

Registered Number: 2366682

YORKSHIRE WATER SERVICES LIMITED

ANNUAL REPORT AND ACCOUNTS 2008

For the year ended
31 March 2008

ANNUAL REPORT AND ACCOUNTS 2008

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Business Review

MANAGING DIRECTOR'S REVIEW

Yorkshire Water has delivered another strong financial, operating and customer service performance in a year in which our business changed ownership and the Yorkshire region faced its worst storms and flooding for over 150 years.

Over two months of rainfall fell in 24 hours, resulting in widespread river and surface water flooding across South and East Yorkshire. In the city of Hull, drainage systems were overwhelmed by the intensity and duration of the rain itself.

The June 2007 storms had a significant impact on Yorkshire Water's assets and operations with over 30 waste water treatment works and more than 100 pumping stations flooded. It is a great tribute to the professionalism and dedication of our people and service partners that we were able to respond quickly to reinstate our assets and that drinking water supplies were maintained throughout the events.

In February 2008 the ownership of our business changed, with the acquisition of our parent Kelda Group plc by Saltaire Water, a consortium of global infrastructure investment companies.

Under the circumstances we are therefore pleased to have delivered a capital programme of £378m on time and within budget. We have also maintained a strong customer service and environmental performance and remain on target to out-perform our regulatory contract during the current investment period.

Financial performance and efficiency remained satisfactory during the year, despite the impact of the floods and operating cost pressures. Turnover rose by 6.0% as a result of tariff increases and operating profit before exceptional costs increased by 8.1% to £349.2m.

Stretching efficiency targets ensured that operating costs for the year were £6.5m below the expectations of our regulator Ofwat, helping to offset the impact of rising energy costs and depreciation. For 2007/08, Yorkshire Water was again awarded four 'A' ratings by Ofwat, for the efficient way we run our water and waste water operations.

We have decided to invest an additional £33.7m in schemes which directly benefit customers in Yorkshire. The new investment will be used to bring forward a number of critical service enhancements, including new water mains to extend the 'Yorkshire grid' to Scarborough, providing improved security of drinking water supply.

We are also investing over £20m to upgrade and improve our pumping and sewerage infrastructure in Hull, which came under close scrutiny and criticism following the extreme rainfall and flooding there during June 2007.

We believe that this major new investment demonstrates the commitment of Yorkshire Water's new owners to improve Yorkshire's water and sewerage infrastructure and provide customers with an improved, value for money service.

A good overall customer service performance was also maintained during the year. We achieved our leakage target for the tenth year running and the Drinking Water Inspectorate (DWI) announced that the quality of Yorkshire's tap water remains high with a compliance level of 99.967%.

We were ranked second in Ofwat's annual Overall Performance Assessment for 2006/07 and customer satisfaction remains stable at 86%, despite the storms. A report released by

Business Review

the Consumer Council for Water during the year showed that Yorkshire Water has the lowest number of complaints per 10,000 customers in the UK water industry.

The summer flooding of course had a major impact on a number of customer service measures, with an increase in the number of properties at risk of sewer flooding and over 10,628 customer contacts in the month of June, compared to a monthly average of 2,100. The business also managed intense stakeholder and media interest around June's flooding and engaged fully in both national and regional flooding reviews.

On environmental measures, we completed a number of major capital schemes at our waste water treatment works to improve the quality of Yorkshire's rivers as part of the Freshwater Fish Directive and whilst our aim is zero pollution incidents, we also saw a dramatic reduction in Category 1 and 2 pollution incidents from 17 in 2006/07 to only 3 in 2007/08.

We also remain committed to making a difference in society and were pleased to maintain our position as one of the UK's top 50 companies for good corporate responsibility by creating new opportunities for volunteering and delighting visitors to our reservoirs.

Looking further ahead, Yorkshire Water set out its longer term challenges and priorities in our 25 year 'Strategic Direction Statement' (SDS) published during the year. Over the past 15 years, we have invested around £6.3bn in Yorkshire, which has provided significant social, economic and environmental benefits.

It is important that we continue to invest to improve our infrastructure to maintain the same high level of service which customers have come to expect and to make further in-roads into reducing leakage and eliminating the risk of sewer flooding.

This will require substantial additional capital investment and our priority is to ensure that the impact on customer bills is no higher than absolutely necessary to fund the programme from 2010. Our new owners will ensure that Yorkshire Water is as financially efficient as possible in order to finance the investment programme but our regulator Ofwat also plays a critical role by setting an appropriate cost of capital.

There are significant challenges ahead, not least understanding the impact that climate change is likely to have on our operations and any changes in the regulatory regime which may be brought about by increased competition.

Only by working in partnership with our regulators and other stakeholders will we rise to these challenges and strike the right balance for all. Under strong new ownership and through our continued focus on efficiency and innovation, we are confident we will maintain the momentum we have generated over recent years.

Kevin Whiteman
Managing Director, Yorkshire Water

Business Review

OUR BUSINESS

Yorkshire Water Services Ltd (Yorkshire Water) is the principal UK subsidiary of Kelda Group Ltd, formerly Kelda Group plc (Kelda), providing water and waste water services to more than 4.8m people and 130,000 businesses.

Every day the company supplies more than 1.3bn litres of water to homes and businesses in Yorkshire. Through the efficient operation of its extensive waste water network and treatment facilities, it also ensures that the region's domestic and industrial waste is returned safely to the environment.

BUSINESS STRATEGY

Our strategy is to be clearly the best water company in the UK and to focus on striking the right balance between service, compliance, value, people, partners and society.

Value

We are committed to creating enduring value by a focus on efficiency in everything we do. Our goal is to deliver consistently good financial results by outperforming regulatory and other financial targets and delivering efficiencies across the company. We will achieve this by sharing best practice across the Kelda group and employing world-class technology.

Our customers

Our aim is to provide a quality of service which is significantly better than any other utility and at a price which represents value for money. To achieve this we will design our service from the outside-in, by considering the customer's point of view and eliminating service failures. This will lead to improved financial and operational performance and an enjoyable customer experience.

Our people

Yorkshire Water employs almost 2,200 people. Our aim is to create a great place to work, with zero accidents, a good work-life balance and the opportunity to make a real difference. We want to attract and retain the best people, with performance and contribution recognised and rewarded and success celebrated as part of our culture.

Environmental leadership

Yorkshire Water deals with environmental issues as diverse as land management, sustainable water management and river and bathing water standards. Our performance affects all customers and everyone who lives in the regions we serve. Our aim is to achieve 100% compliance with legal and regulatory obligations and to go beyond compliance where the benefits exceed the cost.

Society

Our aim is to make a difference to society, opening up land for public enjoyment and promoting the value of water, health and nutrition in schools. Over 30% of colleagues are involved in community volunteering, external leadership roles and in influencing matters relating to water.

Business Review

Service partners

Yorkshire Water has created a new level of partnership, understanding and transparency with its key service providers. Our aim is to achieve a win-win-win, which means better customer service, lower costs and healthy profits for all. To make this happen, we set clear expectations and encourage new ideas and innovation.

OPERATIONAL PERFORMANCE

Our strategy of continuing to focus on what we do best, providing high quality water and waste water services, has enabled us once again to deliver what we believe is sector leading financial and operational performance.

The summer floods of 2007 had a major impact, affecting many areas of the business, but the additional efforts of employees and our service partners enabled us to maintain services to customers and begin to reinstate damaged assets.

Another significant event was the acquisition in February 2008 of Kelda, including Yorkshire Water, by Saltaire Water Ltd, a company owned by a consortium of investment companies comprising Citigroup, GIC, Infracapital and HSBC.

Key performance indicators

	Target	Current year	Previous year
Overall customer satisfaction	100%	86%	85%
Overall drinking water quality	99.975%	99.967%	99.965%
Waste water treatment works compliance	100%	99.51%	99.99%
Accidents			
- major and over 3 day accidents	15	28	35
- all accidents	75	150	180

Explanation of measures provided in Appendix to Business Review on page 12

Value

The company's financial performance is described in detail on page 7.

In line with our aim to be clearly Ofwat's frontier company, we were once again awarded four 'A' ratings for the cost efficient way we run our water and waste water operations. We retained our position as the benchmark company for water operating expenditure and improved our performance by also becoming the benchmark for water capital expenditure.

The summer floods put significant pressure on both operating and capital costs in the year and resulted in a loss in revenue. However our insurance cover ensured that we recovered a substantial proportion of the funds needed to pay for the repairs and reinstate damaged assets.

Due to the continuing pressure of rising energy prices, energy management is increasingly important and we have been proactively driving a major programme of energy efficiency throughout our operations. This has the dual benefit of addressing our commitment to reduce carbon emissions to assist in mitigating the impact of climate change. We have also focused on increasing the amount of renewable energy we generate, with an

Business Review

aspiration of generating 10% of our energy needs in-house by 2010. During 2007/08, three new wind turbines were commissioned at our Loftsome Bridge water treatment works and our waste water treatment works at Saltend, near Hull.

Customer service

For the third year running we have maintained our position in the top two of Ofwat's annual Overall Performance Assessment (OPA). We have now remained consistently in the top four water and sewerage companies over the past six years on this measure - the only company to achieve this.

As part of our Clear Water initiative, Yorkshire Water is driving innovation in customer service. This year has seen the use of platelet technology to repair leaks in a live environment and the installation of a live meter with no excavation or interruption to supply - both industry 'firsts'. These technologies will play a significant role in helping us to achieve our aspiration of zero interruptions to supply. In 2007/08 there was also a significant improvement in unplanned interruptions to supply and a continued downward trend in the number of properties suffering from low water pressure.

Our achievements in service this year have been recognised in the National Customer Service Awards where we won two accolades; the 'Utility Customer Service Team of the Year' and the 'Best Use of Technology in Customer Service' for the innovative use of mobile phone technology to detect problems in water pipes. We have also met the Government's Charter Mark standard for excellence in customer service again.

Customers are clearly benefiting from our focused approach to customer service, as we achieved our best ever score in Ofwat's customer satisfaction survey. Also, in November 2007, the Consumer Council for Water published its annual review of the industry for 2006/07 which showed that we have the lowest number of complaints per 10,000 customers in the industry, at 23 compared with an average of 80.

Environmental performance and compliance

The Drinking Water Inspectorate announced that the quality of Yorkshire's tap water remains high at 99.97% compliance and our leakage reduction programme and investment in specialised monitoring equipment have ensured that we have achieved Ofwat's leakage target for the tenth year running.

Our continued focus on the proactive maintenance and operation of our assets has resulted in a marked improvement in waste water related pollution incidents, with serious incidents reducing from 17 in 2006/07 to 3 in 2007/08. Better use of telemetry and changed operating practices have allowed problems to be identified before they impact on customers or the environment. For example, 68% of combined sewer overflows are now fitted with real time monitoring equipment giving better visibility of asset performance and advanced warning of potential problems.

Despite the unprecedented rainfall in June and July 2007, our waste water treatment works on the East Coast coped well and the majority of the region's bathing waters met the Environment Agency's mandatory standards.

Significant progress continued towards achieving the target set by Natural England for improving the condition of Sites of Special Scientific Interest (SSSIs) on Yorkshire Water land, with 50.9% now in recovering status compared to 10% in 2003.

Business Review

Social impact

It is now three years since the company's society vision was launched, including our clear commitment to supporting and enhancing the society we serve. Our community volunteering initiatives continued to make a real difference to the quality of lives in the region, with over 850 employees and service partners involved in community work during the past year.

Building on the success of our recent 'Cool Schools' campaign which tackled hydration issues, 2007/08 saw the launch of 'One Million Green Fingers', our biggest and most ambitious campaign to date. Yorkshire Water volunteers will create healthy and sustainable allotments and gardens in more than 350 primary schools across our region over the next three years, in line with our aspiration to become a national role model for volunteering.

We promoted awareness of our first land and recreation 'supersite' at the Washburn Valley, near Harrogate, and a survey of visitors showed that 82% were delighted with the improvements made to the facilities and signage.

We maintained platinum status in the Business in the Community's 'Top 100 Companies that Count 2007' report, published in partnership with the Sunday Times. This is the third year running that we have achieved the highest accolade for our overall impact on society, consistently scoring more than 95% against a range of social, ethical and environmental criteria.

Employees

It is testimony to the professionalism and dedication of our employees that we continued to maintain industry leading levels of service throughout 2007/08 despite the operational challenges posed by the floods.

As part of our ongoing drive to be clearly the best, the restructuring of two key parts of the business took place in 2007/08. The business unit dealing with waste water was renamed the 'Environmental Business' and restructured at the start of the year to bring all customer facing teams into one regional team. At the end of the year, the Water Business was reorganised to give improved focus on attaining the operational improvements and efficiencies identified through our Clear Water initiative.

Our Information Technology department was named as the UK's 'Best Place to Work in IT' by Computer Weekly magazine in recognition both of the positive way in which IT strategy is aligned with the company vision and the commitment to innovation and provision of a stimulating, enjoyable and productive workforce. Our approach to diversity was also recognised by the Personnel Today publication which awarded us its top annual accolade, the award for 'Diversity in the Workplace'.

We continue to develop a culture of 'Think Safety First'. For the fifth consecutive year, we were awarded a Royal Society for the Prevention of Accidents Gold award for health and safety performance which reflects our achievements and approach to seek to continuously improve our health and safety performance although we recognise more needs to be done.

Business Review

Partners

We continue to work with our service partners, including our extended supply chain, to deliver an improved service to customers and develop innovative solutions and processes. We have extended our use of information technology to key partners to share a common platform.

To this end, we have undertaken a series of initiatives to promote innovation in the way we operate and maintain our assets, including integrated research and development activities which have, for example, undertaken trials of a more robust new pump gearbox that uses significantly less energy. In consultation with partners, we have also undertaken a number of initiatives to promote a stronger culture of health and safety issues across the supply chain.

In the aftermath of the summer flooding, our service partners played a significant supporting role in the emergency response and clean up operations. For example, during the first 24 hours, our repair and maintenance partner was required to attend almost 900 incidents, the equivalent of a normal week. Our electrical, maintenance and capital partners were also instrumental in helping to reinstate the assets affected.

FINANCIAL PERFORMANCE

Key financial performance indicators

	2008	2007
Interest cover	2.5x	2.8x
Gearing	71.7%	71.7%
Net debt to Regulatory Capital Value (RCV)	60.4%	60.6%

Explanation of measures provided in Appendix to Business Review on page 12

Turnover increased by 6.0% to £795.5m (2007: £750.2m), compared with an average tariff increase of 7.9%, following the impact on consumption of the summer weather and floods. Operating profit before exceptional costs and income increased by 8.1% to £349.2m (2007: £323.0m).

Total regulated operating costs (before exceptional operating costs) increased by 2.8% to £270.6m, which is below the level of inflation. This achievement is due to the delivery of continued stretching efficiencies and lower electricity consumption and prices than in 2006/07, and has resulted in costs for the year below Ofwat's operating cost targets. However recent fluctuations in the energy market will result in significant increases in energy costs in 2008/09 which the company is seeking to mitigate through various initiatives.

The 2007/08 results include exceptional operating costs of £7.0m, including £4.7m relating to business restructuring. The comparative results for 2006/07 included an exceptional cost of £47.0m relating to a lump sum contribution to reduce the group's then pension deficit. The company continues to account for pensions on a cash contributions basis, adopting the multi-employer exemption under FRS17. An exceptional profit of £17.5m on the disposal of fixed assets relates to insurance proceeds received to reinstate flood damaged assets, the cost of which will appear within capital expenditure as incurred.

Business Review

Regulated capital investment for the year was £377.8m (2007: £362.7m). This is below the level assumed in Ofwat's final determination of prices due to the delivery of efficiencies, the early delivery of outputs and the timing of expenditure on Freshwater Fisheries Directive related schemes. The company's efficiencies, which are over and above the challenging targets set by Ofwat, have been achieved whilst maintaining and improving outputs and customer service.

Net debt increased by £151.9m from £2,412.0m at 31 March 2007 to £2,563.9m at March 2008, with a corresponding increase in interest of £47.6m to £144.6m, which also includes the full year impact of special dividends of £717.0m paid to Kelda in 2006/07. Gearing has remained stable at 71.7% (2007: 71.7%) and net debt to RCV at 60.4% (2007: 60.6%), which is in line with the 55-65% range assumed by Ofwat in the 2004 Final Determination. Interest cover also reduced from 2.8x to 2.5x.

Dividend payments of £112.1m were made in the year (2007: £826.9m, including a special dividend of £717.0m). No final dividend is proposed in respect of 2007/08.

Accounting policies

The company accounts have been prepared in accordance with the accounting policies described in Note 1.

Treasury policy

The company's treasury operations are controlled centrally for the group in accordance with approved board policies, guidelines and procedures. Treasury strategy is designed to manage exposure to fluctuations in interest rates, preclude speculation and to source and structure the group's borrowing requirements.

The group uses a combination of fixed capital, retained profits, long term loans, finance leases and bank facilities to finance its operations. Any funding required is raised by the group treasury department in the name of the appropriate company and supported by guarantees as necessary. Funds raised by the holding company may be lent to the company at commercial rates of interest. Cash surplus to operating requirements is on-lent to the holding company at commercial rates of interest and then invested in short term instruments with institutions having a long term rating of at least A- or A3 and a short term rating of at least A1 or P1 issued by Standard and Poor's and Moody's respectively.

LOOKING FORWARD

Keeping the right balance for all of Yorkshire Water's stakeholders is fundamental to achieving the company's vision of being clearly the best water company in the UK. The company's plans are therefore aligned with making progress in six key areas – service, compliance, value, people, partners and society.

A great customer service

A key aspiration is to develop innovative thinking and employ new technologies to deliver an improved level of operational and customer service. By reducing the number of customer supply interruptions and the invasive nature of repair and maintenance work, the company will deliver better service for lower cost. By March 2009 we aim to have carried out 2,000 repairs using new, non-invasive technology.

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Environmental leadership

Real progress was made in 2007/08 in terms of minimising pollution incidents and enhancing waste water treatment works compliance, which we aim to emulate in 2008/09. Over the next year we are targeting our best ever performance in Ofwat's overall performance assessment, with a focus on eliminating serious pollution incidents altogether.

Setting the pace for value

In 2008/09 the aim remains to outperform key financial targets and to be Ofwat's frontier company for efficiency.

During 2008/09 we will deliver a £369m investment programme, with a further injection of £24m of capital efficiency to help meet the aspirations set out in our 25 year Strategic Direction Statement and Water Resource and Asset Management Plans.

A great place to work

Health and safety will remain a key area of focus for 2008/09 with a continued push on 'Think Safety First' initiatives. We will be taking leadership to the next level with a senior management leadership development programme based around our Clear Leadership framework. There will also be more work on career planning and personal development, embedding a coaching culture amongst line managers.

The bigger team

Successful service partners share Yorkshire Water's philosophy of improved service and lower costs. During 2008/09 there will be further sharing of IT platforms, innovation and accommodation. We will also roll out a new strategy for electrical and mechanical asset maintenance within our Environmental Business Unit to minimise asset and compliance failures.

Making a difference in Yorkshire

In 2008/09 Yorkshire Water volunteers will be creating 100 healthy and sustainable school gardens as part of the company's new One Million Green Fingers campaign.

Work will begin on the company's first ever environmental visitor centre at Esholt, near Bradford. We also plan to officially launch significant improvements to the recreational facilities at Langsett Reservoir in South Yorkshire.

PRINCIPAL RISKS AND UNCERTAINTIES

The company's risk management process aims to be comprehensive, systematic and continuous and based on constant monitoring of business risk. The board is also responsible for the company's internal control and for reviewing its effectiveness.

We classify principal risks in five categories:

- Changes to the regulatory environment
- Changes in legislation
- Climatic changes
- Social influences
- Supplier markets

Business Review

Changes to the regulatory environment

PR09 price review

In December 2007 Yorkshire Water submitted its 25 year Strategic Direction Statement to Ofwat, the first milestone in the 2009 price review process. Companies will submit and publish their draft business plans in August 2008, after which a period of consultation will follow.

Final business plans will be submitted in April 2009, with draft determinations published by Ofwat in July 2009 and final determinations in November 2009. New price limits will take effect in April 2010.

Water industry competition

In February 2008, the Government published its new water strategy for England, 'Future Water'. At the same time it announced an independent review of competition and innovation in the water industry, which is expected to be completed in Spring 2009, to be led by Professor Martin Cave, a former member of the Competition Commission and Ofwat's advisory board.

Review of metering policy

An independent review of water charging was also announced which will cover the role of metering and the potential to introduce mandatory metering in seriously water stressed areas where there is a clear case for doing so. Measures, such as tariffs, to help vulnerable customers would also be covered. Further details are expected to be announced shortly.

Changes in legislation

Water Framework Directive

The Water Framework Directive (WFD) is the most substantial piece of European water legislation to date. It requires all inland and coastal waters to reach 'good' status by 2015. It will do this by establishing a river basin district structure within which demanding environmental objectives will be set, including ecological targets for surface waters. The WFD therefore sets a framework which aims to provide substantial benefits for the long term sustainable management of water.

This new Directive has the potential to drive major additional capital investment and increases in customers' charges.

Climate Change Bill

The Government's Climate Change Bill was introduced in Parliament in November 2007 and completed its passage through the House of Lords on 31 March 2008. It will then go to the House of Commons for consideration before receiving Royal Assent which is planned to happen by summer 2008.

The Bill creates a new approach to managing and responding to climate change by setting ambitious targets, taking powers to achieve them and establishing clear and regular accountability to Parliament.

For the first time, the Government is proposing to set clear and legally binding targets for reducing carbon dioxide emissions. In doing so, the Government is encouraging businesses to make significantly more efficient use of energy and invest more in low carbon fuels and technologies, such as carbon capture and storage, wind, wave and solar power.

Business Review

As some aspects of the water and sewage treatment process can be relatively energy intensive, this legislation has the potential to impact on the company's energy strategies and operating costs.

Climatic changes

The company's core activities, the provision of high quality water and sewerage services, are inextricably linked with the weather and therefore any climate changes have the potential to impact on the business. This was evidenced by the widespread flooding which affected the Yorkshire region and many of the company's assets in Summer 2007.

As the company's resources are a mixture of water captured in reservoirs or abstracted from rivers or underground aquifers, climate change could alter many of the variables in this complex equation.

Social influences

The company is subject to social influences and may be required to change its business practices in light of regulatory changes brought about by stakeholder and consumer pressure.

Public and private sewers

In February 2007, Defra announced that private sewers, which are currently the responsibility of the owners of the properties they serve, are to be transferred into the ownership of the nine statutory water and sewerage companies in England.

This decision follows an extensive review of private sewers which was launched in 2001 in response to concerns raised by householders. A consultation in 2003 revealed a high level of support for the transfer and the Government concluded there was a clear case for action. This will almost double the length of sewers that Yorkshire Water is responsible for maintaining in the future.

In July 2007 the Government launched a second public consultation to seek views on how the transfer should be implemented. Defra is currently examining the issues raised and will make an announcement on the method of transfer before consulting further on regulations to bring any transfer into effect.

Supplier markets

The company is also subject to external market forces, where input prices can sometimes rise beyond the regulatory allowance, for example, the current fluctuation in energy and chemical prices.

Business Review - Appendix

KPI Glossary of Terms

FINANCIAL KEY PERFORMANCE INDICATORS

Interest cover

This measure provides an indication of whether the company's profit is sufficient to cover its interest obligations and is calculated as operating profit divided by net interest payable. These figures are disclosed in the audited accounts in the profit and loss account.

Gearing

This ratio measures the proportion of assets invested in the business that are financed by borrowing and is calculated as net debt as a proportion of net debt plus net assets. These figures are disclosed in the audited accounts in the balance sheet and Note 14 on aggregate borrowings and cash.

Net debt to Regulatory Capital Value (RCV)

The RCV is determined by Ofwat and is the value of the capital base on which a return is allowed for price setting purposes. The values are calculated and published annually by Ofwat. This ratio expresses Yorkshire Water's regulated net debt as a proportion of the RCV, both of which are published in Yorkshire Water's audited regulatory accounts.

NON FINANCIAL KEY PERFORMANCE INDICATORS

Overall customer satisfaction

The company recognises the value of listening to customers in order to deliver improvements that not only meet but surpass expectations. Customer satisfaction is monitored on a regular basis using a combination of random telephone surveys and event-based questionnaires.

Yorkshire Water's tracker research is an ongoing telephone survey involving 900 customers chosen at random each quarter. This monitors customers' general perceptions and the experience that customers receive when they come into contact with the company.

The survey covers a range of issues including satisfaction with the service received and whether the customer agrees that Yorkshire Water is trustworthy, listens to its customers, considers the customer's point of view, deals with complaints quickly and satisfactorily, is enjoyable to deal with, is sensitive to customers' needs and plays key roles in protecting the environment and helping people with the community.

Yorkshire Water also has a separate telephone survey each month to a sample of customers who have telephoned our contact centre. This survey is based upon Ofwat's regulatory customer survey.

Ongoing event-based surveys cover 12 specific areas of customer contacts, namely clean water and waste water repair and maintenance work, customer visits by water and waste water field technicians, meter installations, supply pipe repairs, new supply applications, mains rehabilitation works, waste water capital works and calls to our contact centre about billing and operational matters.

Water quality

The Drinking Water Inspectorate (DWI) regulates public water supplies in England and Wales. It is responsible for assessing the quality of drinking water, taking enforcement action if standards are not being met and appropriate action when water is unfit for human consumption.

Business Review - Appendix

KPI Glossary of Terms

The Government has set legal standards for drinking water in the Water Quality Regulations. Most of these standards come directly from European law and are based on World Health Organisation guidelines. The UK has additional standards to safeguard the already high quality of water in England and Wales. The standards are strict and generally include wide safety margins. They cover:

- Bacteria
- Chemicals such as nitrate and pesticides
- Metals such as lead
- Appearance and taste

The measure we use is for overall drinking water quality which consists of the average mean zonal compliance for 40 different parameters.

Waste Water Treatment Works compliance

The Environment Agency issues consents to allow the discharge of treated water from waste water treatment works. The three principal consented limits are for suspended solids, biochemical oxygen demand and ammonia. A range of other substances may be limited depending on the type of discharge. This indicator shows loads for the following determinands:

- suspended solids, which can blanket the river bed, thereby destroying fish habitat;
- biochemical oxygen demand (BOD), which is a measure of the amount of oxygen consumed in water - usually by organic pollution - and therefore reflects the quality of the water;
- ammonia, which is toxic to fish;
- phosphate, which can lead to eutrophication in fresh waters.

All waste water treatment works are monitored for compliance with their discharge consents and the receiving waters are monitored to assess their compliance with water quality targets. The frequency of monitoring depends on the size of the treatment works; small works are monitored on a quarterly basis and large works are monitored every week.

Reportable and notifiable accidents

The Health and Safety Commission is responsible for health and safety regulation in Great Britain. The Health and Safety Executive and local government are the enforcing authorities who work in support of the Commission.

RIDDOR - or the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR) - places a legal duty on employers to notify and report some work-related accidents, diseases and dangerous occurrences.

These include, for example, deaths, injuries to employees, members of the public or people not at work, some work-related diseases and dangerous occurrences (where no injury results, but could have done).

Directors' Report

For the Year Ended 31 March 2008

The directors present their report and audited accounts for the year ended 31 March 2008.

Principal activities

The directors' report should be read in conjunction with the business review. The principal activities of the company are the supply of clean water and the treatment and disposal of waste water in Yorkshire, for which the company is the appointed water and sewerage undertaker. The majority of the company's operations are regulated by Ofwat (the Water Services Regulation Authority, formerly the Office of Water Services).

Financial results for the year

Profit on ordinary activities was £172.9m (2007: £147.2m).

Share capital

There has been no change during the year to the company's issued share capital of £775m in shares of £1 each fully paid, all of which is held by Kelda.

Business review

A review of the development and performance of the business of the company, including strategy, the financial performance during the year, key performance indicators, forward-looking statements and a description of the principal risks and uncertainties facing the company are set out in the business review on pages 1 to 13.

The purpose of this annual report is to provide information to the company's stakeholders and contains certain forward-looking statements with respect to the operations, performance and financial condition of the company. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this report should be construed as a profit forecast.

Directors

The directors who served during the year, including any changes, are shown below.

John Napier	Chairman
Kevin Whiteman	Managing Director
Richard Ackroyd (resigned 7.3.08)	
Allison Bainbridge	
Richard Flint	
Graham Dixon	
Alan Harrison	
Michael Smith (resigned 31.5.07)	
Julie Allan (appointed 30.7.07)	

Jonathan Hodgkin was appointed as a director on 30 April 2008.

Directors' Report

For the Year Ended 31 March 2008

Non executive directors

Elizabeth Kerry (resigned 30.7.07)
Christopher Fisher (resigned 26.2.08)
Roger Hyde
Stuart Baldwin (appointed 1.3.08)
Martin Havenhand (appointed 1.10.07)
Juan Bejar Ochoa (appointed 1.3.08)
Kathryn Pinnock (appointed 1.3.08)

All the directors held office at 1 April 2007 and throughout the year, except as otherwise stated.

The company has directors' and officers' insurance in place.

Dividends

The total dividend of £112.1m paid to the parent company, Kelda, in the year comprises the following:

	£m
Interim dividend	29.2
Prior year final dividend	<u>82.9</u>
Total dividend for the year	<u>112.1</u>

No final dividend for the year is proposed.

The company's dividend policy is:-

- to deliver real growth in dividends recognising the management of economic risks, the continuing need for investment of profits in the business and to pay additional dividends which reflect efficiency improvement, particularly improvements beyond those assumed in the determination of price limits;
- to pay dividends in respect of the non-appointed business reflecting the profitability of those activities; and
- where it is foreseeable that the company will have sufficient profits available for distribution, to continue to pay annual dividends consistent with this policy, the company can also pay special dividends as part of any capital reorganisation which the board concludes to be in the best interests of the company and complies with its obligations under its licence.

The directors believe that the dividends paid in the year are in accordance with these principles.

Reserves

An amount of £172.9m has been transferred to reserves, bringing the balance held in reserve to £235.3m (after dividends in the year of £112.1m).

Directors' Report

For the Year Ended 31 March 2008

Research and development

The company undertakes a major programme of research in pursuit of improvements in service and operating efficiency. In 2007/08, £4.4m was committed to research and development including £3.6m on fixed assets.

Fixed assets

The directors are aware that the value of certain land and buildings in the balance sheet may not be representative of their market value. However, a substantial proportion of land and buildings comprises specialised operational properties and structures for which there is no ready market and it is not therefore practicable to provide a full valuation.

Movements in fixed assets are shown in Note 9 to the accounts and include transfers to KeyLand Developments Limited, a fellow subsidiary of Kelda, all of which have been made on the basis of independent external valuations obtained specifically for the purpose and approved by Ofwat. With effect from 1 April 1996, only those transfers with a value of over £500,000 have been subject to approval by Ofwat.

Capital and infrastructure renewals expenditure

Total expenditure on regulated activities during the year amounted to £377.8m (2007: £362.7m). This excludes expenditure on non-regulated activities of £0.1m.

Payment of suppliers

The company's policy on the payment of suppliers is to ensure that all payments are made in accordance with the terms and conditions agreed with suppliers. For construction contracts, payment terms are covered by the appropriate Conditions of Contract, such as NEC Form of Contract, ICE 6th Edition and Model Form of Conditions of Contract for Process Plants (IchemEng).

The payment day ratio (the figure, expressed in days, which bears the same proportion to the number of days in the year as the amount owed to trade creditors at the year end bears to the amounts invoiced by suppliers during the year) is 31 days (2007: 39 days).

Instrument of Appointment

Condition F of the company's Instrument of Appointment as a water and sewerage undertaker requires the company to publish regulatory accounting information in a prescribed format in addition to that required for the statutory accounts. This additional information is included on pages 45 to 73. These statements can be downloaded from the company's website at yorkshirewater.com.

Directors' Report

For the Year Ended 31 March 2008

Employees and employment policies

The company strives to create a positive working environment for all colleagues and places great emphasis on open two-way communications. It values involvement at all levels, recognising that everyone in the business is a potential source of innovation and change. Internal consultation and communication processes provide the key to this involvement and play a major part in achieving our vision to be a great place to work.

The company promotes freedom of association, principally through its diversity strategy and through its information and consultation framework. In addition to collective bargaining arrangements with its recognised trade unions, consultative forums take place across the company, comprising elected (union and non-union) who meet regularly with directors and senior managers.

The company communications strategy is based on a 'face to face' first approach and all messages are delivered through 'two way' channels, including regular 'Talk Back' sessions with senior management. The company magazine 'Connections' is distributed throughout the business and aims to provide business news through the eyes of the company's employees.

Regular employee satisfaction surveys are undertaken throughout the group, using a variety of survey tools including telephone-based, online and paper-based surveys.

A 'total reward' approach is taken to salary and benefits which are designed to be competitive. Performance related pay gives colleagues at all levels the opportunity to share in the success of the business, through quarterly or annual bonus payments linked to the achievement of business plan targets.

The company's equality and diversity, 'open to all', policy covers gender, marital status, parental status, sexual orientation, race, colour, ethnic or national origin, disability, age, religion or belief and trade union membership. During the year the company completed a diversity recruitment project and held a successful diversity conference for colleagues and external partners. The company's diversity work was recognised with Yorkshire Water receiving the Personnel Today award for Diversity in the Workplace. Also in 2007 the company's business-focused approach to diversity featured as a case study on a website created by the London Development Agency for businesses in their region. We have an active approach to keeping employees who become disabled in employment and our commitment to equal opportunities for less able job applicants has been recognised with the 'double tick' accreditation from the UK Employment Service.

The company provides a wide range of development opportunities, including in-house and accredited programmes to help employees develop the necessary skills, knowledge, values and experience to realise their performance potential.

Health and safety

The company is committed to achieving high health and safety standards throughout the business. The management of health and safety issues operates in the context of the health and safety policy adopted by the board and the system of internal control.

The group has established a framework of policy procedural requirements by which all subsidiaries must have in place appropriate health and safety policies and procedures and provide necessary information, instruction, training and supervision. In addition, the

Directors' Report

For the Year Ended 31 March 2008

company provides occupational health, safety and welfare advisory services for employees.

Specific health and safety goals are also set by the business. These goals include a combination of reduction in accidents and working time lost as a result of accidents, training delivery, internal safety audits and health promotion and surveillance programmes.

Senior management awareness and active employee involvement in health and safety is fundamental to company success. The 'Think Safety First' programme launched in 2006 included projects for sharing personal accident experiences, promoting key safety messages, managers leading by example, rewarding and recognising colleagues and implementing a behavioural safety coaching process. We have seen raised safety awareness, a 20% reduction in reported accidents and reduced sickness absence since the programme was launched.

Consultation with all employees via health and safety forum groups and safety committees is actively encouraged. Where possible, the intent is for local health and safety issues to be discussed and resolved with line management. In Yorkshire Water there are health and safety champions who work alongside the Trade Union safety representatives and line management. This ensures that health and safety issues are regularly discussed within each team in the Water and Environmental business units.

The company places significant emphasis on both accident prevention and health promotion. Yorkshire Water has again been awarded a National Safety Award from the British Safety Council and a Gold Award for Occupational Safety from the Royal Society for the Prevention of Accidents for its health and safety performance during 2007/08.

Environment and community

The environmental policy of the company recognises that a sustainable water and waste water business is dependent on environmentally sustainable operations. It is therefore committed to integrating environmental best practice and continuous improvement in environmental performance through the efficient, effective and proper conduct of its business.

Environmental performance is reported through the company's web based environment and community report which is regularly updated and independently verified. This can be viewed at www.keldagroup.com/kel/csr/ourenv/oehighlights.

The company contributes actively to the communities which it serves. It encourages and supports colleagues in volunteering, charitable giving and community involvement. One in three employees is active in a wide range of supported community activities. These include a Speakers' Panel and support to local education ranging from 'right to read' in junior schools through to coaching at senior schools and mentoring university students from diverse ethnic backgrounds.

Going concern

After making enquiries, the directors have a reasonable expectation, given the nature of the regulated water services business, that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Directors' Report

For the Year Ended 31 March 2008

Directors' statement as to disclosure of information to auditors

As at the date of this report, as far as each director is aware, there is no relevant audit information of which the company's auditor is unaware and each director has taken steps as he or she should have taken as a director in order to make him or herself aware of any relevant audit information, and to establish that the company's auditor is aware of that information.

Independent auditors

PricewaterhouseCoopers LLP were appointed auditors during the year and have indicated their willingness to continue in office. A resolution concerning their reappointment will be proposed at the Annual General Meeting.

BY ORDER OF THE BOARD

STUART D McFARLANE,
COMPANY SECRETARY,
2008

REGISTERED OFFICE: Western House, Halifax Road, Bradford BD6 2SZ
REGISTERED IN ENGLAND NO 2366682

Profit and Loss Account

for the Year Ended 31 March 2008

	Notes	2008 £m	2007 £m
Turnover		795.5	750.2
Operating costs	2	(446.3)	(427.2)
Exceptional operating costs	2	(7.0)	(47.0)
Total operating costs		(453.3)	(474.2)
Operating profit		342.2	276.0
Exceptional profit on disposal of fixed assets	3	17.5	-
Profit on ordinary activities before interest		359.7	276.0
Net interest payable	5	(144.6)	(97.0)
Profit before taxation		215.1	179.0
Tax on profit on ordinary activities	6	(42.2)	(31.8)
Profit for the year	17	172.9	147.2

All of the above results relate to continuing activities.

Statement of Total Recognised Gains and Losses

for the Year Ended 31 March 2008

There are no recognised gains and losses other than those included in the profit and loss account.

There is no difference between the profit before taxation and the profit for the year stated above and their historical cost equivalents.

Balance Sheet

as at 31 March 2008

	Notes	2008 £m	2007 £m
Fixed assets			
Intangible assets	8	10.4	11.3
Tangible assets	9	4,023.2	3,862.9
Investments	10	16.7	16.7
		<u>4,050.3</u>	<u>3,890.9</u>
Current assets			
Stocks	11	0.7	0.5
Debtors	12	140.8	217.2
		<u>141.5</u>	<u>217.7</u>
Creditors: amounts falling due within one year			
Short term borrowings	14	(174.5)	(22.8)
Other creditors	13	(300.3)	(1,009.8)
		<u>(474.8)</u>	<u>(1,032.6)</u>
Net current liabilities		<u>(333.3)</u>	<u>(814.9)</u>
Total assets less current liabilities		3,717.0	3,076.0
Creditors: amounts falling due after more than one year			
Long term borrowings	14	(752.0)	(767.7)
Other creditors	13	(1,760.8)	(1,153.8)
		<u>(2,512.8)</u>	<u>(1,921.5)</u>
Provisions for liabilities and charges	15	<u>(191.2)</u>	<u>(202.5)</u>
Net assets		<u>1,013.0</u>	<u>952.0</u>
Capital and reserves			
Called up share capital	16	775.0	775.0
Profit and loss account	17	235.3	174.5
Share-based payment reserve	17	2.7	2.5
Total shareholder's funds	17	<u>1,013.0</u>	<u>952.0</u>

Approved by the board of directors on 25 June 2008 and signed on their behalf by:

Kevin Whiteman
Managing Director

Notes to the Accounts

1. ACCOUNTING POLICIES

The following paragraphs summarise the more important accounting policies applied in the preparation of the accounts.

Basis of preparation and accounting

The company's financial statements are prepared under the historical cost convention in compliance with all applicable United Kingdom accounting standards (Financial Reporting Standards 'FRS', Statement of Standard Accounting Practice 'SSAP' and Urgent Issues Task Force abstract 'UITF') and, except where otherwise stated in the notes to the accounts, with the Companies Act 1985.

The accounting policies have been reviewed in accordance with the requirements of FRS 18. The directors consider that the accounting policies set out below remain most appropriate to the company's circumstances, have been consistently applied and are supported by reasonable and prudent estimates and judgements.

The financial statements are prepared on the going concern basis as the immediate holding company has agreed that it will continue to provide financial support to this company to enable it to meet its liabilities as they fall due.

The financial statements present information about the company as an individual company undertaking and do not contain consolidated financial information as the parent of a group. The company is exempt from preparing group financial statements under Section 228A of the Companies Act 1985 as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its parent, Kelda Group Ltd, a company registered in England and Wales.

Turnover

Turnover comprises charges to customers for water, sewerage and other services excluding value added tax and is derived only from the United Kingdom.

Turnover is not recognised until the service has been provided to the customer. Turnover relates to charges due in the year, excluding any amounts paid in advance. Turnover for measured water charges includes amounts billed plus as estimation of the amounts unbilled at the year end. The accrual is estimated using a defined methodology based upon daily average water consumption, which is calculated based upon historical billing information.

Pensions

The company accounts for its pensions in accordance with FRS 17 "Retirement Benefits" and has early adopted the amendment to this standard, to bring disclosure into line with the group's accounts. The company's employees may participate in the Kelda Group Pension Plan (KGPP), a group defined benefit pension scheme as described in Note 20 of the financial statements. The KGPP is a group multi-employer scheme, such that the company's pension schemes' assets and liabilities are included with those of other companies in the KGPP. The company is unable to identify its share of the underlying assets and liabilities in the schemes on a consistent and reasonable basis and therefore accounts for the schemes as if they were defined contribution schemes.

Share based payments

Savings related share option scheme

In prior years, the ultimate parent company, Kelda, operated a savings related share option scheme under which options were granted to employees. The fair value of options granted

Notes to the Accounts

in exchange for employee services rendered was recognised as an expense in the profit and loss account with a corresponding credit to equity.

The total amount expensed over the vesting period was determined by the fair value of the option at the date of the grant. The fair value of the option calculated was determined by use of mathematical modelling including the Black Scholes option pricing model.

The group reassesses its estimate of the number of options that are expected to become exercisable at each balance sheet date. Any adjustments to the original estimates are recognised in the profit and loss account (and equity). No expense is recognised for awards that did not ultimately vest, except for awards where vesting was conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition was satisfied, provided that all other performance conditions are satisfied.

During the year, the scheme was closed following the acquisition of Kelda by Saltaire Water Limited. Certain schemes have been allowed to continue until the planned maturity, with members choosing whether to continue to contribute. For any member who has taken that option, charges to the profit and loss account will continue until the maturity of the scheme. For any other member who has opted to close their scheme, charges to the profit and loss account ceased in the month that they chose to leave the scheme.

Long Term Incentive Plan

In previous years, the group ran a Long Term Incentive Plan (LTIP). Awards under the plan had 2 separate vesting conditions, both of which were dependent on market-based conditions (Kelda shareholder return against a comparator group and against the market). The market-based conditions of the award were taken into account in valuing the award at the grant date. At each subsequent balance sheet date, the group revised its estimate of the number of employees who would receive awards. It recognised the impact of the revision of original estimates, if any, in the profit and loss account, and a corresponding adjustment to equity over the remaining vesting period.

In the current year, the plan was closed following the acquisition of Kelda by Saltaire Water Limited. Any vesting which occurred as a result of the takeover has been dealt with in the same way as in previous years.

For both share options and LTIPs, the corresponding entries to equity represent capital contributions from the parent company. When the amounts are recharged by the parent, a corresponding entry to reserves is recorded.

Research and development expenditure

Research and development expenditure is written off in the profit and loss account in the financial year in which it is incurred. Expenditure on fixed assets relating to development projects is written off over the expected useful life of those assets.

Taxation

The taxation charge is based on the result for the year as adjusted for disallowable and non taxable items using current rates and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and for accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date, subject to the following:

Notes to the Accounts

- provision is made for gains on disposals of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets;
- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is calculated at the rates at which it is estimated that tax will arise based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is discounted.

Investments

Other fixed asset investments are stated at cost and reviewed for impairment if there are any indications that the carrying value may not be recoverable.

Intangible assets

Goodwill is the excess of the fair value of the consideration paid for a business or an associate over the fair value of the identifiable assets and liabilities acquired. Goodwill is capitalised and amortised on a straight line basis over its economic useful life, which normally will not exceed 20 years. Impairment tests on the carrying value of goodwill are undertaken at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

Tangible fixed assets and depreciation

Tangible fixed assets comprised the following:-

Infrastructure assets

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

Expenditure on infrastructure assets to increase capacity or enhance the network and to maintain the operating capability of the network in accordance with defined standards of service is treated as a fixed asset addition and included at cost after deducting grants and contributions.

The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network based on an independently certified asset management plan.

Other tangible fixed assets

Other tangible fixed assets are included at cost, which represents the purchase price, less accumulated depreciation. Finance costs incurred in respect of the construction of other tangible fixed assets are not capitalised.

Freehold land is not depreciated. Depreciation is charged on other tangible fixed assets on a straight-line basis over their estimated economic lives, or the estimated useful economic lives of their individual major components, from the month following commissioning. Useful economic lives are principally as follows:-

Buildings	25 – 60 years
Fixed plant	5 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

Notes to the Accounts

Assets in the course of construction are not depreciated until commissioned. The carrying values of tangible fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable.

Leased assets

Assets which are financed by leasing agreements that transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised in tangible fixed assets and the corresponding capital cost is shown as an obligation to the lessor in borrowings. Depreciation is generally charged to the profit and loss account over the shorter of the estimated useful life and the term of the lease. If the operational life of an asset is longer than the lease term, and the agreement allows an extension to that term, the asset may be depreciated over its operational life. The capital element of lease payments reduces the obligation to the lessor and the interest element is charged to the profit and loss account over the term of the lease in proportion to the capital amount outstanding.

All other leases are operating leases and the rentals are charged to the profit and loss account on a straight-line basis over the term of the lease.

Grants and contributions

Grants and contributions in respect of tangible assets, other than infrastructure assets as described below, are deferred and credited to the profit and loss account by instalments over the expected economic useful lives of the related assets.

Grants and contributions in respect of expenditure enhancing the infrastructure network are applied in reducing that expenditure. This is not in accordance with Schedule 4 to the Companies Act 1985, which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. The presentation is adopted because infrastructure assets do not have determinable finite lives and therefore such grants and contributions would remain as liabilities in perpetuity. The directors consider that the company's presentation shows a true and fair view of the investment in infrastructure assets. The effect on the company's balance sheet of this departure is to decrease the net book value of tangible fixed assets by £346.7m (2007: £327.5m).

Grants and contributions received in respect of expenditure charged to the profit and loss account during the year are included in the profit and loss account.

Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence. Work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, and an appropriate proportion of overheads.

Receipts in advance

Receipts in advance include the monies received from customers where the related turnover has not yet been recognised and also grants and contributions received in relation to capital schemes where the work has not yet commenced.

Foreign currencies

Individual transactions denominated in foreign currencies are translated into sterling at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currency are translated at the exchange rates prevailing at the balance sheet date. Profits and losses on both individual currency transactions settled during the year and unsettled monetary assets and liabilities are dealt with in the profit and loss account.

Notes to the Accounts

Provisions

Provision is made in accordance with FRS 12 for self insured claims, including an estimate for claims incurred but not reported.

Financial instruments

Trade debtors and creditors

Trade debtors do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated recoverable amounts. There is no intention to trade the debtors. Trade creditors are not interest bearing and are stated at their nominal value.

Derivative financial instruments

Interest rate swaps are used to hedge the company's exposure to fluctuations in interest rates on its borrowings. The amounts payable or receivable in respect of interest rate swaps are accounted for on an accruals basis through adjustments to the interest expense of the corresponding liability.

Notes to the Accounts

2. OPERATING COSTS

Net operating costs (before exceptional costs) are shown below:

	2008	2007
	£m	£m
Own work capitalised	(26.2)	(25.2)
Raw materials and consumables	13.7	14.0
Other external charges	199.0	193.8
Wages and salaries	66.9	64.2
Social security costs	6.0	5.7
Other pension costs	14.6	13.7
Depreciation of fixed tangible assets:		
On owned assets		
- infrastructure	49.1	47.3
- other assets	121.0	107.4
On assets held under finance leases		
- infrastructure	1.8	1.8
- on other assets	10.7	10.6
Operating lease rentals		
- plant and equipment	2.3	2.1
- other	0.4	0.3
Amortisation of grants & contributions	(3.2)	(3.2)
Amortisation of goodwill on subsidiary undertakings	0.9	1.0
Restructuring costs	0.9	1.1
Research and development	0.8	0.9
Other operating income	(12.4)	(8.3)
	446.3	427.2

Exceptional operating costs

The company incurred exceptional costs of £7.0m (2007: £47.0m) which include £4.7m of exceptional restructuring costs relating to reductions in manpower required to achieve the company's efficiency targets and payments of £2.3m relating to the termination of long term incentive plans following the acquisition by Saltaire Water. 2007 costs of £47.0m related to a lump sum payment into the group pension scheme.

Audit services

During the year the company obtained the following services from the company's auditors at costs as detailed below:

	£000	£000
Fees payable to company auditors for the audit of the company accounts	92	129
Fees payable to the company's auditors for other services	19	30
	111	159

Employees

The average number of persons employed by the company during the year was:

2,234	2,198
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Notes to the Accounts

3. EXCEPTIONAL PROFIT ON DISPOSAL OF FIXED ASSETS

The £17.5m exceptional profit on disposal of fixed assets results from insurance proceeds of £33.0m received from insurers to replace assets damaged during the floods of 2007, offset by a £15.5m net book value of related assets written off. The cost of the replacement asset will be substantially higher and will appear within capital expenditure as incurred.

4. DIRECTORS' EMOLUMENTS

	2008	2007
	£000	£000
Aggregate emoluments	<u>1,742</u>	<u>1,168</u>
The amounts in respect of the highest paid director are as follows:		
Emoluments	<u>390</u>	<u>209</u>

The Chairman, J. A. Napier, the Managing Director, K. I. Whiteman, S. H. Baldwin and C. C. Fisher were directors of the holding company, Kelda, and their emoluments are shown in the accounts of that company. A. M. Bainbridge became a director of Kelda on 18 February 2008 and her emoluments are shown in the accounts of that company with effect from that date.

All the executive directors have service agreements which are terminable by the company on 12 months' notice.

During 2007/08, all executive directors were contributory members of the Kelda Group Pension Plan, a defined benefit scheme. The accrued pension benefit of the highest paid director in 2007/08 was £72,960.

5. INTEREST

	2008	2007
	£m	£m
Interest payable on:		
Bank loans and overdrafts	24.9	21.2
Finance leases	25.2	20.4
Inter-company loans	96.9	62.2
Other	0.4	-
	147.4	103.8
Interest receivable:		
Inter-company loans	(0.8)	(4.4)
Other	(2.0)	(2.4)
	<u>144.6</u>	<u>97.0</u>

Notes to the Accounts

6. TAXATION

	2008	2007
	£m	£m
Current tax		
Corporation tax at 30% (2007: 30%)	52.7	45.0
Group relief payments	0.3	-
	<hr/>	<hr/>
Total current tax	53.0	45.0
	<hr/>	<hr/>
Deferred tax		
Charge for timing differences arising and reversing in the year	11.2	5.9
Effect of abolition of industrial buildings balancing allowances/charges	(20.4)	-
Adjustments in respect of prior years	1.9	(1.8)
Effect of change in corporation tax rate to 28% (2007:30%)	(38.8)	-
	<hr/>	<hr/>
	(46.1)	4.1
Decrease/(increase) in discount	35.3	(17.3)
	<hr/>	<hr/>
Total deferred tax (see Note 15)	(10.8)	(13.2)
	<hr/>	<hr/>
Total tax on profit on ordinary activities	42.2	31.8
	<hr/>	<hr/>

The differences between the total current tax charge shown and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2008	2007
	£m	£m
Profit before tax	215.1	179.0
	<hr/>	<hr/>
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2007: 30%)	64.5	53.7
Effects of:		
Expenses not deductible/ income not chargeable for tax purposes	(0.2)	(2.1)
Share-based payments	(0.1)	(0.7)
Capital allowances in excess of depreciation and other timing differences	(11.2)	(5.9)
	<hr/>	<hr/>
Current tax charge for period	53.0	45.0
	<hr/>	<hr/>

Notes to the Accounts

The tax charge in future periods may be affected by the following factors:

- capital investment is expected to remain at similar levels. The company expects to be able to continue to claim capital allowances in excess of depreciation in future years.
- changes in the medium and long-term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account.

From 1 April 2008, the UK corporation tax rate changed from 30% to 28%.

Also, from 1 April 2008, the annual allowances available for capital allowance plant pools changed from 25% p.a. to 20% p.a. (general pool) and 6% p.a. to 10% p.a. (long life pool). In addition, industrial buildings allowance (currently 4%) will be phased out over a period ending in March 2011. The net impact of the above changes is not expected to be material.

7. DIVIDENDS

	2008	2007
	£m	£m
Prior year final dividend paid	82.9	78.0
Interim paid	29.2	31.9
Special interim dividends	-	717.0
	<u>112.1</u>	<u>826.9</u>

No final dividend for the year has been proposed. In 2006/07 a regulated dividend of £82.0m and a non-regulated dividend of £0.9m were proposed.

8. INTANGIBLE ASSETS

	<i>Goodwill</i>
Cost	£m
Balance at 1 April 2007 and 31 March 2008	17.9
Amortisation	
Balance at 1 April 2007	(6.6)
Charge for the year	(0.9)
	<u>(7.5)</u>
Net book amount as at 31 March 2008	<u>10.4</u>
Net book amount as at 31 March 2007	<u>11.3</u>

Goodwill arose on the transfer of the trade and net assets of The York Waterworks Ltd and is being amortised over a 19 year period.

Notes to the Accounts

9. TANGIBLE ASSETS

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Under construction £m	Total £m
Cost					
At 1 April 2007	1,434.5	2,387.6	1,929.6	308.2	6,059.9
Additions	21.0	42.5	61.3	253.1	377.9
Transfers on commissioning	31.5	68.1	67.8	(167.4)	-
Transfers to other Group companies	(0.1)	-	(0.1)	-	(0.2)
Disposals - external	(5.0)	-	(44.8)	(0.2)	(50.0)
Grants and contributions	-	-	-	(19.2)	(19.2)
At 31 March 2008	1,481.9	2,498.2	2,013.8	374.5	6,368.4
Depreciation					
At 1 April 2007	454.0	859.6	883.4	-	2,197.0
Disposals	(4.2)	-	(29.9)	(0.2)	(34.3)
Transfers to other Group companies	(0.1)	-	-	-	(0.1)
Depreciation for the year	28.3	50.9	103.2	0.2	182.6
At 31 March 2008	478.0	910.5	956.7	-	2,345.2
Net book amount at 31 March 2008	1,003.9	1,587.7	1,057.1	374.5	4,023.2
Net book amount at 31 March 2007	980.5	1,528.0	1,046.2	308.2	3,862.9

At 31 March 2008 assets included above held under finance leases amounted to:

Cost	126.5	89.8	207.0	10.2	433.5
Depreciation	(27.5)	(15.4)	(109.8)	-	(152.7)
Net book amount at 31 March 2008	99.0	74.4	97.2	10.2	280.8
Net book amount at 31 March 2007	101.8	72.4	116.6	-	290.8

	Cost at 31 March 2008 £m	Depreciation at 31 March 2008 £m	Net book value at 31 March 2008 £m	Net book value at 31 March 2007 £m
The net book amount of land and buildings comprised:				
Freehold properties	1,480.2	(477.5)	1,002.7	979.3
Properties held on long lease	0.5	-	0.5	0.5
Properties held on short lease	1.2	(0.5)	0.7	0.7
	1,481.9	(478.0)	1,003.9	980.5

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets. The company's accounting policy in respect of grants and contributions is a departure from the Companies Act 1985 requirements and is adopted, as explained in the accounting policy note on page 25, in order to show a true and fair view of the investment in infrastructure assets. As a consequence, the net book amount of fixed assets is £346.7m (2007: £327.5m) lower than it would have been had this treatment not been adopted.

Notes to the Accounts

10. INVESTMENTS

	Shares in group undertakings £m	Other unlisted investments £m	Total £m
Cost and net book value as at 1 April 2007 and 31 March 2008	<u>16.6</u>	<u>0.1</u>	<u>16.7</u>

Shares in group undertakings

The balance at 1 April 2007 and 31 March 2008 relates to the 100% holding in The York Waterworks Ltd which was written down to the value of the underlying net assets in 2001 and the 99.9% holding in Yorkshire Water Services Finance Plc, whose principal activity is the raising of finance.

Other unlisted investments

The company holds £27,119 of 8% Unsecured Loan Stock in Water Research Centre (1989) Plc, which conducts research on behalf of the water industry.

The company has taken advantage of the exemption from preparing group accounts under section 228 of The Companies Act 1985. Consolidated accounts have been prepared by Kelda Group Ltd, the company's immediate parent undertaking. Copies can be available from its registered office: Kelda Group Ltd, Western House, Halifax Road, Bradford, BD6 2SZ.

11. STOCKS

	2008 £m	2007 £m
Raw materials and consumables	0.4	0.4
Work in progress	0.3	0.1
	<u>0.7</u>	<u>0.5</u>

12. DEBTORS

	2008 £m	2007 £m
Receivable within one year		
Trade debtors	65.1	56.2
Amounts owed by group undertakings	2.0	86.2
Amounts owed by associated undertakings	0.4	0.4
Prepayments and accrued income	66.2	61.3
Other debtors	7.1	13.0
	<u>140.8</u>	<u>217.1</u>
Receivable after more than one year		
Other debtors	-	0.1
	<u>140.8</u>	<u>217.2</u>

Notes to the Accounts

13. OTHER CREDITORS

	2008	2007
	£m	£m
Amounts falling due within one year:		
Trade creditors	46.7	39.7
Capital creditors	44.3	60.3
Deferred grants and contributions on depreciating fixed assets	3.1	3.2
Amounts owed to group undertakings	54.0	750.6
Amounts owed to subsidiary undertakings	27.0	25.0
Social security and other taxes	3.6	2.3
Taxation payable	23.4	44.9
Receipts in advance	57.4	52.8
Other creditors	40.8	31.0
	300.3	1,009.8
Amounts falling due after more than one year:		
Amounts owed to parent company	440.0	440.0
Amounts owed to subsidiary undertakings	1,173.4	557.9
Deferred grants and contributions on depreciating fixed assets	76.5	79.4
Other creditors	70.9	76.5
	1,760.8	1,153.8

14. AGGREGATE BORROWINGS AND CASH

	2008			
	<i>Bank loans and overdrafts</i>	<i>Other loans</i>	<i>Finance leases</i>	<i>Total</i>
	£m	£m	£m	£m
Repayments				
Within one year or on demand	168.7	-	5.8	174.5
Between one and two years	25.0	1.6	6.0	32.6
Between two and five years	111.0	-	19.8	130.8
After five years	218.8	-	369.8	588.6
	523.5	1.6	401.4	926.5
Amounts owed to parent company				464.0
Amounts owed to subsidiary company				1,173.4
Net debt as at 31 March 2008				2,563.9

Notes to the Accounts

	2007			
	<i>Bank loans and overdrafts</i>	<i>Other loans</i>	<i>Finance leases</i>	<i>Total</i>
	£m	£m	£m	£m
Repayments				
Within one year or on demand	16.8	-	6.0	22.8
Between one and two years	24.7	-	6.4	31.1
Between two and five years	93.6	2.0	21.9	117.5
After five years	261.2	-	357.9	619.1
	396.3	2.0	392.2	790.5

Amounts owed to parent company	1,157.0
Amounts owed by parent company	(80.0)
Amounts owed to subsidiary company	544.5
Net debt as at 31 March 2007	2,412.0

Borrowings repayable in instalments after more than five years include £369.8m (2007: £357.9m) in respect of finance leases which have expiry dates ranging from 2018 to 2043 and carry interest rates based on 12 month LIBOR and 6 month LIBOR (London Inter-Bank Offered Rate). The finance lease creditors are secured on the underlying assets.

15. PROVISION FOR LIABILITIES AND CHARGES

	<i>Deferred tax</i>	<i>Self insurance</i>	<i>Total</i>
	£m	£m	£m
At 1 April 2007	201.6	0.9	202.5
Charged/(credited) to profit and loss account in the year	(10.8)	0.4	(10.4)
Utilised in year	-	(0.9)	(0.9)
At 31 March 2008	190.8	0.4	191.2

Deferred tax

	2008	2007
	£m	£m
At 1 April 2007	201.6	214.8
Deferred tax credited to the profit and loss account	(10.8)	(13.2)
At 31 March 2008	190.8	201.6

Notes to the Accounts

Deferred tax is provided as follows:

	At 31 March 2008	At 31 March 2007
	£m	£m
Accelerated capital allowances	545.2	590.2
Short term timing differences	(1.6)	(0.5)
Undiscounted provision for deferred tax	543.6	589.7
Discount	(352.8)	(388.1)
Discounted provision for deferred tax	190.8	201.6

The corporation tax rate of 28% (2007: 30%) has been used to calculate the amount of deferred tax. The effect of industrial buildings allowances has been excluded from the deferred tax calculations on account of the abolition of balancing allowances and charges included in the 2007 budget. Other than this, provision has been made for all deferred tax assets and liabilities in respect of accelerated capital allowances and other material timing differences. These deferred tax assets and liabilities have been discounted to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse.

16. CALLED UP SHARE CAPITAL

	Authorised	Allotted and fully paid
Ordinary shares of £1 each at 31 March 2007 and 2008	775,000,000	775,000,000

17. MOVEMENT IN SHAREHOLDER'S FUNDS

	<i>P & L reserve</i>	<i>Share-based payment reserve</i>	<i>Share capital</i>	<i>Total funds</i>
	£m	£m	£m	£m
At 1 April 2006	854.2	1.9	775.0	1,631.1
Profit for the year	147.2	-	-	147.2
Dividends	(826.9)	-	-	(826.9)
Share-based payments amount due to parent	-	1.3	-	1.3
Other	-	(0.7)	-	(0.7)
At 31 March 2007	174.5	2.5	775.0	952.0
Profit for the year	172.9	-	-	172.9
Dividends	(112.1)	-	-	(112.1)
Share-based payments amount due to parent	-	1.2	-	1.2
Other	-	(1.0)	-	(1.0)
At 31 March 2008	235.3	2.7	775.0	1,013.0

Notes to the Accounts

18. COMMITMENTS

	2008	2007
	£m	£m
Capital and infrastructure renewals expenditure commitments for contracts placed at 31 March were:	349.4	345.5

The long term investment programme for the company, which identified substantial future capital expenditure commitments in the period 1 April 2005 to 31 March 2010, was agreed as part of the Periodic Review process which was finalised in December 2004.

At 31 March 2008 the company was committed to making the following payments during the next financial year under non-cancellable operating leases expiring as set out below:

	<i>Land and buildings</i>		<i>Land and buildings</i>	
	<i>Other</i>	<i>Other</i>	<i>Other</i>	<i>Other</i>
	2008	2008	2007	2007
Leases which expire:	£m	£m	£m	£m
Within one year	-	1.4	0.3	1.1
Between one and five years	0.4	0.2	-	0.3
Over five years	-	-	0.1	-
	0.4	1.6	0.4	1.4

19. CONTINGENT LIABILITIES

The banking arrangements of the company operate on a pooled basis with other group companies and the bank balances of each subsidiary can be offset against each other.

The company had guaranteed the following bonds at 31 March 2008:

	<i>Nominal</i>	<i>Coupon</i>	<i>Maturity</i>	<i>Liability At 31 March 2008</i>
	£m	%		£m
Fixed rate				
Kelda	200	6.875	2010	199.6
Kelda	240	6.625	2031	240.3
YWSF	200	5.375	2023	196.4
YWSF	200	5.125	2037	194.5
YWSF	150	5.5	2027	148.7
Total fixed:				979.5
Index linked				
YWSF	100	3.048	2033	116.6
YWSF	125	1.462	2051	131.3
YWSF	125	1.460	2056	131.2
YWSF	85	1.75756	2054	86.7
YWSF	100	1.7085	2058	101.8
YWSF	65	1.8225	2050	66.2
Total index linked:				633.8

Notes to the Accounts

20. PENSIONS

The group sponsors a UK pension scheme, the Kelda Group Pension Plan (KGPP). The KGPP has a number of benefit categories providing benefits on a defined benefit basis and one category providing benefits on a defined contribution basis.

Contributions during the year ended 31 March 2008 were paid by members at 3%, 4%, 4.5% or 6% of pensionable pay (depending on benefit category). The company contributed at 475% of members' contributions during the accounting year in respect of the majority of members.

The most recent finalised actuarial valuation of the KGPP was carried out as at 31 March 2004 when the market value of assets was £500.0m.

The company participates in the group multi-employer scheme, such that the company's pension scheme's assets and liabilities are included with those of other companies in the Kelda Group. The company is unable to identify its share of the underlying assets and liabilities of the KGPP as, with the exception of KWS Wales, the scheme's members are not unitised by company. The company therefore accounts for pension costs on a contribution basis.

The company's total pension charge for the year was £14.6m. At 31 March 2008, the company had outstanding contributions of £1.6m (2007: £2.9m). An accrual for unfunded benefits of £1.8m at 31 March 2008 (2007: £1.4m) has been included in the company's accounts.

A summary of the scheme position as disclosed in the Kelda accounts as at 31 March 2008 is as follows:

	2008		2007	
	Market value	Expected long term rate of return	Market value	Expected long term rate of return
	£m	%	£m	%
Fair value of scheme assets				
Equities	474.7	7.05	493.9	7.15
Bonds	233.8	5.11	233.5	4.71
Property	68.5	7.05	78.9	7.15
Other	13.6	4.30	11.6	4.40
Total value of assets	790.6		817.9	
Present value of scheme liabilities	(763.3)		(810.6)	
Net pension asset	27.3		7.3	

Pension contributions are determined with the advice of independent qualified actuaries, Mercer Human Resource Consulting, on the basis of annual valuations using the projected unit credit method and use the following assumptions:

	2008	2007
Inflation	3.4%	3.0%
Rate of increase in salaries	4.6%	4.2%
Rate of increase to pensions in payment and deferred pensions	3.4%	3.0%
Discount rate for scheme liabilities	6.1%	5.3%
Life expectancy of male pensioner aged 60 (in years)	24.9	23.0
Projected life expectancy at age 60 for male aged 40 (in years)	26.0	25.9

Notes to the Accounts

21. ULTIMATE PARENT COMPANY

The company's immediate parent company is Kelda Group Ltd. The company's ultimate parent company and controlling party is Skeldergate Topco Ltd, a company registered in Jersey. Kelda Group Ltd, a company registered in England and Wales, is the parent undertaking of the smallest and largest group to consolidate these accounts. Copies of the group accounts may be obtained from the Company Secretary, Kelda Group Ltd, Western House, Halifax Road, Bradford BD6 2SZ.

22. CASHFLOW STATEMENT

The accounts do not include a cashflow statement because the cashflows of the company are consolidated in the cashflow statement of the holding company in accordance with Financial Reporting Standard 1 (Revised).

23. RELATED PARTY TRANSACTIONS

As a wholly owned subsidiary of Kelda, where consolidated statutory accounts are publicly available the company has taken advantage of the exemption provided by Financial Reporting Standard 8 not to report on related party transactions pertaining to companies within the group or investees of the group qualifying as related parties.

During the year the group entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into, and trading balances outstanding at 31 March, are as follows:

Related party	Sales to related party £000	Amounts owed from related party £000
Brey Services Ltd		
2008	398	378
2007	275	350

Kelda Water Services Ltd, a wholly owned subsidiary of Kelda, has a 45% interest in Brey Services Ltd.

24. SEGMENTAL INFORMATION

The Regulatory Accounting Information, commencing at page 45 of this document, shows a split of the company's activities between the Appointed Business (provision of water and sewerage services) and Non-Appointed Business.

For statutory purposes, the directors consider there to be only one business segment, being the provision of water and sewerage services.

Notes to the Accounts

25. SHARE-BASED PAYMENTS

Share options

In prior years the ultimate parent company, Kelda, operated a savings related share option scheme under which options were granted to employees and provided for an exercise price equal to the daily average market price on the date of grant less 20%. The options vested if the employee remained in service for the full duration of the options scheme (either 3 or 5 years).

During the year, the scheme was closed following the acquisition of Kelda by Saltaire Water Ltd. Certain schemes have been allowed to continue until the planned maturity with members choosing whether to continue to contribute.

	Options	2008 Weighted average exercise price £	Options	2007 Weighted average exercise price £
Outstanding at the beginning of the year	2,264,544	5.36	2,569,963	4.50
Granted during the year	-	-	426,748	7.41
Lapsed during the year	(198,751)	6.01	(152,160)	4.77
Exercised during the year	(633,040)	4.22	(580,007)	3.29
Outstanding at the end of the year	1,432,753	5.76	2,264,544	5.36
Of which exercisable at the end of the year	271,515	3.82	45,114	3.44

The weighted average share price at the date of exercise for share options exercised during the year was £10.78 (2007: £8.56).

The options outstanding at 31 March 2008 had a weighted average exercise price of £5.76 and a weighted average remaining contractual price of 2.1 years.

The fair value of the share options granted is estimated as at the date of grant using the Black Scholes statistical model. No shares were granted in 2008. The inputs to the Black Scholes model for 2007 were as follows:

Share price at date of grant	2007 929p
Exercise price	741p
Expected volatility	25%
Expected life	3 and 5 years
Risk free rate	5.08%
Expected dividends	31p

Expected volatility was determined by calculating the historical volatility of the group's share price over the previous 6 years.

Long term incentive plan

In previous years the group ran a Long Term Incentive Plan (LTIP). Awards under the plan had 2 separate vesting conditions, both of which were dependent on market-based conditions. In the current year the plan was closed following the acquisition of Kelda by Saltaire Water Ltd, with vesting following the plan rules, as noted overleaf.

Notes to the Accounts

70% of the full value of the LTIPs was to vest based on the company's total shareholder return (TSR) performance over the performance period (3 years). The group's share performance would be compared with reference to the 6 listed water companies. At the end of the performance period the TSR of all 7 companies would be calculated, and the results ranked. Full vesting would require top ranking and, if Kelda was ranked between median and top position, between 30% and 100% of the shares would vest depending on how close Kelda's TSR was to the first and fourth companies.

For the remaining 30%, the group's TSR would be compared to the constituents of the FTSE 350 index. No shares would vest unless Kelda was ranked at least median. 30% vested at median and 100% would vest if Kelda is in the top 20% of companies, with pro-rata vestings based on ranking position for intermediate performance.

	2008		2007
	Weighted		Weighted
	average		average
	LTIPs	fair value	LTIPs
		£	fair value
			£
Outstanding at the beginning of the year (adjusted)	410,718	2.27	489,500 2.64
Granted during the year	139,460	3.50	137,125 2.78
Lapsed during the year	(357,532)	2.73	(123,245) 3.13
Vested during the year	(192,646)	2.28	(92,662) 3.40
Outstanding at the end of the year	-	-	410,718 2.33

Directors' Responsibilities

Directors' responsibilities in respect of the Annual Report and the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the 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.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF YORKSHIRE WATER SERVICES LIMITED

We have audited the financial statements of Yorkshire Water Services Limited for the year ended 31 March 2008 which comprise the Profit and Loss Account, the Balance Sheet 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 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 also 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 Business Review that is cross referred from the Business Review section of the Directors' Report.

In addition we 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 the Directors' Report, the Business Review and other matters listed on the contents page. 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.

The maintenance and integrity of the Yorkshire Water Services Ltd website is the responsibility of the directors; 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 financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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

Independent Auditors' Report

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 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Leeds

Regulatory Accounting Information 2008

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Explanatory note

Pages 46 to 73 include the regulatory accounting information which the company is required to publish under the company's Instrument of Appointment as a water and sewerage undertaker. The information has been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Director General of Water Services.

Historical Cost Profit and Loss Account

for the year ended 31 March 2008

	2008			2007		
	Appointed £m	Non- appointed £m	Total £m	Appointed £m	Non- appointed £m	Total £m
Turnover	784.9	10.6	795.5	740.9	9.3	750.2
Operating costs	(328.5)	(7.7)	(336.2)	(359.4)	(7.3)	(366.7)
Historical cost depreciation	(129.5)	-	(129.5)	(115.6)	(0.2)	(115.8)
Operating income	27.7	-	27.7	6.2	-	6.2
Operating profit	354.6	2.9	357.5	272.1	1.8	273.9
Other income	2.2	-	2.2	2.1	-	2.1
Net Interest	(144.6)	-	(144.6)	(96.9)	(0.1)	(97.0)
Profit on ordinary activities before taxation	212.2	2.9	215.1	177.3	1.7	179.0
Taxation - current tax	(52.2)	(0.8)	(53.0)	(44.4)	(0.6)	(45.0)
- deferred tax	10.8	-	10.8	13.2	-	13.2
Profit on ordinary activities after taxation	170.8	2.1	172.9	146.1	1.1	147.2
Dividends - interim	(29.2)	-	(29.2)	(31.9)	-	(31.9)
- special interim	-	-	-	(717.0)	-	(717.0)
- prior year final	(82.0)	(0.9)	(82.9)	(78.0)	-	(78.0)
Retained profit/(loss) for the year	59.6	1.2	60.8	(680.8)	1.1	(679.7)

The accounting policies set out on pages 22 to 26 apply to the historical cost regulatory accounting information, with the exception of the accounting for infrastructure assets and the investment in The York Waterworks Ltd (explained in Note 1 on page 52).

Statement of total recognised gains and losses (historical cost accounting) for Appointed Business

year ended 31 March 2008

There are no other recognised gains and losses arising other than the profit for the year of £170.8m (2007: £146.1m).

Historical Cost Balance Sheet

as at 31 March 2008

	2008			2007		
	Appointed	Non-	Total	Appointed	Non-	Total
	£m	appointed	£m	£m	appointed	£m
Fixed assets						
Tangible assets	4,030.5	4.5	4,035.0	3,867.4	4.7	3,872.1
Investment - other	10.5	-	10.5	11.4	-	11.4
	4,041.0	4.5	4,045.5	3,878.8	4.7	3,883.5
Current assets						
Stocks	0.7	-	0.7	0.5	-	0.5
Debtors	138.1	2.7	140.8	135.5	1.7	137.2
Short term deposits	-	-	-	80.0	-	80.0
	138.8	2.7	141.5	216.0	1.7	217.7
Creditors: amounts falling due within one year						
Overdrafts	(4.2)	-	(4.2)	(2.3)	-	(2.3)
Infrastructure renewals accrual	(11.8)	-	(11.8)	(9.2)	-	(9.2)
Creditors	(232.8)	(0.4)	(233.2)	(227.9)	(0.2)	(228.1)
Borrowings	(194.7)	0.4	(194.3)	(737.4)	(0.1)	(737.5)
Corporation tax payable	(22.6)	(0.8)	(23.4)	(44.3)	(0.6)	(44.9)
	(466.1)	(0.8)	(466.9)	(1,021.1)	(0.9)	(1,022.0)
Net current liabilities	(327.3)	1.9	(325.4)	(805.1)	0.8	(804.3)
Total assets less current liabilities	3,713.7	6.4	3,720.1	3,073.7	5.5	3,079.2
Creditors: amounts falling due after more than 1 year						
Borrowings	(2,365.4)	-	(2,365.4)	(1,752.2)	-	(1,752.2)
Other creditors	(70.9)	-	(70.9)	(89.9)	-	(89.9)
	(2,436.3)	-	(2,436.3)	(1,842.1)	-	(1,842.1)
Provisions for liabilities and charges						
Deferred tax provision	(190.8)	-	(190.8)	(201.6)	-	(201.6)
Deferred income – grants and contributions	(75.3)	(4.3)	(79.6)	(78.0)	(4.6)	(82.6)
Other provisions	(0.4)	-	(0.4)	(0.9)	-	(0.9)
	1,010.9	2.1	1,013.0	951.1	0.9	952.0
Capital and reserves						
Called up share capital	775.0	-	775.0	775.0	-	775.0
Profit and loss account	233.2	2.1	235.3	173.6	0.9	174.5
Other reserves	2.7	-	2.7	2.5	-	2.5
	1,010.9	2.1	1,013.0	951.1	0.9	952.0

Current Cost Profit and Loss Account for the Appointed Business

for the year ended 31 March 2008

	Notes	2008 £m	2007 £m
Turnover	5	784.9	740.9
Current cost operating costs	6	(518.7)	(534.5)
Operating income	5	31.3	6.2
Working capital adjustment	5	1.4	2.4
Current cost operating profit		298.9	215.0
Other income		2.2	2.1
Net interest		(144.6)	(96.9)
Financing adjustment		98.7	82.2
Current cost profit on ordinary activities before taxation		255.2	202.4
Taxation - current tax		(52.2)	(44.4)
- deferred tax		10.8	13.2
Current cost profit on ordinary activities after taxation		213.8	171.2
Dividends		(111.2)	(826.9)
Current cost profit/(loss) retained		102.6	(655.7)

Current Cost Balance Sheet for the Appointed Business

for the year ended 31 March 2008

	Notes	2008 £m	2007 £m
Fixed assets			
Tangible assets	8	23,707.2	22,725.3
Third party contributions since 1989/90		(394.0)	(370.2)
Other operating assets and liabilities			
Working capital	9	(29.3)	(40.1)
Short term deposits		-	80.0
Overdrafts		(4.2)	(2.3)
Infrastructure renewals accrual		(11.8)	(9.2)
Net operating assets		23,267.9	22,383.5
Non operating assets and liabilities			
Borrowings		(194.7)	(737.4)
Non-trade debtors		7.2	13.0
Non-trade creditors due within one year		(71.9)	(64.8)
Investment - other		10.5	11.4
Corporation tax payable		(22.6)	(44.3)
Total non operating assets and liabilities		(271.5)	(822.1)
Creditors: amounts falling due after more than one year			
Borrowings		(2,365.4)	(1,752.2)
Other creditors		(70.9)	(89.9)
Total creditors falling due after more than one year		(2,436.3)	(1,842.1)
Provisions for liabilities and charges:			
Deferred tax provision		(190.8)	(201.6)
Other provisions		(0.4)	(0.9)
		(191.2)	(202.5)
Net assets		20,368.9	19,516.8
Capital and reserves			
Called up share capital		775.0	775.0
Profit and loss account		(276.0)	(378.6)
Other reserves		2.7	2.5
Current cost reserve	10	19,867.2	19,117.9
		20,368.9	19,516.8

Current Cost Cash Flow Statement

for the year ended 31 March 2008

	Notes	2008			2007		
		Appointed £m	Non- appointed £m	Total £m	Appointed £m	Non- appointed £m	Total £m
Net cash flow from operating activities	11	517.2	2.0	519.2	429.5	2.6	432.1
Returns on investments and servicing of finance							
Interest received		2.8	-	2.8	5.9	-	5.9
Interest paid		(99.7)	-	(99.7)	(70.7)	(0.1)	(70.8)
Interest in finance lease rentals		(22.1)	-	(22.1)	(6.8)	-	(6.8)
Net cash flow from returns on investments and servicing of finance		(119.0)	-	(119.0)	(71.6)	(0.1)	(71.7)
Taxation							
Tax paid		(73.6)	(0.6)	(74.2)	(49.1)	-	(49.1)
Capital expenditure and financing of investment							
Gross cost of purchase of fixed assets		(338.7)	-	(338.7)	(322.8)	-	(322.8)
Receipt of grants and contributions		13.9	-	13.9	15.6	-	15.6
Infrastructure renewals expenditure		(48.3)	-	(48.3)	(41.7)	-	(41.7)
Disposal of fixed assets		45.1	-	45.1	6.3	-	6.3
Net cash outflow from investing activities		(328.0)	-	(328.0)	(342.6)	-	(342.6)
Equity dividends paid		(111.2)	(0.9)	(112.1)	(826.9)	-	(826.9)
Net cash (outflow)/inflow before financing		(114.6)	0.5	(114.1)	(860.7)	2.5	(858.2)
Financing							
New leasing finance		70.0	-	70.0	-	-	-
Capital element in finance lease rentals		(60.8)	-	(60.8)	(62.2)	-	(62.2)
New bank loans		730.9	-	730.9	933.0	-	933.0
Repayment of bank loans		(627.9)	-	(627.9)	(15.0)	-	(15.0)
Net cash inflow from financing		112.2	-	112.2	855.8	-	855.8
(Decrease)/increase in cash		(2.4)	0.5	(1.9)	(4.9)	2.5	(2.4)

Notes to the Regulatory Accounting Information

1. ACCOUNTING POLICIES - CURRENT COST INFORMATION

The current cost information has been prepared for the Appointed Business of Yorkshire Water Services Ltd in accordance with guidance issued by the Director General of Water Services for modified real terms financial statements suitable for regulation in the water industry. Profitability is measured on the basis of real financial capital maintenance in the context of assets which are valued at their modern equivalent asset value to the business.

The accounting policies used are the same as those adopted in the statutory historical cost accounts, except as set out below.

Infrastructure assets

As noted on page 46, FRS 12 has not been implemented in the regulatory accounts and the difference between planned and actual expenditure on infrastructure renewals is shown separately in the current cost balance sheet.

Tangible fixed assets

Assets in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for the possible funding of future replacements of assets by contributions from third parties and, to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amount.

The modern equivalent asset values arising from the last Periodic Review are incorporated in the 2007/08 Regulatory Accounting Information.

- Land and buildings

Non-specialised operational properties are valued on the basis of open market value for existing use and have been expressed in real terms by indexing using the Retail Price Index (RPI).

Specialised operational properties are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between periodic Asset Management Plan (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).

- Infrastructure assets

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

Values now reflect the AMP carried out at the last Periodic Review. 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.

Notes to the Regulatory Accounting Information

- **Other fixed assets**
All other fixed assets are valued periodically at depreciated replacement cost. Between periodic AMP reviews, values are restated for inflation as measured by changes in the RPI.
- **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 Instrument of Appointment.

Grants and other third party contributions

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

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:

- **Working capital adjustment**
This is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors and the provision for liabilities and charges.
- **Financing adjustment**
This is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

Investment in York Waterworks

The intangible assets accounting policy on page 24 and Note 8 of the accounts outline the treatment of the transfer of the trade and net assets of The York Waterworks Ltd to Yorkshire Water Services Ltd. In the regulatory accounts, the investment figure and compensating inter-company creditor of £16.6m have been netted to provide suitable comparisons with the previous year and consistency with the approach agreed with Ofwat.

2. APPOINTED AND NON-APPOINTED BUSINESS

The historical cost accounting information shows separate figures for Appointed and Non-appointed Business.

The Appointed Business is defined to be the regulated activities of the Appointee, i.e. those necessary to fulfil the functions and duties of a water and sewerage undertaker. The Non-appointed Business encompasses those activities for which Yorkshire Water Services Ltd is not a monopoly supplier or the activity involves the optional use of an asset owned by the Appointed Business.

Notes to the Regulatory Accounting Information

3. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Allocation of costs

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

Direct costs attributable to the provision of services other than the Appointed Business are separately allocated and identified as 'Non-Appointed'. Indirect costs, relating to non-appointed activities, are recovered as a fixed percentage of direct costs based upon the analysis of operating costs.

Borrowings or sums lent

Kelda

On 31 March 2000 £200m was lent by the parent company, Kelda, at a fixed rate of 6.875%, repayable in 2010, on 17 April 2000 £150m was lent by Kelda at a fixed rate of 6.625% repayable in 2031, and on 16 November 2001 a further £90m was lent by Kelda at 6.625% repayable in 2031.

During the year, an amount was borrowed from the parent company which represented the deficit in funds at 3 month LIBOR rates. An additional short-term loan was issued by Kelda for £400m on 30 November 2006 and £317m on 30 March 2007 both to cover the payment of special dividends. At 31 March 2008, the remaining amount borrowed was £24.0m.

Yorkshire Water Services Finance Plc

The following amounts were lent by Yorkshire Water Services Finance plc (YWSF), a subsidiary of the company:-

<i>Issue date</i>	<i>Rate</i>	<i>Maturity</i>	<i>Liability at 31 March 2008 £m</i>
	<i>%</i>		
Fixed rate			
21/2/03	5.375	2023	196.4
29/5/07	5.125	2037	194.5
29/05/07	5.5	2027	148.7
Total fixed:			539.6
Index linked			
21/2/03	3.048	2033	116.6
27/11/06	1.462	2051	131.3
27/11/06	1.460	2056	131.2
1/6/07	1.75756	2054	86.7
11/6/07	1.7085	2058	101.8
11/6/07	1.8225	2050	66.2
Total index linked:			633.8
Total loan with YWSF			1,173.4

No other material sums were lent to or borrowed from other associated companies.

Notes to the Regulatory Accounting Information

Dividends paid to associated undertakings

Amounts paid to the parent company, Kelda, and the underlying dividend policy, are disclosed in the Directors' Report on page 15 of these accounts.

Guarantees/securities

The bankers for Kelda current accounts provide an arrangement whereby debit and credit balances are pooled with interest charged on the net group balance. This facility is subject to provision of cross guarantees by each company within the pooling arrangement, guaranteeing each of the other companies' current account liabilities with the bank. This is provided the net amount of aggregate cleared debit less credit balances must not exceed £20m nor must the aggregate cleared debit balances exceed £25m.

Transfer of assets and liabilities

During the course of the year land and buildings were sold to group companies at market value. Total sale proceeds were £9.9m (2007: £5.1m).

Supply of service

Details of services supplied to the Appointee by associates during the year are disclosed below where these exceed a materiality level of £1m (in line with RAG 5.04 requirements). No services of a material value were provided by the Appointee to associates.

Service	Associate Company	Turnover of Associate £m	Terms of Supply	Value £m
Corporate charges	Kelda	4.3	Cost allocation	3.3
Customer Services	Loop Customer Management	19.7	Cost allocation	18.0

The Directors declare that, to the best of their knowledge, all appropriate transactions with associated companies have been disclosed.

4. LINK BETWEEN DIRECTORS' PAY AND STANDARDS OF PERFORMANCE

The remuneration policy of the company, which is set within the context of the group's remuneration policy, is to enable directors to receive remuneration which is competitive in the market and which encourages and enables upper quartile performance, taking into account individual performance, responsibilities and experience. Accordingly, in 2007/08 the remuneration of the directors of the company was structured into three elements: base salary, annual incentive and long term incentive plan (LTIP).

Salary

The base salary is a fixed figure and does not vary in relation to business or individual performance.

Notes to the Regulatory Accounting Information

Annual incentive plan

Under the annual incentive plan, each director has the opportunity to earn an annual incentive award based on a percentage of their salary. Awards are entirely performance related but not linked formulaically or directly to the standard of performance of the regulated business. When determining the actual annual incentive award for each director, the group remuneration committee considers overall business and individual performance taking account of a range of factors including financial performance and standards of performance against regulatory measures. The amount of any annual incentive award is determined by and at the discretion of the group board taking account of and making a judgement in the context of the balance of all matters relevant to overall performance. The group board believes that this is the most appropriate means of aligning directors' remuneration to performance.

Long term incentive plan

Until 1 August 2007, awards under the long term incentive plan (the Plan) were not based on the performance of the regulated business, and not therefore subject to disclosure under the Water Act 2003. Instead they were based on the total shareholder return (TSR) over a three year performance period of the group, compared to that of a comparator group of companies including other water and sewerage undertakers whose shares are listed on the London Stock Exchange.

At the Kelda annual general meeting on 1 August 2007 shareholder approval was given to change the basis of awards granted after this date to include a link to the company's performance against Ofwat comparative efficiency measures. This link was as a result of change to the TSR performance condition as set out below.

The group remuneration committee (the Committee) conducted a review of the group's executive incentive arrangements for executive directors. The Plan permitted share awards of up to 80% of salary in normal circumstances (with an "exceptional" limit of 200% of salary), vesting being subject to TSR performance conditions relative to the other listed water companies and other FTSE 350 companies excluding Investment Trusts. However, the committee felt that the group's outstanding performance was not being properly recognised in the outturns from the existing incentive arrangements, in particular by the level of awards vesting under the Plan. The existing arrangements were, therefore, reviewed to ensure that they were:

- in accordance with the Committee's published remuneration policy, in particular its desire to incentivise key executives by use of an appropriately competitive remuneration package, a significant element of which is based on performance-related variable remuneration (to provide alignment with shareholders) rather than fixed remuneration;
- subject to appropriate performance conditions; and
- consistent with current corporate governance best practice.

The review found that:

- The total incentive potential available to executive directors was below lower quartile market potential. This did not reflect the aspiration of the Committee that executives should be fairly and appropriately rewarded if the company achieves upper quartile levels of performance, in particular relative to the other water and sewerage companies.
- The TSR performance measure compared against the comparator group of listed water companies was becoming increasingly problematic given the declining

Notes to the Regulatory Accounting Information

number of such companies. In particular, results could become highly volatile in such a small group when one or more of these companies become the subject of takeover speculation or fundamentally changes its capital structure. This has resulted in recent payments under the Plan which, in the opinion of the Committee, had not been properly reflective of the performance of the company and its management.

The rules of the new basis were as follows:-

- Awards can be made of up to 100% (an increase from 80%) of salary in normal circumstances (with no change to the pre-existing 'exceptional' limit of 200% of salary);
- Vesting is subject to a mixture of performance against TSR and Ofwat measures as summarised below:-

	Performance condition	Vesting schedule
50% of award	Based on the company's TSR relative to companies in the FTSE 350 excluding Investment Trusts.	30% vesting for median performance rising to 100% vesting for upper 20% performance on a straight-line basis.
50% of award	Based on the company's Operating Efficiency and Capital Maintenance Efficiency performance relative to the other nine water and sewerage companies based on Ofwat published data.*	25% vesting for a ranking of 5 th out of 10 companies rising to 100% vesting for a ranking in the top 2 positions. No vesting for ranking below 5 th position.

- * Ofwat's report on 'Water and Sewerage Service Unit Costs and Relative Efficiency' (the Ofwat Report) is used to produce an average ranking for the company for the financial year for the four operating and capital efficiency measures.

The Ofwat Report contains Ofwat's assessment of each water company's operating and capital maintenance efficiency for water and, in respect of the water and sewerage companies, the same efficiency measures in respect of sewerage. These assessments are based primarily on Ofwat's econometric models and unit cost comparisons.

Based on these assessments, the Ofwat Report contains a ranking amongst the companies based on their relative performance for each of the four measures (Operating Efficiency – Water; Capital Maintenance Efficiency – Water; Operating Efficiency – Sewerage; Capital Maintenance Efficiency – Sewerage). For the purposes of this performance condition, the water only companies are ignored from the analysis as they do not feature in the sewerage measures, leaving the 10 water and sewerage companies as the comparator group.

This process of producing an average ranking would be repeated for the next two years in the performance period to establish an average for the 3 years. On the basis of this overall average, a ranking is established (with the company having the lowest overall average being ranked 1st and so on).

No awards vest under the Plan unless, in the opinion of the Committee, the underlying financial performance of the company has been satisfactory over the

Notes to the Regulatory Accounting Information

performance period, taking into account all relevant circumstances, including the regulatory regime in place during the performance period. The Committee had the power to scale back vesting to any extent considered appropriate in light of the company's financial performance.

The first conditional award under this revised Plan was made on 27 September 2007. Vesting of shares awarded under this Plan was triggered by the acquisition of Kelda by Saltaire Water Ltd in February 2008 and the Plan was then closed.

The full performance period would have consisted of three financial years but this was foreshortened to one financial year because of the acquisition and the Ofwat measure was based on the performance in the 2006/07 financial year based on the Ofwat Report for that year published in December 2007. This placed Yorkshire Water first in the rankings resulting in full vesting of 50% of the 27 September 2007 award based on the Ofwat measure.

Information on the remuneration of directors including the shares awarded and vested under the plan is set out below.

	Total awarded	Total vested	Awarded on Ofwat measure	Vested on Ofwat measure
K. Whiteman	9,068	7,250	4,534	4,534
R. K. Ackroyd	3,076	2,459	1,538	1,538
A. M. Bainbridge	3,040	2,430	1,520	1,520
G. Dixon	2,840	2,270	1,420	1,420
R. D. Flint	2,923	2,337	1,462	1,462
A. Harrison	3,266	2,611	1,633	1,633

50% of the shares granted were subject to the Ofwat measure and therefore vested in full, together with the associated dividend shares.

Notes to the Regulatory Accounting Information

5. ANALYSIS OF TURNOVER & OPERATING INCOME FOR THE APPOINTED BUSINESS for the year ended 31 March 2008

	2008			2007		
	Water services £m	Sewerage services £m	Total appointed business £m	Water services £m	Sewerage services £m	Total appointed business £m
Turnover						
Unmeasured	193.0	218.4	411.4	187.4	210.4	397.8
Measured	155.1	144.1	299.2	142.4	127.4	269.8
Trade effluent	-	8.1	8.1	-	7.6	7.6
Large user and special agreement	24.6	29.4	54.0	24.8	29.0	53.8
Rechargeable works	9.3	-	9.3	8.5	0.1	8.6
Other sources	0.7	2.2	2.9	0.8	2.5	3.3
Total turnover	382.7	402.2	784.9	363.9	377.0	740.9
Operating income						
Current cost profit on fixed assets net of expenses	3.1	28.2	31.3	4.7	1.5	6.2
Total operating income	3.1	28.2	31.3	4.7	1.5	6.2
Working capital adjustment	0.7	0.7	1.4	1.2	1.2	2.4

6. ANALYSIS OF OPERATING COSTS AND ASSETS

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

Notes to the Regulatory Accounting Information

6. ANALYSIS OF OPERATING COSTS AND ASSETS

for the year ended 31 March 2008

	Resources		Water supply	Sewerage	Sewage treatment	Sludge Treatment & disposal	Sewerage services
	& treatment	Distribution	sub total	treatment			sub total
	£m	£m	£m	£m	£m	£m	£m
DIRECT COSTS							
Employment costs	4.6	6.6	11.2	3.5	7.0	2.7	13.2
Power	12.0	4.9	16.9	2.6	13.6	4.2	20.4
Agencies	-	-	-	-	-	-	-
Hired and contracted services	4.5	13.2	17.7	7.1	10.1	9.6	26.8
Associated companies	0.1	-	0.1	-	0.1	0.1	0.2
Materials and consumables	6.2	0.2	6.4	0.1	1.3	2.6	4.0
Service charges	5.7	-	5.7	1.3	3.0	0.2	4.5
Bulk supply imports	3.1	-	3.1	-	-	-	-
Other direct costs	0.7	1.2	1.9	0.6	0.6	0.5	1.7
Total direct costs	36.9	26.1	63.0	15.2	35.8	19.9	70.8
General and support expenditure	10.7	14.9	25.6	5.9	12.6	5.4	23.9
Functional expenditure	47.6	41.0	88.6	21.1	48.3	25.3	94.7
BUSINESS ACTIVITIES							
Customer services			11.7				10.5
Scientific services			6.1				2.2
Other business activities			2.3				1.7
Business activities sub-total			20.1				14.4
Local authority rates			21.6				13.5
Doubtful debts			4.1				4.3
Exceptional items			5.3				1.8
Total opex less third party services			139.7				128.6
Third party services - opex			9.3				-
Total operating expenditure			149.0				128.6
CAPITAL MAINTENANCE							
Infrastructure renewals charge	7.2	22.1	29.3	21.6	-	-	21.6
Current cost depreciation							
- service activities	58.3	19.7	78.0	12.5	82.1	19.1	113.7
- business activities			0.2				0.2
Amortisation of grants			(1.4)				(1.4)
Amortisation of intangible assets			0.9				-
Total capital maintenance			107.0				134.1
TOTAL OPERATING COSTS			256.0				262.7
CCA NET MEA VALUES							
Service activities	4,295.0	5,090.9	9,385.9	12,485.2	1,625.5	203.5	14,314.2
Business activities			3.5				3.6
Service totals			9,389.4				14,317.8
Services for third parties			-				-
TOTAL			9,389.4				14,317.8

Notes to the Regulatory Accounting Information

7. ANALYSIS OF OPERATING COSTS AND ASSETS

for the year ended 31 March 2007

	Resources		Water supply	Sewerage	Sewage treatment	Sludge treatment & disposal	Sewerage services
	& treatment	Distribution	sub total	treatment			sub total
	£m	£m	£m	£m	£m	£m	£m
DIRECT COSTS							
Employment costs	4.7	6.7	11.4	2.2	5.4	3.5	11.1
Power	13.2	5.6	18.8	2.8	15.9	4.2	22.9
Agencies	-	-	-	-	-	-	-
Hired and contracted services	4.6	11.4	16.0	7.3	9.4	9.0	25.7
Associated companies		-	-	-	-	-	-
Materials and consumables	6.4	0.2	6.6	0.1	1.2	3.2	4.5
Service charges	5.6	-	5.6	0.9	3.0	0.1	4.0
Bulk supply imports	2.9	-	2.9	-	-	-	-
Other direct costs	1.1	0.9	2.0	1.0	1.0	0.6	2.6
Total direct costs	38.5	24.8	63.3	14.3	35.9	20.6	70.8
General and support expenditure	11.0	12.9	23.9	5.0	11.9	5.8	22.7
Functional expenditure	49.5	37.7	87.2	19.3	47.8	26.4	93.5
BUSINESS ACTIVITIES							
Customer services			10.3				11.2
Scientific services			5.8				1.9
Other business activities			2.1				1.8
Business activities sub-total			18.2				14.9
Local authority rates			21.1				12.4
Doubtful debts			3.4				3.6
Exceptional items			26.8				20.2
Total opex less third party services			156.7				144.6
Third party services - opex			8.9				0.1
Total operating expenditure			165.6				144.7
CAPITAL MAINTENANCE							
Infrastructure renewals charge	7.2	25.7	32.9	16.2	-	-	16.2
Current cost depreciation							
- service activities	53.1	19.6	72.7	10.8	76.5	16.8	104.1
- business activities			0.1				0.1
Amortisation of grants			(1.5)				(1.4)
Amortisation of intangible assets			1.0				-
Total capital maintenance			105.2				119.0
TOTAL OPERATING COSTS			270.8				263.7
CCA NET MEA VALUES							
Service activities	4,155.8	4,846.9	9,002.7	12,014.1	1,496.7	205.6	13,716.4
Business activities			3.1				3.1
Service totals			9,005.8				13,719.5
Services for third parties			-				-
TOTAL			9,005.8				13,719.5

Notes to the Regulatory Accounting Information

8. CURRENT COST ANALYSIS OF FIXED ASSETS BY ASSET TYPE

as at 31 March 2008

	Specialised operational assets £m	Non- specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
WATER SERVICES					
Gross replacement cost					
At 1 April 2007	2,087.8	21.1	7,779.3	280.7	10,168.9
RPI adjustment	79.3	0.8	295.6	10.7	386.4
Disposals	(20.9)	-	-	(1.5)	(22.4)
Additions	46.3	0.5	51.0	22.0	119.8
At 31 March 2008	2,192.5	22.4	8,125.9	311.9	10,652.7
Depreciation					
At 1 April 2007	992.8	6.8	-	163.5	1,163.1
RPI adjustment	37.8	0.3	-	6.2	44.3
Disposals	(20.9)	-	-	(1.4)	(22.3)
Charge for year	53.0	0.1	-	25.1	78.2
At 31 March 2008	1,062.7	7.2	-	193.4	1,263.3
Net book amount at 31 March 2008	1,129.8	15.2	8,125.9	118.5	9,389.4
Net book amount at 1 April 2007	1,095.0	14.3	7,779.3	117.2	9,005.8
SEWERAGE SERVICES					
Gross replacement cost					
At 1 April 2007	3,577.5	51.3	11,797.3	273.6	15,699.7
RPI adjustment	136.0	1.9	448.3	10.4	596.6
Disposals	(20.8)	-	-	(8.4)	(29.2)
Additions	163.0	2.3	15.8	21.9	203.0
At 31 March 2008	3,855.7	55.5	12,261.4	297.5	16,470.1
Depreciation					
At 1 April 2007	1,810.2	21.5	-	148.5	1,980.2
RPI adjustment	68.8	0.8	-	5.6	75.2
Disposals	(10.5)	-	-	(6.5)	(17.0)
Charge for year	86.0	0.7	-	27.2	113.9
At 31 March 2008	1,954.5	23.0	-	174.8	2,152.3
Net book amount at 31 March 2008	1,901.2	32.5	12,261.4	122.7	14,317.8
Net book amount at 1 April 2007	1,767.3	29.8	11,797.3	125.1	13,719.5

Notes to the Regulatory Accounting Information

8. CURRENT COST ANALYSIS OF FIXED ASSETS BY ASSET TYPE (continued) as at 31 March 2008

	Specialised operational assets £m	Non- specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
TOTAL					
Gross replacement cost					
At 1 April 2007	5,665.3	72.4	19,576.6	554.3	25,868.6
RPI adjustment	215.3	2.7	743.9	21.1	983.0
Disposals	(41.7)	-	-	(9.9)	(51.6)
Additions	209.3	2.8	66.8	43.9	322.8
At 31 March 2008	6,048.2	77.9	20,387.3	609.4	27,122.8
Depreciation					
At 1 April 2007	2,803.0	28.3	-	312.0	3,143.3
RPI adjustment	106.6	1.1	-	11.8	119.5
Disposals	(31.4)	-	-	(7.9)	(39.3)
Charge for year	139.0	0.8	-	52.3	192.1
At 31 March 2008	3,017.2	30.2	-	368.2	3,415.6
Net book amount at 31 March 2008	3,031.0	47.7	20,387.3	241.2	23,707.2
Net book amount at 1 April 2007	2,862.3	44.1	19,576.6	242.3	22,725.3

Notes to the Regulatory Accounting Information

9. WORKING CAPITAL

	2008	2007
	£m	£m
Stocks	0.7	0.5
Trade debtors – measured household	19.3	13.7
- unmeasured household	24.2	22.2
- measured non-household	16.8	15.8
- unmeasured non-household	0.3	0.2
- other	3.2	3.6
Measured income accrual	45.7	39.1
Prepayments and other debtors	21.4	27.9
Trade creditors	(52.9)	(43.3)
Deferred income – customer advance receipts	(57.4)	(52.8)
Capital creditors	(44.3)	(60.2)
Accruals and other creditors	(6.3)	(6.8)
	<u>(29.3)</u>	<u>(40.1)</u>

10. MOVEMENT ON CURRENT COST RESERVE

	2008	2007
	£m	£m
Balance at 1 April	19,117.9	18,184.2
RPI adjustments		
Fixed assets	863.5	1,034.7
Working capital	(1.4)	(2.4)
Financing	(98.7)	(82.2)
Grants & third party contributions	(14.1)	(16.4)
	<u>19,867.2</u>	<u>19,117.9</u>
Balance at 31 March	19,867.2	19,117.9

Notes to the Regulatory Accounting Information

11. RECONCILIATION OF APPOINTED BUSINESS OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2008 £m	2007 £m
Current cost operating profit	298.9	215.0
Working capital adjustment	(1.4)	(2.4)
Movement in working capital	5.1	(11.4)
Receipts from other income	2.2	2.1
Current cost depreciation	190.2	175.1
Current cost profit on sale of fixed assets	(31.3)	(6.2)
Infrastructure renewals charge	50.9	49.1
Other non-cash profit and loss items	2.6	8.2
Net cash flow from operating activities	517.2	429.5

12. NET DEBT ANALYSIS

	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Maturity profile				
Less than one year	28.5	166.2	-	194.7
Between one and two years	30.0	3.7	-	33.7
Between two and five years	323.8	6.0	-	329.8
Between five and twenty years	845.3	30.0	-	875.3
In more than twenty years	463.6	29.2	633.8	1,126.6
	1,691.2	235.1	633.8	2,560.1
Overdraft				4.2
Short term deposits				-
Total net debt at 31 March 2008				2,564.3

Notes to the Regulatory Accounting Information

13. RECONCILIATION BETWEEN STATUTORY AND REGULATORY ACCOUNTS

for the year ended 31 March 2008

	Statutory UK GAAP £m	Regulatory £m	
Profit and loss account			
Operating profit	342.2	357.5	Exceptional profit on sale of fixed assets of £17.5m is included in operating profit (operating income) in regulatory accounts. Rental income of £2.2m classified as other income in regulatory accounts
Profit before tax	215.1	215.1	Profit before tax is unaffected by this classification
Balance Sheet			
Tangible fixed assets (net book value)	4,023.2	4,035.0	FRS 15 adopted in statutory accounts does not permit infrastructure renewals accounting as required by Ofwat. The accrual of £11.8m is therefore netted off fixed assets.
Infrastructure renewals accrual	-	(11.8)	
Investments/intangible assets	27.1	10.5	The investment in York Waterworks of £16.6m is eliminated in regulatory accounts with a compensating entry in creditors.
Deferred income— grants/contributions	-	(79.6)	In the statutory accounts deferred income is included within: <ul style="list-style-type: none"> - creditors due within one year £3.1m - creditors due after more than one year £76.5m
Borrowings - due within one year	(174.5)	(194.3)	Internal loans are classified within borrowings in the regulatory accounts but as creditors in the statutory accounts. This includes £24m due within one year and £1,613.4m due after one year. Overdrafts are also contained within short term borrowings in the statutory accounts.
- due after more than one year	(752.0)	(2,365.4)	
Overdrafts	-	(4.2)	
Corporation tax payable	-	(23.4)	Corporation tax payable of £23.4m is included within creditors in statutory accounts but is itemised separately in regulatory accounts.
Creditors – due within one year	(300.3)	(233.2)	The items described and itemised above are included elsewhere in the regulatory accounts.
- due after more than one year	(1,760.8)	(70.9)	

Notes to the Regulatory Accounting Information

14. REGULATORY CAPITAL VALUES AT 2007/08 PRICES

		2008 £m
Opening regulatory capital value for the year	*	4,130
Capital expenditure (excluding IRE)	*	320
Infrastructure renewals expenditure		57
Infrastructure renewals charge		(42)
Grants and contributions		(14)
Depreciation		(177)
Outperformance of regulatory assumptions (5 years in arrears)		(29)
Other adjustments		-
Closing regulatory capital value	*	4,245
Average regulatory capital value		4,116

- * The table shows the regulatory capital value used in setting the price limits for the period 2007/08 to 2009/10 as published by Ofwat in April 2005, inflated to March 2008 prices, with the exception of the average RCV, which is shown at average prices. The differences from the actual capital expenditure, depreciation, etc will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation for the next periodic review.

Regulatory Operating and Financial Review

INTRODUCTION

The requirements of the Regulatory Operating and Financial Review are set out in this section and, where noted by cross reference below, in the Business Review and Directors' Report that accompany the statutory financial statements.

The Business Review on page 1 contains a description of the business, its strategy and review of financial and operational performance in the year, together with key performance indicators, based on the statutory accounts. It also sets out forward-looking statements and the principal risks and uncertainties facing the business.

This review contains additional information and disclosures on regulatory financial information.

The Directors' Report in respect of the statutory accounts on page 14 sets out the principal activities of the company, subsequent events and company's policy in respect of employees, employment practices, environment and community matters.

The Regulatory Operating and Financial Review in the Regulatory Accounts is required by Ofwat. The contents, including the cross-referencing to the statutory financial statements where appropriate, have been prepared following the Accounting Standards Board's Reporting Statement, as supplemented by additional Ofwat requirements.

FINANCIAL PERFORMANCE

Key financial performance indicators

	2008	2007
Interest cover	2.5x	2.8x
Gearing	71.7%	71.7%
Net debt to Regulatory Capital Value (RCV)	60.4%	60.6%

Historical cost profit before tax has increased by £34.9m to £212.2m and operating profit has increased by £82.5m to £354.6m since 2006/07. However this is after charging exceptional costs of £7.0m (2007: £47.0m) and exceptional profit on sale of fixed assets of £17.5m, which are described in more detail below. Excluding the impact of these items, profit before tax has reduced by £22.6m to £201.7m, and operating profit has increased by £25.0m to £344.1m.

Total regulated turnover for 2007/08 amounted to £784.9m, an increase of £44.0m (5.9%) over the 2006/07 total of £740.9m. Main charges increased by 6.0% (£43.7m) over the previous year, primarily as a result of the price increase of 7.9%, which included the Ofwat set K factor of 3.6% in addition to RPI. This was offset by the decline in demand due to the summer wet weather and floods and large business closures and the continuing impact of domestic meter options. Income is £8.6m (1%) below the level forecast in Ofwat's final determination for PR04 due to these factors, offset by higher trade effluent income and increases from rechargeable works.

Operating costs have reduced by £30.9m to £328.5m, which comprises regulated operating costs of £270.6m, exceptional costs of £7.0m and an infrastructure renewals charge of £50.9m. Regulated operating costs have increased by £7.3m (2.8%) from the 2006/07 figure of £263.3m. The impact of inflation, together with the operating cost effect of capital schemes, has been offset by the continuing delivery of efficiencies. The increase of £1.8m in the infrastructure renewals charge reflects the anticipated capital expenditure over the period

Regulatory Operating and Financial Review

to 2010. Depreciation increased by £13.9m, reflecting an increase in base and accelerated depreciation.

The interest charge of £144.6m is £47.7m higher than 2006/07, reflecting an increase in net debt from £2,411.9m in 2006/07 to £2,564.3m in 2007/08 and the full year effect of the increase in net debt which took place in 2006/07.

The current year tax charge of £52.2m is £7.8m higher than in 2006/07, which benefited from the £47m cash contribution to the pension scheme in that year. The deferred tax provision reduced to £190.8m, resulting in a £10.8m credit to profit. This is due to the change in the future corporation tax rate to 28% and the abolition of Industrial Buildings Allowance, offset by a change in gilt rates affecting the discount rate.

Atypical items

Exceptional costs of £7.0m in 2007/08 include £4.7m of additional restructuring costs and £2.3m of payments made to employees following the termination of their Long Term Incentive plans. The 2006/07 exceptional cost of £47.0m related to the company's share of lump sum contribution to decrease the deficit in the Kelda Group pension scheme.

In addition, 2007/08 costs include a further £0.9m of atypical restructuring costs, compared with £1.6m in 2006/07. Other atypical costs in 2007/08 include £0.8m relating to a fire at an incinerator, £0.3m in dealing with an unprecedented level of flies at a waste water treatment works and a further £0.2m due to theft and vandalism at operational sites. 2006/07 atypical figures included £0.3m energy costs relating to wet winter weather affecting raw water quality and £0.1m tankering costs related to the maintenance of rural supplies in dry summer weather conditions. In addition, waste water tankering costs of £0.2m were incurred following excessive discharges from a local brewery and a further £0.1m associated with cleaning a contaminated sewer. Refunds of Local Authority rates, following successful rating appeals, and related accruals amounted to £0.4m in the year (2007: £0.5m).

Operating income includes an exceptional profit of £17.5m on the disposal of fixed assets resulting from proceeds of £33.0m received from insurers to replace assets damaged by the floods of Summer 2007. This has been offset by the write-off of net book values of £15.5m relating to the assets destroyed.

Donations to charitable trusts

No donations were made by the company to the Community Trust which assists customers with payment difficulties, but £0.6m was donated by the parent company, Kelda.

Dividends

The dividend for the year of £111.2m includes a final dividend of £82.0m in respect of 2006/07 and an interim dividend of £29.2m for 2007/08. These compare with a total dividend reported in 2006/07 of £826.9m, which included £717.0m of special interim dividends paid to Kelda in connection with their return of capital to shareholders, a final dividend for 2005/06 of £78.0m and a 2006/07 interim dividend of £31.9m.

Cautionary statement

The purpose of this annual report is to provide information to members of the company and contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this report should be construed as a profit forecast.

Directors' Responsibilities

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible under Condition F of the Instrument of Appointment by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Act 1991 for:

- a) ensuring that proper accounting records are kept by the Appointee as required by paragraph 3 of Condition F of the Instrument and having regard to the terms of any guidelines notified from time to time by the Director to the Appointee;
- b) preparing on a consistent basis in respect of each financial year accounting statements in agreement with the Appointee's accounting records and in accordance with the requirements of Condition F and any guidelines notified from time to time by the Director to the Appointee. So far as reasonably practicable these should have the same content as the annual accounts of the Appointee prepared under the Companies Act 1985 Act and be prepared in accordance with the formats and the accounting policies and principles which apply to those accounts;
- c) preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued to the Appointee from time to time.

DISCLOSURE OF INFORMATION TO THE AUDITORS

As stated in the Directors' Report on page 19, as far as each director is aware there is no relevant audit information of which the company's auditor is unaware and each director has taken such steps as he or she should have taken as a director in order to make him or herself aware of any relevant audit information and to establish that the company's auditor is aware of the information.

Other Regulatory Declarations

RING FENCING

In the opinion of the Directors, the company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year. This relates to the availability of rights and assets in the event of a special administration order.

DIRECTORS' CERTIFICATE – CONDITION F

The Directors declare that the company will have available, for at least the next 12 months, sufficient financial resources and facilities to enable it to carry out its regulated activities and sufficient management resources to enable it to carry out its functions. In making this declaration, the Directors have taken into account:-

- a) the net worth of the company and the strength of key performance indicators as shown in the audited accounts for the year ended 31 March 2008 and the company's business plan for 2008/09 and the remainder of the AMP4 period;
- b) the strong investment grade credit ratings in the 'A' band;
- c) borrowing facilities which include significant committed undrawn bank facilities;
- d) parental support provided by the holding company which will provide financial support to the company to enable it to meet its liabilities as they fall due;
- e) the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners.
- f) the company's employment policies and strategy as described in detail in the Directors' Report on pages 17 and 18.

The Directors also declare that all contracts entered into with Associated Companies, and any arrangements made with any relevant authority for the discharge of any of the Appointee's sewerage functions, include all necessary provisions and requirements concerning the standard of service to be supplied to ensure that the company is able to meet all its obligations as a water and sewerage undertaker, as required in Section 6A.2A(3) of Condition F of the Instrument of Appointment. This opinion has been formed following examination of the documents in question.

Auditors' Report on the Regulatory Accounting Information

Independent Auditors' report to the Water Services Regulation Authority and Directors of Yorkshire Water Services Limited

We have audited the Regulatory Accounts of Yorkshire Water Services Limited ("the company") on pages 45 to 70 for the year ended 31 March 2008 which comprise:

- the regulatory historical 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 obligations 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 Principles ("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 Statements of Directors' Responsibilities for Regulatory Information on page 69.

Auditors' Report on the Regulatory Accounting Information

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 the classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 48 to 50 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03. 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 appointees' accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06, and Regulatory Accounting Guideline 4.03.

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 performance review, the notes on the regulatory information and the additional information required by the company's Regulatory Licence.

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 financial statements of the company (our "Statutory" audit) was made solely to the company's members, as a body, in accordance with

Auditors' Report on the Regulatory Accounting Information

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 the Company's members those matters we are required to state to them in a Statutory auditors' 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 46 to 47 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting 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 65.

Opinion

In our opinion the Regulatory Accounts of the company for the year ended 31 March 2008 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 to 52, the state of the company's affairs at 31 March 2008 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 of Appointment;
- 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 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
- c) the regulatory historical cost accounting statements on pages 46 to 47 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 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
- d) the regulatory current cost accounting statements on pages 48 to 50 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors, Leeds