

# Notes to the consolidated financial statements

## 1. Accounting policies

### (a) Statement of compliance

The consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union as it applies to the financial statements of the Group for the year ended 31 March 2009 and in accordance with the Companies Act 1985. The consolidated financial statements are also consistent with IFRS as issued by the IASB.

The Group has adopted 'IFRIC 14: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' during the year. Adoption of this interpretation did not have any effect on the financial performance or position of the Group.

The directors consider the following accounting policies to be relevant in relation to the Group's financial statements. The financial statements of the Group for the year ended 31 March 2009 were authorised for issue by the Board of directors on 2 June 2009 and the balance sheet was signed on the Board's behalf by Sir Derek Wanless (Chairman) and John Cuthbert (Managing Director).

Northumbrian Water Group plc is a public limited company incorporated and domiciled in England and Wales. The Company's ordinary shares are traded on the London Stock Exchange.

The Group financial statements are presented in sterling and all values are rounded to the nearest one hundred thousand pounds (£0.1 million) except where otherwise indicated.

### (b) Basis of consolidation

The consolidated financial statements include the Company and its subsidiary undertakings. The results of subsidiaries acquired during the period are included from the date of their acquisition. The results of subsidiaries disposed of during the period are included to the date of their disposal. Inter segment sales and profits are eliminated fully on consolidation. Where, for commercial reasons, the accounting reference date of a subsidiary is a date other than that of the Company, management accounts made up to the Company's accounting reference date have been used. In accordance with SIC 12 'Consolidation – Special Purpose Entities', the financial statements of two companies are consolidated as special purpose entities, with effect from 12 May 2004, the date of the transaction which utilised these entities.

Where necessary, adjustments are made to bring the accounting policies used under relevant local GAAP in the individual financial statements of the Company, subsidiaries and jointly controlled entities into line with those used by the Group under IFRS.

Minority interests represent the portion of profit or loss and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separately from parent shareholders' equity.

### (c) Associates and jointly controlled entities

Investments in associates and jointly controlled entities in the Group financial statements are accounted for using the equity method of accounting where the Group exercises significant influence over the associate. Significant influence is generally presumed to exist where the Group's effective ownership is 20% or more. The Group's share of the post tax profits less losses of associates and jointly controlled entities is included in the consolidated income statement and the carrying value in the balance sheet comprises the Group's share of their net assets/liabilities less distributions received and any impairment losses. Goodwill arising on the acquisition of associates and jointly controlled entities, representing the excess of the cost of investment compared to the Group's share of net fair value of the associate's identifiable assets, liabilities and contingent liabilities, is included in the carrying amount of the associate and is not amortised. Financial statements of jointly controlled entities and associates are prepared for the same reporting period as the Group. Where necessary, adjustments are made to bring the accounting policies used into line with those of the Group to take into account fair values assigned at the date of acquisition and to reflect impairment losses where appropriate. Adjustments are also made to the Group's financial statements to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its jointly controlled entities and associates.

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

### (d) Goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses represents the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Prior to 1 April 2004, goodwill was amortised over its estimated useful life; such amortisation ceased on 31 March 2004. Goodwill relating to acquisitions since 1 April 2004 is not amortised. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. For the purposes of impairment testing, goodwill is allocated to the related cash-generating units monitored by management at statutory company level. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement. The carrying amount of goodwill allocated to a cash-generating unit is taken into account when determining the gain or loss on disposal of the unit, or of an operation within it.

### (e) Intangible assets other than goodwill

Other intangible fixed assets represent the right to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme. The value of this intangible asset has been assessed with reference to the net monies raised in accordance with the 'Kielder securitisation' on 12 May 2004. The term of the operating agreement is in perpetuity and, accordingly, no amortisation is provided. The value of this intangible is assessed for impairment on an annual basis in accordance with IAS 36 'Impairment of Assets'.

Expenditure on internally developed intangible assets, excluding development costs, is taken to the income statement in the year in which it is incurred. Intangible assets acquired separately from a business are carried initially at cost. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably. Development expenditure is recognised as an intangible asset only after its technical feasibility and commercial viability can be demonstrated, the availability of adequate technical and financial resources and an intention to complete the project have been confirmed and the correlation between development costs and future revenues has been established.

### (f) Property, plant and equipment

#### Property, plant and equipment and depreciation

Property, plant and equipment, including assets in the course of construction, comprise infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, overground plant and equipment).

Property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment. Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended. Borrowing costs attributed to assets under construction are recognised as an expense as incurred.

Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows: freehold buildings, 30-60 years; operational structures, plant and machinery, 4-92 years; infrastructure assets 13-200 years (see below); and fixtures, fittings, tools and equipment, 4-10 years.

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and where adjustments are required these are made prospectively.

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

#### Infrastructure assets

In the regulated water services business, infrastructure assets comprise a network of systems being mains and sewers, reservoirs, dams and sea outfalls.

Infrastructure assets were measured at a date prior to transition to IFRS (23 May 2003) at their fair value, which was adopted as deemed historical cost on transition to IFRS. The assets and liabilities were measured at fair value as a result of the acquisition on 23 May 2003.

## 1. Accounting policies continued

Expenditure on infrastructure assets which enhances the asset base is treated as fixed asset additions while maintenance expenditure which does not enhance the asset base is charged as an operating cost.

Infrastructure assets are depreciated evenly to their estimated residual values over their estimated economic lives, which are principally as follows:

Dams and impounding reservoirs	150 years
Water mains	100 years
Sea outfalls	60 years
Sewers	200 years
Dedicated pipelines	4-20 years

### (g) Financial assets

Financial assets comprise loans to third parties, recoverable in more than one year and include cash held on long term deposit as a guaranteed investment contract relating to the Kielder securitisation. These assets are recognised at cost and are measured annually based on the ability of the borrower to repay. Any impairment is taken to the income statement in the period in which it arises. Loans and receivables are measured at amortised cost using the effective interest rate method. The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

### (h) Foreign currencies and foreign currency transactions

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated at the functional currency rate of exchange ruling at the balance sheet date. The functional and presentational currency of Northumbrian Water Group plc is United Kingdom sterling (£). Assets and liabilities of subsidiaries and jointly controlled entities in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial period and the results of foreign subsidiaries are translated at the average rate of exchange for the period. Differences on exchange arising from the re-translation of the opening net investment in subsidiary companies and jointly controlled entities, and from the translation of the results of those companies at average rate, are taken to equity. All other foreign exchange differences are taken to the income statement in the period in which they arise.

Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities, where material, and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

### (i) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs, as well as an element of overheads that have been incurred in bringing the inventories to their present locations and condition.

### (j) Revenues

#### Provision of services

Revenue, which excludes value added tax, represents the fair value of the income receivable in the ordinary course of business for services provided. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

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

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

### Interest

Revenue is recognised as the interest accrues, taking into account the effective yield of the asset.

### Dividends

Revenue is recognised when the shareholders' right to receive the revenue is established.

### (k) Grants and contributions

Grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Revenue grants are credited to the income statement in the period to which they relate. Capital grants and contributions relating to property, plant and equipment are treated as deferred income and amortised to the income statement over the expected useful economic lives of the related assets.

### (l) Leases

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the Group, the assets are treated as if they had been purchased at their fair value or, if lower, at the present value of the minimum lease payments. Rentals or leasing payments are treated as consisting of a capital element and finance charges, the capital element reducing the outstanding liability and the finance charges being charged to the income statement over the period of the leasing contract at a constant rate on the reducing outstanding liability.

Rentals under operating leases (where the lessor retains a significant proportion of the risks and rewards of ownership) are expensed in the income statement on a straight line basis over the lease term.

### (m) Pensions and other post-employment benefits

#### Defined benefit scheme

The cost of providing benefits under the defined benefit scheme is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight line basis over the vesting period or immediately if the benefits have vested. When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs, the obligation and related plan assets are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year.

The service cost is disclosed in employment costs and the expected interest income and interest cost on obligations have been disclosed within finance costs payable/(income receivable).

Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the consolidated statement of recognised income and expense.

#### Defined contribution scheme

The Group also operates a defined contribution scheme. Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

## 1. Accounting policies continued

### (n) Share-based payments

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by an external valuer using the Monte-Carlo simulation model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired, management's best estimate of the achievement or otherwise of non-market conditions and the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

### (o) Taxes

#### Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the balance sheet date.

#### Deferred tax

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

Deferred tax liabilities are recognised for all taxable temporary differences except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in jointly controlled entities, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in jointly controlled entities, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

# Notes to the consolidated financial statements continued

## 1. Accounting policies continued

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted, or substantively enacted, at the balance sheet date.

Deferred tax is recognised in the income statement unless it relates to items accounted for in equity.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

### Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax except:

- where the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables.

The net amount of value added tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

### (p) Derivative financial instruments

The Group utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Group in line with the Group's risk management policies. Interest rate swap agreements are used to manage interest rate exposures. Derivative financial instruments are stated at their fair value.

Under IAS 39, derivative financial instruments are always measured at fair value, with hedge accounting employed in respect of those derivatives fulfilling the stringent requirements for hedge accounting as prescribed under IAS 39. In summary, these criteria relate to initial designation and documentation of the hedge relationship, prospective testing of the relationship to demonstrate the expectation that the hedge will be highly effective throughout its life and subsequent retrospective testing of the hedge to verify effectiveness.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swaps is determined by reference to market values for similar instruments.

Hedging transactions undertaken by the Company are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to variability in currency cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in equity. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement. Where the adjustment is to the carrying amount of a hedged interest bearing financial instrument, the adjustment is amortised to the net profit and loss such that it is fully amortised by maturity.

## 1. Accounting policies continued

In relation to cash flow hedges to hedge firm currency commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or a non-financial liability then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same periods in which the hedged firm commitment affects the net profit and loss.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for special hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

### (q) Interest bearing loans and borrowings

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period. The carrying amount of index linked borrowings increases annually in line with the July RPI, with the accretion being charged to the income statement as finance costs payable. Other borrowing costs are recognised as an expense when incurred.

Loans and borrowings acquired at acquisition are restated to fair value. The adjustment arising on acquisition is amortised to the income statement on the basis of the maturity profile of each instrument. Realised gains and losses that occur from the early termination of loans and borrowings are taken to the income statement in that period.

Net debt is the sum of all current and non-current liabilities less cash and cash equivalents, short term cash deposits, financial investments and loans receivable.

### (r) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available for sale. Gains and losses are recognised in income when the investments are de-recognised or impaired, as well as through the amortisation process.

### (s) Cash and cash equivalents and short term cash deposits

Cash and cash equivalents disclosed in the balance sheet comprise cash at bank and in hand and short term deposits with a remaining maturity of up to three months or less, which are held for the purpose of meeting short term cash commitments rather than for investment or other purposes. Cash equivalents are readily convertible to a known amount of cash and subject to an insignificant risk of changes in value.

Short term cash deposits disclosed in the balance sheet comprise cash deposited with a remaining maturity of greater than three months, a fixed interest rate and which do not constitute as cash equivalents under IAS 7 'Statement of Cash Flows'.

For the purpose of the consolidated cash flow statement, cash and cash equivalents are as defined above, net of outstanding bank overdrafts.

# Notes to the consolidated financial statements

## continued

### 1. Accounting policies continued

#### (t) Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. Invoices for unmeasured water and waste water charges are due on fixed dates; other receivables generally have 30 day payment terms. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified. Trade and other receivables do not carry any interest.

#### (u) Investments

Investments are initially recorded at the fair value of the consideration given and including the acquisition charges associated with the investment.

#### (v) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required and a reliable estimate can be made of the amount of the obligation.

#### (w) Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses on continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

#### (x) De-recognition of financial assets and liabilities

A financial asset or liability is generally de-recognised when the contract that gives rise to it is settled, sold, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the income statement.

## 1. Accounting policies continued

### (y) Accounting standards

During the year, the IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

International Accounting Standards (IAS/IFRS)	Effective for accounting periods beginning on or after
IFRS 2: Share-based Payments – Vesting Conditions and Cancellations	1.1.2009
IFRS 3: Business Combinations (Revised)	1.7.2009
IFRS 8: Operating Segments	1.1.2009
IAS 1: Presentation of Financial Statements (Revised)	1.1.2009
IAS 23: Borrowing Costs (Revised)	1.1.2009
IAS 27: Consolidated and Separate Financial Statements (Revised)	1.7.2009
Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation	1.1.2009
Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items	1.7.2009
Improvements to IFRS May 2008	1.1.2009, 1.7.2009
Improvements to IFRS April 2009	1.7.2009, 1.1.2010

  

International Financial Reporting Interpretation Committee (IFRIC)	Effective for accounting periods beginning on or after
IFRIC 15: Agreements for the Construction of Real Estate	1.1.2009
IFRIC 16: Hedges of a Net Investment in a Foreign Operation	1.10.2008
IFRIC 17: Distributions of Non-Cash Assets to Owners	1.7.2009
IFRIC 18: Transfers of Assets from Customers	1.7.2009

With the exception of IAS 23: Borrowing Costs (Revised), the directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application. The directors continue to assess the impact of IAS 23: Borrowing Costs (Revised) on the Group's financial statements.

### (z) Key assumptions

The directors consider that the key assumptions applied at the balance sheet date, which may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are:

- those assumptions used in arriving at the pension asset/liability under IAS 19. These key assumptions and their possible impact are disclosed in note 25, 'Pensions and other post-retirement benefits';
- the bad debt provision which is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied; and
- the asset lives assigned to property, plant and equipment, details of which can be found in note 1(f).

## 2. Segmental analysis

The primary segment reporting format is determined to be business segments. The secondary segment reporting format is determined to be geographical. However, as more than 98% of the Group's activities are within the UK, revenue, profit before interest, assets and liabilities have been attributed to one geographical segment.

### Northumbrian Water Limited

NWL is one of the ten regulated water and sewerage businesses in England and Wales. NWL operates in the north east of England, where it trades as Northumbrian Water, and in the south east of England, where it trades as Essex & Suffolk Water. NWL also has non-regulated activities closely related to its principal regulated activity.

### Water and waste water contracts

NWG owns a number of special purpose companies for specific water and waste water contracts in Scotland, Ireland and Gibraltar.

# Notes to the consolidated financial statements continued

## 2. Segmental analysis continued

### Other

Agrer provides overseas aid funded project work in developing countries through a number of funding agencies. Central unallocated costs and provisions are also included.

Transfer prices between business segments are set on an arm's length basis in a manner similar to transactions with third parties. Segment revenue, segment expense and segment result include transfers between business segments. Those transfers are eliminated on consolidation.

### Revenue

	Northumbrian Water Limited £m	Water and waste water contracts £m	Other £m	Total £m
<b>Year ended 31 March 2009</b>				
Segment revenue	647.0	39.8	13.0	699.8
Inter segment revenue	–	–	(5.7)	(5.7)
Revenue to external customers	647.0	39.8	7.3	694.1
<b>Year ended 31 March 2008</b>				
Segment revenue	628.0	35.5	12.6	676.1
Inter segment revenue	–	–	(5.7)	(5.7)
Revenue to external customers	628.0	35.5	6.9	670.4

All revenue above represents services provided.

### Profit on ordinary activities before interest

	Northumbrian Water Limited £m	Water and waste water contracts £m	Other £m	Total £m
<b>Year ended 31 March 2009</b>				
Segment profit on ordinary activities before interest	266.9	9.1	(2.4)	273.6
Net finance costs				(121.7)
Share of profit from associates and jointly controlled entities				0.8
Profit on ordinary activities before taxation				152.7
Taxation				(164.6)
Loss for the year from continuing operations				(11.9)
<b>Year ended 31 March 2008</b>				
Segment profit on ordinary activities before interest	272.0	8.4	(2.6)	277.8
Net finance costs				(108.0)
Share of profit from associates and jointly controlled entities				0.5
Profit on ordinary activities before taxation				170.3
Taxation				(12.0)
Profit for the year from continuing operations				158.3

### Assets and liabilities

	Northumbrian Water Limited		Water and waste water contracts		Other		Total	
	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m
Segment assets	3,446.1	3,398.9	131.7	133.1	302.0	325.5	3,879.8	3,857.5
Segment liabilities	431.9	303.8	20.8	23.0	3,169.7	3,038.9	3,622.4	3,365.7

Other comprises taxation, interest and net debt.

## 2. Segmental analysis continued

Other segment information:

	Northumbrian Water Limited		Water and waste water contracts		Total	
	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m
Property, plant and equipment additions	229.6	233.8	3.0	1.5	232.6	235.3
Depreciation	95.0	93.0	5.7	5.3	100.7	98.3

## 3. Operating costs

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Materials and consumables	23.3	22.3
Manpower costs (see note 5)	103.0	106.9
Own work capitalised	(27.0)	(26.2)
Depreciation of property, plant and equipment	100.7	98.3
Profit on disposal of property, plant and equipment	(1.2)	(1.2)
Amortisation of capital grants	(4.8)	(4.8)
Costs of research and development	1.8	1.8
Operating lease payments	1.6	1.1
Bad debt charge	17.5	13.7
Other operating costs	205.6	180.7
Operating costs	420.5	392.6

## 4. Auditors' remuneration

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Audit of the financial statements†	0.3	0.3
Other fees to auditors:		
Taxation services	0.1	0.1

† £97,000 of this relates to the Company (2008: £90,000)

## 5. Employee information

The total employment costs of all employees (including directors) of the Group were:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Wages and salaries	85.2	82.8
Social security costs	7.1	7.0
Defined benefit pension service cost (see note 25)	9.9	15.7
Other pension costs	0.8	1.4
Total employment costs	103.0	106.9

Total employment costs were charged as follows:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Capital schemes and infrastructure renewals	23.3	25.9
Manpower costs	79.7	81.0
	103.0	106.9

Included in wages and salaries is a total expense of shared-based payments of £0.9 million (2008: £0.8 million) which arises from transactions accounted for as equity-settled share-based payments.

# Notes to the consolidated financial statements continued

## 5. Employee information continued

The average monthly number of employees of the Group during the year was:

	Year to 31.3.2009 Number	Year to 31.3.2008 Number
Northumbrian Water Limited	2,966	2,890
Water and waste water contracts	156	155
Other	25	25
	<b>3,147</b>	3,070

The information required by Schedule 6 of the Companies Act is contained in the directors' remuneration report under directors' emoluments, directors' pensions and pension benefits, directors' interests in shares and debentures, directors' interests in LTIP awards and directors' interests in shares under the Share Incentive Plan.

## 6. Finance costs payable/(income receivable)

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Finance costs payable on debentures, bank and other loans and overdrafts	122.8	125.3
Amortisation of discount, fees, loan issue costs and other financing items	(4.9)	(5.6)
Accretion on index linked bonds	22.4	16.2
Interest cost on pension plan obligations	38.5	35.2
Finance costs payable on hire purchase contracts and finance leases	4.7	2.4
Total finance costs payable	183.5	173.5
Expected return on pension plan assets	(44.3)	(48.4)
Finance income receivable	(17.5)	(17.1)
Net finance costs payable	121.7	108.0

## 7. Taxation

### (a) Tax on profit on ordinary activities

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Current tax:		
Current income tax charge at 28% (2008: 30%)	33.0	28.1
Income tax reported in equity on cash flow hedges	0.1	–
Adjustment in respect of prior periods	(1.1)	(2.7)
UK corporation tax	32.0	25.4
Overseas tax	0.1	0.2
Total current tax	32.1	25.6
Deferred tax:		
Origination and reversal of temporary differences in the year at 28%	13.8	15.1
Effect of changes in tax rates and laws:		
– Impact of Industrial Buildings Allowances abolition	117.2	–
– Impact of opening rate reduction	–	(35.4)
Income tax reported in equity on cash flow hedges	(0.1)	–
Adjustment in respect of prior periods	1.6	6.7
Total deferred tax	132.5	(13.6)
Tax charge in the income statement	164.6	12.0

## 7. Taxation continued

### (b) Tax relating to items charged or credited to equity

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Current tax:		
Current tax recycled to income statement on cash flow hedges	(0.1)	–
Deferred tax:		
Actuarial gains and losses on pension schemes	(58.2)	7.6
Deferred tax recycled to income statement on cash flow hedges	0.1	–
Interest rate swaps	(3.3)	–
Share-based payment	–	0.2
<b>Tax (credit)/charge in the statement of recognised income and expense</b>	<b>(61.5)</b>	<b>7.8</b>

### (c) Reconciliation of the total tax charge

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Accounting profit before tax	152.7	170.3
Accounting profit multiplied by standard rate of corporation tax (28%) (2008: 30%)	42.8	51.1
Effects of:		
Expenses not deductible for tax purposes	3.6	3.0
Depreciation in respect of non-qualifying items	0.9	0.8
Non-taxable income and enhanced tax reliefs	(0.1)	(0.6)
Non-taxable amortisation of financing items	(1.6)	(1.8)
Refinancing of infrastructure assets	1.6	(7.7)
Adjustment to tax charge in respect of prior periods	0.5	4.0
Other	(0.3)	(0.3)
	47.4	48.5
Effect of changes in tax rates and laws:		
– Impact of Industrial Buildings Allowances abolition	117.2	–
Impact of rate reduction on deferred tax:		
– Restatement of opening balance	–	(35.4)
– Movement in the year	–	(1.1)
<b>Total tax expense reported in the income statement</b>	<b>164.6</b>	<b>12.0</b>

The effective tax rate for the year to 31 March 2009 was 107.8% (2008: 7.0%). The increase of 100.8% is mainly due to the impact of the abolition of Industrial Buildings Allowances (IBA), the restatement of deferred tax in 2008 and the refinancing of certain infrastructure assets. In the absence of the IBA adjustment, the effective rate would have been 31.0%.

### (d) Unrecognised tax losses

The Group has tax losses of £8.2 million (2008: £8.7 million) which have arisen in its Gibraltar subsidiary for which a deferred tax asset has not been recognised as they may not be used to offset taxable profits elsewhere in the Group and it is not expected that the subsidiary will utilise significant amounts in the foreseeable future. The losses are, however, available for offset against future taxable profits without time limit.

### (e) Temporary differences associated with Group investments

At 31 March 2009, there was no recognised deferred tax liability (2008: £nil) for taxes that would be payable on the unremitted earnings of the Group's subsidiaries as the Group has determined that undistributed profits of its subsidiaries will not be distributed in the foreseeable future. The temporary difference associated with investments in subsidiaries for which a deferred tax liability has not been recognised aggregate to £10.9 million (2008: £8.5 million).

# Notes to the consolidated financial statements continued

## 7. Taxation continued

### (f) Deferred tax

The deferred tax included in the income statement is as follows:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Accelerated capital allowances	134.3	(18.0)
Intangible asset	–	(1.3)
Shared-based payments	–	(0.1)
Provisions	–	0.5
Deferred grant income	(1.7)	(0.5)
Retirement benefits	0.5	6.1
Losses carried forward	(0.3)	0.8
Fair value adjustment on previous business combinations	(0.2)	(1.1)
Other	(0.1)	–
	<b>132.5</b>	<b>(13.6)</b>

The deferred tax included in the balance sheet is as follows:

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Deferred tax assets:		
Provisions	1.2	1.2
Deferred income	58.9	57.2
Retirement benefits	34.2	–
Losses available for offset against future taxable income	5.1	4.8
Interest rate swaps	3.3	–
Share-based payments	0.2	0.2
Cash flow hedges	1.0	1.1
Other	0.3	0.2
Deferred tax asset	<b>104.2</b>	64.7
Deferred tax liabilities:		
Accelerated capital allowances	671.4	537.1
Intangible asset	18.0	18.0
Fair value adjustment on previous business combinations	11.3	11.5
Retirement benefits	–	23.5
Deferred tax liability	<b>700.7</b>	590.1
Net deferred tax liability	<b>596.5</b>	525.4

### (g) Factors that may affect future tax charges

The Group expects to continue to incur high levels of capital expenditure and be able to claim tax relief in excess of depreciation for the remainder of NWL's current regulatory period. The annual excess has been falling mainly because, since 1 April 2005, tax deductions for deferred revenue expenditure are claimed on a depreciation basis (as originally set out in HM Revenue and Customs' Tax Bulletin 53).

In addition to abolition of industrial buildings allowances, future capital allowances claims will be made at the revised rates introduced by the Finance Act 2008. The main changes being a reduction in the rate of allowance for items of general plant and machinery from 25% to 20% per annum and an increase in the rate for long life assets from 6% to 10% per annum with effect from 1 April 2008.

## 8. Earnings per share

Basic earnings per share (EPS) is calculated by dividing the (loss)/profit attributable to ordinary equity holders of the parent Company by the weighted average number of ordinary shares in issue during the year. Treasury shares held are excluded from the weighted average number of shares for basic EPS.

	Loss 31.3.2009 £m	Weighted average number of shares 31.3.2009 million	Loss per share 31.3.2009 pence	Earnings 31.3.2008 £m	Weighted average number of shares 31.3.2008 million	Earnings per share 31.3.2008 pence
Basic EPS	<b>(12.7)</b>	<b>518.0</b>	<b>(2.45)</b>	158.1	518.0	30.52

The weighted average number of shares for diluted EPS is calculated by including the treasury shares held.

	Loss 31.3.2009 £m	Weighted average number of shares 31.3.2009 million	Loss per share 31.3.2009 pence	Earnings 31.3.2008 £m	Weighted average number of shares 31.3.2008 million	Earnings per share 31.3.2008 pence
Diluted EPS	<b>(12.7)</b>	<b>518.6</b>	<b>(2.45)</b>	158.1	518.6	30.48

Adjusted EPS is considered by the directors to give a better indication of the Group's underlying performance and is calculated as follows:

	Loss/ (earnings) 31.3.2009 £m	Weighted average number of shares 31.3.2009 million	Loss/ (earnings) per share 31.3.2009 pence	Earnings 31.3.2008 £m	Weighted average number of shares 31.3.2008 million	Earnings per share 31.3.2008 pence
Basic EPS	<b>(12.7)</b>	<b>518.0</b>	<b>(2.45)</b>	158.1	518.0	30.52
Deferred tax	<b>132.5</b>		<b>25.58</b>	(13.6)		(2.62)
Amortisation of debt fair value	<b>(5.6)</b>		<b>(1.08)</b>	(6.1)		(1.18)
Adjusted EPS	<b>114.2</b>	<b>518.0</b>	<b>22.05</b>	138.4	518.0	26.72

## 9. Dividends paid and proposed

	Year to 31.3.2009 £m	Year to 31.3.2008 £m
Declared and paid during the year:		
Equity dividends on ordinary shares:		
Final dividend for 2007/08: 8.07 pence (2006/07: 7.52 pence)	<b>41.8</b>	39.0
Interim dividend for 2008/09: 4.29 pence (2007/08: 4.00 pence)	<b>22.2</b>	20.7
Dividends paid	<b>64.0</b>	59.7

Proposed for approval by shareholders at the AGM:

Final dividend for 2008/09: 8.50 pence (2007/08: 8.07 pence)	<b>44.0</b>	41.8
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# Notes to the consolidated financial statements continued

## 10. Intangible assets

	Goodwill £m	Other £m	Total £m
Cost:			
<b>At 1 April 2007, 1 April 2008 and 31 March 2009</b>	<b>3.8</b>	<b>64.2</b>	<b>68.0</b>
Impairment:			
<b>At 1 April 2007, 1 April 2008 and 31 March 2009</b>	<b>(0.2)</b>	<b>–</b>	<b>(0.2)</b>
<b>Net book value at 31 March 2009</b>	<b>3.6</b>	<b>64.2</b>	<b>67.8</b>
Net book value at 1 April 2007 and 31 March 2008	3.6	64.2	67.8

As from 1 April 2004, the date of transition to IFRS, goodwill is no longer amortised but is now subject to an annual impairment review.

Goodwill has been allocated to the water and waste water cash-generating unit and the other intangible asset has been allocated to the Northumbrian Water Limited cash-generating unit, which are also the reportable segments.

The other intangible asset represents the right in perpetuity to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme and, therefore, the directors consider the asset has an indefinite life. Accordingly, future cash flows, which increase in line with inflation, have been discounted at a rate of 6.83% in perpetuity. This represents a long term nominal gilt yield and an assumed credit spread. This calculation satisfied the Group that the carrying value at 31 March 2009 had not been impaired. Furthermore, it is improbable that the discount rate would increase to such a level that the carrying value would be impaired.

## 11. Property, plant and equipment

	Freehold land and buildings £m	Infrastructure assets £m	Operational structures, plant and machinery £m	Fixtures, fittings, tools and equipment £m	Assets in the course of construction £m	Total £m
Cost:						
At 1 April 2007	92.4	1,534.5	1,942.0	167.3	100.0	3,836.2
Additions	–	0.1	1.4	–	233.8	235.3
Schemes commissioned	0.4	82.2	96.8	7.9	(187.3)	–
Reclassifications	0.9	(0.1)	(0.8)	–	–	–
Disposals	(0.4)	(7.5)	(2.5)	–	–	(10.4)
At 1 April 2008	93.3	1,609.2	2,036.9	175.2	146.5	4,061.1
Additions	–	0.1	2.7	0.2	229.6	232.6
Schemes commissioned	2.0	101.5	96.6	5.5	(205.6)	–
Disposals	–	(7.9)	(11.2)	–	–	(19.1)
<b>At 31 March 2009</b>	<b>95.3</b>	<b>1,702.9</b>	<b>2,125.0</b>	<b>180.9</b>	<b>170.5</b>	<b>4,274.6</b>
Depreciation:						
At 1 April 2007	30.1	56.3	521.1	108.8	–	716.3
Charge for the year	2.0	21.2	65.3	9.8	–	98.3
Disposals	–	(7.5)	(2.3)	–	–	(9.8)
At 1 April 2008	32.1	70.0	584.1	118.6	–	804.8
Charge for the year	1.9	21.6	67.8	9.4	–	100.7
Disposals	–	(7.9)	(11.2)	–	–	(19.1)
<b>At 31 March 2009</b>	<b>34.0</b>	<b>83.7</b>	<b>640.7</b>	<b>128.0</b>	<b>–</b>	<b>886.4</b>
<b>Net book value at 31 March 2009</b>	<b>61.3</b>	<b>1,619.2</b>	<b>1,484.3</b>	<b>52.9</b>	<b>170.5</b>	<b>3,388.2</b>
Net book value at 31 March 2008	61.2	1,539.2	1,452.8	56.6	146.5	3,256.3
Net book value at 1 April 2007	62.3	1,478.2	1,420.9	58.5	100.0	3,119.9

## 11. Property, plant and equipment continued

Operational structures, plant and machinery include an element of land and buildings dedicated to those assets. The Group does not capitalise finance costs.

The net book value of property, plant and equipment held under hire purchase contracts and finance leases was as follows:

	31.3.2009 £m	31.3.2008 £m
Infrastructure assets	<b>48.3</b>	28.9
Operational structures, plant and machinery	<b>24.1</b>	23.7
	<b>72.4</b>	52.6

## 12. Investments

	31.3.2009 £m	31.3.2008 £m
Investments in jointly controlled entities	<b>3.8</b>	3.8

### (a) Investments in jointly controlled entities

The Group holds 50% of the nominal value of issued ordinary £1 shares in Vehicle Lease and Service Limited (VLS), the Group's principal jointly controlled entity. VLS was incorporated in England and Wales and undertakes the business of hiring, leasing and servicing of vehicles and plant.

The Group also holds a 50% interest in Agreco, a jointly controlled entity incorporated in Belgium.

The following table illustrates summarised financial information of the Group's share of the results of VLS and Agreco.

	VLS 31.3.2009 £m	Agreco 31.3.2009 £m	VLS 31.3.2008 £m	Agreco 31.3.2008 £m
Revenue	<b>6.5</b>	<b>2.5</b>	5.8	1.7
Operating costs	<b>(5.7)</b>	<b>(2.0)</b>	(5.1)	(1.5)
Profit on ordinary activities before interest	<b>0.8</b>	<b>0.5</b>	0.7	0.2
Finance costs payable	<b>(0.4)</b>	–	(0.4)	–
Finance income receivable	–	–	0.1	–
Profit on ordinary activities before taxation	<b>0.4</b>	<b>0.5</b>	0.4	0.2
– current taxation	<b>(0.1)</b>	–	(0.1)	–
Profit for the year	<b>0.3</b>	<b>0.5</b>	0.3	0.2

Share of the jointly controlled entities' balance sheet:

Non-current assets	<b>7.2</b>	–	5.7	–
Current assets	<b>6.5</b>	<b>2.9</b>	6.0	3.5
Share of gross assets	<b>13.7</b>	<b>2.9</b>	11.7	3.5
Current liabilities	<b>(3.9)</b>	<b>(2.4)</b>	(3.6)	(3.1)
Non-current liabilities	<b>(6.5)</b>	–	(4.7)	–
Share of gross liabilities	<b>(10.4)</b>	<b>(2.4)</b>	(8.3)	(3.1)
Share of net assets	<b>3.3</b>	<b>0.5</b>	3.4	0.4

# Notes to the consolidated financial statements continued

## 12. Investments continued

(b) The Group's interests in principal subsidiaries at 31 March 2008 and 31 March 2009 were as follows:

Name of undertaking	Country of incorporation or registration and operation	Description of shares held	Proportion of nominal value of issued shares held by Group (%)	Business activity
Northumbrian Services Limited	England and Wales	Ordinary shares of £1	100	Holding of investments and loans
Northumbrian Water Limited	England and Wales	Ordinary shares of £1	100	Water and sewerage services
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Caledonian Environmental Services plc	Scotland	Ordinary shares of £1	75	Waste water services
Caledonian Environmental Levenmouth Treatment Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Limited	Scotland	Ordinary shares of £1	75	Waste water services
Ayr Environmental Services Operations Limited	Scotland	Ordinary shares of £1	100	Waste water services
AquaGib Limited	Gibraltar	Ordinary shares of £1	67	Water and sewerage services
Northumbrian Water Projects Limited	England and Wales	Ordinary shares of £1	100	Waste water services
SA Agrer NV	Belgium	Ordinary shares of £1	100	Aid funded project work

The directors consider that to give full particulars of all subsidiary and associated undertakings would lead to a statement of excessive length. The above information relates to those subsidiary and associated undertakings or groups of undertakings whose results or financial position, in the opinion of the directors, principally affect the figures of the Group. A full list of the Company's subsidiaries is attached to the Company's latest annual return filed at Companies House.

## 13. Inventories

	31.3.2009 £m	31.3.2008 £m
Stores	3.2	3.4

## 14. Trade and other receivables

	31.3.2009 £m	31.3.2008 £m
Trade receivables	68.7	66.5
Amounts owed by jointly controlled entities	0.5	0.7
Prepayments and accrued income	51.7	48.9
Financial assets	1.4	1.7
Other receivables	9.4	7.3
	<b>131.7</b>	125.1

#### 14. Trade and other receivables continued

As at 31 March 2009, trade receivables at nominal value of £31.7 million (2008: £27.3 million) were impaired. Movements in the provision for impairment of trade receivables were as follows:

	£m
At 1 April 2007	24.7
Charge for the year	13.7
Utilised	(11.1)
At 1 April 2008	27.3
Charge for the year	17.5
Utilised	(13.1)
<b>At 31 March 2009</b>	<b>31.7</b>

At 31 March, the analysis of trade receivables overdue but not impaired is as follows:

	0-3 months £m	3-12 months £m	12-24 months £m	24-36 months £m	36-48 months £m	>48 months £m	Total £m
<b>2009</b>	<b>0.5</b>	<b>23.9</b>	<b>10.3</b>	<b>5.3</b>	<b>2.6</b>	<b>0.4</b>	<b>43.0</b>
2008	0.4	21.4	9.1	4.7	2.0	0.4	38.0

#### 15. Cash and cash equivalents and short term cash deposits

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise the following at 31 March:

	31.3.2009 £m	31.3.2008 £m
Cash at bank and in hand	<b>40.0</b>	92.3
Short term deposits	<b>68.8</b>	201.9
	<b>108.8</b>	294.2
Bank overdrafts	<b>(16.5)</b>	(27.8)
Cash and cash equivalents	<b>92.3</b>	266.4
	<b>31.3.2009 £m</b>	<b>31.3.2008 £m</b>
Short term cash deposits > 3 months	<b>120.8</b>	-
Short term cash deposits < 3 months	<b>39.8</b>	-
Short term cash deposits	<b>160.6</b>	-

Short term cash deposits of £39.8 million, with a maturity of less than three months represent amounts on deposit at fixed rates with the Northumbrian Water Pension Scheme.

#### 16. Trade and other payables

	31.3.2009 £m	31.3.2008 £m
Trade payables	<b>10.4</b>	9.7
Other payables	<b>19.2</b>	16.7
Interest payable	<b>35.9</b>	38.7
Accruals and deferred income	<b>82.3</b>	87.8
	<b>147.8</b>	152.9

# Notes to the consolidated financial statements continued

## 17. Interest bearing loans and borrowings

	31.3.2009 £m	31.3.2008 £m
Current:		
Bank overdrafts	16.5	27.8
Current instalments due on borrowings (principal £20.6 million, 2008: £96.8 million)	25.8	102.4
Current obligations under finance leases and hire purchase contracts (see note 18)	6.9	6.1
	<b>49.2</b>	136.3
Non-current:		
Non-current obligations under finance leases and hire purchase contracts (principal £104.8 million, 2008: £83.6 million) (see note 18)	104.8	83.7
Non-current instalments on borrowings (principal £2,326.6 million, 2008: £2,204.1 million)	2,360.5	2,242.7
	<b>2,465.3</b>	2,326.4
Borrowings comprise the following:		
Loans (principal £567.4 million, 2008: £543.6 million)	572.6	550.5
Subordinated loan stock	6.6	6.4
Eurobonds – due 11 October 2017 bearing interest rate of 6.0% (principal £300.0 million, 2008: £300.0 million)	309.8	311.0
Eurobonds – due 6 February 2023 bearing interest rate of 6.875% (principal £350.0 million, 2008: £350.0 million)	389.7	392.7
Eurobonds – due 29 April 2033 bearing interest rate of 5.625% (principal £350.0 million, 2008: £350.0 million)	346.0	345.6
Eurobonds – due 23 January 2034 bearing interest rate of 5.87526% (principal £248.0 million, 2008: £248.0 million)	240.7	240.4
Eurobonds – due 31 March 2037 bearing interest rate of 6.627% (principal £61.6 million, 2008: £61.6 million)	58.9	58.8
Index linked Eurobonds – due 15 July 2036 bearing interest rate of 2.033% (principal £171.9 million, 2008: £163.7 million)	170.9	162.6
Index linked Eurobonds – due 30 January 2041 bearing interest rate of 1.6274% (principal £67.7 million, 2008: £64.4 million)	67.5	64.3
Index linked Eurobonds – due 16 July 2049 bearing interest rate of 1.7118% (principal £112.0 million, 2008: £106.6 million)	111.8	106.4
Index linked Eurobonds – due 16 July 2053 bearing interest rate of 1.7484% (principal £112.0 million, 2008: £106.6 million)	111.8	106.4
	<b>2,386.3</b>	2,345.1
Less current instalments due on bank loans (principal £20.6 million, 2008: £96.8 million)	<b>(25.8)</b>	(102.4)
	<b>2,360.5</b>	2,242.7

The difference between the principal value of £2,326.6 million (2008: £2,204.1 million) and the carrying value of £2,360.5 million (2008: £2,242.7 million) are unamortised issue costs of £15.4 million (2008: £15.9 million) and a credit of £49.3 million (2008: £54.5 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

The Eurobonds – due 23 January 2034 are secured on the income receivable under the Kielder Water transfer scheme for the period to 23 January 2034.

The value of the capital and interest elements of the index linked Eurobonds are linked to movements in the UK Retail Price Index (see note 1(q)).

## 18. Obligations under hire purchase contracts and finance leases

	31.3.2009 £m	31.3.2008 £m
Amounts due:		
Not later than one year	6.9	6.1
After one year but not more than five years	23.2	19.2
Later than five years	160.0	123.8
	<b>190.1</b>	149.1
Less finance charges allocated to future periods	<b>(78.4)</b>	(59.3)
Present value of minimum lease payments	<b>111.7</b>	89.8
Disclosed as due:		
Not later than one year	6.9	6.1
After more than one year	104.8	83.7
	<b>111.7</b>	89.8

### Lease commitments

The Group has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The future minimum rentals payable under non-cancellable operating leases are as follows:

	31.3.2009 £m	31.3.2008 £m
Not later than one year	0.9	0.7
After one year but not more than five years	3.1	2.6
After five years	26.8	25.7
	<b>30.8</b>	29.0

## 19. Provisions

	£m
At 1 April 2008	
Current	0.2
Non-current	2.8
At 1 April 2008	3.0
Utilised	(0.3)
<b>At 31 March 2009</b>	<b>2.7</b>
Analysed as:	
Current	0.2
Non-current	2.5
	<b>2.7</b>

The provision represents outstanding discretionary pension liabilities. The discretionary pension liabilities have been calculated by an independent actuary and are expected to be paid over the remaining lives, which is approximately twelve years.

## 20. Financial instruments

### (a) Group strategy

The level of capital expenditure which the Group is obliged to incur is such that it cannot be wholly financed by internally generated sources. As a result, the Group must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required in its regulated business. The Group's strategy is to finance such investment by raising medium to long term debt, to provide a balance sheet match with long term assets and to fix a major proportion of interest rates.

# Notes to the consolidated financial statements continued

## 20. Financial instruments continued

### (b) Treasury operations

The main purpose of the Group's treasury function is to assess the Group's ongoing capital requirement and to raise funding on a timely basis, taking advantage of any favourable market opportunities. It also invests any surplus funds the Group may have, based upon its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process but the Group's policies prohibit their use for speculation.

### (c) Risks arising from the Group's financial instruments

The main risks arising from the Group's financial instruments are liquidity risk, interest rate risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. All treasury activities are conducted in accordance with these policies.

### (d) Liquidity risk

As regards day to day liquidity, the Group's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0 million and with a bank agreement availability period of no less than three months. At 31 March 2009, the Group had £75.0 million of undrawn committed bank facilities (2008: £75.0 million).

### (e) Interest rate risk

The Group finances its operations through a mixture of retained profits and bank borrowings. It borrows at both fixed and floating rates of interest and, accordingly, uses interest rate swaps to generate the desired interest profile and to manage the Group's exposure to interest rate fluctuations. The Group's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2009, 75% (2008: 63%) of the Group's borrowings were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

### (f) Foreign currency risk

The Group's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3.0 million sterling equivalent of a translation nature, should be covered immediately on identification.

### (g) Market price risk

The Group's exposure to market price risk principally comprises interest rate exposures. The Group's policy is to accept a degree of interest rate risk. On the basis of the Group's analysis, it is estimated that a 1% rise in interest rates would not have a material effect on the Group's pre-tax profits.

### (h) Credit risk

There are no significant concentrations of credit risk within the Group. Management's assessment of the maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date. A significant proportion of the trade debtor balances are with domestic customers who are unlikely to have a published credit rating.

### (i) Counterparty risk

The treasury strategy which is approved by the Board, requires that investments are limited to certain money market and treasury instruments, and that the Group's exposure to any single bank, building society or market is controlled, with maximum deposits allowed with any single counterparty. The investment criteria cover credit rating and asset size, including sovereign and political risk. Current market conditions have resulted in closer monitoring of counterparties and cancellation or suspension of deposits.

## 20. Financial instruments continued

### (j) Interest rate risk table

In relation to financial liabilities, the following table shows the impact on profit and equity of an increase in the variable cost of borrowing. The 2009 analysis below reflects a larger possible change in interest rates than in 2008, due to the increased volatility in the financial markets. The range is considered a reasonable basis and highlights this is not material to the Group:

Increase in basis points	Effect on profit/equity £m
<b>2009</b>	
<b>+50</b>	<b>0.8</b>
<b>+100</b>	<b>1.5</b>
<b>+150</b>	<b>2.3</b>
2008	
+35	0.5
+25	0.4
+10	0.2

### (k) Contractual maturity of financial liabilities (principal and future interest payments)

The table below summarises the maturity profile of the Group's financial liabilities at 31 March based on contractual undiscounted payments:

#### Year ended 31 March 2009

	On demand £m	Less than 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Interest bearing loans and borrowings	16.5	40.7	113.9	671.6	4,632.9	5,475.6
Trade and other payables	–	63.0	27.6	0.2	–	90.8
	<b>16.5</b>	<b>103.7</b>	<b>141.5</b>	<b>671.8</b>	<b>4,632.9</b>	<b>5,566.4</b>

#### Year ended 31 March 2008

	On demand £m	Less than 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Interest bearing loans and borrowings	27.8	42.7	208.0	797.2	4,531.3	5,607.0
Trade and other payables	–	65.5	28.3	–	–	93.8
	27.8	108.2	236.3	797.2	4,531.3	5,700.8

# Notes to the consolidated financial statements continued

## 20. Financial instruments continued

### (I) Interest rate risk profile of financial assets and liabilities

The interest rate profile of the financial assets and liabilities of the Group as at 31 March is as follows:

#### Year ended 31 March 2009

	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Fixed rate:							
Eurobonds	(3.9)	(4.0)	(4.1)	(4.1)	(4.1)	(1,324.9)	(1,345.1)
Subordinated loan stock	–	–	–	–	–	(6.6)	(6.6)
Bank loans	(19.3)	(17.8)	(24.5)	(21.0)	(21.1)	(189.4)	(293.1)
Obligations under finance leases and hire purchase contracts	(2.7)	(2.1)	(1.8)	(1.1)	(0.5)	(0.3)	(8.5)
Other loans	–	(0.4)	(0.3)	(0.3)	(0.3)	(1.5)	(2.8)
<b>Fixed rate at 31 March 2009</b>	<b>(25.9)</b>	<b>(24.3)</b>	<b>(30.7)</b>	<b>(26.5)</b>	<b>(26.0)</b>	<b>(1,522.7)</b>	<b>(1,656.1)</b>
Variable rate:							
Cash and cash equivalents	108.8	–	–	–	–	–	108.8
Short term cash deposits	160.6	–	–	–	–	–	160.6
Financial investments	1.4	1.2	0.9	0.6	0.2	11.1	15.4
Eurobonds	–	–	–	–	–	(462.0)	(462.0)
Bank loans	(2.5)	(2.5)	(171.7)	(10.0)	(10.0)	(80.0)	(276.7)
Overdrafts	(16.5)	–	–	–	–	–	(16.5)
Obligations under finance leases and hire purchase contracts	(4.2)	(4.3)	(4.4)	(4.5)	(4.5)	(81.3)	(103.2)
<b>Variable rate at 31 March 2009</b>	<b>247.6</b>	<b>(5.6)</b>	<b>(175.2)</b>	<b>(13.9)</b>	<b>(14.3)</b>	<b>(612.2)</b>	<b>(573.6)</b>
<b>Net borrowings at 31 March 2009</b>							<b>(2,229.7)</b>

#### Year ended 31 March 2008

	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Fixed rate:							
Loans receivable	–	–	–	–	–	1.0	1.0
Eurobonds	(4.1)	(4.1)	(4.4)	(5.0)	(5.3)	(1,325.6)	(1,348.5)
Subordinated loan stock	–	–	–	–	–	(6.4)	(6.4)
Bank loans	(20.2)	(19.3)	(17.9)	(16.2)	(13.3)	(106.6)	(193.5)
Obligations under finance leases and hire purchase contracts	(2.6)	(1.9)	(1.4)	(1.0)	(0.4)	(0.1)	(7.4)
Other loans	–	–	–	–	–	(2.3)	(2.3)
<b>Fixed rate at 31 March 2008</b>	<b>(26.9)</b>	<b>(25.3)</b>	<b>(23.7)</b>	<b>(22.2)</b>	<b>(19.0)</b>	<b>(1,440.0)</b>	<b>(1,557.1)</b>
Variable rate:							
Cash and cash equivalents	294.2	–	–	–	–	–	294.2
Financial investments	1.7	1.4	1.2	0.9	0.6	11.3	17.1
Eurobonds	–	–	–	–	–	(439.7)	(439.7)
Bank loans	(78.0)	(2.5)	(127.5)	(46.7)	–	(100.0)	(354.7)
Overdrafts	(27.8)	–	–	–	–	–	(27.8)
Obligations under finance leases and hire purchase contracts	(3.7)	(3.5)	(3.6)	(3.6)	(3.6)	(64.4)	(82.4)
<b>Variable rate at 31 March 2008</b>	<b>186.4</b>	<b>(4.6)</b>	<b>(129.9)</b>	<b>(49.4)</b>	<b>(3.0)</b>	<b>(592.8)</b>	<b>(593.3)</b>
<b>Net borrowings at 31 March 2008</b>							<b>(2,150.4)</b>

The variable rate net borrowings comprise sterling denominated bank borrowings and deposits that bear interest at rates based upon up to 12 months LIBOR.

## 20. Financial instruments continued

### (m) Currency exposures

At 31 March 2009, after taking into account the effects of forward foreign exchange contracts, the Group had no currency exposures (2008: £nil).

### (n) Borrowing facilities

The Group has various undrawn committed borrowing facilities. The facilities available at 31 March, in respect of which all conditions precedent have been met, are as follows:

	31.3.2009 £m	31.3.2008 £m
Expiring in more than one year but not more than two years	75.0	–
Expiring in more than two years but not more than four years	–	75.0
	<b>75.0</b>	75.0

### (o) Fair values of financial assets and financial liabilities

A comparison by category of book values and fair values of the Group's financial assets and liabilities as at 31 March is set out below:

	Book value		Fair value	
	31.3.2009 £m	31.3.2008 £m	31.3.2009 £m	31.3.2008 £m
Financial assets:				
Cash and cash equivalents	108.8	294.2	108.8	294.2
Short term cash deposits	160.6	–	163.0	–
Financial investments	15.4	17.1	15.4	17.1
Sterling loans receivable	–	1.0	–	1.0
Financial liabilities:				
Overdraft	(16.5)	(27.8)	(16.5)	(27.8)
Bank loans (principal of £567.4 million, 2008: £543.6 million)	(572.6)	(550.5)	(589.0)	(547.9)
Subordinated loan stock	(6.6)	(6.4)	(6.6)	(6.4)
Eurobonds (principal of £1,773.2 million, 2008: £1,750.9 million)	(1,807.1)	(1,788.2)	(1,578.9)	(1,819.6)
Obligations under finance leases and hire purchase contracts (principal of £111.6 million, 2008: £89.7 million)	(111.7)	(89.8)	(111.7)	(89.8)
Interest rate swaps	–	–	(11.7)	–
	<b>(2,229.7)</b>	(2,150.4)	<b>(2,027.2)</b>	(2,179.2)

The fair values of the interest rate swaps, forward foreign currency contracts and sterling denominated long term fixed rate debt with a book value of £1,807.1 million (2008: £1,788.2 million), have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

In the absence of an openly traded market value for the index linked bonds with a book value of £462.0 million, the fair value at the balance sheet date has been calculated by considering the remaining debt maturity, the relevant UK index linked gilt rate and an appropriate credit spread by reference to market evidence for conventional bonds.

The difference between the principal value of £2,452.2 million (2008: £2,384.2 million) and the carrying value of £2,491.4 million (2008: £2,428.5 million) are unamortised issue costs of £15.4 million (2008: £15.9 million) and a credit of £54.6 million (2008: £60.2 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

# Notes to the consolidated financial statements continued

## 20. Financial instruments continued

### (p) Hedges

#### Cash flow hedges – currency forward contracts

At 31 March 2009, the Group held no forward exchange contracts.

At 31 March 2008, the Group held the following forward exchange contracts, designated as hedges of expected future purchases for which the Group had firm commitments. The forward currency contracts were used to hedge the foreign currency risk of the firm commitments. The terms of these contracts were as follows:

Currency bought	Maturity	Exchange rate
EUR 473,100	30.4.2008	1.2669
USD 150,000	19.5.2008	2.0216
EUR 150,000	18.6.2008	2.0163

These hedges were designated as highly effective. At 31 March 2008, no change occurred in the fair value and, therefore, no gain or loss was included in equity.

#### Cash flow hedges – interest rate swap

At 31 March 2009, the Group held three interest rate swaps, designated as a hedge of future interest cash flows, for which the Group has firm commitments. The swap is used to convert variable rate interest payments to a fixed rate basis. The terms of these swaps are as follows:

Notional amount	Start date	Termination date	Fixed rate %
<b>GBP 100 million</b>	<b>15.9.2008</b>	<b>15.3.2022</b>	<b>4.79</b>
<b>GBP 62.5 million</b>	<b>29.1.2009</b>	<b>31.5.2011</b>	<b>2.345</b>
<b>GBP 62.5 million</b>	<b>29.1.2009</b>	<b>31.5.2011</b>	<b>2.435</b>

These hedges were designated as highly effective.

At 31 March 2008, the Group held one interest rate swap, designated as a hedge of future interest cash flows, for which the Group had firm commitments. The swap was used to convert cash deposit interest receipts to a fixed rate basis. The terms of this swap were as follows:

Notional amount	Start date	Termination date	Fixed rate %
GBP 50 million	16.3.2007	16.3.2009	5.665

This hedge was designated as highly effective.

## 21. Authorised and issued share capital

	31.3.2009 £m	31.3.2008 £m
Authorised:		
700 million ordinary shares of 10 pence each	<b>70.0</b>	70.0
Allotted, called up and fully paid:		
518.6 million ordinary shares of 10 pence each	<b>51.9</b>	51.9

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, currently holds 1,038,252 (2008: 443,507) ordinary 10 pence shares in the Company for use under the Company's Long Term Incentive Plan (LTIP). All of these shares have been conditionally awarded under the LTIP. Details of the main features of the LTIP and the conditions for vesting can be found in the directors' remuneration report on pages 57 to 61. As at 31 March 2009, the share price of the ordinary 10 pence shares in the Company was 218.25 pence (2008: 349.25 pence).

## 22. Reconciliation of movements in equity

	Equity share capital £m	Share premium reserve £m	Cash flow hedge reserve £m	Treasury shares £m	Currency translation £m	Retained earnings £m	Total equity £m	Minority interests £m	Total £m
At 1 April 2007	51.9	446.5	1.0	(1.3)	(0.2)	(126.5)	371.4	1.7	373.1
Total recognised income and expense for the year	–	–	–	–	0.3	177.6	177.9	0.2	178.1
Share-based payment	–	–	–	–	–	0.5	0.5	–	0.5
Exercise of LTIP awards	–	–	–	0.5	–	(0.5)	–	–	–
Equity dividends paid	–	–	–	–	–	(59.7)	(59.7)	(0.2)	(59.9)
At 1 April 2008	51.9	446.5	1.0	(0.8)	0.1	(8.6)	490.1	1.7	491.8
Shares purchased	–	–	–	(1.7)	–	–	(1.7)	–	(1.7)
Total recognised income and expense for the year	–	–	(8.6)	–	0.9	(162.2)	(169.9)	0.8	(169.1)
Share-based payment	–	–	–	–	–	0.5	0.5	–	0.5
Exercise of LTIP awards	–	–	–	0.2	–	(0.2)	–	–	–
Equity dividends paid	–	–	–	–	–	(64.0)	(64.0)	(0.1)	(64.1)
<b>At 31 March 2009</b>	<b>51.9</b>	<b>446.5</b>	<b>(7.6)</b>	<b>(2.3)</b>	<b>1.0</b>	<b>(234.5)</b>	<b>255.0</b>	<b>2.4</b>	<b>257.4</b>

### Nature and purpose of other reserves

#### Cash flow hedge reserve

This reserve is used to reflect the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge.

#### Treasury shares

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, acquires shares to be used in the future to satisfy the vesting and exercise of awards under the Company's LTIP.

## 23. Additional cash flow information

### Analysis of net debt as at 31 March 2009

	As at 1.4.2008 £m	Cash flow £m	Other non-cash movements £m	As at 31.3.2009 £m
Cash and cash equivalents	266.4	(174.1)	–	<b>92.3</b>
Short term cash deposits	–	160.6	–	<b>160.6</b>
Loans (principal of £2,331.8 million, 2008: £2,282.8 million)	(2,327.0)	(26.4)	(17.5)	<b>(2,370.9)</b>
Finance leases (principal of £111.6 million, 2008: £89.7 million)	(89.8)	(13.8)	(8.1)	<b>(111.7)</b>
	(2,150.4)	(53.7)	(25.6)	<b>(2,229.7)</b>

The difference between the principal value of £2,443.4 million (2008: £2,372.5 million) and the carrying value of £2,482.6 million (2008: £2,416.8 million) are unamortised issue costs of £15.4 million (2008: £15.9 million) and a credit of £54.6 million (2008: £60.2 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

Non-cash movements on loans relate to the principal uplift on index linked borrowings and amortisation of loan issue costs offset by the amortisation of debt fair value for the year. Non-cash movements on finance leases relate to the inception of new finance leases on the acquisition of plant and machinery during the year.

# Notes to the consolidated financial statements continued

## 23. Additional cash flow information continued

### Analysis of net debt as at 31 March 2008

	As at 1.4.2007 £m	Cash flow £m	Other non-cash movements £m	As at 31.3.2008 £m
Cash and cash equivalents	315.8	(49.4)	–	266.4
Loans (principal of £2,282.8 million, 2007: £2,284.0 million)	(2,334.1)	18.0	(10.9)	(2,327.0)
Finance leases (principal of £89.7 million, 2007: £61.2 million)	(61.3)	(22.7)	(5.8)	(89.8)
	(2,079.6)	(54.1)	(16.7)	(2,150.4)

The difference between the principal value of £2,372.5 million (2007: £2,345.2 million) and the carrying value of £2,416.8 million (2007: £2,395.4 million) are unamortised issue costs of £15.9 million (2007: £16.1 million) and a credit of £60.2 million (2007: £66.3 million) in excess of the original loan proceeds to reflect the fair value of loans owed by subsidiaries acquired in 2003.

## 24. Financial commitments

### Capital expenditure

	31.3.2009 £m	31.3.2008 £m
Expenditure contracted for	168.8	166.8

In addition to these commitments, the Group has longer term expenditure plans, which include investment to meet shortfalls in performance and condition, and to provide for new demand and growth within the water and sewerage business.

## 25. Pensions and other post-retirement benefits

The Group operates a defined benefit pension scheme, Northumbrian Water Pension Scheme (NWPS or the scheme), providing benefits based on final pensionable remuneration to 2,169 active members at 31 March 2009 (2008: 2,391).

The assets of the NWPS are held separately from those of the Group in independently administered funds.

The most recent actuarial valuation of the scheme was at 31 December 2007. At that date the value of assets amounted to £732.3 million and the funding level was 106.1%.

The future service contribution rate jointly payable by members and the employers from 31 December 2007 was 22.6% of pensionable salaries. Members' contributions are 7.3% on average with the employers paying 15.3%.

The employer contribution rate was assessed using the projected unit method and the following actuarial assumptions:

	%
Pre-retirement	6.1
Post-retirement	5.2
Pay increases	3.65
Pension increases	3.4
Price inflation	3.4

Following the 2004 actuarial valuation the employers had prepaid contributions to the scheme up to 31 December 2010. The scheme actuary recommended that regular contributions should recommence from 1 January 2011.

The scheme also has a defined contribution section which had 310 active members at 31 March 2009 (2008: 219). Members can choose to contribute either, 3%, 4% or 5% of salary, with employers contributing at either, 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Group in the year totalled £0.4 million (2008: £0.1 million).

## 25. Pensions and other post-retirement benefits continued

The additional disclosures regarding the Group's defined benefit scheme as required under IAS 19 'Employee benefits', and the relevant impact on the Group's financial statements are set out below.

A qualified actuary, using revised assumptions that are consistent with the requirements of IAS 19, has updated the actuarial valuation described above as at 31 March 2009. Investments have been valued, for this purpose, at fair value.

IAS 19 actuarial assumptions:

	31.3.2009	31.3.2008
Pay increases <sup>1</sup>	4.0%	4.5%
Pension increases	3.0%	3.5%
Price inflation	3.0%	3.5%
Discount rate	6.1%	6.8%
Mortality assumptions <sup>2,3</sup>	<b>PCMA/PCFA00</b>	PMA/PFA00
– Life expectancy for a member aged 60 – female (years)	–	28.0
– Life expectancy for a member aged 60 – male (years)	–	25.2
– Life expectancy for a member aged 65 – female (years)	22.9	–
– Life expectancy for a member aged 65 – male (years)	20.6	–

Notes:

1. Including promotional salary scale.

2. 115% of PCMA/PCFA00 and PMA/PFA00.

3. PCMA/PCFA00 and PMA/PFA00 (year of birth with medium cohort improvements).

The fair value of the assets in the NWPS, the present value of the liabilities in the scheme and the long term expected rate of return at 31 March were:

	Long term expected rate of return 31.3.2009 %	31.3.2009 £m	Long term expected rate of return 31.3.2008 %	31.3.2008 £m
Equities	7.2	369.0	7.5	457.1
Corporate bonds	6.1	38.9	6.8	51.6
Government bonds	4.2	50.0	4.5	66.1
Property	5.7	58.7	6.0	76.3
Cash	4.0	1.8	5.3	15.6
Loan to scheme from Company	2.0	(39.8)	–	–
Total fair value of assets		478.6		666.7
Present value of liabilities		(598.0)		(576.2)
(Deficit)/surplus		(119.4)		90.5

The discount rate at 31 March 2009 has been set by reference to the yield on AA corporate bonds (AA over 15 years) at that date, extrapolated forward to a duration of 18 years which reflect the duration of the expected benefit payments. The expected rate of return on equities represents a 3% premium of the yield on long term Government bonds at 31 March 2009. The gross redemption yield on index linked UK Government stocks was 1.1%. The long term inflation rate implied by these yields is 3.1% which has been reduced by 0.1% to allow for an inflation risk premium. Mortality rates have been based on the PA00 tables, applying medium cohort adjustment of 115% loading to mortality rates based on the year of birth of membership.

# Notes to the consolidated financial statements continued

## 25. Pensions and other post-retirement benefits continued

The amounts recognised in the income statement and in the statement of recognised income and expense for the year are analysed as follows:

	31.3.2009 £m	31.3.2008 £m
Recognised in the income statement:		
Current service cost	9.6	15.3
Past service cost	0.3	0.4
Recognised in operating costs in arriving at profit on ordinary activities before interest	9.9	15.7
Interest cost on plan obligations	38.5	35.2
Expected return on plan assets	(44.3)	(48.4)
Recognised in finance costs payable/(income receivable)	(5.8)	(13.2)
Recognised in the statement of recognised income and expense:		
Actual return on scheme assets	(161.0)	(45.0)
Less expected return on scheme assets	(44.3)	(48.4)
	(205.3)	(93.4)
Other actuarial gains and losses	(2.5)	120.7
Net actuarial (losses)/gains	(207.8)	27.3
Cumulative amounts recognised since adopting the standard	(81.6)	126.2

History of experience gains and losses:

	31.3.2009 £m	31.3.2008 £m	31.3.2007 £m	31.3.2006 £m	31.3.2005 £m
Fair value of assets	478.6	666.7	710.8	659.8	523.8
Present value of defined benefit obligation	(598.0)	(576.2)	(668.1)	(663.5)	(600.2)
(Deficit)/surplus	(119.4)	90.5	42.7	(3.7)	(76.4)
Experience adjustments arising on plan assets	(205.3)	(93.4)	0.6	87.1	25.6
Experience adjustments arising on plan liabilities	18.7	0.6	1.7	34.0	(4.4)

Changes in the present value of the defined benefit pension obligations are analysed as follows:

	31.3.2009 £m	31.3.2008 £m
At 1 April	576.2	668.1
Current service cost	9.6	15.3
Past service cost	0.3	0.4
Interest cost on plan obligations	38.5	35.2
Contributions by plan participants	0.1	0.1
Actuarial loss/(gain) on obligations	2.5	(120.7)
Benefits paid	(29.2)	(22.2)
<b>At 31 March</b>	<b>598.0</b>	<b>576.2</b>

Present value of funded defined benefit obligations

	598.0	576.2
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Changes in the fair value of plan assets are analysed as follows:

	31.3.2009 £m	31.3.2008 £m
At 1 April	666.7	710.8
Expected return on plan assets	44.3	48.4
Actuarial loss on plan assets	(205.3)	(93.4)
Contributions by employer	2.0	23.0
Contributions by plan participants	0.1	0.1
Benefits paid	(29.2)	(22.2)
<b>At 31 March</b>	<b>478.6</b>	<b>666.7</b>

## 25. Pensions and other post-retirement benefits continued

The Group through its subsidiary, AquaGib, also operates a non-contributory defined benefit scheme. The surplus at 31 March 2009, under local GAAP, was £0.3 million (2008: £0.2 million). The Group made contributions amounting to £0.5 million (2008: £0.6 million) to the defined benefit pension scheme.

Sensitivity to key assumptions:

IAS 1 requires disclosure of the sensitivity of the results to the methods and assumptions used.

The costs of a pension arrangement require estimates regarding future experience. The financial assumptions used for IAS 19 reporting are the responsibility of the directors of the Company. These assumptions reflect market conditions at the balance sheet date. Changes in market conditions which result in changes in the net discount rate (essentially the difference between the discount rate and the assumed rates of increases of salaries, deferred pension revaluation or pensions in payment), can have a significant effect on the value of the liabilities reported.

A reduction in the net discount rate will increase the assessed value of liabilities, as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have an opposite effect of similar magnitude. The overall effect of a change in the net discount rate of 0.1% would change the liabilities by around £12.0 million.

There is also uncertainty around life expectancy for the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

The disclosures have been prepared using the mortality assumptions adopted for the 2007 formal valuation – namely the PCMA/PCFA00 tables, applying a medium cohort adjustment with a 115% loading to mortality rates based on the year of birth of the membership. These assumptions imply an assumed life expectancy for a member aged 65 at 31 March 2009 of 20.6 years (2008: member aged 60 years of 25.2 years) for males and 22.9 years (2008: member aged 60 years of 28.0 years) for females.

The effect of increasing the assumed life expectancies by one year would be to increase the value of liabilities by around 2.9%.

## 26. Share incentive plans

### Long Term Incentive Plan (LTIP)

Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Company. Further details of the LTIP can be found in the directors' remuneration report on page 57.

The following table illustrates the movements in conditional share awards during the year.

	31.3.2009 Number	31.3.2008 Number
Outstanding at 1 April	1,103,069	1,114,715
Granted during the year	462,700	364,370
Forfeited/lapsed during the year	(270,480)	(102,606)
Exercised	(105,255)	(273,410)
Outstanding at 31 March	1,190,034	1,103,069
Exercisable at 31 March	9,023	4,062

The weighted average exercise price throughout the year was £nil (2008: £nil). The fair value of conditional share awards granted during the year was £0.1 million (2008: £0.1 million).

The weighted average share price at the date of exercise for the conditional share awards is 248.08 pence (2008: 343.34 pence).

For the conditional awards outstanding as at 31 March 2009, the weighted average remaining contractual life is 1.8 years (2008: 1.7 years).

# Notes to the consolidated financial statements continued

## 26. Share incentive plans continued

The fair value of conditional share awards granted was estimated using the Monte-Carlo model. The significant inputs to the model were as follows:

	31.3.2009	31.3.2008
Dividend yield	4.9%	3.5%
Expected share price volatility	28%	24%
Share price at award	251.50p	334.00p
Expected FTSE 250 Index volatility	23%	13%
Risk free interest rate	2.6%	4.6%
Expected life of option (years)	3	3

The expected life of these options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

### Share Incentive Plan (SIP)

The SIP scheme provides one free matching share for every three shares purchased by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants.

The following table illustrates the movements in conditional share awards during the year.

	31.3.2009 Number	31.3.2008 Number
Outstanding at 1 April	97,876	115,219
Granted during the year	119,922	100,721
Forfeited during the year	(2,861)	(3,647)
Exercised	(97,250)	(114,417)
Outstanding at 31 March	117,687	97,876

## 27. Special purpose entities

As noted under accounting policy 1(b), under SIC 12, two companies are consolidated as special purpose entities. The principal special purpose entity is Bakethin Holdings Limited, the shares in which are owned by Bakethin Charitable Trust. The other special purpose entity is Bakethin Finance plc, which is a wholly owned subsidiary of Bakethin Holdings Limited.

Bakethin Finance plc was established for the purpose of issuing guaranteed secured Eurobonds. On 12 May 2004, Bakethin Finance plc issued £248.0 million of guaranteed secured bonds maturing January 2034. Bakethin Finance plc used the proceeds of the bond issue to make a loan to Reiver Finance Limited to fund the consideration given by that company to Northumbrian Water Limited for the securitisation of the cash flows receivable from the Environment Agency under the Water Resources Operating Agreement relating to Kielder reservoir. The assignment is for a period of 30 years.

The summarised combined financial statements of the special purpose entities are as follows:

	31.3.2009 £m	31.3.2008 £m
Income statement:		
Finance costs receivable	15.0	15.0
Finance costs payable	(15.0)	(15.0)
<b>Profit for the year</b>	–	–
Balance sheet:		
Investments	240.7	240.4
Current assets	4.7	4.6
Non-current liabilities	(242.6)	(242.2)
Current liabilities	(2.7)	(2.7)
<b>Net assets</b>	0.1	0.1

## 28. Related parties

During the year, the Group entered into transactions, in the ordinary course of business, with other related parties. Those transactions with directors of the Company are disclosed in the directors' remuneration report on pages 54 to 63. In accordance with IAS 24, the directors consider that there are no further disclosures in respect of key management. Transactions entered into, and trading balances outstanding at 31 March with other related parties, are as follows:

	Sales to related party £m	Purchases from related party £m	Amounts owed by related party £m	Amounts owed to related party £m
Related party:				
Jointly controlled entities				
<b>2009</b>	<b>0.1</b>	<b>10.7</b>	<b>0.5</b>	<b>8.4</b>
2008	0.1	10.0	0.7	7.3

Purchases from jointly controlled entities include £3.9 million (2008: £3.8 million) in respect of capital purchases under finance leases, £0.2 million (2008: £0.4 million) in respect of operating leases, £6.0 million (2008: £5.0 million) in respect of costs payable under finance leases and £0.6 million (2008: £0.8 million) in respect of other purchases.

At 31 March 2009, the Group had a short term cash deposit with the Northumbrian Water Pension Scheme of £39.8 million (2008: £nil).

Outstanding balances due from related parties are expected to be settled within 60 days and amounts due to related parties are in respect of leasing arrangements, where the amounts owed will relate specifically to the terms of the lease.

## 29. Contingent liability

The Group's subsidiary responsible for a contract with Scottish Water, Caledonian Environmental Services plc (CES), has received a claim from its Design and Construction Consortium (DCC), primarily in respect of the DCC's additional costs attributed by it to non-conforming influent at the treatment works. CES is defending this claim and has also issued a counterclaim against the DCC. As non-conforming influent is ultimately the responsibility of the client, CES has protected its position by issuing a claim against Scottish Water. The directors do not expect any material loss to arise as a result of these claims.