



2003/04

Statutory Accounts and Supplementary Regulatory Accounting Statements

FOR THE YEAR ENDED 31 MARCH 2004

Southern
Water



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Preface

FOR THE YEAR ENDED 31 MARCH 2004

This document includes the statutory Accounts of Southern Water Services (SWS) Limited to be filed with the Registrar of Companies as required under the Companies Act 1985, together with a set of supplementary regulatory accounting statements required by the Instrument of Appointment (the "Licence") issued to the company by the Secretary of State for the Environment.

The Director General of Water Services ("the Director General") has a duty under the Water Industry Act 1991 to ensure compliance with the conditions of this Licence.

A particular point of definition is worth noting. The "Appointee" is Southern Water Services Limited, appointed in the Licence to be the undertaker. Southern Water Services Limited has other functions and activities which are not regulated by the Licence. These activities are termed the "Non-Appointed Business".

Ring fencing statement

Under paragraph 3.1 of Condition K of its Licence, the company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the company.

In the opinion of the directors, the company was in compliance with that requirement as at 31 March 2004.

Protection of the core business (Licence Condition F6A)

The directors state that the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least 12 months, its regulated activities and sufficient management resources to enable it to carry out its functions.

The directors confirm that all contracts entered into with any Associate Company

include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

Directors' responsibilities for the preparation of the supplementary regulatory accounting statements

In addition to their responsibilities to prepare Accounts in accordance with the Companies Act 1985, described on page 2, the directors are also responsible under Condition F of the Licence issued to the company by the Secretary of State for the Environment as a water and sewerage undertaker under the Water Industry Act 1991 for:

- (a) ensuring that proper accounting records are maintained by the Appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by the Director General to the Appointee from time to time;
- (b) preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, having regard also to the terms of guidelines notified by the Director General from time to time, which so far as is reasonably practicable have the same content as the annual Accounts of the Appointee prepared under the Companies Act 1985 and which are prepared in accordance with the formats, 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 by the Director General from time to time;
- (d) preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by the Director General from time to time.

The directors approved the statutory Accounts on pages 5 to 20 on 2 July 2004. They approved the supplementary regulatory accounting statements on pages 24 to 37 and pages 40 to 41 on 6 July 2004.

By order of the Board



Stuart Derwent
Managing Director
6 July 2004



Report of the Directors

The directors present their report and the audited Accounts for the year ended 31 March 2004.

Results and dividend

The profit after taxation for the financial year amounted to £58.4 million (2003: £63.6 million). The directors recommend a final dividend of £60.71 per ordinary share (2003: £nil) which together with an interim dividend totalling £956.40 per ordinary share (2003: £1,214.29) gives a total dividend of £1,017.11 per ordinary share for the year (2003: £1,214.29). The company also paid preference dividends amounting to £9.5m (2003: £nil) with class A1 shareholders receiving £4.2m and class B shareholders £5.3m. Class A2 shareholders did not receive a dividend because the company did not meet the outperformance requirements outlined in note 19. The aggregate dividends on the ordinary and preference shares amount to £66.5m (2003: £68.0m). In September 2004 class A1 shareholders will be paid a dividend of £3.0m, class A2 £nil and class B £3.8m. Class A2 shareholders are not expected to be paid a dividend in 2004/05. The retained loss for the year of £8.1 million (2003: £4.4 million) has been transferred to reserves.

Principal activities and review of the business

The principal activities of the company are the provision of water supply and wastewater services in the south-east of England.

Turnover in 2003/04 increased by 4.3% to £455.1m (2002/03 £436.5m) resulting from an increase in charges and new growth. Cost of sales increased by 9.3% in 2003/04 to £252.2m (2002/03 £230.7m). Administration expenses increased by 12.0% to £29.9m (2002/03 £26.7m). The increases in cost of sales and administration expenses result from the effects of inflation together with increases in depreciation and bad debts and costs arising from newly commissioned schemes and new regulatory obligations offset by operating efficiencies.

The company has undertaken a major refinancing project in the year.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.7 million (2003: £1.8 million).

Directors and their interests

The directors who held office at 31 March 2004 were as follows:

Martin Baggs
Barrie Delacour
Stuart Derwent
Anthony Fegan
John Harris
David Stainthorpe

Robert Thian (Chairman, appointed 13 May 2003)
Howard Goodbourn (appointed 29 March 2004)
David Golden (appointed 1 November 2003)
Jean Claude Banon (appointed 7 May 2003)
Rory Cullinan (appointed 7 May 2003)
François Darley (appointed 7 May 2003)
Paul de Rosen (appointed 24 February 2004)

Cyril Roger-Lacan (appointed 7 May 2003, resigned 24 February 2004)
Eric Hutchinson (resigned 30 May 2003)
Anthony Nelson (resigned 7 May 2003)
Prof Christopher Chapman (resigned 18 November 2003)

None of the directors who held office at the end of the financial year had any disclosable interests in the shares of the company.

Directors' responsibilities

Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss of the company for that period. In preparing those accounts, 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 accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. The directors are responsible for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements. 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.

Employees

The company has developed its communications processes with its employees to ensure greater understanding of and involvement in the business. This has been achieved through the "Waterline" staff magazine, produced to complement "Southern Water News", and by staff briefings.

The Southern Water Learning business is now firmly established with programmes for school leavers and the long-term unemployed to work alongside and learn from our employees. The Open Learning facilities at all the main company locations reinforce the commitment of the company to providing learning opportunities.

The company has, during the last 12 months, set up a consultation process with local, functional and a company-wide forum, with representatives being voted onto the forum by their teams, irrespective of whether they are Trade Union representatives. The objective in setting up the new process is to ensure that all areas of the company are adequately represented for consultation purposes.

Equal opportunity

Southern Water Services Limited policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The company is a member of the Employers' Forum on Disability, which supports the efforts to meet the needs of the disabled for employment and access to the company and its buildings.

Health and safety

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety, and there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

Southern Water Services Limited has its own internal occupational health service, including the provision of physiotherapy. These services are being developed to meet the needs of the business and our employees at work. These services are continuously being reviewed and developed to meet the changing needs of the business and our employees at work.

Creditor payment policy and practice

The company's current policy and practice concerning the payment of its trade creditors is to follow the Better Payment Practice Code to which it is a signatory. Copies of the Code may be obtained from the Department of Trade and Industry or from the website www.payontime.co.uk.

The company's policy and practice is to settle terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in accordance with its contractual and legal obligations. The company's creditor days at 31 March 2004 were 44 days (2003 : 52 days).

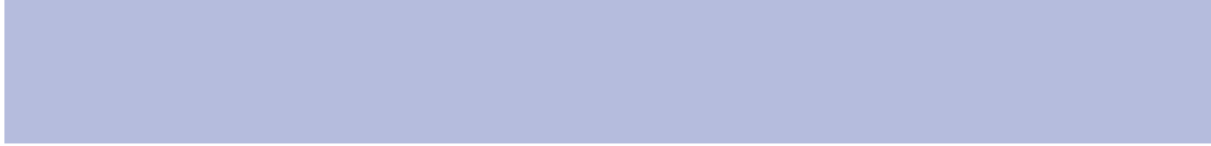
Auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution that they be reappointed will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board.



Kevin Hall
Secretary
2 July 2004



Profit and Loss Account

FOR THE YEAR ENDED 31 MARCH 2004

	Notes	2004 £m	2003 £m
Turnover	1,2,3	455.1	436.5
Cost of sales	3	(252.2)	(230.7)
Gross profit		202.9	205.8
Administrative expenses	3	(29.9)	(26.7)
Other operating income	3	1.6	1.5
Operating profit and profit on ordinary activities before interest and taxation	5	174.6	180.6
Profit on disposal of fixed assets		3.8	8.8
Net interest and similar charges – normal	7	(93.4)	(76.3)
– exceptional	4,7	–	(14.0)
Total net interest and similar charges		(93.4)	(90.3)
Profit on ordinary activities before taxation	5	85.0	99.1
Tax on profit on ordinary activities	8	(26.6)	(35.5)
Profit on ordinary activities after taxation	20	58.4	63.6
Dividends	9,20	(66.5)	(68.0)
Retained (loss) for the financial year	20	(8.1)	(4.4)

The above results relate entirely to continuing operations. The company has no recognised gains and losses other than those included in the loss above and therefore no separate statement of total recognised gains and losses has been presented.

The Notes on pages 8 to 20 form part of these Accounts.

Balance Sheet

AS AT 31 MARCH 2004

	Notes	2004 £m	2003 £m
Fixed assets			
Tangible assets	10	2,711.5	2,631.9
Investments	11	29.2	–
		2,740.7	2,631.9
Current assets			
Stocks	12	1.4	1.8
Debtors: amounts falling due within one year	13	104.7	97.8
Debtors: amounts falling due after one year	14	816.6	–
Cash and deposits		96.6	–
		1,019.3	99.6
Creditors: amounts falling due within one year	15	(225.2)	(1,516.5)
Net current assets/(liabilities)		794.1	(1,416.9)
Total assets less current liabilities		3,534.8	1,215.0
Creditors: amounts falling due after more than one year	16	(2,062.4)	–
Provision for liabilities and charges	17	(375.9)	(372.2)
Grants and contributions	18	(42.5)	(40.7)
Net assets		1,054.0	802.1
Capital and reserves			
Called up share capital	19	0.4	0.1
Share premium	20	306.0	46.3
Profit and loss account	20	747.6	755.7
Total equity shareholders' funds		1,054.0	802.1

The Accounts on pages 5 to 20 were approved by the Board on 2 July 2004 and signed on its behalf by:



Stuart Derwent
Managing Director

Cash Flow Statement

FOR THE PERIOD ENDED 31 MARCH 2004

	Notes	2004 £m	2003 £m
Net cash inflow from operating activities	21	249.8	327.2
Returns on investments and servicing of finance			
Issue costs of new loans		(53.7)	–
Interest paid		(134.8)	(116.2)
Interest received		43.5	–
Non-equity dividends		(9.5)	–
Net cash outflow from returns on investments and servicing of finance		(154.5)	(116.2)
Taxation		(29.5)	(18.6)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(221.0)	(203.7)
Receipt of grants and contributions		10.3	15.8
Disposal of fixed assets		2.2	8.8
Net cash outflow for capital expenditure and financial investment		(208.5)	(179.1)
Acquisitions			
Acquisition of Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)		(29.2)	–
Equity dividends paid		(53.6)	(68.0)
Net cash outflow before financing		(225.5)	(54.7)
Financing			
Increase in borrowings		2,133.5	1,210.6
Repayment of loans		(1,210.6)	(1,148.1)
Issue of long-term loan		(816.6)	–
Proceeds from share issues		260.0	–
Net cash inflow from financing		366.3	62.5
Increase in net cash		140.8	7.8
Reconciliation to net debt			
Net debt at beginning of year		(1,257.3)	(1,202.6)
Increase in net cash		140.8	7.8
Movements in borrowings		(922.9)	(62.5)
Non cash items		(8.7)	–
Net debt at end of year		(2,048.1)	(1,257.3)

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

1 Accounting policies

Basis of accounting

The Accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 1985.

Basis of preparation

The Accounts contain information about Southern Water Services Limited as an individual company and do not contain consolidated financial information as the parent of subsidiary companies.

The company is exempt under section 228 of the Companies Act 1985 from the requirement to prepare consolidated accounts as it and its subsidiary undertaking are included by full consolidation in the consolidated Accounts of the holding company, Southern Water Capital Limited.

Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of the business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured and unmeasured income.

Measured income arises from customers who have meters fitted at their premises. Therefore amounts billed are based on actual water consumption. Unmeasured income bills are based on the rateable value of properties.

The income accrual is an estimation of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average tariffs and historical billing and consumption information.

Bad debts

The bad debt provision is calculated by applying recovery rates to an aged debt profile to ensure that the age of debt not covered by the provision is an accurate reflection of the recoverability of debt.

Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred.

Tangible fixed assets

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

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs represent those costs directly related to the construction of a specific infrastructure asset and are capitalised as part of infrastructure assets on the basis of the amount of time spent by individuals on capital projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

ii) Other assets (including overground assets, plant and equipment) are stated at cost less accumulated depreciation. Other assets are depreciated on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 – 60
Operational structures	15 – 80
Fixed plant	10 – 40
Vehicles, computers and mobile plant	3 – 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

iii) Freehold land is not depreciated.

Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

Grants and contributions

Capital grants and customer contributions in respect of additions to non-infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 4 of the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions, hence these would have been accounted for as deferred income.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the Accounts to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Leased assets

Fixed assets leased to the company under finance leases are capitalised and depreciated in line with the company's depreciation policy. The interest element of finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rentals payable under operating leases are charged to profit and loss account as incurred.

Stocks

Stocks are valued at the lower of cost and net realisable value.

Taxation

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with FRS 19 "Deferred Tax". Deferred taxation balances are not discounted.

Pensions

Southern Water Services Limited operates pension schemes which cover the majority of the employees. A valuation of the defined benefits pension schemes is normally conducted by an independent actuary every three years. In accordance with Statement of Standard Accounting Practice (SSAP) 24, the regular cost of providing pensions and related benefits and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Any difference between the charge to the profit and loss account and the actual contributions paid to the pension schemes is included as an asset or liability in the balance sheet.

Provisions

A provision is recognised when there is a present obligation, whether legal or constructive, as a result of a past event for which it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the obligation.

2 Segmental analysis

The directors believe that the whole of Southern Water Services Limited's activities constitute a single class of business. The company's turnover is generated wholly from within the UK.

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income relates to rents receivable.

4 Exceptional items

During the year ended 31 March 2003, a net exceptional finance cost of £14.0m was incurred with respect to the early redemption of the £100m bonds issued by Southern Water Services Finance plc and charged to Southern Water Services Limited.

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

5 Profit on ordinary activities before taxation

	2004 £m	2003 £m
Profit on ordinary activities before taxation is stated after charging/(crediting):		
Staff costs (note 6a)	51.7	45.5
Depreciation on		
– owned assets	108.1	92.9
– assets held under finance leases	0.4	0.4
	108.5	93.3
Rentals under operating leases	4.9	4.9
Research and development expenditure	1.7	1.8
Release of grants and contributions (note 18)	(1.9)	(1.9)
Auditors' remuneration for audit work	0.2	0.1
Auditors' remuneration for non-audit services to the company	0.1	0.1

Auditors' remuneration of £1.4m has been capitalised as part of the debt issue costs, in accordance with FRS 4, which have been offset against the loans (notes 15 and 16)

6 Employee information

(a) Employee costs (including directors' emoluments):	2004 £m	2003 £m
Wages and salaries	52.7	50.4
Social security costs	4.3	3.6
Pension costs	10.7	8.0
Total employee costs	67.7	62.0
Less: charged as capital expenditure	(16.0)	(16.5)
Charged to the profit and loss account	51.7	45.5

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

(b) Average number of persons employed	2004 No.	2003 No.
Operations	1,177	1,163
Project Delivery	66	65
Customer Services	516	470
Corporate Centre	336	317
	2,095	2,015

Prior year numbers have been restated in order to be consistent with the current year's disclosures. The total numbers have not changed.

7 Net interest and similar charges

	2004 £m	2003 £m
Interest payable on bank loans and overdraft	(0.7)	(1.2)
Interest payable on other loans	(126.2)	(75.1)
Indexation	(8.7)	–
Amortisation of issue costs	(1.7)	–
Exceptional cost arising due to early redemption of £100m bond by subsidiary (note 4)	–	(14.0)
Total interest payable	(137.3)	(90.3)
Interest receivable from Southern Water Services Group Limited	39.4	–
Other interest receivable	4.5	–
Net interest charge	(93.4)	(90.3)

For the years ended 31 March 2003 and 31 March 2004, the company paid interest of £75.1m and £126.2m respectively to Group companies.

8 Tax on profit on ordinary activities

	2004 £m	2003 £m
Current tax		
UK corporation tax on profits of the year at 30% (2003: 30%)	19.4	18.5
Adjustment in respect of prior years	3.3	–
	22.7	18.5
Deferred tax		
Origination and reversal of timing differences	6.6	11.9
Adjustment in respect of prior years	(2.7)	5.1
Total deferred tax	3.9	17.0
Total tax on profit on ordinary activities	26.6	35.5

The rate of current tax charge on profit on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2004 £m	2003 £m
Current tax		
Profit on ordinary activities before tax	85.0	99.1
Current tax:		
UK corporation tax rate at 30% (2003: 30%) on profit for the period	25.5	29.7
Adjustment in respect of prior years	3.3	–
Other differences	0.7	(0.6)
Utilisation of capital losses	(1.2)	–
Permanent differences	1.0	1.3
Tax charge on ordinary activities	29.3	30.4
Effect of deferred tax	(6.6)	(11.9)
Current tax charge for period	22.7	18.5

9 Dividends per share

	2004 £ per ordinary share	2003 £ per ordinary share	2004 £m	2003 £m
Ordinary shares				
Interim dividend – 23 April	267.86	–	15.0	–
Interim dividend – 23 July	196.43	482.14	11.0	27.0
Interim dividend – 30 Sept	134.93	–	7.6	–
Interim dividend – 23 Oct	–	364.29	–	20.4
Interim dividend – 31 Dec	182.56	–	10.2	–
Interim dividend – 23 Jan	–	367.86	–	20.6
Interim dividend – 31 Mar	174.62	–	9.8	–
Total interim dividend	956.40	1,214.29	53.6	68.0
Final dividend	60.71	–	3.4	–
Total ordinary dividend	1,017.11	1,214.29	57.0	68.0
Preference shares				
Class A				
Interim dividend – 30 Sept	7.78	–	1.2	–
Interim dividend – 31 Mar	20.00	–	3.0	–
Class B				
Interim dividend – 30 Sept	13.61	–	1.5	–
Interim dividend – 31 Mar	35.00	–	3.8	–
Total preference dividend	76.39	–	9.5	–
Total dividends	1,093.50	1,214.29	66.5	68.0

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

10 Fixed assets and capital commitments

	Freehold land and buildings £m	Plant and machinery £m	Infrastructure assets £m	Assets in the course of construction £m	Other £m	Total £m
(a) Tangible assets						
Cost:						
At 1 April 2003	816.8	839.4	1,202.6	310.6	281.0	3,450.4
Additions	41.3	73.3	54.7	–	25.4	194.7
Transfers	32.6	24.5	12.5	(67.1)	(2.5)	–
Grants and contributions	–	–	(6.6)	–	–	(6.6)
Disposals	(0.7)	(0.9)	(1.2)	–	(10.9)	(13.7)
At 31 March 2004	890.0	936.3	1,262.0	243.5	293.0	3,624.8
Depreciation:						
At 1 April 2003	186.3	228.4	252.4	–	151.4	818.5
Charge for the year	23.0	35.8	26.7	–	23.0	108.5
Disposals	(0.7)	(0.9)	(1.2)	–	(10.9)	(13.7)
At 31 March 2004	208.6	263.3	277.9	–	163.5	913.3
Net book value:						
At 31 March 2004	681.4	673.0	984.1	243.5	129.5	2,711.5
At 31 March 2003	630.5	611.0	950.2	310.6	129.6	2,631.9

Of the additions to infrastructure assets, the amount spent on infrastructure renewals during the years ended 31 March 2003 and 31 March 2004 was £41.0m and £32.0m, respectively. Of the grants and contributions set against infrastructure assets during the years ended 31 March 2003 and 31 March 2004 £8.9m and £3.9m respectively, relates to infrastructure renewals.

For the years ended 31 March 2003 and 31 March 2004, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £125.7m and £132.3m, respectively.

Freehold land is stated at a cost of £40.8m and £42.3m at 31 March 2003 and 31 March 2004, respectively, and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices. Motor vehicles have also been included in this category as at 31 March 2004. The opening balances of cost and depreciation have therefore been increased from £280.3m and £150.7m to £281.0m and £151.4m respectively.

Assets held under finance leases are capitalised and included in plant and machinery.

	2004 £m	2003 £m
Cost	11.7	11.7
Aggregate depreciation	(7.5)	(7.1)
Net book amount	4.2	4.6

(b) Capital commitments

	2004 £m	2003 £m
In respect of contracts placed	105.7	151.3

11 Fixed asset investments

	2004 £m	2003 £m
Shares in group undertakings		
At 1 April	–	–
Additions in year	29.2	–
At 31 March	29.2	–

Southern Water Services Limited acquired on 23 July 2003 all the issued shares of Southern Water Services (Finance) Limited, a company incorporated in the Cayman Islands. The principal activity of the company is to raise debt finance.

Southern Water Services Limited sold its holding of 49,999 shares of Southern Water Services Finance plc to Southern Water Limited on 23 July 2003. There was no profit or loss on the sale.

12 Stocks

	2004 £m	2003 £m
Raw materials	1.2	1.2
Work in progress	0.2	0.6
	1.4	1.8

13 Debtors: amounts falling due within one year

	2004 £m	2003 £m
Trade debtors	59.0	56.2
Unbilled income	35.9	34.8
Amounts owed by group undertakings	1.9	–
Prepayments	2.0	0.1
Other debtors	5.9	6.7
	104.7	97.8

14 Debtors: amounts falling due after one year

	2004 £m	2003 £m
Loan to Southern Water Services Group Limited (formerly First Aqua Limited)	816.6	–

The loan to Southern Water Services Group Limited (formerly First Aqua Limited) is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7%.

15 Creditors: amounts falling due within one year

	2004 £m	2003 £m
Bank overdraft	2.5	46.7
Trade creditors	18.9	21.6
Loans from group undertakings (see below)	30.3	1,210.6
Capital creditors and capital accruals	90.0	116.4
Amounts owed to group undertakings	3.8	52.6
Corporation tax	7.3	7.3
Other taxation and social security	1.5	1.4
Other accruals and deferred revenue	70.0	59.9
Debt issue costs (note 16)	(2.5)	–
Dividend payable	3.4	–
	225.2	1,516.5

In 2003 the loans from the parent company and group undertakings were unsecured and repayable on demand with varying interest rates between 5-7%. The loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) is unsecured, interest free, and shall be repayable in whole or part upon demand at any time, provided that:

- (a) on the date of such demand, no class A debt is outstanding, no class B debt is outstanding and no mezzanine debt is outstanding; or
- (b) with the consent of the security trustee

An analysis is shown below:

	2004 £m	2003 £m
Loan from parent company	–	495.6
Loan from intermediate holding company	–	594.4
Loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)	30.3	120.6
	30.3	1,210.6

The prior year amount of £120.6m has been reclassified from 'loan from intermediate company' to 'loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)' in order to be consistent with the current year's disclosure. The total numbers have not changed.

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

16 Creditors: amounts falling due after more than one year

	2004 £m	2003 £m
Loans and other borrowings:		
Loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)	2,111.9	–
Debt issue costs	(49.5)	–
	2,062.4	–

	2004 £m	2003 £m
Repayments fall due as follows:		
Between one to two years	–	–
Between two and five years	300.0	–
After five years not by instalments	1,811.9	–
After five years by instalments	–	–
	2,111.9	–

As part of the Southern Water Group refinancing on 23rd July 2003 Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) raised new debt in the financial markets and on-lent the borrowings to Southern Water Services Limited.

Under the loan agreement between Southern Water Services Limited and Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited), Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) on-lends an amount equal to each bond or other debt raised at the same interest rate plus 0.01%. Therefore each individual back to back inter company loan has been separately disclosed.

An analysis of the loans is shown below:

	2004 £m	2003 £m
Loans		
Class A £350m 6.202% fixed rate 2029	350.0	–
Class A £150m 3.716% index linked 2034	152.6	–
Class A £35m 3.716% index linked 2034	35.6	–
Class A £300m 6.185% fixed rate 2007	300.0	–
Class A £350m 6.650% fixed rate 2026	350.0	–
Class A £150m 3.826% index linked 2023	152.9	–
Class A £120m 6.935% fixed rate 2013 (note (i) below)	120.0	–
Class B £250m 7.879% fixed rate 2038 (note (ii) below)	250.0	–
Artesian £165m 4.086% index linked 2033	167.6	–
Senior mezzanine £127.2m 11.97% fixed rate 2038 (note (iii) below)	127.2	–
Junior mezzanine £106m 16.01% fixed rate 2038	106.0	–
Debt issue costs	(49.5)	–
	2,062.4	–

These loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) Southern Water Services Holdings Limited, and Southern Water Services Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and Licence.

The following loans were repaid on the 23rd July 2003: -

	£m
Loan from Southern Water Limited (formerly Southern Water plc)	495.6
Loan from Southern Water Services Group Limited (formerly First Aqua Limited)	594.4
Loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)	120.6

Debt issue costs represent issue fees paid to Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited). These are being amortised over the weighted average life of the loan advances noted above. As at 31 March 2004 debt issue costs amounted to £52.0m of which £2.5m represents the short-term amount which is disclosed separately in note 15.

Notes

- (i): The interest rate on the class A6 £120m is fixed at 6.935% until March 2009 when it reverts to LIBOR plus 2.95% with a premium of 0.01%.
- (ii): The interest rate on the class B1 £250m is fixed at 7.879% until March 2014 when it reverts to LIBOR plus a margin to be determined with a premium of 0.01%.
- (iii): The interest rate on the senior mezzanine £125m loan is fixed at 11.97% until March 2022 when it reverts to LIBOR plus 6.25% with a premium of 0.01%. For the remaining senior mezzanine loan of £2.2m the interest rate is LIBOR plus 6.25% with a premium of 0.01%.

17 Provision for liabilities and charges

	2004 £m	2003 £m
(a) Environmental obligations		
At 1 April	3.1	3.1
Utilised in year	(0.2)	–
At 31 March	2.9	3.1
(b) Deferred taxation		
Accelerated capital allowances	383.4	378.0
Other timing differences	(10.4)	(8.9)
Deferred taxation	373.0	369.1
Total	375.9	372.2

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. As the period over which the provision will be utilised cannot be determined the provision is not discounted.

	2004 £m	2003 £m
Movement in deferred tax provision		
Deferred tax provided at 1 April	369.1	352.1
Deferred tax charge in Profit and Loss Account	3.9	17.0
Deferred tax provided at 31 March	373.0	369.1

18 Grants and contributions

	£m
At 1 April 2003	40.7
Receivable in year	3.7
Released to profit and loss account	(1.9)
At 31 March 2004	42.5

Grants and contributions relate to non-infrastructure assets.

19 Share capital

	2004 £m	2003 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	46.1	46.1
Non equity shares		
Preference shares		
150,000 Class A1 shares of £1 each	0.2	–
150,000 Class A2 shares of £0.01 each	0.0	–
110,000 Class B shares of £1 each	0.1	–
Allotted, called up and fully paid		
56,000 ordinary shares of £1 each	0.1	0.1
Non equity shares		
Preference shares issued		
150,000 Class A1 shares of £1 each	0.2	–
150,000 Class A2 shares of £0.01 each	0.0	–
110,000 Class B shares of £1 each	0.1	–
	0.4	0.1

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

19 Share capital *continued*

The preference shares which do not carry voting rights, were issued on 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0m for both classes of shares. Class A2 were issued for £0.01 per share and the amount received totalled £1,500. Shareholders are entitled to receive dividends as follows:-

Class A1

- £40 per share

Class A2

- the base value dividend plus an amount for company outperformance. The base value is £nil per share increasing by £15 every five years. (Outperformance is the difference between the company's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by OFWAT in the periodic review).

Class B

- £70 per share

These dividends are payable on the 31 March and 30 September each year. On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

20 Reconciliation of movement in shareholders' funds

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2002	0.1	46.3	760.1	806.5
Profit before dividends paid	–	–	63.6	63.6
Dividends paid	–	–	(68.0)	(68.0)
At 31 March 2003	0.1	46.3	755.7	802.1
At 1 April 2003	0.1	46.3	755.7	802.1
Issue of preference shares	0.3	259.7	–	260.0
Profit before dividends paid	–	–	58.4	58.4
Dividends paid	–	–	(66.5)	(66.5)
At 31 March 2004	0.4	306.0	747.6	1,054.0

21 Cash Flow from operating activities

	2004 £m	2003 £m
Continuing operations		
Operating profit and profit on ordinary activities before interest and taxation	174.6	180.6
Depreciation charge	108.5	93.3
Amortisation of grants and contributions	(1.9)	(1.8)
Decrease in environmental provision	(0.2)	–
Decrease in stocks	0.4	2.3
(Increase)/decrease in debtors	(5.3)	14.0
(Decrease)/increase in creditors	(26.3)	38.8
Total net cash inflow from operating activities	249.8	327.2

22 Pensions

The company accounted for pension costs during the year under SSAP 24, but has also made the detailed disclosures required under the transitional arrangements under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £104.5 million (2003 deficit £99.5m). The deficit has arisen mainly as a result of turbulence in the stock market and low interest rates.

Pension schemes operated

At 1 April 2003 the company principally operated three schemes, but in November 2003 ceased their involvement with the Scottish Power plc pension scheme and transferred the assets to the Southern Water Pension Scheme (SWPS). Details of the schemes are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme which was closed to new members in 31 December 1998 but re-opened in July 2003. This scheme has nine trustee directors.
 2. Southern Water Executive Pension Scheme (SWEPS), which is a funded defined benefit scheme. This scheme has four trustee directors.
- Both of the above schemes are operated by Southern Water Services Limited.
- The assets of the schemes are held separately from those of the company. State Street Bank and Trust Company acts as custodian for the defined benefit scheme and asset management is delegated to external fund managers.
3. Scottish Power plc pension scheme, which was a defined benefit scheme was closed to Southern Water employees in November 2003, when they were transferred back to SWPS. This was administered by Scottish Power plc, however, the company made contributions on behalf of certain of its employees.

Members of both remaining schemes receive an annual statement of their accrued benefits.

The latest actuarial valuations of the Southern Water Pension Scheme (SWPS) and Southern Water Services Executive Pension (SWEPS) schemes were carried out as at 31 March 2001 using the projected unit method. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments, the rate of future pensionable salary increases and the level of pension increases.

The principal assumptions made by the actuary in the valuation were as follows:

	2001 SWPS %pa	2001 SWEPS %pa
Return on investments	6.2	5.3
Salary growth	4.5	4.5
Pension increases on the excess over guaranteed minimum pensions	2.5	2.5

The assets of the scheme had a market value of £296.0m for the SWPS and £22.0m for the SWEPS at 31 March 2001. This was sufficient to cover 107% and 102% of the benefits of SWPS and SWEPS respectively, that had accrued to members at that date, after allowing for expected future increases in earnings.

The funding level is likely to have deteriorated since the March 2001 actuarial valuation due to adverse stock movements.

Regular pension costs under SSAP 24

1. Pension costs for the SWPS (including costs transferred from the Scottish Power plc scheme) and SWEPS during the year were £10.1m (2003 - £7.1m). The pension cost for the year was greater than the actual contribution paid of £7.4m (2003 - £4.1m) resulting in an accrual in the balance sheet at 31 March 2004 of £5.9m (2003 - £3.2m). The increased cost is in relation to the fund deficits.
2. Pension costs for the employees previously in the Scottish Power plc scheme (now transferred to the SWPS) were £0.6m (2003 - £0.9m). The actual contributions for the year were also £0.6m, resulting in no accruals or prepayments being held on the balance sheet (2003 - £0.9m).

FRS 17 – disclosures

The Company is following the transitional arrangements under FRS 17 and the required disclosures are made below.

FRS 17 – assumptions, asset, liability and reserves disclosures

Formal actuarial funding valuations of the two principal defined benefit schemes in the UK were carried out at 1 April 2001 and updated to 31 March 2004 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below:

	2004 %pa	2003 %pa	2002 %pa
Price inflation	2.9	2.5	2.8
Rate of increase in salaries (plus an age-related promotional scale)	4.4	4.0	4.3
Rate of increase of pensions in payment	2.9	2.5	2.8
Rate of increase for deferred pensions	2.9	2.5	2.8
Discount rate	5.6	5.6	6.0
Expected return on assets – SWPS	7.3	7.5	7.3
Expected return on assets – SWEPS	5.6	5.6	6.0

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

22 Pensions *continued*

FRS 17 – assumptions, asset, liability and reserves disclosures

The assets and liabilities in the schemes and the expected rates of return at the 31 March 2004, 31 March 2003 and 31 March 2002 were:

	Rate of return 2004	Rate of return 2003	Rate of return 2002	Value at 2004 £m	Value at 2003 £m	Value at 2002 £m
Equities	8.4%	8.7%	8.0%	192.6	156.4	210.3
Bonds	4.8%	4.7%	5.3%	87.9	78.6	84.2
Cash	3.9%	4.0%	3.8%	4.9	1.9	5.1
Total market value of Plan assets				285.4	236.9	299.6
Total value of Plan liabilities				(434.6)	(379.1)	(338.6)
Accrued deficit in the Plan				(149.2)	(142.2)	(39.0)
Related deferred tax asset				44.7	42.7	11.7
Net pension liability				(104.5)	(99.5)	(27.3)

If FRS 17 had been adopted and therefore the pension liabilities as discussed above were to be recognised, the company's net assets and profit and loss account after taking account of the effect of both pension schemes would have been as follows:

	2004 £m	2003 £m
Shareholders' funds		
As reported (note 20)	1,054.0	802.1
SSAP 24 accrual in relation to SWPS and SWEPS, net of related deferred tax	4.1	2.1
FRS 17 net pension liability as above	(104.5)	(99.5)
As adjusted for FRS 17	953.6	704.7

	2004 £m	2003 £m
Profit and loss account		
As reported (note 20)	747.6	755.7
SSAP 24 accrual as above	4.1	2.1
FRS 17 net pension liability as above	(104.5)	(99.5)
As adjusted for FRS 17	647.2	658.3

FRS 17 – profit and loss account disclosures

The following amounts would have been recognised in the profit and loss account for the year to 31 March 2004 under the requirements of FRS 17.

	2004 £m	2003 £m
Analysis of amounts charged to operating profit		
Employer's current service cost	7.2	6.4
Employer's past service cost	0.2	2.0
Total charged to operating profit	7.4	8.4

	2004 £m	2003 £m
Analysis of other amounts credited to the profit and loss account		
(Gain) on settlements	(0.2)	–
Net gain credited to profit and loss account	(0.2)	–

22 Pensions *continued*

	2004 £m	2003 £m
Analysis of the amount charged to other finance income		
Interest on pension scheme liabilities	21.1	20.3
Expected return on pension scheme assets	(17.0)	(21.4)
Net charge/(credit) to other finance income	4.1	(1.1)
Total P&L charge before tax	11.3	7.3

	2004 £m	2003 £m
Analysis of the amounts recognised in STRGL		
Actuarial gain/(loss) on scheme assets	33.4	(77.6)
Experience loss arising on scheme liabilities	(6.8)	(3.0)
Loss on change of assumptions (financial and demographic)	(27.5)	(19.4)
Total loss recognised in STRGL before adjustment for tax	(0.9)	(100.0)

	2004 £m	2003 £m
Analysis of the movement in the schemes' deficits during the year		
Deficit in the plan at 1 April 2003	(142.2)	(39.0)
Employer's contributions	7.4	4.1
Employer's current service cost	(7.2)	(6.4)
Employer's past service cost	(0.2)	(2.0)
Settlement gain	0.2	–
Acquisitions loss	(2.2)	–
Other finance income	(4.1)	1.1
Actuarial loss	(0.9)	(100.0)
Deficit in the scheme at end of year	(149.2)	(142.2)

	2004 £m	2003 £m
Details of experience gains and losses for the year to 31 March 2004 are as follows:		
a. Actuarial (gain)/loss on scheme assets		
Amount (£m)	(34.0)	77.6
Percentage of the scheme assets	11.9%	32.8%
b. Experience loss on scheme liabilities		
Amount (£m)	6.8	3.0
Percentage of the present value of the scheme liabilities	1.6%	0.8%
c. Total actuarial loss recognised in STRGL		
Amount (£m)	0.3	100.0
Percentage of the present value of the scheme liabilities	0.1%	26.4%

23 Contingent liabilities

	2004 £m	2003 £m
Capital claims	21.9	22.5

Contractors submit claims to the company for the estimated final cost of their works. These claims are reviewed by Southern Water, who assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractors claim and Southern Water's valuation.

Notes to the Accounts

FOR THE YEAR ENDED 31 MARCH 2004

24 Financial commitments

	2004 £m	2003 £m
At 31 March 2004, the company had annual commitments under non-cancellable operating lease agreements in respect of vehicles for which the payment extends over a number of years as follows:		
Expiring within one year	1.0	1.6
Expiring between two and five years	2.8	2.0
	3.8	3.6

Operating leases are charged to the Profit and Loss Account over the lease term.

25 Directors' emoluments

	2004 £000	2003 £000
Aggregate emoluments (including benefits in kind)	1,568	922

Retirement benefits are accruing to five directors under a Southern Water defined benefit scheme.

Details of emoluments and benefits for the highest paid director:

	2004 £000	2003 £000
Aggregate highest paid director's emoluments and benefits	331	234
Defined benefit scheme: Accrued annual pension at 31 March	99	90

26 Related party transactions

The company has taken an exemption, as allowed by Financial Reporting Standard 8, not to disclose related party transactions with other group companies as the holding company, Southern Water Capital Limited publishes full statutory consolidated Accounts.

Prior to 7 May 2003, an immediate parent undertaking Southern Water Services Group Limited (formerly First Aqua Limited) published full statutory consolidated Accounts.

27 Ultimate holding company

The immediate parent undertaking is SWS Holdings Limited.

Up to 7 May 2003, the ultimate parent undertaking and controlling party was First Aqua Holdings Limited.

At 31 March 2004, the ultimate parent undertaking and controlling party was Southern Water Capital Limited, which prepares consolidated accounts. Copies of Southern Water Capital Limited's consolidated Accounts may be obtained from the Company Secretary of Southern Water Services Limited at Southern House, Yeoman Road, Worthing, BN13 3NX.

Independent Auditors' Report

FOR THE YEAR ENDED 31 MARCH 2004

Independent auditors' report to the members of Southern Water Services Limited.

We have audited the accounts which comprise the profit and loss account, the balance sheet, the cash flow statement, and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the accounting policy note.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the directors' report and the accounts in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. 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 accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the accounts, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the accounts and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. The other information comprises only the directors' report.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the 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 accounts 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 accounts.

Opinion

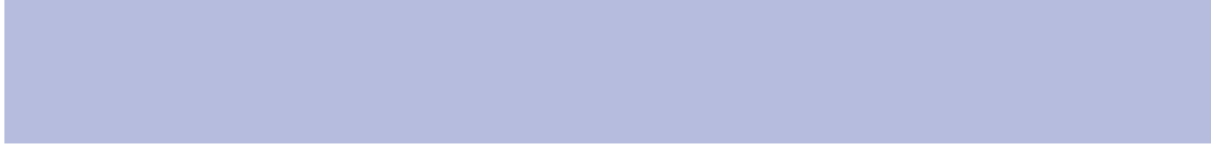
In our opinion the accounts give a true and fair view of the state of the company's affairs at 31 March 2004 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PricewaterhouseCoopers LLP

Chartered Accountants
and Registered Auditors
London

7 July 2004



Supplementary Regulatory Accounting Statements

The following **Supplementary Accounts** are published under the terms of the company's Instrument of Appointment as a water and sewerage undertaker under the Water Industry Act 1991 and have been prepared in accordance with the requirements of the Regulatory Accounting Guidelines issued by the Director General of Water Services.

Regulatory Historical Cost Profit and Loss Account

FOR THE YEAR ENDED 31 MARCH 2004

	Notes	Appointed Business £m	2004 Non- Appointed Business £m	Total £m	Appointed Business £m	2003 Non- Appointed Business £m	Total £m
Turnover		448.3	6.8	455.1	431.1	5.4	436.5
Operating costs		(278.3)	(3.8)	(282.1)	(254.3)	(3.1)	(257.4)
Operating income	(a)	3.8	–	3.8	8.8	–	8.8
Operating profit		173.8	3.0	176.8	185.6	2.3	187.9
Other income		0.4	1.2	1.6	0.4	1.1	1.5
Net interest - normal		(93.4)	–	(93.4)	(76.3)	–	(76.3)
- exceptional		–	–	–	(14.0)	–	(14.0)
Profit on ordinary activities before taxation		80.8	4.2	85.0	95.7	3.4	99.1
Taxation							
- Current tax		(22.7)	–	(22.7)	(18.5)	–	(18.5)
- Deferred tax		(3.9)	–	(3.9)	(17.0)	–	(17.0)
Profit on ordinary activities after taxation		54.2	4.2	58.4	60.2	3.4	63.6
Dividends		(62.3)	(4.2)	(66.5)	(68.0)	–	(68.0)
Retained (loss)/profit for the year		(8.1)	–	(8.1)	(7.8)	3.4	(4.4)

(a) This relates to profit on sale of fixed assets.

The appointed business comprises those activities which are necessary for the company to fulfil its function and duties as a water and sewerage undertaker.

No separate calculation or allocation of UK corporation tax or net interest charge has been performed for the non-appointed business.

Regulatory Historical Cost Balance Sheet

AS AT 31 MARCH 2004

	Notes	Appointed Business £m	2004 Non- Appointed Business £m	Total £m	Appointed Business £m	2003 Non- Appointed Business £m	Total £m
Fixed assets							
Tangible assets	(a)	2,673.2	1.3	2,674.5	2,594.9	1.5	2,596.4
Investments		845.8	–	845.8	–	–	–
Current assets							
Stocks		1.2	0.2	1.4	1.4	0.4	1.8
Debtors		140.8	0.9	141.7	132.9	0.4	133.3
Cash		96.6	–	96.6	–	–	–
Total current assets		238.6	1.1	239.7	134.3	0.8	135.1
Creditors: amounts falling due within one year:							
Short term borrowing		(2.5)	–	(2.5)	(1,257.3)	–	(1,257.3)
Dividends payable		(3.4)	–	(3.4)	–	–	–
Other creditors		(186.1)	(2.4)	(188.5)	(229.0)	(2.3)	(231.3)
Creditors due within one year		(192.0)	(2.4)	(194.4)	(1,486.3)	(2.3)	(1,488.6)
Net current assets/(liabilities)		46.6	(1.3)	45.3	(1,352.0)	(1.5)	(1,353.5)
Total assets less current liabilities		3,565.6	–	3,565.6	1,242.9	–	1,242.9
Creditors: amounts falling due after one year:							
Borrowings		(2,062.4)	–	(2,062.4)	–	–	–
Other creditors	(b)	(42.5)	–	(42.5)	(40.7)	–	(40.7)
Total creditors: amounts falling due after one year		(2,104.9)	–	(2,104.9)	(40.7)	–	(40.7)
Provisions for liabilities and charges:							
Deferred tax		(373.0)	–	(373.0)	(369.1)	–	(369.1)
Other provisions		(2.9)	–	(2.9)	(3.1)	–	(3.1)
Deferred income	(c)	(30.8)	–	(30.8)	(27.9)	–	(27.9)
Net assets employed		1,054.0	–	1,054.0	802.1	–	802.1
Capital and reserves							
Called up share capital		0.4	–	0.4	0.1	–	0.1
Share premium		306.0	–	306.0	46.3	–	46.3
Profit and loss account		747.6	–	747.6	755.7	–	755.7
Total equity shareholders' funds		1,054.0	–	1,054.0	802.1	–	802.1

(a) see page 26 for reconciliation to Statutory Accounts.

(b) this amount relates to grants and contributions.

(c) this amount is included in the "Other accruals and deferred revenue" line in note 15 to the Statutory Accounts.

Historical Cost Balance Sheet Reconciliation to Statutory Accounts

FOR THE YEAR ENDED 31 MARCH 2004

In the preparation of its Statutory Accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis set out in FRS 15. Note 1(d) to the Regulatory Accounts sets out this basis of infrastructure renewals accounting.

However, for the purposes of the Regulatory Accounts, OFWAT have requested that this FRS 15 basis is not applied, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the Statutory Accounts and the balance sheet shown above, is set out below:

	2004 £m	2003 £m
Fixed assets		
Cost per Regulatory Accounts	3,303.9	3,157.7
Adjustment to opening balance	292.7	260.6
Infrastructure renewals expenditure capitalised in the year	28.2	32.1
Cost per Statutory Accounts	3,624.8	3,450.4
Depreciation per Regulatory Accounts	629.4	561.3
Adjustment to opening balance	257.2	233.5
Depreciation charge for infrastructure renewals expenditure	26.7	23.7
Depreciation per Statutory Accounts	913.3	818.5
Net book value per Regulatory Accounts	2,674.5	2,596.4
Adjustment for infrastructure renewals accounting	37.0	35.5
Net book value per Statutory Accounts	2,711.5	2,631.9
Debtors		
Per Regulatory Accounts	141.7	133.3
Infrastructure renewals prepayment	(37.0)	(35.5)
Per Statutory Accounts	104.7	97.8

Current Cost Profit and Loss Account for the Appointed Business

FOR THE YEAR ENDED 31 MARCH 2004

	Notes	2004 £m	2003 £m
Turnover	2	448.3	431.1
Current cost operating costs	3,4	(337.1)	(314.6)
Operating income	2	3.8	8.8
		115.0	125.3
Working capital adjustment	1(c),2	3.3	2.3
Current cost operating profit		118.3	127.6
Other income		0.4	0.4
Net interest - normal		(93.4)	(76.3)
- exceptional		-	(14.0)
Financing adjustment	1(c)	42.2	48.2
Current cost profit before taxation		67.5	85.9
Taxation			
- Current tax		(22.7)	(18.5)
- Deferred tax		(3.9)	(17.0)
Current cost profit attributable to shareholders		40.9	50.4
Dividends		(62.3)	(68.0)
Current cost loss retained		(21.4)	(17.6)

Current Cost Balance Sheet for the Appointed Business

FOR THE YEAR ENDED 31 MARCH 2004

	Notes	2004 £m	2003 £m
Tangible fixed assets	5	13,278.6	12,919.5
Third party contributions since 31 March 1990		(156.4)	(148.0)
		13,122.2	12,771.5
Working capital	6	(45.7)	(120.7)
Net operating assets		13,076.5	12,650.8
Cash and investments		942.4	–
Non-trade debtors		5.9	6.8
Non-trade creditors due within one year		(37.6)	(1,264.6)
Creditors due after one year		(2,062.4)	–
Provisions for liabilities and charges:			
Deferred tax		(373.0)	(369.1)
Other provisions		(2.9)	(3.1)
Dividends payable		(3.4)	–
Net assets employed		11,545.5	11,020.8
Capital and reserves			
Called up share capital		0.4	0.1
Share premium		306.0	46.3
Profit and loss account		(88.7)	(67.3)
Current cost reserve	7	11,327.8	11,041.7
Total capital and reserves		11,545.5	11,020.8

Note: For 2003, £7.3m has been reclassified from “working capital” to “non-trade creditors within one year” in order to be consistent with the current year’s disclosure.

Current Cost Cash Flow Statement for the Appointed Business

FOR THE YEAR ENDED 31 MARCH 2004

	Notes	Appointed Business £m	2004 Non- Appointed Business £m	Total £m	Appointed Business £m	2003 Non- Appointed Business £m	Total £m
Net cash inflow from operating activities	8	245.6	4.2	249.8	327.0	0.2	327.2
Returns on investments and servicing of finance							
Issue costs of new loans		(53.7)	–	(53.7)	–	–	–
Interest received		43.5	–	43.5	–	–	–
Interest paid		(134.8)	–	(134.8)	(116.2)	–	(116.2)
Non-equity dividends paid		(9.5)	–	(9.5)	–	–	–
Net cash outflow from returns on investments and servicing of finance		(154.5)	–	(154.5)	(116.2)	–	(116.2)
Taxation		(29.5)	–	(29.5)	(18.6)	–	(18.6)
Capital expenditure and financial investment							
Gross purchase of fixed assets		(188.9)	–	(188.9)	(171.4)	(0.2)	(171.6)
Receipts of grants and contributions		6.4	–	6.4	15.8	–	15.8
Infrastructure renewals expenditure		(28.2)	–	(28.2)	(32.1)	–	(32.1)
Disposal of fixed assets		2.2	–	2.2	8.8	–	8.8
Net cash outflow from capital expenditure and financial investment		(208.5)	–	(208.5)	(178.9)	(0.2)	(179.1)
Equity dividends paid		(49.4)	(4.2)	(53.6)	(68.0)	–	(68.0)
Purchase of other investments		(29.2)	–	(29.2)	–	–	–
Net cash (outflow) before financing		(225.5)	–	(225.5)	(54.7)	–	(54.7)
Financing							
Increase in borrowings		2,133.5	–	2,133.5	1,210.6	–	1,210.6
Repayment of borrowings		(1,210.6)	–	(1,210.6)	(1,148.1)	–	(1,148.1)
Issue of long-term loan		(816.6)	–	(816.6)	–	–	–
Proceeds from share issues		260.0	–	260.0	–	–	–
Net cash inflow from financing		366.3	–	366.3	62.5	–	62.5
Increase in cash and cash equivalents	9	140.8	–	140.8	7.8	–	7.8



Notes to the Current Cost Accounts

FOR THE YEAR ENDED 31 MARCH 2004

1 Accounting Policies

(a) General

These supplementary current cost Accounts have been prepared in accordance with guidance issued by the Director General of Water Services for modified real terms Accounts for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of assets which are valued at their current cost value to the business with the exception of assets acquired prior to 31 March 1990, the effective commencement of the new regulatory regime.

These Accounts have been prepared in accordance with Regulatory Accounting Guidelines (RAGs) 1 to 4. In respect of cost allocations the company has continued to allocate costs as in previous years on the basis suggested in RAG 4 (Analysis of Operating Costs and Assets). The accounting policies used are the same as those adopted in the statutory historical cost Accounts, except as set out below.

(b) Periodic review

The Strategic Business Plan produced by the company for the Periodic Review re-assessed asset stock and valuations. The valuations used in the current cost statements have been based on data from the 1999 Strategic Business Plan.

(c) Real financial capital maintenance adjustments

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

Depreciation adjustment – this is the difference between depreciation based on the current cost value of assets in these Accounts and depreciation charged in arriving at historical cost profit. The depreciation adjustment is incorporated within operating costs in the Profit and Loss Account.

Working capital adjustment – this is calculated by applying the change in the Retail Price Index (RPI) over the year to the opening total of trade debtors and stock less trade creditors.

Disposal of fixed assets adjustment – the difference between the values of realised assets in these current cost Accounts and in the historical cost Accounts. The disposal of fixed assets adjustment is incorporated within operating income in the Profit and Loss Account.

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.

(d) Infrastructure renewals accounting

For the purposes of the Regulatory Accounts, infrastructure renewals accounting has been continued and the relevant sections of FRS 15 have been dis-applied. A reconciliation between the statutory and Regulatory Accounts has been provided on page 26.

(e) Tangible fixed assets

Assets acquired prior to 31 March 1990 and 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 possible funding of future replacements of pre-31 March 1990 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.

Land and buildings – non-specialised operational properties have been valued using existing current cost values at 31 March 1993 as an estimate of open market value for existing use at that date, as the directors believe that there is no material difference between these values. These values have been adjusted for inflation using RPI since that date.

Specialised operational properties are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between Periodic Reviews by adjusting for inflation using 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 Asset Management Plan (AMP).

A process of continuing refinement of asset records is expected to produce adjustments to existing values when Periodic Reviews of the AMP take place. In intervening years, values are restated for inflation using the RPI.

Other operational fixed assets – all other operational fixed assets are valued periodically at depreciated replacement cost. Between Periodic Reviews, values are restated for inflation using the RPI.

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

(f) 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 released to profit. The balance carried forward is restated for the change in the RPI for the year and is treated as deferred income.

2 Analysis of turnover and operating income for the appointed business

	Water Supply £m	2004 Sewerage Services £m	Total Appointed Business £m	Water Supply £m	2003 Sewerage Services £m	Total Appointed Business £m
Turnover						
Measured	43.1	95.0	138.1	41.3	86.9	128.2
Unmeasured	65.6	219.0	284.6	65.5	212.5	278.0
Trade effluent	–	6.8	6.8	–	7.1	7.1
Large user revenues	3.9	2.4	6.3	4.0	2.4	6.4
Other sources (excluding third parties)	0.7	6.9	7.6	0.6	6.6	7.2
Third party services	4.9	–	4.9	4.2	–	4.2
Total turnover	118.2	330.1	448.3	115.6	315.5	431.1
Operating income						
Current cost profit on disposal of fixed assets	1.4	2.4	3.8	4.6	4.2	8.8
Working capital adjustment	0.9	2.4	3.3	0.6	1.7	2.3

3 Reconciliation of Historical to Current Cost operating costs

	2004 £m	2004 £m	2003 £m	2003 £m
Historical cost operating costs		278.3		254.3
Current cost depreciation	139.1		129.8	
Historical cost depreciation	(81.8)	57.3	(69.5)	60.3
Current cost infrastructure renewals charge	28.2		23.7	
Historical cost infrastructure renewals charge	(26.7)	1.5	(23.7)	–
Current cost operating costs		337.1	–	314.6

Infrastructure renewals charge

The difference originated in the 31 March 1993 accounts when the infrastructure renewals charge in the Current Cost Accounts of £15.1m had been calculated in accordance with the guidance issued by the Office of Water Services in May 1993. It was thus based on 87/88 prices indexed by the cumulative RPI movement since that date of 36%.

The charge in the Historical Cost Accounts was £16.6m based on 91/92 prices indexed by the average 92/93 inflation rate.

This difference has now been reversed in the current year.

Notes to the Current Cost Accounts

FOR THE YEAR ENDED 31 MARCH 2004

4 Analysis of current cost operating costs by service - 2004

	Service analysis								Business services			
	Water supply			Sewerage					Sewerage service sub total £m	Customer services £m	Scientific services £m	Cost of regulation £m
	Resources and treatment £m	Distribution £m	Water supply sub total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment and disposal £m					
Direct costs												
Employment costs	1.1	3.2	4.3	3.5	3.9	3.9	7.8	11.3				
Power	1.1	3.5	4.6	2.1	5.9	1.2	7.1	9.2				
Hired & contracted services	0.9	5.5	6.4	1.6	1.3	2.0	3.3	4.9				
Materials & consumables	0.1	1.5	1.6	0.5	0.6	0.3	0.9	1.4				
Service charges, EA	3.7	–	3.7	0.5	2.5	–	2.5	3.0				
Other direct costs	1.2	0.3	1.5	0.4	1.1	14.0	15.1	15.5				
Total direct costs	8.1	14.0	22.1	8.6	15.3	21.4	36.7	45.3	11.2	2.8	1.4	
General & support expenditure	6.8	10.5	17.3	7.8	14.8	12.7	27.5	35.3	4.6	1.3	0.6	
Functional expenditure	14.9	24.5	39.4	16.4	30.1	34.1	64.2	80.6	15.8	4.1	2.0	
Total Business Activities			9.2					12.7				
Rates			6.5					8.8				
Doubtful debts			2.6					8.3				
Total opex less third party services			57.7					110.4				
Third party services – opex			3.7					–				
Total operating expenditure			61.4					110.4				
Capital costs												
Infrastructure renewal expenditure accrual/prepayment	0.7	17.2	17.9	10.0	0.3	–	0.3	10.3				
Current cost depreciation (allocated)	–	(3.6)	(3.6)	3.6	–	–	–	3.6				
Amortisation of deferred credits	29.1	4.2	33.3	30.7	46.3	28.8	75.1	105.8				
			(0.5)					(1.5)				
Capital maintenance												
excluding third party services			47.1					118.2				
Third party services – capital maintenance			–					–				
Total capital maintenance			47.1					118.2				
Total operating costs			108.5					228.6				
Total operating expenditure above includes												
Reactive and Planned Maintenance of:												
Infrastructure	–	10.0	10.0	5.0	–	–	–	5.0				
Non-Infrastructure	2.8	0.4	3.2	2.9	3.7	4.2	7.9	10.8				
CCA (MEA) values												
Service activities	544.9	2,714.5	3,259.4	8,174.2	1,125.3	699.4	1,824.7	9,998.9				
Business activities			–					–				
Service totals	544.9	2,714.5	3,259.4	8,174.2	1,125.3	699.4	1,824.7	9,998.9				
Services for third parties			20.3					–				
Total CCA (MEA) values			3,279.7					9,998.9				

4 Analysis of current cost operating costs by service - 2003

	Service analysis								Business services		
	Water supply			Sewerage					Customer services £m	Scientific services £m	Cost of regulation £m
	Resources and treatment £m	Distribution £m	Water supply sub total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment and disposal £m	Sewerage service sub total £m			
Direct costs											
Employment costs	0.9	2.8	3.7	3.2	4.2	3.5	7.7	10.9			
Power	1.2	3.1	4.3	2.3	6.8	1.4	8.2	10.5			
Hired & contracted services	1.0	4.7	5.7	1.4	1.1	2.0	3.1	4.5			
Materials & consumables	0.2	1.1	1.3	0.4	0.6	0.3	0.9	1.3			
Service charges, EA	3.7	–	3.7	0.8	2.2	–	2.2	3.0			
Other direct costs	1.5	0.4	1.9	0.3	0.7	11.9	12.6	12.9			
Total direct costs	8.5	12.1	20.6	8.4	15.6	19.1	34.7	43.1	10.2	3.0	1.3
General & support expenditure	7.6	9.2	16.8	6.9	14.1	10.0	24.1	31.0	3.1	1.1	0.5
Functional expenditure	16.1	21.3	37.4	15.3	29.7	29.1	58.8	74.1	13.3	4.1	1.8
Total Business Activities			8.3					10.9	(13.3)	(4.1)	(1.8)
Rates			6.4					8.8			
Doubtful debts			3.9					10.1			
Total opex less third party services			56.0					103.9			
Third party services – opex			3.0					–			
Total operating expenditure			59.0					103.9			
Capital costs											
Infrastructure renewal expenditure	2.3	15.6	17.9	13.7	0.5	–	0.5	14.2			
Movement in infrastructure renewal prepayment	–	(7.0)	(7.0)	(1.4)	–	–	–	(1.4)			
Current cost depreciation (allocated)	26.4	4.0	30.4	30.1	42.7	26.6	69.3	99.4			
Amortisation of deferred credits			(0.4)					(1.4)			
Capital maintenance											
excluding third party services			40.9					110.8			
Third party services – capital maintenance			–					–			
Total capital maintenance			40.9					110.8			
Total operating costs			99.9					214.7			
Total operating expenditure above includes Reactive and Planned Maintenance of:											
Infrastructure	–	7.5	7.5	4.7	–	–	–	4.7			
Non-Infrastructure	2.4	0.4	2.8	2.9	3.8	3.7	7.5	10.4			
CCA (MEA) values											
Service activities	541.0	2,632.6	3,173.6	7,971.4	1,082.2	672.6	1,754.8	9,726.2			
Business activities			–					–			
Service totals	541.0	2,632.6	3,173.6	7,971.4	1,082.2	672.6	1,754.8	9,726.2			
Services for third parties			19.7					–			
Total CCA (MEA) values			3,193.3					9,726.2			

Notes to the Current Cost Accounts

FOR THE YEAR ENDED 31 MARCH 2004

5(a) Current cost analysis of fixed assets by asset type – Water Supply

	Specialised operational assets £m	Non- specialised operational assets £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
Balance at 1 April 2003	903.1	17.9	2,654.9	108.6	3,684.5
RPI adjustment	23.5	0.5	69.0	2.8	95.8
Disposals	(0.5)	(0.2)	–	(2.5)	(3.2)
Additions	20.6	0.4	6.5	9.1	36.6
Balance at 31 March 2004	946.7	18.6	2,730.4	118.0	3,813.7
Accumulated depreciation					
Balance at 1 April 2003	416.0	4.9	–	70.3	491.2
RPI adjustment	10.8	0.1	–	1.8	12.7
Disposals	(0.5)	(0.2)	–	(2.5)	(3.2)
Charge for year	24.7	0.3	–	8.3	33.3
Balance at 31 March 2004	451.0	5.1	–	77.9	534.0
Net book value at 31 March 2004	495.7	13.5	2,730.4	40.1	3,279.7
Net book value at 31 March 2003	487.1	13.0	2,654.9	38.3	3,193.3

5(b) Current cost analysis of fixed assets by asset type – Sewerage Services

	Specialised operational assets £m	Non- specialised operational assets £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
Balance at 1 April 2003	2,840.1	71.7	7,950.4	153.9	11,016.1
RPI adjustment	73.8	1.9	206.7	4.0	286.4
Disposals	(1.8)	(0.9)	–	(10.8)	(13.5)
Additions	91.6	1.7	16.2	16.6	126.1
Balance at 31 March 2004	3,003.7	74.4	8,173.3	163.7	11,415.1
Accumulated depreciation					
Balance at 1 April 2003	1,152.8	19.7	(0.5)	117.9	1,289.9
RPI adjustment	30.0	0.5	0.5	3.0	34.0
Disposals	(1.8)	(0.9)	–	(10.8)	(13.5)
Charge for year	93.7	1.3	–	10.8	105.8
Balance at 31 March 2004	1,274.7	20.6	–	120.9	1,416.2
Net book value at 31 March 2004	1,729.0	53.8	8,173.3	42.8	9,998.9
Net book value at 31 March 2003	1,687.3	52.0	7,950.9	36.0	9,726.2

5(c) Current cost analysis of fixed assets by asset type – Total

	Specialised operational assets £m	Non- specialised operational assets £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
Balance at 1 April 2003	3,743.2	89.6	10,605.3	262.5	14,700.6
RPI adjustment	97.3	2.4	275.7	6.8	382.2
Disposals	(2.3)	(1.1)	–	(13.3)	(16.7)
Additions	112.2	2.1	22.7	25.7	162.7
Balance at 31 March 2004	3,950.4	93.0	10,903.7	281.7	15,228.8
Accumulated depreciation					
Balance at 1 April 2003	1,568.8	24.6	(0.5)	188.2	1,781.1
RPI adjustment	40.8	0.6	0.5	4.8	46.7
Disposals	(2.3)	(1.1)	–	(13.3)	(16.7)
Charge for year	118.4	1.6	–	19.1	139.1
Balance at 31 March 2004	1,725.7	25.7	–	198.8	1,950.2
Net book value at 31 March 2004	2,224.7	67.3	10,903.7	82.9	13,278.6
Net book value at 31 March 2003	2,174.4	65.0	10,605.8	74.3	12,919.5

6 Working capital

	2004 £m	2003 £m
Stocks	1.2	1.4
Trade debtors	94.1	90.5
Trade creditors	(18.8)	(21.0)
Short-term capital creditors	(90.0)	(116.4)
Infrastructure renewals prepayment	37.0	37.0
Other accruals	(37.2)	(74.1)
Receipts in advance	(30.6)	(27.9)
Payroll related tax and social security	(1.5)	(1.4)
Other short term group debtors/(creditors)	(1.9)	(8.9)
Prepayments	2.0	0.1
Total working capital	(45.7)	(120.7)

Note: For 2003, £7.3m has been reclassified from “working capital” to “non-trade creditors within one year” in order to be consistent with the current year’s disclosure.

7 Movement on Current Cost Reserve

	2004 £m	2003 £m
Balance at 1 April	11,041.7	10,709.9
RPI Adjustments		
Fixed assets	335.5	386.7
Grants and third party contributions	(3.9)	(4.4)
Working capital	(3.3)	(2.3)
Financing	(42.2)	(48.2)
Balance at 31 March	11,327.8	11,041.7

Notes to the Current Cost Accounts

FOR THE YEAR ENDED 31 MARCH 2004

8 Reconciliation of current cost operating profit to net cash flow from operating activities

	2004 £m	2003 £m
Current cost operating profit	118.3	127.6
Working capital adjustment	(3.3)	(2.3)
Increase in stocks	0.2	2.4
Receipt from other income	0.4	0.4
Current cost depreciation	139.1	129.8
Current cost profit on sale of assets	(3.8)	(8.8)
Decrease/(increase) in debtors and prepaid expenses	(5.1)	13.9
Increase/(decrease) in creditors and accrued expenses	(26.3)	42.1
Infrastructure renewals expenditure	28.2	32.1
Decrease in provision for infrastructure renewals	–	(8.4)
Decrease in other provisions	(0.2)	–
Amortisation of grants and contributions	(1.9)	(1.8)
Net cash flow from operating activities	245.6	327.0

9 Analysis of net debt

	At 31 March 2003 £m	Cash flows £m	Non cash flows £m	At 31 March 2004 £m
Bank overdrafts	(46.7)	44.2	–	(2.5)
Cash deposits	–	96.6	–	96.6
Cash and cash equivalents	(46.7)	140.8	–	94.1
Loans due within one year	(1,210.6)	1,210.6	–	–
Loans due after one year	–	(2,133.5)	(8.7)	(2,142.2)
Total	(1,257.3)	(782.1)	(8.7)	(2,048.1)

10 Regulated Capital Value (RCV)

OFWAT in its letter to the Regulatory Directors of Water and Sewerage and Water only companies dated 10 March 2004 (RD 05/04) published the closing Regulated Capital Value of Southern Water at 31 March 2004 as £2,276m at 2002/03 prices.

	£m
RCV at 31 March 2003	2,126
Indexation	66
Opening RCV	2,192
Capital expenditure (excluding IRE)	182
Infrastructure renewals expenditure	23
Infrastructure renewals charge	(23)
Grants & contributions	(8)
Depreciation	(103)
Outperformance of regulatory assumptions (5 years in arrears)	14
RCV at 31 March 2004	2,276
Average Year RCV	2,204

Numbers are as published by OFWAT and do not add due to rounding.

The table shows the RCV used in setting the price limits for the period in 2000/01 to 2004/05; the differences from the actual capital expenditure and 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.

Five Year Rolling Summary

Current cost profit and loss account for appointed business

	2004 £m	2003 £m	2002 £m	2001 £m	2000 £m
Turnover	448.3	443.2	444.9	443.3	510.2
Current cost operating costs (including exceptional item)	(337.1)	(323.4)	(315.6)	(286.7)	(308.2)
Operating income	3.8	9.0	1.7	1.6	4.4
Working capital adjustment	3.3	2.4	2.1	2.9	4.5
Current cost operating profit	118.3	131.2	133.1	161.1	210.9
Other income	0.4	0.4	0.6	0.6	0.6
Net interest (including exceptional item)	(93.4)	(92.8)	(75.5)	(70.6)	(63.0)
Financing adjustment	42.2	49.5	19.1	32.1	22.8
Current cost profit before taxation	67.5	88.3	77.3	123.2	171.3
Taxation	(26.6)	(36.5)	(40.2)	(28.5)	(64.4)
Current cost profit attributable to shareholders	40.9	51.8	37.1	94.7	106.9
Dividends	(62.3)	(69.9)	–	(50.9)	(50.3)
Current cost (loss)/profit retained	(21.4)	(18.1)	37.1	43.8	56.6

Current cost balance sheet for appointed business

	2004 £m	2003 £m	2002 £m	2001 £m	2000 £m
Tangible fixed assets	13,278.6	13,257.0	13,195.4	13,108.7	12,950.0
Third party contributions since 31 March 1990	(156.4)	(151.9)	(146.7)	(142.7)	(138.1)
Working capital	(45.7)	(123.8)	(78.2)	(168.6)	(133.3)
Net operating assets	13,076.5	12,981.3	12,970.5	12,797.4	12,678.6
Cash and investments	942.4	–	–	–	–
Non-trade debtors	5.9	6.9	4.4	6.5	3.9
Non-trade creditors due within one year	(37.6)	(1,297.6)	(762.2)	(416.6)	(800.9)
Creditors due after one year	(2,062.4)	–	(510.0)	(683.9)	(583.6)
Deferred tax	(373.0)	(378.7)	(372.5)	(355.5)	–
Other provisions for liabilities and charges	(2.9)	(3.2)	(3.3)	(3.3)	(3.4)
Dividends payable	(3.4)	–	–	(51.2)	(50.2)
Net assets employed	11,545.5	11,308.7	11,326.9	11,293.4	11,244.4
Capital and reserves					
Called up share capital	0.4	0.1	0.1	0.1	0.1
Share premium	306.0	47.5	49.0	49.7	50.8
Profit and loss account	(88.7)	(69.0)	(52.6)	(91.1)	(138.4)
Current cost reserve	11,327.8	11,330.1	11,330.4	11,334.7	11,331.9
Total capital and reserves	11,545.5	11,308.7	11,326.9	11,293.4	11,244.4

The prior year figures above have been adjusted for subsequent inflation using the indexation procedures prescribed by the Director General in letter RD 10/04. Accordingly the 2003 figures are different from the comparatives on pages 27 to 36 which have not been indexed.



Independent Auditors' Report to the Director General of Water Services ("the Regulator") and the Directors of Southern Water Services Limited

We have audited the Regulatory Accounts of Southern Water Services Limited ("the Company") on pages 23 to 37 which comprise:

- the regulatory historical cost accounting statements comprising the historical cost profit and loss account and balance sheet; and
- the regulatory current cost accounting statements comprising the current cost profit and loss account, balance sheet, 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 Regulator 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 Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Regulator 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 Regulator, 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 and have not been prepared

under the basis of Generally Accepted Accounting Principles in the United Kingdom ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does 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 Regulator, the Directors and Auditors

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

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 1.

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

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 27 to 29 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03

(Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the preface, the additional accounting information and the additional commentary on trends and comparisons.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards 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

Regulator, 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 Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company on which we reported on 7 July 2004, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 24 and 25 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on page 26.

Opinion

In our opinion the Regulatory Accounts for the Company contain the information for the year ended 31 March 2004 to comply 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.

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

- (a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;
- (b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;
- (c) the regulatory historical cost accounting statements on pages 24 to 25 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;
- (d) the regulatory current cost accounting statements on pages 27 to 29 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator.



PricewaterhouseCoopers LLP

Chartered Accountants
and Registered Auditors
London

7 July 2004

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

Additional Accounting Information

Services supplied to the appointee by associated companies

From 1 April 2002 to 6 May 2003, the parent company was Southern Water Services Group Limited (SWSG).

On 7 May 2003, the ultimate parent undertaking, First Aqua Holdings Limited, sold its entire interest in the ordinary shares of Southern Water Services (Finance) Limited (formerly First Aqua (JV Co) Limited) (an intermediate parent company) to Southern Water Capital Limited ('SWC'). SWC is now regarded as the ultimate parent company.

Southern Water Investments Limited is an intermediate parent of Southern Water Services Limited. During the year management fees were charged to Southern Water Services Limited as follows:

	Value 2004	Value 2003
Southern Water Investments Limited	£1.5m	–

Allocation of costs between regulated and non-regulated businesses

Each non-appointed activity is treated separately within the company's financial records. Examples of non-appointed activities include non-monopoly rechargeable works, property searches and recreation and amenity services. Revenues, costs, assets and liabilities are generally directly allocated to particular business activities. Administrative overheads have been apportioned from the appointed business to the non-appointed business on an activity cost basis.

Details of inter-company loans

Loans granted to Southern Water Services Limited

	2004 £m	2003 £m
Parent company	–	495.6
Intermediate holding company	–	594.4
Southern Water Services (Finance) Limited	2,090.2	120.6
	2,090.2	1,210.6

The loans have varying interest rates between 3.716% and 16.01% with maturity dates ranging from 2007 to 2038. The loans are secured. One loan amounting to £30.3m is repayable on demand.

Loans granted by Southern Water Services Limited

	2004 £m	2003 £m
Southern Water Services Group Limited (SWSG) (formerly First Aqua Limited)	816.6	–

The loan to Southern Water Services Group Limited (formerly First Aqua Limited) is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7%.

Dividends paid by Southern Water Services Limited to group companies

	2004 £m	2003 £m
Preference shares paid to:		
Veolia	1.1	–
Other	8.4	–
	9.5	–
Ordinary Shares – Southern Water Services Holdings Limited	3.4	–
Southern Water Services Holdings Limited	53.6	68.0
	66.5	68.0

Of the £53.6m dividend to Southern Water Services Holdings Limited, £26.0m relates to pre-acquisition, the remainder of £27.6m is paid to allow Southern Water Services Group to service its interest obligations on the Southern Water Services/Southern Water Services Group loan Agreement.

Asset transfers

There were no asset transfers during the year.

Recharges

An amount of £76,709 has been recharged to Veolia during the year with respect to consultancy services provided by Southern Water Services to Veolia.

Additional Commentary on Trends and Comparisons

Five year trend

In real terms current cost operating profit fell by £92.6 million over five years mainly reflecting the decrease in turnover relating to the Final Determination P-nought adjustment. Major cost efficiencies continue to be made through the use of new technology and new business processes. These efficiencies have offset cost increases due to inflation, additional operating costs arising from capital, new obligations and increased depreciation resulting from schemes commissioned during the year.

Movements from prior year

Turnover

	£m
Turnover 2002/03	431.1
Price limits and inflation	14.2
Other	3.0
Turnover 2003/04	448.3

Operating costs (net of capital maintenance)

	£m
Operating costs 2002/03	162.9
Reductions	(3.1)
Additional cost obligations	12.0
Operating costs 2003/04	171.8

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