

Notes to the accounts

Year ended 31 March 2003

1 Accounting policies

Basis of accounting

The accounts of the group are prepared under the historical cost convention in compliance with the requirements of the Financial Services Authority, all applicable accounting standards (Financial Reporting Standard 'FRS', Statement of Standard Accounting Practice 'SSAP' and Urgent Issues Task Force abstract 'UITF') and with the Companies Act 1985.

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

Basis of consolidation

The accounts of the group include the results of the company, its subsidiaries, associates and joint ventures. The results of undertakings acquired or disposed of during the year are included in the group profit and loss account from the date of acquisition or up to the date of disposal.

Foreign currencies

In the accounts of the group's companies, individual transactions denominated in foreign currencies are translated into local currency at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into local currency at the exchange rates ruling at the balance sheet date, or if appropriate, at the forward exchange rate. Profits and losses on both individual foreign currency transactions during the year and monetary assets and liabilities are dealt with in the profit and loss account.

On consolidation, the profit and loss accounts of overseas subsidiaries are translated at the average exchange rates for the year and the balance sheets at the exchange rates at the balance sheet date. The exchange differences arising as a result of translating profit and loss accounts at average rates and restating opening net assets at closing rates are taken to reserves. Exchange differences on foreign currency borrowings used to finance the group's equity investments in its foreign subsidiaries are taken to reserves only to the extent of the exchange differences arising on net investments in foreign subsidiaries.

Goodwill arising on the acquisition of an overseas subsidiary is calculated using exchange rates applicable at the date of acquisition and is not subsequently re-translated at the balance sheet date.

Turnover

Turnover comprises charges to customers for water and waste water services, excluding value added tax, together with the proceeds from the sale of commercial and residential properties to third parties.

Pensions

The cost of providing retirement pensions and related benefits is charged to the profit and loss account over the period benefiting from the employees' services in accordance with SSAP 24.

Research and development expenditure

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

Taxation

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

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

- provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets,

- provision is made for the tax that would arise on remittance of the retained earnings of overseas subsidiaries only to the extent that, at the balance sheet date, dividends have been accrued as receivable,

- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

1 Accounting policies continued

Deferred tax is calculated at the rates at which it is estimated that tax will arise based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is discounted using the post tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred tax assets and liabilities.

Intangible assets

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

A useful economic life in excess of 20 years, or an indefinite life, is assigned to goodwill if the directors are satisfied that its durability can be demonstrated and that it is capable of continued measurement. Goodwill with a useful economic life in excess of 20 years, or an indefinite life, is reviewed for impairment at each financial year end.

Prior to 1 April 1998, the group's policy was to charge the cost of goodwill directly to reserves in the year of acquisition. Goodwill originally charged against reserves remains eliminated against reserves, to the extent that it has not been charged to the profit and loss account on the disposal of the business to which it relates.

Infrastructure assets

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

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

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

Infrastructure assets in the US water services business are accounted for as for other tangible fixed assets.

Other tangible fixed assets

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

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

Useful economic lives are principally as follows:

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

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

Leased assets

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

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

Notes to the accounts

1 Accounting policies continued

Grants and contributions

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

Grants and contributions in respect of expenditure enhancing the infrastructure network are applied in reducing that expenditure. This is not in accordance with Schedule 4 to the Companies Act 1985, which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. The presentation is adopted because infrastructure assets do not have determinable finite lives and, therefore, such grants and contributions would remain as liabilities in perpetuity. The directors consider that the group's presentation shows a true and fair view of the investment in infrastructure assets.

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

Investments

Investments in associated undertakings in the group accounts are accounted for using the equity method of accounting where the directors consider that 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. Investments in joint ventures are accounted for using the gross equity basis where the company exercises proportionate control under a contractual arrangement. The consolidated profit and loss account includes the group's share of the operating results, interest, pre-taxation results and taxation of the associates and joint ventures for the relevant reporting period. The consolidated balance sheet includes the group's share of the net assets of the associates and joint ventures at the balance sheet date, including any goodwill on acquisition less any provision for impairment in value.

Other fixed asset investments are stated at cost less provision for impairment in value.

Kelda Group plc shares held in an employee share ownership trust (ESOT) and a qualifying employee share ownership trust (QUEST) are carried at cost as other fixed asset investments, less any provision for impairment in accordance with UITF 17.

Current asset investments are stated at the lower of cost and net realisable value.

Stocks

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

Provisions

Provision is made in accordance with FRS 12 for self insured third party liability claims incurred but not reported, and other known liabilities which exist at the balance sheet date.

Financial instruments

Debt instruments Debt instruments are included in borrowings at the net proceeds received after the deduction of issue costs and any discount on issue. Discounts and issue costs are charged to the profit and loss account over the term of the debt at a constant rate on the balance sheet carrying amount. Realised gains and losses that occur from the early termination of debt instruments are taken to profit and loss account in that period.

Forward exchange contracts Forward exchange contracts are used to hedge foreign exchange exposures arising on forecast payments and receipts in foreign currencies. Foreign currency assets and liabilities outstanding at the balance sheet date are re-translated at the forward exchange rate in appropriate cases.

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

Currency swaps Currency swaps are used to hedge exposures on foreign currency borrowings and foreign currency assets arising from fluctuations in exchange rates. Borrowings hedged through currency swaps are shown in the group's balance sheet re-translated at the swap exchange rate.

The group uses hedge accounting in respect of its interest rate swaps only where the financial instrument does not exceed the underlying debt, the interest characteristics of the debt are altered and the contractual maturities do not exceed the maturities of the debt. Hedge accounting is used in respect of currency swaps only where they relate to an existing asset, liability or firm commitment and move inversely in relation to the foreign currency exposures of the group's activities.

2 Segmental information

	Turnover		Operating profit		Operating assets	
	2003 £m	2002 £m	2003 £m	2002 £m	2003 £m	2002 £m
Business analysis						
Water services						
– UK regulated	567.0	559.8	233.7	225.5	2,823.0	2,666.9
– US continuing operations	64.2	70.5	24.4	28.2	382.4	356.4
– US acquisitions	29.5	–	10.5	–	148.2	–
Waste Recycling Group plc (associate)	138.0	129.3	16.2	18.5	110.4	114.0
Other activities						
– group	20.1	16.7	4.4	3.4	17.0	19.2
– associates and joint ventures	9.6	1.1	2.6	0.4	8.2	5.6
Discontinued operations						
– group	9.7	11.8	(1.8)	(6.9)	–	8.3
– associates	–	10.6	–	1.4	–	–
	838.1	799.8	290.0	270.5	3,489.2	3,170.4
Corporate costs			(5.9)	(5.2)		
Total: group and share of associates and joint ventures (before exceptional items)	838.1	799.8	284.1	265.3	3,489.2	3,170.4
Exceptional items						
– Waste Recycling Group plc (associate)	–	–	(7.0)	–		
Total: group and share of associates and joint ventures	838.1	799.8	277.1	265.3	3,489.2	3,170.4
Other investments					19.5	25.2
Dividend creditor					(70.4)	(68.6)
Net debt					(1,720.4)	(1,436.5)
Net assets					1,717.9	1,690.5
Geographical analysis						
United Kingdom	734.7	706.9	244.0	242.6	2,958.6	2,805.7
North America	64.2	70.5	24.4	28.2	382.4	356.4
North America acquisitions	29.5	–	10.5	–	148.2	–
Discontinued operations	9.7	22.4	(1.8)	(5.5)	–	8.3
Total: group and share of associates and joint ventures	838.1	799.8	277.1	265.3	3,489.2	3,170.4

Trading between geographical and business segments is not material. There is no material difference between turnover by origin and by destination. The group's associated undertakings and joint ventures are based in the UK.

The group's share of Waste Recycling Group's operating profit is shown after goodwill amortisation.

The weighted average exchange rates used in the translation of profit and loss accounts were £1=\$1.55 (2002: \$1.43). Exchange rates used to translate assets and liabilities at the balance sheet date were £1=\$1.58 (2002: \$1.42).

Notes to the accounts

3 Operating costs

	Continuing operations £m	Acquisitions £m	Discontinued operations £m	2003 Total £m	Continuing operations £m	Discontinued operations £m	2002 Total £m
Own work capitalised	(23.5)	(1.1)	–	(24.6)	(24.1)	(0.1)	(24.2)
Raw materials and consumables	18.8	–	6.3	25.1	19.8	7.9	27.7
Other external charges	168.3	13.0	2.8	184.1	172.7	4.9	177.6
Staff costs (see note 29)	96.9	4.4	2.2	103.5	91.7	3.7	95.4
Depreciation of tangible fixed assets:							
On owned assets – UK infrastructure	34.7	–	–	34.7	32.2	–	32.2
– other assets	92.3	2.7	0.2	95.2	93.1	2.3	95.4
On assets held under finance leases – UK infrastructure	1.3	–	–	1.3	1.3	–	1.3
– other assets	13.6	–	–	13.6	13.5	–	13.5
Operating lease rentals – plant and equipment	2.0	–	–	2.0	1.4	–	1.4
– other	0.4	–	–	0.4	0.4	–	0.4
Amortisation of grants and contributions	(3.3)	–	–	(3.3)	(3.4)	–	(3.4)
Amortisation of goodwill on subsidiary undertakings	1.0	–	–	1.0	1.1	–	1.1
Research and development	0.9	–	–	0.9	1.0	–	1.0
Other operating income	(8.7)	–	–	(8.7)	(5.6)	–	(5.6)
	394.7	19.0	11.5	425.2	395.1	18.7	413.8

Auditors' remuneration

	2003 £m	2002 £m
Audit fees and expenses	0.5	0.4
Assurance work	0.1	0.4
Other services	0.2	–
	0.8	0.8

4 Net exceptional profit on sale of land (US)

	2003 £m	2002 £m
Sale of land (US)	–	60.3
Taxation	–	19.0

The group announced the completion of a \$90m land sale to the state of Connecticut and the international conservation organisation, The Nature Conservancy on 29 March 2002.

5 Net exceptional loss on disposal of operations

	2003 £m	2002 £m
First Renewables	–	25.9
Taxation	–	–

6 Exceptional loss on closure of operations

	2003 £m	2002 £m
Timco (US)	3.9	–
Deferred tax	0.9	–

7 Net interest payable

	2003 £m	2002 £m
Interest payable on:		
Bank loans and overdrafts	18.8	14.1
Other loans	13.1	12.7
6.625% bond 2031	15.7	12.2
6.875% guaranteed bonds 2010	13.8	13.7
5.25% Eurobond 2006	19.4	23.8
5.375% bond 2023	1.2	–
3.048% Index Linked bond 2033	0.5	–
Amortisation of issue costs in respect of bonds	0.6	0.8
Finance leases	23.9	24.9
Total interest payable	107.0	102.2
Interest receivable	(8.9)	(8.9)
Net interest payable	98.1	93.3

Notes to the accounts

8 Taxation on profit on ordinary activities

	2003 £m	2002 £m
Current tax		
UK corporation tax at 30% (2002: 30%)	9.7	2.3
Foreign tax	9.0	26.3
Adjustments in respect of prior years:		
UK corporation tax	(4.8)	(0.1)
US tax	(6.9)	(2.2)
Total current tax	7.0	26.3
Deferred tax		
Charge for timing differences arising and reversing in the year	34.1	39.5
Adjustments in respect of prior years	(6.6)	(4.8)
Decrease (increase) in discount	1.5	(23.2)
Adjustment to discount in respect of prior years	-	3.3
Total deferred tax (see note 20)	29.0	14.8
Share of associates' and joint ventures' tax	2.0	4.7
Total tax on profit on ordinary activities	38.0	45.8

The differences between the total current tax charge shown above and the amount calculated by applying the national rates of corporation tax (UK 30%, US 39.5%) to the profit on ordinary activities before tax is as follows:

	2003 £m	2002 £m
Profit on ordinary activities before tax	164.3	197.1
Less: share of associates' and joint ventures' profit before tax	1.0	11.0
Group profit on ordinary activities before tax	163.3	186.1
Tax on group profit on ordinary activities at standard national tax rates	50.7	63.7
Effects of:		
Expenses not deductible for tax purposes	2.2	2.3
Capital allowances in excess of depreciation	(34.1)	(39.5)
Utilisation of tax losses	(0.1)	(0.4)
Disallowable loss on disposal of operations	-	7.7
Tax benefits arising on US land sale	-	(5.2)
Adjustments to tax charge in respect of previous periods	(11.7)	(2.3)
Group current tax charge for period	7.0	26.3

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

- (i) capital investment for the UK water services business is expected to remain at similar levels and the group expects to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year,
- (ii) the US tax rates are higher than those in the UK, primarily because the profits earned in the US are taxed at a rate of 39.5%,
- (iii) changes in the medium and long term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account.

9 Profit attributable to parent company

The profit of the parent company, after taking account of dividends from subsidiary undertakings, was £94.7m (2002: £38.6m). Advantage has been taken of the exemption available under Section 230 of the Companies Act 1985 not to present a profit and loss account for the company alone. The parent company profit and loss account was approved by the board on 5 June 2003.

10 Dividends

	2003 £m	2002 £m
Equity – ordinary		
Interim paid: 7.86p (2002: 7.70p) per share	30.4	29.7
Final proposed: 18.19p (2002: 17.80p) per share	70.4	68.6
	100.8	98.3

Dividends amounting to £1.6m (2002: £2.0m) in respect of the company's shares held by the ESOT and the QUEST (see note 22) have been waived and are, therefore, excluded from the aggregate of dividends paid and proposed.

11 Earnings per share

Basic earnings per share (EPS) is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year. The ordinary shares held in the ESOT and the QUEST are excluded from the weighted average number of ordinary shares for this purpose.

For diluted EPS, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The group has only one category of dilutive potential ordinary shares: those share options granted to employees where the exercise price is less than the average market price of the company's ordinary shares during the year.

	Earnings £m	Weighted average number of shares m	2003 Earnings per share p	Earnings £m	Weighted average number of shares m	2002 Earnings per share p
Basic EPS	126.1	385.8	32.7	151.4	385.2	39.3
Effect of dilutive share options		1.3	(0.1)		1.1	(0.1)
Diluted EPS	126.1	387.1	32.6	151.4	386.3	39.2

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

Basic EPS	126.1	385.8	32.7	151.4	385.2	39.3
Share of associates net exceptional items (WRG)	4.4		1.1	–		–
Net exceptional profit on sale of land (US)	–		–	(41.3)		(10.7)
Net exceptional loss on disposal of operations	–		–	25.9		6.7
Exceptional loss on closure of operations	3.0		0.8	–		–
Deferred tax	29.9		7.8	14.8		3.8
Adjusted EPS (excluding deferred tax)	163.4	385.8	42.4	150.8	385.2	39.1

Notes to the accounts

12 Intangible assets

Goodwill	Group £m
Cost	
At 1 April 2002	188.0
Additions	59.9
At 31 March 2003	247.9
Aggregate amortisation	
At 1 April 2002	3.1
Charge for the year	1.0
At 31 March 2003	4.1
Net book amount at 31 March 2003	243.8
Net book amount at 31 March 2002	184.9

The goodwill arising on the original acquisition of Aquarion Company of the US in 2000, which amounted to £164.3m has, in the opinion of the directors, an indefinite life and therefore is not being amortised. Aquarion operates in the stable US market of clean water supply in which barriers to entry are high due to significant infrastructure requirements. In addition, Aquarion effectively has the rights to operate in its service territory in perpetuity. Consequently, the goodwill is demonstrated to be 'durable' and, is capable of 'continued measurement' as defined by FRS 10 'Goodwill and Intangible Assets'. In accordance with FRS 10 an impairment review was carried out at 31 March 2003, which showed that the carrying value of the goodwill was not more than its recoverable amount. The subsequent acquisition by Aquarion of the New England operations of American Water Works in April 2002 gave rise to goodwill of £59.4m. The directors are also of the opinion that this goodwill has an indefinite life. This accounting treatment is a departure from the requirements of Paragraph 21 of Schedule 4 to the Companies Act 1985 and is adopted in order to present a true and fair view of the group's results. If the goodwill arising on the US acquisitions had been amortised over 20 years, the amortisation charge for the period ended 31 March 2003 would have been £10.9m and the net book amount of this goodwill at 31 March 2003 would have been £194.3m (2002: £145.8m). Goodwill in respect of the group's other acquisitions since 1 April 1998 has been assigned a useful economic life of 20 years.

During the year £0.5m of goodwill was created as a result of the purchase of the New England water operations contract business from AquaSource Inc in the US.

13 Tangible fixed assets

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Under construction £m	Group total £m	Company total £m
Cost						
At 1 April 2002	1,261.5	1,694.6	1,587.6	293.2	4,836.9	0.4
Exchange adjustments	(10.5)	-	(35.7)	(0.3)	(46.5)	-
Additions	35.3	34.9	54.3	220.7	345.2	-
Acquisitions	40.3	-	112.5	3.8	156.6	-
Transfers on commissioning	40.4	102.7	103.6	(246.7)	-	-
Disposals	(1.6)	-	(8.0)	(0.5)	(10.1)	(0.1)
Closure of operations	-	-	(6.2)	-	(6.2)	-
Grants and contributions	-	-	-	(17.0)	(17.0)	-
At 31 March 2003	1,365.4	1,832.2	1,808.1	253.2	5,258.9	0.3
Depreciation						
At 1 April 2002	356.5	647.6	500.6		1,504.7	0.4
Exchange adjustments	(2.2)	-	(8.6)		(10.8)	-
Acquisitions	4.8	-	23.0		27.8	-
Disposals	(1.6)	-	(8.0)		(9.6)	(0.1)
Closure of operations	-	-	(4.7)		(4.7)	-
Charge for the year	21.8	36.0	87.0		144.8	-
At 31 March 2003	379.3	683.6	589.3		1,652.2	0.3
Net book amount at 31 March 2003	986.1	1,148.6	1,218.8	253.2	3,606.7	-
Net book amount at 31 March 2002	905.0	1,047.0	1,087.0	293.2	3,332.2	-

13 Tangible fixed assets continued

The assets of the parent company comprise plant and equipment.

Grants and contributions received relating to infrastructure assets are deducted from the cost of tangible fixed assets. The group's accounting policy in respect of grants and contributions is a departure from the Companies Act 1985 requirements and is adopted, as explained in note 1, in order to show a true and fair view of the investment in infrastructure assets. As a consequence, the net book amount of tangible fixed assets is £241.2m lower than it would have been had this treatment not been adopted.

Assets included above held under finance leases amount to:

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Under construction £m	Group total £m	Company total £m
Cost	150.8	59.4	282.9	32.5	525.6	–
Depreciation	(19.5)	(7.3)	(94.8)	–	(121.6)	–
Net book amount at 31 March 2003	131.3	52.1	188.1	32.5	404.0	–
Net book amount at 31 March 2002	134.0	53.4	199.3	32.5	419.2	–

	Group 2003 £m	2002 £m
The net book amount of land and buildings comprises:		
Freeholds	985.0	903.9
Long leaseholds	0.3	0.3
Short leaseholds	0.8	0.8
	986.1	905.0

14 Investments

Group	Goodwill £m	Share of net assets in associated undertakings £m	Loans to associated undertakings £m	Total investments in associated undertakings £m	Share of net assets in joint ventures £m	Loans to joint ventures £m	Total investments in joint ventures £m	Other investments £m
Cost and share of post acquisition retained profits								
At 1 April 2002	66.6	59.2	–	125.8	0.1	3.3	3.4	25.2
Share of retained profits for the year	–	–	–	–	(0.3)	–	(0.3)	–
Disposals	–	–	–	–	–	–	–	(5.7)
Movement in the year	–	–	2.6	2.6	–	–	–	–
At 31 March 2003	66.6	59.2	2.6	128.4	(0.2)	3.3	3.1	19.5
Aggregate amortisation								
At 1 April 2002	9.6	–	–	9.6	–	–	–	–
Charge for the year	3.3	–	–	3.3	–	–	–	–
At 31 March 2003	12.9	–	–	12.9	–	–	–	–
Net book amount at 31 March 2003	53.7	59.2	2.6	115.5	(0.2)	3.3	3.1	19.5
Net book amount at 31 March 2002	57.0	59.2	–	116.2	0.1	3.3	3.4	25.2

The group's share of retained profits for the year in respect of Waste Recycling Group plc (WRG) is based on the published financial statements of WRG for the year ended 31 December 2002. Goodwill arising on the group's interest in WRG, totalling £66.6m, is being amortised on a straight line basis over 20 years.

Notes to the accounts

14 Investments continued

Company	Shares in group undertakings £m	Loans to group undertakings £m	Total investments in group undertakings £m	Investments in associated undertakings £m	Other investments £m
Cost					
At 1 April 2002	932.2	583.2	1,515.4	105.8	25.5
Disposals	–	–	–	–	(5.2)
Movement in the year	–	139.1	139.1	–	–
At 31 March 2003	932.2	722.3	1,654.5	105.8	20.3

Other investments are stated at cost and consist primarily of 6,195,745 ordinary shares of the company with a nominal value of 15⁵p which are held in the ESOT and the QUEST, explained in note 22. The market value of the shares held by the ESOT and the QUEST at 31 March 2003 was £25.4m (net book value £20.3m). The market value of the shares held by the ESOT and the QUEST on 4 June 2003 was £27.0m.

Details of principal subsidiary companies, associated undertakings and joint ventures are set out on page 69.

15 Stocks

	Group 2003 £m	2002 £m
Raw materials and consumables	1.5	3.0
Work in progress	–	0.1
	1.5	3.1

16 Debtors

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Trade debtors	57.4	54.9	–	–
Amounts owed by subsidiary undertakings			109.3	104.0
Amounts owed by associated undertakings	2.2	2.0	1.7	1.7
Prepayments and accrued income	93.6	109.7	19.5	18.3
Other debtors:				
Receivable within one year	41.2	44.5	17.8	13.7
Receivable after more than one year	3.8	3.7	3.8	3.7
	198.2	214.8	152.1	141.4

17 Short term borrowings

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Bank loans	37.9	27.4	12.3	1.1
Other unsecured loans	–	5.3	–	5.3
Finance leases	6.5	4.2	–	–
	44.4	36.9	12.3	6.4

Short term borrowings are denominated in a number of currencies and bear interest at normal commercial rates appropriate to the country in which the borrowing is made.

18 Other creditors

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Amounts falling due within one year:				
Trade creditors	60.4	55.6	–	–
Capital creditors	48.1	94.8	–	–
Amounts owed to subsidiary undertakings			344.0	26.9
Deferred grants and contributions on depreciated fixed assets	3.9	3.8	–	–
Taxation	14.8	42.7	–	–
Social security and payroll deductions	2.4	2.4	–	–
Receipts in advance	37.6	31.2	–	–
Other creditors	88.3	74.8	52.9	51.5
Proposed dividends	70.4	68.6	70.4	68.6
	325.9	373.9	467.3	147.0
Amounts falling due after more than one year:				
Deferred grants and contributions on depreciated fixed assets	153.2	144.2	–	–
Other creditors	84.1	81.0	1.9	1.8
	237.3	225.2	1.9	1.8

Notes to the accounts

19 Long term borrowings

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Bank loans	247.1	178.4	–	9.8
6.625% bond 2031	239.8	243.2	239.8	243.2
6.875% guaranteed bonds 2010	198.9	198.8	198.9	198.8
5.25% Eurobond 2006	408.2	406.1	408.2	406.1
5.375% bond 2023	195.8	–	–	–
3.048% Index Linked bond 2033	98.9	–	–	–
Other loans	144.7	91.6	–	0.8
Finance leases	470.6	477.0	–	–
	2,004.0	1,595.1	846.9	858.7
Long term borrowings are repayable as follows:				
In more than one year but not more than two years	29.4	38.6	–	10.6
In more than two years but not more than five years	480.0	485.3	408.2	406.1
After more than five years	1,494.6	1,071.2	438.7	442.0
	2,004.0	1,595.1	846.9	858.7

Borrowings repayable by instalments after more than five years include £440.6m (2002: £448.7m) in respect of finance leases which have expiry dates ranging from 2018 to 2033 and carry interest rates based on 12 month LIBOR (London Inter-Bank Offered Rate). Long term borrowings are denominated in a number of currencies and bear interest at normal commercial rates appropriate to the country in which the borrowing is made. During the year two new bonds were issued; £200m 5.375% bond due 2023 and £100m 3.048% index linked bond due 2033. An additional 15 year £100m European Investment Bank facility was also drawn down. The group also entered into interest rate swaps for notional principal amounts totalling £100m. £50m of the interest rate swaps receive interest at a rate of 12 month LIBOR and pays interest at an average rate of 4.3% with a maturity of 1 April 2004. The remaining £50m receives interest at 6 month LIBOR and pays interest at an average rate of 4.7% with a maturity date of July 2006.

20 Provisions for liabilities and charges

	Deferred tax £m	Other £m	Group total £m	Company total £m
At 1 April 2002	149.9	3.8	153.7	1.0
Additions during the year	29.0	1.3	30.3	0.4
Acquisitions	6.2	–	6.2	–
Exchange difference	(2.0)	–	(2.0)	–
Utilised in year	–	(1.1)	(1.1)	(0.4)
Released in year	–	(0.3)	(0.3)	(0.3)
At 31 March 2003	183.1	3.7	186.8	0.7

Other provisions are principally in respect of self insurance and vacant properties. Provisions in the parent company are other provisions.

20 Provisions for liabilities and charges continued

Deferred tax is provided as follows:

	2003 £m	Group 2002 £m
Accelerated capital allowances	515.8	482.5
Short term timing differences	(2.1)	(3.8)
Undiscounted provision for deferred tax	513.7	478.7
Discount	(330.6)	(328.8)
Discounted provision for deferred tax	183.1	149.9

National rates of corporation tax have been used to calculate the amount of deferred tax. Provision has been made for all deferred tax assets and liabilities in respect of accelerated capital allowances and other material timing differences. These deferred tax assets and liabilities have been discounted to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries. As the earnings are continually reinvested by the group, no tax is expected to be payable in the foreseeable future.

21 Financial instruments

Treasury policy is described in the Financial review on page 19. The disclosures below exclude short term debtors and creditors which are primarily of a trading nature and expected to be settled within normal commercial terms.

(a) Interest rate risk profile of financial liabilities

The interest rate risk profile of the group's financial liabilities at 31 March, after taking account of the interest rate and currency swaps used to manage the interest and currency profile, was as follows:

	Floating rate financial liabilities £m	Fixed rate financial liabilities £m	Gross debt £m	Financial liabilities on which no interest is paid £m	Total £m
Sterling	579.1	1,203.7	1,782.8	84.1	1,866.9
US dollars	113.9	140.7	254.6	–	254.6
Euros	3.2	7.8	11.0	–	11.0
At 31 March 2003	696.2	1,352.2	2,048.4	84.1	2,132.5
Sterling	454.7	933.5	1,388.2	81.0	1,469.2
US dollars	134.5	86.0	220.5	–	220.5
Euros	16.3	7.0	23.3	–	23.3
At 31 March 2002	605.5	1,026.5	1,632.0	81.0	1,713.0

Financial liabilities on which no interest is charged comprise other creditors falling due after more than one year.

Euro liabilities at 31 March 2002 included the conversion of existing Dutch guilder instruments from the previous year.

Notes to the accounts

21 Financial instruments continued

Floating rate Sterling, US dollar and Euro debt bears interest at rates based on sterling LIBOR (London Inter-Bank Offered Rate), US dollar LIBOR and EURIBOR (European Inter-Bank Offered Rate), respectively.

The group uses interest rate swaps to fix a proportion of its floating rate sterling debt.

The weighted average interest rates and periods for borrowings in each of the group's principal currencies is as follows:

	Fixed rate financial liabilities		Financial liabilities on which no interest is paid
	Weighted average interest rate %	Weighted average period for which rate is fixed Years	Weighted average period until maturity Years
Sterling	6.1	14	5.5
US dollars	6.9	24	–
Euros	7.1	–	–
Weighted average at 31 March 2003	6.2	15	5.5
Sterling	6.7	14	3.6
US dollars	6.4	27	–
Euros	7.1	1	–
Weighted average at 31 March 2002	6.7	14	3.6

(b) Interest rate risk profile of financial assets

The interest rate risk profile of the financial assets of the group at 31 March was as follows:

	Cash at bank and in hand £m	Short term deposits £m	2003 Total £m	Cash at bank and in hand £m	Short term deposits £m	2002 Total £m
Sterling	0.6	283.7	284.3	1.1	120.9	122.0
US dollars	2.2	39.0	41.2	61.5	11.8	73.3
Euros	2.5	–	2.5	–	0.2	0.2
At 31 March	5.3	322.7	328.0	62.6	132.9	195.5

Surplus cash is invested in short term instruments at rates based on LIBOR and US dollar LIBOR with institutions rated at least A1 or P1 by Standard & Poor's and Moody's.

21 Financial instruments continued

(c) Maturity of financial liabilities

The maturity profile of the carrying amount of the group's financial liabilities at 31 March was as follows:

	Debt £m	Finance leases £m	Gross debt £m	Other financial liabilities £m	Total £m
In one year, or less, or on demand	37.9	6.5	44.4	–	44.4
In more than one year but not more than two years	6.5	0.2	6.7	7.5	14.2
In more than two years but not more than five years	417.3	–	417.3	38.5	455.8
After more than five years	1,117.3	470.4	1,587.7	38.1	1,625.8
	1,579.0	477.1	2,056.1	84.1	2,140.2
Unamortised issue costs	(7.7)		(7.7)		(7.7)
At 31 March 2003	1,571.3	477.1	2,048.4	84.1	2,132.5
In one year, or less, or on demand	32.7	4.2	36.9	–	36.9
In more than one year but not more than two years	10.5	–	10.5	17.3	27.8
In more than two years but not more than five years	430.4	0.3	430.7	47.0	477.7
After more than five years	680.0	476.7	1,156.7	16.7	1,173.4
	1,153.6	481.2	1,634.8	81.0	1,715.8
Unamortised issue costs	(2.8)		(2.8)		(2.8)
At 31 March 2002	1,150.8	481.2	1,632.0	81.0	1,713.0

(d) Borrowing facilities

The group has the following undrawn committed borrowing facilities available to it:

	2003 £m	2002 £m
Expiring in one year or less	–	–
Expiring in more than one year but not more than two years	–	100.0
Expiring in more than two years	100.0	69.5
	100.0	169.5

Notes to the accounts

21 Financial instruments continued

(e) Fair values of financial assets and financial liabilities

The following table provides a comparison by category of the book values and the fair values of the group's financial assets and liabilities at 31 March:

	2003 Book value £m	2003 Fair value £m	2002 Book value £m	2002 Fair value £m
Primary financial instruments financing the group's operations				
Short term borrowings	(44.4)	(45.8)	(36.9)	(37.7)
Long term borrowings	(2,025.9)	(2,110.5)	(1,566.2)	(1,577.7)
Cash and short term deposits	328.0	328.0	195.5	195.5
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	-	5.6	-	(9.7)
Interest rate caps and collars	-	-	-	-
Currency swaps	21.9	21.9	(28.9)	(28.9)
Net debt	(1,720.4)	(1,800.8)	(1,436.5)	(1,458.5)
Other financial liabilities	(84.1)	(84.1)	(81.0)	(81.0)
Total	(1,804.5)	(1,884.9)	(1,517.5)	(1,539.5)

Market values, where available, have been used to determine fair values, otherwise fair values have been calculated by discounting cash flows at year end interest rates.

(f) Currency exposures

The group may borrow in appropriate foreign currencies in order to mitigate the effects of the currency exposures arising from its net investments overseas. The group's residual investments in Holland were financed by Dutch guilder or Euro borrowings in order to fully hedge against the impact of movements in the guilder and Euro/sterling exchange rates on the translation of net assets denominated in Dutch guilders. The proceeds from the Euro 625m bond issue in July 1999, used to fund the acquisition of Aquarion Company, were also predominantly swapped into sterling. The foreign exchange exposure on the translation into sterling of the net assets of Aquarion, denominated in US dollars is principally hedged by a US dollar currency swap taken on in March 2001. Funds of \$115m to acquire five companies from American Water Works in April 2002 were borrowed in US dollars.

Gains and losses arising on net investments overseas and the financial instruments used to hedge the currency exposures are recognised in the statement of total recognised gains and losses.

There are no currency exposures on short term debtors and creditors or monetary assets and liabilities giving rise to a profit and loss account charge.

21 Financial instruments continued

(g) Hedges

The group's policy is to hedge interest rate risk within approved board policies and guidelines.

Interest rate swaps, interest rate caps and collars and forward rate agreements are used to manage interest rate exposure under a policy that requires between 80% and 95% of Yorkshire Water Services Limited's net debt and 60% and 85% of Kelda Group plc's net debt to be held at fixed rates. At the financial year end the proportions were 99% and 79% respectively. The proportion of Yorkshire Water Services Limited's net debt held at fixed rates is above the target range at the year end, but is anticipated to fall to within this range during the year ending 31 March 2004.

Gains and losses on hedges are not recognised until the interest payment that is being hedged is itself recognised. Unrecognised gains and losses on hedges and the movements during the year are as follows:

	Gains £m	Losses £m	Total net gains (losses) £m
At 31 March 2003			
Unrecognised gains and losses on hedges			
At 1 April 2002	6.6	(16.3)	(9.7)
Gains and losses arising in previous years recognised during the year	8.3	(3.7)	4.6
Gains and losses arising in the year that were not recognised	20.0	(9.3)	10.7
At 31 March 2003	34.9	(29.3)	5.6
of which:			
Gains and losses expected to be recognised during the year ending 31 March 2004	11.6	(6.9)	4.7
Gains and losses expected to be recognised in later years	23.3	(22.4)	0.9
At 31 March 2002			
Unrecognised gains and losses on hedges			
At 1 April 2001	8.1	(18.3)	(10.2)
Gains and losses arising in previous years recognised during the year	(1.1)	6.1	5.0
Gains and losses arising in the year that were not recognised	(0.4)	(4.1)	(4.5)
At 31 March 2002	6.6	(16.3)	(9.7)
of which:			
Gains and losses expected to be recognised during the year ended 31 March 2003	1.8	(3.5)	(1.7)
Gains and losses expected to be recognised in later years	4.8	(12.8)	(8.0)

The table excludes the fair value of currency swaps maturing in 2005 and 2006 amounting to £21.9m (2002: £(28.9)m) which is recognised in the book value of long term borrowings at 31 March 2003.

(h) Financial instruments held for trading purposes

The group does not trade in financial instruments.

Notes to the accounts

22 Called up share capital

	2003 Number	2003 Nominal value	2002 Number	2002 Nominal value
Authorised				
Ordinary shares of 15 ⁵ /p each	814,395,257	126,683,707	814,395,257	126,683,707
Allotted, called up and fully paid				
Ordinary shares of 15 ⁵ /p each	392,983,317	61,130,738	392,982,517	61,130,614

During the year, 800 ordinary shares of 15⁵/p were issued directly to employees exercising Sharesave options.

The group has both an ESOT and a QUEST, which are trusts used to administer the issue of shares to employees and directors under the company's "Sharesave" save-as-you-earn share option scheme and, in the case of the ESOT, the Long Term Incentive Plan. The QUEST, like the ESOT, is a trust funded by interest free loans from the company. All the administration costs of the trusts are written off to the profit and loss account as they accrue. The shares held by the trusts are included as fixed assets investments in note 14.

Options granted and outstanding at 31 March 2003	Date of grant	2003 Number of shares	2002 Number of shares	Option price	Normal exercise date
Sharesave schemes					
Three year schemes	7 January 2000	80,728 **	896,709 **	240.0p	Mar-Aug 2003
	5 January 2001	366,829 **	394,015 **	299.0p	Mar-Aug 2004
	4 January 2002	378,301 **	410,541 **	275.0p	Mar-Aug 2005
	10 January 2003	730,531 **	-	320.0p	Mar-Aug 2006
Five year schemes	17 December 1997	-	491	280.3p	Feb-Jul 2003
	31 December 1997	91,665 *	243,287 *	389.0p	Mar-Aug 2003
	21 December 1998	2,079	2,079	249.7p	Feb-Jul 2004
	6 January 1999	83,464 *	91,877 *	457.0p	Mar-Aug 2004
	7 January 2000	910,418 **	942,052 **	240.0p	Mar-Aug 2005
	5 January 2001	237,052 **	246,079 **	299.0p	Mar-Aug 2006
	4 January 2002	321,737 **	340,748 **	275.0p	Mar-Aug 2007
	10 January 2003	517,252 **	-	320.0p	Mar-Aug 2008

* Shares under options to be satisfied by the ESOT

** Shares under options to be satisfied by the QUEST

23 Reserves

	Group £m	Company £m
Share premium account		
At 1 April 2002 and 31 March 2003	16.7	16.7
Capital redemption reserve		
At 1 April 2002 and 31 March 2003	142.6	142.6
Profit and loss account		
At 1 April 2002	1,470.1	620.8
Exchange adjustments	1.5	(1.8)
Transfer from the profit and loss account	25.3	(6.2)
At 31 March 2003	1,496.9	612.8

The cumulative amount of goodwill written off against reserves is £14.1m (2002: £14.1m).

In accordance with the Institute of Chartered Accountants of England and Wales technical release 7/03 issued in March 2003, £231.3m of the company profit and loss account reserves are classified as non-distributable.

24 Reconciliation of group movements in equity shareholders' funds

	2003 £m	2002 £m
Profit attributable to shareholders	126.1	151.4
Dividends	(100.8)	(98.3)
Other recognised gains and losses relating to the year	25.3 1.5	53.1 (1.5)
Net increase in equity shareholders' funds	26.8	51.6
Opening equity shareholders' funds	1,690.5	1,638.9
Closing equity shareholders' funds	1,717.3	1,690.5

25 Commitments

	2003 £m	Group 2002 £m	2003 £m	Company 2002 £m
Contracts placed at 31 March	197.7	239.1	-	-

The long term investment programme for the UK regulated water services business, which is expected to identify substantial future capital expenditure commitments in the period 1 April 2005 to 31 March 2010, will be determined as part of the Periodic Review 2004. Final price limits are due to be announced in November 2004.

Notes to the accounts

25 Commitments continued

At 31 March, group companies were committed to making the following payments during the next financial year under non-cancellable operating leases expiring as set out below:

	2003 Land and buildings £m	2003 Other £m	Group 2002 Land and buildings £m	2002 Other £m
Operating leases which expire:				
Within one year	–	0.4	–	0.5
Between two and five years	0.3	0.9	0.3	0.9
After five years	0.1	–	–	–
	0.4	1.3	0.3	1.4

26 Acquisitions

On 25 April 2002 Aquarion acquired the business and assets of Connecticut-American Water Company, Massachusetts-American Water Company, New York-American Water Company and Hampton Water Company. In addition Massachusetts Capital Resource Company, which owns and leases certain assets to Massachusetts-American Water Company was also acquired. The consideration was \$120m in cash and the assumption of debt of \$104m.

The book values of the assets and liabilities of the acquired companies has been adjusted by £27.3m in order to reflect their fair values and ensure compliance with the group's stated accounting policies. The acquired companies contributed turnover of £29.5m and operating profit of £10.5m in the period from the date of acquisition to 31 March 2003. The acquired companies contributed £10.3m to the group's net operating cash flows, paid £4.4m in respect of interest, utilised £5.5m in respect of capital expenditure and repaid long term debt of £12.4m.

	Book Value £m	Consistency of accounting policy £m	Other £m	Fair Value £m
Tangible fixed assets	128.8	–	–	128.8
Stock	0.5	–	–	0.5
Debtors	16.1	–	–	16.1
Creditors	(30.5)	–	(9.0) ¹	(39.5)
Deferred taxation	–	(6.2) ²	–	(6.2)
Cash	1.6	–	–	1.6
Loans net of deposits	(69.9)	–	(12.1) ³	(82.0)
Minority interest	(0.7)	–	–	(0.7)
Net assets acquired	45.9	(6.2)	(21.1)	18.6
Goodwill				59.4
Consideration satisfied by cash				78.0

The book values of the assets and liabilities have been taken from the completion accounts of the acquired companies at 25 April 2002 at actual exchange rates on that date. The significant fair value adjustments are:

- ¹ The book value of the pension scheme deficit of the acquired companies has been adjusted to reflect its fair value in accordance with FRS 7 'Fair value in acquisition accounting'. Provision was also made for existing environmental liabilities.
- ² The deferred taxation liability in the acquisition balance sheets of the acquired companies is calculated using the undiscounted full provision method in accordance with US accounting standards. The fair value adjustment in respect of deferred taxation has been calculated in accordance with the requirements of both FRS 7 and FRS 19, which allows discounting of the full provision.
- ³ An adjustment has been made to reflect the market value of the loans acquired.

27 Contingent liabilities

The parent company has guaranteed certain subsidiary undertakings' borrowings of £745.8m (2002: £661.1m).

At the time of completion of the WRG merger, an indemnity was given to WRG by Yorkshire Environmental Solutions Limited, backed by a Kelda Group plc guarantee, in respect of a landfill site managed by 3C Waste Limited and known as the Rhonda site. The indemnity is unlimited in amount and the time limit for bringing claims is seven years from 26 January 1999, except for personal injury claims where the limit is 15 years. The matters covered under this indemnity are any losses arising out of:

- (a) non compliance with an Environment Agency notice served in May 1998;
- (b) any claims by individuals for personal injury, harm to health, nuisance etc;
- (c) liability for negligent performance of the contract between 3C Waste Limited and Rhonda Waste Disposal Limited.

28 Pensions

UK pension scheme

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

The most recent actuarial valuation of the KGPP was carried out as at 31 March 2001 when the market value of assets was £559.9m and the scheme surplus £22.2m.

The UK pension cost under SSAP 24 'Accounting for Pension Costs' for KGPP has been assessed in accordance with the advice of Mercer Human Resource Consulting Limited, using the projected unit method. For this purpose, the actuarial assumptions adopted are based upon investment growth of 5.4% per annum, pay growth of 4% per annum and increases to pensions in payment and deferred pensions of 2.5% per annum. The market value of the assets represented 107.5% of the value of the accrued benefits after allowing for expected future earnings increases. In deriving the pension costs under SSAP 24, the surplus is being spread over the future working lifetime of the employees.

Contributions over the year ended 31 March 2003 were paid by members at 3%, 4%, 4.5%, 5% or 6% of pensionable pay (depending on benefit category). The company contributed at 200% of members contributions during the accounting year in respect of the majority of members.

An accrual for unfunded benefits of £1.8m (2002: £1.6m) has been included in the group's accounts at 31 March 2003.

US pension schemes

Aquarion in the US operates a number of non contributory defined benefit retirement plans. The two principal retirement plans relate to Aquarion Company (acquired in 2000) and employees of the American Water Works companies acquired in April 2002. Aquarion also provides healthcare benefits for certain categories of employees.

The latest valuations of the US schemes were carried out at 31 December 2002. The market value of assets of the principal retirement plans was \$56.3m and exceeded the benefit obligations (including those acquired during the year) at that date by \$3.5m. The benefit obligation of the post retirement healthcare plans exceeded the market value of assets by \$19.7m. The Aquarion pension assets and liabilities have been recorded at fair value on acquisition and full provision for the post retirement healthcare benefit obligations has been made in the group's accounts at 31 March 2003.

The group's total pension charge for the year was £11.2m (2002: £9.0m).

Notes to the accounts

28 Pensions continued

The additional disclosures required by FRS 17 are set out below. A qualified independent actuary has updated the most recent valuations of the principal schemes to 31 March 2003. In calculating the liabilities at 31 March 2003, the following financial assumptions have been used:

Major assumptions	2003	2003	2002	2002
	UK %	US %	UK %	US %
Inflation	2.5	–	2.8	–
Rate of increase in salaries	3.7	4.0	4.3	5.0
Rate of increase to pensions in payment and deferred pensions	2.5	–	2.8	–
Discount rate for scheme liabilities	5.4	6.3	6.0	7.3

The Aquarion retirement plan does not guarantee to increase pensions in payment and there is no pre-funding of pensions increases. Discretionary increases have been awarded in the past on an ad hoc basis. The rate of increase in healthcare costs in the US varies by year of projection with an ultimate rate of 5% from 2010.

The market values of the assets and the FRS 17 value of liabilities of KGPP and the principal US defined benefit plans at 31 March 2003, together with the expected long term rate of returns were as follows:

	2003		2003	
	UK Market value £m	Expected long term rate of return %	US Market value £m	Expected long term rate of return %
Market value of assets				
Equities	314.7	7.25	20.0	7.75
Bonds	69.8	4.90	16.9	6.30
Other	22.6	4.50	3.3	5.00
	407.1		40.2	
Present value of scheme liabilities	(566.9)		(57.4)	
Pension deficit before deferred tax	(159.8)		(17.2)	
Deferred tax	47.9		6.9	
Net pension deficit	(111.9)		(10.3)	

	2002		2002	
	UK Market value £m	Expected long term rate of return %	US Market value £m	Expected long term rate of return %
Market value of assets				
Equities	431.8	6.75	21.1	8.0
Bonds	81.9	5.70	11.2	7.3
Other	26.5	5.25	7.2	6.0
	540.2		39.5	
Present value of scheme liabilities	(515.0)		(36.7)	
Pension asset before deferred tax	25.2		2.8	
Deferred tax	(7.6)		(1.1)	
Net pension asset	17.6		1.7	

FRS 17 requires that the pension schemes are valued using market conditions at the company's year end. This produces a volatile figure for any surplus or deficit as it is largely dependent on the levels of stock markets on one particular date. The group's pension liabilities are funded on a long term basis based on the periodic actuarial reviews rather than the FRS 17 disclosures.

Analysis of the amounts that would be charged to the profit and loss account in accordance with FRS 17:

	2003 UK £m	2003 US £m
Analysis of amount that would be charged to operating costs:		
Current service cost	9.0	1.2
Past service cost	1.8	-
Total charge	10.8	1.2
Analysis of amount that would be credited to other finance income:		
Expected return on pension scheme assets	35.2	3.1
Interest on pension scheme liabilities	(30.8)	(3.4)
Net return	4.4	(0.3)
Amounts charged to the profit and loss account before taxation	6.4	1.5
Analysis of amounts that would be recognised in statement of total recognised gains and losses:		
Actual return less expected return on pension scheme assets	(162.9)	(7.0)
Experience gains and losses arising on the scheme's liabilities	-	-
Changes in assumptions underlying the present value of the scheme's liabilities	(23.5)	(5.3)
Actuarial loss recognised in the statement of total recognised gains and losses	(186.4)	(12.3)
Movement in deficit during the year:		
Surplus in scheme at beginning of year	25.2	2.8
Movement in year		
- acquisitions	-	(7.2)
- current service cost	(9.0)	(1.2)
- contributions	7.8	0.8
- past service cost	(1.8)	-
- other finance income	4.4	(0.3)
- actuarial loss	(186.4)	(12.3)
Exchange differences	-	0.2
	(159.8)	(17.2)
Related deferred tax asset - full provision basis (FRS 19)	47.9	6.9
Net pension deficit at end of year	(111.9)	(10.3)

History of experience gains and losses:

Difference between the expected and actual return on scheme assets		
Amount (£m)	(162.9)	(7.0)
Percentage of scheme assets	40.0%	19.6%
Experience gains and losses on scheme liabilities		
Amount (£m)	-	-
Percentage of the present value of scheme liabilities	-	-
Total amount recognised in the statement of total recognised gains and losses		
Amount (£m)	(186.4)	(12.3)
Percentage of the present value of scheme liabilities	32.9%	36.3%

If the amounts in the table above had been recognised in the financial statements the group's net assets and profit and loss account reserve at 31 March 2003 would be as follows:

	2003 Profit and loss account £m	2003 Net assets £m
Excluding net pension deficit	1,496.9	1,717.9
Net pension deficit under FRS 17	(122.2)	(122.2)
Net assets already recognised in accounts under SSAP 24 reversed (US)	(0.8)	(0.8)
Including net pension deficit	1,373.9	1,594.9

Notes to the accounts

29 Employees

	2003 Number	Group 2002 Number
Average number of people employed		
Water services		
– UK regulated	2,147	2,103
– US operations	490	411
Other activities	621	650
	3,258	3,164
	£m	£m
Total employment costs		
Wages and salaries	85.8	79.9
Social security contributions	6.5	6.5
Other pension costs (see note 28)	11.2	9.0
	103.5	95.4

The emoluments, share options and LTIP interests of the directors are described in the Remuneration report on pages 33 to 37.

30 Related parties

Group companies have extended finance to Aberdeen Environmental Services (Holdings) Limited, on a proportionate basis with other principal shareholders. These loans are included in investments analysed in note 14.

	2003 £m	2002 £m
Aberdeen Environmental Services (Holdings) Limited	3.3	3.3

The loans carry market rates of interest. Total interest received on loans to associated undertakings and joint ventures was £0.5m (2002: £0.1m). There were no loans outstanding at 31 March 2003 between the group and Waste Recycling Group plc.

There were no other material transactions between the group and its associated undertakings during the year.