AWG Plc
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Annual Report and Accounts 2006

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Group publications

AWG Plc
Annual Report and Accounts 2006

Anglian Water Services Limited
Annual Report and Accounts 2006
Environment Report 2006
Drinking Water Quality Report 2005

Front cover shows a photograph taken in May 2006 of Pitsford Water near Northampton, one of Anglian Water's reservoirs.

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Disability and Discrimination Act
AWG Plc shareholder communications are also available on audio tape, in braille and in large print versions.
Please call 0870 606 0382 or textphone 0870 600 3950.

Morrison and
AWG Property
offices

- Morrison
- AWG Property

The Anglian Water region

- water supply and wastewater services
- wastewater services only
- water supply only

map excludes Hartlepool

Nature of market	Performance
Anglian Water provides water and wastewater services under licence from the Government. The quality of its service and the prices Anglian Water is able to charge its customers are regulated by the Office of Water Services (Ofwat). Anglian Water's customer base is increasing as the population grows.	Turnover – £m 2006 865.7 2005 796.8
Morrison operates in a competitive market, providing support services to business customers. The market for utility services skills is large and stable. Most utility clients undertake planning in five-year cycles, providing Morrison with good visibility of work. The facilities market has grown considerably in recent years as local authorities have increasingly outsourced services. Of the five million social homes within the UK, two million have been outsourced to date.	Turnover – £m Utility Services 2006 405.4 2005 295.0 Facilities Services 2006 192.5 2005 150.1
AWG Property uses its local knowledge, commercial partnerships and strong track record to develop commercial and residential property in Scotland, as well as realise value from assets elsewhere in the group.	Turnover – £m 2006 35.2 2005 26.0

Table excludes head office and other.

Source of supply

- groundwater aquifer

Surface water

- reservoir
- bankside storage
- abstraction point

Areas in which we provide sewerage services only

1 Severn Trent Water
2 Thames Water
3 Cambridge Water
4 Three Valleys Water
5 Essex and Suffolk Water
6 Tendring Hundred Water

	Geographical area	Average no. of employees	Contact / website
Operating profit – £m 2006 372.8 2005 318.6	The Anglian Water region extends from the Humber to the Thames estuary and from Northamptonshire to the east coast. It also serves Hartlepool. The map above shows the services Anglian Water provides to different areas of its region. Huntingdon head office.	3,322	+44 (0)1480 323000 www.anglianwater.co.uk
Operating profit – £m Utility Services 2006 12.7 2005 5.2	Utilities Services UK-wide. Stevenage head office.	Utility Services 3,377	+44 (0)1438 743744 www.morrisonplc.com
Facilities Services 2006 7.9 2005 3.8	Facilities Services Established presence in Scotland, the North East, the Midlands, Norfolk, London and Essex. London head office.	Facility Services 2,283	+44 (0) 207 383 8888 www.morrisonplc.com
Operating loss – £m 2006 (1.9) 2005 (13.7)	Focused on the Scottish market. Edinburgh head office.	60	0131 228 4188 www.awgproperty.co.uk

AWG Plc

AWG Plc's principal business is Anglian Water, the group's regulated water and wastewater company, which serves in excess of five million customers in the east of England and Hartlepool. The group also includes Morrison, a support services business, and AWG Property, a specialist property development company.

Water

Anglian Water provides more than one billion litres of high-quality drinking water to 4.2 million customers every day. The water comes from a variety of sources: reservoirs, underground reserves (aquifers) and via extraction from rivers.

Wastewater services

Anglian Water receives approximately 950 million litres of wastewater a day from 5.4 million customers, including 1.2 million customers who receive their water from other companies. The wastewater is treated to a high standard and returned to the environment via rivers or coastal outlets. The organic waste is treated, dried and used in agriculture as a natural, high-quality fertiliser.

Morrison is now a focused repair and maintenance business. The business consists primarily of two segments, Utility Services and Facilities Services.

Utility Services

Morrison Utility Services manages infrastructure maintenance, renewals, installation and specialist services to blue-chip utility clients in the gas, water, electricity and telecommunications sectors.

Facilities Services

Morrison Facilities Services provides repair and maintenance and capital investment services to local authority clients. Facilities Services currently manages more than 300,000 social houses and other local authority buildings, making it the largest provider of social housing repairs and maintenance in the UK.

AWG Property

AWG Property is a specialist commercial and residential property development business. It is also responsible for managing the group's offices around the UK.

Highlights

	2006	2005	Change
Financial summary from continuing operations			
Group turnover	£1,552.2m	£1,358.9m	+14.2%
Operating profit	£377.9m	£288.8m	+30.9%
Profit before tax	£108.8m	£32.4m	+235.8%
Profit before tax, IAS 39[1] and exceptional items[2]	£135.0m	£56.8m	+137.7%
Profit after tax	£77.7m	£28.3m	+174.6%
Earnings per share – basic	54.5p	19.7p	+176.6%
Adjusted earnings per share – before IAS 39[1] and exceptional items[2]	67.1p	32.6p	+105.8%
Dividend per share – paid and proposed	50.8p	48.7p	+4.3%
From continuing and discontinued operations combined[3]			
Profit after tax	£30.1m	£33.7m	–10.7%
Earnings per share – basic	21.1p	23.4p	–9.8%

Continuing operations

Group turnover

Up by 14.2%

Earnings per share – basic

Up by 176.6%

Group operating profit

Up by 30.9%

Dividend

Up by 4.3%

[1] Before IAS 39 refers to the incremental impact IAS 39 'Financial Instruments' has on profit, compared with UK GAAP, of £26.2 million (2005: £17.4 million). The AWG IFRS impact analysis presentation and announcement, which defines the incremental impact of IAS 39, is available in note 40 of the accounts and at www.awg.com.

[2] Exceptional items from continuing operations in 2005/6 were £nil. In 2004/5 the exceptional charge was £7.0 million and related to the loss on disposal of MVM, a non-core software development company within Morrison, of £8.3 million, net of profits of £1.3 million on international business closures and disposals.

[3] Including loss on disposal of discontinued businesses of £56.4 million (2005: £nil) and net profits from discontinued businesses of £8.8 million (2005: £5.4 million).

Chairman's statement

Peter Hickson
Chairman

AWG produced an excellent strategic and operational performance last year. The strategic issues resolved included the disposal of Morrison Construction, the continuing exit from legacy properties and further remaining international activities, and the settlement of the longstanding litigation with Sir Fraser Morrison.

Operationally, further efficiency improvements in Anglian Water and Morrison, combined with a capital programme of nearly £300 million, were delivered. AWG's total operating profit from continuing operations rose 31 per cent to £377.9 million. Profit before tax was £108.8 million, compared with £32.4 million in the prior year, producing a 177 per cent increase in earnings per share of 54.5 pence.

The board has proposed a final dividend of 36.0 pence per share, bringing the total dividend for the year to 50.8 pence. This will be an increase of two percentage points above the RPI index. Against the background of improving performance across the group, the board has reviewed its dividend policy. I am pleased to confirm that the board is recommending an increase in the group dividend per share by two per cent above the prevailing rate of RPI for each year in the current regulatory period, ending 2010.

Anglian Water's financial performance showed further improvement in 2005/6. An 8.6 per cent increase in turnover, together with cost efficiencies, contributed to a 17.0 per cent increase in operating profit.

Operating expenditure for the year (excluding depreciation) increased by 4.7 per cent to £327.2 million, largely due to increased employment costs, much higher power costs, increases in rates, and the incremental running costs of new capital projects. These increases were mitigated by savings generated from the manpower reduction programme at the start of the year, as well as other efficiency initiatives. Overall, operating expenditure as a percentage of turnover reduced from 39.2 per cent to 37.8 per cent.

Gross capital expenditure for the year was £292 million, of which a significant part was delivered by our alliance of six partner companies working in close co-operation with Anglian Water. During the year, we successfully delivered our regulatory obligations for year one of the new five-year asset management period.

One of the major challenges facing both water companies and customers is water resources. This is an increasingly serious issue, particularly when set against the background of climate change and the prevailing dry conditions throughout the critical winter period in much of the UK.

Anglian Water's region is the driest in the UK, with only two-thirds of the average rainfall of England and Wales. Rainfall for the last winter period (November to February) in our region was 65 per cent of the long-term average. In spite of this shortfall, our water resources were maintained close to normal levels throughout the year, principally due to leakage control, winter pumping to recharge reservoirs and our relatively high proportion of metered customers. Our reservoir levels are currently 93 per cent full, although ground water levels in parts of the drier area in the south of our region are below average for the time of year. We continue to monitor our water resources closely.

Service quality remained good during the year and Anglian Water met the leakage targets set by Ofwat. At 6 cubic metres per kilometre of main per day, this was below the UK industry average of 11 cubic metres per kilometre of main per day. Drinking water quality remained excellent, and overall microbiological compliance remains at a high level. We had our best bathing water results ever, achieving 100 per cent compliance with mandatory standards for the seventh time in the past nine years.

The Morrison business showed further progress across all divisions during the year under review, having begun the year operating in three segments: support services (principally Utility Services and Facilities Services), Construction Services and the Project Investments business. Following the sale of Construction Services and Project Investments, which previously represented the part of the Morrison business with the highest inherent risk profile and lowest margin, Morrison became a dedicated support services business.

Morrison's continuing operations built on the improvements seen in the first year to deliver a strong performance in the second year of its business improvement programme. Turnover increased 25.2 per cent to £637.2 million, while operating profit before exceptional items increased by £14.1 million to £17.9 million. Overall operating profit margins from support services, measured on a traditional UK GAAP basis, increased to 3.0 per cent compared with 2.5 per cent last year.

Turnover in Utility Services increased significantly to £405 million from £295 million. This was as a result of both retaining and increasing work for the new regulatory period from existing utility clients, and winning work with new or returning clients. Operating profit also increased significantly to £12.7 million from £5.2 million.

Facilities Services' turnover increased 28.2 per cent to £192.5 million, while operating profit more than doubled to £7.9 million. Facilities Services has won a number of significant contracts in the year, including social housing maintenance and 'Decent Homes' work in Newcastle and Gateshead, together with a 10-year, £54 million repair and maintenance contract in Redbridge, Essex. Facilities Services now has an established presence in Scotland, the North East, the Midlands, London and Essex.

At the year-end, Morrison's order book stood at £1.42 billion compared with £1.18 billion at the half year.

AWG Property continued to develop new business within its core Scottish market. In a successful year for commercial development and investment activities, a number of projects were completed, which produced an operating cash flow of £27 million.

Significant progress was made on the strategic front. The sale of Morrison Construction, together with the Edinburgh-based PFI business, was an important move for AWG. The sale enables us to focus on the lower risk, higher margin businesses, which are now delivering strong performance and growth.

Further progress was also made in the disposal of legacy properties in the United Kingdom and Ireland, and the closure or sale of overseas activities in five countries.

During the year we settled the longstanding litigation with Sir Fraser Morrison. This had been a distraction for the management team for some time, and achieving a satisfactory result has enabled us to put the matter behind us.

These operational and strategic achievements could only have come about as a result of focused and decisive management action. The management team in AWG has performed outstandingly during the year in addressing difficult business issues across the company. Many members of the team have less than two years' service with the group and they have all contributed very effectively in the course of the year. I would also like to pay tribute to all our employees for their continued dedication in this time of change.

At board level, Bill Cockburn and Sue Lyons stood down as Non-Executive Directors in January and March this year. Both joined the board early in 2003 when the company's position was less clear, and they provided invaluable support at that time. I am grateful for their contribution to the board. Roger Witcomb, who has sat on the board of Anglian Water as a Non-Executive Director for the last four years, joined the board in April this year as Senior Independent Director.

The year ahead will see Anglian Water continue to concentrate on delivering its regulatory obligations, while seeking further operating and capital expenditure efficiencies. At an operational level, it will be focusing on customer service, maintaining sufficient water resources and the other key aspects of its service.

Morrison will focus on driving profitable growth and performance improvement from its support services businesses. The key objective will be to realise optimal shareholder value.

AWG Property will drive the development and profitable recycling of capital employed in its Scottish market, while continuing to release cash from its remaining legacy properties.

Overall, with the board's commitment to its dividend policy, we will continue to build value for our shareholders.

Peter Hickson
30 May 2006

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Overall, with the board's commitment to its dividend policy, we will continue to build value for our shareholders.

Peter Hickson
30 May 2006

Operating and Financial Review[1]

The following Operating and Financial Review (OFR) is written principally for shareholders and investors.

It is intended to give the reader a clear and objective explanation of AWG's financial results, its activities and the markets in which it operates.

Group financial performance

Group turnover from continuing operations[2] increased by 14.2 per cent to £1,552.2 million (2005: £1,358.9 million). This reflects additional revenue from Anglian Water of £68.9 million and increased sales by Morrison of £128.2 million.

The increased turnover in Anglian Water was a consequence of the regulatory pricing formula (including a K factor of 3.8 per cent) and the increased demand for water during the dry weather in the early part of the summer in 2005. Within Morrison the increase was driven by turnover growth in both Utility Services and Facilities Services. Utility Services' turnover grew by 37 per cent to £405.4 million as a result of higher volumes on existing framework contracts and several new contracts won and commenced in the year, including Transco and Scotia Gas. Facilities Services' turnover grew by 28 per cent to £192.5 million, with new contracts in Newcastle and Redbridge, Essex.

Group operating profit grew from £288.8 million in the previous year to £377.9 million. The improvement resulted from increased revenues and the realisation of efficiencies in Anglian Water, together with higher turnover and margins in Morrison. AWG Property also improved its result compared with the previous year, due to higher turnover in its Scottish business and reduced losses on legacy properties.

[1] Prepared in accordance with the Accounting Standards Board's (ASB) Reporting Statement: Operating and Financial Review, published in January 2006.

[2] On 31 March 2006 the group completed the disposal of Morrison Construction Services and the Morrison Project Investments business. The results of these operations are reported as 'discontinued' in the financial statements and the principal focus of the commentary in the OFR is on the results from continuing operations.

The share of post-tax losses from joint ventures and associates was £3.5 million (2005: profit of £3.5 million), which primarily reflects the timing and structuring of deal completions in AWG Property.

Non-cash movements in derivative financial instruments amounted to a charge of £45.9 million (2005: £35.4 million). This includes an indexation charge of £17.5 million (2005: £17.9 million) that would have been charged under UK GAAP, and the balance of £28.4 million (2005: £17.5 million) representing the major proportion of the incremental impact of IAS 39[3].

Excluding the incremental impact of IAS 39, the net interest charge for the year was £238.4 million, £4.2 million lower than the prior year. This reflects the reduced weighted average cost of debt from refinancing, partially offset by the increase in overall net debt, and non-recurring debt refinancing costs of £4.5 million.

Profit before tax from continuing operations was £108.8 million (2005: £32.4 million), an increase of £76.4 million over the previous year, which is explained by the improved performance seen across all parts of the group.

The loss attributable to discontinued operations of £47.6 million comprises the loss on disposal of Construction Services and Project Investments of £56.4 million (primarily attributable to £93.1 million of goodwill written off in respect of Construction Services net of proceeds received) and post-tax trading profits from discontinued operations of £8.8 million (2005: £5.4 million).

[3] IAS 39 refers to the incremental impact of IAS 39 'financial instruments', compared to UK GAAP. The AWG IFRS impact analysis presentation and announcement, which defines the incremental impact of IAS 39, is available in note 40 of the accounts and at www.awg.com.

Operating and Financial Review continued

Total goodwill remaining from the Morrison acquisition that is recognised in the balance sheet comprises £63.4 million in Support Services and £12.7 million in the retained PFI investments. The PFI investments, which have an equity value of £7.6 million, have been retained with a view to future sales options.

The tax charge on continuing operations for the year was £31.1 million, which equates to an effective rate (before the loss on disposal) of 28.6 per cent (2005: 12.7 per cent). The low tax rate for 2005 was primarily due to the effect of non-recurring tax credits in the prior year.

Profit after tax from continuing operations (before the IAS 39 incremental impact and exceptional items[1]) was £95.7 million (2005: £46.8 million). Overall profit after tax from continuing and discontinued operations was £30.1 million (2005: £33.7 million), reflecting the book loss on disposal of Construction Services and Project Investments.

Basic earnings per share amounted to 21.1 pence (2005: 23.4 pence). Earnings per share from continuing operations (before the incremental impact of IAS 39 and exceptional items[1]) was 67.1 pence (2005: 32.6 pence).

Cash flow

The total operating cash flow for the group was £586.3 million (2005: £498.9 million), an increase of 17.5 per cent on the previous year. The improvement is as a result of the strong performance across the group.

The net cash outflow from capital expenditure was £240.9 million, which is £28.7 million down on last year. The vast majority of capital expenditure relates to the Anglian Water capital programme, which delivered gross capital investment projects over the year of £292 million (2005: £294 million). Net cash outflow from capital expenditure is after grants and contributions of £24.1 million (2005: £26.9 million) received towards the capital programme and refers to the actual cash spend net of creditors and accruals for work completed but not yet paid for. The reduction in cash spend of £28.7 million compared to the prior year reflects the phasing of the capital programme, with greater activity towards the end of the current financial year and consequently a higher year-end level of creditors and accruals for capital projects completed but not yet paid for.

Included within cash flows from investing activities are £34 million of cash proceeds from the sale of Construction Services and Project Investments. The remaining cash receivable from the sale (£8 million) has been deferred into the 2006/7 financial year, primarily pending financial close of a PFI project and the transfer of two equity investments to the purchaser, Galliford Try. Of the deferred consideration, £2 million was received in April on financial close of the Highland Schools PFI contract.

Other significant cash outflows in the year were the interim dividend and last year's final dividend amounting to £70.0 million, the repurchase of the last remaining redeemable shares (£14.7 million) and £37.1 million in respect of the £75 million share buy-back programme.

[1] Exceptional charges for continuing operations were £nil in 2005/6 and £7.0 million in 2004/5 in respect of the loss on the disposal of MVM of £8.3 million, net of profits of £1.3 million on international business closures and disposals.

Net debt

Net debt for the group on a UK GAAP basis was £3,263.2 million at 31 March 2006 (2005: £3,247.5 million), an increase of £15.7 million compared with last year. This increase reflects the on-going capital enhancement programme with Anglian Water and the share buy-back programme, partially offset by the strong operating cash flows across the group, proceeds from the sale of Construction Services, and realisation of cash from reduced capital employed in AWG Property.

At 31 March 2006 the IFRS net debt was £3,443.5 million (2005: £3,403.8 million), an increase of £39.7 million over the previous year-end position. These net debt figures include derivative assets and liabilities not previously recognised under UK GAAP. The increase in the year is greater than under UK GAAP due to the volatile nature of derivative fair value adjustments required by IAS 39, which have no cash flow impact.

Share buy-back

The £75 million on-market share buy-back programme announced in June 2005 has progressed steadily. As at 31 March 2006, £37.1 million (49.5 per cent) had been spent on share repurchases. In addition, all outstanding redeemable shares were repurchased in October 2005 at a cost of £14.7 million as a result of the return to a cash dividend.

Dividend

The board is recommending a final dividend of 36.0 pence per share, to be paid in cash on 15 September 2006 to shareholders on the register at 5pm on 11 August 2006. Together with the interim dividend of 14.8 pence, this makes a total dividend for the year of 50.8 pence per share, a 4.3 per cent increase over the previous year.

Against the background of a strong performance by AWG, the board has reviewed its dividend policy and is recommending an increase in the group dividend per share of 2 per cent above the prevailing RPI for each year of the current regulatory period, ending March 2010.

The proposed increase will take effect from the final dividend declared with these results.

International Financial Reporting Standards (IFRS)

In accordance with the requirement for all listed European companies, AWG's consolidated financial statements have been prepared under IFRS, as adopted by the European Union. All comparatives have been provided under IFRS and an explanation of the adjustments between UK GAAP and IFRS is provided in note 40 to the financial statements.

The AWG Plc company financial statements have been prepared under UK GAAP.

Anglian Water provides water and wastewater services to domestic and commercial customers in the east of England and Hartlepool.

Key performance indicators

Accident Frequency Rate[1]

2005/6	0.39
2004/5	0.42

Operating expenditure UK GAAP[2]

2005/6	£326m determination[3]
2005/6	£314m actual

Capital expenditure UK GAAP[2]

2005/6	£305m determination[4]
2005/6	£292m actual

Overall Performance Assessment (OPA) results

2005/6	Results yet to be published
2004/5	408
2003/4	421

Leakage
UK industry average: 11m^3 per km/day

Anglian Water

2006	6m^3 per km/day
2005	6m^3 per km/day

Drinking water[5] **– overall zonal compliance**

2005	99.96%
2004	99.95%

[1] Number of accidents per 100,000 hours worked
[2] Anglian Water's regulatory performance is monitored on a UK GAAP basis

Introduction

Anglian Water provides water and wastewater services to domestic and commercial customers in the east of England and Hartlepool.

The Anglian Water region, the largest of any water company in England and Wales, stretches from the Humber to the Thames estuary and from Northamptonshire to the east coast.

The group aims to provide a high-quality, cost-effective service to all customers while complying with, or exceeding, all relevant public health and environmental standards.

Company structure and financing
Anglian Water is the principal subsidiary of AWG Plc, its parent company.

The Anglian Water group was first listed on the London Stock Exchange in 1989 when the water industry in England and Wales was privatised.

AWG carried out a financial restructuring in 2002 in order to reduce Anglian Water's weighted average cost of capital. The group issued new debt in the form of bonds and redeemed some of its existing debt. As part of the process, a common set of covenants was established to enhance the protection for lenders.

The refinancing in 2002, increased the proportion of the group's finance provided by debt, rather than equity, from 52 per cent to 84 per cent at that time. However, as a result of the strong cash flows from Anglian Water, the company's gearing has since fallen to 79 per cent. See chart on page 9 for key ratios.

[3] Inflated by Retail Price Index (RPI)
[4] Inflated by Construction Outputs Price Index (COPI)
[5] Drinking water results published in 2006 for calendar year 2005

Key ratios (UK GAAP)

	2001/2	2002/3	2003/4	2004/5	2005/6
RCV[1]	3,777	3,911	4,251	4,387	4,501
Anglian Water gross debt	1,803	3,466	3,923	4,339	4,039
Anglian Water net debt	1,971	3,289	3,451	3,499	3,539
Anglian Water Net debt[2]/RCV[1]	52%	84%	81%	80%	79%

Net debt for Anglian Water defined as debt and overdrafts less total cash.

[1] Regulatory Capital Value – the value of Anglian Water's assets, as measured by the Regulator, Ofwat.

[2] Net debt as measured under Common Terms Agreement definitions.

Anglian Water's infrastructure

18	reservoirs
138	water treatment works
199	boreholes
261	service reservoirs
1,075	wastewater treatment works
35,881	km of sewers
36,762	km of water mains

160 water towers

AWG used the funds that were raised to repay debt, carry out a share consolidation and returned the remaining capital to shareholders.

Market operations

Drinking water

Every day Anglian Water supplies more than one billion litres of high-quality drinking water to 4.2 million water customers via 138 water treatment works and 36,762 kilometres of water mains.

The water in the west of the region is primarily sourced from water reservoirs, the largest of which is Rutland Water. The east of the region relies principally on groundwater reserves, known as aquifers.

Two-thirds of the annual supply is used by households, of which 57 per cent are metered. The remaining third of the supply is used by non-household customers, 87 per cent of whom are metered. The total metered usage for household and non-household is 62 per cent.

Wastewater

Anglian Water collects and treats the water it puts into supply, returning it to the environment via rivers and coastal outlets. The water is regularly sampled and tested against strict Environment Agency standards.

Approximately 950 million litres of wastewater are collected each day from 5.4 million customers, including 1.2 million customers who receive their water from other companies. Anglian Water's sewerage network includes more than 35,881 kilometres of pipes connected to 1,075 wastewater treatment works.

The Anglian Water region

Anglian Water serves an area of 27,500 square kilometres, the largest region served by any water company in England and Wales. Employing approximately 3,300 staff at 31 March 2006, Anglian Water is one of the region's biggest employers.

As well as being the largest region, it is also one of the country's fastest growing regions in terms of population. More than 200,000 new homes are due to be built in the region in the next 10 years, partly accelerated by the Office of the Deputy Prime Minister's plans aimed at addressing housing shortages in the Southeast. Meeting this growing demand is a key priority for Anglian Water.

Management

Structure

Anglian Water has its own board of Directors, which consists of two AWG Plc Directors, three independent Non-Executive Directors, including one vacancy since 27 April 2006, and four Executive Directors.

The board is responsible for the strategy and overall management of the regulated business. The executive members of the board include the Group Chief Executive, Group Finance Director, Chief Operating Officer, Director of Asset Management, Director of Regulation and Finance Director. Day-to-day operations are led by the operating board of Anglian Water.

People

Anglian Water appreciates the importance of ensuring its employees have the necessary skills, experience and training to be able to deliver the company's strategic aims.

In April 2005, Anglian Water launched a new skills and behaviour framework for all employees. The framework, which is part of the personal development process, is designed to recognise the importance of behaviours as well as delivering against set objectives.

Anglian Water continued

Creating operational efficiencies

The Operational Management Centre (OMC) represents one of Anglian Water's most important changes to the way it operates, both now and in the future.

Main photo shows employees at the Operational Management Centre in Lincoln.

Inset: an operational team accessing job information remotely.

By centralising key aspects of its operations, Anglian Water aims to improve significantly the efficiency of planned and reactive maintenance. The OMC will play a vital role in making decisions relating to infrastructure maintenance and investment.
These operational changes are being made with one overriding priority in mind: to improve the service Anglian Water provides to its customers.

The OMC was established to improve the co-ordination of all planned, routine and emergency work for both water and wastewater-related operations. It also manages emergency procedures, contingency plans and business continuity.

The OMC represents a new way of working for the majority of Anglian Water's operational staff and has been a significant challenge, both technically and culturally.

The first phase of the programme has been to implement a new, centralised scheduling system across both water and wastewater operations. Working within the parameters set by the business, the scheduling system helps improve the efficiency of its operational work.

Field-based teams receive tasks and acknowledge their completion remotely via hand-held units. The scheduling team and local managers can see details of current and planned work, including location, estimated completion time and relative priority. The system can be over-ridden when urgent, reactive work must take priority over planned work.

The OMC will ultimately provide valuable operational data for improving understanding, and therefore investment decisions, relating to the company's water and wastewater networks. This will have a direct impact on Anglian Water's efficiency and customer service.

Above: a member of the Alliance listening for leaks; the first stage in detection and repair.

Anglian Water continued

Key organisational milestones in AMP4

1. Anglian Water has implemented a new way of organising and prioritising its work in order to improve its operating efficiency. The new centralised Operational Management Centre (OMC) has implemented radical changes to processes, systems and culture.
2. A Capital Alliance has been created between Anglian Water and its six Alliance partners to deliver approximately half of the £1.5 billion AMP4 capital investment programme.
3. Major contracts have been re-tendered for network and developer services partners, local capital partners and information services.
4. Comprehensive organisational restructuring to increase productivity and efficiency.
5. A new staff performance measurement and development framework has been established, which takes into consideration behaviours as well as job-related tasks.

Anglian Water operates a number of specialised training schemes including a graduate scheme and apprentice schemes within both operational and non-operational roles. It also provides general training and development identified through the performance and development review (PDR) process.

Attracting and retaining skilled people is key to ensuring an effective workforce. Anglian Water has a wide range of policies to meet both its statutory obligations and those that arise from its commitment to provide a high-quality working environment. Examples include flexible working, discretionary leave and the recognition of the importance of work-life balance.

Anglian Water's voluntary turnover rate of employees was 4.8 per cent for 2005/6. This is significantly below the national average. The absence rate of employees has also been consistently below the national average. During 2005/6 the absence rate for Anglian Water employees was 2.7 per cent compared to the national average of 3.7 per cent.

During 2005 Anglian Water commenced a remuneration benchmarking review process in order to ensure both attractiveness in the market place and cost-effectiveness of the company. This was in addition to a four-year pay and pensions deal which was agreed in December 2005. For more information, see page 34.

Competitive environment

Domestic customers cannot currently choose which company supplies their water or wastewater services.

Since privatisation, water companies have been able to offer water to large industrial or commercial customers outside their regional boundaries through the creation of what is known as inset appointments.

In December 2005, Ofwat announced a new water supply licensing regime in England and Wales, whereby licensees will be able to supply water to business customers who use at least 50 megalitres of water a year.

To date, five companies have applied for a licence, four of which have been granted. AWG is in the process of applying for a licence in order to take advantage of opportunities as the competitive market develops.

Regulatory environment

Anglian Water supplies water under licence from the Government's economic regulator, Ofwat.

On 1 April 2006 the role of the Director General of Ofwat was replaced by a board structure, which will now take responsibility for the economic regulation of the water and sewerage industry in England and Wales. Although it will continue to be known as Ofwat, the statutory name was changed to the Water Services Regulation Authority (WSRA).

The industry operates on five-year Asset Management Periods. The current Asset Management Period, known as AMP4, began in April 2005 and ends in March 2010.

Between 2005 and 2010, Ofwat assumed investment for Anglian Water of a further £1.5 billion (at 2002/3 prices) in its services, in addition to the £4.6 billion that it has invested since privatisation in 1989. Approximately half of the £1.5 billion investment will be on capital maintenance expenditure.

Efficiency challenge

Ofwat's final determination, the last stage in the price review process, established the lowest price increases for Anglian Water of any water and wastewater company in England and Wales. It also set a number of challenging efficiency targets.

Key achievement
The Capital Alliance

Another way in which Anglian Water has changed the way in which it works is the adoption of a Capital Alliance model for delivering its capital investment programme.

The Capital Alliance is made up of Anglian Water and six partners in a collaborative and integrated team with common objectives and incentives. Its purpose is to deliver programmes of work, for example, refurbishment and upgrading of water and wastewater treatment works, as quickly and efficiently as possible.

The Alliance will deliver approximately half of Anglian Water's £1.5 billion AMP4 investment programme. 2005/6 saw the first projects delivered by the new Alliance, these included two first-time sewerage schemes and a nitrate removal scheme.

In response to the efficiency targets and known additional cost pressures from increases in energy costs, infrastructure renewals and pensions, the management team has put in place the framework and detailed plans to address these challenges.

As a first step, the company carried out a restructuring programme in the 2004/5 financial year, that resulted in savings of approximately £10 million per annum in operating costs, beginning in the financial year 2005/6. Further efficiency savings will come from a range of projects, including the centralisation of operations, the management of energy purchasing and usage, a four-year agreement on pay and pension costs, re-tendering of IT and telecommunications contracts, and programmes to reduce customer bad debt.

Financial performance

	2006 £m	2005 £m
Turnover	865.7	796.8
Total operating profit	372.8	318.6

Anglian Water's financial performance showed a continuing improvement in 2005/6 compared to the previous year.

Turnover increased by 8.6 per cent as a result of the regulatory pricing formula (including a K factor[1] of 3.8 per cent), higher than normal revenues due to the effect of the dry weather in the early part of the summer in 2005 and growth in customer numbers. This net increase in revenue of £68.9 million, together with the realisation of cost efficiencies, contributed to an increase in operating profit of 17.0 per cent (£54.2 million).

[1] Ofwat defines K as the amount by which a company can increase, or must decrease, its average charge above or below inflation each year to finance its services and meet its legal obligations. When inflation is included, this is commonly referred to as the 'price limit'.

Operating expenditure for the year (excluding depreciation) increased by 4.7 per cent to £327.2 million (2005: £312.6 million). This was due to upward pressures from employment costs, power, rates and the incremental running costs of new capital projects. These costs were mitigated by savings generated from the manpower reduction programme at the start of the year, as well as other efficiency initiatives. Overall, operating expenditure as a percentage of turnover decreased slightly from 39.2 per cent to 37.8 per cent.

The reduction in manpower costs and other identified initiatives will generate a significant proportion of the total operating efficiency savings required in AMP4 by the regulatory settlement.

The K factor set through the price determination included an element to fund increased corporation tax. The corporation tax charge for Anglian Water has increased by £22.3 million in 2005/6.

Gross capital expenditure for the year was £292 million, £76.5 million of which was delivered by an alliance of six partner companies working in close co-operation with Anglian Water. During the year, Anglian Water successfully delivered the regulatory obligations for the first year of the new five-year Asset Management Period.

Achievements in AMP4

The priority for Anglian Water in the first year of AMP4 has been to meet the efficiency challenge and deliver on the regulatory targets set for the first year of the period.

This has involved delivering planned cost reductions, as well as implementing changes to structures and systems identified before the start of the period (see panel on page 12).

Anglian Water continued

Anglian Water leakage since 1989 (Ml/d)

Source: Anglian Water data, 2006

Anglian Water leakage performance - m^3/km/per day compared to other water and wastewater companies

Anglian	6
South West	6
Wessex	6
Southern	7
Dwr Cymru	8
Northumbrian South	8
Northumbrian North	9
Yorkshire	9
WaSC[1] average	11
Severn Trent	11
United Utilities	12
Thames	29

Source: Ofwat 'Security of supply, leakage and efficient use of water report, 2004-2005'. 2005-2006 data to be published by Ofwat in October 2006.

[1] Water and sewerage company

Operational performance

Anglian Water started AMP4 with a large number of new consent standards, which represented a significant operating challenge. Issues at two wastewater treatment plants led to consent breaches that are expected to have a negative impact in this year's Overall Performance Assessment. Remedial action has been implemented to improve performance in future years.

The overall score for the previous year 2004/5 was 408, ranking it joint third. The 2005/6 overall performance assessment will be published in September 2006.

Anglian Water maintained its excellent record of success in water quality compliance and leakage control as detailed below.

Drinking water quality

Anglian Water is committed to providing its customers with a high level of service and a consistent supply of wholesome drinking water. This is demonstrated by excellent compliance with the water quality standards of the Drinking Water Regulations in 2005. Drinking water quality remained high throughout the year, with an overall mean zonal compliance of 99.96 per cent for 2005 (2004: 99.95 per cent). Overall microbiological compliance remained high with 99.93 per cent of samples in 2005 complying with mandatory standards (2004: 99.88 per cent).

The company has translated all of the regulatory requirements, as well as internal standards, into a set of detailed policies, standards and procedures for maintaining water supply hygiene. These documents provide a robust risk framework, within which Anglian Water operates, to ensure drinking water quality is protected. A web-based tool has been developed to provide a central access point to this valuable information, ensuring it is available throughout Anglian Water via its intranet.

The company carries out continuous monitoring at treatment works and other key sites to complement the extensive laboratory sampling and analysis.

All water companies have a duty to inform the Drinking Water Regulator of any events that have affected, or are likely to affect, drinking water quality. The Regulator then assesses the information provided to determine whether the event is significant or not. If it is deemed significant then it is classified as an incident and enforcement action against the company concerned may also be considered. Of the events notified by Anglian Water to the Regulator in 2005, only a small number were classified as incidents.

Water resources and leakage

The Anglian Water region receives two-thirds of the national long-term average rainfall. Minimising leakage is therefore a priority for the company.

Anglian Water's target, set by Ofwat, is set at the economic level of leakage. This is the point at which it would cost more to make further reductions than to produce the water from another source.

Anglian Water's leakage performance is one of the best in the industry. In 2004/5, its leakage rate was six cubic metres per kilometre of main per day. The industry average is 11 cubic metres per kilometre.

More than 100 people are employed in proactive leakage detection. In excess of 19,000 leakage repair jobs were completed in 2005/6 at a cost of more than £10 million.

Investing in the environment

Significant investment since privatisation has resulted in dramatic improvements in both bathing and river water quality across the region.

Water quality

Bathing water quality Mandatory standard

2005/6	100%
2004/5	100%

River water quality* Biological quality (Very Good to Fair)

2004/5	98.1%
2003/4	98.0%

River water quality* Chemical quality (Very Good to Fair)

2004/5	90.4%
2003/4	89.8%

* River quality results published in August 2005 for 2004 calendar year.

Customer surveys 2005/6

Customer satisfaction – Very/Fairly satisfied
source: Millward Brown

Jul 2005	81%
Sep 2005	82%
Nov 2005	86%
Mar 2006	91%

Bathing water quality
In 2005/6, Anglian Water delivered its best bathing waters results to date, achieving 100 per cent compliance with mandatory standards for the seventh time in the past nine years. Compliance with the stricter guideline standard also significantly improved to 83 per cent (2004: 65 per cent). Guideline standard is one of the requirements for a beach to be awarded a Blue Flag.

In May 2006, the environmental organisation Encams announced that there are 19 Blue Flag bathing water beaches in the Anglian Water region, one more than in 2004/5.

River water quality
The Environment Agency published its latest assessment of river water quality in the region in August 2005, relating to the 2004 calendar year. The assessment showed that 98.1 per cent of rivers' biological quality was classed as 'Very Good' to 'Fair' (2003: 98.0 per cent). In 90.4 per cent of the region's rivers, chemical quality was in the 'Very Good' to 'Fair' range (2003: 89.8 per cent).

Biodiversity Action Plan
Since 1999 Anglian Water has been committed to making a positive contribution to the east of England's biodiversity by delivering a 10-year Biodiversity Action Plan (BAP).

The plan has seen the successful reintroduction of two species to England, the osprey and the pool frog. The development of many partnership projects such as Water for Wildlife, a project with the Environment Agency and the Wildlife Trusts, has focused on wetland habitat and work to protect species in their natural environment. A new 10-year BAP will be prepared for 2010.

Customer service
Anglian Water carries out regular surveys in order to measure customer satisfaction, the results of which are used to help improve customer service. An independent research company surveys 200 customers each quarter.

The latest results for March 2006 showed 91 per cent of customers were 'very' or 'fairly' satisfied with Anglian Water's overall service. The average overall satisfaction level for the year was 85 per cent (2005: 85 per cent). The survey results for overall customer satisfaction improved in the second half of the year. These results are shared annually with the regulator.

A customer experience survey was introduced in 2005/6 to focus on customers who have contacted Anglian Water in the previous two months. The survey is run by an independent research company and reviews six major areas of customer-facing activity each quarter. 2,500 customers have been interviewed to date. In the last quarter's results, customers' overall satisfaction rating was 77 per cent 'very' or 'fairly' satisfied.

In addition, the company has introduced a Customer Service Index to help it keep track of improvements to service. This measure looks at the time taken to complete customer work and the quality of the work carried out.

Health and safety
The health and safety of staff, contractors and the public is paramount. The company's adage is 'There is nothing so important that employees cannot take the time to do it safely' and the commitment to health and safety is enshrined in the group's 'Safety First – Second Nature' philosophy.

Anglian Water continued

Energy efficiencies

Anglian Water uses a by-product of the wastewater treatment process to reduce its annual energy bill.

A 2,000 cubic metre methane storage facility near Cambridge.

Inset: A Works Technician – Process Optimiser next to a Combined Heat and Power (CHP) unit.

The wastewater treatment process creates methane, a renewable fuel, which is stored in large tanks. The methane is used to drive Combined Heat and Power (CHP) engines to create electricity and heat.
The electricity is fed into the national grid, while any excess heat is recycled to continue the process.

Health and safety

The health and safety of employees, contractors and the public is of paramount importance. A 'safety first, second nature' culture is part of daily life for everyone in the group.

Anglian Water has an Occupational Health and Safety (OH&S) management system in place, which continues to drive improvements in this area. In order to further strengthen this, and to provide external validation, it is actively seeking Occupational Health and Safety Assessment Series (OHSAS)-18001 accreditation (the internationally recognised quality award for OH&S).

The company continued to show improvement in the two OH&S performance measures: Accident Frequency Rate (number of accidents per 100,000 hours worked) reduced from 0.42 to 0.39, and Sickness Absence (number of days lost per person) reduced from 8.26 days to 7.30 days.

In recognition of the high standards that Anglian Water has demonstrated over the past three years, the company was awarded a Royal Society for the Prevention of Accidents (RoSPA) Silver Award in 2006.

Seeking continuous improvement in its OH&S performance, Anglian Water has again set stringent targets for the year ahead and has a comprehensive action plan in place to meet them.

Risks

Pensions

Anglian Water closed its defined benefit (final salary) pension scheme to new employees in 2002. Employees have subsequently been offered the opportunity to join a defined contribution scheme.

The defined benefit scheme remains a financial risk, with continued exposure to investment and mortality risk.

An in-depth review of pension arrangements was carried out during the year, focusing on controlling and reducing costs through the current regulatory period, while maintaining core pension provisions for employees.

Anglian Water continued

Following consultation with employees, proposals were developed and agreed with pension trustees. The agreed solution, which takes effect in 2006, leaves the final salary benefit intact and involves a four-year agreement on pay and changes to early retirement terms for future service.

The changes helped to reduce Anglian Water's deficit on all schemes from around £150 million at 31 March 2005 to £50 million at 31 March 2006 on an IAS 19 'Employee Benefits' basis.

The company is working closely with the Trustees, the in-house treasury team and its advisers to develop solutions for managing investment risk.

For more information on pensions, please see page 34.

Energy

Energy costs represent a key risk to Anglian Water's operating efficiency. Anglian Water is one of the largest energy users in the east of England due to the energy required to pump and treat water and wastewater. In 2005/6, energy expenditure represented 12 per cent of total operating costs (£39.8 million).

In total, Anglian Water used 736 Gigawatt hours (GWh) in 2005/6, or 0.2 per cent of total electricity usage in the UK.

The chart (above) demonstrates energy consumption by the key processes.

Electricity prices are on a rising trend and increased 24 per cent in 2005/6. Electricity costs for Anglian Water are anticipated to continue to increase over the current regulatory period.

Anglian Water's energy costs are currently fixed until October 2007. One contract, to procure energy through to October 2007, is from entirely renewable sources and represents 21 per cent of Anglian Water's energy demand. Reducing energy consumption is imperative for Anglian Water for both economic and environmental reasons.

In 2005/6, Anglian Water strengthened its existing energy team, which is tasked with identifying and reducing controllable energy usage and promoting the need for energy efficiency throughout the company.

The energy team is also investigating opportunities to increase the proportion of self-generated energy from renewable sources, such as wind and combined heat and power (CHP) on wastewater treatment works.

In 2005/6 Anglian Water generated 11 GWhs of renewable energy from its CHP engines.

This saved 4,975 tonnes of carbon and delivered more than £1.1 million of benefits through offsetting power bought from the grid and from the sale of Renewable Obligation Certificates.

Supply and demand

Anglian Water's region receives two-thirds of the national average rainfall, making it the driest region in the country. It is also one of the fastest growing. This growth places additional demand on water resources, often on a very localised basis.

In addition to low average rainfall, the region received only two-thirds of its usual rainfall between November 2005 and February 2006, a period essential for re-charging water reserves, particularly underground aquifers. The potential deficit in the availability of water resources was managed through effective planning and investment in water storage and supply systems, for example, increased pumping of water from rivers into reservoirs, within abstraction limits set by the Environment Agency.

Anglian Water manages the supply and demand of water by a combination of leakage control and metering. Its leakage rate is close to half the industry average, and more than half of households (57 per cent) are now on metered water supplies, which is twice the industry average.

The chart above demonstrates how this approach has meant that Anglian Water supplies roughly the same amount of water to the region as it did around privatisation in 1989, despite a 20 per cent growth in households since that time.

As a result of these measures, Anglian Water's resources remained close to normal ranges throughout the year. At the time of writing, reservoirs were at target levels (93 per cent full on average as at 30 May 2006). Groundwater levels in some parts of the drier southern region were below average, although within the normal operating range.

Long-term water resource planning

As part of its long-term water resource planning, Anglian Water has been preparing to extract more water from Rutland Water, its largest reservoir. Anglian Water has typically used only three-quarters of the amount available in the reservoir. As part of its plan to use a greater proportion of the water in the reservoir, Anglian Water has consulted with local residents and statutory organisations regarding an extension of its existing water treatment works. An important part of the consultation has been to explain how Anglian Water intends to extract more water from the reservoir while minimising the impact on the wildlife at this internationally important Special Protection Area (SPA).

Mindful of the potential consequences of climate change and Government plans for continued regional growth, the company is developing long-term plans to manage increased demand, one aspect of which is to raise customer awareness of the issues and the need to be waterwise.

A regional advertising campaign encouraging customers to be 'Waterwise' was launched in May 2006.

Sewage sludge (biosolids)

Sewage sludge is a by-product of wastewater treatment. The safe and sustainable management of sludge, or biosolids as it is known when it is treated for use in agriculture, remains a key issue for Anglian Water and the industry as a whole.

Anglian Water uses a number of methods for managing sludge, the most important of which is recycling it to land. Around 90 per cent of treated biosolids are used as a high quality fertiliser on agricultural land. If legislation or demand changed, removing agricultural land as an option, it would pose a substantial challenge to the industry. The company, therefore, maintains the highest standards within the current operation and continuously researches alternative treatment and management methods.

At present the company does not believe that there is any reason to expect a significant detrimental change in legislation. The treatment of sludge, and the recycling of biosolids, are both highly regulated processes and are undertaken in accordance with strict quality guideline procedures. Both the Government and the European Commission support this method of managing sludge.

Anglian Water continues to work, at a national and European level, with the water industry, the Government and regulators, to ensure the understanding and confidence of stakeholders in the safe and sustainable practise of recycling is maintained and improved.

Anglian Water continued

Environmental incidents
One of Anglian Water's key objectives is to minimise the impact of its operations on the environment. Unfortunately, given the scale of the company's operations, covering an area of 27,500 square kilometres, there can be instances of failure.

During the financial year 2005/6, the Environment Agency brought six court actions against Anglian Water for pollution incidents. Anglian Water was acquitted in one case, but pleaded guilty to the other five.

Fines from the five convictions totalled £44,500 (2004/5: £61,500). Anglian Water works closely with the Environment Agency to learn the lessons from such incidents and to strive to prevent further incidents.

Climate change
Climate change will directly affect Anglian Water. The company is currently investigating the impacts that this will have on the supply of drinking water and the collection and treatment of wastewater in the region.

The key implications for Anglian Water are:

- Requirement for increased winter raw water storage.
- Supply infrastructure improvements – peak demand resilience.
- Impact on infrastructure – temporary or permanent asset loss due to flooding, sea level rise and coastal realignment.
- Resource competition – environmental/economic pressure to share water.
- Requirement to adapt design standards, for example sewer capacity.

Anglian Water recognises the serious nature of the challenges that it faces and has developed a strategy identifying the implications and required actions, both in terms of mitigation and adaptation.

The company is keen to play an active role in tackling the issues of climate change and in preparing the business for the inevitable requirements of adaptation. See page 39 for more information on Anglian Water's Climate Change Action Plan.

Water Framework Directive
The Water Framework Directive (WFD) is the most substantial piece of EC water legislation to date. The WFD (2000/60/EC) came into force in December 2000 and became law in December 2003.

The main objectives of the WFD are to:

- Enhance the status and prevent further deterioration of aquatic ecosystems and associated wetlands – there is a requirement for nearly all inland and coastal waters to achieve good status by 2015.
- Promote the sustainable use of water.
- Reduce pollution of water, especially by priority hazardous substances.
- Lessen the effects of floods and droughts.
- Rationalise and update existing water legislation and introduce a co-ordinated approach to water management based on the concept of river basin planning.

The water industry has an important contribution to make in achieving the WFD objectives. Anglian Water is working closely with Water UK, the Environment Agency and other key regulators on the implementation of the WFD to ensure that the benefits are achieved in a sustainable way, with all sectors contributing appropriately and equitably.

Any new obligations on the water industry arising from contributions or measures towards meeting WFD objectives, will be funded by Ofwat through the periodic review process, using appropriate change mechanisms where WFD timescales are not compatible with Anglian Water's business planning process.

Outlook

In the year ahead Anglian Water will continue to focus on delivering its regulatory obligations while continuing to seek further operating and capital expenditure efficiencies. At an operational level, it will be focusing on customer service, maintaining sufficient water resources and the other key aspects of its service that make up Ofwat's Overall Performance Assessment.

Corporate responsibility

Working in communities

Anglian Water has operated its *give me five* scheme for a number of years whereby, providing it links to personal development, employees who volunteer in community activities are given a matched number of work hours (up to 30 hours per year).

As part of the Community Service Volunteers 'Make a Difference Day' in June 2005, some 75 Anglian Water employees and Capital Alliance partners worked at Peterborough District Hospital to create a sensory garden, play zone and magic garden for young patients. The team was involved in all aspects of the work, from creating designs to providing the materials and labour.

During 2005/6 nearly 120 employees have given time to their communities, and have been supported by Anglian Water with the offer of matched time. Much of the 6,000 hours donated by employees and the company have been in less visible, but equally important activities, such as working with scouting organisations, as school governors, sports coaches, fundraisers for local charities, reading in schools, and local conservation projects. Anglian Water has set a target to increase, year on year, the number of hours donated by staff and Anglian Water.

In addition, AWG is part of the Business in The Community (BiTC) Percent Club. The Percent Club is a voluntary benchmark, measuring the contributions made by companies though cash donations, staff time, gifts in kind and management time, shown as a percentage of pre-tax profits.

Education

One way in which Anglian Water engages with its customers is to open its water and wastewater treatment works to the public.

A water bottle house has been erected at Grafham Water in Cambridgeshire, which provides a way to visually convey to customers the amount of water used every day by the average family of four. The house, which is constructed from 1,000 half-litre water bottles, is popular with children and adults alike.

An extensive Education Programme is planned for 2006 onwards. The programme includes purpose-built classrooms on operational sites and an educational bus that will visit schools, open days and other community events. Professional teaching staff will conduct lessons and activities about the water cycle, its use, treatment and conservation that will be linked to the National Curriculum. The overall aim is to educate young people about the real value of water and why it is so important to treat it as a precious resource.

WaterAid

For many years, Anglian Water has supported WaterAid, an international charity dedicated to helping people escape poverty and disease caused by living without safe water and sanitation.

Through a combination of Anglian Water donations and employee contributions, more than £0.5 million has been raised in the past five years. In 2005/6 Anglian Water's customers donated £75,000 to WaterAid, £40,000 was donated corporately and employees raised a further £66,000.

Morrison is a support services business principally providing services to blue-chip utility clients and facilities management to local authorities.

Key performance indicators

Accident Frequency Rate[1]

2006	0.30
2005	0.30

Profit margin[2]

2005/6	3.4%
2004/5	2.0%

Order book

Mar 06	£1,424m
Sep 05	£1,179m

Dividend contribution to group

2005/6	£9.3m
2004/5	£7.7m

[1] Accidents per 100,000 hours worked
[2] From support services operations, under IFRS (before head office costs)

Introduction

In 2004, AWG carried out a business review of Morrison, looking at ways to maximise shareholder value. Having considered all options for Morrison, it was decided to retain the business and improve its performance over a two to three-year period.

Morrison began the year operating in three segments: Support Services (principally Utility Services and Facilities Services), Construction Services and Project Investments.

Following the sale of Construction Services and the Project Investments business, Morrison is now a dedicated support service business. Construction Services previously represented the part of the Morrison business with the highest inherent risk profile and lowest margin.

During the year, Morrison Construction Services and the PFI business, Project Investments, were sold. The sale generated total cash proceeds of some £42 million and gave rise to a book loss on disposal in the current year of £56.4 million, which is classified within discontinued operations. The loss on disposal is primarily attributable to £93.1 million of unamortised goodwill written off in respect of Construction Services (which arose when Morrison was acquired in 2000), net of proceeds received.

Continuing operations

Morrison's support services businesses provide principally repair and maintenance and capital maintenance services to the utility and public sectors. It operates primarily through two segments: Utility Services and Facilities Services, both of which have long-term relationships with their customers.

The business review in 2004 focused Morrison on improving its commercial and financial discipline by concentrating on three key objectives:

- To raise operating margins.
- To ensure a healthy conversion of profit to cash.
- To ensure that the order book is strong enough to sustain and grow the business profitably.

The business is self-financed through its own cash generation. Revenues are used to finance business development and to pay a dividend contribution to AWG.

Utility Services
Utility Services provides support services to 12 key blue-chip clients in the gas, water, electricity and telecommunications sectors. Its services range from implementing planned capital investment schemes to reactive repair and maintenance.

The water and gas markets are considered to be relatively mature. The electricity and telecommunications sectors still provide good opportunities for expansion and increased market penetration.

During 2005/6 there were a number of significant additions to the order book, including new and extended contracts.

Facilities Services
Facilities Services principally provides outsourced property repair and maintenance and capital investment services to the public sector, typically through three to 10-year contracts.

It is one of the largest providers of social housing repair and maintenance services to local authorities in the UK, managing more than 300,000 homes and other local authority buildings. It also provides facilities services to a number of schools and the National Probation Service.

As well as offering repair and maintenance services and related services, such as call centre management and tenant liaison, Facilities Services also manages local authorities' capital spending programmes, such as kitchen and bathroom replacement programmes. The market for these services is considerable (see page 29 under Growth Drivers).

Facilities Services currently has 16 major clients. During 2005/6 a number of contracts were won and extended with local authorities and housing associations including Tower Hamlets, Newcastle, Gateshead, Redbridge and Gloucester.

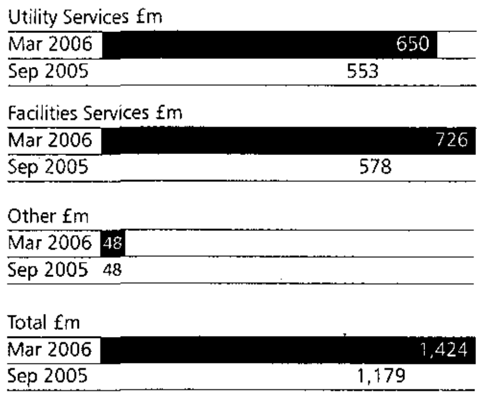
Other
Project Investments
As part of the Construction Services sale announced on 2 March 2006, Project Investments, the specialist Private Finance Initiative (PFI) business, was also sold. The small Project Investments team was transferred, and there is an intention to transfer two early-stage PFI projects (Defence Housing Executive in Portsmouth and Highland Schools).

As part of the sale agreement, the Project Investments team will continue to manage Morrison's remaining PFI concessions, with a view to divesting them at the appropriate time. These will be managed outside the Morrison business and are therefore no longer reported as part of Morrison. The six remaining PFI investments have a book value of £7.6 million.

Purac
Morrison retains Purac, a process engineering, technology and project management company serving municipal and industrial clients. Purac operates principally in the environmental sector, specialising in water and wastewater treatment.

Morrison continued

Order book



Financial performance

Continuing operations	2006 £m	2005 £m
Turnover	637.2	509.0
Operating profit before exceptional items[1]	17.9	3.8

[1] 2005 comparative excludes the exceptional loss on disposal of the MVM business of £8.3 million.

Morrison's continuing operations, Utility Services and Facilities Services, have built on the improvements seen in the first year to deliver a strong performance in the second year of its business improvement programme.

Turnover for Morrison's continuing operations as a whole increased 25.2 per cent to £637.2 million (2005: £509.0 million), while operating profit before exceptional items increased by £14.1 million to £17.9 million (2005: £3.8 million). Overall operating profit margin from Support Services on the traditionally measured UK GAAP basis[1], increased to 3.0 per cent (2005: 2.5 per cent).

Turnover in Utility Services increased significantly to £405.4 million (2005: £295.0 million). This was a result of retaining and increasing work from existing clients. Operating profit also increased significantly to £12.7 million (2005: £5.2 million).

Facilities Services' turnover increased 28.2 per cent to £192.5 million (2005: £150.1 million), while operating profit more than doubled to £7.9 million (2005: £3.8 million). Facilities Services has won a number of significant contracts in the year, including social housing maintenance and 'Decent Homes' (capital investment) work in Newcastle and Gateshead, the full-year impact of which will be seen next year.

[1] Operating profit margin on a UK GAAP basis includes joint venture turnover and operating profit.

During the year, Facilities Services also won a 10-year, £54 million repair and maintenance contract in Redbridge, Essex. Facilities Services now has an established presence in Scotland, the North East, the Midlands, Norfolk, London and Essex.

After the year-end in April 2006, Facilities Services won a contract with Highland Schools worth £100 million to provide maintenance services over 30 years.

Management

Structure

Morrison has its own operating board of eight directors, which includes the Group Chief Executive and Group Finance Director of AWG and the Managing Director and Finance Director of Morrison.

Responsibility and control

A Managing Director has responsibility for the performance of each of the operating divisions, which are in turn supported by a small number of key head office employees including finance, human resources, legal and supply chain management.

Morrison has reinforced the commercial discipline and financial control processes for new business tendering and project development and management. The selection criteria for tendering projects have been tightened, focusing on core skills in geographic areas where Morrison has appropriate capability, experience or supply chain availability.

All new contracts must contribute to Morrison's strategic and financial targets, which are measured in terms of cash generation and sustainable profit margin. In addition, the risk profile of contracts must be acceptable.

Key drivers of shareholder value are reported on a monthly basis at a contract level. All tenders are rigorously reviewed and are assessed against the criteria of delivering a sustainable improvement in profit margin for the business to ensure that management can be confident that the order book will deliver improving results in the future.

People

The reshaping of the business is intended to enable more efficient and profitable delivery of Morrison's services. In order to realise this ambition it is vital that Morrison's employees are properly skilled and motivated to deliver the strategy. During 2005/6 the average number of training days per person per annum within Morrison was 6.3 days compared to European standard set at five days.

Utility Services has become the first utility services company in the UK to re-qualify more than 100 Gas Distribution level 1 (GD1) gas engineers to the Gas Network (GNO) level two qualification. Under new regulations issued by the Energy and Utility Skills Council, companies will need to comply with the new standard by 2008 to enable engineers to work on the gas network.

Morrison also works very closely with the Learning and Skills Council, the Energy and Utility Sector Skills Council and regional colleges in relation to the ongoing training and development of employees.

Competitive environment

Morrison operates in the highly competitive support service sector in which there are a large number of companies offering a wide range of different services.

Morrison has performed strongly by concentrating on its core skills in markets in which it has experience, competitive advantage and an established supply chain. In doing so, risk and start-up costs have been significantly reduced, leading to faster, more efficient operations.

Both support service divisions, Utility Services and Facilities Services, have an excellent safety record, which is essential for long-term success in these competitive sectors. Morrison has maintained an excellent safety performance over many years and has won a series of awards in recognition of its achievements in this area.

Availability of skilled workers is an issue faced by all companies in this sector. To help retain its existing workforce, Morrison invests in the development of its employees. Both Utility Services and Facilities Services are accredited Investors In People. In order to help tackle ongoing skills shortages, both divisions have been actively involved in apprentice schemes and training the long-term unemployed. In conjunction with a key client, Utility Services is also continuing to offer training to selected young offenders.

In Facilities Services, a client's Direct Labour Organisation (DLO), involving a workforce of hundreds of employees, is often transferred en masse to Morrison. The sensitive management of this process is critical to the smooth handover of work, subsequent efficiency and individuals' job satisfaction. This is an area in which Morrison has considerable experience.

Commercial relationships

The support service businesses operate under framework contracts of typically three to 10-years duration.

Within Utility Services most contracts operate on a schedule of rates basis with increases each year to allow for inflation. Each contract has it own unique set of key performance indicators (KPIs) agreed with the client. These KPIs can influence the profit on the contracts.

Facilities Services' contracts tend to be on a measured-term basis with a schedule of rates. However, in recent years there has been a move to partnership arrangements, where the price is based on output specifications.

Morrison continued

Growing skills

Morrison Utility Services is one of the leading providers of services to the gas, water, electricity and telecommunications sectors.

Main photo: a Morrison TE Services Limited engineer installing a 'Next Generation Network' at a client's premises in Dublin.

During the year, Utility Services acquired Dublin-based TE Services Limited, a small, specialist telecommunications contractor. The acquisition, funded from Utility Services' operating cashflow, provides Utility Services with additional skills for the telecommunications sector.

Inset (left): switching on a 33kV circuit.

Risks

Economic trends

Much of Morrison's activities are operated within framework agreements with government agencies, local authorities and utility operators. These are relatively insulated from general economic trends.

Contractual risk

The majority of Morrison's contracts are with public authorities and major blue-chip clients.

Both the funding of programmes and the political support for private involvement may be subject to change.

The regulatory risks for Morrison's utility clients are cyclical. For example, in the water industry prices are set every five years. 2005/6 is the first year of the latest Asset Management Period. The risks relate to the operating cost targets set by the Regulator, Ofwat. However, once the final determination is announced, the industry has considerable visibility of its targets and costs for the next five years.

As well as increasing the proportion of its work in framework contracts, Morrison spreads its contractual risk by carrying out a larger number of small, low-risk contracts. When assessing potential contracts, emphasis is placed on whether it fits with Morrison's core skills and how close it is to Morrison's established supply chain.

Pensions

Prior to the sale of Morrison Construction Services, agreement had been reached with Trustees of the largest Morrison pension scheme, Morrison Pension and Life Assurance Plan (MPLAP) and with a large degree of employee support following consultation, to switch from final salary to a career average accrual scheme for future service. This maintained defined benefit provision for those employees whilst reducing the cost and risk to Morrison.

Morrison continued

Following the sale of Construction Services, MPLAP closed to future service accrual. A new scheme was established to provide career average benefits to those scheme members not part of the disposal.

The Facilities Services business, working on local authorities' social housing, often involves a transfer of employees under Transfer of Undertakings, Protection of Employment (TUPE) arrangements to Morrison. The pension provision for these employees must therefore be equivalent to that received when employed by the local authority.

Morrison achieves this either by allowing employees to remain in the Local Government Pension Scheme (LGPS) by agreement with the local authority, or providing employees with an equivalent pension scheme through the company. Morrison has a policy for managing such pension obligations and has specialised in developing pensions solutions with its clients.

Skills shortages
Morrison operates in an economic climate where skill shortages prevail and consequently invests heavily in training and developing employees to their maximum potential. Morrison has been very successful in recruiting from local communities in which it works and in developing and retraining staff.

Over the past year Morrison has employed over 200 personnel from the long-term unemployed as a result of its association with Job Centre Plus. A number are mature apprentices, which supports Morrison's involvement in social inclusion in the community programmes.

Morrison is also running its ninth programme with the prison services Young Offenders Rehabilitation Scheme. Morrison employs people from this scheme as well as working with its clients to place young people back into work.

Reliance on suppliers
The business has preferred supplier relationships, which are generally not exclusive and always seek to ensure that a balanced and stable supply chain is maintained, which helps to deliver best value to clients.

Health and safety
Health and safety considerations form a key part of Morrison's operational practices. Morrison operates safe and reliable working practices through a policy of honesty, trust and sharing best practices across all business operations.

The Accident Frequency Rate (AFR) within Morrison during the year was 0.30 against a target of 0.38. A particular achievement during the year was in Utility Services where four million hours were worked on a gas contract without any lost time through injury.

AWG's Safety First – Second Nature approach is highlighted in campaigns throughout Morrison, requiring that employees and sub-contractors participate in safety improvement.

In April 2005, Morrison was awarded the British Safety Council – International Safety award in recognition of its safety performance across the Morrison business.

Utility Services has become the first utility service business in the UK to devise and implement a bespoke Institution of Occupational Safety and Health (IOSH) accredited training course for the utility sector.

Managing waste

Excavated material is taken to a site where a machine recycles the spoil and mixes structured material for reinstatement (SMR) with the excavated material to create a high-quality material that can be used as backfill, sub-base or road-base.

The machine provides a consistent mix and rejects any stones or material above a certain size, ensuring a high degree of quality control with the production of the recycled material.

This has significant benefits for the company, as well as the environment, as it reduces the amount of spoil taken to landfill sites. The cement-like SMR absorbs moisture and allows further compaction by as much as five per cent.

Using SMR also reduces pollution as lorries do not need to transport natural stone or spoil to and from site.

The Utility Services division also won the Construction Sector Royal Society for the Prevention of Accidents (RoSPA) sector award in April 2006 for safety, the first time the same company has won the award two years in succession. During the year, Alpheus, Morrison's environmental services company, and Purac won RoSPA Gold Occupational Health and Safety Awards.

Facilities Services is undertaking significant work in raising standards within its local authority-derived businesses. The health and safety management systems within Facilities Services have been accredited by the Contractors Health and Safety Assessment Scheme (CHAS). CHAS is used by local authorities to assess the health and safety capability of potential suppliers.

During the year, Morrison Facilities Services was prosecuted by the Health and Safety Executive for the incorrect removal of notifiable asbestos from a property in 2004. Morrison pleaded guilty and was fined £32,000. Morrison has chosen to use specialist asbestos sub-contractors to undertake this work since 31 March 2006.

Growth drivers

The social housing sector represents a significant growth opportunity for Morrison. Of the five million social houses in the UK, two million have so far been outsourced to the private sector. In addition to local authorities' own current spending, the Government has committed funding of £19 billion in order to bring all social houses up to its 'Decent Homes' standard by 2010.

Morrison is working in partnership with its clients to unlock this funding and the sizeable market opportunity it represents.

Utility Services is a leading company in the mature utility sectors of water and gas. In addition, the electricity sector and telecommunications markets represent good opportunities for expansion and increased market penetration. During the year Morrison acquired TE Services Limited, a small telecommunications business based in Ireland in order to offer specialised services to one of its key clients.

Outlook

Morrison will focus on the continued profitable growth and performance improvement of its support service business, with the key objective of realising optimal shareholder value.

Corporate responsibility

Working in communities

An important part of Facilities Services' role in social housing contracts is to engage effectively with the community. In doing so, Morrison builds trust with tenants which enables much more effective delivery of repair and maintenance and capital investment schemes.

An example of investment in the community is an apprentice scheme that is operated by many of the social housing contracts. In the London Borough of Havering, for example, there are currently four apprentices involved in courses learning a range of skills, including electrical installation, carpentry and domestic (plumbing) installations. Once completed, apprentices will be awarded a National Vocational Qualification (NVQ) and a technical certificate.

This community engagement is managed by dedicated Resident Liaison Managers (RLMs) with support from the local teams. During the year, Facilities Services created a new post of National Resident Liaison Manager to support and guide the network of RLMs.

Managing wastes

Utility Services has been given approval to use waste material as a soil stabiliser on class 2 roads by Hampshire County Council. The structured material for reinstatement was previously only permitted to be used on footways (see panel above).

AWG Property

AWG Property is one of Scotland's leading development and investment companies, pursuing low-risk opportunities with its joint venture partners. It is also seeking to realise value from surplus land elsewhere in the group.

Key performance indicators

Accident Frequency Rate[1]

2006	0
2005	0

Capital employed

Mar 06	£62m
Mar 05	£90m

Operating cash flow

2006	£27m
2005	£(3.4)m

Operating loss

2006	£(1.9)m
2005	£(13.7)m

[1] Accidents per 100,000 hours worked

Introduction

AWG Property has developed a reputation as one of the leading Scottish development and investment companies. It manages a large property portfolio, in many cases through joint ventures covering commercial development, residential development and property investment.

It also has a remit to develop surplus land and property assets owned by other parts of the group.

AWG Property's focus on its Scottish operations has enabled the management team to attract new project partners and secure investment capital to expand its financial strength within this market.

Commercial developments

AWG Property is a specialist commercial property developer across Scotland, with extensive experience in retail and leisure, office and business space, mixed-use, industrial and distribution markets.

In 2005/6, AWG Property concluded 284,337 square feet of commercial contracts. These included the new Centre of Excellence for Scottish Power, the new Scottish headquarters for First Engineering and the first disaster recovery office for ICM in Scotland.

Residential developments

An estimated 13,000* new homes a year will be required over the next five years in Scotland. This market therefore represents a significant opportunity for AWG Property.

AWG Property provides a wide range of services and support to suit independent developers, small builders, landowners and financial institutions. AWG Property is actively involved in all aspects of the residential business in Scotland and is currently involved in a number of projects.

*Source: Scottish Executive Projections.

In September 2005 it was named preferred developer with the Scottish Agricultural College (SAC) to deliver a 500 acre master plan for its site in Ayr.

Strategic land holdings
AWG Property manages some 1,589 acres of strategic land holdings across Scotland with the potential for 10,000 new homes. During 2005/6 this was expanded with further purchases in residential growth areas, including Ayr, Neilston, Carluke and Longridge.

Fund launches
AWG Property has launched fund initiatives in conjunction with investment partners. Its main role within these initiatives is to manage the project development and co-ordinate the funding requirements. In some cases, AWG Property provides a small equity investment into these funds.

Legacy contracts
Following the change in strategic focus of the group as a result of a business review carried out in 2004, AWG Property began realising value from its existing, non-Scottish developments.

Group property holdings
AWG Property is reviewing the surplus land and assets owned by Anglian Water. There are currently 47 sites being considered, ranging from 0.5 acres to 25 acres across the AWG portfolio. 2005/6 saw the first return on this strategy with three sites successfully taken through various property transactions realising some £0.8 million of value.

Financial performance

	2006 £m	2005 £m
Turnover	35.2	26.0
Operating loss	(1.9)	(13.7)

Total operating loss for AWG Property for the year was £1.9 million (2005: loss of £13.7 million) on a turnover of £35.2 million (2005: £26.0 million). The improvement mainly relates to the restructuring and disposal of a number of loss-making legacy properties.

Capital employed within AWG Property reduced from £90 million at 31 March 2005 to £62 million at 31 March 2006. This is targeted to reduce slightly in future years as the few remaining legacy properties are sold.

The reduction in capital employed mainly reflects the continued release of invested capital from its property assets. Projects completed during the year included the sale of the Great Northern Warehouse joint venture in Manchester, residential and commercial properties in Cambuslang and the sale of residential land and developments in the Republic of Ireland. This has resulted in an operating cash flow of some £27 million.

With the repayment of bank facilities, debt guarantees have effectively reduced further from £23 million at 31 March 2005 to £11 million at 31 March 2006. The group's share of off balance sheet debt has been managed downwards for some time and was reduced further by 43 per cent in the year to a new total of £55 million.

AWG Property continues to develop new business within its core Scottish market. In a successful year for commercial development and investment activities various deals were concluded, delivering a gross operating profit of £6.5 million in Scotland. Further sites were also secured, including prime office development sites in Edinburgh and Glasgow. The operating profit delivered in Scotland was offset by losses on residual legacy properties, a number of which, as noted above, were disposed of during the year.

AWG Property continued

Enhancing reputation

AWG Property is a leading developer of commercial property in Scotland.

In 2005 it concluded 284,337 square feet of commercial contracts, including computer group ICM's first disaster recovery office in Scotland.

Management
AWG Property has its own board, which consists of two AWG Plc Directors (the Group Chief Executive and the Group Finance Director), the Managing Director of AWG Property and six further Executive Directors. The Managing Director oversees the day-to-day operations.

Risks
AWG Property faces a variety of business risks. The principal risk is the economic cycle, which property developments tend to follow. AWG Property minimises the risk of these cycles adversely affecting its business in a number of ways.

The principal approach is to ensure that AWG Property has a balanced property portfolio to spread the exposure to individual market sectors, while allowing it to respond quickly to new opportunities.

All projects are subject to extensive due diligence before proceeding and are within core market sectors and geographical areas in which it has experience. AWG Property also ensures that it maintains a strong pipeline of projects at different stages of development. Developments range from low-risk projects work with local authorities and occupiers to larger multi-let schemes and office developments with established commercial partners.

AWG's role in the development process is designed to minimise risk. It adopts a facilitation role in identifying the opportunity, and the client, and drawing on established joint venture partners to deliver projects. The financial risk involved in building properties is invariably borne by its third-party construction partners.

The demand for property developments and land generally continues to be strong in Scotland. The market is underpinned by the large number of blue-chip financial businesses in the region and continued regional redevelopment, for example in Cambuslang. Residential house price growth in Scotland continues to compare favourably to England.

A new strategic land tax, the Property Gain Supplement, will be introduced in Scotland; the timetable for implementation is yet to be confirmed. Although the full implications of the tax are currently being considered, it will be a prerequisite of future land purchases that they will be able to absorb the tax and remain financially viable.

Pensions
The majority of employees participated in the Morrison Pension and Life Assurance Plan (MPLAP). This scheme was closed to future service on 31 March 2006 and the employees were given a choice of whether to join the group defined contribution scheme or a newly created career average earning scheme.

Outlook
AWG Property will focus on continued development and profitable recycling of capital employed in its core Scottish market while continuing to release cash from its few remaining legacy properties.

Corporate responsibility
Working in communities
The AWG Property team has been involved in a number of charity projects. One example is in Ayrshire where the team designed and painted a children's playroom for the charity CLIC Sargent.

Other financial matters

Other business activities
The 'Other' business segment mainly comprises head office, the six remaining PFI investments, a wastewater treatment works in the Republic of Ireland and a few residual international interests.

The group continued to exit from its remaining international investments during the year, completing disposals in Norway, Australia, Germany, Poland and two operations in China. During the year the Aguas Argentinas water and wastewater concession in Argentina was terminated, and the group's debt obligations to secured lenders were settled.

This leaves an operating business in Brazil, and a non-operating contract in China. In addition, the group continues to operate its long-term, wastewater treatment joint venture in Ireland.

Pensions
This was the first year that AWG accounted for pensions in accordance with IAS 19 'Employee Benefits'. At 31 March 2006 the total deficit for the group (before deferred tax) was £105.0 million (2005: £216.6 million). There are a number of reasons for this reduction as explained below.

The Trustees reduced pre-funding of early retirement and ill-health early retirement benefits, and reduced the allowance for cash commutation in the main Anglian Water defined benefit scheme. This had the effect of reducing the deficit by approximately £50 million.

As part of the cost efficiency measures in Anglian Water, and following consultation with staff and unions, it is planned to hold general salary increases during the remainder of AMP4 in line with inflation. This has had a beneficial impact on the pension deficit of some £17 million.

Better than expected asset performance contributed £104 million to the reduced deficit. However, this was more than offset by the effect of the decline in bond yields over the year, and allowing for increased life expectancy which had the effect of increasing the deficit by £100 million and £16 million respectively.

Anglian Water made an additional pension contribution of £7.7 million (2005: £9.4 million) in March 2006 to reduce the deficit, followed by a further £3.0 million paid in April 2006. Future additional contributions will continue to be made in line with actuarial advice.

The main Morrison scheme's link with final salaries was broken when it was switched to a career average earnings arrangement. It was then closed to future service, following the sale of Construction Services. This reduced the deficit by around £4 million. It is intended that the remaining deficit in the scheme, £34.7 million, will be reduced to £nil by contribution payments over the next four years.

The full actuarial valuations as at 31 March 2005 were performed on the two largest pension schemes. The results of these valuations were available in December 2005 and have been reflected in the reported deficit at 31 March 2006. This resulted in the opening deficit estimates being reduced by some £40 million.

Treasury management
Group financing, including debt, interest costs and foreign exchange, is substantially managed by a central treasury team reporting to the Group Finance Director. Treasury policy continues to be focused on the efficient and effective management of cash and financial resources within the group. The central treasury function actively:

- Secures funds and invests temporary surplus cash to best advantage at minimal risk.
- Protects the group's foreign exchange and interest rate exposures.
- Maintains an excellent reputation with providers of finance and rating agencies.
- Monitors compliance with the group's financial covenants (both on an actual and forecast basis).
- Promotes improvement of cash management techniques, systems and controls throughout the group.

AWG's board, through the Treasury Advisory Group, regularly reviews treasury policy, organisation and reporting to ensure continued effectiveness and relevance.

Liquidity
The group's objective is to maintain flexibility and continuity of funding through access to different markets and debt instruments. At 31 March 2006 the group held cash, deposits and current asset investments of £775.9 million (2005: £1,098.6 million) and had undrawn committed multi-currency facilities of £683.0 million (2005: £683.0 million). These resources are maintained to ensure liquidity and the continuation of the group's investment programme. The maturity profile of the group's borrowings is set out in note 26 of the consolidated financial statements.

Capital structure
AWG's capital structure is largely driven by the requirements of Anglian Water's capital expenditure programme, which is met by a combination of cash flow and debt issuance.

In 2002 AWG carried out a financial restructuring which increased its gearing and reduced Anglian Water's weighted average cost of capital. The group issued debt in the form of bonds and other financial instruments, secured on Anglian Water's assets. At 31 March 2006 Anglian Water's net debt to capital value ratio (net debt as defined in the Common Terms Agreement expressed as a percentage of Anglian Water's regulated capital value) was 79.0 per cent (2005: 80.1 per cent).

Borrowing covenants
The financing within Anglian Water is secured under a common terms agreement with investors. All other group borrowings are raised or guaranteed by AWG Plc, AWG Group Limited and, in certain instances, subsidiary companies. The central treasury function is responsible for monitoring ongoing compliance with the group's financial covenants, which principally relate to Anglian Water's ratio of net debt to Regulatory Capital Value and interest coverage. At 31 March 2006, Anglian Water was compliant with all covenants.

Interest rates
The group's policy, as agreed by the board, is to achieve an efficient mix of funding at fixed rates of interest, floating rates of interest and rates indexed to retail prices. This mix also reflects utilisation of interest rate swaps so as to manage the group's net exposure to interest rate and retail price variations.

The composition of the group's total borrowings, after swaps, at the year-end was:

	31 March 2006	31 March 2005
Indexed	43.2%	29.9%
Fixed	48.1%	57.7%
Floating	8.7%	12.4%

Other financial matters continued

The change in the composition in the table (on page 35) reflects the repayment of £659 million of callable bonds, the repayment and amortisation of £88 million of US Dollar private placement borrowings and Sterling leases, £46 million of indexation on index-linked debt and the issuance of £402 million of index-linked debt in April 2005.

The objective of this refinancing was to reduce the weighted average cost of capital and, as a consequence, the group's prospective interest costs.

Foreign currency

The group has minimal currency exposures resulting from overseas investments and foreign currency purchases and sales. The group uses a range of instruments to hedge such exposures. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets, profits and anticipated disposal proceeds.

The group's foreign exchange exposure management policy, as agreed by the board, is to hedge material transactional exposures against the reporting currency by means of forward foreign exchange contracts.

Net assets are held in a number of currencies and translated at prevailing year-end exchange rates. The resulting exposures are monitored and, at certain thresholds, are hedged by currency borrowings, cross-currency swaps, forward foreign exchange contracts or foreign exchange options.

Credit risk

The group's main credit risk is in relation to trade receivables and is managed by regular review of problem accounts. Due to the nature of the customer base in Anglian Water, credit checks are not generally performed, but the risk is spread over a very large number of individually small customer accounts. For the group's non-regulated operations, credit risk assessments are generally performed and payments in advance are obtained where possible.

Joint venture financing

In accordance with current accounting standards, assets and liabilities in certain joint venture investments within the Morrison, AWG Property and the Other business segments are not included on the group's balance sheet on a gross basis. This is because these joint ventures are accounted for on an equity basis and the group's share of assets and liabilities (including debt) is shown in the balance sheet as interests in joint ventures.

Following the agreement to sell two PFI projects on 31 March 2006, Morrison Project Investments, now part of the Other business segment, had remaining equity investments in six PFI projects, all of which are joint ventures. The group's share of the debt within these remaining investments was £50.8 million at 31 March 2006 (2005: £79.9 million).

The group's share of the debt within Morrison Cleanaway Ltd (operating as CityCare), a Morrison Facilities Services joint venture, was £1.9 million at 31 March 2006 (2005: £2.2 million).

AWG Property's share of the debt within its joint venture companies at 31 March 2006 was £55.0 million (2005: £96.6 million).

As at 31 March 2006 the group had guaranteed debt obligations of joint ventures and associates totalling £31.8 million (2005: £43.1 million). These are disclosed as contingent liabilities in note 34 of the consolidated financial statements.

Corporate responsibility

Corporate responsibility (CR) is an integral part of the way AWG does business. Through its CR standards, AWG reinforces the importance of making decisions based on social and environmental considerations, as well as economic ones.

Corporate responsibility standards

Safety	Nothing that we do in AWG is so important that we cannot find the time to do it safely. We recognise that good safety performance, and the safety of everyone who works for us or is affected by our work, are critical to the success of our business. Our goal is for no accidents and no harm to people and we are committed to the achievement of that goal.
People	Employees will be treated in a manner that respects them as individuals, develops their potential in the context of the business, encourages them to play a part in AWG's development and enables them to share in AWG's success.
Community	We will show sensitivity to the values and concerns of communities in which we do business and we aim to enhance community wellbeing, principally through contributions of time and expertise.
Environment	We believe that natural resources should be used sustainably and we will adopt working practices that help achieve that goal.
Risk	We will recognise and manage risk in all aspects of our business.
Integrity	We will demonstrate integrity and honesty in the way we conduct business.
Accountability	We will account for our actions in a way that meets all that might justifiably be expected of us.

For more information about how the AWG Corporate Responsibility Standards are applied to our businesses and how AWG meets them, please visit www.awg.com.

What corporate responsibility means to AWG

AWG believes corporate responsibility is about supporting and actively encouraging strategies and behaviours that demonstrate its commitment to the long-term viability of the business. This reinforces the belief that good business decisions take into account social and environmental issues, as well as economic ones.

AWG recognises that it must behave responsibly when making decisions, both as individuals and collectively as a group.

At AWG corporate responsibility is not about taking specific actions to 'tick boxes', but making sure that it manages the key elements of its day-to-day business and long-term planning in ways that are sustainable. Applying the Corporate Responsibility Standards helps identify the risks and the opportunities that responsible management brings.

The Corporate Responsibility Committee oversees the Standards. The Committee is chaired by Robert Napier, an Anglian Water Non-Executive Director and Chief Executive of the Worldwide Fund for Nature. The Committee helps, encourages and challenges management in planning and communicating environmental, reputational and social issues that are expected to impact on AWG.

Corporate responsibility continued

Education

Anglian Water has created a house made out of 1,000 half-litre bottles to represent the amount of water an average family of four uses every day.

The house, which is permanently located at Grafham Water in Cambridgeshire, is popular with children and adults alike.

Anglian Water encourages its customers to play their part in conserving water.

A regional advertising campaign, which began in May 2006, demonstrated some simple ways to save water.

All areas of corporate responsibility are important to AWG. However, due to the diverse nature of the businesses, each has focused on the issues that are of particular relevance.

Examples of some of these areas include:

Climate change
AWG recognises that decisions made now in relation to climate change will affect its ability to deliver services in the future. The Anglian Water region is potentially the most at risk in the UK from climate change impacts such as raised sea levels and hotter, drier summers.

In April 2005 AWG held a climate change workshop for senior Anglian Water managers, looking at possible scenarios, how to mitigate current impacts and how to adapt to environmental changes. As a result, Anglian Water developed its Climate Change Action Plan that takes it into and beyond the next regulatory period, 2010 to 2015. Anglian Water has already set demanding targets for reducing energy, wastes, transport and chemical use and reducing its greenhouse gas emissions.

More information on the implications of climate change for Anglian Water is detailed on page 20 of this report.

For more information on AWG's climate change work, see the Anglian Water Environment Report 2006 (see the inside cover of this report for details of how to obtain a copy) and the AWG website: www.awg.com.

Within Morrison, Facilities Services is contributing toward emissions reduction through its 'Decent Homes' contracts, by meeting clients' needs in the installation of condensing boilers, insulation and replacement windows. These actions bring lower emissions and reduced bills for tenants.

Examples of the advertising campaign, featuring Bill Oddie, which were used on buses and in radio advertisements.

Corporate responsibility continued

Biodiversity
The natural environment and biodiversity are high priorities for Anglian Water. Anglian Water continues to perform strongly against the regulatory standards for water quality.

There are more Sites of Special Scientific Interest (SSSIs) in the Anglian Water region than in any other part of the country, which means that Anglian Water's operations, such as pipe laying, abstraction and discharges are managed to ensure these sites are not affected by its activities. Anglian Water manages 51 sites located on SSSIs across the region, 96 per cent of which are in 'recovering' or 'favourable' condition.

A particular success for biodiversity has been the reintroduction of the pool frog into East Anglia after a 13-year absence. This was achieved by Anglian Water, working together with English Nature and others.

Community engagement
AWG aims to protect and enhance its reputation with customers and the communities in which they live.

AWG seeks the views of its customers and communities through continuous surveying and consultation. A new initiative this year is *focus*, a magazine that Anglian Water sends to customers. It contains information about Anglian Water's activities such as the *give me five* employee volunteering scheme, the recreation and sports facilities provided and information about the biodiversity and habitat enhancement work it does.

The magazine *focus* also gives information about Anglian Water's concerns about energy use, how to avoid sewer blockages, why water conservation is so important and water saving advice. Through *focus*, Anglian Water is actively seeking views and comments on these issues.

Communities in developing countries have been supported for many years by the group's active involvement with WaterAid. This year a total of £106,000 has been donated; this is made up of money contributed directly by Anglian Water and money raised by employees. The total amount raised in 2005/6, including that raised by customers, is £181,000.

As a large employer keen to ensure a well-trained work force into the future, Morrison Utility Services has undertaken an extensive training programme for 270 operatives, who have attained NVQs in gas network operations and water mains laying. The company has also recruited and trained, through Job Centres Plus, 200 meter installers, usually from the long-term unemployed. Its Young Offenders' Programme (with National Grid Transco) is now in its ninth programme. Thirty-two trainees have been trained to date and in 2005/6 Anglian Water also recruited two young offenders. Morrison believes that these initiatives bring long-term benefits to the individuals, their communities and AWG.

Morrison Facilities Services recognises that with its social housing contracts it has a responsibility to interact with the communities in which it operates. It has a network of Resident Liaison Managers who work directly with tenants and residents on practical and community issues.

Staff engagement
AWG believes that employees should be respected, enabled to achieve their potential and to play a part in AWG's development.

Corporate responsibility highlights 2005/6

- Review of corporate responsibility in AWG.
- Corporate responsibility embedded in Anglian Water's five-year business plan.
- Improved health and safety performance across the business with AFR decreased from 0.42 to 0.39 in Anglian Water and to 0.30 from a target of 0.38 in Morrison.
- Purchase of renewable energy increased to 21.4 per cent.
- Self generated energy from wastes risen by 50 per cent.
- 96 per cent of sites within SSSIs in Recovering or Favourable condition.
- Winner of the RoSPA Construction Sector Award (Morrison Utility Services).
- £181,000 donated to WaterAid by Anglian Water, its employees and customers.
- £1 million donated to the Anglian Water Trust Fund.

For more information about corporate responsibility in AWG and its performance, please visit the website: www.awg.com.

At Anglian Water people processes, including performance, development and rewards, are driven by the personal development review process which considers an individual's performance against objectives, as well as skills and behaviours. It allows individuals to be valued for their talents, performance and achievements in a fair and consistent way.

This year Anglian Water has concluded consultation with all employees and has agreed a four-year plan for pay and pensions. This approach gives certainty to both company and employees and establishes a sustainable cost base for the future.

Safety

Anglian Water has one of the lower Accident Frequency Rates (AFR) in the industry and has improved its year-on-year safety performance since 2003.

Morrison has a nationally recognised safety culture and has continued to improve its safety performance. Morrison Utility Services has become the first utility services business in the UK to devise and implement a bespoke Institution of Occupational Safety and Health (IOSH)-accredited training course for the utility sector. It has also won the Royal Society for the Prevention of Accidents (RoSPA) Construction Sector Award for the second year running.

The future

AWG is considering ways in which it can improve its dialogue with stakeholders. Anglian Water has an extensive communications plan underway, including educational and health-related programmes.

AWG will also continue its work to understand and prepare for the challenge of climate change.

Ultimately, the aim is that corporate responsibility becomes part of business as usual.

Board of Directors

Chairman and Executive Directors

Peter Hickson (61) Chairman
Peter Hickson was appointed to the AWG board in April 2002 and became Chairman in January 2003. Prior to joining AWG, he was Group Finance Director of Powergen plc from 1996 to 2002 and Group Finance Director of MAI Plc from 1991 to 1996. He is a Non-Executive Director of telent plc (formerly Marconi Corporation plc) and chairs its Remuneration Committee. He chairs AWG's Nomination Committee and is a Fellow of the Institute of Chartered Accountants in England and Wales.

Jonson Cox (49) Group Chief Executive
Jonson Cox was appointed Group Chief Executive of AWG in January 2004. He was a Director of Kelda Group plc from 1994 to 2000 where he led the recovery of Yorkshire Water, Kelda's principal business. Immediately before joining AWG he was Chief Executive of business services provider Valpak Limited from 2002 to the end of 2003 and Chief Operating Officer of Railtrack PLC from 2000 to 2001. He worked for the Royal Dutch/Shell Group in a range of roles from 1979 to 1992. He is a Non-Executive Director of Wincanton plc.

Scott Longhurst (38) Group Finance Director
Scott Longhurst was appointed Group Finance Director of AWG in November 2004. Prior to joining AWG, he held a number of positions with TXU Corporation between 2000 and November 2004, including Chief Financial Officer and Senior Vice President Oncor Group, USA and Group Financial Controller and Chief Accounting Officer, TXU Corporation. Between 1991 and 2000 he held a number of UK and international financial and commercial roles with Royal Dutch/Shell Group including Chief Financial Officer of oil products joint ventures in Saudi Arabia between 1997 and 2000. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Peter Hickson Jonson Cox Scott Longhurst

Independent Non-Executive Directors

Roger Witcomb (59) Senior Independent Director
Roger Witcomb was appointed as a Non-Executive Director and Senior Independent Director of AWG in April 2006. He was a Non-Executive Director of Anglian Water Services Limited until April 2006 and served as an Executive Director of National Power plc from 1996 to 2000. He is a senior adviser at Actis Capital LLP and chairs AWG's Remuneration Committee.

Frances Heaton (61) Non-Executive Director
Frances Heaton was appointed a Non-Executive Director of AWG in 2002. She was an Executive Director of Lazard from 1987 to 2001, a Non-Executive Director of the Bank of England from 1993 to 2001 and Director-General of the Takeover Panel from 1992 to 1994. She is also a Non-Executive Director of Legal & General Group Plc and of Jupiter Primadona Growth Trust PLC. She chairs AWG's Audit Committee.

Andrew Carr-Locke (52) Non-Executive Director
Andrew Carr-Locke was appointed a Non-Executive Director of AWG in October 2003. He has been Group Finance Director of George Wimpey Plc since 2001 and was previously Finance Director of Courtaulds Textiles Plc from 1999 to 2000. He has held financial and management positions with Eastman-Kodak, Scott Paper and Diageo between 1974 and 1998 and is a member of the Chartered Institute of Management Accountants.

Jim McKenna (51) Non-Executive Director
Jim McKenna was appointed a Non-Executive Director of AWG in 2000. He is currently Chief Operating Officer of LogicaCMG plc. Until December 2004 he was the UK Chief Executive of LogicaCMG plc and has served on its board since 1993. He is also a governor of the University of East London.

Roger Witcomb Frances Heaton Andrew Carr-Locke Jim McKenna

Directors' report

The Directors present their report and the audited financial statements of AWG Plc for the year ended 31 March 2006.

Principal activities, business review and future developments

The principal activities during the year were water supply and distribution, wastewater collection and treatment; building and maintaining infrastructure in the utility, social housing, highways and property markets. On 31 March 2006 the group completed the sale of Morrison Construction Services Limited to Galliford Try Plc. Further details of this disposal can be found in the operating and financial review (OFR) on page 22. The information that fulfils the requirement of the business review, and a summary of the group's performance, future prospects and key risk management policies are included in the OFR on pages 5 to 41.

Group results and returns to shareholders

The income statement on page 60 shows the group's results for the year. A final dividend of 34.3 pence was paid following the 2005 final results. A dividend of 14.8 pence was paid following the interim results. The Directors recommend the payment of a final dividend of 36.0 pence per share. This will bring the total dividend paid and proposed for the year to 50.8 pence per share (2005: 48.7 pence per share).

Subsequent events

There have been no material adjusting subsequent events.

Research and development

The group and its subsidiaries have a continuing policy of undertaking research and development on process plant, infrastructure management, biosolids treatment and other water and wastewater related matters.

Share capital

At the Annual General Meeting (AGM) held on 28 July 2005, the company was authorised to make market purchases of ordinary shares up to a maximum number of 14,369,733 shares. For the year ended 31 March 2006 the company acquired 3,739,000 of its own ordinary shares (nominal value $19\frac{181}{201}$ pence), as part of the £75 million share buy-back programme announced on 2 June 2005. The total consideration paid for these shares was £37.1 million. Shareholders will be asked to approve a similar authority at the AGM on 26 July 2006. It is expected that the company will continue to purchase shares in the forthcoming financial year under those authorities. Details of AWG Plc's share capital are shown in note 31 on page 105. Options and awards outstanding under the group's share schemes at 31 March 2006 are set out below. These include options granted and awards made to Directors as detailed on pages 57 and 58.

Outstanding options and awards over ordinary shares at 31 March 2006 were:

	No of ordinary shares	Date of grant/award	Option/award price
Sharesave Scheme	4,539	9 December 1998	£7.12
Sharesave Scheme	100,776	12 January 2000	£4.34
Sharesave Scheme	479,304	31 January 2001	£4.68
Sharesave Scheme	434,974	6 February 2002	£4.20
Sharesave Scheme	2,395,417	31 January 2003	£3.38
Sharesave Scheme	854,613	5 February 2004	£4.28
Sharesave Scheme	360,320	28 January 2005	£7.42
Sharesave Scheme	536,797	8 February 2006	£9.54
Executive Share Option Scheme[1]	431,208	9 July 2002	£5.38
Executive Share Option Scheme	1,055,770	31 July 2003	£5.40
Executive Share Option Scheme	5,703	16 January 2004	£5.26
Phantom Executive Share Option Scheme	222,433	16 January 2004	£5.26
Long Term Incentive Plan	253,064	2 August 2004	£5.72
Long Term Incentive Plan	20,341	6 September 2004	£6.14
Long Term Incentive Plan	57,095	25 November 2004	£6.87
Long Term Incentive Plan	251,273	3 June 2005	£8.53
Long Term Incentive Plan	8,556	30 August 2005	£9.45
Phantom Long Term Incentive Plan	17,760	30 August 2005	£9.45
Long Term Incentive Plan Scheme	2,021	24 November 2005	£9.63
Annual Retained Bonus Scheme (matching shares)	3,904	11 July 2003	£5.61
Annual Retained Bonus Scheme (matching shares)	4,853	2 June 2004	£6.23
Annual Retained Bonus Scheme (matching shares)	19,866	2 June 2005	£9.05

[1] Options granted under the Executive Share Option Scheme (ESOS) in 2002 are subject to re-testing in 2007 but are unlikely to meet the performance condition and are expected to lapse.

Options granted under the Sharesave Scheme are exercisable within a period of six months after either the third, fifth or seventh anniversary of the date of the savings contract. Options granted under the ESOS are exercisable during a period commencing on the third anniversary and ending on the tenth anniversary of the date of grant, provided performance conditions are met. Awards made under the Long Term Incentive Plan (LTIP) will vest after the end of the three-year performance period, provided performance conditions are met. Awards of matching shares made under the Annual Retained Bonus Scheme (ARBS) will vest three years after the date of award provided performance conditions are met.

Directors

The current Directors of the company are listed below and their biographies are on pages 42 and 43:

Peter Hickson	Andrew Carr-Locke
Jonson Cox	Frances Heaton
Scott Longhurst	Jim McKenna
	Roger Witcomb

With the exception of Roger Witcomb, who was appointed on 27 April 2006, all of the above Directors served throughout the year. Other Directors who served during the year were Roy Pointer, Bill Cockburn and Sue Lyons who resigned on 26 April 2005, 22 January 2006 and 25 March 2006 respectively.

Jim McKenna will retire by rotation at the forthcoming AGM in accordance with Article 124 of the company's Articles of Association and, being eligible, will offer himself for re-election at that meeting.

Roger Witcomb, having been appointed since the last AGM, will retire at the forthcoming AGM in accordance with Article 103 of the company's Articles of Association and the Directors will recommend his election at that meeting in accordance with Article 126 of the company's Articles of Association.

Directors' interests

The interests of Directors in the shares of the company and in options over such shares granted under the group's ESOS and Sharesave Scheme are set out on pages 56 to 58 of the remuneration report.

Substantial shareholders

According to notifications received at 30 May 2006 the following shareholders held 3.0 per cent or more of the company's issued share capital:

Name	%
Pictet Asset Management Limited	10.3
Standard Life Investments	3.2

Furthermore, the company believes that Invesco Perpetual holds, through various funds, some 14 per cent (2005: 12 per cent); Newton Investment Management 4.85 per cent and Legal & General Investment Management 3.54 per cent of the company's issued share capital. No notification has been received by the company in respect of these holdings, consequently they are omitted from the above table. The company's belief is based on analysis of its register of members.

Policy on the payment of creditors

It is AWG's policy to provide suppliers of goods and services with standard terms and conditions of contract. This document is available from each of the company's principal subsidiaries and, in the case of Anglian Water, can be downloaded from its website at www.anglianwater.co.uk. In general, regional purchasing agreements are in place with preferred suppliers and the terms will apply to all transactions. The group abides by the terms of payment. At 31 March 2006, the group had 46 days purchases outstanding (2005: 48 days). At 31 March 2006, the company had no trade creditors (2005: £nil).

Charitable donations (community investment)

During the year the group made a payment of £1.0 million (2005: £1.0 million) to the Anglian Water Trust Fund and gave £210,000 to various community causes through a combination of cash and in-kind support. However, it is the group's policy that its community investment should be based predominantly on the practical involvement of employees in community activities. This involvement is described on page 40.

Political donations

There were no political donations during the year (2005: £nil).

Employees

Employees are kept informed of changes in the business and general financial and economic factors influencing the group. This is done through a systematic approach to employee communication through regular briefings, presentations, electronic mailings and the wide circulation of the group magazine. The group's intranets are also widely used as a source of information.

The group values the views of its employees and consults with them and their representatives on a regular basis about matters that may affect them.

Directors' report continued

The group has a number of policies and procedures, which are published on the group's intranet systems and which inform employees of the group's approach to a range of issues such as equal opportunities, dignity at work, family friendly working and compassionate leave. Procedures are in place to deal with allegations of misconduct, harassment, bullying and other inappropriate behaviour.

The group continues to invest in the development of its employees with more than £3.8 million being devoted to skills and basic management development and leadership. Morrison Utility Services Limited, Morrison Facilities Services Limited and Purac Limited have achieved Investors in People status.

A Sharesave Scheme and a Sharebuy Plan are in place to encourage participation in the group's performance and both schemes are open to all eligible employees.

The group values diversity within its workforce and has put in place processes to ensure that it is an equal opportunities employer. All job applications, including those from disabled persons, are fully and fairly considered, having regard to the aptitudes and abilities of the applicant. In the event of disability, every effort is made to ensure that employment continues and appropriate training is given. Career development and the promotion of disabled people, is, as far as possible, identical to that of other employees.

Auditors and disclosure of information to auditors

So far as the Directors are aware, there is no relevant audit information of which PricewaterhouseCoopers LLP (PwC) are unaware, and the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that PwC are aware of that information.

PwC has indicated its willingness to continue in office and a resolution proposing its re-appointment will be put to the AGM.

Annual General Meeting

The notice convening the AGM to be held on 26 July 2006 is included with this document, together with an explanation of the business to be conducted at the meeting, form of proxy and an e-communications leaflet/duplicate mailing form.

By order of the board

Patrick Firth
Company Secretary and Group Legal Counsel
30 May 2006

Registered Office: Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ
Registered in England and Wales No. 3936645
AWG Plc

Corporate governance

The board is committed to high standards of corporate governance and supports the Combined Code on Corporate Governance (the Code) published in July 2003. The statement below, together with the remuneration report on pages 51 to 58, are intended to show how the board has applied the main and supporting principles of the Code and confirms that it has been in compliance with the Code's provisions throughout the year except as explained in the two reports.

The board

The board of AWG currently comprises the Chairman, Group Chief Executive, one Executive Director and four Non-Executive Directors (details on pages 42 and 43).

The roles of Chairman and Group Chief Executive are separate and clearly defined. The duties of each are set out in writing in their respective contracts. No further division of responsibilities has been set out in writing or approved by the board.

The Chairman, Peter Hickson, is responsible for the working of the board. He leads the process of board evaluation and ensures there are constructive relationships between Executive and Non-Executive Directors.

The Group Chief Executive, Jonson Cox, is responsible for the management of the group and its business. He ensures that an appropriate business strategy is developed for board approval and that this is effectively implemented and monitored, with guidance and direction being given where appropriate.

Bill Cockburn was the Deputy Chairman and Senior Independent Director until his resignation on 22 January 2006. Roger Witcomb became the Senior Independent Director on 27 April 2006.

The Non-Executive Directors bring a wide range of skills and experience to the group and all are considered to be independent.

The Joint Company Secretaries, Patrick Firth and Claire Russell, are responsible for advising the board on governance matters and ensuring that board procedures are complied with. They are also responsible for facilitating the induction and professional development of board members. All Directors have access to the services of the Company Secretaries. During the year the procedure for Directors to seek independent professional advice at the group's expense was reviewed and amended to allow any Director to seek such advice.

Role of the board

The role of the board is to determine overall strategy and business objectives; to ensure that the necessary capital resources are available to meet objectives; to maintain an effective risk management system; to monitor performance and consider compliance, corporate responsibility and health and safety matters; and to ensure that responsibilities to shareholders and other stakeholders are met.

A schedule of matters reserved to the board and a scheme of delegation to executives and subsidiary boards provides a clear framework enabling the board to exercise leadership and manage risk. The types of decisions reserved to the board include approval of financial statements, returns to shareholders, consideration of significant contracts and the appointment of Directors. Decisions delegated to management include day-to-day operational matters and contracts for services below a fixed value. In September 2005, a statement of Business Standards, which addresses the group's values and standards, was adopted.

Attendance at board meetings during the year was as follows:

	Number of meetings attended	Total eligible meetings[1]
Peter Hickson	16	16
Bill Cockburn[2]	7	11
Jonson Cox	16	16
Scott Longhurst	15	16
Andrew Carr-Locke	16	16
Frances Heaton	14	16
Sue Lyons[3]	10	15
Jim McKenna	10	16
Roger Witcomb[4]	N/A	N/A
Roy Pointer[5]	0	0

[1] There were 10 scheduled meetings and 6 other meetings held by the board at short notice to deal with specific matters such as the disposal of Morrison Construction Services Limited. Members of the board attended the majority of these meetings in person or by telephone. Occasionally the short notice of such meetings prevented attendance when other fixed commitments had been made.

[2] Until 22 January 2006.

[3] Until 25 March 2006.

[4] Roger Witcomb was appointed as a Director on 27 April 2006.

[5] Roy Pointer served on the board until his resignation as a Director on 26 April 2005. No board meetings were held between 1 and 26 April 2005.

Performance evaluation

During the year the board undertook a formal evaluation of its own performance and that of its major committees, including a focus on individual performance, which identified no major concerns. This exercise was facilitated by an external body and included a written questionnaire on collective performance and individual contribution.

Objectives have been set for the board and board committees against which performance is measured on an annual basis.

Committees of the board

Nomination Committee

The current members are Peter Hickson (Chairman), Jonson Cox, Roger Witcomb, Andrew Carr-Locke, Frances Heaton and Jim McKenna.

The Committee's Terms of Reference, which are published on the company's website, www.awg.com, include a duty to make recommendations for the appointment and removal of Directors, and to ensure that succession planning is in place for Directors and senior management.

All board appointments have been subject to full board approval of candidates recommended by the Nomination Committee. The Committee considers candidates against objective criteria and takes into consideration the overall balance of skills, knowledge and experience of the board.

The board met, without Jim McKenna, to consider his re-election. The board also met to consider the possible appointment of another Non-Executive Director to provide the board with the right balance of skills, knowledge and experience. The board did not consider it necessary to use an external search consultancy in this case and accepted the re-election of Jim McKenna for a third term and the appointment of Roger Witcomb as a Non-Executive Director and Senior Independent Director.

Except in the case of Roger Witcomb, who was appointed in 2006, letters of appointment for Non-Executive Directors do not set out the expected time commitment, because all the Non-Executive Directors had been appointed before this requirement was introduced. The Non-Executive Directors have an agreed time commitment of 25 days a year which will be included in their contracts when they are next reviewed.

Corporate governance continued

Remuneration Committee
Details of the membership and role of the Committee and of the group's remuneration policy are disclosed in the remuneration report on pages 51 to 58.

Audit Committee
Current members and other Directors who served on the Committee during the year are shown in the attendance table below.

	Number of committees attended	Total eligible committees
Frances Heaton (Chairman)	4	4
Andrew Carr-Locke	4	4
Bill Cockburn[1]	3	3
Jim McKenna	4	4
Roger Witcomb[2]	N/A	N/A

[1] Until 22 January 2006.
[2] Appointed on 27 April 2006.

The Audit Committee comprises four Non-Executive Directors all of whom are considered by the board to be independent. The Chairman of the Committee is Frances Heaton. Andrew Carr-Locke is a qualified accountant and considered to have recent and relevant financial experience as Group Finance Director of George Wimpey Plc.

The Committee meets at least four times each year. Its Terms of Reference, which are published on the company's website, www.awg.com, include reviewing the integrity of financial information and assessing the effectiveness of financial controls and risk management processes.

The Committee's duties include consideration of the effectiveness of the group's internal audit function and that of the external auditors and recommendations to the board on the external auditors' remuneration. The Committee has also approved a policy on the independence of the external auditor and its provision of non-audit services.

Relationships with PricewaterhouseCoopers LLP (PwC), the group's external auditors, are dealt with largely through the Group Finance Director. In addition, PwC meets with the Audit Committee at least annually without the presence of executive management. They also have regular meetings with the Chairman and direct access to the Audit Committee and senior employees.

PwC has provided non-audit services during the year in accordance with the group's policy on these services. That policy states that the external auditor will only be used for non-audit work where it is demonstrably in the best interests of the group.

Additionally, PwC carefully consider each piece of work offered to ensure that acceptance would not impair independence and report annually on this issue to the Audit Committee. The report for the year under review, which was accepted by the Audit Committee, concluded that PwC was independent and that its objectivity was not impaired. During the year the Committee:

- Considered and recommended approval of 2004/5 final and 2005/6 interim financial statements and returns to shareholders.
- Considered the effectiveness of the external auditors.
- Reviewed the external and internal audit reports and management responses to recommendations contained therein.
- Considered significant litigation throughout the group.
- Reviewed the internal control framework and its effectiveness.
- Recommended the re-appointment of PwC as external auditors at the 2005 AGM.

The Committee also reviews the arrangements by which group employees may, in confidence, raise concerns about possible wrongdoing in financial reporting or other matters (so-called *whistleblowing procedures*) and is responsible for ensuring that arrangements allow proportionate and independent investigation of such matters and for appropriate follow-up action.

Financial reporting
The group's financial position and prospects are presented in a number of ways during the year to ensure shareholders and potential shareholders can make a balanced assessment of the company. During 2005/6 this included:

- A presentation on the adoption of International Financial Reporting Standards (IFRS) (a copy of which is available on the company's website, www.awg.com).
- Annual Report and Accounts, which includes an operating and financial review and statements on Directors' responsibilities and going concern.
- Interim Report and Accounts.
- Pre-close period trading statements.
- Announcements regarding developments and contract wins that may affect the share price of the company are made as and when necessary.
- Reports to Ofwat regarding the regulated water business including the Annual (June) Return, the Procurement Plan and the Special Agreements Register.

Internal control

The group has been in compliance with the Turnbull provisions regarding internal controls throughout the year and ongoing monitoring of its effectiveness has been in place throughout the year and up to the date of approval of this report. Internal control is executed through the Audit Committee, Internal Audit, and the Risk Monitoring Committee, which together review the overall business control framework. Key components of the control framework include the schedule of matters reserved to the board, the scheme of delegation, the group finance manual and other group policies and standards.

The group finance manual and other policies provide guidance to the operational businesses about delegated authorities, independent review of transactions, the bidding process and project delivery. The underlying controls are similar in Anglian Water, Morrison and AWG Property, but the emphasis on aspects of control varies. For example, in Anglian Water there is a higher priority on regulatory matters. Operating divisions provide quarterly written confirmation of their compliance with financial controls, and the central finance function also provides oversight of specific financial controls.

Within defined delegated authorities, operating businesses are responsible for risk assessment and control. Both project-based and business risks (financial and non-financial, including those of a social, ethical or environmental nature) are identified and dealt with in this way through the management structure. An annual statement of responsibility is signed off by the Chief Operating Officers and Finance Directors of each business, who have assured themselves that the operation of their internal control framework is effective.

Material changes in risk and control profiles are discussed at performance review meetings and the Risk Monitoring Committee. Group finance provides further independent review of projects at initiation and thereafter through to commitment.

The Risk Monitoring Committee oversees risk management practice and the control response within the business and advises the Audit Committee of issues identified as required.

The Executive Directors report to the board material changes in the business and the marketplace that are considered to affect the business risk profile.

The system of internal controls seeks to manage risk and can provide only reasonable and not absolute assurance against mis-statement or loss. The process for dealing with any failure of the internal control system would generally be to prepare a mitigation plan and to establish ownership. The Risk Monitoring Committee and the Audit Committee would then monitor progress against this plan.

Internal audit

The group has had an internal audit function in place throughout the year. The function is outsourced to Ernst & Young which gives access to a wider range of experienced auditors. The Audit Committee has various responsibilities in respect of this function including:

- Monitoring and reviewing its effectiveness.
- Considering its remit and resources.
- Reviewing and assessing the internal audit annual plan.
- Reviewing internal audit reports and monitoring management's response to any recommendations contained therein.

The Head of Internal Audit has direct access to the Chairman of the Audit Committee when required. The internal audit plan, which is approved annually by the Audit Committee, focuses on the key controls and material risks faced by the business. The internal audit plan is supplemented by ad hoc audits at the request of the board and management. Internal audit findings are reported to the Risk Monitoring Committee, the board and the Audit Committee.

The Head of Internal Audit meets regularly with the Audit Committee without the presence of executive management.

The board has reviewed the effectiveness of the system of internal controls in the group. These controls continue to be upgraded and refreshed as appropriate with due regard to the operational and external environment.

Relations with shareholders

The group, largely through the Group Chief Executive and Group Finance Director, maintains a dialogue with institutional shareholders throughout the year. This includes regular presentations, meetings and press briefings to coincide with particular events, for example the announcement of final and interim results and discussion of specific matters as and when they arise. All group announcements are made available on the website, www.awg.com, which also contains corporate and customer information updated on a regular basis.

Corporate governance continued

A report regarding investor relations is made by the Group Finance Director to each regular board meeting to ensure the whole board is kept informed of shareholder matters. This report covers investor reaction to key announcements and events, a summary of analysts' reports, investor issues and meetings and share performance.

During the year the Chairman met with two shareholders at their request.

The AGM provides an opportunity for shareholders to discuss with Executive and Non-Executive Directors any issues they have concerning the company and its activities. Voting at the AGM is by way of a show of hands by members present at the meeting unless a poll is validly called. Details of the level of proxies lodged on each resolution, the balance for and against the resolution and the number of votes withheld are available at the meeting. The Chairman's statement and the results of voting are published on the company's website after the meeting.

Going concern
After making enquiries, the Directors have a reasonable expectation that the group and company have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Statement of Directors' responsibilities
The Directors are responsible for preparing the financial statements. They are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRS) and have chosen to prepare the company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

In the case of group accounts, IAS 1 requires that the financial statements present fairly for each financial year the group's financial position, financial performance and cash flows. This requires the fair presentation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's *Framework for the Preparation and Presentation of Financial Statements*. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards.

In the case of company accounts, company law requires the Directors to prepare financial statements which give a true and fair view of the state of affairs of the company, each financial year.

In preparing each of the group and the company financial statements, the Directors are required to:

- Properly select and apply accounting policies.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- Make judgments and estimates that are reasonable and prudent.
- For the group financial statements provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.
- For the company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

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

The Directors are responsible for the maintenance and integrity of the AWG Plc website. Information published on the website is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements, which results in uncertainty regarding legal requirements.

Patrick Firth
Company Secretary and Group Legal Counsel
30 May 2006

Remuneration report

The Committee

The Remuneration Committee advises the board on the group's executive remuneration policy and determines the remuneration packages of the two Executive Directors and the most senior managers and direct reports of the Group Chief Executive. The Committee's Terms of Reference are published on the company's website, www.awg.com.

Directors who served on the Committee during the year are shown in the attendance table below.

	Number of committees attended	Total eligible committees
Bill Cockburn[1]	5	6
Andrew Carr-Locke[2,3]	1	1
Frances Heaton	6	6
Jim McKenna[2]	1	1
Sue Lyons[4]	5	6
Roger Witcomb[5]	N/A	N/A

[1] Until 22 January 2006.
[2] Appointed to the committee on 26 January 2006.
[3] Acted as Chairman for one meeting.
[4] Until 25 March 2006.
[5] Appointed as a member and Chairman on 27 April 2006.

Peter Hickson and Jonson Cox attend the meetings at the invitation of the Committee, but do not participate in discussions concerning their own remuneration. The Committee is supported by the Group Director of Human Resources, Susannah Clements, and the Joint Company Secretaries, Patrick Firth and Claire Russell.

Kepler Associates were retained throughout the year to provide advice on Executive Director remuneration, but do not provide any other service to the group. A complete review of Directors' remuneration is carried out annually, taking into account comparable practice in similar companies and the financial and operational performance of the group.

Remuneration policy

The primary aim of the company's remuneration policy is to ensure that AWG is well managed by high calibre executives who are encouraged to produce superior performance and leadership on a sustainable basis for the benefit of shareholders, customers and employees. The remuneration package is designed to attract, retain, motivate and reward the executive and senior management of AWG whilst reflecting their responsibilities and experience. In addition, the current policy aims to align the interests of executives with those of all the company's stakeholders by ensuring that the award of annual bonuses reflects a balance between financial and non-financial measures. Long-term incentives are in place to reward the achievement of long-term performance targets.

The remuneration policy is designed to ensure that there is a significant emphasis on the performance-linked element of total compensation. To this end, base salaries are targeted at mid-market when compared with similar companies in the utilities and support services sectors. Executives and senior managers are able to achieve additional earnings via the annual bonus scheme and the Long Term Incentive Plan (LTIP) only if demanding performance targets are achieved.

Objective benchmarking of other relevant peer group companies is carried out by Kepler Associates to guide the Committee in its annual review of remuneration. The main focus of comparison is towards:

- Water companies.
- Support service companies.
- Comparable companies with a similar enterprise value.

Over the coming year there will, as usual, be individual reviews of base salary, annual bonus and LTIP awards.

Remuneration package

Each Executive Director's package comprises four elements: base salary and benefits, annual bonus, participation in the LTIP and pension. The benefits comprise a car or cash equivalent; insurance policies covering disability, personal accident, life and health; 30 days' holiday and, in common with all eligible employees, participation in a Sharesave Scheme and Sharebuy Plan. As Chairman, Peter Hickson receives the fees and benefits detailed on page 55. He does not participate in the annual bonus, the LTIP, the Sharesave Scheme or the Sharebuy Plan.

Remuneration report continued

Base salary and benefits

Base salary and benefits are reviewed annually, taking into account competitive practice. The Committee targets a mid-market position once an individual is fully established in the role.

Incentive arrangements

Annual bonus scheme

The Executive Directors and other senior managers participate in an annual bonus scheme, which rewards them for achieving demanding short-term performance targets and personal objectives. The annual bonus scheme comprises two elements, one year business plan targets (earning two-thirds of the bonus) and personal and strategic objectives (earning one-third of the bonus). 50 per cent of the business plan element pays out if the annual budget is achieved and a further payment of up to 50 per cent is made for exceeding the plan to levels approved by the Committee.

During 2005, the Committee reviewed the group's annual bonus opportunities and decided to combine a moderate increase with a retention requirement so as to reflect the strategic challenge faced by AWG during the turnaround process, and to strengthen the link between pay and performance. For Executive Directors, the maximum bonus payable is 75 per cent of base salary and for senior managers the maximum bonus ranges between 45 per cent and 75 per cent.

The Committee recognises that it is in the interests of all shareholders that Executive Directors and senior management build up a personal stake in the group and as a result has developed share ownership guidelines as outlined on page 53. Accordingly, the Committee agreed that participants in the 2005/6 Annual Retained Bonus Scheme (ARBS) should invest at least one-third of their post-tax annual bonus in AWG shares for a period of three years. If performance targets are achieved over this period, participants receive matching free shares in AWG Plc equal in value to the gross amount of the bonus used to buy the shares. The Group Chief Executive recommends to the Remuneration Committee which of his direct reports should also participate in the ARBS.

The performance target for the 2005/6 ARBS is based on an earnings per share (EPS) target.

Executive Share Option Scheme (ESOS)

The ESOS was replaced by an LTIP in 2004 and no further grants of options were made under this scheme during the year ended 31 March 2006. The participants of the scheme were the Executive Directors and a number of senior managers.

Under the scheme, each participant previously received annual option grants, equating to a percentage of base salary, which varied according to seniority, up to a maximum of three times base salary each year. The exercise of options depends on the group's growth in earnings per share (EPS, as defined in the scheme rules) relative to inflation, which the Committee considered to be the most appropriate way of measuring the group's underlying financial performance.

EPS targets are measured cumulatively from a fixed base, initially over a three-year period. Conditions apply, so that a proportion (one-third) of the options are exercisable if EPS growth exceeds inflation by a cumulative average of three per cent per annum, rising to the full vesting of options if EPS growth exceeds inflation by a cumulative average of 14 per cent per annum. Between three per cent and 14 per cent growth, the proportion of options that may vest increases on a straight-line basis.

The 2001 ESOS did not meet its minimum performance conditions in the three-year period to 31 March 2004 or upon retesting following completion of the financial periods ended 31 March 2005 and 2006 and all outstanding options made under this award have therefore lapsed.

The 2002 ESOS did not meet its minimum performance conditions in the three-year period to 31 March 2005 or upon retesting following completion of the financial period ended 31 March 2006. It will be retested in 2007, but is not expected to vest.

The 2003 ESOS has met its performance conditions in full in the three-year period to 31 March 2006.

Long Term Incentive Plan 2004

The 2004 LTIP was approved at the 2004 AGM and replaces the ESOS. Under this plan, Directors and senior managers may receive, at the discretion of the Remuneration Committee, annual awards of shares subject to performance conditions. Awards are normally in the range of 25 per cent to 150 per cent of salary.

For the 2004/5 award, the proportion of shares that vest will depend upon the group's performance in terms of total shareholder return (TSR).

For the 2005/6 award, the proportion of shares that vest will depend 60 per cent upon the group's performance in terms of TSR and 40 per cent upon its performance in terms of EPS. The continued use of an element of relative TSR aligns managers' and shareholders' interests and provides a robust measurement of performance relative to peers. Linking vesting of awards partially to real EPS growth is simple, transparent and motivational for participants. The Remuneration Committee has reviewed the LTIP and believes it remains relevant. In determining the award level, the Committee took into account the fact that the performance target was upper decile rather than upper quartile as is usual in comparative schemes.

Vesting of the TSR element of the award is based on the group's three-year TSR relative to a comparator index weighted 80 per cent on the five major water companies which are considered to be the group's closest peers (Kelda, Northumbrian, Pennon, Severn Trent and United Utilities). The balance (20 per cent) of the comparator index is based on the smaller listed water companies and seven other companies considered to be peers of the Morrison business (Bristol Water, Dee Valley, Alfred MacAlpine, Amec, Balfour Beatty, Carillion, Costain, Jarvis, and W S Atkins). The TSR element vests in full only if the group's three-year TSR exceeds that of the index by at least 6.5 per cent per year, with 25 per cent of the TSR element vesting if the group's TSR matches the index. Between these levels of performance, vesting is based upon a straight-line sliding scale. None of the TSR element vests if the group's TSR is below the performance of the comparator index and there is no re-testing.

The EPS element of the award will vest if dividends are maintained in real terms throughout the performance period and then only to the extent that the EPS element of the performance condition is met. EPS is measured cumulatively from a fixed base over a three-year period.

If EPS growth exceeds inflation by a cumulative average of three per cent per annum, then 25 per cent of the EPS element will vest, rising to 100 per cent vesting if EPS growth exceeds inflation by a cumulative average of seven per cent per annum or more. No EPS-based shares will vest if EPS growth is less than a cumulative average of three per cent per annum above inflation. Shares vest on a straight-line basis if average EPS growth is between three per cent and seven per cent per annum above inflation.

As a matter of policy all Executive Directors and recipients of an LTIP are required to retain a minimum shareholding in the company, equivalent to annual base salary for Executive Directors and 50 per cent of annual base salary for certain senior managers. Fifty per cent of any post-tax award made under the LTIP will be retained until these guidelines are achieved.

Service contracts

All Executive Directors have service contracts with a notice period of one year from the company and six months from the Executive Director. None of the service contracts provides for a pre-determined amount of compensation in the event of early termination.

Director	Date contract effective
Jonson Cox	15/01/04
Scott Longhurst	01/11/04
Roy Pointer[1]	14/06/00

[1] Until 26 April 2005.

Non-Executive Directors do not have service agreements and are initially appointed under letters of appointment for two three-year terms, except for Roger Witcomb who was initially appointed for one three-year term. The Chairman and other Non-Executives are subject to a mutual notice period of 12 months and six months respectively. They are subject to re-appointment after the first term, which is not automatic. Their current terms of appointment are as follows:

Name	Date first appointed to board	Expiry date of letter of appointment	Unexpired term
Andrew Carr-Locke	02/10/03	01/10/06	4 months
Bill Cockburn	23/01/03	22/01/06	–
Frances Heaton	17/01/02	16/01/08	20 months
Peter Hickson	25/04/02	24/04/08	23 months
Sue Lyons	26/03/03	25/03/06	–
Jim McKenna	20/01/00	19/01/09	32 months
Roger Witcomb	27/04/06	26/04/09	35 months

Remuneration report continued

Performance graph

This graph illustrates the performance of AWG Plc compared to the FTSE All-Share index. The Committee considers this to be the most appropriate broad equity market index for illustrating the company's performance relative to other companies with a similar market capitalisation.

--- AWG — FTSE All-Share Index

This graph shows the value, by the end of March 2006, of £100 invested in AWG on 31 March 2001 compared with the value of £100 invested in the FTSE All-Share Index. £100 invested in AWG on 31 March 2001 would have been worth £333 five years later compared with £128 if invested in the FTSE All-Share Index over the same period.

Pensions

Jonson Cox and Scott Longhurst participate in the AWG Pension Scheme (Defined Contribution section). Details of the amounts paid by the group in respect of these arrangements are shown below:

	2006 £000	2005 £000
Jonson Cox	49	58
Scott Longhurst	26	11

For the year ended 31 March 2006, these amounts represented 46 per cent and 25 per cent of the Inland Revenue earnings cap for Jonson Cox and Scott Longhurst respectively. In addition, Jonson Cox receives a pension allowance which is invested in an unfunded, unapproved, retirement benefit defined contribution arrangement. The combined value of Jonson Cox's contributions is equivalent to 50 per cent of his salary.

In the event of an employee's death in service, the AWG Scheme provides for payment of a lump sum equivalent to four times salary, together with a pension paid to dependents.

Roy Pointer, a former Director, was a member of the Mirror Image Section of the AWG Pension Scheme (AWGPS), an exempt approved pension scheme. The Mirror Image Section's normal retirement age is 65, or as early as age 60 on reaching 40 years' service. The maximum benefits are attained after 45 years' service, being a pension of 56 per cent of pensionable salary plus a tax-free lump sum of 168 per cent of pensionable salary. Pensionable salary is base salary and benefits, excluding bonus payments. Pension payments are increased annually in line with price inflation. Roy Pointer resigned as a Director on 26 April 2005 prior to his retirement from the group on 17 July 2005 and received his normal benefits under the Scheme Rules.

The pension benefit of the remaining Director in the Mirror Image Section of AWGPS during the year to 31 March 2006 (rounded to the nearest thousand pounds) is summarised below[†] in accordance with the Companies Act 1985 and the Listing Rules of the Financial Services Authority.

	Accrued pension 2006 £000[1]	Increase in accrued pension 2006 £000	Accrued lump sum 2006 £000[2]	Increase in accrued lump sum 2006 £000	Increase in transfer value less Directors' contributions 2006 £000[3]	Transfer value at 2006 £000	Transfer value at 2005 £000	Accrued pension 2005 £000	Accrued lump sum 2005 £000
Roy Pointer	125	–	337	5	476	3,218	2,742	125	332

[1] The 2006 accrued pension shown is that which was in payment as at 31 March 2006.
[2] The 2006 accrued lump sum shown is that which was received on retirement.
[3] The transfer value of increases has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.

[†] denotes auditable elements of the remuneration report.

	Additional accrued pension in year (excluding inflation) £000	Additional accrued lump sum in year (excluding inflation) £000	Transfer value of the increase in benefits (excluding inflation) £000
Roy Pointer	–	–	–

The transfer values disclosed in the tables above and on page 54 are actuarially determined to provide for pensions liability and not sums paid by the group to the individuals concerned. They cannot meaningfully be added to their annual remuneration.

Non-Executive Directors' fees†

The board sets the fees for the Non-Executive Directors. For the year ended 31 March 2006 these fees were £35,000 per annum. The Senior Independent Director receives an additional £5,000 per annum and the Audit and Remuneration Committee Chairmen receive an additional £10,000 per annum.

The Non-Executive Directors do not receive benefits or pension contributions from the group, nor do they participate in any of the group's incentive schemes.

Directors' emoluments†

The emoluments of the Directors of the company for their services as Directors of the company and (where relevant) its subsidiaries are set out below, rounded to the nearest thousand pounds.

	Salary/ fees £000	Benefits in kind[1] £000	Annual bonus £000	Other £000	2006 Total £000	2005 Total £000
Chairman						
Peter Hickson[3]	184	5	–	–	189	181
Executive Directors						
Jonson Cox	450	28	338	–	816	657
Scott Longhurst[2]	228	131	199	31	589	148
Non-Executive Directors[3]						
Andrew Carr-Locke	36	–	–	–	36	36
Frances Heaton	45	–	–	–	45	47
Jim McKenna	36	–	–	–	36	38
Former Directors						
Bill Cockburn[3 4]	53	–	–	–	53	58
Sue Lyons[3 4]	35	–	–	–	35	36
Roy Pointer[5]	69	7	–	–	76	362
Total					1,875	1,563

Notes

[1] Benefits in kind principally comprise the provision of a company car, fuel for company cars, medical insurance, life insurance and for Scott Longhurst, relocation costs.

[2] Scott Longhurst's salary increased to £265,000 on 1 January 2006 and his annual bonus represents 75 per cent of this amount. Payments made above the pension salary cap are paid as a salary supplement. Scott Longhurst received £31,000.

[3] All Non-Executive Directors received 25 per cent of their fee in the form of shares from September 2004. In order to simplify administration, these shares are purchased annually in September. The amounts disclosed in this table include the following prepayments in respect of 2006/7: Peter Hickson, £18,750; Andrew Carr-Locke, £3,646; Bill Cockburn, £6,250; Frances Heaton, £4,687; Sue Lyons, £3,646 and Jim McKenna, £3,646. The figures above also include amounts due from the previous financial year of £4,757, £853 and £837 for Peter Hickson, Andrew Carr-Locke and Jim McKenna respectively.

[4] Until 22 January 2006 and 23 March 2006 respectively.

[5] Roy Pointer resigned as a Director on 26 April 2005 and retired from the company on 17 July 2005.

† denotes auditable elements of the remuneration report

Remuneration report continued

Executive Directors' Non-Executive Directorship of a third party

The group encourages its Executive Directors to become Non-Executive Directors of other groups, provided that these appointments are not with competing groups, or likely to lead to any conflicts of interest, and do not require a level of time commitment which would prejudice their ability to fulfil their primary role within the group. This serves to add to their personal and professional experience and knowledge, to the benefit of the group. Any fees derived from such appointments may be retained by the Executive Director.

In this respect, Jonson Cox was appointed to the board of Wincanton plc on 21 October 2005 and received a fee of £20,000 during the year in his position as Non-Executive Director.

Directors' interests in shares†

Throughout this report, all interests in shares as at 31 March 2006 are in relation to AWG Plc ordinary shares of $19^{181}/_{201}$ pence each, except where stated otherwise.

The Directors' interests in the shares of the company are shown below:

Beneficial and family interests in shares:	Number of ordinary shares 1 April 2005	31 March 2006
Jonson Cox	11,013	17,350
Scott Longhurst	–	1,392
Andrew Carr-Locke	5,783	6,316
Peter Hickson	58,006	60,747
Frances Heaton	2,056	5,253
Jim McKenna	1,285	1,818

Roger Witcomb held no shares on appointment (27 April 2006).

The figures in the table above include ordinary shares held in trust for Directors being the share element of the ARBS and shares bought through dividend reinvestment as at 31 March 2006, Jonson Cox 7,619 (2005: 1,927) and Scott Longhurst 1,158 (2005: nil). The figures also include the shares purchased and awarded under the AWG Plc Sharebuy Plan, a scheme which is open to all employees. For every two partnership shares purchased, the company also awards one matching share. Participants can also choose to reinvest any dividends earned on shares held in the plan. The first monthly purchase under this plan was made in April 2005. Details of partnership, matching and dividend shares are detailed below:

	1 April 2005	Partnership shares bought	Matching shares awarded	Dividend shares bought	31 March 2006
Jonson Cox	–	153	76	5	234
Scott Longhurst	–	153	76	5	234

† denotes auditable elements of the remuneration report

Twenty five per cent of the fee paid to the Chairman and Non-Executive Directors is invested in shares in the company. To simplify administration all those shares are purchased in a single tranche, in September, and the monthly payments adjusted accordingly. Consequently the 25 per cent invested in shares represents an advance fee. These shares are included in the above figures, being at 31 March 2006: Peter Hickson, 6,100 (2005: 3,359); Frances Heaton, 1,704 (2005: 1,007); Jim McKenna, 1,316 (2005: 783) and Andrew Carr-Locke, 1,316 (2005: 783). The Directors must hold these shares for the duration of their appointment.

Long Term Incentive Plan 2004†

Contingent awards over shares were awarded to Jonson Cox and Scott Longhurst on both 3 June 2005 and 30 August 2005 at prices of £8.53 and £9.45 respectively. Any potential vesting is subject to the performance conditions outlined on page 53.

Maximum contingent interests in shares under the group's Long Term Incentive Plan are set out in the table below:

	1 April 2005	Awarded	31 March 2006*	End of earliest performance period
Jonson Cox	104,895	81,032[1]	185,927	1 April 2007
Scott Longhurst	29,126	34,333	63,459	25 November 2007
Roy Pointer	13,738	–	13,738	1 April 2007

[1] This includes a phantom award of 17,760 shares made on 30 August 2005 which have the same performance period and condition. On vesting cash will be awarded to the market value of the shares at the time.
*or date of resignation.

Matching share element of Annual Retained Bonus Scheme†

Matching shares were allocated on 2 June 2005 at a share price of £9.05. The release of matching shares is subject to the achievement of performance conditions outlined on page 52.

Maximum contingent interests in matching shares under the group's Annual Retained Bonus Scheme are set out in the table below:

	1 April 2005	Allocated	Lapsed	31 March 2006*	Earliest release date for outstanding awards
Jonson Cox	3,212	8,839	–	12,051	From 2 June 2007
Scott Longhurst	–	1,841	–	1,841	From 2 June 2008
Roy Pointer	8,261	–	2,716	5,545	From 11 July 2006

*or date of resignation.

† denotes auditable elements of the remuneration report.

Remuneration report continued

Share options†

Executive Directors have the right to participate in the AWG Sharesave Scheme. Details of Directors' options are available in the company's Register of Directors' Interests, which is open to inspection. The market price of the company's shares at 31 March 2006 was £11.44 and the range during the year was £8.28 to £11.46.

Options to subscribe for ordinary shares, under the Sharesave and Executive Share Option Schemes (as detailed on pages 52 and 53) that were granted to, lapsed and exercised by Directors during the year, are summarised below.

	Options outstanding as at 1 April 2005	Options granted		Options lapsed	Options exercised		Options outstanding as at 31 March 2006		Exercise period for outstanding options	
	Number	Number	Option price (£)	Number	Number	Option price (£)	Number	Weighted average exercise price (£)	From	To
Sharesave scheme options										
Jonson Cox	2,227	–	–	–	–	–	2,227	7.42	01/04/10	30/09/10
Roy Pointer[1]	1,033	–	–	–	1,033	£3.38	–	–	–	
Roy Pointer[1]	777	–	–	–	777	£4.28	–	–	–	
Executive share options										
Jonson Cox[2]	228,136	–	–	–	–	–	228,136	5.26	16/01/07	16/01/14
Roy Pointer	318,246	–	–	233,062	–	–	85,184	5.40	31/07/06	31/01/07

[1] Under the scheme rules, Roy Pointer was able to continue to save into the Sharesave Scheme for six months following his retirement date. He exercised his outstanding options on 11 January 2006. The closing price at the date of exercise was £10.75.

[2] This award comprises 5,703 approved options and 222,433 phantom options. Both awards have the same option price, performance period and condition. On the exercise of the phantom only the cash equivalent of any gain will be paid and disclosed at the time.

There have been no changes to the shareholdings, options or awards shown at 31 March 2006 in the tables above, except as follows:

The following shares have been purchased or awarded under the AWG Plc Sharebuy Plan:

On 13 April 2006 Jonson Cox and Scott Longhurst each purchased 11 partnership shares and were awarded six matching shares under the AWG Plc Sharebuy Plan at a price of £11.18 per share. On 12 May 2006 Jonson Cox and Scott Longhurst each purchased 11 partnership shares and were awarded five matching shares under the AWG Plc Sharebuy Plan at a price of £11.14 per share.

† denotes auditable elements of the remuneration report

On behalf of the board

Peter Hickson
Chairman
30 May 2006

Independent auditors' report to the members of AWG Plc

We have audited the consolidated financial statements of AWG Plc for the year ended 31 March 2006 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of recognised income and expense and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of AWG Plc for the year ended and on the information in the Directors' remuneration report that is described as having been audited.

Respective responsibilities of Directors and auditors
The Directors' responsibilities for preparing the annual report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the consolidated financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Directors' report is consistent with the consolidated financial statements. The information given in the Directors' report includes that specific information presented in the operating and financial review that is cross referred from the business review section of the Directors' report. We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not.

We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the annual report and consider whether it is consistent with the audited consolidated financial statements. The other information comprises only the Chairman's statement, the operating and financial review, the Directors' report, the corporate governance statement and the non-auditable part of the remuneration report. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the consolidated 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 group financial statements are free from material mis-statement, 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 consolidated financial statements.

Opinion
In our opinion:

- The consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2006 and of its profit and cash flows for the year then ended.
- The consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.
- The information given in the Directors' report is consistent with the consolidated financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
30 May 2006

Consolidated income statement for the year ended 31 March

Notes		2006 £m	2005 £m
	Continuing operations		
2	**Group revenue**	1,552.2	1,358.9
	Operating costs		
	– Loss on disposal of businesses not treated as discontinued	–	(7.0)
	– Other operating costs	(1,174.3)	(1,063.1)
5	**Group operating costs**	(1,174.3)	(1,070.1)
2	**Group operating profit**	377.9	288.8
	Finance costs		
3	Interest payable and similar charges	(270.4)	(259.1)
3	Interest receivable	50.7	34.6
3	Fair value losses on derivative financial instruments	(45.9)	(35.4)
	Finance costs (net)	(265.6)	(259.9)
2	Share of post tax (losses)/profits from joint ventures and associates	(3.5)	3.5
	Profit before tax	108.8	32.4
7	Taxation	(31.1)	(4.1)
	Profit for the financial year from continuing operations	77.7	28.3
	Discontinued operations		
9	Loss on disposal of businesses	(56.4)	–
9	Post tax profit from discontinued operations	8.8	5.4
		(47.6)	5.4
	Profit for the financial year	30.1	33.7
	Attributable to:		
	Equity shareholders of the company	30.0	33.6
	Minority interests	0.1	0.1
	Profit for the financial year	30.1	33.7
	Earnings per share from continuing operations expressed in pence per share		
10	Basic	54.5p	19.7p
10	Diluted	53.7p	19.5p
	Total earnings per share expressed in pence per share		
10	Basic	21.1p	23.4p
10	Diluted	20.8p	23.2p
11	Proposed dividend per share	50.8p	48.7p

The notes on pages 65 to 118 are an integral part of these consolidated financial statements.

The comparative numbers shown above have been restated from those previously reported as the group has adopted International Financial Reporting Standards (IFRS) for the first time this year and has restated comparatives accordingly. A reconciliation from the numbers previously reported can be found in note 40 to these financial statements.

Consolidated statement of recognised income and expense for the year ended 31 March

Notes		2006 £m	2005 £m
	Profit for the financial year	30.1	33.7
	Net exchange adjustments taken to reserves	0.4	(0.7)
	Cash flow hedges:		
	– net fair value losses	(30.4)	(34.1)
	– reclassified and reported in net profit	16.0	20.1
	Actuarial gains on defined benefit pension schemes	97.8	29.1
7	Tax on items taken directly to equity	(19.4)	(4.5)
	Net gains not recognised in income statement	64.4	9.9
	Total recognised income and expense for the year	94.5	43.6
	Attributable to:		
32	Equity shareholders of the company	94.4	43.1
	Minority interests	0.1	0.5
		94.5	43.6

Consolidated balance sheet at 31 March

Notes		2006 £m	2005 £m
	Non-current assets		
13	Goodwill	83.6	176.5
14	Other intangible assets	78.8	97.6
15	Property, plant and equipment	4,534.5	4,406.4
16	Investments in associates	0.9	5.2
17	Interest in joint ventures	10.6	19.9
18	Other investments	0.1	3.1
26	Derivative financial instruments	18.2	25.7
21	Trade and other receivables	0.4	0.3
		4,727.1	4,734.7
	Current assets		
20	Inventories	50.6	48.8
21	Trade and other receivables	380.5	428.8
26	Derivative financial instruments	16.6	11.4
23	Cash and cash equivalents	775.9	1,098.6
		1,223.6	1,587.6
9	Assets classified as held for sale	1.4	9.4
		1,225.0	1,597.0
	Current liabilities		
24	Trade and other payables	(472.5)	(503.6)
25	Financial liabilities – borrowings	(299.5)	(194.5)
26	– derivative financial instruments	(12.3)	(22.7)
	Current tax liabilities	(9.3)	(4.2)
30	Provisions	(11.2)	(10.3)
		(804.8)	(735.3)
9	Liabilities directly associated with assets classified as held for sale	(1.8)	(12.8)
		(806.6)	(748.1)
	Net current assets	418.4	848.9
	Non-current liabilities		
25	Financial liabilities – borrowings	(3,741.2)	(4,104.9)
26	– derivative financial instruments	(201.2)	(217.4)
27	Deferred tax liabilities	(662.4)	(614.9)
28	Retirement benefit obligations	(105.0)	(216.6)
29	Other non-current liabilities	(260.0)	(247.6)
30	Provisions	(45.8)	(44.6)
		(5,015.6)	(5,446.0)
	Net assets	129.9	137.6
	Shareholders' equity		
31	Ordinary shares	28.0	28.7
31	Share premium	13.8	10.8
32	Capital redemption reserve	17.3	1.8
32	Retained earnings	82.8	98.4
32	Hedging reserve	(11.1)	(0.9)
32	Translation reserve	(0.3)	(0.7)
	Total shareholders' equity	130.5	138.1
	Minority interests	(0.6)	(0.5)
	Total equity	129.9	137.6

The notes on pages 65 to 118 are an integral part of these consolidated financial statements. The financial statements on pages 60 to 118 were approved by the board of Directors on 30 May 2006 and were signed on its behalf by:

Peter Hickson Chairman Scott Longhurst Group Finance Director

Consolidated cash flow statement for the year ended 31 March

Notes		2006 £m	2005 £m
	Cash flows from operating activities		
(a)	Cash generated from operations	586.3	498.9
	Tax (paid)/received	(4.2)	2.1
	Net cash inflow from operating activities	582.1	501.0
	Cash flows from investing activities		
	Purchase of property, plant and equipment	(260.1)	(285.5)
	Proceeds from sale of property, plant and equipment	6.7	4.8
	Purchase of intangible assets	(11.6)	(15.8)
	Grants and contributions received	24.1	26.9
(b)	Proceeds from sale of subsidiary, net of cash disposed	12.1	18.3
	Cash paid in respect of disposals made in previous years	–	(2.8)
	Cash and overdrafts held in subsidiary transferred into disposal group	–	(2.8)
	Purchase of subsidiary, net of cash acquired	(2.9)	–
	Purchase of trade investments and joint ventures	(0.3)	(0.3)
	Proceeds from sale of trade investments and joint ventures	–	0.2
	Dividends received from joint ventures	–	0.9
	Interest received	51.4	34.6
	Interest paid	(236.5)	(226.4)
	Interest element of finance lease rental payments	(7.8)	(8.7)
	Non-equity dividends paid	(0.5)	(0.5)
	Net cash used in investing activities	(425.4)	(457.1)
	Cash flows from financing activities		
31	Proceeds from issue of ordinary shares	3.1	4.1
32	Share buy-back	(37.1)	–
32	Redemption of redeemable shares	(14.7)	(48.9)
	Decrease/(increase) in long-term bank deposits	109.9	(114.9)
	Net proceeds from issue of new loans	399.5	401.2
	Repayments of borrowings	(736.5)	(15.4)
	Finance lease principal payments	(23.4)	(20.6)
	Net cash (outflow)/inflow from derivative financial instruments	(0.2)	0.8
	Equity dividends paid	(70.0)	(20.6)
	Net cash (used in)/generated from financing activities	(369.4)	185.7
	Net (decrease)/increase in cash and cash equivalents	(212.7)	229.6
	Cash and cash equivalents at beginning of the year	983.6	754.0
23	**Cash and cash equivalents at end of the year**	770.9	983.6

Included within net cash inflow from operating activities, net cash outflow for investing activities and net cash outflow for financing activities are amounts in relation to discontinued operations of £23.8 million (2005: £(2.9) million), £(0.1) million (2005: £0.4 million) and £(25.0) million (2005: £nil) respectively.

Notes to the consolidated cash flow statement

(a) Cash generated from operations

	2006 £m	2005 £m
Profit for the financial year	30.1	33.7
Adjustments for:		
– Tax	35.7	3.8
– Depreciation net of amortisation of grants and contributions	152.6	152.7
– Amortisation	24.4	24.5
– Profit on sale of property, plant and equipment	(2.1)	(0.9)
– Loss on disposal of businesses (continuing and discontinued)	56.4	7.0
– Interest receivable	(50.7)	(34.6)
– Interest payable and similar charges	267.7	257.6
– Fair value losses on derivative financial instruments	45.9	35.4
– Share of loss/(profit) from joint ventures and associates after taxation	3.9	(3.7)
– Net movement in provisions	(13.0)	(26.3)
– Employee share option costs	1.7	1.1
Changes in working capital:		
– Inventories	(1.7)	(2.9)
– Trade and other receivables	(25.3)	60.9
– Trade and other payables	60.7	(9.4)
Cash generated from operations	586.3	498.9

(b) **Proceeds from sale of subsidiaries, net of cash disposed**

During the year the group disposed of its Construction Services and Project Investments businesses (see note 9) and also disposed of certain international assets. In 2005 the group disposed of MVM, a non-core software development company within Morrison and certain international assets.

The assets and liabilities disposed of in relation to the transactions described above were as follows:

	2006 £m	2005 £m
Property, plant and equipment	1.0	1.3
Intangible assets	0.1	–
Interest in joint ventures and associates	4.1	–
Inventories	0.2	7.8
Trade and other receivables	96.1	2.4
Assets classified as held for sale	9.4	–
Cash and cash equivalents	25.7	0.6
Trade and other payables	(136.5)	(6.8)
Liabilities directly associated with assets classified as held for sale	(12.8)	–
Deferred tax liabilities	1.1	0.1
	(11.6)	5.4
Unamortised goodwill	93.1	18.6
Group's share of net assets disposed of	81.5	24.0

The cash flows in relation to the assets disposed of above were as follows:

	2006 £m	2005 £m
Consideration	44.9	19.5
Accrued consideration, not yet received	(5.0)	–
Disposal costs	(2.1)	(0.6)
Cash at bank of disposed businesses	(25.7)	(0.6)
Proceeds from sale of subsidiaries, net of cash disposed	12.1	18.3

Notes to the consolidated financial statements

1 **Accounting policies**

The financial statements of the group are for the year ended 31 March 2006 and have been prepared in accordance with the International Financial Reporting Standards (IFRS), International Financial Reporting Interpretations Committee (IFRIC) interpretations issued and effective or issued and early adopted as at 31 March 2006 and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

The financial statements have also been prepared in accordance with IFRSs as adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation. At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures; and the related amendment to IAS 1 on capital disclosures
IFRIC 4	Determining Whether an Arrangement Contains a Lease
IFRIC 5	Rights to Interest Arising from Decommissioning, Restoration and Environmental Rehabilitation Finds
IFRIC 6	Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29 'Financial Reporting in Hyperinflationary Economies'
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the group except for additional disclosures on capital and financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007.

The group's principal accounting policies adopted in the presentation of these financial statements are set out below and have been consistently applied to all the periods presented.

a) **Basis of preparation**

The disclosures required by IFRS 1 'First-time Adoption of International Financial Reporting Standards' showing reconciliations for comparative periods between UK GAAP and IFRS are shown in note 40.

These consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available for sale financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

b) **Basis of consolidation**

i **Subsidiaries**

Subsidiaries are fully consolidated from the date on which power to control is transferred to the group. They are de-consolidated from the date on which control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the group. On acquisition the identifiable assets, liabilities and contingent assets are measured at their fair values at the date of acquisition. The excess of the cost of acquisition over the fair value of the group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the group's share of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Subsidiaries' accounting policies have been changed where necessary to ensure consistency with the policies adopted by the group.

Notes to the consolidated financial statements continued

1 Accounting policies continued

ii Joint ventures

Joint ventures are those entities over whose activities the group has the ability to exercise joint control, established by contractual agreement. The group's interests in jointly controlled enterprises are accounted for by the equity method of accounting and are initially recognised at cost.

The consolidated financial statements include the group's share of the total recognised income and expense of the jointly controlled enterprises on an equity accounting basis, from the date that joint control commences until the date that joint control ceases.

Jointly controlled operations and assets, where each party has its own separate interest in particular risks and rewards, are accounted for by including the attributable share of the assets, liabilities and cash flows measured according to the terms of the agreement. To the extent that joint ventures have net liabilities and a contractual commitment exists for the group to settle those net liabilities, the aggregate amount is added back to investments and offset firstly against loans and trading balances with the joint venture, with any excess transferred to provisions.

iii Associates

Associates are entities over which the group has the power to exert significant influence but not the power to control, generally accompanying a shareholding of between 20 per cent and 50 per cent of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost.

c) Assets held for sale

Where an asset or group of assets (a disposal group) is available for immediate sale and the sale is highly probable and expected to occur within one year, the disposal group is deemed held for sale. At this point the gross assets and gross liabilities of the disposal group are shown separately as held for sale. The value of the disposal group is measured at the lower of the carrying amount and fair value less costs to sell.

d) Revenue recognition

Revenue comprises the fair value of the sale of goods and services, net of value added tax, rebates and discounts and after eliminating sales within the group. Revenue is recognised as follows:

i Water and wastewater services – revenue includes an estimation of the amount of mains water and wastewater charges unbilled at the period end. The revenue accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical billing information.
ii Construction contracts – revenue from construction contracts is recognised in accordance with the group's accounting policy on construction contracts (note o).
iii Property development – where legally binding contracts exist, revenue and expenses on the construction and refurbishment elements of property development are recognised on the same basis as for construction, in proportion to the stage of completion of the contact.
iv Services contracts – revenue from service contracts is recognised by reference to the stage of completion, as measured by reference to services performed to date as a percentage of total services to be performed.
v Insurance claims and other recoveries – where expenditure on a contract is expected to be reimbursed by a third party such as an insurance company, revenue is recognised only when receipt of the amount is virtually certain.
vi Interest income – recognised on a time-proportion basis using the effective interest method.
vii Dividend income – recognised when the right to receive payment is established.

e) Segmental reporting

The group's primary reporting segments are business segments, each of which provide services that are subject to risks and returns that are different from those of the other segments. Geographical segments are reported as secondary segments.

f) Foreign currency translation

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

Differences on foreign currency borrowings that provide a hedge against a net investment in a foreign operation are taken directly to equity until the disposal of the net investment, at which time they are recognised in the consolidated income statement. On disposal of a foreign operation, the deferred cumulative amount recognised in equity, subsequent to 1 April 2004, relating to that particular foreign operation shall be recognised in the income statement.

On consolidation, the income statements of the overseas subsidiaries are translated at the average exchange rates for the year and the balance sheets at the exchange rates at the balance sheet date. The exchange differences arising as a result of translating income statements at average rates and restating opening net assets at closing rates are taken to the translation reserve. Exchange differences on foreign currency borrowings are taken to reserves to the extent that they provide an effective hedge of the exchange differences arising on net investments in foreign subsidiaries.

Goodwill arising on the acquisition of an overseas subsidiary, associate or joint venture is calculated using exchange rates applicable at the date of acquisition and is subsequently re-translated at each balance sheet date.

g) Derivative financial instruments and hedging

The group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its treasury policy, the group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivatives are initially recognised at cost and subsequently re-measured at fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The group designates certain derivatives as either a fair value or cash flow hedge in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'.

i Fair value hedge

Changes in the fair value of derivatives designated and qualifying as fair value hedges are recorded in the income statement, together with changes in the fair value of the hedged asset or liability attributable to the hedged risk.

ii Cash flow hedge

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item will affect profit or loss (for example, in the periods when interest income or expense is recognised, or when the forecast sale that is hedged takes place).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Gains and losses accumulated in equity are included in the income statement when disposal of the foreign operation occurs.

iii Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. Such derivatives are classified at fair value through profit or loss, and changes in fair value are recognised immediately in the income statement.

Notes to the consolidated financial statements continued

1 Accounting policies continued

h) Property, plant and equipment

Property, plant and equipment comprises:

- Land and buildings – comprising land and non-operational buildings (i.e. buildings not used for water and wastewater treatment).
- Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls.
- Operational assets – comprising structures at sites used for water and wastewater treatment, pumping or storage where not classed as infrastructure along with associated fixed plant.
- Vehicles, mobile plant and equipment.
- Assets under construction.

All property, plant and equipment is shown at cost less subsequent depreciation and impairment, except for land and assets under construction, which are shown at cost less impairment. Cost includes expenditure directly attributable to the acquisition or construction of the items.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate assets.

Borrowing costs incurred for the construction of qualifying assets are capitalised during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement as incurred.

Freehold land is not depreciated, nor are assets in the course of construction until commissioned. Depreciation on other assets is charged at rates expected to write off cost less estimated residual value to the income statement on a straight-line basis over its estimated useful life, as follows:

• Non-operational buildings	30-60 years
• Water infrastructure	50-120 years
• Wastewater infrastructure	50-160 years
• Operational structures	30-80 years
• Fixed plant	12-40 years
• Vehicles, mobile plant and equipment	3-10 years

Residual values and useful lives of assets are reassessed annually, and adjusted if appropriate.

An impairment loss is recognised immediately if the carrying amount of an asset exceeds its recoverable amount.

The gain or loss on disposal or retirement of an asset is determined as the difference between the sales proceeds or compensation received and the carrying amount of the asset and is recognised in the income statement.

i) Grants and contributions

Grants and contributions comprise government grants, infrastructure and connection charges, sewer adoption charges, deficit contributions for requisitioned water and wastewater infrastructure under the Water Acts, non-domestic deficit contributions, other capital and revenue contributions, and contributions for infrastructure diversions.

Capital grants and contributions are credited to a deferral account within creditors and are released to revenue evenly over the expected useful life of the related assets.

Deficit contributions are also credited to a deferral account within creditors, and are recognised as revenue in line with the expected expenditure they are intended to compensate.

Contributions for diversion are allocated between compensation for the loss of the asset given up, treated in accordance with the asset disposal policy, and capital contribution towards the cost of the replacement asset according to the nature of the diversion.

j) Intangible assets

i Goodwill

Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures. In respect of business acquisitions that have occurred since 1 April 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the group's share of net identifiable assets acquired. In respect of acquisitions prior to 1 April 2004 goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous GAAP. This is in accordance with the transitional provisions of IFRS 1.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to income-generating units and, from the date of transition to IFRS, is no longer amortised but is tested annually for impairment. In respect of joint ventures and associates, the carrying amount of goodwill is included in the carrying amount of the investment in the joint venture or associate.

ii Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of two to seven years.

Costs associated with maintaining computer software are recognised as an expense as incurred.

iii Customer lists

The fair value attributable to customer lists or portfolio at the point of acquisition is determined by discounting the expected future cash flows to be generated from that asset. This amount is included in intangible assets as 'customer lists' and amortised over the estimated useful life on a straight-line basis. Amortisation periods are currently 10 years but will be dependent on the business. Separate values are not attributed to internally generated customer lists or relationships.

k) Leased assets

Leases of property, plant and equipment where the group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other non-current payables. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life and the lease term.

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

The land and buildings elements of a lease are considered separately for the purpose of lease classification.

l) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and current balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of six months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of bank deposits with original maturity dates of more than three months and outstanding bank overdrafts.

Notes to the consolidated financial statements continued

1 Accounting policies continued

m) Investments

The group has restated its comparatives to adopt IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 from 1 April 2004.

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as held for trading or available for sale are measured at fair value, with gains or losses recognised in income or equity respectively. When an available for sale investment is disposed of, or impaired, the gain or loss previously recognised in equity is taken to the income statement.

Other investments are classified as held to maturity when the group has the positive intention and ability to hold to maturity and there is a set maturity date. Investments held for an undefined period are excluded from this classification. Such investments (and those held to maturity) are subsequently measured at amortised cost using the effective interest method, with any gains or losses being recognised in the income statement.

n) Inventories

Inventories (including development land and properties) are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

o) Construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract at the balance sheet date, as measured by the proportion that contract costs incurred for work performed to date relative to the estimated total contract costs.

Claims are only recognised as revenue when negotiations are at an advanced stage and the outcome is substantially agreed. Following initial recognition, provision for estimated irrecoverable amounts is made whenever ultimate payment seems doubtful.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

Full provision is made for all known or expected losses on individual contracts immediately such losses are foreseen. Variations in contract work, claims and incentive payments are included to the extent that it is probable they will result in revenue.

Where costs incurred plus recognised profits less recognised losses exceed progress billings, the balance is shown as due from customers on construction contracts within trade and other receivables. Where progress billings exceed costs incurred plus recognised profits less recognised losses, the balance is shown as due to customers on construction contracts within trade and other payables.

p) Bid and pre-contract costs

Bid and pre-contract costs are expensed as incurred until it is probable that a contract will be awarded, from which time further pre-contract costs are recognised as an asset and amortised as an expense over the period of the contract. Amounts recovered in respect of costs that have been written off are deferred and amortised over the life of the contract.

q) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Redeemable shares, mandatorily redeemable at par at the option of shareholders, are classified as liabilities. Non-discretionary dividends on these redeemable shares are recognised in the income statement as interest expense.

r) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. The deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

s) Employee benefits

i Pensions

The group companies operate various pension schemes. The schemes are funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations performed by independent actuaries. The group has both defined benefit and defined contribution schemes.

The group has chosen under IFRS 1 to recognise in retained earnings all cumulative actuarial gains and losses as at 1 April 2004, the date of transition to IFRS. The group has chosen to recognise actuarial gains and losses arising subsequent to 1 April 2004 in full in retained earnings in the period in which they occur, and in the 'consolidated statement of recognised income and expense'.

The liability recognised in the balance sheet in respect of defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date less the fair value of scheme assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method with updates performed at half year. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of sterling denominated AA credit rated bonds with maturity dates approximating to the terms of the group's obligations.

Contributions to defined contribution schemes are charged to the income statement as they fall due.

ii Share-based payments

The group operates a Save As You Earn (SAYE) share option scheme for all employees to encourage participation in the group's results. In addition the group operated an Executive Share Option Scheme (ESOS) until 2003, which was then replaced by a Long-Term Incentive Plan (LTIP). Participation in the ESOS and LTIP schemes is restricted to Executive Directors and a number of senior managers.

The group determines the fair value of share options granted using a binomial option pricing model and their fair value is recognised as an employee benefits expense with a corresponding increase in other reserve equity over the vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

t) Research expenditure

Research expenditure is expensed when incurred.

u) Provisions

A provision is recognised when the group has a present legal or constructive obligation as a result of a past event for which it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the liability.

Notes to the consolidated financial statements continued

1 Accounting policies continued
u) Provisions continued

The group's policy on specific areas is as follows:

i Onerous lease costs
Provision is made for the expected future costs of property and other leases to the extent that these costs are not expected to be of future benefit to the business, net of any recoveries from sub-leases.

ii Closure costs
Once irrevocable decisions have been made to close an operation, provisions are made to reflect the extent to which obligations, including redundancy costs, have been incurred that are not expected to be covered by future profits of the operation. Provisions include only the direct costs of termination and any operating losses up to the date of the termination, after taking account of the aggregate profit, if any, to be recognised from the future profits of the operation.

iii Redundancy costs
Redundancy costs are charged to the income statement in the period in which the group both becomes irrevocably committed to incurring the costs and has raised a valid expectation with, and announced the main features of the programme to, affected employees or their representatives.

iv Self insurance
Some subsidiary companies self insure the risks where it is commercially prudent to do so. Provision is made in respect of notified claims to the extent that it is probable that a cash settlement will arise. Provision is made in the group's captive insurance company, Rutland Insurance Limited, for the expected cost of claims incurred but not reported. The provision is determined from an actuarial assessment based on past experience.

v) Bad and doubtful debts
In Anglian Water the bad debt provision is calculated by applying expected recovery rates, based on actual historical cash collection performance, to the aged debt profile. In the remaining subsidiary companies specific provisions are made for those debts on which recovery is regarded as doubtful.

w) Key assumptions and significant judgments
The group use estimates and make judgments in the preparation of its financial statements. The areas where the most judgment is required are highlighted below.

i Goodwill impairment
Goodwill is tested for impairment on an annual basis. In performing these tests assumptions are made in respect of the discount rate applied to the future cash flows of income-generating units. This discount rate is selected on the basis of the inherent risk associated with the income-generating unit.

ii Pensions
The group operates a number of defined benefit schemes (most of which are closed to new members) as well as defined contribution schemes. Under IAS 19 'Employee Benefits' the group has recognised a pension deficit of £105.0 million (2005: £216.6 million). The change in the deficit is mainly attributable to changes in certain scheme benefits (such as ill health and early retirement), and changes in discount rate and inflation assumptions. The main assumptions are set out in note 28 of the financial statements.

iii Property, plant and equipment
The property, plant and equipment used in the group is primarily the infrastructure and operational assets of the regulated water business. These have estimated service lives of between 30 and 160 years and the depreciation charge is clearly sensitive to the lives allocated to the various types of asset. Asset lives are reviewed regularly and changed where necessary to reflect the current view on their remaining lives in light of the technological change, prospective economic utilisation and the physical condition of the assets.

iv Taxation
The group's tax charge is based on the profit for the year and tax rates in force at the balance sheet date. Estimation of the tax charge involves an assessment of the potential tax treatment of certain items which will only be resolved once finally agreed with the tax authorities.

2 Segmental analysis

Primary reporting format – business segments for the year ended 31 March 2006

At 31 March 2006 the group is organised into three main businesses:

- Anglian Water; regulated water, wastewater and environmental service provider to domestic and industrial customers in eastern England and Hartlepool.
- Morrison; see below.
- AWG Property; commercial and residential property developer.

The Morrison business is further analysed into the following segments of the group:

- Utility Services; manages infrastructure maintenance, renewals, installation and specialist services to blue-chip utility clients in the gas, water, electricity and telecommunications sectors.
- Facilities Services; provides repair and maintenance and capital investment services to local authority clients.
- Other support services; provides contracting for water and wastewater treatment processes.
- Morrison centre; provides financial and administrative support to the Morrison businesses. Whilst this does not strictly meet the criteria for classification as a 'segment' under IFRS, the Directors believe that separate disclosure is important to understanding the overall performance of Morrison.

	External revenue £m	Internal revenue[1] £m	Revenue £m	Operating profit £m	Share of post tax (losses)/profits of joint ventures and associates £m	Profit before interest and tax £m
Anglian Water	865.5	0.2	865.7	372.8	–	372.8
Utility Services[2]	389.8	15.6	405.4	12.7	–	12.7
Facilities Services[2]	191.5	1.0	192.5	7.9	–	7.9
Other support services[2]	38.9	0.7	39.6	1.3	(0.1)	1.2
Morrison centre and intra-Morrison trading	–	(0.3)	(0.3)	(4.0)	–	(4.0)
Morrison	620.2	17.0	637.2	17.9	(0.1)	17.8
AWG Property	34.3	0.9	35.2	(1.9)	(4.2)	(6.1)
Other[3]	26.0	–	26.0	(11.0)	0.8	(10.2)
Less: Intersegmental trading	–	(11.9)	(11.9)	0.1	–	0.1
	1,546.0	6.2	1,552.2	377.9	(3.5)	374.4

Interest payable and similar charges	(270.4)
Interest receivable	50.7
Fair value losses on derivative financial instruments	(45.9)
Profit before tax	108.8
Taxation	(31.1)
Profit for the financial year from continuing operations	77.7
Loss on disposal of businesses (note 9)	(56.4)
Post tax profit from discontinued operations (note 9)	8.8
Profit for the financial year	30.1
Attributable to:	
Equity shareholders of the company	30.0
Minority interests	0.1
	30.1

[1] Internal revenues relate to revenues by the respective segments from trading with other segments of the group. After eliminating internal revenues within the continuing operations of the group a balance of £6.2 million is left relating to revenues from continuing operations from trading with the discontinued operations of the group.

[2] Following the disposal of Construction Services and Project Investments segments from the Morrison business the remaining support services segment has been further analysed between Utility Services, Facilities Services and Other support services, which in 2006 consists solely of Purac.

[3] Other includes corporate head office costs, Celtic Anglian Water, Anglian Water Direct and the remaining six PFI concessions which were reclassified from Morrison Project Investments.

Notes to the consolidated financial statements continued

2 Segmental analysis continued

Primary reporting format – business segments for the year ended 31 March 2006 continued

	Segment operating assets £m	Equity accounted joint ventures and associates £m	Total operating assets £m	Segment operating liabilities £m	Segment net operating assets/(liabilities) £m
Anglian Water	4,772.5	–	4,772.5	(588.6)	4,183.9
Utility Services	158.4	–	158.4	(95.0)	63.4
Facilities Services	64.2	–	64.2	(35.3)	28.9
Other support services	9.9	–	9.9	(18.3)	(8.4)
Morrison centre and intra-Morrison trading	15.0	–	15.0	(6.7)	8.3
Morrison	247.5	–	247.5	(155.3)	92.2
AWG Property	99.5	5.7	105.2	(42.9)	62.3
Other	17.9	5.8	23.7	(109.5)	(85.8)
Less: Intersegmental trading	(7.5)	–	(7.5)	–	(7.5)
	5,129.9	11.5	5,141.4	(896.3)	4,245.1

The segment operating assets and liabilities stated above can be reconciled to the gross assets and liabilities of the group as follows:

	Gross assets £m	Gross liabilities £m	Net assets £m
Segment operating assets and liabilities as stated above	5,141.4	(896.3)	4,245.1
Cash and cash equivalents	775.9	–	775.9
Borrowings	–	(4,040.7)	(4,040.7)
Derivative financial instruments	34.8	(213.5)	(178.7)
Current tax liabilities	–	(9.3)	(9.3)
Deferred tax liabilities	–	(662.4)	(662.4)
Group assets and liabilities	5,952.1	(5,822.2)	129.9

	Capital expenditure £m	Depreciation[1] £m	Amortisation of intangible assets £m	Impairment of trade receivables £m	Other non-cash expenses[2] £m
Anglian Water	290.8	141.8	23.9	15.9	72.8
Utility Services	7.1	5.2	0.1	–	–
Facilities Services	1.6	0.9	0.4	–	–
Other support services	0.3	0.4	–	–	–
Morrison centre and intra-Morrison trading	0.6	2.7	–	–	–
Morrison	9.6	9.2	0.5	–	–
AWG Property	0.4	0.2	–	–	0.4
Other	1.0	1.4	–	–	(1.1)
	301.8	152.6	24.4	15.9	72.1

[1] Depreciation is stated net of amortisation of grants and contributions.

[2] Other non-cash expenses represent fair value movements on derivative financial instruments charged through 'Fair value losses on derivative financial instruments' and indexation of index-linked debt charged through 'Interest payable and similar charges'.

Primary reporting format – business segments for the year ended 31 March 2005

	External revenue £m	Internal revenue £m	Revenue £m	Operating profit £m	Share of post tax (losses)/profits of joint ventures and associates £m	Profit before interest and tax £m
Anglian Water	796.8	–	796.8	318.6	–	318.6
Utility Services	287.2	7.8	295.0	5.2	–	5.2
Facilities Services	149.3	0.8	150.1	3.8	(0.2)	3.6
Other support services[1]	59.9	4.0	63.9	(6.6)	–	(6.6)
Morrison centre and intra-Morrison trading	–	–	–	(6.9)	–	(6.9)
Morrison	496.4	12.6	509.0	(4.5)	(0.2)	(4.7)
AWG Property	23.9	2.1	26.0	(13.7)	3.3	(10.4)
Other[2]	34.3	0.2	34.5	(10.7)	0.4	(10.3)
Less: Intersegmental trading	–	(7.4)	(7.4)	(0.9)	–	(0.9)
	1,351.4	7.5	1,358.9	288.8	3.5	292.3
Interest payable and similar charges						(259.1)
Interest receivable						34.6
Fair value losses on derivative financial instruments						(35.4)
Profit before tax						32.4
Taxation						(4.1)
Profit for the financial year from continuing operations						28.3
Post tax profit from discontinued operations (note 9)						5.4
Profit for the financial year						33.7
Attributable to:						
Equity shareholders of the company						33.6
Minority interests						0.1
						33.7

[1] Other support services consists of Purac and the results of MVM up to its disposal on 11 February 2005 and also the associated loss on disposal of £8.3 million.

[2] Other includes corporate head office costs, Celtic Anglian Water, Anglian Water Direct and the remaining six PFI concessions which were reclassified from Morrison Project Investments.

Notes to the consolidated financial statements continued

2 Segmental analysis continued

Primary reporting format – business segments for the year ended 31 March 2005 continued

	Segment operating assets £m	Equity accounted joint ventures and associates £m	Total operating assets £m	Segment operating liabilities £m	Segment net operating assets/ (liabilities) £m
Anglian Water	4,615.7	–	4,615.7	(621.8)	3,993.9
Utility Services	139.0	–	139.0	(77.4)	61.6
Facilities Services	58.2	–	58.2	(38.3)	19.9
Other support services	12.7	0.1	12.8	(22.3)	(9.5)
Morrison centre and intra-Morrison trading	3.6	–	3.6	(15.1)	(11.5)
Morrison	213.5	0.1	213.6	(153.1)	60.5
AWG Property	138.3	15.0	153.3	(63.5)	89.8
Other	36.7	10.0	46.7	(86.8)	(40.1)
Less: Intersegmental trading	(8.7)	–	(8.7)	–	(8.7)
	4,995.5	25.1	5,020.6	(925.2)	4,095.4
Discontinued operations	175.4	–	175.4	(110.3)	65.1
	5,170.9	25.1	5,196.0	(1,035.5)	4,160.5

The segment operating assets and liabilities stated above can be reconciled to the gross assets and liabilities of the group as follows:

	Gross assets £m	Gross liabilities £m	Net assets £m
Segment operating assets and liabilities as stated above	5,196.0	(1,035.5)	4,160.5
Cash and cash equivalents	1,098.6	–	1,098.6
Borrowings	–	(4,299.4)	(4,299.4)
Derivative financial instruments	37.1	(240.1)	(203.0)
Current tax liabilities	–	(4.2)	(4.2)
Deferred tax liabilities	–	(614.9)	(614.9)
Group assets and liabilities	6,331.7	(6,194.1)	137.6

	Capital expenditure £m	Depreciation[1] £m	Amortisation of intangible assets £m	Impairment of trade receivables £m	Other non-cash expenses[2] £m
Anglian Water	293.9	142.2	23.4	13.8	55.8
Utility Services	3.4	5.2	0.2	–	–
Facilities Services	0.8	1.0	–	–	–
Other support services	0.5	1.2	–	–	–
Morrison centre and intra-Morrison trading	1.6	1.9	0.1	–	–
Morrison	6.3	9.3	0.3	–	–
AWG Property	0.1	0.2	–	–	–
Other	5.4	1.0	0.8	–	(0.4)
Less: Intersegmental trading	(0.9)	–	–	–	–
	304.8	152.7	24.5	13.8	55.4

[1] Depreciation is stated net of amortisation of grants and contributions.

[2] Other non-cash expenses represent fair value movements on derivative financial instruments charged through 'Fair value losses on derivative financial instruments' and indexation of index-linked debt charged through 'Interest payable and similar charges'.

Internal sales between the divisions are considered to be immaterial. They are entered into under normal commercial terms and conditions that would also be available to unrelated third parties.

Capital expenditure comprises additions to property, plant and equipment (note 15) and other intangible assets (note 14), including additions resulting from acquisitions through business combinations.

Secondary reporting format – geographical segments
The United Kingdom is the home country of the group and substantially all the group's operations occur within the United Kingdom.

No other individual country contributed more than 10 per cent of consolidated sales or assets. Sales are based on the country in which the customer is located. Total assets and capital expenditure are where the assets are located. All internal sales were within the United Kingdom.

	Revenue		Segment assets		Capital expenditure	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Continuing operations						
United Kingdom	1,513.8	1,317.9	5,112.4	4,989.8	301.1	304.4
Europe	23.9	21.7	10.1	3.6	0.1	–
Rest of world	8.3	11.8	7.4	2.1	0.1	0.1
	1,546.0	1,351.4	5,129.9	4,995.5	301.3	304.5
Discontinued operations						
United Kingdom	329.6	326.6	–	173.5	0.5	0.3
Rest of world	6.8	4.9	–	1.9	–	–
	336.4	331.5	–	175.4	0.5	0.3
Joint ventures	–	–	11.5	25.1	–	–
Unallocated assets	–	–	810.7	1,135.7	–	–
	1,882.4	1,682.9	5,952.1	6,331.7	301.8	304.8

Analysis of revenue by category

	2006 £m	2005 £m
Sale of water and wastewater services	872.4	789.4
Services supplied	405.3	350.1
Construction contract revenue	213.2	176.9
Sale of goods	51.7	31.1
Leasing income	6.2	7.5
Other	3.4	3.9
	1,552.2	1,358.9

Notes to the consolidated financial statements continued

3 Finance costs (net)

	2006 £m	2005 £m
Interest payable and similar charges:		
Interest payable on bank borrowings and overdrafts	(1.0)	(1.4)
Amortisation of issue costs	(3.0)	(4.4)
Interest payable on other loans including indexation of index-linked debt	(257.5)	(240.2)
Interest payable on finance leases	(7.8)	(8.4)
Interest credits/(costs) on pension obligations	0.2	(3.4)
Dividend on redeemable preference shares	(0.3)	(0.5)
Unwinding of discounts in provisions	(1.0)	(0.8)
Interest payable and similar charges	(270.4)	(259.1)
Interest receivable	50.7	34.6
Fair value losses on derivative financial instruments (note 4)	(45.9)	(35.4)
Finance costs (net)	(265.6)	(259.9)

In addition to the interest payable on other loans above a further £11.6 million (2005: £12.3 million) of interest payable was capitalised into assets at a capitalisation rate of 6.71 per cent (2005: 6.65 per cent).

4 Fair value losses on derivative financial instruments

	2006 £m	2005 £m
Fair value losses on derivative financial instruments recognised in the income statement (including RPI swaps)	(45.9)	(35.4)

The group uses index-linked debt to hedge against RPI movements in the Regulated Capital Value (RCV) and revenues of Anglian Water. The group issues index-linked debt and additionally uses swaps to achieve the desired level of index-linked debt. The index-linked debt issued qualifies for hedge accounting under IAS 39 whereas the synthetic swaps used do not qualify for hedge accounting and consequently are held at fair value with movements taken to the income statement. It is the opinion of the Directors that they remain highly effective economic hedges.

Given the economic substance and commercial similarity of the transactions the Directors are of the opinion that it is appropriate to also report the financial results excluding the incremental effect of applying IAS 39.

The reconciliation between the movement in derivatives taken through the income statement and the amount added back as the incremental effect of applying IAS 39 in note 10 (Earnings per share) is as follows:

	2006 £m	2005 £m
Fair value losses on derivative financial instruments recognised in the income statement (including RPI swaps)	(45.9)	(35.4)
Less: Indexation charged before applying IAS 39	17.5	17.9
	(28.4)	(17.5)
Change in operating profit on sale of joint ventures	(0.2)	–
Change in basis of amortisation of issue costs included in finance costs	1.2	0.2
Amounts charged through share of post tax profits from joint ventures and associates	1.2	(0.1)
Incremental impact of applying IAS 39 on continuing operations	(26.2)	(17.4)
Incremental impact of applying IAS 39 on discontinued operations	(0.3)	0.6
Total incremental impact of applying IAS 39	(26.5)	(16.8)

5 Group operating costs

	2006 £m	2005 £m
Operating costs (excluding depreciation and intangible asset amortisation):		
Change in inventories of finished goods and work in progress	(1.7)	(2.9)
Raw materials and consumables used	83.0	81.8
Employee benefit costs (note 12)	311.1	304.9
Other expenses[1]	648.9	541.0
Own work capitalised	(45.0)	(39.9)
Contribution to Anglian Water Trust Fund	1.0	1.0
Loss on disposal of businesses not treated as discontinued	–	7.0
Operating costs (excluding depreciation and intangible asset amortisation)	997.3	892.9
Depreciation of property, plant and equipment[2]	163.3	160.8
Amortisation of deferred grants and contributions	(10.7)	(8.1)
Depreciation net of amortisation of grants and contributions	152.6	152.7
Amortisation of intangible assets	24.4	24.5
Group operating costs	1,174.3	1,070.1

[1] Other expenses arising in the financial year mainly represents contractor costs, power and water costs, hired and contract services, and hire and maintenance costs of property, plant and equipment.

[2] Depreciation shown above relates to continuing operations. Depreciation shown in note 15 of £163.5 million (2005: £161.2 million) includes depreciation in discontinued operations of £0.2 million (2005: £0.4 million).

6 Profit before taxation

	2006 £m	2005 £m
The following items have been included in arriving at profit before taxation for continuing operations:		
Profit on disposal of property, plant and equipment	(2.1)	(0.9)
Other operating lease rentals payable:		
– Plant and machinery	24.7	19.3
– Property	7.1	7.5
Repairs and maintenance expenditure on property, plant and equipment	24.8	23.2
Research expenditure	1.1	1.3
Trade receivables impairment	15.9	13.8
Fees paid to the auditors:		
– for statutory audit services (principal auditors only)	0.7	0.6
– for regulatory audit services	0.1	0.1
– total audit services	0.8	0.7
– for other assurance services	0.9	0.5
Total fees paid to the auditors	1.7	1.2
Fees paid to other accounting firms for other work	2.9	4.9

Fees paid to the principal auditors for other assurance services are primarily in respect of vendor due diligence and accounting advice on the disposal of Construction Services and Project Investments, and the review of comparatives on the adoption of International Financial Reporting Standards. In 2005 fees paid to the principal auditors for other assurance services are primarily in respect of preparatory work for the adoption of International Financial Reporting Standards and a review of the business plans for the Ofwat regulatory submission.

Fees paid to other accounting firms for other work comprise £1.1 million (2005: £1.2 million) for internal audit work, £1.2 million (2005: £2.8 million) for legal advice and £0.6 million (2005: £0.9 million) for tax and other advice.

Notes to the consolidated financial statements continued

7 Taxation

	2006 £m	2005 £m
Analysis of charge in the year		
Current tax	16.1	(2.8)
Deferred tax	15.0	6.9
Total taxation (all continuing operations)	31.1	4.1
Tax on items taken directly to equity		
Deferred tax charge on actuarial gains on defined benefit pension schemes offset in reserves	(29.3)	(8.7)
Deferred tax credit on fair value cash flow hedge losses offset in reserves	4.2	4.2
Deferred tax credit on employee share options	5.7	–
	(19.4)	(4.5)

The loss on disposal of businesses in 2006 does not attract tax relief as the disposal meets the requirements of substantial shareholdings exemption legislation and is therefore a non-qualifying loss for UK tax purposes. The tax charge for the year is lower (2005: lower) than the standard rate of corporation tax in the UK (30 per cent). The differences are explained below:

	2006 £m	2005 £m
Profit before tax for continuing operations	108.8	32.4
Profit on ordinary activities multiplied by corporation tax in the UK of 30 per cent	32.6	9.7
Effect of:		
Adjustments to tax in respect of prior years	(4.1)	(15.7)
Adjustments in respect of foreign tax rates	0.1	2.1
Expenses not deductible for tax purposes	4.4	8.3
Other	(1.9)	(0.3)
Total taxation (all continuing operations)	31.1	4.1

8 Net foreign exchange losses

The exchange differences charged to the income statement are included as follows:

	2006 £m	2005 £m
Operating costs	(0.1)	(0.1)

9 **Discontinued operations**

On 31 March 2006 the group completed the disposal of its Construction Services and Project Investments businesses within Morrison to Galliford Try Plc for a total consideration of approximately £42 million. As at 31 March 2006 £34 million had been received.

The results of the discontinued businesses which have been included in the consolidated income statement, were as follows:

	2006 £m	2005 £m
Revenue	336.4	331.5
Operating costs	(325.3)	(328.1)
Operating profit	11.1	3.4
Interest receivable	2.7	1.5
Share of post tax (losses)/profits from joint ventures and associates	(0.4)	0.2
Profit before tax	13.4	5.1
Taxation	(4.6)	0.3
Post tax profit from discontinued operations	8.8	5.4
Loss on disposal of businesses	(56.4)	–
(Loss)/profit for the year from discontinued operations	(47.6)	5.4

The effect of discontinued operations on segment results is disclosed in note 2.

As part of the transaction announced on 2 March 2006 and substantially completed on 31 March 2006, the group is committed to disposing of two PFI concessions once certain conditions have been met. These operations, which are expected to be sold within 12 months, have been classified as a disposal group held for sale and presented separately in the balance sheet. Their results for the year are included in discontinued businesses above. The proceeds of disposal are expected to exceed the book value of the related net assets and accordingly no impairment losses have been recognised on the classification of these operations as held for sale.

The major classes of assets and liabilities comprising the operations classified as held for sale are as follows:

	2006 £m
Trade and other receivables	1.4
Total assets classified as held for sale	1.4
Trade and other payables	(1.7)
Provisions	(0.1)
Total liabilities directly associated with assets classified as held for sale	(1.8)
Net liabilities of disposal group	(0.4)

The assets and liabilities held for sale at 31 March 2005 of £9.4 million and £(12.8) million respectively related to international businesses that were disposed of during the current year.

Notes to the consolidated financial statements continued

10 Earnings per share

	2006			2005		
	Earnings £m	Weighted average number of shares millions	Per share amount pence	Earnings £m	Weighted average number of shares millions	Per share amount pence
Continuing operations						
Basic earnings per share	77.6	142.4	54.5	28.2	143.3	19.7
Effect of dilutive options	1.4	4.8	(0.8)	0.1	1.5	(0.2)
Diluted earnings per share	79.0	147.2	53.7	28.3	144.8	19.5
Supplementary earnings per share:						
Basic earnings per share	77.6	142.4	54.5	28.2	143.3	19.7
Effect of:						
Exceptional items[2]	–	–	–	7.0	–	4.9
Tax relating to exceptional items	–	–	–	(0.7)	–	(0.5)
Incremental impact of IAS 39 (note 4)	26.2	–	18.4	17.4	–	12.1
Tax relating to the incremental impact of IAS 39	(8.2)	–	(5.8)	(5.2)	–	(3.6)
Adjusted basic earnings per share excluding exceptional items and the incremental impact of IAS 39	95.6	142.4	67.1	46.7	143.3	32.6
Diluted earnings per share	79.0	147.2	53.7	28.3	144.8	19.5
Adjustment for anti-dilutive options[1]	–	–	–	0.5	1.5	0.2
Effect of:						
Exceptional items[2]	–	–	–	7.0	–	4.8
Tax relating to exceptional items	–	–	–	(0.7)	–	(0.5)
Incremental impact of IAS 39 (note 4)	26.2	–	17.8	17.4	–	11.9
Tax relating to the incremental impact of IAS 39	(8.2)	–	(5.6)	(5.2)	–	(3.6)
Adjusted basic earnings per share excluding exceptional items and the incremental impact of IAS 39	97.0	147.2	65.9	47.3	146.3	32.3
Discontinued operations						
Basic earnings per share	(47.6)	142.4	(33.4)	5.4	143.3	3.7
Effect of dilutive options	–	–	–	–	1.5	–
Diluted earnings per share	(47.6)	142.4	(33.4)	5.4	144.8	3.7
Continuing and discontinued operations						
Basic earnings per share	30.0	142.4	21.1	33.6	143.3	23.4
Effect of dilutive options	–	1.5	(0.3)	–	1.3	(0.2)
Diluted earnings per share	30.0	143.9	20.8	33.6	144.6	23.2

Adjusted earnings per share before exceptional items and the incremental impact of IAS 39 are disclosed as the Directors consider it to be an appropriate reflection of the group's normalised earnings performance. The impact of IAS 39 adjusted for above represents the incremental effect of adopting IAS 39 compared to UK GAAP standards previously adopted. The composition of the IAS 39 charge can be seen in note 4.

In addition to the dilutive share options included opposite are the following share options and grants which are not included as they are considered to be anti-dilutive due to the fact that their inclusion in the above calculations would increase the earnings per share figures shown.

	2006		2005	
	Earnings adjustment omitted £m	Dilutive effect omitted millions	Earnings adjustment omitted £m	Dilutive effect omitted millions
SAYE 2003[1]	–	–	0.5	1.5
SAYE 2004	–	–	0.3	0.4
ESOS 2003	–	–	0.3	0.3
LTIP 2005	0.4	0.2	–	–
	0.4	0.2	1.1	2.2

[1] SAYE 2003 share options are included in the adjusted diluted earnings per share calculation as they have a dilutive effect in this instance but are however excluded from the unadjusted diluted earnings per share calculation.

[2] Exceptional items in 2005 represent the loss on disposal of MVM of £8.3 million and profit on disposal of international businesses of £1.3 million.

11 Dividends

The following dividends were paid by the group:

	2006		2005	
	£m	Pence per share	£m	Pence per share
Previous year final dividend	49.0	34.3	–	–
Current year interim dividend	21.0	14.8	20.6	14.4
	70.0	49.1	20.6	14.4

The following dividends were proposed by the group in respect of the accounting year presented:

	2006		2005	
	£m	Pence per share	£m	Pence per share
Current year interim dividend (paid)	21.0	14.8	20.6	14.4
Current year final dividend (proposed)	50.7	36.0	49.4	34.3
	71.7	50.8	70.0	48.7

The final dividend for 2005/6 of £50.7 million (equivalent to 36.0 pence per share), will be proposed at the AGM on 26 July 2006, and has not been included as a liability as at 31 March 2006. The final dividend will be paid on 15 September 2006 to shareholders on the register at 5pm on 11 August 2006.

The final payment to shareholders for the year ended 31 March 2004 was made by way of an issue of redeemable shares. A total of 47,568 million redeemable shares were issued on 21 June 2004 at the rate of 332 redeemable shares per ordinary share held, equivalent to 33.2 pence per ordinary share, with a total value of £47.6 million.

Notes to the consolidated financial statements continued

12 Employee information

	2006 £m	2005 £m
Staff costs in continuing operations for the group during the year		
Wages and salaries	257.3	251.6
Social security costs	23.5	21.0
Pension costs – defined contribution (note 28)	5.1	4.3
Pension costs – defined benefit plans (note 28)	23.5	26.9
Share-based payments	1.7	1.1
	311.1	304.9

Staff costs for the year ended 31 March 2006 include £45.0 million (2005: £37.3 million) of costs that have been capitalised as 'own work capitalised' and redundancy costs relating to Anglian Water of £1.3 million (£0.5 million of wages and salaries and £0.8 million of pension costs) wholly relating to a reorganisation undertaken by the business (2005: £11.4 million of which £6.2 million represented wages and salaries and £5.2 million represented pension costs).

Average number of full time equivalent persons (including Executive Directors) employed

	2006	2005
By business group		
Continuing operations		
Anglian Water	3,322	3,376
Utility Services	3,377	2,616
Facilities Services	2,283	2,050
Other support services	208	406
Morrison centre	16	22
AWG Property	60	103
Other	244	368
	9,510	8,941
Discontinued operations		
Construction Services	1,529	1,588
Project Investments	15	20
Total group	11,054	10,549

The numbers above for continuing operations include 231 full time equivalent persons employed outside the UK (2005: 309). Details of the Directors' emoluments and interests, which form part of these consolidated financial statements, are included in the remuneration report on pages 51 to 58.

	2006 £m	2005 £m
Key management compensation		
Salaries and short-term employee benefits	6.5	6.0
Post-employment benefits	0.6	0.6
Termination benefits	0.3	0.4
Share-based payments	1.4	0.5
	8.8	7.5

The key management figures given above include AWG Plc Directors and members of the divisional boards.

13 Goodwill

	2006 £m	2005 £m
Cost		
At 1 April	250.0	291.7
Acquisition of subsidiary undertakings (note 19)	0.2	–
Disposals of subsidiary undertakings	(129.5)	(41.7)
At 31 March	120.7	250.0
Amortisation		
At 1 April	(73.5)	(96.6)
Disposals of subsidiary undertakings	36.4	23.1
At 31 March	(37.1)	(73.5)
Net book value		
At 31 March	83.6	176.5

At the end of the year, the acquired goodwill in respect of TE Services Limited and all goodwill previously recognised was tested for impairment in accordance with IAS 36 'Impairment of Assets'.

Goodwill has been tested for impairment by comparing the carrying amount of each income-generating unit, including goodwill, with the recoverable amount of that income-generating unit.

The recoverable amount of an income-generating unit is determined based on the higher of value in use calculations and its fair value less costs to sell. These value in use calculations use cash flow projections based on internal business plans approved by the Directors covering a three-year period.

Following the above impairment tests, no impairment of goodwill was required in the year or the preceding year.

Notes to the consolidated financial statements continued

13 Goodwill continued

The net book value of goodwill at 31 March 2006 relates to the Utility Services and Facilities Services businesses within Morrison and the remaining Project Investments concessions (reported as part of the 'other' segment). The carrying amounts of goodwill are as follows:

	2006 £m	2005 £m
Utility Services	45.6	45.4
Facilities Services	25.3	25.3
Morrison	70.9	70.7
Other (Project Investments)	12.7	12.7
Total continuing operations	83.6	83.4
Discontinued operations	–	93.1
	83.6	176.5

Goodwill arises within the following geographical segments:

	2006 £m	2005 £m
United Kingdom	83.4	176.5
Europe	0.2	–
	83.6	176.5

The key assumptions in the value in use calculations were:

Utility Services and Facilities Services

The recoverable amount is based on value in use relating to cash flow projections contained in the internal business plan. These cash flows are similar to those achieved in 2005/6. The internal business plan estimates operating cash flows for the next three years and these have been extrapolated to five years assuming a growth rate of 2.25 per cent. Thereafter, a terminal value has been applied. The growth rate does not exceed the long-term average growth rate for the industry in which the income-generating unit operates.

A pre-tax weighted average discount rate of 10.5 per cent has been used to discount the cash flows. This is in line with the expected returns from the sector.

Project Investments

The recoverable amount is based on an offer recently received from a potential purchaser, less an estimate of the costs to sell.

14 **Other intangible assets**

Year ended 31 March 2006

	Licences £m	Customer lists £m	Software £m	Total £m
Cost				
At 1 April 2005	–	–	218.7	218.7
Additions	–	–	2.8	2.8
Acquisition of subsidiary undertakings	–	3.4	–	3.4
Disposals of subsidiary undertakings	–	–	(0.2)	(0.2)
Disposals	–	–	(10.7)	(10.7)
At 31 March 2006	–	3.4	210.6	214.0
Amortisation				
At 1 April 2005	–	–	(121.1)	(121.1)
Charge for the year	–	(0.1)	(24.3)	(24.4)
Disposals of subsidiary undertakings	–	–	0.1	0.1
Disposals	–	–	10.2	10.2
At 31 March 2006	–	(0.1)	(135.1)	(135.2)
Net book value				
At 31 March 2006	–	3.3	75.5	78.8

Year ended 31 March 2005

	Licences £m	Customer lists £m	Software £m	Total £m
Cost				
At 1 April 2004	12.1	–	192.4	204.5
Additions	–	–	35.4	35.4
Disposals	–	–	(9.1)	(9.1)
Subsidiary deconsolidated due to severe long-term restrictions (note 16)	(12.1)	–	–	(12.1)
At 31 March 2005	–	–	218.7	218.7
Amortisation				
At 1 April 2004	(1.1)	–	(106.2)	(107.3)
Charge for the year	(0.5)	–	(24.0)	(24.5)
Disposals	–	–	9.1	9.1
Subsidiary deconsolidated due to severe long-term restrictions (note 16)	1.6	–	–	1.6
At 31 March 2005	–	–	(121.1)	(121.1)
Net book value				
At 31 March 2005	–	–	97.6	97.6

Licences represent payments to operate a water treatment works for a fixed period, and were amortised over that fixed period until disposed of. All amortisation of intangible assets is charged through operating costs (note 5).

There are no internally generated intangible assets.

Notes to the consolidated financial statements continued

15 Property, plant and equipment

Year ended 31 March 2006

	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Vehicles, plant and equipment £m	Assets under construction £m	Total £m
Cost						
At 1 April 2005	37.5	2,329.5	3,107.2	528.5	148.9	6,151.6
Additions	–	–	–	7.1	288.4	295.5
Acquisition of subsidiary undertakings	–	–	–	1.7	–	1.7
Transfers on commissioning	1.9	81.5	127.5	21.1	(232.0)	–
Disposals	(1.3)	–	(0.1)	(15.5)	–	(16.9)
Disposals of subsidiary undertakings	(0.9)	–	–	(2.5)	–	(3.4)
At 31 March 2006	37.2	2,411.0	3,234.6	540.4	205.3	6,428.5
Depreciation						
At 1 April 2005	(5.2)	(228.7)	(1,108.5)	(402.8)	–	(1,745.2)
Charge for the year	(0.5)	(18.7)	(105.3)	(39.0)	–	(163.5)
Disposals	0.3	–	0.1	11.9	–	12.3
Disposals of subsidiary undertakings	0.7	–	–	1.7	–	2.4
At 31 March 2006	(4.7)	(247.4)	(1,213.7)	(428.2)	–	(1,894.0)
Net book value						
At 31 March 2006	32.5	2,163.6	2,020.9	112.2	205.3	4,534.5

Year ended 31 March 2005

	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Vehicles, plant and equipment £m	Assets under construction £m	Total £m
Cost						
At 1 April 2004	36.0	2,255.5	2,910.5	548.4	176.0	5,926.4
Additions	0.1	–	–	11.6	257.7	269.4
Transfers on commissioning	1.4	74.0	197.0	12.4	(284.8)	–
Disposals	–	–	(0.3)	(31.7)	–	(32.0)
Disposals of subsidiary undertakings	–	–	–	(11.5)	–	(11.5)
Transfer to disposal group	–	–	–	(0.7)	–	(0.7)
At 31 March 2005	37.5	2,329.5	3,107.2	528.5	148.9	6,151.6
Depreciation						
At 1 April 2004	(4.7)	(209.6)	(1,007.1)	(401.2)	–	(1,622.6)
Charge for the year	(0.5)	(19.1)	(101.6)	(40.0)	–	(161.2)
Disposals	–	–	0.2	27.5	–	27.7
Disposals of subsidiary undertakings	–	–	–	10.2	–	10.2
Transfer to disposal group	–	–	–	0.7	–	0.7
At 31 March 2005	(5.2)	(228.7)	(1,108.5)	(402.8)	–	(1,745.2)
Net book value						
At 31 March 2005	32.3	2,100.8	1,998.7	125.7	148.9	4,406.4

Assets held under finance leases have the following net book amount:

	2006 £m	2005 £m
Cost	263.7	265.0
Accumulated depreciation	(135.7)	(134.6)
Net book amount	128.0	130.4

All assets held under finance leases relate to vehicles, plant and equipment.

16 Investments in associates

	2006 £m	2005 £m
At 1 April	5.2	0.1
Additions	–	0.2
Share of post tax (losses)/profits	(0.2)	0.8
Subsidiary deconsolidated due to severe long-term restrictions	–	4.1
Disposals	(4.1)	–
At 31 March	0.9	5.2

The group's interest in its principal associate as at 31 March 2006, which was unlisted, was as follows:

Undertaking	Country of incorporation	Assets	Liabilities	Revenues	Profit	Interest held
Strathclyde Business Park (Developments) Limited	Scotland	0.9	–	–	(0.2)	31%

The accounting year end for the above undertaking is 28 February.

The class of shares held are £1 ordinary shares in Strathclyde Business Park (Developments) Limited. This company principally operates in Scotland and its shares are held by a subsidiary of AWG Plc.

The subsidiary deconsolidated due to severe long-term restrictions in 2005 within associated undertakings of £4.1 million is in respect of Taizhou-Anglian Water Company Limited which was consolidated in previous years. On 17 September 2004 a conditional contract was exchanged for the sale of the company to Jiangsu Taizhou Water Company. The conditions in the contract were not resolved until 10 May 2005, nevertheless the purchaser took over the effective management and control of the company after the expected completion date in October 2004 and the group determined that it should be deconsolidated with effect from 31 December 2004. From that date it was held at a fixed amount within associated undertakings, until its disposal on 10 May 2005.

17 Interest in joint ventures

	2006 £m	2005 £m
At 1 April		
– Net assets excluding goodwill	19.7	16.9
– Goodwill	0.2	0.2
Net value of investment	19.9	17.1
Additions		
– Net assets	0.3	–
Disposals	(0.2)	0.3
Share of post tax (losses)/profits (included in continuing operations)	(3.3)	2.7
Share of post tax (losses)/profits (included in discontinued operations)	(0.4)	0.2
Dividends declared from joint ventures	(3.7)	(0.9)
Transfer to disposal group	0.2	–
Amounts offset against trade balances	(1.3)	–
Fair value losses on cash flow hedges	(0.5)	–
Transfer (from)/to provisions	(0.4)	0.5
	(9.3)	2.8
At 31 March		
– Net assets excluding goodwill	10.4	19.7
– Goodwill	0.2	0.2
Net value of investment	10.6	19.9

The proportionate interest in joint ventures' capital commitments are shown in note 35.

The contingent liabilities relating to the group's interest in joint ventures are shown in note 34. There are no contingent liabilities within the joint ventures themselves.

Notes to the consolidated financial statements continued

17 **Interest in joint ventures continued**

In relation to the group's interest in joint ventures, the assets, liabilities, income and expenses are shown below:

	2006 £m	2005 £m
Current assets	82.2	178.4
Non-current assets	89.2	50.9
Current liabilities	(75.9)	(171.0)
Non-current liabilities	(84.9)	(38.4)
	10.6	(19.9)
Revenue	64.7	106.8
Operating costs	(61.6)	(91.9)
Operating profit	3.1	14.9
Interest payable and similar charges	(6.4)	(10.4)
Fair value gains/(losses) on derivative financial instruments	1.4	(0.2)
Profit before tax	(1.9)	4.3
Taxation	(1.8)	(1.4)
Share of post tax results from joint ventures	(3.7)	2.9

The group's principal joint ventures at 31 March 2006 are as follows:

Undertaking	Country of incorporation	Activity	Proportion of shares held (ii)
Property Developments			
Northwood Residential Limited (i), (iii)	Ireland	Development of residential properties	40%
AWG Outlets (Rathdowney) Limited (iii)	Ireland	Development of land and buildings	50%
Private Finance Initiative Projects			
Catchment Moray Limited	Scotland	Financing and operation of wastewater treatment plant	33%
Alpha Schools (West Lothian) Limited	Scotland	Financing and facilities management of school premises	50%
Morrison Edison Investments Limited	Scotland	Development of land and buildings	50%
Facilities Management			
AWG Cleanaway Limited (formerly Morrison Serviceteam Limited)	England	Maintenance and repair services	50%

These undertakings principally operate in their country of incorporation, and are held by subsidiaries of AWG Plc.

(i) The accounting year end for all the above undertakings is 31 March, with the exception of Northwood Residential Limited which has an accounting year end of 30 June.

(ii) Unless otherwise stated the class of shares held are ordinary shares of £1 each.

(iii) The class of shares held is one Euro each.

18 **Other investments**

	2006 £m	2005 £m
At 1 April	3.1	2.9
Additions	–	0.4
Disposals	(3.0)	(0.2)
At 31 March	0.1	3.1

Other investments include a 4.25 per cent investment in Aguas Argentinas, a consortium which operates the water and wastewater system in Buenos Aires, Argentina and a 4.64 per cent investment in Rockingham Motor Speedway. The investment in Rockingham Motor Speedway was fully provided for in 2003 and the investment in Aguas Argentinas of £3.8 million was fully provided for in 2002. The disposal in the year related to the group's equity investment in the Edinburgh Royal Infirmary PFI project. The net book value at 31 March 2006 included £nil (2005: £2.9 million) of loans and £0.1 million (2005: £0.2 million) of shares.

19 Acquisition of subsidiary

The group acquired one subsidiary in the year as explained below:

Name of subsidiary	Description	Investment held	Date of acquisition
TE Services Limited	Provides cabling services to the telecoms sector	100% of share capital	2 December 2005

This transaction has been accounted for by the purchase method of accounting.

Assets acquired at book and provisional fair value:

	Book value at acquisition £m	Fair value at acquisition £m
Property, plant and equipment	1.7	1.7
Other intangible assets (customer lists)	–	3.4
Inventories	0.1	0.1
Trade and other receivables – current	10.0	10.0
Cash and cash equivalents	1.5	1.5
Trade and other payables – current	(8.9)	(8.9)
Current tax liabilities	(0.6)	(0.6)
Borrowings		
– bank loans	(0.7)	(0.7)
– finance leases	(0.1)	(0.1)
Net assets acquired	3.0	6.4

Consideration paid:	
Cash	4.1
Deferred consideration	2.2
Directly attributable costs	0.3
	6.6
Goodwill arising	0.2
Net cash outflow for purchase of subsidiary undertaking	
Cash consideration paid	(4.1)
Directly attributable costs	(0.3)
Cash and cash equivalents acquired	1.5
Net cash outflow for purchase of subsidiary undertaking	(2.9)

The goodwill arising on the acquisition of TE Services Limited is attributable to the future operating synergies arising in the enlarged group.

The unaudited proforma consolidated results of operations acquired during the year, presented as if the acquisition had been made at the beginning of the financial year, would be as follows:

	2006 £m
Revenue	38.2
Profit attributable to equity shareholders	1.1

TE Services Limited contributed a loss before tax of £0.3 million to the group for the period from 2 December 2005 to 31 March 2006.

Notes to the consolidated financial statements continued

20 Inventories

	2006 £m	2005 £m
Raw materials	11.2	8.6
Work in progress	39.4	40.2
	50.6	48.8

The cost of inventories recognised as expense and included in cost of goods sold amounted to £83.0 million (2005: £87.0 million).

21 Trade and other receivables

	2006 £m	2005 £m
Trade receivables	214.8	170.5
Less: provision for impairment of receivables	(50.3)	(44.9)
Net trade receivables	164.5	125.6
Amounts due from customers for contract work	47.8	97.6
Retentions on contracts	1.8	1.8
Amounts owed by joint ventures and associates		
– trade balances	26.6	33.3
– loans	2.0	27.8
Prepayments and accrued income	94.7	106.5
Other receivables	43.5	36.5
	380.9	429.1
Less: non-current portion	(0.4)	(0.3)
Current portion	380.5	428.8

All non-current receivables are due within five years from the balance sheet date.

Prepayments and accrued income as at 31 March 2006 includes water and wastewater income not yet billed of £26.1 million (2005: £37.5 million) and service contract income not yet billed of £46.3 million (2005: £32.5 million).

There is no concentration of credit risk with respect to trade receivables as the majority of trade receivables are made up of a large number of small balances. In Anglian Water the bad debt provision is calculated by applying expected recovery rates, based on actual historical cash collection performance, to the aged debt profile. In the remaining subsidiary companies specific provisions are made for those debts on which recovery is regarded as doubtful.

22 Construction contracts

	2006 £m	2005 £m
Contracts in progress at balance sheet date:		
Continuing operations		
Amounts due from contract customers included in trade and other receivables	46.1	34.6
Amounts due to contract customers included in trade and other payables	(8.5)	(7.5)
	37.6	27.1
Discontinued operations		
Amounts due from contract customers included in trade and other receivables	–	54.1
Amounts due to contract customers included in trade and other payables	–	–
	37.6	81.2
Continuing operations		
Contract costs incurred plus recognised profits less recognised losses	75.8	67.1
Less: progress billings	(38.2)	(40.0)
	37.6	27.1
Discontinued operations		
Contract costs incurred plus recognised profits less recognised losses	–	272.0
Less: progress billings	–	(217.9)
	37.6	81.2

At 31 March 2006 retentions held by customers for contract work amounted to £1.8 million (2005: £1.8 million). Advances received from customers for contract work amounted to £1.6 million (2005: £11.2 million).

At 31 March 2006 amounts of £0.3 million (2005: £nil) included in trade and other receivables and arising from construction contracts are due for settlement after more than one year.

23 Cash and cash equivalents

	2006 £m	2005 £m
Cash at bank and in hand	128.4	178.6
Short-term bank deposits (between one day and three months)	642.5	805.1
Long-term bank deposits (between three months and six months)	5.0	114.9
	775.9	1,098.6

The effective interest rate on short-term deposits was 4.5 per cent (2005: 4.8 per cent); these deposits have an average maturity of 16 days (2005: 28 days).

The effective interest rate on long-term deposits was 4.6 per cent (2005: 4.9 per cent); these deposits have an average maturity of 180 days (2005: 129 days).

Net cash and bank overdrafts include the following for the purposes of the consolidated cash flow statement:

	2006 £m	2005 £m
Cash at bank and in hand	128.4	178.6
Short-term bank deposits (between one day and three months)	642.5	805.1
Bank overdraft (note 25)	–	(0.1)
Cash and cash equivalents for cash flow reporting	770.9	983.6

24 Trade and other payables

	2006 £m	2005 £m
Trade payables	195.2	210.6
Amounts due to joint ventures and associates (all trading balances)	2.1	8.6
Amounts due to customers for contract work	9.5	8.1
Receipts in advance	106.0	83.7
Other taxation and social security payable	21.4	19.4
Accrued expenses	102.8	121.8
Other payables	25.4	41.8
Deferred grants and contributions	10.1	9.6
	472.5	503.6

Receipts in advance include £81.7 million (2005: £52.6 million) relating to amounts received from customers for water and wastewater charges in respect of the following year.

Notes to the consolidated financial statements continued

25 Borrowings

	2006 £m	2005 £m
£100m 12.375% Fixed 2014 (d), (f)	102.5	102.4
£200m 6.875% Fixed 2023 (d), (f)	205.1	205.0
£200m 6.625% Fixed 2029 (d), (f)	201.0	201.0
£100m 5.5% Index-Linked 2008 (a), (d), (f)	165.2	161.0
£150m 4.125% Index-Linked 2020 (a), (d), (f)	174.4	169.7
Euro 350m 5.375% Fixed 2009 (d), (f)	253.7	249.6
US$55m 6.85% Private Placement 2006 (d), (f)	–	29.2
£150m 8.25% Fixed 2006 (d), (f)	153.8	153.9
US$25m 7.07% Private Placement 2009 (d), (f)	9.9	11.4
US$10m Amortising 7.21% Private Placement 2006 (d), (f)	0.3	0.8
US$40m 6.57% Private Placement 2005 (d), (f)	–	21.4
US$35m 6.62% Private Placement 2006 (d), (f)	20.4	18.7
US$100m 7.01% Private Placement 2008 (d), (f)	58.1	53.4
US$23m 7.13% Private Placement 2009 (d), (f)	13.4	12.3
US$195m 7.23% Private Placement 2011 (d), (f)	113.2	103.9
Euro 650m 4.625% Fixed 2013 (d), (f)	455.3	458.1
US$400m LIBOR plus 0.4% 2007 (d), (g)	–	211.3
Euro 115m EURIBOR plus 2.8% 2010/2037 (c), (d), (g)	–	79.4
£246m 6.293% Fixed 2030 (d), (f)	253.7	253.7
£275m 7.882% Fixed 2012/2037 (c), (d), (f)	287.3	287.0
£180m LIBOR plus 1.25% 2009/2014 (c), (d), (g)	–	181.6
£100m LIBOR plus 2.8% 2010/2037 (c), (d), (g)	–	101.1
£50m LIBOR plus 1.2% 2007/2012 (c), (d), (g)	–	50.4
£250m 5.837% Fixed 2022 (d), (f)	256.2	256.1
£200m 3.07% Index-Linked 2032 (a), (d), (f)	219.2	213.1
£60m 3.07% Index-Linked (LPI) 2032 (a), (d), (f)	65.8	63.9
£75m 3.666% Index-Linked 2024 (a), (d), (f)	82.9	80.6
£250m 5.25% 2015 (d), (f)	256.1	247.3
£150m 5.5% 2017/2040 (d), (f)	152.5	147.2
£402m 2.4% Index-Linked 2035 (a), (d), (f)	413.7	–
Finance leases (d), (e), (g)	121.2	144.8
THB 301.8m Bank of Asia 2005 (g)	–	1.1
Bank loan – HSBC (g)	–	3.3
Morrison Loan Notes LIBID minus 0.5% 2007 (g)	5.0	9.5
Other loan notes LIBOR minus 1.0% (g)	0.3	1.1
Redeemable shares LIBOR x 75% (g)	–	14.7
Euro 2.5m Bank of Scotland (Ireland) invoice financing 2006 (g)	0.4	–
Other loans (b), (g)	0.1	0.3
Overdraft (b), (g)	–	0.1
Total loans and other borrowings	4,040.7	4,299.4
Less: current portion	(299.5)	(194.5)
Loans and other borrowings (non-current portion)	3,741.2	4,104.9

a) The value of the capital and interest elements of the index-linked debt are linked to movements in the Retail Price Index (RPI). The increase in the capital value during the year of £28.4 million (2005: £20.2 million) has been taken to the income statement as part of interest payable.
b) The unspecified loans, borrowings and overdraft are at floating rates of interest.
c) Legal maturity of these instruments is the second of the two years quoted. Coupons increase from the first of the years quoted in accordance with the pricing terms agreed at issue.
d) Under a security agreement dated 30 July 2002 between Anglian Water Services Financing Plc (AWSF), Anglian Water Services Limited (AWS), Anglian Water Services Overseas Holdings Limited (AWSOH), Anglian Water Services Holdings Limited (AWSH) and Deutsche Trustee Company Limited a fixed and floating charge was created over the assets of AWS to the extent permissible under the Water Industry Act 1991. In addition there is a fixed charge over the issued share capital of AWS, AWSOH and AWSF. At 31 March 2006 £4,210.5 million of the group debt and derivatives was secured under this charge (2005: £4,466.9 million).
e) Under the terms of the finance leases security is granted to the various lessors.
f) These instruments are exposed to fair value interest rate risk before taking into account the impact of interest rate swaps.
g) These instruments are exposed to cash flow interest rate risk before taking into account the impact of interest rate swaps. Of the £121.2 million (2005: £144.8 million) finance leases indicated, only £118.2 million (2005: £139.0 million) are exposed to cash flow interest rate risk before swaps. The balance is exposed to fair value interest rate risk.

The exposure of the group to interest rate changes when borrowings reprice is as follows:

	Total £m	Indexed £m	Floating £m	Fixed £m
As at 31 March 2006				
Nominal debt before swaps	4,010.5	1,120.1	122.2	2,768.2
Effect of swaps	53.7	636.7	228.9	(811.9)
	4,064.2	1,756.8	351.1	1,956.3

	Total £m	Indexed £m	Floating £m	Fixed £m
As at 31 March 2005				
Nominal debt before swaps	4,353.8	689.6	825.8	2,838.4
Effect of swaps	36.2	619.2	(270.4)	(312.6)
	4,390.0	1,308.8	555.4	2,525.8

This table shows the exposure of the group to each of three interest rate risk types based on contractual balances, rather than accounting balances, and therefore directly indicates exposure to interest rate changes. Under the terms of the group's index-linked swaps, the index-linked base upon which interest is calculated increases with RPI over time, whereas the floating base remains unchanged. Consequently the £53.7 million (2005: £36.2 million) total of effect of swaps relates to the increase in the notional capital value upon which interest is payable. All foreign currency debt and swaps are shown at hedged rates.

The effective interest rates at the balance sheet dates were as follows:

	2006	2005
Borrowings – GBP	6.5%	6.9%
Borrowings – USD	7.2%	4.9%
Borrowings – EUR	6.0%	6.1%
Finance leases	6.1%	5.6%
Other	N/A	3.6%

Notes to the consolidated financial statements continued

26 Financial instruments

Derivative financial instruments designated as hedges

	2006 Assets £m	2006 Liabilities £m	2005 Assets £m	2005 Liabilities £m
Designated as cash flow hedges				
Interest rate swaps	–	(10.9)	–	(8.7)
Cross currency interest rate swaps	24.1	(55.8)	33.1	(129.2)
	24.1	(66.7)	33.1	(137.9)
Designated as fair value hedges				
Interest rate swaps	6.2	(0.3)	–	(5.3)
Cross currency interest rate swaps	4.3	(7.1)	3.7	(3.9)
	10.5	(7.4)	3.7	(9.2)
Designated as hedges of net investment				
Foreign exchange options	0.1	–	0.2	–
	0.1	–	0.2	–
Derivative financial instruments designated as hedges	34.7	(74.1)	37.0	(147.1)
Derivative financial instruments not designated as hedges	0.1	(139.4)	0.1	(93.0)
Total derivative financial instruments	34.8	(213.5)	37.1	(240.1)
Derivative financial instruments can be analysed as follows:				
Current portion	16.6	(12.3)	11.4	(22.7)
Non-current portion	18.2	(201.2)	25.7	(217.4)
	34.8	(213.5)	37.1	(240.1)

The net fair value loss since inception at 31 March 2006 on interest rate swaps designated as cash flow hedges are £10.9 million (2005: £8.7 million). These will be transferred to the income statement when the forecast transactions occur over the next 16 years.

The net fair value loss since inception at 31 March 2006 on cross currency interest rate swaps designated as cash flow hedges is £31.7 million (2005: £96.1 million). These will be transferred to the income statement when the forecast transactions occur over the next five years.

In accordance with IAS 39 the group has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. There were no amounts recorded in the income statement for gains or losses on embedded derivatives for the year ended 31 March 2006 (2005: £nil).

Interest rate swaps

The notional principal amount of the outstanding interest rate swap contracts at 31 March 2006 was £2,524.6 million (2005: £2,791.3 million).

At 31 March 2006 the fixed interest rates vary from 4.8 per cent to 7.2 per cent, floating interest rates vary from 4.5 per cent to 8.3 per cent and index-linked interest rates vary from 2.7 per cent to 3.7 per cent.

At 31 March 2005 the fixed interest rates vary from 4.8 per cent to 8.9 per cent, floating interest rates vary from 4.8 per cent to 5.9 per cent and index-linked interest rates vary from 2.7 per cent to 3.7 per cent.

Hedge of net investment in foreign entity

The group has entered into Euro denominated foreign exchange call options which it has designated as hedges of net investment in its subsidiaries in Italy (and Ireland at 31 March 2005). The fair value of these options at 31 March 2006 was £0.1 million (2005: £0.2 million). The amounts recognised in the income statement relating to hedges of net investments in foreign entities for the year ended 31 March 2006 was a loss of £0.3 million (2005: £nil). There was a gain of £0.1 million recognised in equity (2005: £nil).

Fair values of non-derivative financial assets and financial liabilities

Where market values are not available, fair values of financial assets and financial liabilities have been calculated by discounting expected future cash flows at prevailing interest rates and by applying year end exchange rates.

Fair value of financial assets and financial liabilities

	2006		2005	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Current asset investments	5.0	5.0	114.9	114.9
Cash at bank and in hand (including short-term deposits)	770.9	770.9	983.7	983.7
Current borrowings	(299.5)	(298.3)	(194.5)	(192.1)
Non-current borrowings	(3,741.2)	(4,181.0)	(4,104.9)	(4,396.3)
Current derivative financial instruments	4.3	4.3	(11.3)	(11.3)
Non-current derivative financial instruments	(183.0)	(183.0)	(191.7)	(191.7)
"Net debt"	(3,443.5)	(3,882.1)	(3,403.8)	(3,692.8)
Other non-current investments	(0.1)	(0.1)	(3.1)	(3.1)
Non-current trade and other receivables	(0.4)	(0.4)	(0.3)	(0.3)
Provisions (excluding joint ventures net liabilities)	(51.0)	(51.0)	(48.5)	(48.5)
Non-current trade and other payables	–	–	(0.3)	(0.3)
	(3,495.0)	(3,933.6)	(3,456.0)	(3,745.0)

The estimated fair values of quoted loans and other borrowings are based on year end mid-market quoted prices (where available). The fair value of derivative financial instruments is determined by calculating (with reference to market exchange and interest rates at 31 March) the net realisable value that would have arisen if these contracts terminated at 31 March. Fair values of other non-current investments, non-current trade and other receivables, provisions (excluding joint ventures net liabilities) and non-current trade and other payables have been estimated as not materially different from book value.

Derivative transactions expose the group to credit risk against the counterparties concerned. Anglian Water has credit protection measures in place within agreements which provide protection in the event of counterparty rating downgrade or default. Other group subsidiaries entering into such transactions generally do so under the terms of exposure netting agreements such that the credit risk is limited to the net value of transactions within each subsidiary and counterparty combination. The group only enters into derivative transactions with banks of high credit standing (as measured by reputable rating agencies) and also seeks to diversify exposure such that concentration with individual banks is avoided.

Notes to the consolidated financial statements continued

26 Financial instruments continued

Maturity of financial liabilities

The maturity profile of the carrying amount of the group's liabilities, at 31 March 2006 was as follows:

	Debt £m	Finance leases £m	Derivatives £m	Total £m
Less than one year	272.0	27.5	(4.3)	295.2
Between one and two years	1.3	28.4	0.5	30.2
Between two and five years	478.1	7.7	9.1	494.9
After five years	3,168.1	57.6	173.4	3,399.1
	3,919.5	121.2	178.7	4,219.4

The maturity profile of the carrying amount of the group's liabilities, at 31 March 2005 was as follows:

	Debt £m	Finance leases £m	Derivatives £m	Total £m
Less than one year	168.9	25.6	11.3	205.8
Between one and two years	169.4	25.5	7.0	201.9
Between two and five years	908.1	33.7	48.2	990.0
After five years	2,908.2	60.0	136.5	3,104.7
	4,154.6	144.8	203.0	4,502.4

Borrowing facilities

The group has the following undrawn committed borrowing facilities available at 31 March 2006 in respect of which all conditions precedent had been met at that date:

	Anglian Water		Group	
	2006 £m	2005 £m	2006 £m	2005 £m
Expiring within one year	333.0	333.0	333.0	333.0
Expiring between one and two years	–	–	125.0	–
Expiring between two and five years	225.0	–	225.0	125.0
Expiring in more than five years	–	225.0	–	225.0
	558.0	558.0	683.0	683.0

Anglian Water's borrowing facilities comprise a syndicated £225 million authorised loan facility for working capital and capital expenditure requirements provided by Barclays Bank Plc and syndicated to certain other banks; Class A and Class B debt service reserve facilities totalling £257 million provided by Barclays Bank Plc, HSBC Bank Plc and Royal Bank of Scotland Plc and a £76 million operating and capital maintenance expenditure reserve facility provided by Barclays Bank Plc, BNP Paribas Plc and Royal Bank of Scotland Plc. In addition, under 'group', AWG Group Limited borrowing facility comprise a syndicated £125 million loan facility for general corporate purposes provided by seven banks including all those mentioned in respect of Anglian Water.

The minimum lease payments under the finance leases fall due as follows:

	2006 £m	2005 £m
Not later than one year	31.0	30.1
Later than one year but not more than five	48.7	74.5
More than five years	75.1	80.2
	154.8	184.8
Future finance charges on finance leases	(33.6)	(40.0)
Present value of finance lease liabilities	121.2	144.8

27 Deferred tax liabilities

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 30 per cent.

The movement on the deferred tax account is as follows:

	2006 £m	2005 £m
At 1 April	(614.9)	(603.4)
Charged to the income statement	(15.0)	(6.9)
ACT recovery	(12.0)	–
Disposal	(1.1)	(0.1)
Taken to equity:		
– Derivative financial instruments	4.2	4.2
– Share-based payments	5.7	–
– Defined benefit pension schemes	(29.3)	(8.7)
At 31 March	(662.4)	(614.9)

The movement in deferred tax assets and liabilities during the year, (prior to the offsetting of balances within the same tax jurisdiction as permitted by IAS 12 'Income Taxes'), are shown below:

Deferred tax liabilities:

	Accelerated tax depreciation £m	Total £m
At 1 April 2005	(869.4)	(869.4)
Charged to the income statement	(12.5)	(12.5)
At 31 March 2006	(881.9)	(881.9)

Deferred tax assets:

	Surplus ACT £m	Timing differences £m	Total £m
At 1 April 2005	149.8	104.7	254.5
Charged to the income statement	(0.8)	(1.7)	(2.5)
ACT recovered	(12.0)	–	(12.0)
Charged to equity	–	(19.4)	(19.4)
Disposal of subsidiary undertakings	–	(1.1)	(1.1)
At 31 March 2006	137.0	82.5	219.5

Net deferred tax liability, non-current portion	
At 31 March 2006	(662.4)
At 31 March 2005	(614.9)

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

The following are deferred tax assets and surplus ACT that are not recognised in the accounts:

	2006 £m	2005 £m
Surplus ACT	22.8	22.8
Tax losses carried forward	1.7	2.4
	24.5	25.2

The surplus ACT was written off in prior years and will not be recognised in the balance sheet until its recoverability becomes more certain. The tax losses carried forward relate to losses which are not eligible for group relief. As they exist in companies where future profits are uncertain and no deferred tax liabilities exist, no asset has been recognised.

Notes to the consolidated financial statements continued

28 **Retirement benefit obligations**

Pension arrangements for the majority of the group's UK employees are of the funded defined benefit type, principally through the AWG Pension Scheme (AWGPS), the Morrison Pension and Life Assurance Plan (MPLAP), the AWG Pensions & Life Assurance Plan (AWGPLAP) and various other smaller arrangements. These are all final salary pension schemes. The administration and investment of the pension funds are maintained separately from the finances of the group. The group's actuaries are Aon Consulting.

The majority of defined benefit arrangements are closed to new members, who are eligible instead for entry to the group's defined contribution schemes. For closed schemes, under the projected unit method, the current service cost will increase as the members of the scheme approach retirement.

On 31 March 2006 the MPLAP scheme was closed to future service as a result of the disposal of the Construction Services business, with current AWG employees being offered alternative schemes in the group. AWG and the trustees of MPLAP have agreed a funding plan to eliminate the current IAS 19 'Employee Benefits' deficit over a four-year period from 31 March 2006.

A number of defined contribution schemes operate predominantly in the UK and contributions to these schemes amounted to £5.1 million (2005: £4.3 million). There were no outstanding or prepaid balances at the year end.

The accounting for pension costs has been undertaken in accordance with IAS 19, based on the most recent actuarial valuations, updated by independent actuaries to take account of the requirements of IAS 19 in order to assess the assets and liabilities of the schemes as at 31 March 2006. The most recent actuarial valuations for AWGPS and MPLAP were carried out at 31 March 2005, and in the case of the other main scheme, AWGPLAP, the most recent actuarial valuation was at 31 March 2003. The principal actuarial assumptions used for the valuation update were as follows:

	2006	2005
Inflation assumption	2.8%	2.8%
Discount rate	4.9%	5.4%
Salary increase assumption	3.8%[1]	3.8%
Rates of increase to pensions in payment	2.8%	2.8%
Increase to deferred benefits during deferment	2.8%	2.8%
Longevity at age 65 for current pensioners (years)		
– Men	18.6	18.5
– Women	21.5	21.4
Longevity at age 65 for future pensioners (years)		
– Men	19.9	19.3
– Women	22.8	22.2

The group contributed 20.1 per cent of pensionable pay into AWGPS in the year plus £7.7 million in deficit reduction payments. The group contributions as a proportion of pensionable pay to the two other main schemes, MPLAP and AWGPLAP, were 13.2 per cent and 20.3 per cent respectively. For the year ending 31 March 2007 the expected contribution rates for AWGPS and AWGPLAP are 14.9 per cent and 20.3 per cent respectively.

The estimated amount of contributions expected to be paid into the group's defined benefit schemes during the year ended 31 March 2007 is approximately £43.0 million.

[1] For the AWGPS the salary increase assumption has been restricted in 2006 to RPI for the remainder of the current regulatory period to 2009/10.

Defined benefit schemes

The long-term expected rates of return on the defined benefit schemes assets are determined as follows:

	2006 % pa	2005 % pa
Equities	7.3%	7.7%
Corporate bonds	4.7%	5.1%
Government bonds	4.3%	4.7%
Property	6.3%	6.7%
Other	4.4%	4.8%

The expected return on scheme assets are based on long-term expectations at the beginning of the year for returns over the entire life of the benefit obligations. These returns are determined by setting rates of return for equities and property by adopting fixed margins above current gilt yields. The expected rates of return for corporate bonds and gilts have been based on market yields at the balance sheet date, with equity and property returns assumed to be 3.0 per cent per annum and 2.0 per cent per annum respectively above gilt returns.

For the purposes of the following analyses the MPLAP, AWGPLAP and other smaller funded defined benefit pension schemes have been aggregated and are referred to as 'total other funded schemes'. As the AWGPS is the group's principal pension scheme it has been shown separately. An allowance for expenses for all schemes, including AWGPS is included in 'total other funded schemes'.

The fair value of the assets in the schemes are analysed as follows:

	2006				2005			
	AWGPS £m	Total other funded schemes £m	Unfunded pensions £m	Total £m	AWGPS £m	Total other funded schemes £m	Unfunded pensions £m	Total £m
Equities	504.6	133.8	N/A	638.4	376.1	113.0	N/A	489.1
Corporate bonds	122.6	14.6	N/A	137.2	37.0	12.9	N/A	49.9
Government bonds	83.4	28.2	N/A	111.6	132.1	13.0	N/A	145.1
Property	19.7	3.6	N/A	23.3	16.0	1.6	N/A	17.6
Other	15.5	6.2	N/A	21.7	40.9	2.0	N/A	42.9
Total assets	745.8	186.4	N/A	932.2	602.1	142.5	N/A	744.6

The amounts included in the balance sheet arising from the group's obligations in respect of the schemes are as follows:

	2006				2005			
	AWGPS £m	Total other funded schemes £m	Unfunded pensions £m	Total £m	AWGPS £m	Total other funded schemes £m	Unfunded pensions £m	Total £m
Present value of defined benefit obligations	(745.0)	(248.1)	(42.0)	(1,035.1)	(713.7)	(207.3)	(40.2)	(961.2)
Fair value of plan assets	745.8	186.4	–	932.2	602.1	142.5	–	744.6
Defined benefit scheme surplus/(deficit)	0.8	(61.7)	(42.0)	(102.9)	(111.6)	(64.8)	(40.2)	(216.6)
Amount not recognised as an asset[1]	–	(2.1)	–	(2.1)	–	–	–	–
Surplus/(deficit) in the balance sheet	0.8	(63.8)	(42.0)	(105.0)	(111.6)	(64.8)	(40.2)	(216.6)

[1] The amount not recognised as an asset relates to a surplus that cannot be recovered through refunds or a reduction in future contributions.

Notes to the consolidated financial statements continued

28 Retirement benefit obligations continued

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

	2006 AWGPS £m	2006 Total other funded schemes £m	2006 Unfunded pensions £m	2006 Total £m	2005 AWGPS £m	2005 Total other funded schemes £m	2005 Unfunded pensions £m	2005 Total £m
Present value of obligations at 1 April	(713.7)	(207.3)	(40.2)	(961.2)	(686.0)	(152.9)	(39.7)	(878.6)
Current service costs	(15.8)	(10.2)	–	(26.0)	(16.7)	(11.9)	–	(28.6)
Interest costs	(37.6)	(11.1)	(2.1)	(50.8)	(37.2)	(9.8)	(2.1)	(49.1)
Members' contributions	(3.4)	(2.6)	–	(6.0)	(3.3)	(2.5)	–	(5.8)
Benefits paid	24.8	4.2	2.3	31.3	19.9	7.2	2.2	29.3
Past service cost	–	(0.3)	–	(0.3)	(2.4)	–	–	(2.4)
Curtailments	–	4.0	–	4.0	–	0.5	–	0.5
Bulk transfer	(17.8)	(3.1)	–	(20.9)	–	(41.5)	–	(41.5)
Actuarial gains/(losses)	18.5	(21.7)	(2.0)	(5.2)	12.0	3.6	(0.6)	15.0
Present value of obligations at 31 March	(745.0)	(248.1)	(42.0)	(1,035.1)	(713.7)	(207.3)	(40.2)	(961.2)

Changes in the fair value of the scheme assets are as follows:

	2006 AWGPS £m	2006 Total other funded schemes £m	2006 Unfunded pensions £m	2006 Total £m	2005 AWGPS £m	2005 Total other funded schemes £m	2005 Unfunded pensions £m	2005 Total £m
Fair value of scheme assets at 1 April	602.1	142.5	–	744.6	535.2	84.4	–	619.6
Expected return on plan assets	40.9	10.1	–	51.0	37.1	8.6	–	45.7
Actuarial gains/(losses)	84.2	18.8	–	103.0	9.8	4.3	–	14.1
Contributions by employer	24.4	9.2	2.3	35.9	36.6	8.4	2.2	47.2
Contributions by plan participants	3.4	2.6	–	6.0	3.3	2.5	–	5.8
Transfers in	15.6	7.4	–	23.0	–	41.5	–	41.5
Benefits paid	(24.8)	(4.2)	(2.3)	(31.3)	(19.9)	(7.2)	(2.2)	(29.3)
Fair value of scheme assets at 31 March	745.8	186.4	–	932.2	602.1	142.5	–	744.6

The actual returns on scheme assets are determined as follows:

	2006 AWGPS £m	2006 Total other funded schemes £m	2006 Unfunded pensions £m	2006 Total £m	2005 AWGPS £m	2005 Total other funded schemes £m	2005 Unfunded pensions £m	2005 Total £m
Expected return on scheme assets	40.9	10.1	–	51.0	37.1	8.6	–	45.7
Gain on scheme assets	84.2	18.8	–	103.0	9.8	4.3	–	14.1
Actual return on scheme assets	125.1	28.9	–	154.0	46.9	12.9	–	59.8

The amounts recognised in the consolidated income statement are determined as follows:

	2006 AWGPS £m	2006 Total other funded schemes £m	2006 Unfunded pensions £m	2006 Total £m	2005 AWGPS £m	2005 Total other funded schemes £m	2005 Unfunded pensions £m	2005 Total £m
Current service cost	(15.8)	(10.2)	–	(26.0)	(16.7)	(11.9)	–	(28.6)
Past service cost	–	(0.3)	–	(0.3)	(2.4)	–	–	(2.4)
Gain on curtailment	–	4.0	–	4.0	–	0.5	–	0.5
Expected return on scheme assets	40.9	10.1	–	51.0	37.1	8.6	–	45.7
Interest cost	(37.6)	(11.1)	(2.1)	(50.8)	(37.2)	(9.8)	(2.1)	(49.1)
Total charged to the income statement	(12.5)	(7.5)	(2.1)	(22.1)	(19.2)	(12.6)	(2.1)	(33.9)

The charge in the consolidated income statement was allocated as follows:

	2006 £m	2005 £m
Staff costs in continuing operations (note 12)	(23.5)	(26.9)
Staff costs in discontinued operations	(2.8)	(3.6)
Finance costs (note 3)	0.2	(3.4)
Loss on disposal of businesses	4.0	–
	(22.1)	(33.9)

The actuarial gains and losses recognised in the consolidated statement of recognised income and expenses are determined as follows:

	2006 AWGPS £m	2006 Total other funded schemes £m	2006 Unfunded pensions £m	2006 Total £m	2005 AWGPS £m	2005 Total other funded schemes £m	2005 Unfunded pensions £m	2005 Total £m
Gains on scheme assets	84.2	18.8	–	103.0	9.8	4.3	–	14.1
Actual gains/(losses) arising on the scheme obligations	18.5	(21.7)	(2.0)	(5.2)	12.0	3.6	(0.6)	15.0
Net income recognised directly in equity	102.7	(2.9)	(2.0)	97.8	21.8	7.9	(0.6)	29.1

The cumulative actuarial gains and losses recognised in the consolidated statement of recognised income and expenses at 31 March 2006 are as follows:

	AWGPS £m	Total other funded schemes £m	Unfunded pensions £m	Total £m
Cumulative actuarial gains/(losses) at 1 April 2005	21.8	7.9	(0.6)	29.1
Actuarial gains/(losses) recognised in the year	102.7	(2.9)	(2.0)	97.8
Cumulative actuarial gains/(losses) at 31 March 2006	124.5	5.0	(2.6)	126.9

Notes to the consolidated financial statements continued

28 Retirement benefit obligations continued

The history of experience adjustments are determined as follows:

	2006 AWGPS £m	2006 Total other funded schemes £m	2006 Unfunded pensions £m	2006 Total £m	2005 AWGPS £m	2005 Total other funded schemes £m	2005 Unfunded pensions £m	2005 Total £m
Experience gains/(losses) arising on the scheme assets	84.2	18.8	–	103.0	9.8	4.3	–	14.1
Percentage of scheme assets	11.3%	10.1%	–	11.0%	1.6%	3.0%	–	1.9%
Experience gains/(losses) arising on the scheme obligations	31.5	2.2	–	33.7	8.5	1.3	–	9.8
Percentage of scheme obligations	(4.2)%	(0.9)%	–	(3.3)%	(1.2)%	(0.6)%	–	(1.0)%

29 Other non-current liabilities

	2006 £m	2005 £m
Trade payables	–	(0.3)
Deferred grants and contributions	(260.0)	(247.3)
	(260.0)	(247.6)

30 Provisions

	Onerous leases £m	Business closures and disposals £m	Contract and other £m	Coupon enhance-ment £m	Joint venture net liabilities £m	Total £m
At 1 April 2005	4.6	8.5	10.3	25.1	6.4	54.9
Additional provisions	2.2	7.6	1.5	–	–	11.3
Transfer from investments	–	–	–	–	(0.4)	(0.4)
Unwinding of discount	0.2	–	–	0.8	–	1.0
Utilised during the year	(0.3)	(3.3)	(2.3)	(3.9)	–	(9.8)
At 31 March 2006	6.7	12.8	9.5	22.0	6.0	57.0

Analysis of total provisions:

	2006 £m	2005 £m
Non-current	45.8	44.6
Current	11.2	10.3
	57.0	54.9

The onerous lease provision relates to the cost of leasehold properties not occupied by the group including two properties which were vacated following recent business closures and disposals. These provisions are discounted and are expected to be utilised over the next 17 years.

Business closure and disposal provisions relate to exit costs, principally the disposal of Morrison Construction Services and the international businesses, which are expected to crystallise over a period of approximately two years.

The contract and other provisions comprise potential warranty and certification costs of £5.3 million, which are expected to crystallise over a period of approximately three years and £4.2 million in respect of insurance claims against the group incurred but not reported, which are expected to be utilised over a period of approximately 10 years. This provision has been made following an actuarial assessment of the obligation taking account of past claims experience.

The coupon enhancement provision of £22.0 million relates to coupon enhancement and other related costs incurred on the transfer of debt from AWG Group Limited to Anglian Water Services Financing Plc at the end of the refinancing exercise in 2002. The provision relates to several instruments with varying maturity dates and is expected to be utilised at varying amounts over the next 23 years and has been discounted.

The provision for joint venture liabilities represents the aggregate amount of net liabilities in joint ventures at the balance sheet date. The amounts have been transferred from investments in order to separate the gross amounts of investments with net liabilities from those with net assets as prescribed in the accounting policy note (c). Movements in the group's share of joint venture assets and liabilities are disclosed in note 17.

31 Share capital

	2006 £m	2005 £m
Authorised		
2,763.7 million (2005: 2,763.7 million) ordinary shares of 19.9 pence each	550.0	550.0
Issued and fully paid		
140.7 million (2005: 143.8 million) ordinary shares of 19.9 pence each	28.0	28.7

During the year, 682,799 19.9 pence (2005: 912,059 19.9 pence) ordinary shares were allotted with an aggregate nominal value of £0.1 million (2005: £0.2 million) for total consideration of £3.1 million (2005: £4.1 million).

On 2 June 2005 the company announced a return of capital to shareholders of £75.0 million by means of an on-market share buy-back programme. At the AGM on 28 July 2005, the company was authorised to make market purchases of up to 14.4 million ordinary shares. During the year 3.7 million ordinary shares were purchased with a nominal value of 19.9 pence each, £0.8 million in value; these shares have subsequently been cancelled.

	Ordinary share capital £m	Share premium account £m	Total £m
Year ended 31 March 2006			
At 1 April 2005	28.7	10.8	39.5
Issue of shares	0.1	3.0	3.1
Cancellation of treasury shares	(0.8)	–	(0.8)
At 31 March 2006	28.0	13.8	41.8

	Ordinary share capital £m	Share premium account £m	Total £m
Year ended 31 March 2005			
At 1 April 2004	28.5	6.9	35.4
Issue of shares	0.2	3.9	4.1
At 31 March 2005	28.7	10.8	39.5

Notes to the consolidated financial statements continued

32 Reserves

	Capital redemption reserve £m	Retained earnings £m	Hedging reserve £m	Translation reserve £m	Total £m
Year ended 31 March 2006					
At 1 April 2005	1.8	98.4	(0.9)	(0.7)	98.6
Total recognised income for the year attributable to equity shareholders	–	104.2	(10.2)	0.4	94.4
Dividends paid	–	(70.0)	–	–	(70.0)
Employee share option costs	–	2.1	–	–	2.1
Share buy-back	–	(37.1)	–	–	(37.1)
Redemption of redeemable shares	14.7	(14.7)	–	–	–
Investment in own shares	–	(0.1)	–	–	(0.1)
Cancellation of treasury shares	0.8	–	–	–	0.8
At 31 March 2006	17.3	82.8	(11.1)	(0.3)	88.7

	Capital redemption reserve £m	Retained earnings £m	Hedging reserve £m	Translation reserve £m	Total £m
Year ended 31 March 2005					
At 1 April 2004	600.9	(487.3)	8.9	–	122.5
Total recognised income for the year attributable to equity shareholders	–	53.6	(9.8)	(0.7)	43.1
Dividends paid	–	(20.6)	–	–	(20.6)
Employee share option costs	–	1.1	–	–	1.1
Redeemable shares issued	–	(47.5)	–	–	(47.5)
Redemption of redeemable shares	48.9	(48.9)	–	–	–
Capitalisation of capital redemption reserve	(648.0)	648.0	–	–	–
At 31 March 2005	1.8	98.4	(0.9)	(0.7)	98.6

On 11 October 2005 the redeemable shares were redeemed following approval by the board on 20 June 2005.

In 2005 the capitalisation of capital redemption reserve related to a court approved capital reduction on 29 September 2004, whereby the capital redemption reserve was converted into retained earnings.

33 **Share-based payments**

Equity settled share-based payments

All employee Save As You Earn (SAYE) schemes

The group operates a SAYE share option scheme for all employees to encourage participation in the group's results. Options are exercisable at a price equal to the quoted market price of the company's shares on the date of grant less a discount of between 10 and 20 per cent. The options mature after either three years or five years and there is an exercise period of six months from when the share options become exercisable after which period the options lapse.

Details of the share options outstanding during the year are as follows:

	2006 Number of share options	2005 Number of share options
Outstanding at the beginning of the year	5,631,336	6,690,337
Granted during the year	541,520	408,844
Exercised during the year	(628,548)	(879,717)
Forfeited during the year	(122,829)	(285,468)
Expired during the year	(254,739)	(302,660)
Outstanding at the end of the year	5,166,740	5,631,336
Exercisable at the end of the year	1,045,422	226,988

The weighted average share price at the date of exercise for share options exercised during the year was £9.87. The options outstanding at 31 March 2006 had a weighted average exercise price of £4.66 (2005: £4.11), and a weighted average remaining contractual life of 1.5 years (2005: 2.2 years). During the year options were granted on 8 February 2006. The aggregate of the estimated fair values of the options granted on those dates is £1.0 million.

The inputs into the binomial model that the group uses to value share options were:

	2006 3 year	2006 5 year	2005 3 year	2005 5 year
Share price at date of grant	1060p	1060p	824.5p	824.5p
Exercise price	954p	954p	742p	742p
Expected volatility	21.1%	24.5%	25.6%	30.9%
Expected life	3.5 years	5.5 years	3.5 years	5.5 years
Risk free rate	4.3%	4.3%	4.5%	4.5%
Expected dividend yield	4.6%	4.6%	6.1%	6.1%

Expected volatility was determined by calculating the historical volatility for a period up to the date of grant equal to the length of the expected life of the options.

Executive Share Option Scheme (ESOS)

The group also operated an ESOS from 2001 to 2003, which was then replaced by an LTIP (see below). The participants in the ESOS were the Executive Directors and a number of senior managers. Options are exercisable at a price equal to the quoted market price of the company's shares on the date of grant. The vesting period is three years and there is then a further exercise period of seven years from when the share options become exercisable after which period the options lapse.

Vesting is subject to achieving EPS growth over a three year period, subject to retesting in year's four and five if vesting has not been achieved.

Details of the share options outstanding during the year are as follows:

	2006 Number of share options	2005 Number of share options
Outstanding at the beginning of the year	3,743,518	4,763,122
Exercised during the year	–	(32,342)
Forfeited during the year	(2,250,837)	(987,262)
Outstanding at the end of the year	1,492,681	3,743,518
Exercisable at the end of the year	–	–

The options outstanding at 31 March 2006 had a weighted average exercise price of £5.39 (2005: £5.34), and a weighted average remaining contractual life of 0.3 years (2005: 0.8 years). No options were granted during the year or the preceding year under the ESOS.

Notes to the consolidated financial statements continued

33 Share-based payments continued

Long-Term Incentive Plan (LTIP)

In 2004 the group replaced the ESOS with an LTIP which was approved at the 2004 AGM. Under this plan, Directors and senior managers may receive, at the discretion of the Remuneration Committee, annual awards of shares that are subject to performance conditions.

Details of the share awards outstanding during the year are as follows:

	2006 Number of share awards	2005 Number of share awards
Outstanding at the beginning of the year	353,475	–
Awarded during the year	267,151	380,952
Forfeited during the year	(28,276)	(27,477)
Outstanding at the end of the year	592,350	353,475

The awards outstanding at 31 March 2006 had a weighted average remaining contractual life of 1.8 years (2005: 2.3 years). During the year awards were made on 3 June 2005, 30 August 2005 and 24 November 2005. The aggregate of the estimated fair values of the shares awarded on those dates is £2.4 million.

The proportion of the LTIP shares awarded during the year ended 31 March 2005 that will vest is dependent on the company's performance relative to a comparator index of companies in terms of total shareholder return (TSR) over a three-year period. Valuation of these share awards was based on the total value of the shares awarded and an expectation of the number likely to vest based on statistical sampling.

The proportion of the LTIP shares awarded during the year ended 31 March 2006 that will vest depends 60 per cent on the company's performance relative to a comparator index of companies in terms of TSR and 40 per cent on its performance in terms of EPS over a three-year period. Valuation for the TSR element is as above and valuation for the EPS element is based on inputs into a binomial model.

The inputs used for the statistical sampling were as follows:

	2006	2005
Share price at date of grant	906p	613p
Mean TSR over three years up to date of award	26.2%	11.3%
Standard deviation of comparator group	0.09	0.03
Expected life	3 years	3 years
Expected number of awards to vest under market based vesting condition	41%	31%

The inputs into the binomial model that the group uses to value share awards were as follows:

	2006	2005
Share price at date of grant	906p	–
Exercise price	–	–
Expected volatility	25.2%	–
Expected life	3 years	–
Risk free rate	4.5%	–
Expected dividend yield	5.5%	–

Expected volatility was determined by calculating the historical volatility for a period up to the date of award equal to the length of the expected life of the awards.

34 **Contingencies**

The group has entered into a number of performance bonding and guarantee arrangements in the normal course of business. Provision is made for any amounts that the Directors consider may become payable under such arrangements. The group has also guaranteed obligations of joint ventures and associates totalling £31.8 million (2005: £43.1 million).

The group has entered into a variety of restructuring and re-financing initiatives over time to optimise the efficiency of its balance sheet and organisation in order to create value for customers and shareholders. Extensive professional advice has been taken which supports the view that all group restructurings have been correctly treated for accounting and tax purposes and therefore, since any risk here is very low no provisions for tax liabilities are considered to be necessary.

At 31 March 2006 the group had £137.0 million (2005: £149.8 million) of recoverable ACT, subject to this contingency, recorded in the balance sheet. This ACT is expected to be recovered in full over time and therefore no provision is considered appropriate in respect of this asset.

35 **Capital commitments**

The group has a substantial long-term investment programme in Anglian Water, which includes expenditure to meet regulatory requirements, shortfalls in performance and condition, and to provide for new demand and growth. The commitments shown below reflect only the value of orders placed at 31 March 2006.

	2006 £m	2005 £m
Contracts placed for future capital expenditure not provided in the financial statements	113.6	72.8

There were no capital commitments relating to the group's share of joint ventures (2005: £nil).

36 **Operating lease commitments – minimum lease payments**

Commitments under non-cancellable operating leases expiring were as follows:

	2006		2005	
	Land and Buildings £m	Vehicles plant and equipment £m	Land and Buildings £m	Vehicles plant and equipment £m
Within one year	4.9	4.9	4.7	5.5
Later than one year and less than five years	17.7	24.1	17.0	23.6
After five years	30.5	–	33.3	–
	53.1	29.0	55.0	29.1

The group lease various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The group also leases plant and machines under non-cancellable operating lease agreements.

Notes to the consolidated financial statements continued

37 Related party transactions

The group's related party transactions are summarised below:

	2006 Sale of goods £m	2006 Sale of services £m	2005 Sale of goods £m	2005 Sale of services £m
Cambuslang Retail Portfolio	–	–	6.6	–
Hamilton Park Developments (Plot 7b) Limited	1.6	–	–	–
Hamilton Park Developments (Plot 7g) Limited	1.8	–	–	–
Other joint ventures with AWG Property	4.2	–	0.5	2.5
Sonico Limited	–	0.5	–	0.5
Other joint ventures	–	–	–	0.7
	7.6	0.5	7.1	3.7

Sales to the joint ventures were carried out on commercial terms and conditions and at market prices.

Year end balances arising from sale of goods/services

	2006 Amounts owed from related parties £m	2006 Amounts owed to related parties £m	2006 Provision for bad and doubtful debts £m	2005 Amounts owed from related parties £m	2005 Amounts owed to related parties £m	2005 Provision for bad and doubtful debts £m
AWG Property joint ventures	24.7	(2.1)	(5.3)	28.8	(5.6)	(5.3)
Sonico Limited	0.9	–	–	0.3	–	–
Alpha Schools Highland	0.6	–	–	–	–	–
Alpha Schools	0.3	–	–	–	–	–
Other joint ventures	–	–	–	4.2	(3.0)	–
	26.5	(2.1)	(5.3)	33.3	(8.6)	(5.3)

Loans to related parties

Year ended 31 March 2006

	At 1 April 2005 £m	Advanced during the year £m	Repaid during the year £m	Provision £m	Interest charged £m	Interest received £m	At 31 March 2006 £m
Morrison Merlin Limited	12.5	–	(12.5)	–	0.4	(0.4)	–
Other joint ventures	15.3	1.9	(15.3)	–	–	–	1.9
	27.8	1.9	(27.8)	–	0.4	(0.4)	1.9

Year ended 31 March 2005

	At 1 April 2004 £m	Advanced during the year £m	Repaid during the year £m	Provision £m	Interest charged £m	Interest received £m	At 31 March 2005 £m
Morrison Merlin Limited	12.5	–	–	–	0.8	(0.8)	12.5
Other joint ventures	23.3	0.2	(8.1)	(0.1)	0.5	(0.5)	15.3
	35.8	0.2	(8.1)	(0.1)	1.3	(1.3)	27.8

38 **Events after balance sheet date**

The final dividend for 2005/6 of £50.7 million (equivalent to 36.0 pence per share), will be proposed at the AGM on 26 July 2006, and has not been included as a liability as at 31 March 2006. The final dividend will be paid on 15 September 2006 to shareholders on the register at 5pm on 11 August 2006.

39 **Principal group companies**

The principal subsidiary undertakings at 31 March 2006 are shown below. A full list of the group's subsidiaries, joint ventures and associates will be delivered to the registrar with the next annual return.

	Country of incorporation	Activities
Group and Other		
AWG Group Limited	England	Holding company
AWG Central Services Limited[1]	England	Provision of administration services to group companies
AWG Holdings Limited	Jersey	Holding company
AWG UK Holdings Limited	England	Holding company
Anglian Water Direct Limited	England	Home service products
Celtic Anglian Water Limited	Ireland	Water and wastewater treatment
Morrison Project Investments Limited	Scotland	Managing PFI projects
Rutland Insurance Limited	Guernsey	Provision of insurance to group companies
Anglian Water		
Anglian Water Services Limited[2]	England	Water and wastewater undertaker, regulated principally by the Water Industry Act 1991
Anglian Water Services Financing Plc	England	Financing company
Anglian Water Services Holdings Limited	England	Holding company
Anglian Water Services Overseas Holdings Limited	Cayman Islands	Holding company
Morrison		
Alpheus Environmental Limited	England	Wastewater treatment
Power Services HVDE Limited	England	Utility contracting
Morrison Utility Services Limited	England	Utility contracting
Morrison Facilities Services Limited	Scotland	Property maintenance and repair work
Maintenance and Property Care Limited	Scotland	Property maintenance and repair work
Purac Limited	England	Contracting for water and wastewater processes
Property Services		
AWG Property Solutions Limited	England	Corporate property management
Ambury Developments Limited	England	Corporate property management
AWG Developments Limited	Scotland	Development of land and buildings
AWG Residential Limited	Scotland	Development of residential estates

[1] This company is owned directly by AWG Plc

[2] Including Anglian Water Services trading as Hartlepool Water Limited.

The group also owns a number of smaller and non-trading companies. All of the subsidiaries listed above are 100 per cent owned by the group or the company with the exception of Maintenance and Property Care Limited which is 66.7 per cent owned and Celtic Anglian Water Limited which is 50.0 per cent owned.

The voting rights in respect of each subsidiary are in the same proportion as the shares held. Those companies shown as incorporated in England are registered in England and Wales. All companies operate principally in their country of incorporation, except for Purac Limited.

All subsidiaries have a year end of 31 March.

All subsidiary undertakings disclosed above are included within the consolidated financial statements.

Notes to the consolidated financial statements continued

40 Transition to IFRS

This is the first year that the group has presented its financial statements under IFRS. The last financial statements under UK GAAP were for the year ended 31 March 2005. The group's date of transition to IFRS is 1 April 2004 and all comparative information in these financial statements has been restated to reflect the group's adoption of IFRS, except where otherwise required or permitted by IFRS 1.

IFRS 1 requires that IFRS is applied retrospectively to establish the group's balance sheet at the date of transition, 1 April 2004, unless a specific exemption is applied. In preparing this IFRS information, the group has adopted the following exemptions:

- To elect not to apply IFRS 3 'Business Combinations' retrospectively to past business combinations that occurred before the date of transition to IFRS.
- To apply IFRS 2 'Share-based Payments' only to those share options granted after 7 November 2002 that had not vested by 1 April 2004.
- *To deem cumulative translation differences for all foreign operations to be zero as at the transition IFRS balance sheet date.*
- To recognise in full all actuarial gains and losses relating to defined benefit pension schemes at the date of transition to IFRS.

In addition, the group has chosen to adopt IAS 32 and IAS 39 at its date of transition and to apply hedge accounting when the requirements of IAS 39 are met.

The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP at 31 March 2005 to the revised net assets and profit under IFRS reported in these consolidated financial statements.

Restatement of 31 March 2005

Reconciliation of consolidated income statement for the year ended 31 March 2005

	UK GAAP £m	Fixed asset accounting £m	Capitalised interest £m	Deferred tax discounting £m	Pensions £m	Remove final dividend £m	IAS 39 £m	Joint ventures and associates £m	Goodwill amortisation reversal £m	Other £m	Discontinued operations £m	Restated under IFRS £m
Revenue	1,690.1	–	–	–	–	–	–	–	–	0.3	(331.5)	1,358.9
Operating costs before exceptional operating items and goodwill amortisation	(1,357.5)	(0.5)	(11.0)	–	(13.8)	–	0.7	–	–	(9.1)	328.1	(1,063.1)
Loss on disposal and closure of businesses (net)	–	–	–	–	–	–	–	–	(1.0)	(6.0)	–	(7.0)
Goodwill amortisation	(12.0)	–	–	–	–	–	–	–	12.0	–	–	–
Group operating costs	(1,369.5)	(0.5)	(11.0)	–	(13.8)	–	0.7	–	11.0	(15.1)	328.1	(1,070.1)
Group operating profit	320.6	(0.5)	(11.0)	–	(13.8)	–	0.7	–	11.0	(14.8)	(3.4)	288.8
Share of operating profits from joint ventures and associates	12.9	–	–	–	–	–	–	(12.9)	–	–	–	–
Share of post tax profits from joint ventures and associates	–	–	–	–	–	–	(0.2)	0.6	–	3.3	(0.2)	3.5
Profit from operations	333.5	(0.5)	(11.0)	–	(13.8)	–	0.5	(12.3)	11.0	(11.5)	(3.6)	292.3
Loss on disposal and closure of businesses (net)	(6.0)	–	–	–	–	–	–	–	–	6.0	–	–
Profit on ordinary activities before interest	327.5	(0.5)	(11.0)	–	(13.8)	–	0.5	(12.3)	11.0	(5.5)	(3.6)	292.3
Finance costs	(262.2)	–	12.3	–	(0.9)	–	(18.0)	10.8	–	(0.4)	(1.5)	(259.9)
Profit on ordinary activities before taxation	65.3	(0.5)	1.3	–	(14.7)	–	(17.5)	(1.5)	11.0	(5.9)	(5.1)	32.4
Taxation	(13.8)	0.2	(0.4)	(0.8)	4.4	–	5.4	1.5	–	(0.3)	(0.3)	(4.1)
	51.5	(0.3)	0.9	(0.8)	(10.3)	–	(12.1)	–	11.0	(6.2)	(5.4)	28.3
Dividends – non-equity	(0.5)	–	–	–	–	–	–	–	–	0.5	–	–
Profit for the financial year – continuing operations	51.0	(0.3)	0.9	(0.8)	(10.3)	–	(12.1)	–	11.0	(5.7)	(5.4)	28.3
Discontinued operations	–	–	–	–	–	–	–	–	–	–	5.4	5.4
Profit for the financial year	51.0	(0.3)	0.9	(0.8)	(10.3)	–	(12.1)	–	11.0	(5.7)	–	33.7
Attributable to:												
Equity shareholders of the parent	50.5	(0.3)	0.9	(0.8)	(9.9)	–	(12.1)	–	11.0	(5.7)	–	33.6
Minority interests	0.5	–	–	–	(0.4)	–	–	–	–	–	–	0.1
	51.0	(0.3)	0.9	(0.8)	(10.3)	–	(12.1)	–	11.0	(5.7)	–	33.7

Reconciliation of consolidated balance sheet at 31 March 2005

	UK GAAP £m	Fixed asset accounting £m	Capitalised interest £m	Deferred tax discounting £m	Pensions £m	Remove final dividend £m	IAS 39 £m	Joint ventures and associates £m	Goodwill amortisation reversal £m	Other £m	Discontinued operations £m	Restated under IFRS £m
Non-current assets												
Goodwill	165.5	–	–	–	–	–	–	–	11.0	–	–	176.5
Intangible assets	0.1	–	4.6	–	–	–	–	–	–	92.9	–	97.6
Property, plant and equipment	3,936.8	283.0	278.3	–	–	–	–	–	–	(91.7)	–	4,406.4
Investments	25.1	–	–	–	–	–	(0.8)	–	–	3.9	–	28.2
Derivative financial instruments	–	–	–	–	–	–	25.7	–	–	–	–	25.7
Trade and other receivables	90.9	–	–	–	(86.2)	–	–	–	–	(4.4)	–	0.3
	4,218.4	283.0	282.9	–	(86.2)	–	24.9	–	11.0	0.7	–	4,734.7
Current assets												
Inventories	78.5	–	–	–	–	–	–	–	–	(29.7)	–	48.8
Trade and other receivables	414.2	–	–	–	–	–	(0.2)	–	–	14.8	–	428.8
Derivative financial instruments	–	–	–	–	–	–	11.4	–	–	–	–	11.4
Cash and cash equivalents	1,101.5	–	–	–	–	–	–	–	–	(2.9)	–	1,098.6
	1,594.2	–	–	–	–	–	11.2	–	–	(17.8)	–	1,587.6
Assets classified as held for sale	–	–	–	–	–	–	–	–	–	9.4	–	9.4
	1,594.2	–	–	–	–	–	11.2	–	–	(8.4)	–	1,597.0
Current liabilities												
Financial liabilities												
Borrowings	(106.0)	–	–	–	–	–	(73.8)	–	–	(14.7)	–	(194.5)
Derivative financial instruments	–	–	–	–	–	–	(22.7)	–	–	–	–	(22.7)
Trade and other payables	(628.4)	(2.4)	–	–	–	49.4	87.1	–	–	(9.3)	–	(503.6)
Current tax liabilities	(4.5)	–	–	–	–	–	–	–	–	0.3	–	(4.2)
Provisions	–	–	–	–	–	–	–	–	–	(10.3)	–	(10.3)
	(738.9)	(2.4)	–	–	–	49.4	(9.4)	–	–	(34.0)	–	(735.3)
Liabilities directly associated with assets classified as held for sale	–	–	–	–	–	–	–	–	–	(12.8)	–	(12.8)
	(738.9)	(2.4)	–	–	–	49.4	(9.4)	–	–	(46.8)	–	(748.1)
Net current assets/(liabilities)	855.3	(2.4)	–	–	–	49.4	1.8	–	–	(55.2)	–	848.9
Non-current liabilities												
Financial liabilities												
Borrowings	(4,243.0)	–	–	–	–	–	137.1	–	–	1.0	–	(4,104.9)
Derivative financial instruments	–	–	–	–	–	–	(217.4)	–	–	–	–	(217.4)
Deferred tax liabilities	(95.6)	(39.5)	(84.9)	(491.3)	82.9	–	15.8	–	–	(2.3)	–	(614.9)
Other non-current liabilities	(98.7)	(148.9)	–	–	–	–	–	–	–	–	–	(247.6)
Retirement benefit obligations	–	–	–	–	(216.6)	–	–	–	–	–	–	(216.6)
Provisions	(91.7)	–	–	–	26.7	–	(0.4)	–	–	20.8	–	(44.6)
	(4,529.0)	(188.4)	(84.9)	(491.3)	(107.0)	–	(64.9)	–	–	19.5	–	(5,446.0)
Net assets	544.7	92.2	198.0	(491.3)	(193.2)	49.4	(38.2)	–	11.0	(35.0)	–	137.6
Shareholders' equity												
Issued share capital	43.4	–	–	–	–	–	–	–	–	(14.7)	–	28.7
Share premium	10.8	–	–	–	–	–	–	–	–	–	–	10.8
Capital redemption reserve	1.8	–	–	–	–	–	–	–	–	–	–	1.8
Profit & loss account	486.0	92.2	198.0	(491.3)	(190.2)	49.4	(38.2)	–	11.0	(20.1)	–	96.8
Total shareholders' equity	542.0	92.2	198.0	(491.3)	(190.2)	49.4	(38.2)	–	11.0	(34.8)	–	138.1
Minority interests	2.7	–	–	–	(3.0)	–	–	–	–	(0.2)	–	(0.5)
Total equity	544.7	92.2	198.0	(491.3)	(193.2)	49.4	(38.2)	–	11.0	(35.0)	–	137.6

Notes to the consolidated financial statements continued

40 Transition to IFRS continued

Restatement of 1 April 2004 (date of transition to IFRS)

Reconciliation of consolidated balance sheet at 1 April 2004

	UK GAAP £m	Fixed asset accounting £m	Capitalised interest £m	Deferred tax discounting £m	Pensions £m	Remove final dividend £m	IAS 39 £m	Joint ventures and associates £m	Goodwill amortisation reversal £m	Other £m	Discontinued operations £m	Restated under IFRS £m
Non-current assets												
Goodwill	195.1	–	–	–	–	–	–	–	–	–	–	195.1
Intangible assets	11.0	–	5.3	–	–	–	–	–	–	80.9	–	97.2
Property, plant and equipment	3,832.2	274.4	276.4	–	–	–	–	–	–	(79.2)	–	4,303.8
Investments	18.6	–	–	–	–	–	5.4	–	–	(3.9)	–	20.1
Derivative financial instruments	–	–	–	–	–	–	17.0	–	–	–	–	17.0
Trade and other receivables	71.6	–	–	–	(58.0)	–	–	–	–	–	–	13.6
	4,128.5	274.4	281.7	–	(58.0)	–	22.4	–	–	(2.2)	–	4,646.8
Current assets												
Inventories	136.0	–	–	–	–	–	–	–	–	(83.6)	–	52.4
Trade and other receivables	412.6	–	–	–	–	–	(8.8)	–	–	68.8	–	472.6
Derivative financial instruments	–	–	–	–	–	–	22.8	–	–	–	–	22.8
Cash and cash equivalents	755.4	–	–	–	–	–	–	–	–	205.3	–	960.7
	1,304.0	–	–	–	–	–	14.0	–	–	190.5	–	1,508.5
Assets classified as held for sale	–	–	–	–	–	–	–	–	–	5.8	–	5.8
	1,304.0	–	–	–	–	–	14.0	–	–	196.3	–	1,514.3
Current liabilities												
Financial liabilities												
Borrowings	(45.9)	–	–	–	–	–	(100.1)	–	–	(223.3)	–	(369.3)
Derivative financial instruments	–	–	–	–	–	–	(7.8)	–	–	–	–	(7.8)
Trade and other payables	(603.9)	(2.3)	–	–	–	–	93.9	–	–	2.7	–	(509.6)
Current tax liabilities	(5.5)	–	–	–	–	–	–	–	–	–	–	(5.5)
Provisions	–	–	–	–	–	–	–	–	–	(12.6)	–	(12.6)
	(655.3)	(2.3)	–	–	–	–	(14.0)	–	–	(233.2)	–	(904.8)
Liabilities directly associated with assets classified as held for sale	–	–	–	–	–	–	–	–	–	(8.6)	–	(8.6)
	(655.3)	(2.3)	–	–	–	–	(14.0)	–	–	(241.8)	–	(913.4)
Net current assets/(liabilities)	648.7	(2.3)	–	–	–	–	–	–	–	(45.5)	–	600.9
Non-current liabilities												
Financial liabilities												
Borrowings	(3,900.1)	–	–	–	–	–	159.5	–	–	–	–	(3,740.6)
Derivative financial instruments	–	–	–	–	–	–	(204.0)	–	–	–	–	(204.0)
Deferred tax liabilities	(80.1)	(39.6)	(84.5)	(493.7)	87.2	–	6.2	–	–	1.1	–	(603.4)
Other non-current liabilities	(93.6)	(140.0)	–	–	–	–	–	–	–	–	–	(233.6)
Retirement benefit obligations	–	–	–	–	(259.0)	–	–	–	–	–	–	(259.0)
Provisions	(93.8)	–	–	–	26.0	–	(0.7)	–	–	18.1	–	(50.4)
	(4,167.6)	(179.6)	(84.5)	(493.7)	(145.8)	–	(39.0)	–	–	19.2	–	(5,091.0)
Net assets	609.6	92.5	197.2	(493.7)	(203.8)	–	(16.6)	–	–	(28.5)	–	156.7
Shareholders' equity												
Issued share capital	28.5	–	–	–	–	–	–	–	–	–	–	28.5
Redeemable shares	16.1	–	–	–	–	–	–	–	–	(16.1)	–	–
Share premium	6.9	–	–	–	–	–	–	–	–	–	–	6.9
Capital redemption reserve	600.9	–	–	–	–	–	–	–	–	–	–	600.9
Profit & loss account	(45.0)	92.5	197.2	(493.7)	(203.8)	–	(16.6)	–	–	(9.0)	–	(478.4)
Total shareholders' equity	607.4	92.5	197.2	(493.7)	(203.8)	–	(16.6)	–	–	(25.1)	–	157.9
Minority interests	2.2	–	–	–	–	–	–	–	–	(3.4)	–	(1.2)
Total equity	609.6	92.5	197.2	(493.7)	(203.8)	–	(16.6)	–	–	(28.5)	–	156.7

Notes to the reconciliations

i) Fixed Assets – Infrastructure Accounting (IAS 16)

Material Differences to UK GAAP

The most material impact of IAS 16 'Property, Plant and Equipment' relates to the accounting for water and wastewater infrastructure assets within the group's licensed utility operations. Under UK GAAP, these assets were accounted for in accordance with the renewals accounting paragraphs of FRS 15 'Tangible Fixed Assets'. Such provisions are not present within IAS 16 and it is therefore necessary to change the way in which the assets are accounted for on transition to IFRS.

Under renewals accounting as permitted by FRS 15, the water and wastewater infrastructure networks are assumed to be single assets and the depreciation charged is the estimated level of annual expenditure required to maintain the operating capability of the networks. Actual expenditure is then capitalised as incurred.

Renewals accounting is not permitted under IAS 16. The carrying value of infrastructure assets has therefore been recalculated back to privatisation in 1989, as if infrastructure renewals accounting had never been adopted.

Under IFRS, infrastructure expenditure that meets the recognition criteria for property, plant and equipment has been capitalised at cost and depreciated over its expected life. Expenditure relating to repair or maintenance has been expensed.

Infrastructure grants and contractor contributions previously presented as deductions from infrastructure cost under UK GAAP have been allocated to deferred income and amortised over the expected useful lives of the related assets.

There are no significant differences between UK GAAP and IFRS in respect of all other fixed assets, including water and wastewater non-infrastructure assets, other than the separate classification of certain assets as intangibles rather than tangible assets.

Impact

No individual main, sewer or other element of the water and wastewater network forms a significant part of the whole. Accordingly assets have been grouped by type, and depreciated over their estimated useful life ranging from 50 to 160 years. Recalculating the carrying value of infrastructure assets under IFRS has resulted in an increase in net assets, after tax, of £92.2 million as at March 2005.

In the year ended 31 March 2005, under IFRS, the annual depreciation charge of infrastructure assets plus the maintenance costs expensed exceeded the total of renewals expenditure to maintain operational capacity under UK GAAP by £0.5 million.

ii) Capitalisation of Interest (IAS 23)

Material Differences to UK GAAP

Under UK GAAP, borrowing costs were fully expensed as incurred. The group has chosen under IFRS to capitalise that element of borrowing costs incurred for the construction of qualifying tangible and intangible fixed assets. The change in policy under IFRS is applied retrospectively.

Under IFRS the group capitalises the borrowing costs incurred for the construction of any qualifying assets during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

Impact

Under IFRS net assets were £198.0 million higher after tax as at March 2005 and profit before tax higher by £1.3 million.

Notes to the consolidated financial statements continued

40 Transition to IFRS continued
iii) Defined Benefit Pension Scheme Accounting (IAS 19)

Material Differences to UK GAAP
The group prepared its 2005 UK GAAP results in accordance with SSAP 24 'Accounting for Pension Costs', with FRS 17 'Retirement Benefits' transitional disclosures provided in the notes to the accounts. FRS 17 became fully effective for accounting periods beginning on or after 1 January 2005. The group did not adopt FRS 17 for its consolidated financial statements but instead moved directly to IAS 19 'Employee Benefits'.

Under SSAP 24, any pension scheme surplus or deficit identified at the most recent actuarial valuation is recognised gradually through the profit and loss account over the average expected future working lifetime of current employees. The net pension cost under SSAP 24 therefore includes both the cost of providing an additional year of pension benefits to employees (regular cost) and an element of the surplus or deficit relating to previous years (variation).

The difference between employer's contributions paid and the SSAP 24 net pension cost is recognised as a prepayment or accrual, resulting in a balance sheet position that does not necessarily reflect the actuarial position. Interest is calculated on this balance sheet entry and is also included within the net pension cost.

In accordance with IAS 19, legal and constructive obligations for post employment benefit schemes (including pensions) are recognised on the balance sheet. The group has chosen to adopt the amendments to IAS 19, issued by the IASB in December 2004, in advance of their effective date of 1 January 2006. Thus where actual experience differs from the assumptions made at the start of a financial year, actuarial gains and losses will be recognised in full through the statement of recognised income and expense.

The group operates a number of defined benefit pension schemes, which are independent of the group's finances, for the majority of its employees.

Under UK GAAP actuarial valuations of the schemes are carried out as determined by the pension scheme trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

Under IFRS, defined benefit assets are measured annually at fair value while liabilities are measured at present value. The difference between the two amounts is recognised as an asset or liability in the balance sheet.

The cost of providing pension benefits to employees relating to the current year's service is included in the income statement within other operating costs, whilst the difference between the expected return on scheme assets and interest on scheme liabilities is included within finance costs.

All actuarial gains and losses as at 1 April 2004, the date of transition to IFRS, were recognised in full. All future actuarial gains and losses are recognised outside the income statement in retained earnings and presented in the statement of recognised income and expense.

Impact
The adoption of IAS 19 reduced the 2005 profit before tax by £14.7 million compared to the previously published financial statements, representing reduced operating profits of £13.8 million and increased finance costs of £0.9 million.

The de-recognition of the SSAP 24 prepayment and unfunded pension provision reduced net assets by £41.7 million (net of tax) as at 31 March 2005. Total shareholders' equity was then further reduced by the recognition of the IAS 19 deficit of £148.5 million, and minority interests are reduced by £3.0 million.

iv) Deferred Tax (IAS 12)

Material Differences to UK GAAP

FRS 19 'Deferred Tax' permits, but does not require, deferred tax assets or liabilities to be discounted and as a result the group chose to discount its net deferred tax liability. However, IAS 12 'Income Taxes' does not permit discounting of deferred tax in any circumstances. This is of particular significance to a capital intensive utility business, such as AWG, where any reversal of timing differences is likely to be deferred long into the future due to the long asset lives of network assets.

Under IFRS, deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Impact

The prohibition of discounting deferred tax liabilities resulted in an increase in the balance sheet deferred tax liability of £491.3 million at 31 March 2005 and a corresponding reduction in net assets.

In addition, the deferred tax effect on each of the other IFRS adjustments to the balance sheet were recognised, the most significant of which related to pensions (£82.9 million deferred tax asset), capitalised interest (£84.9 million deferred tax liability), and financial instruments (£15.8 million deferred tax asset).

v) Financial Instruments – Accounting for Derivatives (IAS 39)

Material Differences to UK GAAP

Under UK GAAP, debt is carried at its hedged amount and the fair values of derivatives are not recognised in the balance sheet. Under IAS 39 'Financial Instruments: Recognition and Measurement', the default treatment is for debt to be carried at amortised cost, whilst derivatives are recognised separately on the balance sheet at fair value with movements in those fair values reflected through the income statement.

This has the potential to introduce non-cash volatility to both the income statement and balance sheet. Therefore, for fair value hedges, IAS 39 allows changes in the recognised value of hedged debt that are attributable to the hedged risk to be adjusted through the income statement. This is only permitted where the hedge and debt is considered to meet the hedge accounting criteria defined by IAS 39.

In the case of cash flow hedges, movements in the fair value of derivatives are deferred within reserves until they can be recycled through the income statement to match the future income statement effect of changes in the hedged risk. In order to apply this treatment, it must be demonstrated that the derivative has been and will continue to be an effective hedge of the hedged risk within the underlying asset or liability. Any hedge ineffectiveness, provided it is within the range deemed acceptable by IAS 39, is recognised immediately within the income statement.

Interest rate swap agreements are used to manage interest rate exposure, while the group enters into foreign exchange contracts and foreign exchange options to manage its exposure to fluctuations in currency rates. All financial derivatives are recognised in the balance sheet at fair value.

Hedge accounting is applied where possible. Therefore, where derivatives that are designated as fair value hedges meet the hedge effectiveness criteria specified in IAS 39, changes in the recognised value of hedged debt that are attributable to the hedged risk are adjusted through the income statement to offset changes in the fair value of derivatives.

For qualifying cash flow hedges, the fair value gain or loss associated with the effective portion of the cash flow hedge is recognised initially directly in shareholders' equity, and released to the income statement in the periods when the hedged item will affect profit or loss.

Notes to the consolidated financial statements continued

40 Transition to IFRS continued

Where changes in the fair value of a derivative differ to changes in the fair value of the hedged item, the hedge ineffectiveness is recorded in the income statement.

New borrowings are stated at net proceeds received after the deduction of issue costs. Under UK GAAP the issue costs of debt instruments are amortised at a constant rate over the life of the instrument, whereas under IFRS the costs are amortised using the 'effective interest rate' method.

Impact

As a result of applying IAS 39, there was a non-cash charge to the income statement of £17.5 million for the year ended 31 March 2005. This primarily related to RPI swaps, which although economically highly effective, do not qualify for hedge accounting under the strict definition of IAS 39. This means that there is the potential for future volatility through the income statement on these instruments although this will ultimately net to match the cumulative accounting impact under UK GAAP when the instrument matures.

The majority of the group's other derivatives currently qualify for hedge accounting under IAS 39.

The overall reduction in net assets as at 31 March 2005 as result of derivative accounting is £54.0 million before tax.

vi) Redeemable shares

Material Differences to UK GAAP

Under IFRS 32 'Financial Instruments: Disclosures and Presentation', redeemable shares where the holder has the option of redemption are classified as liabilities rather than equity.

Impact

The redeemable shares at March 2005 of £14.7 million were reclassified from share capital to non-current liabilities. The net assets of the group were correspondingly reduced and this is shown in the 'Other' column of the balance sheet reconciliation. These redeemable shares were all subsequently redeemed in October 2005.

vii) Other differences

All other differences between IFRS and UK GAAP are included within the 'Other' column. The main such adjustments are:

- The impact of fair valuing share options granted after 7 November 2002 in accordance with IFRS 2.
- The reclassification of software costs from tangible to intangible fixed assets in accordance with IAS 38.
- The reclassification of long-term contract balances in accordance with IAS 11 'Construction Contracts'.
- Debtors due after one year, included within current assets under UK GAAP are reclassified within non-current assets under IFRS.
- Amended depreciation and amortisation resulting from the application of IAS 36.
- The deferred tax impacts of all other adjustments.

viii) Group cash flow statement

The group cash flow statement prepared in accordance with FRS 1 (revised) presents substantially the same information as that required under IFRS. However, under IFRS there are certain differences from UK GAAP with regard to the classification of items within the cash flow statement and with regard to the definition of cash and cash equivalents.

Under UK GAAP, cash flows are presented separately for operating activities, returns on investments and servicing of finance, taxation, capital expenditure and financial investment, equity dividend paid, management of liquid resources and financing. Under IFRS, only three categories of cash flow activity are reported: operating activities, investing activities and financing activities.

Under IFRS, items which under UK GAAP would be included within management of liquid resources fall within the definition of cash and cash equivalents.

Independent auditors' report to the members of AWG Plc

We have audited the parent company financial statements of AWG Plc for the year ended 31 March 2006 which comprise the company balance sheet, company statement of total recognised gains and losses and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

We have reported separately on the group financial statements of AWG plc for the year ended 31 March 2006.

Respective responsibilities of Directors and auditors
The Directors' responsibilities for preparing the annual report, the Directors' remuneration report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' report is consistent with the parent company financial statements. We also report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Directors' report and the unaudited part of the Directors' remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the Directors' remuneration report to be audited 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 parent company financial statements and the part of the Directors' remuneration report to be audited.

Opinion
In our opinion:
- The parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006.
- The parent company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.
- The information given in the Directors' report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
30 May 2006

Company balance sheet at 31 March

Notes		2006 £m	2005 (restated) £m
	Fixed assets		
7	Investments	1,902.8	1,993.7
	Current assets		
8	Debtors	64.4	19.8
	Cash at bank and in hand	21.2	5.5
		85.6	25.3
9	Creditors – amounts falling due within one year	(77.7)	(4.8)
	Net current assets	7.9	20.5
	Total assets less current liabilities	1,910.7	2,014.2
10	Creditors – amounts falling due after more than one year	(791.0)	(805.7)
	Net assets	1,119.7	1,208.5
	Capital and reserves		
11	Called up share capital	28.0	28.7
12	Share premium account	13.8	10.8
12	Capital redemption reserve	17.3	1.8
12	Profit and loss account	1,060.6	1,167.2
	Equity shareholders' funds	1,119.7	1,208.5

The financial statements were approved by the board of Directors on 30 May 2006 and signed on its behalf by:

Scott Longhurst Group Finance Director

The notes on pages 121 to 124 form part of these financial statements.

Company statement of total recognised gains and losses for the year ended 31 March

Notes		2006 £m	2005 (restated) £m
	Total recognised gains and losses for the year	13.1	1.0
6	Prior year adjustment	(0.5)	
	Total recognised gains and losses since last annual report and financial statements	12.6	

Notes to the company financial statements

1 Accounting policies

These financial statements have been prepared under the historical cost convention in accordance with the Companies Act 1985 and UK GAAP.

The company's principal accounting policies adopted in the presentation of these financial statements are set out below and have been consistently applied to all the periods presented.

a) Changes in accounting policies

The company has adopted FRS 17 'Retirement Benefits', FRS 20 'Share-based Payments', FRS 21 'Events after the Balance Sheet Date', FRS 25 'Financial Instruments: Disclosure and Presentation' and FRS 28 'Corresponding Amounts' in these accounts. The adoption of each of these standards represents a change in accounting policy and the comparatives have been restated. Details of the effect of the prior year adjustments are given in note 6. The company has not adopted FRS 26 'Financial Instruments: Measurement'.

b) Share-based payments

The company operates a SAYE share option scheme for all employees of its subsidiaries to encourage participation in the group's results. In addition the company operated an Executive Share Option Scheme (ESOS) until 2003, which was then replaced by a Long-Term Incentive Plan (LTIP). Participation in the ESOS and LTIP schemes is restricted to Executive Directors and a number of senior managers.

The company determines the fair value of share options granted using a binomial option pricing model and their fair value is recognised as an employee benefits expense with a corresponding movement in equity over the vesting period. The proceeds received, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium when the options are exercised.

c) Pensions

The company operates both a defined benefit pension scheme and a defined contribution pension scheme.

The share of assets and liabilities of the defined benefit pension scheme that relates to current and former employees of the company cannot be separately identified. Therefore, the scheme represents a defined contribution scheme for the company.

Contributions to both the defined benefit and defined contribution schemes are charged to the profit and loss account as they fall due.

d) Cash flow statement and related party disclosures

The results, assets and liabilities of the company are included in the consolidated financial statements of AWG Plc, which are publically available. Consequently, the company has taken exemption from preparing a cash flow statement under the terms of FRS 1 (revised) 'Cash Flow Statements'. The company is also exempt under the terms of FRS 8 'Related Party Disclosures' from disclosing related party transactions with entities that are part of the group.

2 Employee information

Details of Directors' emoluments and interests are included in the remuneration report on pages 51 to 58 in the group annual report. Except for the Directors there were no employees of the company in 2006 or 2005.

3 Dividends

Details of dividends are shown in note 11 of the group consolidated financial statements.

4 Auditor's remuneration

There were no fees for audit or non-audit services provided by the company's auditors borne by the company (2005: £nil).

5 Profit for the year

AWG Plc has not presented its own profit and loss account and related notes as permitted by section 230 (3) of the Companies Act 1985. The profit for the financial year dealt with in the financial statements of the parent company is £13.1 million (2005: £1.0 million).

Notes to the company financial statements continued

6 **Prior year adjustment**

As detailed in note 1, the company has adopted certain new accounting standards this year; the effect of the adoption of these standards on the prior year is detailed below:

FRS 21 – Events after the Balance Sheet Date

The adoption of FRS 21 has resulted in an increase in shareholders' funds of £49.4 million at 1 April 2005 (2005: £nil) due to the write back of the final dividend proposed at 31 March 2005.

FRS 25 – Financial Instruments: Disclosure and Presentation

The adoption of FRS 25 has resulted in an increase in net interest payable of £0.3 million (2005: £0.5 million) and a corresponding reduction in dividends payable to non-equity shareholders. Also, the company's borrowings have increased by £14.7 million with a corresponding reduction in its share capital. These adjustments are due to the reclassification of redeemable shares as debt rather than equity.

The company has not separately disclosed details of financial instruments under FRS 25; these have been included within note 26 in the group consolidated financial statements.

7 **Investments**

	Loans to group under-takings £m	Shares in subsidiary under-takings £m	Total £m
Cost			
At 1 April 2005	–	1,998.3	1,998.3
Additions	1,368.7	625.0	1,993.7
Repayments	(90.9)	–	(90.9)
Disposals	–	(1,993.7)	(1,993.7)
At 31 March 2006	1,277.8	629.6	1,907.4
Provisions for impairment			
At 1 April 2005 and at 31 March 2006	–	4.6	4.6
Total			
At 31 March 2006	1,277.8	625.0	1,902.8
At 31 March 2005	–	1,993.7	1,993.7

During the year, as part of the restructuring of the group, AWG Plc sold its interests in the ordinary share capital of AWG Group Limited to another group subsidiary. The consideration was settled part in cash with the remaining element remaining as a loan due from subsidiary undertaking. The loan is interest bearing with a final repayment date of 2015, though early repayment, in full or part, can be made by the subsidiary company. The addition represents the subscription for ordinary shares in a new group company AWG Holdings Limited.

The proceeds on the disposal represented the value of the net assets disposed.

The principal subsidiary undertakings of the group are listed in note 39 of the group consolidated financial statements.

8 **Debtors: amounts falling due within one year**

	2006 £m	2005 £m
Amounts owed by subsidiary undertakings	64.4	19.8

9 Creditors: amounts falling due within one year

	2006 £m	2005 (restated) £m
Amounts owed to subsidiary undertakings	71.4	4.0
Other creditors	6.3	0.8
	77.7	4.8

Comparative figures have been restated in accordance with FRS 21 (note 6).

10 Creditors: amounts falling due after more than one year

	2006 £m	2005 (restated) £m
Loans and other borrowings		
Nil (2005: 14,748.8 million) redeemable shares of 0.1 pence each	–	14.7
£290m LIBOR plus 2% 2052 (due to AWG Group Limited)	290.0	290.0
£501m LIBOR plus 2% 2052 (due to AWG Group Limited)	501.0	501.0
	791.0	805.7
Redeemable shares		
Authorised:		
1,000,000 million redeemable shares of 0.1 pence each	1,000.0	1,000.0

Comparative figures have been restated in accordance with FRS 25 (note 6).

On 21 June 2004 47,569 million redeemable shares were issued to ordinary shareholders.

On 9 September 2004, 47,126 million redeemable shares were redeemed for cash of 0.1 pence per share, £47.1 million in value. On 10 February 2005, 1,786 million were redeemed for cash of 0.1 pence per share, £1.8 million in value. On 11 October 2005 the remaining 14,749 million redeemable shares were repurchased for cash at a nominal value of 0.1 pence each, £14.7 million in value. All redeemable shares repurchased by the company were cancelled.

11 Share capital

	2006 £m	2005 £m
Authorised		
2,763.7 million ordinary shares of 19.9 pence each	550.0	550.0
Allotted, issued and fully paid		
140.7 million (2005: 143.8 million) ordinary shares of 19.9 pence each	28.0	28.7

During the year, 682,799 19.9 pence (2005: 912,059 19.9 pence) ordinary shares were allotted with an aggregate nominal value of £0.1 million (2005: £0.2 million) for total consideration of £3.1 million (2005: £4.1 million).

On 2 June 2005 the company announced a return of capital to shareholders of £75.0 million by means of an on-market share buy-back programme. At the AGM on 28 July 2005, the company was authorised to make market purchases of up to 14.4 million ordinary shares. During the year 3.7 million ordinary shares were purchased with a nominal value of 19.9 pence each, £0.8 million in value; these shares have subsequently been cancelled.

Notes to the company financial statements continued

12 Share capital and reserves

	Ordinary share capital (restated) £m	Redeemable shares £m	Share premium account £m	Capital redemption reserve £m	Profit and loss account (restated) £m	Total shareholders' funds (restated) £m
At 1 April 2005	28.7	14.7	10.8	1.8	1,117.8	1,173.8
Prior year adjustment (note 6)	–	(14.7)	–	–	49.4	34.7
As restated	28.7	–	10.8	1.8	1,167.2	1,208.5
Issue of shares	0.1	–	3.0	–	–	3.1
Total recognised gains and losses relating to the year	–	–	–	–	13.1	13.1
Dividends paid	–	–	–	–	(70.0)	(70.0)
Redemption of redeemable shares	–	–	–	14.7	(14.7)	–
Share buy-back	–	–	–	–	(37.1)	(37.1)
Cancellation of treasury shares	(0.8)	–	–	0.8	–	–
Employee share option costs	–	–	–	–	2.1	2.1
At 31 March 2006	28.0	–	13.8	17.3	1,060.6	1,119.7

Comparative figures have been restated as detailed in note 6.

13 Related party transactions

The company is the ultimate parent of the AWG Plc group. The group's related party transactions requiring disclosure in the financial statements in accordance with FRS 8 'Related Party Transactions' are listed in note 37 of the group consolidated financial statements.

14 Contingent liabilities

The company is party to cross guarantee arrangements relating to a credit facility for the non-regulated business and certain group companies' accounts at Barclays Bank Plc. Net indebtedness under each of these arrangements at 31 March 2006 was £nil (2005: £nil).

15 Subsequent events

The final dividend for 2005/6 of £50.7 million (equivalent to 36.0 pence per share), will be proposed at the AGM on 26 July 2006, and has not been included as a liability as at 31 March 2006. The final dividend will be paid on 15 September 2006 to shareholders on the register at 5pm on 11 August 2006.

Group financial history

	UK GAAP 2002 £m	UK GAAP 2003 £m	UK GAAP 2004 £m	IFRS 2005[1] £m	IFRS 2006 £m
Profit and loss account					
Continuing operations[2]					
Revenue	1,704.6	1,740.0	1,759.6	1,358.9	1,552.2
Operating profit	147.2	243.6	295.3	288.8	377.9
Finance costs (net)	(191.6)	(281.8)	(253.2)	(259.9)	(265.6)
Share of post tax (losses)/profits from joint ventures and associates	(12.3)	(5.7)	(2.1)	3.5	(3.5)
(Loss)/profit before tax	(56.7)	(43.9)	40.0	32.4	108.8
Taxation	19.5	(8.2)	10.2	(4.1)	(31.1)
(Loss)/profit for the financial year from continuing operations[2]	(37.2)	(52.1)	50.2	28.3	77.7
Discontinued operations					
Loss on disposal of businesses[3]	–	–	(121.5)	–	(56.4)
Post tax results from discontinued operations	–	–	–	5.4	8.8
Profit for the financial year	(37.2)	(52.1)	(71.3)	33.7	30.1
Payment to shareholders	44.6p	44.8p	46.4p	48.7p	50.8p
Total (loss)/earnings per ordinary share – basic	(16.3p)	(26.4p)	(52.0p)	23.4p	20.9p
Continuing operations adjusted basic earnings per share excluding exceptional items and the incremental impact of IAS 39	–	–	–	32.6p	67.1p
Balance sheet					
Fixed assets	4,370.4	4,397.6	4,056.5	4,709.0	4,709.1
Net working capital (stock, debtors and other creditors amounts falling due within one year)	144.1	115.9	10.8	(33.6)	(51.2)
Other creditors amounts falling due after more than one year	(98.1)	(97.5)	(93.6)	(247.6)	(260.0)
Provisions for liabilities and charges (including deferred tax and retirement benefit obligations)	(106.5)	(165.9)	(173.9)	(886.4)	(824.4)
Net debt	(2,612.1)	(3,221.1)	(3,190.6)	(3,403.8)	(3,443.6)
Capital employed	1,697.8	1,029.0	609.2	137.6	129.9

Due to the divisional restructuring during 2004/5, no divisional analysis of turnover and operating profit is provided. A divisional analysis for 2006 and 2005 is provided in note 2 to the financial statements. Operating profits are stated after the following exceptional items: £nil in 2006, £7.0 million in 2005, £22.7 million in 2004, £64.6 million in 2003 and £174.3 million in 2002.

[1] The comparative numbers shown above have been restated from those previously reported as the group has adopted International Financial Reporting Standards (IFRS) for the first time this year and restated comparatives accordingly. A reconciliation from the numbers previously reported can be found in note 40 to these financial statements.

[2] For 2005 and 2006, continuing operations exclude the revenue and profits from the Construction Services and Project Investments operations sold in March 2006. The results for the three earlier years have not been restated to exclude these discontinued operations.

[3] In 2006 the loss on disposal relates to the Construction Services and Project Investments operations sold in March 2006. In 2004 the loss on disposal related to the sale of the overseas operations in Chile and the Czech Republic.

Shareholder information

Electronic communications

Each year the company distributes to shareholders various documents and reports to meet the obligations of the Companies Act 1985 and the UK Listing Rules. These are currently posted to shareholders. The company wishes to take advantage of changes in legislation and send those papers, and any other communications, electronically where shareholders agree. To enable the company to send documents to shareholders electronically, they need to register at the following website, www.shareview.co.uk/awg. Once registered with Shareview, shareholders gain more control of their shares and other investments as they can view details of recent movements in their shareholding and change their address and bank mandate details online. The company believes that electronic communications will improve services to shareholders and reduce costs for the company.

BACS

If shareholders wish to have their cash dividends paid directly into their bank or building society account, a BACS instruction form can be requested from Lloyds TSB Registrars or found attached to dividend cheques. Shareholders are encouraged to use this facility as it makes receiving dividend payments more secure and faster as well as being cheaper for the company.

Cash dividends

An interim dividend payment of 14.8 pence per share was paid on 13 January 2006 to all ordinary shareholders on the register at 5pm on 9 December 2005. The directors recommend the payment of a final dividend of 36 pence per share. The company has now introduced consolidated tax vouchers. This means that if you have your dividend paid directly into your bank or building society account you will now only receive one tax voucher a year with the interim dividend and not the final dividend.

Capital payments to shareholders

In February 2005, AWG returned to paying a cash dividend, prior to that the company made capital payments to ordinary shareholders in the form of redeemable shares. Please see below details of redeemable share issues and returns of capital, for capital gains tax calculation purposes.

For capital gains tax calculations the base cost of the redeemable shares will be taken as a proportion of the shareholders' original base cost in their existing ordinary shares. The apportionment percentages are calculated by reference to market values at the date of issue of redeemable shares:

	Apportionment percentages			
Date and event	O/S	R/S	'Special' R/S	C Shares of £1.77 each
23 October 2000 issue of 310 R/S per O/S	95.25	4.75	–	–
12 February 2001 issue of 132 R/S per O/S	97.80	2.20	–	–
30 July 2001 issue of 308 R/S per O/S	94.85	5.15	–	–
11 February 2002 issue of 134.2 R/S per O/S	97.63	2.37	–	–
23 September 2002 issue of 312 R/S per O/S	93.82	6.18	–	–
16 October 2002 return of capital	55.49	–	–	44.51
6 January 2003 issue of 136 R/S per O/S	96.98	3.02	–	–
16 June 2003 return of cash	77.38	5.54	17.08	–
15 December 2003 issue of 140 R/S per O/S	97.74	2.26	–	–
21 June 2004 issue of 332 R/S per O/S	95.40	4.60	–	–

R/S = Redeemable shares O/S = Ordinary shares

Consequent to the capital reorganisations the only ordinary share certificates that are valid are those dated 13 June 2003 or later.

All outstanding redeemable shares were redeemed on 29 September 2005 and cheques were sent to shareholders on 12 October. Shareholders who held their redeemable shares in certificated form, should destroy any remaining redeemable share certificates as they are no longer valid.

Share register and shareholder enquiries

The company's share register is maintained by Lloyds TSB Registrars.

Shareholders requiring help or information about their shareholding can contact the Registrars by the following methods

- By writing to The Registrar, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex, BN99 6DA – quoting company reference 2714 and account number (which can be found on shareholders' share certificates).
- By telephoning 0870 606 0382 (international: +44 121 415 7103).
- By e-mail at awg_shareholder@lloydstsb-registrars.co.uk – please note that this is for enquiries only. Changes of address and to bank mandates need to be submitted by post or through Shareview, if registered.

Lloyds TSB Registrars provide a number of services for shareholders.

Registration of change of address

If a shareholder changes address they should write to the Registrars, providing their name, company reference number 2714, account number (which can be found on their share certificate) and new address. All future correspondence regarding the shareholding will be sent to the new address.

Lost share certificates

If a shareholder has misplaced their share certificate they should contact the Registrars who will arrange for an indemnity to be sent. Once this has been signed and returned, a new share certificate can be issued. Shareholders should note that they might have to pay a fee, depending on the value of the shares.

Share transfers

If shareholders wish to transfer their shares they should contact the Registrars who will arrange for the appropriate stock transfer forms to be sent. On completion these should be returned to the Registrars who will issue a new certificate.

Registration of a deceased shareholder

The Registrars should be notified upon the death of a shareholder. The original grant of probate and the share certificate(s) should be sent to the Registrars who will send the executor the appropriate forms to enable the shares to be transferred. If there is no requirement for probate, the Registrars can provide a small estates procedure form.

Website

The company's website is www.awg.com, which provides information including:

- Recent news and stock exchange announcements relating to AWG Plc and its subsidiaries
- Investor relation information, which includes details of apportionment figures, FAQs, Annual Reports, the board and share price information
- Details of the different business operations, as well as links to the Anglian Water, Morrison and AWG Property websites.

Shareview dealing

A telephone and internet dealing service has been arranged through the Registrars who will provide a simple way of buying and selling AWG ordinary shares. For telephone sales call 0870 850 0852 between 8.30am and 4.30pm, Monday to Friday, and for internet sales log on to www.shareview.co.uk/dealing. Commission is 0.5 per cent, with a minimum charge of £20 for telephone dealing and £17.50 for internet dealing. Shareholders will need the shareholder reference number shown on their share certificate(s).

A weekly postal dealing service is also available and a form together with terms and conditions can be obtained by calling 0870 242 4244. Commission is one per cent, with a minimum charge of £10.

Shareholder information continued

Calendar of events

AGM	
Last date for proxy votes to be received by the Registrars	24 July 2006 at 11am
AGM date	26 July 2006 at 11am
Final dividend 2005/06	
Ex-dividend date	9 August 2006
Record date	11 August 2006
Payment date	15 September 2006
Interim results and dividend 2006/07 (expected timetable)	
Interim results announcement	30 November 2006
Ex-dividend date	6 December 2006
Record date	8 December 2006
Payment date	12 January 2007

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Shareholder contacts

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Shareholder enquiries: awg_shareholder@lloydstsb-registrars.co.uk
AWG Plc website: www.awg.com
Lloyds TSB Registrars website: www.shareview.co.uk

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Ref no. AWG084/06/06