# ONDEO SERVICES UK PLC

## REPORT AND FINANCIAL STATEMENTS FOR

## THE YEAR ENDED

## 31 DECEMBER 2002

Registered Number 3114615

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## CHAIRMAN'S STATEMENT

After a period of considerable change for our Group, spanning several years, I am delighted to report that 2002 has been the year in which the results of the many strategies and initiatives we have implemented have fully and very tangibly come to fruition. It has been a year of significant achievement for Ondeo Services UK plc.

Northumbrian Water Limited (NWL) had a particularly successful year. The company achieved first position in the Office of Water Services (Ofwat) overall performance league for water and sewerage companies in 2001/02 for the second year in a row. In addition, for the third year in succession, NWL's northern operating area (Northumbrian Water - NW) and southern operating area (Essex & Suffolk Water – ESW) were awarded the maximum 'star' rating in Ofwat's annual levels of service report. I would like to extend my thanks and congratulations to every one of our NWL staff on this magnificent achievement.

NWL's customers have also commended the levels of service and quality they receive. We regularly carry out customer research to check their satisfaction with our services and our impact on the environment. Satisfaction levels are high; in particular, satisfaction levels with respect to the quality of rivers and bathing waters has grown, over the last two years, as customers have become more aware of the benefits of NWL's capital investment programme. However, customers have identified some areas where additional improvements can be made and these will receive further attention.

In addition, our levels of service are regularly checked by WaterVoice, the former Ofwat Customer Service Committees. These committees have also reported consistently high levels of satisfaction with the services we provide. Such excellent reports are not achieved easily. It is testament to the commitment and sheer hard work of our employees that we have maintained our position as the country's premier water company.

We are now a full year into preparation for the next Ofwat Periodic Review of charges, which takes effect in 2005. We have traditionally enjoyed a harmonious and productive relationship with Ofwat and we are resolved to ensure that both the process and the outcome of this review appropriately address our commercial requirements, as well as our operational and environmental obligations. It is imperative that Ofwat recognises our need to operate our assets at realistically profitable levels, both in order to secure future funding and investment and to ensure the continuity and sustainability of our services. We anticipate mutually productive discussions with Ofwat and the other bodies involved in the process, and have entered this review period having established a very solid base of achievement and prudent strategic planning since the last review in 2000.

We have always acted as a good corporate citizen within the communities we serve. We believe that if we can help our communities, we can enhance the areas in which we operate to encourage investment and, consequently, build our business. We focus on five key areas that fit our business objectives and appeal to our stakeholders; these are economy, social inclusion, environment, education and regional support. Whilst we continue to provide cash funding, our approach to community involvement has evolved and developed over the years. Increasingly, we are assisting the voluntary sector through the provision of time and resources and are seeking to develop genuine long-term partnerships with those organisations.

NWL is a member of the Percent Club, whose members commit to contribute one percent of net profit to the community each year. In 2002, we were the highest-placed water business in terms of our total contribution to this initiative, through financial, time and resource donations.

In the north, we work with the regional community foundations to provide support to local community projects in accordance with our five key areas of focus. We are about to launch a similar scheme in the south, through the Essex Community Foundation, that will support local community initiatives in both Essex and Suffolk.

An excellent example of a long-term partnership is our eight year commitment to the development of the youth orchestra, Young Sinfonia, as part of our involvement with the Sage Music Centre in Gateshead. This year, our support has included mentoring, work place recitals, production of a CD and the involvement of Young Sinfonia and music centre professionals in a creativity workshop for senior managers. The CD, which was launched by Prime Minister, Tony Blair MP, in November, features music from Young Sinfonia, complemented by lighter contributions from NWL senior managers and staff.

Another example is our partnerships with local wildlife trusts. We employ several people through the trusts to support our biodiversity programme at key sites. As part of the initiative we have embarked on a unique shared learning programme. We are providing the local wildlife trusts with valuable management development and mentoring for key personnel in subjects such as customer service, strategy development and negotiating skills. In return, they are providing expertise on the impact of environmental legislation and are raising the environmental awareness of staff through site talks and lunchtime seminars.

In the North East, we are active corporate supporters of the bid by the Newcastle Gateshead Initiative (NGI) to secure the accolade of European City of Culture in 2008. The result of this bid process will be announced in June 2003 and, whilst we hope and anticipate that the NGI bid will be successful, there is no question that the process of preparation and bidding has, in itself, significantly benefited the communities of both Newcastle and Gateshead, as well as the wider region.

In the wider context, we continue to support the charity WaterAid, which aims to bring sustainable water and sanitation provision to developing countries in Africa and Asia. Since 1996, our customers and employees have helped to raise over £1 million to this extremely worthwhile charity.

To encourage employees to play a role in their local communities and environment, NWL launched its 'Just an Hour' initiative. This gives employees the opportunity to spend at least an hour of work time each month helping with a community or environmental project. The aim is that 15% of employees will be taking part in 'Just an Hour' by the end of December 2003.

The twin issues of environment and ethics have once again been key to our strategic thinking during 2002. Many of our activities have a direct impact on the environment. In our operations we seek to provide sustainable solutions that meet existing and anticipated legislation and our stakeholders' and customers' varied requirements. As we plan for the future, we shall actively seek to protect and, wherever possible, improve the environment for the benefit of all community and stakeholder groups.

In April 2002, we welcomed two new Non-Executive Directors to the Board of NWL. Anita Frew is a finance and marketing specialist who was previously an executive director at Abbot Mead Vickers plc, the major UK advertising and marketing services group. She is joined by Alastair Balls, chief executive of the International Centre for Life in Newcastle. In addition to their overall responsibilities as directors of the company, Ms Frew will focus particularly on issues relating to our southern operating area, whilst Mr Balls will concentrate on matters of special significance to the north.

Also in April, we announced the promotion of existing Non-Executive Director Richard Allan to the position of Deputy Chairman. I extend both my welcome and best wishes for success to each of them in their new roles.

I began by describing 2002 as a year of significant achievement for our Group. As we continue to build our future for the benefit of our customers and other stakeholders, I am confident that we have established very solid foundations for continued success and achievement.

**PROFESSOR SIR FREDERICK HOLLIDAY**
**CHAIRMAN**
**7 MAY 2003**

## GROUP MANAGING DIRECTOR'S REVIEW

The Chairman talks in his statement of the sense of achievement prevailing throughout Ondeo Services UK plc during 2002 and I concur fully with this view; there is a very real and justified sense of achievement right across the Group.

Notable achievement does not come easily or without hard work from individuals. We have grown the scale, efficiency and reputation of our business through the skills, abilities and enthusiasm of our people, focusing this powerful asset on the achievement of a clearly defined set of commercial objectives.

Significant operational and commercial achievements have been delivered in each of the Group's businesses and, as far as our principal subsidiary, NWL, is concerned, we believe we are in an even stronger position entering the current Ofwat Periodic Review than we were at the same point in the last review five years ago.

Group turnover in 2002 increased by £14.6m to £504.0 million and profit before tax decreased by £17.7 million to £92.2 million. However, the 2001 results included the disposal of the Group's 35% holding in SITA Holdings UK Limited which gave rise to an exceptional profit before tax of £29.4m. Emphasis on profitable growth and sustainable cost management underpinned the underlying improvement in performance, with all Group companies making a contribution. Following a strategic review of its operations, the Group decided to sell Imass to its management and this transaction was completed on 23 December 2002. The 2001 results have also been restated to reflect the adoption of Financial Reporting Standard No. 19, "Deferred taxation".

| ONDEO SERVICES UK PLC | YEAR TO 31 DECEMBER 2002<br>£ MILLION | YEAR TO 31 DECEMBER 2001<br>£ MILLION<br>(AS RESTATED) |
|---|---|---|
| TURNOVER | 504.0 | 489.4 |
| OPERATING PROFIT | 165.3 | 155.9 |
| PROFIT BEFORE TAXATION | 92.2 | 109.9 |
| PROFIT AFTER TAXATION | 91.7 | 98.7 |

We continue to deliver a substantial investment programme both to meet new output obligations and to ensure our substantial asset base is maintained. In November 2002, to help to finance this programme, NWL secured further European Investment Bank lending of £80 million followed, in December 2002, by a new benchmark 30 year bond which raised £250 million. A Group £100 million bond was repaid in February 2002.

Within NWL, we have set out our corporate mission, together with our key themes and business objectives, in our strategic document 'Building our Future'. We want NWL to be a national leader in the provision of sustainable water and waste water solutions, developing stakeholder value and growing our business through our competitive position. 'Building our Future' also sets out the principles underpinning the company's approach to sustainable development. We emphasise 'Building' as a clear, unequivocal reflection of the fact that our business is growing, developing and evolving. Based on a proven track record of delivery our drive towards constantly evolving goals is something we intend to continue.

Building on our performance is not simply a matter of growing revenue and profits. To achieve our objectives we must build in a sustainable way and we have identified five key strategic themes on which our approach is developed. These are customers, people, competitiveness, environment and reputation; taken together they form the foundation of our business planning and are the basis of the NWL company bonus scheme.

In a service business such as ours, success and achievement reflect the commitment and enthusiasm of our people and our approach to customers and, for NWL, 2002 has been a year of focusing on people. During the year, we have developed a Sustainable People Plan that, amongst other critical objectives, ensures that the key issue of succession planning has been addressed throughout the business.

We have also continued with a range of training and development initiatives to help our people realise and maximise their potential. A further 26 managers from the north and the south of the business completed our bespoke management development programme in 2002. The programme is structured around the key competencies required to fulfil our business objectives and ensures that NWL is equipped with an appropriate balance of these competencies. Around 70 managers have now completed the programme and by the end of 2003, most of our senior managers will have benefited from the programme.

Empowerment and accountability play a critical part in our business success and are fundamental components of our culture of individual and collective achievement. An integral part of our performance management system is the use of appraisals throughout the business and the appraisal process itself is subject to a series of annual quality audits. These ensure not only a uniform approach but also identify training requirements. Our rigorous approach to performance management is supported by our Quality Assurance accreditation and we are on target to meeting the requirements of the international management systems standard ISO 9001 2000 in the summer of 2003.

We believe that good employee relations are built on communication and consultation. Our commitment to consultation, through NWL's Company-wide Forum, containing union and non-union representation, played a major part in the successful three year pay deal negotiated during 2002. It was also key to the ongoing discussions on the harmonisation of terms and conditions throughout NWL.

We have also had a hard look at employee communication within NWL in 2002 and during the year introduced a new magazine, 'Hel'eau', in response to employee requests for a publication that focuses on the people in the business. After only four issues, Hel'eau had received two business communications awards. To further enhance communications we also plan to introduce an annual employee attitude survey that will capture trends in employee views and opinions.

Health and safety in all areas of our operations was also a major area of focus for us during 2002. Working with staff we undertook an holistic review of all aspects of health and safety across NWL during the year. This included employee health and safety awareness training and an amnesty to identify issues. We have already implemented many of the findings and have developed a new risk assessment framework. Further improvements will be facilitated by the introduction, in April 2003, of our new fully integrated payroll and HR system.

Our focus on performance in NWL was again recognised as delivering the highest levels in the annual report from Ofwat on levels of service. For the third year running we were the only company to achieve seven stars out of a possible seven in our northern water and sewerage operation, and five stars out of a possible five for our southern water operation.

A notable achievement was secured in both operating areas in respect of the Drinking Water Inspectorate's drinking water quality requirements. Our southern area achieved the highest level of compliance in the country with 99.95% of tests meeting the strict British and European standards. This was the highest level we have ever achieved in the south. In the north, too, we achieved our highest ever pass rate, at 99.91%.

In the south, following a period of having contractors working alongside our own distribution maintenance team to keep our water mains network working efficiently, we decided to reduce our reliance on contractors and to increase our own direct labour workforce. Our own team produced a performance well above the levels achieved by the contractors.

Our significant and ongoing investment in a network of coastal sewage treatment works in North East England has contributed directly to the improved quality of bathing water in the region. Environment Agency monitoring statistics for the May-September 2001 bathing season indicated that all 33 designated bathing waters in NWL's northern operating area reached the mandatory standard for the first time since annual monitoring began in 1990. In addition, 73% of the bathing waters achieved the highest guideline standard under the EU bathing water directive. Despite very poor weather during the bathing season of 2002, all bar one of the region's bathing waters again passed the mandatory standard and 66% passed the guideline standard.

However, this improvement required a significant increase in our energy consumption. To manage this impact, we have developed an energy management strategy covering six interrelated themes: renewable energy, operational energy use management, energy efficiency, staff awareness, energy generation and trading and financial audits. NWL's environment and investment delivery departments completed a project to assess how energy and other environmental and social issues can be incorporated within the design and construction of new assets.

NWL's biodiversity strategies provide a framework to integrate the principles of biodiversity into our business planning process. Our detailed biodiversity action plans seek to focus our efforts and resources on regional habitats and species of the greatest national and international importance. All our major capital projects are screened to reduce the risk of damage to sites designated as being of conservation or archaeological importance and to identify opportunities to enhance the natural environment. We are also exploring the potential for, and benefits of, sustainable agriculture, working with local farming communities to tackle issues such as raw water colouration and pesticide run-off at source.

In September 2002, our expertise enabled us to play a significant part in the World Summit on Sustainable Development in Johannesburg. In the run-up to the summit we funded, assisted in the facilitation of and presented several papers at the United Nations Environment and Development UK (UNED-UK) Round Table on Biodiversity and Natural Resources, a multi-stakeholder forum for dialogue on UK priorities for biological conservation. At the summit itself, we presented two papers and took part in round-table discussions.

The concept of sustainable development is increasingly being integrated within our strategic thinking. We are planning to expand our existing environmental management system to ensure that we achieve ISO 14001 across the whole business by 2005. In addition, we are involved in the Sigma Project, a primarily government funded project run by the British Standards Institute, Forum for the Future and AccountAbility to provide a management framework for sustainability. Our pilot project for this year involved reviewing our existing risk model to ensure that all significant environmental and social risks have been considered. We also continue to be actively involved in WaterUK's sustainability network and in the development of industry-wide sustainability indicators.

The issue of regulation remains very firmly on the agenda for the UK water industry in 2003. The Water Bill has recently been placed before Parliament and we support many of the Government's objectives in introducing the Bill. In a number of areas, for example the proposed changes to the structure of the economic regulator, Ofwat, changes have already been anticipated and implemented by Ofwat and we do not believe, therefore, that these will have significant implications for the industry.

WaterVoice is a powerful consumer champion that in many respects is already increasingly independent of Ofwat. We support the campaign by WaterVoice to maintain a strong regional basis in the Bill's proposed Consumer Council for Water and to ensure that the new body is given sufficient powers to enable it to operate at least as successfully as has WaterVoice thus far.

We are pleased that Ofwat is adopting a more transparent approach for the current Periodic Review of prices, albeit the proposed methodology for the review remains essentially the same as that used in the 1999 review, with a few procedural changes. We submitted a comprehensive response to the methodology proposals and highlighted a number of areas in which we believe Ofwat's approach could be improved to enhance regulatory incentives and deliver a sustainable outcome. We remain of the firm belief that regulation should be based on best estimates and not lowest estimates.

Ofwat now also has sustainability obligations to ensure that companies' decisions are based on a process that involves all stakeholders to deliver long-term holistic solutions that benefit the wider environment, society and the economy. We hope that the regulator takes these obligations seriously in its future activities.

Our commercial activities within NWL continue to build on our strong record of achievement. During the year, we published a new business charter for our industrial customers which sets out the guaranteed levels of service that they can expect from us, regardless of their size or sphere of activity.

In November 2002, NWL secured another significant contract for the treatment of liquid waste at our Bran Sands treatment works on Teesside. In addition, we successfully expanded our tankered waste operation at Bran Sands during the year. We are also assessing the feasibility of utilising the sludge output from these works as a fuel in the cement manufacturing process.

Our strategy for growth in industrial markets focuses strongly on the opportunities provided by small and medium sized enterprises. We are developing products and services specifically targeted at meeting the needs of these businesses and have, in addition, developed powerful databases, analysis and marketing capabilities to allow greater focus to service delivery and also enhance our communications with both existing and potential customers.

Work undertaken during 2002 in the implementation of our domestic marketing plan has strengthened our customer relationship marketing capability. This enhanced capability is being used to develop a still closer relationship with our domestic customers and to identify new opportunities for products and services that we can supply to them.

Our Property Solutions service has been expanded this year to provide house movers, property buyers and their legal representatives with water and sewerage services, flood and environmental search data. We have also further developed a close and beneficial relationship with regional and national housebuilders.

Leisure and fishing activities recovered strongly after the ravages of the foot and mouth outbreak in the previous year, helped by a range of special offers for new and loyal anglers. We aim to further develop these activities, which have an important contribution to make to both our commercial and social objectives.

Outside NWL, our International Division, our environmental and engineering consultancy, Entec, and our laboratories company, AES, once again delivered strong performances in 2002.

As a result of a reorganisation within the Ondeo Group that changed regional responsibilities, the International Division now concentrates on opportunities in Scotland, the Republic of Ireland, Scandinavia and Gibraltar. Our South African business interests are in the process of being transferred to Ondeo Services SA.

During 2002, the International Division concentrated on consolidating existing contracts and further strengthening relationships with clients. The Division recorded some significant achievements during 2002, notably the completion of the waste water treatment works at Levenmouth in the east of Scotland and at Meadowhead, Stevenston and Inverclyde in the west of Scotland. Inverclyde was formally opened in October 2002 by Ross Finnie, Minister for the Environment and Rural Economy in the Scottish parliament. The operating company for Meadowhead, Stevenston and Inverclyde achieved ISO 9001 and that for Levenmouth achieved ISO 9001 and ISO 14001. The sludge treatment centres at Levenmouth and Meadowhead are currently in the final stages of commissioning and we have passed the half way mark in the construction of a new sewage treatment works in Cork, Republic of Ireland.

Like other businesses in the Group, Entec placed considerable emphasis on people issues in 2002, focusing on staff recruitment and retention. Management development was also emphasised during the year, with a series of specifically developed leadership workshops. The business continues to successfully build its third party activity with an excellent client base and high levels of repeat business. It also began the process of ISO 14001 accreditation during the year.

AES expanded by opening a new unit in Scotland, based at the Levenmouth waste water treatment works, and by merging NWL's southern laboratory into the AES structure. The whole company was re-assessed against ISO 9001 and achieved the new ISO 9001 2000 standard. Management development, as part of the Investors in People accreditation, has been a particular focus in 2002.

2002 has been a year of achievement for Ondeo Services UK plc. That achievement is the result of thorough planning, efficient implementation, prudent financial management and the sheer effort and hard work of all our people over a number of, at times extremely testing, years. We have now established a people focused business with a culture driven by success and the desire to achieve the highest possible standards of service for our customers.

We occupy a hard won position of industry leadership in the UK. I am confident that our strategies for the sustainable development of our business will allow us to strengthen this position and to deliver still greater levels of achievement in the future.

**JOHN CUTHBERT**
**GROUP MANAGING DIRECTOR**
**7 MAY 2003**

**DIRECTORS' REPORT**
**ONDEO SERVICES UK plc**

Directors' Report for the year ended 31 December 2002.

The directors are pleased to present their report on the affairs of the Company and its subsidiaries, together called the Group, along with the audited financial statements and the Auditors' Report for the year.

**Activities**

The principal activities of the Group during the year were the provision of water, waste water management and related services. A review of the Group's business is contained in the Chairman's Statement (page 1) and the Group Managing Director's Review (page 4).

**Financial Results and Dividends**

The Group's results and dividends are as follows:

| | **Year to 31.12.2002** | Year to 31.12.2001 (as restated) |
|---|---|---|
| | **£m** | £m |
| Profit for the financial year | **91.8** | 98.1 |
| Dividends | **(62.3)** | (59.6) |
| Transferred to reserves | **29.5** | 38.5 |

The directors have declared a second interim dividend of 6.68p (2001: 6.39p) and recommend a final dividend of 0p (2001: 0p) per ordinary share. The second interim dividend will be paid on 7 May 2003 to shareholders whose names appeared on the Company's Register of Members at the close of business on 18 April 2003. Together with the interim dividend of 6.68p (2001: 6.39p) per ordinary share, paid on 11 October 2002, the total dividend for the year will be 13.36p (2001: 12.78p) per ordinary share.

The prior year financial statements have been restated following the implementation of Financial Reporting Standard No. 19, "Deferred taxation" ("FRS19"), as described in note 2.

**Substantial Shareholdings**

As at 31 December 2002, the Company's register of substantial shareholdings showed the following interests in 3% or more of the Company's ordinary shares:

| | |
|---|---|
| Lyonnaise Europe PLC | 67.5% |
| Northumbrian Partnership | 20% |
| Ondeo Services SA | 12.5% |

On 2 August 2002, Lyonnaise Europe PLC increased its shareholding in the Company from 65% to 67.5%. Lyonnaise Europe PLC, a wholly owned subsidiary of Ondeo Services SA, is a 50 per cent partner in the Northumbrian Partnership. On 31 December 2002, Lyonnaise Europe PLC purchased the other 50 per cent partner in the Northumbrian Partnership, United Water UK Limited, from its sister company, United Water Resources Inc. As a consequence, the Company became ultimately wholly owned by a company incorporated in France, SUEZ SA (SUEZ), which is the parent company of Ondeo Services SA.

## Post Balance Sheet Events

On 24 February 2003, Lyonnaise Europe PLC transferred beneficial ownership and undertook to complete the necessary formalities to transfer legal title of its entire shareholding in the Company to Atlantic Water Limited in exchange for an issue of shares in Atlantic Water Limited to Lyonnaise Europe PLC. Atlantic Water Limited is a company incorporated in Guernsey and is wholly owned by Lyonnaise Europe PLC. On 1 April 2003, the Northumbrian Partnership transferred beneficial ownership of 7.5% of the issued shares in the Company, out of its total holding of 20%, to Atlantic Water Limited in exchange for an issue of shares in Atlantic Water Limited to the Northumbrian Partnership and it undertook to complete the necessary formalities to transfer the legal title.

## Directors

The following served as directors during the year and, unless stated otherwise, were directors of the Company as at 31 December 2002:

Professor Sir Frederick Holliday CBE (67)
Non-Executive Chairman

Richard Allan (68) – appointed on 24 April 2002
Non-Executive Deputy Chairman

Patrick Babin (44) – resigned on 25 July 2002
Non-Executive Director

Alain Chaigneau (51)
Non-Executive Director

Jean-François Thierry Chambolle (63)
Non-Executive Director

Kam-Ling Chan (61) – resigned 7 January 2002
Non-Executive Director

Peter Cheng (49) – resigned 7 January 2002
Non-Executive Director

John Arthur Cuthbert (49)
Group Managing Director

Bernard Guirkinger (50) – appointed on 25 July 2002
Non-Executive Director

Anthony John Harding (53) – resigned on 3 March 2003
Non-Executive Director

Antony Haynes (72) – resigned 31 March 2002
Non-Executive Director

Jacques Francis Petry (48) – appointed 14 October 2002
Non-Executive Director

Patrick Marcel Verschelde (51) – resigned on 25 July 2002
Non-Executive Director

**Directors' Remuneration and Interests**

Information about the remuneration and interests of directors is contained in note 7 to the financial statements.

**Donations**

The Group made charitable donations totalling £58,130 (2001: £63,089) during the year. No political donations were made (2001: £nil).

**Research and Development**

Northumbrian Lyonnaise Technology & Research Centre Limited, a specialist subsidiary wholly owned by the Company, co-ordinates all research and development activities relating to underground assets. This company has very close links with other Ondeo group research organisations worldwide (the Global Technology Network).

The Group, through Northumbrian Water Limited (NWL), maintains a limited programme of research and development activities, which are linked to UK business operations.

During the year, the Group incurred research and development costs of £5.5m (2001: £5.3m).

**Employees and Employment Policies**

*Equal Opportunities*

The Group operates an equal opportunity policy and promotes the equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment on the grounds of age, gender, marital status, nationality, ethnic or national origin, religion, disability or sexual orientation.

*Training and Development*

Training and development of employees is a priority of the Group. Individual training needs are assessed regularly and corporate initiatives include an Accelerated Development Programme for graduates and a Management Development Programme.

*Communication*

Employees receive 'Watermark', the Group employee magazine twice a year. 'Watermark' covers the Group's activities and news from the parent company. When necessary, information is communicated via a group-wide 'news flash' facility ensuring employees are kept abreast of news.

Individual Group companies utilise a range of communication mechanisms, including team briefing, magazines, newsletters, intranet, noticeboards and regular team meetings. In addition, the SUEZ group operates a worldwide intranet, SW@N, and publishes a quarterly employee magazine, 'Terre Bleue', available in English for Group employees.

*Health and Safety*

Health and safety policies are maintained and implemented through the Group's safety team. Employee health services are provided by the Group's Medical Advisor. Most employees are members of a group-wide corporate health care plan managed by CIGNA Healthcare.

*Employee Investment Schemes*

During the year, the Group once again invited its employees to join the employee investment scheme, which is offered by the parent company, SUEZ. The scheme, called SPRING, consists of two elements giving employees a choice of two different types of investment, or a combination of both. They can invest in a fund, SPRING Classic, which holds SUEZ shares that have been purchased at a discount, and/or they can invest in a company, SPRING Multiple, which also holds SUEZ shares. Employees investing in SPRING Multiple are guaranteed the return of their initial investment at the end of the five year investment period. It also gives them an opportunity to increase that investment by participating in the growth in value of SUEZ shares through the existence of a matched investment by Credit Agricole Indosuez, the scheme manager.

The directors believe that employee investment is a valuable method of strengthening the ties between Group employees and SUEZ by providing the opportunity for employees to participate more closely in the parent company's economic performance and results.

**Pensions**

Information about the pension schemes operated by the Group is contained in note 28 to the financial statements.

**Auditors**

In 2002 Arthur Andersen resigned as auditor. The directors appointed Ernst & Young LLP to fill the vacancy arising. A resolution to re-appoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting. Ernst & Young LLP have expressed their willingness to be re-appointed as auditor.

**Creditors**

The Company's policy is to make payment not more than thirty days after receipt of a valid invoice. The number of creditor days for the Company at 31 December 2002 and 2001 was nil.

**Corporate Governance**

The Company's shares are not listed on the Stock Exchange. Therefore, the Company is not required to comply with rule 12.43A of the UKLA Listing Rules or with the Combined Code on Corporate Governance prepared by the Hampel Committee. However, the Company is committed to high standards of corporate governance throughout the Group and the directors have taken account of the recommendations of the Combined Code and also the guidance provided by the Association of British Insurers, regarding the disclosure of social, environmental and ethical matters, in determining the format and content of their report. They have endeavoured to maintain a proper level of disclosure in keeping with the Combined Code provisions, which they considered applicable to the Company's particular circumstances.

On 31 December 2002, the Board of Directors of the Company comprised eight directors, seven of whom were Non-Executive Directors (two were independent Non-Executive Directors).

The following Board Committees operated during the year within defined terms of reference. Their meetings and decisions were reported to the Company's Board of Directors:

*Audit Committee*

The Audit Committee, which usually meets as a joint committee held on behalf of the Company and the Company's principal subsidiary, NWL, comprised exclusively Non-Executive Directors. It met several times during the year with internal and external auditors. The Audit Committee considered the appointment of external auditors, provided an independent perspective on all financial reporting matters, internal control procedures and the consistency of accounting policies and co-ordinated the activities of the Group's internal audit team.

*Remuneration Committee*

The Remuneration Committee is a joint committee held on behalf of the Company and NWL and comprised exclusively Non-Executive Directors. It determined, and agreed with the Boards, the policy for remuneration and other terms of service of the Executive Director and some other members of the executive management in the Group. The objective of such policy is to ensure that members of the executive management are provided with appropriate performance incentives and are, in a fair and responsible manner, rewarded for their individual contributions to the success of the Company and NWL. In addition, the Director General of the Office of Water Services keeps the Chairman of the Remuneration Committee informed of performance in respect of other water companies' levels of service, including leakage.

Further details of the Group's remuneration policy are disclosed in note 7 to the financial statements.

*Standing Committee*

This comprised the Chairman, the Group Managing Director and one Non-Executive Director of the Company and dealt with the day to day business of the Group between Board meetings.

*Nomination Committee*

This comprised all directors of the Company. Its function was to review regularly the Board structure, composition and size and make all necessary adjustments, including proposing candidates for executive and non-executive appointments as directors of the Company.

*Ethics, Environment and Sustainable Development Committee*

This comprised at least two directors of the Company with other members co-opted from the Group. The Committee was strengthened during the year by the appointment of three new permanent members, one from each of the Company's subsidiaries, Entec UK Limited and NWL, and one from its parent company, SUEZ. Its function was to establish best practice and compliance across the Group on ethical, environmental and sustainable development matters and to evaluate future trends. The Committee requires, and reviews annually, a compliance letter from the Group Managing Director.

The Company Secretary acted as Secretary for the above Committees, except for the Remuneration Committee, the Ethics, Environment and Sustainable Development Committee and the Audit Committee when it meets as joint committee. Appropriate notice was given for each meeting and minutes of each meeting were prepared and reported to the Board of Directors of the Company.

**Internal Controls and Risk Management**

The Board of Directors has overall responsibility for the Group's system of internal control. There are inherent limitations in any system of internal control and even the most effective system can only provide a reasonable, and not absolute, assurance against material misstatement or loss. The directors have reviewed the effectiveness of the Group's system of internal control, the major elements of which are detailed below:

*Organisational Structure*

Local boards of directors in the Group's trading subsidiaries, the 'subsidiary boards', are responsible for the operational and financial control of their own businesses. Subsidiary boards report to the Group Managing Director or the Standing Committee (as required) and to the Company's Board of Directors on matters including major strategic, financial, organisational, compliance and regulatory issues.

Following the publication of the Turnbull Report, the subsidiary boards perform a full annual business risk analysis using a risk methodology developed by one of the Company's subsidiaries, Entec UK Limited. This methodology includes consideration of all risks, including operational, external, financial, environmental and reputation risks. The results of the risk reviews are reported to the Audit Committee and a summary is reported to the Company's directors. A review of the risk methodology during the year resulted in the creation of guidelines on the identification and rating of risk, ensuring that social and ethical risks are also embraced by the methodology. Some subsidiaries consider risks on a more frequent basis, such as in NWL, where its management team considers significant risks on a bi-monthly basis.

On a monthly basis, the Group Managing Director and the Group Finance Director compare the actual operational and financial performance of each business with plan and budget. Targets are set to measure performance and regular forecasts are made.

*Information and Reporting System*

Each subsidiary board held a copy of the Group's financial control manual and Company management guidelines, which contained full details about the procedures for distribution of information and financial reporting.

*Budgets and Business Planning*

The Group prepares detailed medium term business plans and annual budgets which are reviewed by the Group Managing Director and Group Finance Director and submitted to the Company's Board for approval. Business plans and budgets include an assessment of the key risks and success factors facing each business unit.

A framework exists which requires the approval of the Board of Directors of the Company for major investments, including those in new and foreign market places, and large capital expenditure programmes. 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 Group's investment strategy aims to fix interest rates for part of the Group's borrowings and investments for periods determined by the forecast cash flow of the individual businesses, thus effectively managing the exposure to the risk of changes in short term interest rates. Foreign currency exposure is also managed as part of the treasury strategy approved by the Board of Directors of the Company.

**Directors' Responsibilities in Respect of the Preparation of the Financial Statements**

Company law requires the directors to prepare financial statements which give a true and fair view of the state of the Group's affairs as at the end of each accounting period and of the profit and loss for the accounting period.

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

- select appropriate accounting policies and apply them consistently;
- state whether applicable United Kingdom law and accounting standards have been followed subject to any material departures disclosed and explained in the financial statements;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on a going concern basis unless they consider it to be inappropriate.

The directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Group and that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**Financial Statements Preparation and Going Concern**

The directors consider that it is appropriate to prepare the financial statements for the financial year on a going concern basis. The directors have arrived at their decision based on consideration of the Group's detailed budget for 2003 and the business plan for the period to 2005. Their analysis included a review of the capital expenditure and investment plans, the anticipated funding requirements and facilities available, and the reasonableness of the underlying assumptions of both the budget and business plan.

By Order of the Board

Chris Green

**CHRIS GREEN**
**COMPANY SECRETARY**
**7 MAY 2003**

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ONDEO SERVICES UK plc**

We have audited the group's financial statements for the year ended 31 December 2002 which comprise the Consolidated Profit and Loss Account, Group Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement, Consolidated Statement of Total Recognised Gains and Losses, and the related notes 1 to 32. These financial statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of directors and auditors**
As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

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

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

**Opinion**
In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 December 2002 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
Newcastle upon Tyne
7 May 2003

Ondeo Services UK plc

## CONSOLIDATED PROFIT AND LOSS ACCOUNT
**For the year ended 31 December 2002**

| | Notes | Year to 31.12.2002 £m | Year to 31.12.2001 £m (as restated) |
|---|---|---|---|
| **Turnover: group and share of joint ventures** | | **511.0** | 494.1 |
| Less share of joint ventures' turnover | | **(7.0)** | (4.7) |
| **Group turnover** | 3 | **504.0** | 489.4 |
| Operating costs | 4 | **(338.7)** | (333.5) |
| **Operating profit** | 3 | **165.3** | 155.9 |
| Share of associated undertakings' operating profit | | **0.6** | 3.3 |
| Share of joint ventures' operating profit | | **1.3** | 1.0 |
| Investment income | | **0.2** | - |
| Net interest payable | 5 | **(75.2)** | (79.7) |
| Exceptional profit on disposal of associate | 6 | **-** | 29.4 |
| **Profit on ordinary activities before taxation** | 3 | **92.2** | 109.9 |
| Tax on profit on ordinary activities | 10 | **(0.5)** | (11.2) |
| **Profit on ordinary activities after taxation** | | **91.7** | 98.7 |
| Minority interest | | **0.1** | (0.6) |
| **Profit for the financial year** | | **91.8** | 98.1 |
| Dividends paid and proposed | 11 | **(62.3)** | (59.6) |
| **Retained profit for the financial year** | 26 | **29.5** | 38.5 |

There is no difference between the operating profit and profit for the financial year as stated above and their historical cost equivalents.

## CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
**For the year ended 31 December 2002**

| | Year to 31.12.2002 £m | Year to 31.12.2001 £m (as restated) |
|---|---|---|
| **Profit for the financial year** | | |
| Group | **89.5** | 96.6 |
| Associates | **1.6** | 1.0 |
| Joint ventures | **0.7** | 0.5 |
| Profit for the financial year attributable to the members of the parent company | **91.8** | 98.1 |
| Exchange differences | **0.2** | - |
| Total recognised gains in the financial year | **92.0** | 98.1 |
| Prior year adjustment (see note 2) | **(146.2)** | - |
| **Total gains and losses recognised since the last annual report and financial statements** | **(54.2)** | 98.1 |

Ondeo Services UK plc

**BALANCE SHEETS**
**As at 31 December 2002**

| | Notes | Group 31.12.2002 £m | Group 31.12.2001 £m (as restated) | Company 31.12.2002 £m | Company 31.12.2001 £m (as restated) |
|---|---|---|---|---|---|
| **Fixed assets** | | | | | |
| Tangible assets | 12 | **2,559.4** | 2,435.9 | - | - |
| Investments | 13 | **4.1** | 2.6 | **1,087.9** | 1,090.6 |
| Investments in joint ventures: share of gross assets | 13 | **11.0** | 11.2 | - | - |
| share of gross liabilities | 13 | **(8.0)** | (9.2) | - | - |
| | | **2,566.5** | 2,440.5 | **1,087.9** | 1,090.6 |
| **Current assets** | | | | | |
| Stocks | 15 | **7.5** | 6.4 | - | - |
| Debtors: receivable within one year | 16 | **546.0** | 127.1 | **775.8** | 237.6 |
| Debtors: receivable after more than one year | 16 | **18.1** | 19.8 | - | - |
| Investments | | **0.1** | 0.2 | - | - |
| Cash at bank and short term deposits | 17 | **84.0** | 399.5 | **47.1** | 380.9 |
| | | **655.7** | 553.0 | **822.9** | 618.5 |
| **Creditors: amounts falling due within one year** | 18 | **(259.7)** | (382.5) | **(92.5)** | (214.4) |
| **Net current assets** | | **396.0** | 170.5 | **730.4** | 404.1 |
| **Total assets less current liabilities** | | **2,962.5** | 2,611.0 | **1,818.3** | 1,494.7 |
| **Creditors: amounts falling due after more than one year** | 19 | **(1,602.6)** | (1,292.8) | **(984.9)** | (684.2) |
| **Provisions for liabilities and charges** | 23 | **(177.9)** | (173.9) | - | - |
| **Accruals and deferred income** | 24 | **(128.2)** | (119.6) | - | - |
| | | **(1,908.7)** | (1,586.3) | **(984.9)** | (684.2) |
| **Net assets** | | **1,053.8** | 1,024.7 | **833.4** | 810.5 |
| **Capital and reserves** | | | | | |
| Called up share capital | 25 | **466.2** | 466.2 | **466.2** | 466.2 |
| Share premium account | 26 | **217.9** | 217.9 | **217.9** | 217.9 |
| Group reconstruction relief reserve | 26 | **107.6** | 107.6 | - | - |
| Profit and loss account | 26 | **259.4** | 229.7 | **149.3** | 126.4 |
| **Equity shareholders' funds** | 27 | **1,051.1** | 1,021.4 | **833.4** | 810.5 |
| Minority equity interest | | **2.7** | 3.3 | - | - |
| **Total capital and reserves** | | **1,053.8** | 1,024.7 | **833.4** | 810.5 |

Approved by the Board of Directors on 7 May 2003 and signed on its behalf by:

F. G. T. Holliday

Professor Sir Frederick Holliday, *Chairman*

John Cuthbert, *Group Managing Director*

Ondeo Services UK plc

## CONSOLIDATED CASH FLOW STATEMENT
**For the year ended 31 December 2002**

| | Notes | Year to 31.12.2002 £m | Year to 31.12.2001 £m |
|---|---|---|---|
| **Net cash inflow from operating activities** | a | **235.8** | 243.6 |
| **Returns on investments and servicing of finance** | | | |
| Interest received | | **13.7** | 4.8 |
| Interest paid | | **(91.7)** | (69.8) |
| Interest paid on hire purchase contracts and finance leases | | **(1.6)** | (2.8) |
| Dividends received from other fixed asset investments | | **0.4** | 0.3 |
| **Net cash outflow from returns on investments and servicing of finance** | | **(79.2)** | (67.5) |
| **Taxation** | | | |
| Taxation paid on ordinary activities | | **(4.4)** | (3.1) |
| **Net cash outflow from taxation** | | **(4.4)** | (3.1) |
| **Capital expenditure and financial investments** | | | |
| Purchase of tangible fixed assets | | **(206.5)** | (206.4) |
| Proceeds on disposal of tangible fixed assets | | **1.2** | 1.1 |
| Capital grants received | | **11.6** | 7.3 |
| **Net cash outflow from capital expenditure and financial investments** | | **(193.7)** | (198.0) |
| **Acquisitions and disposals** | | | |
| Proceeds on disposal of associate | | **0.5** | 132.3 |
| Proceeds on disposal of subsidiary undertaking (see note 14) | | **(0.1)** | - |
| Purchase of minority interests in subsidiary undertakings | | **(0.2)** | - |
| **Net cash inflow from acquisitions and disposals** | | **0.2** | 132.3 |
| **Equity dividends paid** | | **(60.9)** | (58.3) |
| **Cash (outflow)/inflow before management of liquid resources** | | **(102.2)** | 49.0 |
| **Management of liquid resources** | | | |
| Purchase of short term deposits | | **(1,342.7)** | (1,610.0) |
| Disposal of short term deposits | | **1,531.8** | 1,444.1 |
| **Net cash inflow/(outflow) from management of liquid resources** | | **189.1** | (165.9) |
| **Financing** | | | |
| New long term borrowings received | b | **326.4** | 458.0 |
| Borrowings repaid | b | **(135.0)** | (164.6) |
| Movement of loans to associates and parent company | b | **(401.3)** | (12.4) |
| Payment of principal under hire purchase contracts and finance leases | b | **(3.2)** | (3.8) |
| **Net cash (outflow)/inflow from financing** | | **(213.1)** | 277.2 |
| **(Decrease)/increase in cash in the year** | | **(126.2)** | 160.3 |
| | | | |
| **Reconciliation of net borrowings** | | | |
| (Decrease)/increase in cash in the year | | **(126.2)** | 160.3 |
| Cash outflow/(inflow) from increase in net borrowings | | **213.1** | (277.2) |
| Cash (inflow)/outflow from management of liquid resources | | **(189.1)** | 165.9 |
| (Increase)/decrease in net borrowings resulting from cash flows | b | **(102.2)** | 49.0 |
| Inception of new finance lease contracts | b | **(5.4)** | (3.2) |
| (Increase)/decrease in net borrowings in the year | | **(107.6)** | 45.8 |
| Net borrowings at start of the year | | **(1,008.6)** | (1,054.4) |
| **Net borrowings at end of the year** | b | **(1,116.2)** | (1,008.6) |

Net borrowings is the sum of all borrowings net of cash and short term deposits.

Ondeo Services UK plc

## NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT
**For the year ended 31 December 2002**

### (a) Net cash inflow from operating activities

| | Notes | Year to 31.12.2002 £m | Year to 31.12.2001 £m |
|---|---|---|---|
| Operating profit | 3 | **165.3** | 155.9 |
| Depreciation of tangible fixed assets | 4/12 | **85.6** | 81.2 |
| Profit on disposal of tangible fixed assets | 4 | **(1.0)** | (0.6) |
| Profit on disposal of subsidiary | | **(0.4)** | - |
| Other non cash movements | | **0.1** | - |
| Amortisation of capital grants | 24 | **(3.0)** | (3.6) |
| Movement in other provisions | | **(6.2)** | 3.0 |
| (Increase)/decrease in stocks | | **(1.2)** | 0.3 |
| (Increase)/decrease in debtors | | **(13.7)** | 9.4 |
| Increase/(decrease) in creditors | | **10.3** | (2.0) |
| **Net cash inflow from operating activities** | | **235.8** | 243.6 |

### (b) Analysis of net borrowings

| | As at 1.1.2002 £m | Cash flow £m | Other non cash changes £m | As at 31.12.2002 £m |
|---|---|---|---|---|
| Cash at bank | 188.8 | (126.4) | - | **62.4** |
| Bank overdrafts | (21.5) | 0.2 | - | **(21.3)** |
| | 167.3 | (126.2) | - | **41.1** |
| Movement of loans to associates and parent company | 25.7 | 401.3 | 4.0 | **431.0** |
| Borrowings due after one year | (1,224.7) | (326.4) | 18.8 | **(1,532.3)** |
| Borrowings due within one year | (130.7) | 135.0 | (22.8) | **(18.5)** |
| Finance leases | (56.9) | 3.2 | (5.4) | **(59.1)** |
| | (1,219.3) | 86.9 | (5.4) | **(1,137.8)** |
| Short term deposits | 210.7 | (189.1) | - | **21.6** |
| **Net borrowings** | (1,008.6) | (102.2) | (5.4) | **(1,116.2)** |

### (c) Analysis of cash balances

| | As at 1.1.2002 £m | In respect of disposal of subsidiary £m | Trading for the year £m | As at 31.12.2002 £m |
|---|---|---|---|---|
| Cash at bank and short term deposits | 399.5 | (0.1) | (315.4) | **84.0** |
| Less short term deposits with maturity dates greater than one day | (210.7) | - | 189.1 | **(21.6)** |
| | 188.8 | (0.1) | (126.3) | **62.4** |
| Bank overdrafts | (21.5) | - | 0.2 | **(21.3)** |
| | **167.3** | **(0.1)** | **(126.1)** | **41.1** |

The cash position in respect of the disposal of subsidiary, £0.1m, represents a net of £0.3m cash consideration and cash at bank and in hand disposed £0.4m.

NOTES TO THE FINANCIAL STATEMENTS

**1 Accounting Policies**

The financial statements have been prepared in accordance with applicable United Kingdom law and accounting standards. A summary of the more important Group accounting policies is set out below. These have been applied consistently throughout the current and preceding years, with the exception of FRS19 which is described below:

**(a) Basis of accounting.** The financial statements have been prepared under the historical cost convention. As stated in the Directors' Report on page 15, the financial statements have been prepared on the going concern basis.

**(b) Basis of consolidation.** The consolidated financial statements include the Company and its subsidiary undertakings. The results of subsidiaries acquired during the year are included from the date of their acquisition. The results of subsidiaries disposed of during the year are included to the date of their disposal. Intra-group 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. The following subsidiaries' financial statements are made up to 31 March: Lyonnaise des Eaux (Gibraltar) Limited, Caledonian Environmental Levenmouth Treatment Services Limited, Caledonian Environmental Services Holdings Limited, Caledonian Environmental Services plc, Ayr Environmental Services Operations Limited.

**(c) Associated undertakings and joint ventures.** The Group's share of profits less losses of associated undertakings and joint ventures is included in the consolidated profit and loss account and the Group's share of their net assets/liabilities is included in the consolidated balance sheet. Goodwill arising on the acquisition of associates and joint ventures is accounted for in accordance with the accounting policy set out below.

**(d) Goodwill.** Goodwill arising on the acquisition of subsidiary undertakings, businesses, associates and joint ventures, representing the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life. Provision is made for any impairment. Goodwill arising on acquisitions in the period ended 22 December 1998 and prior was written off to reserves in accordance with the accounting standard then in force. As permitted by the current accounting standard, the goodwill previously written off to reserves has not been re-instated in the balance sheet.

**(e) Turnover.** Turnover, which excludes value added tax, represents the income receivable in the ordinary course of business for goods and services provided.

**(f) Tangible fixed assets and depreciation.** Tangible fixed assets, 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):

*i) Infrastructure assets.* Infrastructure assets comprise a network of physical overground and underground systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements to the network and on maintaining the operating capability of the network, in accordance with defined standards of service, is treated as additions which are included at cost. Costs include internal and external costs to bring the asset into use. The depreciation charge for infrastructure assets is the estimated average amount of expenditure required to maintain the operating capability of the network, which is based on independently certified asset management plans, adjusted to reflect differences between estimated and actual expenditure over each five year regulatory period.

*ii) Other assets.* Other assets are included at cost less accumulated depreciation and any provision for impairment. 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; short leasehold land and buildings, 25 years or lease term if shorter; operational structures, plant and machinery, 4-80 years; fixtures, fittings, tools and equipment, 4-10 years.

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

**(g) Grants and contributions.** Revenue grants are credited to the profit and loss account when received. Capital grants and contributions relating to tangible fixed assets are treated as deferred income and amortised in the profit and loss account over the expected useful economic lives of the qualifying assets. Specifically, in the case of infrastructure assets, the expected useful economic lives have been determined by reference to the physical replacement cycle of those assets.

**(h) Fixed asset investments.** Fixed asset investments are stated at their purchase cost, less any provision for impairment.

**(i) Hire purchase and leasing.** Where assets are financed by hire purchase or 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 and the corresponding capital cost is treated as a liability. Rentals or leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the outstanding liability and the finance costs being written off to the profit and loss account over the period of the hire purchase contract or lease in proportion to the reducing outstanding liability. Rental costs arising under operating leases are expensed in the period they are incurred.

**(j) Stocks.** Stores are stated at cost less any provisions necessary to recognise damage and obsolescence. Work in progress and finished goods are valued at the lower of cost and net realisable value. Cost includes labour, materials, transport and an element of overheads.

**(k) Pension costs.** The cost of providing pension benefits is charged to the profit and loss account so as to spread the cost over the expected average service lives of employees. Differences between the amounts funded and amounts charged to the profit and loss account are treated as prepayments or provisions in the balance sheet. Pension surpluses/deficits arising on acquisition are recognised as an asset/liability on the balance sheet, in accordance with FRS7.

**(l) Taxation.** The charge for current UK corporation tax is based on the profit for the year as adjusted for taxation purposes using the rates of tax in force at the balance sheet date.

Financial Reporting Standard No. 19, "Deferred taxation" ("FRS19"), has been adopted in the period. In previous periods deferred tax was dealt with under Statement of Standard Accounting Practice 15 and, by adopting a partial provision approach, no provision was made in the financial statements. Under FRS19, full provision for deferred tax is required for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation.

As permitted by FRS19, the Group has decided to adopt a policy of discounting deferred tax assets and liabilities 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. The discount rates used reflect the post-tax yields to maturity that can be obtained at the balance sheet date on government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

As a consequence of the change in accounting policy, the net assets at 31 December 2001 have been reduced by £145.9m and the profit for 31 December 2001 has been reduced by £7.6m, as described in note 2. Profit for the current year has been reduced by £10.7m as a result of the change.

**(m) Research and development.** Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.

**(n) Foreign currencies.** Assets and liabilities of subsidiaries 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 and associates companies, and from the translation of the results of those companies at average rate, are taken to reserves. All other foreign exchange differences are taken to the profit and loss account in the period in which they arise.

**(o) 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. Amounts payable or receivable in respect of these derivatives are recognised over the period of the contracts as adjustments to net interest payable in the profit and loss account. Forward exchange contracts are valued at the period end rates of exchange. Resultant gains and losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs.

**(p) Capitalisation of interest.** Caledonian Environmental Services plc, a subsidiary company, capitalises finance costs. The Group's policy is not to capitalise such costs and, accordingly, the impact of this policy is reversed on consolidation.

## 2 Prior Year Adjustment

As set out in note 1(l) above, the Group has changed its accounting policy for deferred tax by adopting FRS19. As a result, the comparatives have been restated as follows:

### a Group profit and loss account

| | Taxation £m | Profit for the financial year £m |
|---|---|---|
| Year ended 31 December 2001 as previously reported | (3.6) | 105.7 |
| Prior year adjustment | (7.6) | (7.6) |
| Year ended 31 December 2001 as restated | (11.2) | 98.1 |

### b Group balance sheet

| | Provisions for liabilities and charges £m | Profit and loss account £m | Minority equity interest £m |
|---|---|---|---|
| Year ended 31 December 2001 as previously reported | 6.0 | 375.9 | 3.0 |
| Prior year adjustment | 145.9 | (146.2) | 0.3 |
| Year ended 31 December 2001 as restated | 151.9 | 229.7 | 3.3 |

The brought forward reserves for 2001 have been restated by £138.6m (see note 27).

### c Company balance sheet

| | Debtors: Amounts receivable within one year: Deferred tax £m | Profit and loss reserve £m |
|---|---|---|
| Year ended 31 December 2001 as previously reported | - | 125.5 |
| Prior year adjustment | 0.9 | 0.9 |
| Year ended 31 December 2001 as restated | 0.9 | 126.4 |

The brought forward reserves for 2001 have been restated by £1.6m (see note 27).

## 3 Segmental Analysis

### (a) Analysis by class of business and by geographical origin

| | UK Water 31.12.2002 £m | UK Water 31.12.2001 £m | International Water 31.12.2002 £m | International Water 31.12.2001 £m | Related Services 31.12.2002 £m | Related Services 31.12.2001 £m | Total Year to 31.12.2002 £m | Total Year to 31.12.2001 £m |
|---|---|---|---|---|---|---|---|---|
| **Turnover:** | | | | | | | | |
| UK | **439.2** | 436.1 | **5.8** | 0.3 | **73.8** | 70.2 | **518.8** | 506.6 |
| Rest of Europe, Middle East and Far East | - | - | **7.9** | 7.4 | **5.7** | 6.0 | **13.6** | 13.4 |
| Rest of World | - | - | **1.2** | - | **2.6** | 2.3 | **3.8** | 2.3 |
| Total turnover | **439.2** | 436.1 | **14.9** | 7.7 | **82.1** | 78.5 | **536.2** | 522.3 |
| Inter segment | - | (0.8) | **(0.6)** | - | **(31.6)** | (32.1) | **(32.2)** | (32.9) |
| **External turnover** | **439.2** | 435.3 | **14.3** | 7.7 | **50.5** | 46.4 | **504.0** | 489.4 |
| **Operating profit:** | | | | | | | | |
| UK | **162.2** | 160.5 | **1.8** | (2.6) | **(1.2)** | 0.2 | **162.8** | 158.1 |
| Rest of Europe, Middle East and Far East | - | - | **0.9** | 0.8 | **0.4** | 0.6 | **1.3** | 1.4 |
| Rest of World | - | - | **(1.3)** | (0.3) | **0.2** | 0.2 | **(1.1)** | (0.1) |
| | **162.2** | 160.5 | **1.4** | (2.1) | **(0.6)** | 1.0 | **163.0** | 159.4 |
| Central unallocated costs and provisions | | | | | | | **2.3** | (3.5) |
| **Group operating profit** | | | | | | | **165.3** | 155.9 |
| Share of associates' operating profit | | | | | | | **0.6** | 3.3 |
| Share of joint ventures' operating profit | | | | | | | **1.3** | 1.0 |
| Investment income | | | | | | | **0.2** | - |
| Exceptional profit on disposal of associate (see note 6) | | | | | | | - | 29.4 |
| Net interest payable | | | | | | | **(75.2)** | (79.7) |
| **Profit on ordinary activities before taxation** | | | | | | | **92.2** | 109.9 |

The Central unallocated costs and provisions include those costs that relate to the performance of the Holding Company's functions.

### (b) Analysis of external turnover by geographical destination

| | Year to 31.12.2002 £m | Year to 31.12.2001 £m |
|---|---|---|
| UK | **482.2** | 467.9 |
| Rest of Europe, Middle East and Far East | **19.5** | 19.8 |
| Rest of World | **2.3** | 1.7 |
| **External turnover** | **504.0** | 489.4 |

### (c) Net assets

| | UK Water 31.12.2002 £m | UK Water 31.12.2001 £m as restated | International Water 31.12.2002 £m | International Water 31.12.2001 £m as restated | Related Services 31.12.2002 £m | Related Services 31.12.2001 £m as restated | Total 31.12.2002 £m | Total 31.12.2001 £m as restated |
|---|---|---|---|---|---|---|---|---|
| Subsidiary undertakings | **2,142.9** | 2,030.6 | **55.2** | 55.5 | **(13.9)** | (28.1) | **2,184.2** | 2,058.0 |
| Share of associated undertakings' net assets | - | - | - | - | **6.1** | 4.0 | **6.1** | 4.0 |
| Net operating assets | | | | | | | **2,190.3** | 2,062.0 |
| Unallocated net liabilities | | | | | | | **(1,136.5)** | (1,037.3) |
| **Net assets** | | | | | | | **1,053.8** | 1,024.7 |

Net operating assets comprise tangible fixed assets, stocks, debtors and creditors which relate to segmental operating activities. Unallocated net liabilities comprise other fixed asset investments, current investments, cash and short term deposits, borrowings, current taxation balances, dividends and other common assets and liabilities.

The net assets of the Group are almost entirely situated in the United Kingdom.

## 4 Operating Costs

| Operating profit is stated after charging/(crediting): | **Year to 31.12.2002 £m** | Year to 31.12.2001 £m |
|---|---|---|
| Materials and consumables | **27.8** | 27.6 |
| Manpower costs (see note 9) | **109.8** | 101.3 |
| Own work capitalised | **(28.9)** | (26.2) |
| Depreciation of tangible fixed assets: (see note 12) | | |
| owned | **81.1** | 77.2 |
| under hire purchase contracts and finance leases | **4.5** | 4.0 |
| Amortisation of capital grants (see note 24) | **(3.0)** | (3.6) |
| Other operating charges | **141.2** | 146.3 |
| Profit on disposal of tangible fixed assets | **(1.0)** | (0.6) |
| Operating leases: | | |
| plant and machinery | **0.2** | 0.6 |
| other | **1.2** | 1.3 |
| Costs of research and development | **5.5** | 5.3 |
| Auditors' remuneration: | | |
| audit | **0.2** | 0.2 |
| non-audit services | **0.1** | 0.1 |
| **Total operating costs** | **338.7** | 333.5 |

Own work capitalised includes both employment and other costs charged to capital schemes.

## 5 Net Interest Payable

| | **Year to 31.12.2002 £m** | Year to 31.12.2001 £m |
|---|---|---|
| Interest payable on debentures, bank and other loans and overdrafts | **91.7** | 83.2 |
| Amortisation of discount, fees and loan issue costs | **(0.3)** | 0.3 |
| Amounts receivable on derivative contracts | **(3.1)** | (1.2) |
| Interest payable on hire purchase contracts and finance leases | **2.8** | 2.8 |
| Group interest payable | **91.1** | 85.1 |
| Share of associates' interest payable | **0.8** | 0.7 |
| Share of joint ventures' interest payable | **0.3** | 0.3 |
| Total interest payable | **92.2** | 86.1 |
| Interest receivable | **(17.0)** | (6.4) |
| **Net interest payable** | **75.2** | 79.7 |
| Disclosed as: | | |
| Net interest payable: Group | **74.1** | 78.7 |
| associates | **0.8** | 0.7 |
| joint ventures | **0.3** | 0.3 |
| | **75.2** | 79.7 |

## 6 Exceptional Profit on Disposal of Associate

The Company disposed of its 35% holding in SITA Holdings UK Limited on 29 June 2001 and the profit before tax of £29.4m in the prior year financial statements was stated after charging £116.4m of goodwill previously written off to reserves.

| | **Year to 31.12.2002 £m** | Year to 31.12.2001 £m |
|---|---|---|
| Sale proceeds | - | 132.3 |
| Goodwill previously written off to the group reconstruction relief reserve | - | (107.6) |
| Goodwill previously written off to the profit and loss reserve | - | (8.8) |
| Investment in associate | - | 13.5 |
| Exceptional profit before tax | - | 29.4 |
| Tax arising on disposal | - | (9.0) |
| Exceptional profit after tax | - | 20.4 |

### 7 Directors' Remuneration and Interests

#### (a) Directors' remuneration

The remuneration of the directors of the Company was:

| | Fixed remuneration | Performance related bonus | Benefits in kind | Pension contributions | Total Year to 31.12.2002 | Year to 31.12.2001 |
|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | **£000** | £000 |
| **Serving Directors** | | | | | | |
| Professor Sir Frederick Holliday | 85 | - | 21 | - | **106** | 111 |
| Richard Allan (appointed 24 April 2002) | 27 | - | - | - | **27** | - |
| Kam-Ling Chan (resigned 7 January 2002) | - | - | - | - | - | 21 |
| Peter Cheng (resigned 7 January 2002) | - | - | - | - | - | 21 |
| Donald Correll (resigned 17 January 2001) | - | - | - | - | - | 1 |
| John Cuthbert* (appointed 1 November 2001) | 175 | 49 | 5 | - | **229** | 38 |
| Anthony Harding (resigned 3 March 2003) | - | - | - | - | - | 153 |
| Antony Haynes (resigned 31 March 2002) | 15 | - | - | - | **15** | 61 |
| Martin Nègre (resigned 20 April 2001) | - | - | - | - | - | 67 |
| **Total remuneration** | **302** | **49** | **26** | - | **377** | 473 |

*Executive Director as at 31 December 2002.

The aggregate remuneration of the highest paid director, excluding pension contributions, was £229,000 (2001: £146,000).

Alain Chaigneau, Jean-François Thierry Chambolle, Bernard Guirkinger, Jacques Francis Petry, Patrick Babin and Patrick Verschelde received no remuneration for the year to 31 December 2002 (2001: nil).

**Executive Director**
The emoluments of the Executive Director, including the annual bonus, are determined by the Remuneration Committee which receives independent external advice. In addition to this market information, account is taken of changes in job size, the individual's assessed experience, competency and performance. The Remuneration Committee will also have regard to budgetary constraints and public perceptions. The Remuneration Committee is comprised solely of Non-Executive Directors.

The bonus scheme for senior executives was approved by the Remuneration Committee. The scheme is based upon the principle of rewarding achievement on agreed objectives relating as far as possible to quantifiable criteria. Performance appraisals are conducted annually and recommendations for bonus payments are made to the Remuneration Committee. The scheme can reward both collective and individual performance and is variable from 0% to a maximum of 40% of base salary. There are no other performance linked incentive schemes for executives. The performance related bonus shown above is for the period from 1 January 2002 to 31 December 2002, which is subject to review by the Remuneration Committee following appraisal of the performance of the respective director.

Benefits in kind include work related accommodation, if appropriate, and provision of company cars, permanent health insurance, healthcare and fuel.

**Service contract**
The service contract for the Executive Director has been set at 30 months, on a rolling basis. The contract does not include actions which would be taken in the event of the Executive or Non-Executive being removed from office. In such circumstances, the Board aims to seek an amicable settlement within the terms of the individual's contract of employment.

The Executive Director does not have paid appointments or directorships outside the Group.

**Non-Executive Directors**
The emoluments of the Non-Executive Directors are determined by reference to independent advice. The Chairman is contracted for an average of two days each week and his level of salary is commensurate with this and the duties and responsibilities he performs. The other Non-Executive Directors are expected to be available to the Company for an average of two days each month, which includes membership of certain Board Committees. All notice periods comply with the recommendation of the Combined Code on Corporate Governance. Each Non-Executive Director is appointed for a twelve month period.

Other than the Chairman, the Non-Executive Directors do not receive benefits from the Company, but expenses are reimbursed for attending meetings. The Chairman is provided with work related accommodation and transport, both of which are available to the Company when not used by the Chairman.

**(b) Directors' interests**

In accordance with the Companies (Disclosure of Directors' Interests) (Exemptions) Regulations1985, the Company is no longer required to be notified of, and to report on, directors' interests in its ultimate parent company. This is due to the Company becoming wholly owned by its ultimate parent company during the financial year to 31 December 2002. The ultimate parent company is incorporated outside Great Britain.

**(c) Directors' pension entitlements**

As explained in note 28, the Group operates a defined benefit final salary scheme, the Northumbrian Lyonnaise Pension Scheme (NLPS).

Alain Chaigneau, Jean-François Thierry Chambolle, Bernard Guirkinger, Jacques Francis Petry, Patrick Babin and Patrick Verschelde participate in pension schemes administered by SUEZ SA and not any of the Group's UK pension schemes.

Two of the directors at 31 December 2002 were members of a defined benefit pension scheme (2001: 3).

## 8 Transactions with Directors and Officers

There are no transactions or arrangements with directors and officers which would require disclosure under the provisions of the Companies Act 1985.

## 9 Employee Information

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

| | **Year to 31.12.2002 £m** | Year to 31.12.2001 £m |
|---|---|---|
| Wages and salaries | **94.0** | 85.7 |
| Social security costs | **7.7** | 7.3 |
| Other pension costs | **8.1** | 8.3 |
| Total employment costs | **109.8** | 101.3 |
| Total employment costs were charged as follows: | | |
| Capital schemes and infrastructure renewals | **27.4** | 24.3 |
| Manpower costs | **82.4** | 77.0 |
| | **109.8** | 101.3 |

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

| | **Year to 31.12.2002 Number** | Year to 31.12.2001 Number |
|---|---|---|
| UK Water | **2,259** | 2,185 |
| International Water | **122** | 113 |
| Related Services | **1,182** | 1,141 |
| | **3,563** | 3,439 |

## 10 Tax on Profit on Ordinary Activities

**(a) Analysis of tax charge for the financial year:**

| | Year to 31.12.2002 £m | Year to 31.12.2001 £m |
|---|---|---|
| Current tax: | | |
| UK corporation tax on profits of the year at 30% (2001: 30%) | **6.2** | 1.0 |
| Adjustment in respect of prior years | **(14.4)** | (7.7) |
| Exceptional taxation on disposal of associate | **-** | 9.0 |
| Share of associates' tax (credit)/charge | **(1.8)** | 1.6 |
| Share of joint ventures' tax charge | **0.3** | 0.2 |
| Total current tax (credit)/charge (note 10b) | **(9.7)** | 4.1 |
| | | |
| Deferred tax: | | |
| Origination and reversal of timing differences in the year | **25.5** | 25.9 |
| Adjustment in respect of prior years | **10.9** | 4.2 |
| | **36.4** | 30.1 |
| Increase in discount | **(25.7)** | (22.5) |
| | **10.7** | 7.6 |
| Pension revaluation surplus | **(0.5)** | (0.5) |
| Total deferred tax (see note 23) | **10.2** | 7.1 |
| | | |
| Tax on profit on ordinary activities | **0.5** | 11.2 |

**(b) Factors affecting the tax (credit)/charge for the financial year:**

| | Year to 31.12.2002 £m | Year to 31.12.2001 £m |
|---|---|---|
| Profit on ordinary activities before taxation | **92.2** | 109.9 |
| | | |
| Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%) (2001: 30%) | **27.7** | 33.0 |
| Effects of: | | |
| Expenses not deductible for tax purposes | **2.2** | 2.1 |
| Depreciation in respect of non-qualifying items | **1.1** | 1.1 |
| Capital allowances in excess of depreciation | **(26.1)** | (25.0) |
| Other timing differences | **0.6** | (0.9) |
| Pension revaluation surplus | **0.5** | 0.5 |
| Disposal of investments in subsidiaries/associates | **(0.1)** | 0.2 |
| Differences in associates'/joint ventures' tax | **(1.2)** | 0.8 |
| Adjustment to tax charge in respect of prior years | **(14.4)** | (7.7) |
| Total current tax (credit)/charge (note 10a) | **(9.7)** | 4.1 |

**(c) Factors that may affect future tax charges:**

The Group expects to continue to incur high levels of capital expenditure and, accordingly, it expects to be able to claim capital allowances in excess of depreciation at a similar level to the current year.

Deferred tax is provided on a discounted basis using post-tax yields on UK government gilts. The charge for deferred tax may therefore be influenced by future fluctuations in gilt rates.

## 11 Dividends

| | Year to 31.12.2002 £m | Year to 31.12.2001 £m |
|---|---|---|
| Interim paid of 6.68 pence (2001: 6.39 pence) per £1 ordinary share | **31.1** | 29.8 |
| Second interim proposed of 6.68 pence (2001: 6.39 pence) per £1 ordinary share | **31.2** | 29.8 |
| | **62.3** | 59.6 |

## 12 Tangible Fixed Assets

**Group:**

| | Freehold land and buildings £m | Short leasehold land and buildings £m | Infra-structure 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 January 2002 | 128.4 | 5.2 | 1,172.1 | 1,321.4 | 156.1 | 171.2 | **2,954.4** |
| Additions | - | - | - | 0.4 | 1.6 | 207.4 | **209.4** |
| Schemes commissioned | 0.6 | - | 95.1 | 150.2 | 6.1 | (252.0) | - |
| Reclassifications | (39.4) | - | 37.6 | 20.3 | (32.5) | 13.5 | **(0.5)** |
| Disposals | (0.4) | - | (16.8) | (0.3) | (4.1) | - | **(21.6)** |
| At 31 December 2002 | 89.2 | 5.2 | 1,288.0 | 1,492.0 | 127.2 | 140.1 | **3,141.7** |
| Depreciation: | | | | | | | |
| At 1 January 2002 | 27.1 | 1.4 | 89.7 | 309.5 | 90.8 | - | **518.5** |
| Charge for the year | 0.9 | 0.1 | 29.0 | 48.1 | 7.5 | - | **85.6** |
| Reclassifications | (1.3) | - | - | 0.5 | 0.3 | - | **(0.5)** |
| Disposals | (0.2) | - | (16.9) | (0.3) | (3.9) | - | **(21.3)** |
| At 31 December 2002 | 26.5 | 1.5 | 101.8 | 357.8 | 94.7 | - | **582.3** |
| **Net book value at 31 December 2002** | 62.7 | 3.7 | 1,186.2 | 1,134.2 | 32.5 | 140.1 | **2,559.4** |
| Net book value at 31 December 2001 | 101.3 | 3.8 | 1,082.4 | 1,011.9 | 65.3 | 171.2 | **2,435.9** |

Operational structures, plant and machinery include an element of land and buildings dedicated to those assets.

The net book value of tangible fixed assets held under hire purchase contracts and finance leases was as follows:

| | **31.12.2002 £m** | 31.12.2001 £m |
|---|---|---|
| Infrastructure assets | **2.2** | 2.2 |
| Operational structures, plant and machinery | **25.4** | 27.9 |
| Fixtures, fittings, tools and equipment | **4.5** | 1.9 |
| | **32.1** | 32.0 |

## 13 Fixed Asset Investments

**(a) Group:**

| | Joint ventures £m | Associated undertakings £m | Other investments £m | **Total £m** |
|---|---|---|---|---|
| At 1 January 2002 | 2.0 | 2.0 | 0.6 | **4.6** |
| Additions | - | - | 0.4 | **0.4** |
| Transfer from other debtors | 0.5 | - | - | **0.5** |
| Disposals | - | (0.5) | - | **(0.5)** |
| Share of profits | 0.7 | 1.6 | - | **2.3** |
| Dividends received | (0.2) | - | - | **(0.2)** |
| **At 31 December 2002** | 3.0 | 3.1 | 1.0 | **7.1** |

All fixed asset investments are unlisted.

### (b) Company:

| | Associated undertakings and joint ventures £m | Interests in subsidiaries £m | Other investments £m | Total £m |
|---|---|---|---|---|
| At 1 January 2002 | 2.5 | 1087.5 | 0.6 | **1,090.6** |
| Additions | - | 0.1 | 0.4 | **0.5** |
| Disposals | (0.5) | (2.5) | - | **(3.2)** |
| Dividends | (0.2) | - | - | **(0.2)** |
| **At 31 December 2002** | 1.8 | 1,085.1 | 1.0 | **1,087.9** |

### (c) The Group's interests in principal trading associates at 31 December 2002 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 and Company % | Business activity |
|---|---|---|---|---|
| Water and Sanitation Services South Africa (PTY) Limited | South Africa | Ordinary shares of 1 Rand | 50 | Water and sewerage services |
| Ayr Environmental Services Limited | Scotland | Ordinary shares of £1 | 50 | Water and sewerage services |

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

### (e) The Group's interests in principal subsidiaries at 31 December 2002 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 and Company % | Business activity |
|---|---|---|---|---|
| Northumbrian Water Limited | England and Wales | Ordinary shares of £1 | 100 | Water and sewerage services |
| Lyonnaise des Eaux (Gibraltar) Limited | Gibraltar | Ordinary shares of £1 | 67 | Water and sewerage services |
| Entec UK Limited | England and Wales | Ordinary shares of £1 | 100 | Environmental and engineering consultancy |
| Northumbrian Lyonnaise Technology & Research Centre Limited | England and Wales | Ordinary shares of £1 | 100 | Research and development |
| Analytical & Environmental Services Limited | England and Wales | Ordinary shares of £1 | 100 | Analytical, laboratory and scientific services |
| Fastflow Pipeline Services Limited | England and Wales | Ordinary shares of £1 | 100 | Infrastructure replacement and rehabilitation |
| Caledonian Environmental Services Limited | Scotland | Ordinary shares of £1 | 75 | Water and sewerage services |
| Northumbrian Water Finance plc | England and Wales | Ordinary shares of £1 | 100 | Holding of finance instruments |

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.

## 14 Disposal of subsidiary

On 23 December 2002, the Group sold its investment in Imass Limited. The book and fair values of the related assets and liabilities disposed of were as follows:

| | Sale of investment £m |
|---|---|
| Fixed assets | 0.1 |
| Stocks | 0.1 |
| Debtors | 1.3 |
| Cash at bank and in hand | 0.4 |
| Creditors due in less than one year | (1.6) |
| Net assets disposed of | 0.3 |
| Profit on disposal | 0.4 |
| | 0.7 |
| Satisfied by: | |
| Cash | 0.3 |
| Preference shares | 0.4 |
| | 0.7 |

**Net cash flow in respect of the disposal comprised:**

| | |
|---|---|
| Cash consideration | 0.3 |
| Cash at bank and in hand disposed | (0.4) |
| Net cash outflow | (0.1) |

## 15 Stocks

| | Group | |
|---|---|---|
| | **31.12.2002 £m** | 31.12.2001 £m |
| Stores | **3.2** | 3.1 |
| Work in progress | **4.3** | 3.3 |
| | **7.5** | 6.4 |

## 16 Debtors

| | Group | | Company | |
|---|---|---|---|---|
| | **31.12.2002 £m** | 31.12.2001 £m | **31.12.2002 £m** | 31.12.2001 £m (as restated) |
| Amounts receivable within one year: | | | | |
| Trade debtors | **64.5** | 59.6 | **0.1** | 0.1 |
| Amounts owed by subsidiary undertakings | **-** | - | **462.6** | 206.5 |
| Amounts owed by parent company and fellow subsidiaries | **432.0** | 30.7 | **311.0** | 25.7 |
| Other debtors | **8.7** | 9.2 | **1.3** | 2.1 |
| Deferred tax | **-** | - | **0.7** | 0.9 |
| Prepayments and accrued income | **40.8** | 27.6 | **0.1** | 2.3 |
| | **546.0** | 127.1 | **775.8** | 237.6 |
| Amounts receivable after more than one year: | | | | |
| Pension surplus on acquisition | **18.1** | 19.8 | **-** | - |

Trade debtors are shown net of bills paid in advance. In the Company, the debtor for amounts owed by subsidiary undertakings includes £3.8m (2001: £1.1m) in respect of amounts receivable for the provisional surrender of tax losses by the Company.

The deferred tax asset in the Company relates wholly to other timing differences.

## 17 Cash at Bank and Short Term Deposits

| | Group | | Company | |
|---|---|---|---|---|
| | **31.12.2002** | 31.12.2001 | **31.12.2002** | 31.12.2001 |
| | **£m** | £m | **£m** | £m |
| Short term cash deposits | **21.6** | 210.7 | **9.4** | 203.3 |
| Cash at bank | **62.4** | 188.8 | **37.7** | 177.6 |
| | **84.0** | 399.5 | **47.1** | 380.9 |

## 18 Creditors: Amounts falling due within one year

| | Group | | Company | |
|---|---|---|---|---|
| | **31.12.2002** | 31.12.2001 | **31.12.2002** | 31.12.2001 |
| | **£m** | £m | **£m** | £m |
| Bank loans and overdrafts (see note 20) | **39.7** | 44.1 | **16.6** | 15.9 |
| Eurobond – due 1 February 2002 bearing interest rate of 9.25% (see note 20) | **-** | 100.0 | **-** | 100.0 |
| Debentures (see note 20) | **-** | 8.0 | **-** | - |
| Obligations under hire purchase contracts and finance leases (see note 21) | **3.2** | 3.7 | **-** | - |
| Trade creditors | **8.8** | 10.1 | **0.4** | - |
| Amounts owed to subsidiary undertakings | **-** | - | **0.7** | 2.9 |
| Amounts owed to parent company and fellow subsidiaries | **3.6** | 5.6 | **-** | 14.8 |
| Other creditors | **19.0** | 24.7 | **1.3** | 1.5 |
| Taxation and social security | **8.1** | 22.0 | **8.9** | 1.0 |
| Dividends payable: | | | | |
| non-equity shareholders | **0.5** | 0.2 | **-** | - |
| equity shareholders | **31.1** | 29.8 | **31.1** | 29.8 |
| Accruals and deferred income | **145.7** | 134.3 | **33.5** | 48.5 |
| | **259.7** | 382.5 | **92.5** | 214.4 |

The creditor for taxation and social security in the Group includes corporation tax amounting to £3.3m (2001: £18.7m).

Amounts owed to parent company and fellow subsidiaries in the Group includes amounts payable for the provisional surrender of tax losses amounting to £3.2m (2001: £0.5m).

Taxation and social security in the Company includes corporation tax amounting to £9.0m (2001: £0.9m).

## 19 Creditors: Amounts falling due after more than one year

| | Group | | Company | |
|---|---|---|---|---|
| | **31.12.2002** | 31.12.2001 | **31.12.2002** | 31.12.2001 |
| | **£m** | £m | **£m** | £m |
| Loans (see note 20) | **357.1** | 295.5 | **-** | - |
| Debentures (see note 20) | **14.3** | 14.3 | **-** | - |
| Eurobond – due 28 June 2006 bearing interest rate of 8.625% | **200.0** | 200.0 | **200.0** | 200.0 |
| Eurobond – due 11 October 2017 bearing interest rate of 6.0% | **300.8** | 301.0 | **-** | - |
| Eurobond – due 6 February 2023 bearing interest rate of 6.875% | **351.7** | 351.7 | **351.7** | 351.7 |
| Eurobond – due 29 April 2033 bearing interest rate of 5.625% | **246.5** | - | **-** | - |
| Eurobond – due 31 March 2037 bearing interest rate of 6.627% | **58.1** | 61.7 | **-** | - |
| Amounts owed to parent company and fellow subsidiaries (see note 20) | **3.8** | 0.5 | **433.2** | 132.5 |
| Obligations under hire purchase contracts and finance leases (see note 21) | **55.9** | 53.2 | **-** | - |
| Other creditors | **14.4** | 14.9 | **-** | - |
| | **1,602.6** | 1,292.8 | **984.9** | 684.2 |

At 31 December 2002, the Group had the following interest swap arrangements: £15.0m over a ten year period commencing on 10 May 1994 under which the Group is required to pay interest at a rate linked to LIBOR and will receive interest at 9.00%; £10.0m over a seven year period commencing on 16 December 1996 under which the Group is required to pay interest at a rate linked to LIBOR and will receive interest at 7.45%; £10.0m over a three year period commencing 31 January 2000 under which the Group is required to pay interest at a rate linked to LIBOR and will receive interest at 7.165%; and £25.0m over a three year period commencing on 7 December 2000 under which the Group is required to pay interest at 5.61% and will receive interest at a rate linked to LIBOR.

## 20 Loans

| | Group 31.12.2002 £m | Group 31.12.2001 £m | Company 31.12.2002 £m | Company 31.12.2001 £m |
|---|---|---|---|---|
| Loans are repayable as follows: | | | | |
| Less than one year | **18.5** | 130.7 | **-** | 114.8 |
| Between one and two years | **53.1** | 23.1 | **-** | - |
| Between two and five years | **259.1** | 305.6 | **451.9** | 332.5 |
| In more than five years | **1,220.1** | 896.0 | **533.0** | 351.7 |
| | **1,550.8** | 1,355.4 | **984.9** | 799.0 |
| Disclosed as due: | | | | |
| Within one year: | | | | |
| Bank loans and overdrafts | **39.7** | 44.1 | **16.6** | 15.9 |
| Eurobonds | **-** | 100.0 | **-** | 100.0 |
| Debentures | **-** | 8.0 | **-** | - |
| Amounts owed to parent company and fellow subsidiaries | **0.1** | 0.1 | **-** | 14.8 |
| Less: Bank overdrafts | **(21.3)** | (21.5) | **(16.6)** | (15.9) |
| After one year: | | | | |
| Loans | **357.1** | 295.5 | **-** | - |
| Eurobonds | **1,157.1** | 914.4 | **551.7** | 551.7 |
| Debentures | **14.3** | 14.3 | **-** | - |
| Amounts owed to parent company and fellow subsidiaries | **3.8** | 0.5 | **433.2** | 132.5 |
| | **1,550.8** | 1,355.4 | **984.9** | 799.0 |

Loans to the Group from third parties, any part of which falls due for repayment in five years or more and which are repayable by instalments, amount to £259.9m (2001: £181.4m) and bear rates of interest in the range of 4.94% to 8.55% (2001: 7.16% to 8.55%). None (2001: £0.6m) of these loans bear interest rates linked to LIBOR.

Loans to the Group from third parties repayable otherwise than by instalments which fall due for repayment after more than five years amount to £1,029.8m (2001: £996.7m) and bear rates of interest in the range of 3.5% to 11.75% (2001: 3.5% to 11.75%). Of these loans, £120.5m (2001: £75.0m) bears interest rates linked to LIBOR.

The aggregate amount of Group loans, any part of which falls due for repayment in five years or more, is £1,289.7m (2001: £1,178.1m).

Loans to the Company from third parties repayable otherwise than by instalments which fall due for repayment after more than five years amount to £351.7m (2001: £351.7m).

Included in the loans are debenture stocks as follows:
(a) £8.7m issued by North East Water plc and secured by a floating charge on the assets of Northumbrian Water Limited;
(b) £5.6m issued by Essex and Suffolk Water plc and secured by a floating charge on the assets of Northumbrian Water Limited.

## 21 Obligations under Hire Purchase Contracts and Finance Leases

| | Group 31.12.2002 £m | Group 31.12.2001 £m |
|---|---|---|
| Amounts due: | | |
| In less than one year | **3.2** | 3.7 |
| Between one and two years | **3.2** | 2.9 |
| Between two and five years | **8.9** | 9.2 |
| In more than five years | **68.9** | 75.4 |
| Gross obligations | **84.2** | 91.2 |
| Less: finance charges allocated to future periods | **(25.1)** | (34.3) |
| | **59.1** | 56.9 |
| Disclosed as due: | | |
| Within one year | **3.2** | 3.7 |
| After more than one year | **55.9** | 53.2 |
| | **59.1** | 56.9 |

The aggregate gross amount of obligations under hire purchase contracts and finance leases, any part of which falls due for repayment in five years or more, is £77.2m (2001: £89.6m).

## 22 Derivatives and Financial Instruments

The Group's policy in respect of derivative financial instruments is disclosed in note 1(o).

### (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.

### (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 occasion, derivatives are used as part of this process, but the Group's policies prohibit their use for speculation.

### (c) Risks arising from 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 £50.0m and with a bank agreement availability period of no less than 3 months.

### (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.

### (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 £3.0m 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 affect on the Group's pre-tax profits.

**(h) Interest rate risk profile of financial assets and financial liabilities**

The interest rates and currency profile of the Group's net borrowings at 31 December 2002 were:

| | Total net borrowings £m | Variable rate net borrowings £m | Fixed rate net borrowings: Borrowings £m | Fixed rate net borrowings: Weighted average interest rate % | Fixed rate net borrowings: Weighted average period until maturity Years |
|---|---|---|---|---|---|
| **Currency** | | | | | |
| Sterling borrowings: | | | | | |
| Amounts owed to parent company and fellow subsidiaries | 3.2 | - | 3.2 | 5.25% | 34.3 |
| Bank loans | 375.5 | 135.4 | 240.1 | 6.55% | 10.6 |
| Eurobonds | 1,157.1 | - | 1,157.1 | 6.64% | 18.7 |
| Debentures | 14.3 | - | 14.3 | 9.84% | 4.5 |
| Finance leases | 59.1 | 52.1 | 7.0 | 7.15% | 5.8 |
| | 1,609.2 | 187.5 | 1,421.7 | 6.66% | 11.9 |
| Amounts owed to parent company: | | | | | |
| Euro borrowings | 0.4 | 0.4 | - | | |
| SA Rand borrowings | 0.3 | 0.3 | | | |
| Cash including overdrafts | (62.8) | (62.8) | - | | |
| Sterling loans receivable | (430.9) | (325.9) | (105.0) | | |
| **Net borrowings at 31 December 2002** | **1,116.2** | **(200.5)** | **1,316.7** | | |

The interest rates and currency profile of the Group's net borrowings at 31 December 2001 were:

| | Total net borrowings £m | Variable rate net borrowings £m | Fixed rate net borrowings: Borrowings £m | Fixed rate net borrowings: Weighted average interest rate % | Fixed rate net borrowings: Weighted average period until maturity Years |
|---|---|---|---|---|---|
| **Currency** | | | | | |
| Sterling borrowings: | | | | | |
| Bank loans | 318.1 | 90.8 | 227.3 | 7.56% | 9.4 |
| Eurobonds | 1,014.4 | - | 1,014.4 | 7.13% | 15.0 |
| Debentures | 22.3 | - | 22.3 | 10.53% | 4.5 |
| Finance leases | 56.9 | 51.0 | 5.9 | 8.64% | 6.0 |
| | 1,411.7 | 141.8 | 1,269.9 | 7.47% | 14.2 |
| Euro borrowings: | | | | | |
| Amount owed to parent company | 0.6 | 0.6 | - | | |
| Cash including overdrafts | (378.0) | (378.0) | - | | |
| Sterling loans receivable | (25.7) | (25.7) | - | | |
| **Net borrowings at 31 December 2001** | **1,008.6** | **(261.3)** | **1,269.9** | | |

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

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

Included within the external sterling borrowings of the Group above are loans amounting to £21.3m (2001: £108.8m) whose rates are fixed for a period of 5 to 7 years from their inception and which, under the terms of the respective loan agreements, can then either be repaid or rolled over for a similar period at a new fixed rate, based upon prevailing market rates at that date. The weighted average period for which the rates on such loans are fixed has been taken as the same average period until maturity.

Included in the debentures above are £2.1m (2001: £2.1m) of irredeemable debentures, which have been excluded from the calculation of the weighted average maturity and fixed periods.

**(i) Currency exposures**

At 31 December 2002, after taking into account the effects of forward foreign exchange contracts, the Group had no currency exposures (2001: nil).

### (j) Borrowing facilities

The Group has various undrawn committed borrowing facilities. The facilities available at 31 December 2002, in respect of which all conditions precedent have been met are as follows:

| | **31.12.2002 £m** | 31.12.2001 £m |
|---|---|---|
| Expiring in one year or less | **100.0** | 50.0 |
| Expiring in more than one year but not more than three years | **-** | 75.0 |
| At 31 December | **100.0** | 125.0 |

### (k) 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 December 2002 is set out below:

| | Book value £m | Fair value £m |
|---|---|---|
| Primary financial instruments held or issued to finance the Group's operations: | | |
| Short term financial liabilities and current portion of long term borrowings | 43.0 | 46.6 |
| Long term borrowings | 1,588.2 | 1,695.3 |
| Financial assets | (496.4) | (496.4) |
| Derivative financial instruments held to manage the interest rate and currency profile: | | |
| Interest rate swaps | - | (1.0) |
| **At 31 December 2002** | **1,134.8** | **1,244.5** |

A comparison by category of book values and fair values of the Group's financial assets and liabilities as at 31 December 2001 is set out below:

| | Book value £m | Fair value £m |
|---|---|---|
| Primary financial instruments held or issued to finance the Group's operations: | | |
| Short term financial liabilities and current portion of long term borrowings | 155.9 | 161.7 |
| Long term borrowings | 1,277.9 | 1,325.7 |
| Financial assets | (425.2) | (425.2) |
| Derivative financial instruments held to manage the interest rate and currency profile: | | |
| Interest rate swaps | - | (2.2) |
| **At 31 December 2001** | **1,008.6** | **1,060.0** |

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 £1,174.6m (2001: £1,036.7m) 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.

**(l) Gains and losses on hedges**

The Group enters into forward foreign currency contracts to eliminate the currency exposures that arise on sales denominated in foreign currencies immediately those sales are transacted. It also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures.

An analysis of these unrecognised gains and losses as at 31 December 2002 is as follows:

| | Gains £m | Losses £m | Total net gains/(losses) £m |
|---|---|---|---|
| Unrecognised gains and losses on hedges at 1 January 2002 | 2.6 | 0.4 | 2.2 |
| Gains and losses arising in previous years that were recognised in 2002 | 1.4 | 0.4 | 1.0 |
| Gains and losses arising before 1 January 2002 that were not recognised in 2002 | 1.2 | - | 1.2 |
| Gains and losses arising in 2002 that were not recognised in 2002 | 0.3 | 0.4 | (0.1) |
| **Unrecognised gains and losses on hedges at 31 December 2002** | **1.5** | **0.4** | **1.1** |
| Of which: | | | |
| Gains and losses expected to be recognised in 2003 | 0.8 | 0.4 | 0.4 |
| Gains and losses expected to be recognised in 2004 or later | 0.7 | - | 0.7 |

An analysis of these unrecognised gains and losses as at 31 December 2001 is as follows:

| | Gains £m | Losses £m | Total net gains/(losses) £m |
|---|---|---|---|
| Unrecognised gains and losses on hedges at 1 January 2001 | 2.8 | - | 2.8 |
| Gains and losses arising in previous years that were recognised in 2001 | 1.3 | - | 1.3 |
| Gains and losses arising before 1 January 2001 that were not recognised in 2001 | 1.5 | - | 1.5 |
| Gains and losses arising in 2001 that were not recognised in 2001 | 1.1 | 0.4 | 0.7 |
| **Unrecognised gains and losses on hedges at 31 December 2001** | **2.6** | **0.4** | **2.2** |
| Of which: | | | |
| Gains and losses expected to be recognised in 2002 | 1.4 | 0.3 | 1.1 |
| Gains and losses expected to be recognised in 2003 or later | 1.2 | 0.1 | 1.1 |

**23 Provisions for Liabilities and Charges**

| | Group | | | | |
|---|---|---|---|---|---|
| | Reorganisation and restructuring provision £m | Pension provision £m | Deferred taxation (as restated) £m | Other £m | **Total £m** |
| At 1 January 2002 as previously reported | 6.3 | 8.2 | 6.0 | 7.5 | **28.0** |
| Prior year adjustment (see note 2) | - | - | 145.9 | - | **145.9** |
| At 1 January 2002 as restated | 6.3 | 8.2 | 151.9 | 7.5 | **173.9** |
| Charged/(credited) to the profit and loss account | (0.2) | (0.6) | 10.2 | 1.2 | **10.6** |
| Reclassification | 7.6 | (7.6) | - | - | **-** |
| Utilised during the year | (0.8) | - | - | (5.8) | **(6.6)** |
| **At 31 December 2002** | 12.9 | - | 162.1 | 2.9 | **177.9** |

The reorganisation and restructuring provision represents outstanding pension contributions in respect of costs of restructuring programmes within the Group. Following the recommendation of the actuary of the pension Scheme in which the individuals concerned belong, the amount was paid in full in January 2003 with the approval of the trustees of the pension Scheme.

The provision for deferred tax comprises:

| | Group 31.12.2002 £m | Group 31.12.2001 £m |
|---|---|---|
| Accelerated capital allowances | **457.0** | 420.1 |
| Other timing differences | **(52.8)** | (52.3) |
| Undiscounted provision for deferred tax | **404.2** | 367.8 |
| Discount | **(247.6)** | (221.9) |
| Discounted provision for deferred tax | **156.6** | 145.9 |
| Pension revaluation surplus | **5.5** | 6.0 |
| | **162.1** | 151.9 |

In addition, there are tax losses of approximately £9.0m (2001: £9.8m) available to be carried forward and set against future profits arising in territories outside the United Kingdom.

Other provisions comprise contract issues representing the best estimate of amounts payable, principally in the next 24 months, and provisions held in respect of dilapidations.

### 24 Accruals and Deferred Income

| | Group £m |
|---|---|
| Capital grants and contributions: | |
| At 1 January 2002 | 119.6 |
| Additions | 11.6 |
| Amortisation in the year | (3.0) |
| **At 31 December 2002** | **128.2** |

### 25 Called up Share Capital

The share capital of the Company and Group is shown below:

| | 31.12.2002 £m | 31.12.2001 £m |
|---|---|---|
| Authorised: | | |
| 1,000m ordinary shares of £1 each | **1,000.0** | 1,000.0 |
| Allotted, called up and fully paid: | | |
| 466.2m ordinary shares of £1 each | **466.2** | 466.2 |

### 26 Reserves

| | Share premium account £m | Group reconstruction relief reserve £m | Profit and loss account £m |
|---|---|---|---|
| Group: | | | |
| At 1 January 2002 as previously stated | 217.9 | 107.6 | 375.9 |
| Prior year adjustment (see note 2) | - | - | (146.2) |
| At 1 January 2002 as restated | - | - | 229.7 |
| Exchange differences | - | - | 0.2 |
| Retained profit for the financial year | - | - | 29.5 |
| **At 31 December 2002** | **217.9** | **107.6** | **259.4** |

| | | | |
|---|---|---|---|
| Company: | | | |
| At 1 January 2002 as previously stated | - | - | 125.5 |
| Prior year adjustment (see note 2) | - | - | 0.9 |
| At 1 January 2002 as restated | - | - | 126.4 |
| Retained profit for the financial year | - | - | 22.9 |
| **At 31 December 2002** | - | - | **149.3** |

As permitted by section 230 of the Companies Act 1985, the Company's profit and loss account has not been included in these financial statements. Its profit for the financial year was £85.2m (2001, as restated: £63.3m).

## 27 Reconciliation of Movement in Equity Shareholders' Funds

| | **Group** | | **Company** | |
|---|---|---|---|---|
| | **Year to 31.12.2002 £m** | Year to 31.12.2001 £m (as restated) | **Year to 31.12.2002 £m** | Year to 31.12.2001 £m (as restated) |
| Profit for the financial year | **91.8** | 98.1 | **85.2** | 63.3 |
| Dividends | **(62.3)** | (59.6) | **(62.3)** | (59.6) |
| Retained profit for the financial year | **29.5** | 38.5 | **22.9** | 3.7 |
| Exchange differences | **0.2** | - | - | - |
| Goodwill previously written off (see note 6) | - | 116.4 | - | - |
| Increase in equity shareholders' funds | **29.7** | 154.9 | **22.9** | 3.7 |
| Opening equity shareholders' funds as previously stated | **1,167.6** | 1,005.1 | **809.6** | 805.2 |
| Prior year adjustment (see note 2) | **(146.2)** | (138.6) | **0.9** | 1.6 |
| Opening equity shareholders' funds as restated | **1,021.4** | 866.5 | **810.5** | 806.8 |
| **Closing equity shareholders' funds** | **1,051.1** | 1,021.4 | **833.4** | 810.5 |

## 28 Pensions

The Group operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,345 employees. The Scheme, named the Northumbrian Lyonnaise Pension Scheme, comprises four unitised sub-funds - WPS, LUKPS (North), LUKPS (South) and MIS.

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

The most recent actuarial valuation of the Scheme was at 31 December 2001. At that date the market value of assets amounted to £441m in aggregate (excluding MIS which was transferred into the Scheme on 1 April 2002 and was valued at approximately £20 million). The 2001 valuation disclosed that the combined value of the assets represented 109% of the value of the accrued liabilities. The Group contributed a further £15.0m to the Scheme on the 2 January 2003.

The following table sets out the agreed contributions based on the 31 December 2001 valuations:

| | **Section** | | | |
|---|---|---|---|---|
| | **WPS** | **North** | **South** | **MIS** |
| Members' contributions | 6% | 5% | 5% | 5%/6% |
| Employers' contributions | 15.5% | 10.5% | Nil | 6%/7.2% |

The Company contribution rate was assessed using the Projected Unit Method and the following actuarial assumptions:

| | **Group** | |
|---|---|---|
| | **31.12.2002 %** | 31.12.2001 % |
| Investment return: | | |
| Pre retirement | **6.1** | 6.2 |
| Post retirement | **5.7** | 5.7 |
| Pay increases: | | |
| For 5 years after 1998 valuation date | - | 3.8 |
| Thereafter | **3.5** | 4.3 |
| Pension increases | **2.5** | 2.8 |
| Price inflation | **2.5** | 2.8 |

The next valuation will be carried out at 31 December 2004. An independent qualified actuary performs the actuarial valuation.

The Northumbrian Water Group Personal Pension Plan provides defined contribution benefits to 885 employees.

During the year the Group made contributions amounting to £6.4m of which £5.3m related to the defined benefit pension scheme.

Additional disclosures regarding the Group's defined benefit scheme are required under the transitional provisions of FRS 17 'Retirement benefits' and these are set out below. The disclosures relate to the second year of the transitional provisions.

A qualified actuary using revised assumptions that are consistent with the requirements of FRS 17 has updated the actuarial valuation described above at 31 December 2001. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions:

| | Group | |
|---|---|---|
| | **31.12.2002** | 31.12.2001 |
| | **%** | % |
| Pay increases: | | |
| For 5 years after 1998 valuation date | **-** | 3.8 |
| Thereafter | **3.5** | 4.3 |
| Pension increases | **2.5** | 2.8 |
| Price inflation | **2.5** | 2.8 |
| Discount rate | **5.4** | 5.9 |

The fair value of the assets in the Scheme, the present value of the liabilities in the Scheme and the long-term expected rate of return at 31 December 2002 were:

| | **Long-term expected rate of return 31.12.2002 %** | **31.12.2002 £m** | Long-term expected rate of return 31.12.2001 % | 31.12.2001 £m |
|---|---|---|---|---|
| Equities | **7.0** | **268.9** | 7.5 | 288.0 |
| Corporate bonds | **5.4** | **14.4** | 5.8 | 9.9 |
| Government bonds | **4.8** | **46.9** | 4.9 | 72.1 |
| Property | **6.0** | **48.9** | 6.5 | 47.0 |
| Cash | **4.0** | **9.2** | 4.0 | 23.0 |
| Total fair value of assets | | **388.3** | | 440.0 |
| Present value of scheme liabilities | | **(464.6)** | | (377.0) |
| (Deficit)/surplus in the Scheme | | **(76.3)** | | 63.0 |
| Related deferred tax asset/(liability) | | **22.9** | | (18.9) |
| Net pension (liability)/asset | | **(53.4)** | | 44.1 |

Analysis of the amount that would have been charged to operating profit under FRS17:

| | **31.12.2002 £m** |
|---|---|
| Current service cost | 7.9 |
| Past service cost | - |
| Gain/(loss) on settlements and curtailments | - |
| | 7.9 |

Analysis of the amount that would have been credited to net finance income under FRS17:

| | **31.12.2002 £m** |
|---|---|
| Expected return on pension scheme assets | 25.6 |
| Interest on pension scheme liabilities | (21.8) |
| | 3.8 |

Analysis of the actuarial loss that would have been recognised in the statement of total recognised gains and losses:

| | 31.12.2002 £m |
|---|---|
| Actual return less expected return on pension scheme assets | (67.1) |
| Experience gains and losses arising on the scheme liabilities | (52.1) |
| Changes in assumptions underlying the present value of the scheme liabilities | (22.6) |
| | (141.8) |

**History of experience gains and losses**

| | 31.12.2002 |
|---|---|
| Difference between the expected and actual return on scheme assets: | |
| Amount (£m) | (67.1) |
| Percentage of scheme assets | 17.3% |
| Experience gains and losses on scheme liabilities: | |
| Amount (£m) | (52.1) |
| Percentage of the present value of scheme liabilities | 11.2% |
| Total actuarial gain recognised in the statement of total recognised gains and losses: | |
| Amount (£m) | (141.8) |
| Percentage of the present value of scheme liabilities | 30.5% |

**Reconciliation of net assets and reserves under FRS17**

**Net assets - Group**

| | **31.12.2002 £m** | 31.12.2001 £m |
|---|---|---|
| Net assets as restated in balance sheet | **1,053.8** | 1,024.7 |
| SSAP 24 balance | **(18.1)** | (19.8) |
| Related deferred tax | **5.5** | 6.0 |
| Net assets excluding defined benefit assets/(liabilities) | **1,041.2** | 1,010.9 |
| FRS17 pension assets | **388.3** | 440.0 |
| FRS17 defined benefit liabilities | **(464.6)** | (377.0) |
| Related deferred tax | **22.9** | (18.9) |
| Net assets including defined benefit assets/(liabilities) | **987.8** | 1,055.0 |

**Reserves - Group**

| | **31.12.2002 £m** | 31.12.2001 £m |
|---|---|---|
| Profit and loss account as restated in balance sheet | **259.4** | 229.7 |
| SSAP 24 balance | **(18.1)** | (19.8) |
| Related deferred tax | **5.5** | 6.0 |
| Profit and loss account excluding amounts relating to defined benefit assets/(liabilities) | **246.8** | 215.9 |
| FRS17 pension assets | **388.3** | 440.0 |
| FRS17 defined benefit liabilities | **(464.6)** | (377.0) |
| Related deferred tax | **22.9** | (18.9) |
| Profit and loss account including defined benefit assets/(liabilities) | **193.4** | 260.0 |

**29 Financial Commitments**

**(a) Capital expenditure:**

| | **Group** | |
|---|---|---|
| | **31.12.2002 £m** | 31.12.2001 £m |
| Expenditure contracted for | **67.0** | 95.0 |

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.

**(b) Lease commitments:**

The Group has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The total amount payable under these leases in the next year is as follows:

| | Land and buildings £m | Other £m | **31.12.2002 £m** | 31.12.2001 £m |
|---|---|---|---|---|
| Leases which expire: | | | | |
| Within one year | 0.5 | 0.3 | **0.8** | 1.6 |
| Within two to five years | 0.2 | 0.7 | **0.9** | 0.7 |
| After five years | 0.3 | 0.1 | **0.4** | 0.5 |
| | 1.0 | 1.1 | **2.1** | 2.8 |

**30 Commitments – Group and Company**

(a) The Company is party to a cross guarantee arrangement with certain subsidiary undertakings in respect of their bank overdrafts. The potential liability outstanding at 31 December 2002 amounted to £4.7m (2001: £21.3m).

(b) The Company has guaranteed loan and bank facilities of subsidiary undertakings which in aggregate amount to £335.0m at 31 December 2002 (2001: £271.8m) and interest rate swap agreements of subsidiary undertakings, the commitment of which cannot be quantified since it is dependent on future variable interest rates.

(c) The Company has issued letters of continuing support to subsidiary companies with net current liabilities or net liabilities.

**31 Related Party Transactions**

The Company is a wholly owned subsidiary of SUEZ SA which produces publicly available financial statements which include the Company. Consequently the Company is exempt under the terms of Financial Reporting Standard No 8 "Related Party Disclosures" from disclosing transactions with other members of the group headed by SUEZ SA.

**32 Ultimate Parent Company**

The ultimate parent company and the controlling party of the Company is SUEZ SA, incorporated in France. SUEZ SA consolidates the results of the Company and Group and copies of the consolidated financial statements are available to the public from SUEZ SA, 16 rue de la Ville l'Evêque, 75383 Paris, France.