including the statement of accounting policies.

This report is made, on terms that have been agreed, solely to the Company and the Water Services Regulation Authority (the WSRA) in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991 (the Regulatory Licence). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

basis of preparation

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

The Regulatory Accounts are separate from the statutory financial statements of the Company. There are differences between United Kingdom Generally Accepted Accounting Practice (UK GAAP) and the basis of preparation of information provided in the Regulatory Accounts as the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

respective responsibilities of the WSRA, the Directors and Auditors

The nature, form and content of Regulatory Accounts are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no assessment.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of Directors' responsibilities for regulatory information on page 40.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing issued by the Auditing Practices Board, except as stated in the 'basis of audit opinion', below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 48 to 58 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the notes on regulatory information, the additional information required by the Company's Regulatory Licence and the supplementary regulatory information incorporating the performance review.

basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our 'Statutory' audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 42 and 43 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on page 56.

opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2006 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 51 and 52, the state of the Company's affairs at 31 March 2006 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

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

- (a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument.
- (b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA.
- (c) the regulatory historical cost accounting statements on pages 42 to 43 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA.
- (d) the regulatory current cost accounting statements on pages 48 to 58 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
Birmingham
30 May 2006

1. The maintenance and integrity of the Company web site is the responsibility of the Directors and the maintenance and integrity of the Regulator's web site is the responsibility of the WSRA; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions.

glossary of regulatory terms

AMP adjustment – The revision in the real value of fixed assets arising periodically from improved information notably in the five-year Asset Management Plan process.

Appointed business – The appointed business comprises the regulated activities of the company which are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading – Arm's-length trading is where the company treats the associate companies on the same basis as external third parties.

Asset Management Plan (AMP) – A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP3 covered the investment period April 2000 to March 2005. AMP4 covers the investment period April 2005 to March 2010.

Associate company – Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the company and its associated companies to be disclosed subject to specified materiality considerations.

Final determination – This is the conclusion of discussions on the scale and content of the asset management plan for the forthcoming 5 year period. It is accompanied by a determination of the allowable k factor for the forthcoming 5 year period.

Financing adjustment – The impact of general inflation (RPI) on the real value of net finance for the business.

K factor – The annual increase, set by Ofwat, in charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula $RPI + \text{or} - 'K' + 'U'$. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers and 'U' is the amount of 'K' not taken up by a company in previous years.

Licence – the Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Anglian Water Services Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Modern Equivalent Asset (MEA) – The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing, or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up to date new asset with the same service capability allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset, and is stated gross of third party contributions.

Non-appointed business – The non-appointed business activities of the company are activities for which the company as a water and sewerage undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the company (for example, the use of underground assets for cable television).

Ofwat – The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic regulator of the water industry.

Periodic Review – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits an Asset Management Plan covering the five-year period for which Ofwat will determine prices (the K factor – see above).

Price limit – This is the name given to the combination of the Retail Price Index (RPI), 'K' and 'U'.

Regulatory Accounting Guidelines (RAG) – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Retail Price Index (RPI) – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of good and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Regulatory Capital Value (RCV) – The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (ie after current cost depreciation and infrastructure renewals accrual).

Third party contributions since 1989/90 – Grants and third party contributions received in respect of infrastructure assets and any deferred income relating to grants and third party contributions for non-infrastructure assets.

Working capital – The aggregate of stocks, trade debtors, trade creditors and working cash balances, if material.

Working capital adjustment – The impact of general inflation (RPI) on the real value of working capital to the business.

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