

**DEE VALLEY WATER PLC**  
**REGULATORY FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 MARCH 2004**

# DEE VALLEY WATER PLC

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## **DEE VALLEY WATER PLC**

### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2004**

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#### **Directors' responsibilities**

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

#### **Licence condition F6A**

In the opinion of the Directors, the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil its obligations under the Appointment).

In the opinion of the Directors, the Appointee will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.

#### **Licence condition K3**

In the opinion of the Directors, the Company is in compliance with paragraph 3.1 of Condition K of the Licence.

#### **Transactions with associated companies**

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in these financial statements.

On behalf of the board

D J Guest  
**Director**  
9 July 2004

## DEE VALLEY WATER PLC

### INDEPENDENT AUDITORS' REPORT TO THE DIRECTOR GENERAL OF WATER SERVICES

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We have audited the Historic Cost Profit and Loss Account, Historic Cost Balance Sheet, Current Cost Profit and Loss Account, Current Cost Balance Sheet, Cash Flow Statement, Current Cost Accounting Policies and the Notes to the Accounts for the year ended 31st March 2004 .

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

As described in the directors' report the company's directors are responsible for the preparation of the regulatory financial statements. It is our responsibility to form an independent opinion based on our audit, on those statements and to report our opinion to you.

This report is made solely to the Director General of Water Services in accordance with the Regulatory Accounting Guidelines. Our audit work has been undertaken so that we might state to the Director General of Water Services those matters we are required to state in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Director General of Water Services, for our audit work, for this report, or for the opinions we have formed.

#### **Basis of audit opinion**

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

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

#### **Opinion**

In our opinion the financial statements contain the information for the year to 31 March 2004 required to be published and submitted to you by Dee Valley Water plc to comply with Condition F of the Instruments of Appointment by the Secretary of State for Wales of the company as a water 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, complies with the requirements of Condition F of the Instruments of Appointment and has been properly prepared in accordance with the Regulatory Accounting Guidelines numbers 1 to 4 issued by the Office of Water Services;
- (c) the historic cost profit and loss account and historic cost balance sheet give under the historical cost convention and the historic cost accounting policies, a true and fair view of the revenues, costs, assets and liabilities of the Appointee's Appointed Business: and
- (d) the current cost financial information has been properly prepared in accordance with Regulatory Accounting Guideline 1 "Accounting for Current Costs", issued in January 2003 by the Office of Water Services.

**Saffery Champness**

Chartered Accountants  
Registered Auditors

9 July 2004

Lion House  
Red Lion Street  
London  
WC1R 4GB

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DEE VALLEY WATER PLC

**HISTORIC COST PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2004**

		Appointed	Non	Total	Appointed	Non	Total
		2004	appointed	2004	2003	appointed	2003
			2004		as restated		as restated
	Notes	£000	£000	£000	£000	£000	£000
<b>Turnover</b>	<b>3</b>	16,597	64	16,661	16,214	102	16,316
Operating costs		(11,124)	(142)	(11,266)	(11,673)	(190)	(11,863)
<b>Operating profit</b>		5,473	(78)	5,395	4,541	(88)	4,453
Other income		36	1,147	1,183	50	1,082	1,132
Other interest receivable and similar income		276	-	276	231	-	231
Interest payable and similar charges	<b>7</b>	(2,424)	-	(2,424)	(1,344)	-	(1,344)
<b>Historic cost profit before taxation</b>		3,361	1,069	4,430	3,478	994	4,472
Taxation	<b>8</b>	(1,625)	(321)	(1,946)	(1,104)	(299)	(1,403)
<b>Historic cost profit after taxation</b>		1,736	748	2,484	2,374	695	3,069
Dividends	<b>9</b>	(1,290)	(748)	(2,038)	(1,249)	(695)	(1,944)
<b>Historic cost profit retained</b>		446	-	446	1,125	-	1,125

DEE VALLEY WATER PLC

HISTORIC COST BALANCE SHEET  
AS AT 31 MARCH 2004

		Appointed	Non	Total	Appointed	Non	Total
		2004	appointed	2004	2003	appointed	2003
			2004		as restated		as restated
Notes	£000	£000	£000	£000	£000	£000	£000
<b>Fixed assets</b>							
Tangible assets		41,683	59	41,742	36,413	59	36,472
		<u>41,683</u>	<u>59</u>	<u>41,742</u>	<u>36,413</u>	<u>59</u>	<u>36,472</u>
<b>Current assets</b>							
Stocks	12	145	-	145	174	-	174
Debtors: amounts falling due within one year	13	4,013	-	4,013	3,387	-	3,387
Debtors: amounts falling due after more than one year	13	549	-	549	765	-	765
Short term investments		16,178	243	16,421	17,511	243	17,754
Cash at bank and in hand		(478)	518	40	(436)	461	25
		<u>20,407</u>	<u>761</u>	<u>20,407</u>	<u>21,185</u>	<u>704</u>	<u>21,185</u>
<b>Creditors: amounts falling due within one year</b>	<b>14</b>	<b>(9,076)</b>	<b>(820)</b>	<b>(9,896)</b>	<b>(7,052)</b>	<b>(763)</b>	<b>(7,815)</b>
<b>Net current assets</b>		<u>11,331</u>	<u>(59)</u>	<u>11,272</u>	<u>14,133</u>	<u>(59)</u>	<u>14,074</u>
<b>Total assets less current liabilities</b>		<u>53,014</u>	<u>-</u>	<u>53,014</u>	<u>50,546</u>	<u>-</u>	<u>50,546</u>
<b>Creditors: amounts falling due after more than one year</b>	<b>15</b>	<b>(39,704)</b>	<b>-</b>	<b>(39,704)</b>	<b>(38,633)</b>	<b>-</b>	<b>(38,633)</b>
<b>Provisions for liabilities and charges</b>	<b>16</b>	<b>(8,021)</b>	<b>-</b>	<b>(8,021)</b>	<b>(7,070)</b>	<b>-</b>	<b>(7,070)</b>
		<u>5,289</u>	<u>-</u>	<u>5,289</u>	<u>4,843</u>	<u>-</u>	<u>4,843</u>
<b>Capital and reserves</b>							
Called up share capital		240	-	240	240	-	240
Other reserves		614	-	614	614	-	614
Profit and loss account		4,435	-	4,435	3,989	-	3,989
		<u>5,289</u>	<u>-</u>	<u>5,289</u>	<u>4,843</u>	<u>-</u>	<u>4,843</u>

**DEE VALLEY WATER PLC****CURRENT COST PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2004**

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		<b>2004</b>	<b>2003</b>
	<b>Notes</b>	<b>£000</b>	<b>as restated £000</b>
<b>Turnover</b>	<b>3</b>	16,597	16,214
Operating costs	<b>4 / 5</b>	(12,656)	(13,155)
Working capital adjustment		75	(45)
<b>Current cost operating profit</b>	<b>6</b>	4,016	3,014
Other income	<b>3</b>	3	57
Other interest receivable and similar income		276	231
Interest payable and similar charges	<b>7</b>	(2,424)	(1,344)
Financing adjustment		(532)	(710)
<b>Current cost profit before taxation</b>		1,339	1,248
Taxation	<b>8</b>	(1,625)	(1,104)
<b>Current cost (loss)/profit attributable to shareholders</b>		(286)	144
Dividends	<b>9</b>	(1,290)	(1,249)
<b>Current cost loss retained</b>		(1,576)	(1,105)

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**DEE VALLEY WATER PLC****CURRENT COST BALANCE SHEET  
AS AT 31 MARCH 2004**

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		<b>2004</b>	<b>2003</b>
	<b>Notes</b>	<b>£000</b>	<b>as restated £000</b>
<b>Fixed assets</b>			
Tangible assets	<b>10</b>	289,133	277,069
Third party contributions since 1989-90		(11,067)	(9,881)
		<hr/>	<hr/>
		278,066	267,188
Working capital	<b>11</b>	2,542	3,512
		<hr/>	<hr/>
<b>Net operating assets</b>		280,608	270,700
Cash and investments		5,633	7,480
Non-trade debtors		1,277	1,160
Non-trade creditors due within one year		(880)	(586)
Creditors due after one year		(36,709)	(35,638)
Provisions for liabilities and charges	<b>16</b>	(8,021)	(7,070)
Dividends payable		(867)	(832)
		<hr/>	<hr/>
<b>Net assets employed</b>		241,041	235,214
		<hr/> <hr/>	<hr/> <hr/>
<b>Capital and reserves</b>			
Called up share capital		240	240
Current cost reserve	<b>18</b>	252,048	244,645
Other reserves		614	614
Profit and loss account		(11,861)	(10,285)
		<hr/>	<hr/>
<b>Total capital and reserves</b>		241,041	235,214
		<hr/> <hr/>	<hr/> <hr/>

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**DEE VALLEY WATER PLC**

**CURRENT COST CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2004**

	<b>Appointed</b>	<b>Non</b>	<b>Total</b>	<b>Appointed</b>	<b>Non</b>	<b>Total</b>
	<b>2004</b>	<b>appointed</b>	<b>2004</b>	<b>2003</b>	<b>appointed</b>	<b>2003</b>
	<b>£000</b>	<b>2004</b>	<b>£000</b>	<b>£000</b>	<b>2003</b>	<b>£000</b>
<b>Net cash flow from operating activities</b>	9,365	1,069	10,434	(15,764)	995	(14,769)
Interest received	275	-	275	231	-	231
Interest paid	(1,354)	-	(1,354)	(820)	-	(820)
<b>Net cash outflow for returns on investments and servicing of finance</b>	(1,079)	-	(1,079)	(589)	-	(589)
<b>Taxation</b>	(289)	(299)	(588)	(444)	(287)	(731)
<b>Capital expenditure</b>						
Payments to acquire tangible assets	(7,285)	-	(7,285)	(4,135)	-	(4,135)
Receipt of grants and contributions	929	-	929	835	-	835
Infrastructure renewals expenditure	(2,233)	-	(2,233)	(1,311)	-	(1,311)
<b>Net cash outflow for capital expenditure</b>	(8,589)	-	(8,589)	(4,611)	-	(4,611)
<b>Equity dividends paid</b>	(1,255)	(713)	(1,968)	(2,192)	(679)	(2,871)
<b>Net cash outflow before management of liquid resources and financing</b>	(1,847)	57	(1,790)	(23,600)	29	(23,571)
<b>Management of liquid resources</b>						
Current asset investments	1,704	-	1,704	(7,707)	-	(7,707)
<b>Financing</b>						
New long term bank loan	-	-	-	35,000	-	35,000
<b>(Decrease)/increase in cash</b>	(143)	57	(86)	3,693	29	3,722

DEE VALLEY WATER PLC

NOTES TO THE CURRENT COST CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2004

1	Reconciliation of current cost operating profit to net cash inflow/(outflow) from operating activities	2004	2003
		£000	£000
	Current cost operating profit	4,016	3,014
	Working capital adjustment	(75)	45
	Change in stocks	29	97
	Receipts from other income	36	57
	Current cost depreciation	2,643	2,443
	Increase in debtors	(1,242)	(10,797)
	Increase/(decrease) in creditors	1,725	(11,934)
	Infrastructure renewals expenditure	2,233	1,311
	<b>Net cash inflow/(outflow) from operating activities</b>	<u>9,365</u>	<u>(15,764)</u>

2	Analysis of net debt	1 April 2003	Cash flow	Other non-cash changes	31 March 2004
		£000	£000	£000	£000
	Net cash:				
	Bank overdrafts	(645)	(143)	-	(788)
	Liquid resources:				
	Current asset investments	8,125	(1,704)	-	6,421
	Debts falling due within one year	-	-	-	-
	Debts falling due after one year	(35,638)	-	(1,071)	(36,709)
	<b>Net debt</b>	<u>(28,158)</u>	<u>(1,847)</u>	<u>(1,071)</u>	<u>(31,076)</u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2004**

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**1 Current cost accounting policies**

These accounts have been prepared for the Appointed Business of Dee Valley Water plc in accordance with guidance issued by the Director General of Water Services for modified real terms financial statements suitable for regulation in the water industry.

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.

Except as set out below, the accounting policies used are the same as those adopted in the historical cost accounts, an abstract from which is set out for reference purposes in note 2 to these accounts.

**1.1 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 the 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 amounts.

**Land and buildings**

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

**Infrastructure assets**

Mains, impounding and pumped raw water storage reservoirs 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 assets records is expected to produce adjustments to existing values when periodic reviews of the AMP takes place. In the intervening years, values are restated to take account of the changes in the general level of inflation as measured by changes in the RPI over the year.

**Other fixed assets**

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

**Grants and other third party contributions**

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

**1 Current cost accounting policies** (continued)

**1.2 Real financial capital maintenance adjustments**

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

**Working capital adjustment**

This is calculated by applying the change in the Retail Price Index ('RPI') over the year to the opening total of trade debtors and stock less trade creditors.

**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.

**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.

**1.3 Principles of cost allocation used to prepare activity costing analysis**

The job costing function within the Company's accounting system plays a key role in ensuring expenditure is correctly allocated between operating costs, capital costs and capital maintenance.

The allocation of general and support costs relating to departments providing a company wide service is based, where possible, on a measurement of the level of service provided to a business area. Where no such measure is available costs are allocated in proportion to direct costs for a business area. Whilst every effort is made to ensure year on year consistency of allocation, changes have been made where necessary to adhere as closely as possible to the regulatory reporting guidelines.

**1.4 Dividend policy**

The board sets the dividend payable by Dee Valley Water plc on a prudent basis, taking into account the future financing requirements of the business as evidenced by the latest financial projections. The board also takes into account the financial covenants agreed with the loan provider, which effectively place an upper limit on the cash which can be paid out as dividend.

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

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**2 Extract from historic cost accounting policies**

**2.1 Turnover**

Turnover represents amounts receivable for goods and services net of VAT and trade discounts.

**2.2 Tangible fixed assets and depreciation**

Tangible fixed assets other than freehold land are stated at cost less depreciation. Depreciation is provided at rates calculated to write off the cost less estimated residual value of each asset over its expected useful life, as follows:

Freehold land, buildings and fixed plant - 50 to 80 years

Infrastructure assets - 5 to 25 years

Mobile plant, vehicles and equipment - 3 to 20 years

This accounting policy differs from that now adopted in the published statutory accounts of the Company with regard to the depreciation of infrastructure assets, the policy in respect of which is detailed below.

**2.3 Infrastructure assets**

Infrastructure assets comprise underground systems of mains and impounding and pumped raw water storage reservoirs. As these systems are maintained in perpetuity and have no finite lives, no depreciation is charged on such assets. Expenditure on replacing and maintaining the assets is charged as an operating cost and expenditure to increase or enhance the assets is capitalised.

Charges for infrastructure renewals expenditure take account of planned expenditure on maintaining the operating capability of infrastructure assets in accordance with the Company's investment programme. The timing of the investment programme and operational considerations may result in uneven patterns of infrastructure renewals expenditure. Charges to the profit and loss account are adjusted by way of accruals or deferrals, as appropriate, to take account of any significant fluctuations between actual and planned expenditure.

This accounting policy is not in accordance with FRS12 and differs from that now adopted within the published statutory accounts of the Company. Following the introduction of FRS12 and in accordance with FRS15, 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 in the statutory accounts of the Company as an addition and included at cost after deducting grants and contributions.

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

For Regulatory Accounts purposes, expenditure to refurbish mains for quality enhancement is capitalised in accordance with OFWAT guidelines.

For statutory accounts purposes, all refurbishment expenditure is accounted for in accordance with FRS15 and included within the planned annual expenditure upon which the depreciation charge is based.

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

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**2 Extract from historic cost accounting policies (continued)**

**2.4 Grants and contributions**

Grants and contributions receivable relating to infrastructure assets have been deducted from the cost of tangible fixed assets. This is not in accordance with the Companies Act 1985 which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. This departure from the requirements of the Companies Act 1985 is, in the opinion of the Directors, necessary for the financial statements to show a true and fair view, as these assets do not have determinable finite lives and therefore no basis exists on which to recognise grants and contributions as deferred income.

**2.5 Stock**

Stock is valued at the lower of cost and net realisable value.

**2.6 Pensions**

The regular cost of providing retirement pensions and related benefits is charged to the profit & loss account over the employees' service lives on the basis of a constant percentage of earnings. Any difference between the charge to the profit and loss account and the contributions paid to the scheme is shown as an asset or liability in the balance sheet.

**2.7 Taxation**

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the financial statements. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a discounted basis.

**DEE VALLEY WATER PLC**

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

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**3 Analysis of turnover and operating income for the appointed business**

	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
<b>Turnover</b>		
Measured	7,736	7,293
Unmeasured	8,696	8,844
Other sources	165	77
	<hr/>	<hr/>
Total turnover	16,597	16,214
	<hr/> <hr/>	<hr/> <hr/>
<b>Operating income</b>		
Current cost (loss)/profit on disposal of assets	(33)	7
Other operating income	36	50
	<hr/>	<hr/>
Total operating income	3	57
	<hr/> <hr/>	<hr/> <hr/>
<b>Working capital adjustment</b>	75	(45)
	<hr/> <hr/>	<hr/> <hr/>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

4 Activity costing analysis for the year ended 31 March 2004

	Service analysis			Business analysis		
	Water resource & treat	Water distbn	Water supply sub-tot	Customer services	Scientific services	Cost of regulation
<b>Direct costs</b>						
Employment costs	489	632	1,121			
Power	252	245	497			
Agencies	-	-	-			
Hired and contracted services	103	33	136			
Associated companies	-	90	90			
Materials and consumables	329	111	440			
Service charges NRA	594	-	594			
Bulk supply imports	54	-	54			
Other direct costs	112	73	185			
<b>Total direct costs</b>	1,933	1,184	3,117	702	393	435
General and support expenditure	1,218	790	2,008	223	118	-
<b>Functional expenditure</b>	3,151	1,974	5,125	925	511	435
<b>Total business activities</b>			6,996			
Local authority rates			1,153			
Doubtful debts			139			
Exceptional items			-			
Total Opex less third party services			8,288			
Third party services - opex			157			
<b>Total operating expenditure</b>			8,445			
<b>Capital costs</b>						
Infrastructure renewals expenditure	833	1,339	2,233			
Movement in infrastructure renewals prepayment	-	(665)	(665)			
Current cost depreciation (allocated)	1,659	440	2,099			
Amortisation of deferred credits			-			
Amortisation of intangible assets			-			
Business activities current cost depreciation			544			
Capital maintenance excluding third party services			4,211			
Third party services - capital maintenance			-			
<b>Total capital maintenance</b>			4,211			
<b>TOTAL OPERATING COSTS</b>			12,656			
<b>CCA (MEA) values</b>						
Service activities	89,760	239,258	329,018			
Business activities			9,094			
Water supply total			338,112			
Services for third parties			-			
<b>Total</b>			338,112			

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

5 Activity costing analysis for the year ended 31 March 2003

	Service analysis			Business analysis		
	Water resource & treat	Water distbn	Water supply sub-tot	Customer services	Scientific services	Cost of regulation
<b>Direct costs</b>						
Employment costs	447	378	825			
Power	243	323	566			
Agencies	-	-	-			
Hired and contracted services	98	10	108			
Associated companies	-	622	622			
Materials and consumables	312	88	400			
Service charges NRA	547	-	547			
Bulk supply imports	40	-	40			
Other direct costs	111	67	178			
<b>Total direct costs</b>	1,798	1,488	3,286	658	342	240
General and support expenditure	1,111	691	1,802	207	103	-
<b>Functional expenditure</b>	2,909	2,179	5,088	865	445	240
<b>Total business activities</b>			6,638			
Local authority rates			1,130			
Doubtful debts			98			
Exceptional items			1,062			
Total Opex less third party services			8,928			
Third party services - opex			254			
<b>Total operating expenditure</b>			9,182			
<b>Capital costs</b>						
Infrastructure renewals expenditure	22	1,227	1,311			
Movement in infrastructure renewals prepayment		219	219			
Current cost depreciation (allocated)	1,696	373	2,069			
Amortisation of deferred credits			-			
Amortisation of intangible assets			-			
Business activities current cost depreciation			374			
Capital maintenance excluding third party services			3,973			
Third party services - capital maintenance			-			
<b>Total capital maintenance</b>			3,973			
<b>TOTAL OPERATING COSTS</b>			13,155			
<b>CCA (MEA) values</b>						
Service activities	83,388	230,132	313,520			
Business activities			8,664			
Water supply total			322,184			
Services for third parties			-			
<b>Total</b>			322,184			

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

<b>6 Operating profit</b>	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
Current cost operating profit is stated after charging:		
Depreciation of tangible assets	2,642	2,443
Operating lease rentals	436	11
Auditors' remuneration	18	17
Remuneration of auditors for non-audit work	101	38
	<u>          </u>	<u>          </u>
<b>7 Interest payable</b>	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
On bank overdrafts	4	12
Loan interest	1,349	805
Loan indexation	1,071	524
On overdue tax	-	3
	<u>          </u>	<u>          </u>
	2,424	1,344
	<u>          </u>	<u>          </u>
<b>8 Taxation</b>	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
<b>Domestic current year tax</b>		
U.K. corporation tax	579	395
Adjustment for prior years	-	(157)
Payment in respect of group relief	95	567
	<u>          </u>	<u>          </u>
<b>Current tax charge</b>	674	805
<b>Deferred tax</b>		
Deferred tax charge	951	299
	<u>          </u>	<u>          </u>
	1,625	1,104
	<u>          </u>	<u>          </u>
<b>9 Dividends</b>	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
Ordinary interim paid	423	417
Ordinary final proposed	867	832
	<u>          </u>	<u>          </u>
	1,290	1,249
	<u>          </u>	<u>          </u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

10 Tangible fixed assets

	Infrastructure assets	Operational assets	Other tangible assets	Total
	£000	£000	£000	£000
<b>Gross replacement cost</b>				
At 1 April 2003	215,702	99,979	6,503	322,184
RPI adjustment	5,608	2,599	169	8,376
Transfer from Dee Valley Services Ltd	-	160	-	160
Additions	2,233	4,929	270	7,432
Disposals	-	(46)	(76)	(122)
At 31 March 2004	<u>223,543</u>	<u>107,621</u>	<u>6,866</u>	<u>338,030</u>
<b>Depreciation</b>				
At 1 April 2003	-	42,120	2,995	45,115
RPI adjustment	-	1,095	78	1,173
Transfer from Dee Valley Services Ltd	-	109	-	109
On disposals	-	(58)	(84)	(142)
Charge for the year	-	2,393	249	2,642
At 31 March 2004	<u>-</u>	<u>45,659</u>	<u>3,238</u>	<u>48,897</u>
<b>Net book value</b>				
At 31 March 2004	<u>223,543</u>	<u>61,962</u>	<u>3,628</u>	<u>289,133</u>
At 31 March 2003	<u>215,702</u>	<u>57,859</u>	<u>3,508</u>	<u>277,069</u>

11 Working capital

	Note	2004 £000	2003 £000
Stocks	12	145	174
Trade debtors		853	794
Trade creditors		(6,664)	(5,001)
Infrastructure renewals prepayment		1,776	1,111
Other accruals		(306)	(294)
Trade payments in advance		(531)	(431)
Payroll related taxes and social security		(125)	(78)
Other short term group debtors		6,762	6,391
Prepayments and other debtors		632	846
		<u>2,542</u>	<u>3,512</u>

**DEE VALLEY WATER PLC****NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

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<b>12 Stocks</b>	<b>2004 £000</b>	<b>2003 £000</b>
Raw materials and consumables	145	174

<b>13 Debtors</b>	<b>2004 £000</b>	<b>2003 £000</b>
Trade debtors	1,172	1,097
Pension prepayment	549	765
Corporation tax	715	715
Other debtors	2,043	1,278
Prepayments and accrued income	83	81
	<u>4,562</u>	<u>3,936</u>

Amounts falling due after more than one year and included in the debtors above are:

	<b>2004 £000</b>	<b>2003 £000</b>
Pension prepayment	549	765

<b>14 Creditors: amounts falling due within one year</b>	<b>2004 £000</b>	<b>2003 £000</b>
Bank loans and overdrafts	310	209
Trade creditors	6,664	5,001
Corporation tax	623	524
Other taxes and social security costs	125	78
Other creditors	53	62
Accruals and deferred income	755	645
Proposed dividend	1,366	1,296
	<u>9,896</u>	<u>7,815</u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

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<b>15 Creditors: amounts falling due after more than one year</b>	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
3 1/2% undated irredeemable debentures	114	114
Index linked bank loan	36,595	35,524
Amounts owed to parent and fellow subsidiary undertakings	2,995	2,995
	<u>39,704</u>	<u>38,633</u>

**16 Provisions for liabilities and charges**

	<b>Deferred taxation £000</b>
Balance at 1 April 2003	7,070
Profit and loss account	951
Balance at 31 March 2004	<u>8,021</u>

Deferred taxation provided in the regulatory accounts is as follows:

	<b>Fully provided</b>	
	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
Accelerated capital allowances	<u>8,021</u>	<u>7,070</u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

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**17 Pension costs**

**Defined benefit**

The company participates in a defined benefit pension scheme, the Water Companies Pension Scheme. The scheme funds are administered by trustees and are independent of the Company's finances. Contributions are paid to the scheme in accordance with the recommendations of an independent actuarial adviser.

In line with the requirements of FRS17, published by the Accounting Standards Board in November 2000 and updated in November 2002, details in respect of the scheme are provided below in accordance with both SSAP24 and FRS17. The Company does not anticipate adopting FRS17 earlier than the mandatory requirement to do so and therefore the figures in the accounts reflect the SSAP24 details below.

**i) SSAP24**

Contributions to the Scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the Company. The contributions are determined by a qualified actuary on the basis of triennial valuations using the current unit method for death in service benefits and the projected unit method for other benefits.

The most recent full valuation was at 1 April 2002. In that valuation, the assumptions which had the most significant effect on the results were those relating to the rate of return on investments and the rates of increases in salaries and pensions. It was assumed that investment returns would be 7.2% pa before retirement and 5.2% pa after retirement. General salary increases were assumed to be 4.8% pa and present and future pensions were assumed on average to increase in payment at 2.8% pa.

The valuation at 1 April 2002 showed the following:

Market value of the Scheme's assets - £33,460,000

Value of assets as a percentage of the value of benefits accrued, after allowing for future increases in earnings - 116%

As a result of general falls in stock market values, it should be noted that the funding level will have fallen since the last valuation.

At 31st March 2004 the pension prepayment, calculated by the scheme's actuaries, amounted to £548,894. The prepayment at 1st April 2003 was £764,894, and the movement during the year, which has been debited to the profit and loss account, amounted to £216,000 (2002 - £213,000).

**ii) FRS17**

The formal actuarial valuation at 1 April 2002 was updated to the accounting date by an independent qualified actuary in accordance with the transitional arrangements of FRS17. As required by FRS17, the value of the defined benefit liabilities has been measured using the projected unit method.

The following sets out the key FRS17 assumptions used for the scheme. It also sets out, as at the accounting date, the fair value of assets, a breakdown of the assets into the main classes, the present value of the FRS17 liabilities and the deficit of assets below the FRS17 liabilities (which equals the gross pension liability).

**DEE VALLEY WATER PLC**

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

**17 Pension costs**

**(continued)**

<b>Assumptions</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Inflation	2.9% pa	2.5% pa	2.8% pa
Pension increases	2.9% pa	2.5% pa	2.8% pa
Salary increases	4.9% pa	4.5% pa	4.8% pa
Discount rate	5.5% pa	5.6% pa	6.1% pa
<b>Expected return</b>			
Equities	7.9% pa	7.5% pa	8.3% pa
Bonds	4.7% pa	4.5% pa	5.2% pa
Cash	4.6% pa	3.8% pa	5.2% pa

The market value of the assets of the Scheme at 31 March 2004 was £29,881,000, composed of 51% equities and 49% bonds. At the same date, the present value of the Scheme's liabilities, under FRS17 assumptions, was £33,131,000. Under FRS17, the Scheme would therefore be represented on the balance sheet as a liability of £3,250,000 (£2,275,000 net of deferred tax).

During the year to 31 March 2004, the Company contributed £10,000 (2003 - £16,000) to the Scheme. It has been agreed that employer contributions will be 9.7% of pensionable remuneration for members on the open scale of benefits and 18.5% of pensionable remuneration for members on the closed scale of benefits from 1 April 2004.

The (deficit)/surplus under FRS17 moved over the period as follows:

	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
Deficit)/surplus at start of year	(3,900)	7,100
Current service cost (employee and employer)	(729)	(600)
Contributions (employee and employer)	147	100
Other net finance income	61	1,000
Actuarial gain/(loss)	1,171	(11,500)
Deficit at end of year	<u>(3,250)</u>	<u>(3,900)</u>

The following amounts would have been included within operating profit under FRS17:

Current service cost (employer's part only)	591	500
Past service cost	-	-
Total operating charge	<u>591</u>	<u>500</u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

**17 Pension costs** **(continued)**

The following amounts would have been included as net finance income under FRS17:

	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
Expected return on pension scheme assets	1,687	2,600
Interest on post retirement liabilities	(1,626)	(1,600)
	<u>        </u>	<u>        </u>
Net return to credit to finance income	61	1,000
	<u>        </u>	<u>        </u>

The following amounts would have been recognised within the statement of total recognised gains and losses ("STRGL) under FRS17:

Actual return less expected return on scheme assets	3,751	(9,800)
Experience (losses)/gains arising on scheme's liabilities	(94)	800
Loss due to changes in assumptions underlying the FRS17 value of scheme liabilities	(2,486)	(2,500)
	<u>        </u>	<u>        </u>
Actuarial gain/(loss) recognised in the STRGL	1,171	(11,500)
	<u>        </u>	<u>        </u>

The history of experience gains and losses is:

	<b>2004</b>	<b>2003</b>
Actual return less expected return on scheme assets (£000)	3,751	(9,800)
Percentage of scheme's assets	13%	(39%)
Experience (losses)/gains arising on scheme's liabilities (£000)	(94)	800
Percentage of the FRS17 value of the scheme's liabilities	0%	3%
Total amount recognised in the STRGL (£000)	1,171	(11,500)
Percentage of the FRS17 value of the scheme's liabilities	4%	(39%)

**18 Movement on current cost reserve** **2004** **2003**  
**£000** **£000**

Balance at 1 April 2003	244,645	235,880
Fixed assets	7,203	8,282
Working capital	(75)	45
Financing	532	710
Third party contributions	(257)	(272)
	<u>        </u>	<u>        </u>
<b>Balance at 31 March 2004</b>	<b>252,048</b>	<b>244,645</b>
	<u>        </u>	<u>        </u>

**DEE VALLEY WATER PLC**

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

**19 Regulatory capital value**

	<b>£000</b>
Opening regulatory capital value as at 1 April 2003	45,666
Capital expenditure (excluding infrastructure renewals)	4,200
Infrastructure renewals expenditure	1,675
Infrastructure renewals charge	(1,900)
Grants and contributions	(242)
Current cost depreciation	(2,900)
Outperformance of regulatory assumptions (5 years in arrears)	680
	<u>47,178</u>
<b>Closing regulatory capital value at 31 March 2004</b>	<b>47,178</b>
	<u><u>45,802</u></u>
<b>Average regulatory capital value for the year</b>	<b>45,802</b>

**20 Directors' emoluments**

	<b>2004</b>	<b>2003</b>
	<b>£000</b>	<b>£000</b>
Emoluments for qualifying services	237	282
	<u>237</u>	<u>282</u>

The number of directors for whom retirement benefits are accruing under defined benefit schemes amounted to 3 (2003 - 4).

Emoluments for qualifying services	95	89
Accrued pension at the end of the year	46	42
Accrued lump sum at the end of the year	138	126
	<u>138</u>	<u>126</u>

**21 Employees**

**Number of employees**

The average monthly number of employees (including directors) during the year was:

	<b>2004</b>	<b>2003</b>
	<b>Number</b>	<b>Number</b>
Administration	87	78
Operations	85	49
	<u>172</u>	<u>127</u>

**Employment costs**

	<b>£000</b>	<b>£000</b>
Wages and salaries	4,063	2,965
Social security costs	227	209
Other pension costs	9	13
	<u>4,299</u>	<u>3,187</u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

22 Five year rolling summary

All figures stated in 2003/04 prices

Current cost profit and loss account for appointed business

	99/00	00/01	01/02	02/03	03/04
	£000	£000	£000	£000	£000
Turnover	19,735	17,381	17,110	16,668	16,597
Current cost operating costs	(12,291)	(11,939)	(12,103)	(13,523)	(12,656)
Operating income	588	-	-	-	(33)
Working capital adjustment	(12)	(50)	(16)	(46)	75
Current cost operating profit	8,019	5,391	4,991	3,098	3,983
Other income	66	26	172	59	36
Net interest	489	310	136	(1,144)	(2,148)
Financing adjustment	(590)	(454)	(232)	(730)	(532)
Current cost profit before taxation	7,985	5,274	5,067	1,283	1,339
Taxation	(2,350)	(1,880)	(1,784)	(903)	(1,625)
Dividends	5,635	3,393	3,283	380	(286)
	(2,863)	(2,902)	(9,620)	(1,284)	(1,290)
<b>Current cost profit/(loss) retained</b>	<b>2,772</b>	<b>491</b>	<b>(6,337)</b>	<b>(904)</b>	<b>(1,576)</b>

23 Five year rolling summary

All figures stated in 2003/04 prices

Current cost balance sheet for appointed business

	99/00	00/01	01/02	02/03	03/04
	£000	£000	£000	£000	£000
Tangible fixed assets	278,738	279,481	280,426	284,827	289,133
Third party contributions since 1989-90	(8,189)	(8,562)	(9,209)	(10,158)	(11,067)
Working capital	(1,755)	(512)	(19,002)	3,610	2,542
<b>Net operating assets</b>	<b>268,794</b>	<b>270,407</b>	<b>252,216</b>	<b>278,280</b>	<b>280,608</b>
Cash and investments	10,176	8,675	(245)	7,689	5,633
Non trade debtors	390	194	121	1,192	1,277
Non trade creditors	(5,999)	(4,684)	(3,664)	(602)	(880)
Creditors due after more than one year	(31,174)	(26,811)	(4,041)	(36,636)	(36,709)
Provisions for liabilities and charges	-	(4,853)	(5,270)	(5,238)	(8,021)
Dividends payable	(1,808)	(1,903)	(1,864)	(855)	(867)
<b>Net assets employed</b>	<b>240,378</b>	<b>241,026</b>	<b>237,254</b>	<b>243,830</b>	<b>241,041</b>
<b>Capital and reserves</b>					
Called up share capital	261	256	252	247	240
Profit and loss account	2,780	(1,484)	(7,799)	(8,543)	(11,861)
Current cost reserve	236,669	241,601	244,158	251,495	252,048
Other reserves	668	654	645	631	614
	240,378	241,026	237,254	243,830	241,041

## DEE VALLEY WATER PLC

### NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 31 MARCH 2004

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#### 24 Historic cost balance sheet reconciliation to statutory accounts

In the preparation of its statutory accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS15, Tangible Fixed Assets. However for the purposes of the Regulatory Accounts, Ofwat has requested that FRS15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the statutory accounts is set out below.

	<b>£000</b>
<b>Debtors</b>	
At 31 March 2004 per Regulatory Accounts	4,562
Less: Infrastructure renewals prepayment	(1,800)
Add: Short term loans to group companies	10,000
	<hr/>
At 31 March 2004 per Statutory accounts	12,762
	<hr/> <hr/>
<b>Tangible fixed assets</b>	
<b>Cost</b>	
At 31 March 2004 per Regulatory Accounts	95,770
Adjustment to opening balance	1,135
Infrastructure renewals expenditure capitalised in the year	665
	<hr/>
At 31 March 2004 per Statutory Accounts	97,770
	<hr/> <hr/>
<b>Depreciation</b>	
At 31 March 2004 per Regulatory Accounts	41,712
Adjustment to opening balance	1,218
Depreciation charge for IRE	425
	<hr/>
At 31 March 2004 per Statutory Accounts	43,355
	<hr/> <hr/>
<b>Net book value</b>	
At 31 March 2004 per Regulatory Accounts	41,742
Adjustment for infrastructure renewals accounting	157
	<hr/>
At 31 March 2004 per Statutory Accounts	41,899
	<hr/> <hr/>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004**

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**25 Financial review and commentary**

**Operating performance**

During the reporting period, turnover for the appointed business increased by 2.3%, reflecting the charges increase effective from 1st April 2004. The meter option programme continued to result in a transfer from unmeasured to measured income.

Operating costs (excluding exceptional items incurred in 2003 of £1,062,000) remained largely unchanged. Reduced wages and salaries and other operating cost savings were offset by higher insurance premiums and increased costs of regulation in the year of highest activity in the five-year cycle of regulatory reviews. Depreciation charges increased by 12% due to the prior years levels of capital expenditure.

Operating profits (HCA and CCA) increased by over 20% due to the increase in revenues, and the absence of exceptional items in 2003/04.

**Financing**

The highly geared balance sheet reflects the effect of the Company securing a £35million index linked loan from Artesian Finance in 2002. The proceeds of the loan were used by the parent company to return funds to shareholders. As a condition of the loan, the Company has entered into a number of covenants.

The most recent report to the lender dated 31st March 2004 and covering the period up to 31st March 2006, showed no actual or potential breach of any of the covenants.

Net interest payable increased significantly in 2004 as a full year's interest and indexation charge was incurred on the loan.

**Taxation**

The tax charge of £1,625,000 includes an undiscounted charge for deferred taxation of £951,000. In previous years the charge had been based on the discounted provision in line with FRS 19. This change has been made in the Regulatory Accounts following guidance from Ofwat. The discounted provision continues to be used as the basis of the charge in the statutory accounts. The application of the revised policy has resulted in a prior year adjustment to retained reserves of £1,975,000.

The Regulatory Capital Value (as calculated by Ofwat in 2003/04 prices) at 31st March 2004 was £47million. The post tax return on the Regulatory Capital Value was 7.65%.

**Dividends**

Dividends paid by the appointed business amounted to £1,290,000, which represents a 3% increase from the previous year.

**Cashflow**

The negative net cash flow of £143,000 was due largely to the record level of capital expenditure, reflecting the expenditure necessary to achieve the target for the 5 year period to 2005.

**25 Financial review and commentary**

(continued)

**Five year rolling summaries**

The five year rolling summaries, notes 22 and 23, give the financial results for the last five years in real terms, that is after adjusting for the effects of inflation.

The current cost profit and loss account shows the reduction in turnover and hence profitability that took place in 2000/01 as a result of the new price limits that came into effect that year. After adjusting for the exceptional item of £1,062,000 in 2003, operating costs have increased largely due to the rapid rise in insurance costs between 2002 and 2004 and the need to start making a SSAP 24 pension charge in 2003 (in prior years there had been a credit to operating costs).

Dividends demonstrate the effect of the balance sheet restructuring referred to above. The dividend payment of £9.6m in 2002 was necessary to facilitate the restructuring.

The current cost balance sheets highlight the introduction of the index linked loan in 2003 and the provision for deferred tax introduced in 2001, following the implementation of FRS19.

**26 Report on RAG5 Transfer Pricing**

**Summary**

Procedures for the identification, monitoring and charging of inter-company transactions including the monitoring of cross company directorships and the composition of company Boards, which have been applied during the year, were approved by the Group Board in July 2000.

The methods used have been reviewed in detail in all areas during the year, and allocation methods improved where possible.

The Energy business ceased to trade during 2002/3 and as a consequence, transactions relating to the energy business have declined significantly. During 2003/4 costs charged to the energy business relate to Dee Valley Water plc personnel undertaking cash collection activities relating to the remaining Energy company debtors.

Dee Valley Services Ltd provided a contracting service under a term contract with Dee Valley Water plc, which expired in May 2003. Dee Valley Water plc did not award a new term contract. The contracting work is now being carried out 'in house' by Dee Valley Water plc. The charges between Dee Valley Water plc and Dee Valley Services Ltd thus relate only to April and May 2003.

Whilst the levels of intercompany transaction have been reduced to virtually nil during the year, the principles for calculating charges, as set out below, have been applied consistently during the year.

**Inter-company transactions**

The probability of transactions arising between Group companies was established by the Finance Manager. Monitoring of transactions and the assessment of any new Group companies was incorporated into the procedures. Departmental Managers are key in the identification of new transactions and the procedures reflect this.

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

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26 Report on RAG 5 Transfer Pricing

(continued)

The group currently comprises, in addition to the Water business (DVW), the Dee Valley Services contracting business, and three energy companies which, for RAG5 purposes are treated as one business referred to as 'Energy'.

The probability of transactions arising between the Group companies has been assessed as follows:

Dee Valley Water and Dee Valley Services - High

Dee Valley Water and Energy - High

Dee Valley Services and Energy - Low

Once the probability of transactions has been established, the types of transactions likely to occur have been assessed.

Transactions between DVW and Dee Valley Services as well as those between DVW and Energy are likely to occur in both directions and the assessment had to be made from the point of view of both companies.

**Administration functions provided by DVW to Energy and Dee Valley Services**

Due to the size of the Group, certain administrative functions are provided centrally for all Group companies. The nature of the services provided and the methods of recharge are described below:-

Finance

Nature of service:

payroll, purchase and sales ledgers and management accounting functions

Method of recharge:

all employees complete timesheets, allocating time to appropriate group businesses. Other payroll costs have been allocated on the basis of hours booked.

Comments:

A temporary accountant has been employed throughout the year to prepare Dee Valley Services management accounts. 100% of this cost has been allocated to Dee Valley Services.

Stores and Purchasing

Nature of service:

1. purchasing, receiving and issuing of materials, purchased on behalf of Dee Valley Services, as required by the term contract.

2. provision of purchasing, and order processing services to Dee Valley Services, for goods and services purchased by Dee Valley Services, from third parties.

Method of Recharge:

1. Dee Valley Services are charged for service 1, by the addition of a set percentage to the costs of materials sold to them by DVW. (as specified under the term contract- see below)

2. Dee Valley Services are charged for service 2 above, on the basis of hours booked.

Comments:

The department has not provided any significant services to the energy business during the year.

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2004

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26 Report on RAG 5 Transfer Pricing

(continued)

Customer Accounts

Nature of service:

Call handling and cash allocation services, to maintain customer accounts for the Energy business.

Method of Recharge:

All costs relating directly to the Energy business, including costs for staff working 100% on energy customers, have been captured in a separate cost centre. This has been charged in total to the Energy business. The cost centre includes items such as stationery, postage and temporary staff costs. Supervision has been provided for this department, by the DVW customer accounts manager, the deputy manager, and the debt collection supervisor. These individuals have allocated their time to the energy business as appropriate.

Comments:

This department does not provide any services to the Dee Valley Services business.

Personnel

Nature of service:

the personnel manager provides personnel, and health and safety services for all group businesses.

Method of Recharge:

All personnel costs are captured in a separate cost centre. 50% of the total departmental cost has been allocated based on the average number of employees in each business during the year. This recognises personnel time spent on health and safety, and employment issues. 50% of the cost, has been allocated based on the total number of starters and leavers during the period, reflecting time spent recruiting employees, and terminating employees contracts.

Comments:

Note that training and direct health and safety costs are purchased directly by group businesses.

IT support costs

Nature of service:

2 IT support staff provide services to all group businesses.

Method of Recharge:

Time sheets are completed to allocate time. Other IT costs, such as maintenance and support costs have been allocated in line with the proportion of time booked.

Comments:

Note that IT consumable costs are purchased directly by group businesses.

Corporate Management Team (CMT) costs

Nature of service:

The executive directors provide services to all group businesses.

Method of recharge: Timesheets have been used where available. Otherwise estimated time allocations have been made.

Secretarial Services

Nature of service:

the department provides reception, switchboard and other secretarial support to all group companies.

Method of recharge:

Timesheets have been used where available. Otherwise estimated time allocations have been made.

**26 Report on RAG 5 Transfer Pricing**

(continued)

Accommodation costs

Nature of Service:

Dee Valley Services occupied office accommodation on the DVW site during April and May 2003.

Method of recharge:

The recharge allocates costs incurred by DVW as a consequence of providing this accommodation. Heating, lighting and rates costs have been allocated on the basis of the area of office space occupied. The charge has been made for 2 months only.

Pension costs and administration fees

In recent years the group pension fund has shown an actuarial surplus. During the current financial year, the company has been required to start making a charge in the profit and loss account under SSAP24. (no cash contribution has been made.) The charge has been allocated between group businesses, based on salary costs for employees who are members of the pension scheme. A similar allocation has been made of fund administration fees.

Insurance costs

Insurance costs have been allocated based on average numbers of vehicles, for vehicle related costs, and on payroll cost percentage, for all other costs.

DVW and Dee Valley Services - Term Contract

The decision to award the Term Contract to Dee Valley Services Ltd (DVS), was made by the two non-executive directors with the advice of the DVW engineer to the contract.

The contract was for a two-year period with the option to extend for a further year. DVW's Planning & Regulation Manager is the Engineer to the contract in order to remove the possible conflict of interests of the Engineering Director who is on both the DVW and DVS Boards. DVS were awarded the contract in April 2000 and it commenced on the 5th June 2000. The Engineer must sanction all variations to the contract. All invoices must be authorised by the Engineer before payment can be made to DVS by DVW.

Under the terms of the contract, certain stores items must be purchased by DVS from DVW e.g. meters. These items have a fixed price for the year (latest price plus 9.5%) and are invoiced to DVS by DVW on a monthly basis.

Should DVW purchase items on behalf of DVS, these items are passed through the inter-company account at actual cost. Any such items are flagged by the Stores & Purchasing department and coded in the job costing system accordingly.

**Split between Core and Non-Core**

Laboratory - services to third parties

The job costing system is used to collect all direct costs relating to third party services including time, from timesheets, and direct materials.

## DEE VALLEY WATER PLC

### NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 31 MARCH 2004

#### 26 Report on RAG 5 Transfer Pricing

(continued)

##### Billing commission

Sewerage is billed and collected on behalf of Dwr Cymru and North West Water. The majority of costs incurred relate to the pass-through of commission paid to Wrexham County Borough Council and Flintshire County Council for collection of council house charges. Costs are allocated on the basis of marginal cost, which works out at approximately 10% of the Customer Services departmental costs.

##### Other

Fishing licences make up the remaining non-core income. The associated costs are already separately identified.

##### **Conclusion**

The volume of intercompany transaction has diminished considerably during the year, and in future years it is not anticipated that costs apportionment will only be necessary between core and non core elements of the business.

The procedures reviewed by the Board in July 2000, set out a realistic system for monitoring current activities and to provide a framework to identify new transactions as they arise.

#### 27 Transactions with Associated Companies

The table below sets out the transactions with associated companies

<b>Associated Company</b>	<b>Description</b>	<b>Terms of supply</b>	<b>Associates Annual Turnover £000</b>	<b>Trade Value £000</b>
Dee Valley Services Ltd	Contracting - profit and loss costs	Competitive letting	817	105
Dee Valley Services Ltd	Contracting - capital costs	Competitive letting	817	712
Dee Valley Services Ltd	Support services provided to Dee Valley Services Ltd by Dee Valley Water plc	Cost	817	30
North Wales Gas Ltd	Support services provided to North Wales Gas Ltd by Dee Valley Water plc	Cost	-	6
Energy Supplies UK Ltd	Support services provided to Energy Supplies UK Ltd by Dee Valley Water plc	Cost	-	19

As described in note 26, Dee Valley Services Ltd ceased to trade in June 2003. As a result tangible fixed assets were transferred from Dee Valley Services Ltd to Dee Valley Water plc at a net book value of £51,000.

At 31 March 2004 there is inter-group indebtedness due to Dee Valley plc of £10,000,389 (2003 - £9,629,218) and Wrexham Water plc is indebted to Dee Valley Water plc for £2,995,600 (2003 - £2,995,600)