

**DEE VALLEY WATER PLC**  
**REGULATORY FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 MARCH 2006**

# DEE VALLEY WATER PLC

## CONTENTS

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	<b>Page</b>
Directors' report	1 - 5
Independent auditors' report	6 - 8
Historic cost profit and loss account	9
Historic cost balance sheet	10
Current cost profit and loss account	11
Current cost balance sheet	12
Current cost cash flow statement	13
Notes to the current cost cash flow statement	14
Notes to the regulatory accounts	15 - 35

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**DIRECTORS' REPORT  
FOR THE YEAR ENDED 31 MARCH 2006**

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**Directors' responsibilities**

The Directors are responsible, under Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment and as a water undertaker under the Water Industry Act 1991, for preparing financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

The Directors select applicable accounting policies and follow relevant accounting standards, so as to ensure the Regulatory Accounts show a true and fair view, except for the application of infrastructure renewals accounting as set out below. Accounting policies are reviewed regularly to ensure that they continue to be appropriate and are amended when necessary. The Company's policies are consistent with other companies in the water industry and the accounts also comply with Regulatory Accounting Guidelines.

The policies are applied consistently, and reasonable, prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 March 2006. The financial statements have been prepared on the going concern basis.

The Directors are responsible for keeping proper accounting records as required by United Kingdom company law, for taking reasonable steps to safeguard the assets of the Company, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements for the year ended 31 March 2006 are published in hard copy printed form and on the Company's website on the internet. The Directors are responsible for the maintenance and integrity of the website in accordance with UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

**Certificate of compliance with Licence condition F6A**

In arriving at the certificate provided below, the Audit Committee met on 24 May 2006 to consider the Appointee's financial and management requirements over the next 12 months and the available resources. The Committee were satisfied that sufficient resources existed and recommended that the Board could provide the necessary assurance. The Board duly considered the recommendations from the Audit Committee on 24 May 2006 and resolved that the certificate would be signed on behalf of the Board.

This is to certify that in the opinion of the Directors, the Appointee:

- will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil its obligations under the Appointment):
- will for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions:
- is in compliance with with paragraph 3.1 of condition K of the Licence:
- all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water undertaker.

## DEE VALLEY WATER PLC

### DIRECTORS' REPORT (continued) FOR THE YEAR ENDED 31 MARCH 2006

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#### Transactions with associated companies

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

#### Operating and financial review

##### Principal activities and review of the business

The principal activity of the company continued to be the provision of drinking water services to an area of 831 square kilometres, predominantly in Chester and North East Wales, for which Dee Valley Water plc is the licensed water supply undertaker.

Raw water is abstracted from a mix of river intakes, impounding reservoirs, boreholes and springs with the largest proportion, 81%, taken from the River Dee. The Company's own network of 8 impounding reservoirs supplies approximately 14% of its needs, with the remaining 5% derived from under ground sources.

Treatment of water to the required standards takes place at six treatment works, which are listed below together with their average throughputs:

Name	Average Throughput (Ml/day)
Llwyn Onn	28
Boughton	24
Legacy	10
Pendinas	2
Oerog Springs	3
Plemstall	1
	—
Total	68
	==

Distribution of treated water takes place through a network of approximately 2,000 kilometres of water pipes utilising 34 pumping stations and 38 treated water storage reservoirs.

As the monopoly water supplier in the area, the Company is subject to strict financial, quality and environmental controls through three systems of regulation. Ofwat regulates the financial side of the business as well as ensuring that levels of service provided to customers achieve the required standards. The Drinking Water Inspectorate regulates the quality of the water supplied, and the Environment Agency controls the interface with the environment, in particular the level and timing of abstraction from watercourses and reservoirs and the quality of discharges.

## DEE VALLEY WATER PLC

### DIRECTORS' REPORT (continued) FOR THE YEAR ENDED 31 MARCH 2006

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Financial regulation undertaken by Ofwat is achieved by a system of quinquennial reviews of investment needs from which it sets the maximum annual charges. These Periodic Reviews set charges that are fixed for a five year period, although there are mechanisms in place whereby certain variations in the cost base can trigger an interim review of charges at any time within each five year period. The maximum charges set are based on the assumption by the regulator that they are sufficient for an efficiently run company to adequately remunerate its capital base. For the current five-year period, which commenced on 1st April 2005, the regulator has set the following year-on-year increases in charges. These increases (Ks) are applied annually in addition to the increase in the Retail Prices Index.

Year	K (%)
2005/06	5.7
2006/07	(1.4)
2007/08	0.2
2008/09	0.6
2009/10	(0.7)

#### Operational performance

Key performance indicators measuring the operational performance of the Water Company are those used by Ofwat and comprise the following:

- Number of properties suffering inadequate pressure
- Number of properties affected by unplanned and prolonged interruptions to supply
- Number of properties affected by water restrictions
- Speed of response to billing contacts
- Speed of response to written complaints
- Meter reading performance
- Quality of telephone contact
- Drinking water quality
- Environmental impact (pollution incidents)
- Leakage

Although measured and monitored separately, each of the above indicators is weighted and combined by Ofwat to give an "Overall Performance Assessment" which is compared with the assessment for other water providers in England and Wales.

In addition to the above regulatory measures, the Company produces and monitors a number of departmental performance indicators associated with the quality of customer service, health and safety issues, water resource prospects and performance of the asset base.

#### Operating performance in the year

Ofwat assessed the overall performance achieved in the year ended 31st March 2005 to be a score of 269 out of a maximum possible of 288. For the current year the Company expects to achieve an improvement on this score. This improvement has been mainly achieved in the areas of water pressure and water quality.

With regard to water resources, the situation at the end of the year was one of reasonable confidence that no restrictions on the use of water will be required during 2006.

## DEE VALLEY WATER PLC

### DIRECTORS' REPORT (continued) FOR THE YEAR ENDED 31 MARCH 2006

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#### Financial

Financial operating performance is reviewed in note 26.

In order to finance Dee Valley Water's capital expenditure programme over the period 2005 to 2010, it will be necessary to increase borrowings on a temporary basis. It is currently anticipated that additional borrowings will be required in 2006/07, that a peak will be reached in 2007/08 and that a significant portion of the additional borrowings will be repaid by the end of 2009/10. An appropriate borrowing facility will be put into place shortly

#### Key performance indicators (KPI's)

Dee Valley Water is a licensed water undertaker and is under a duty to promote the efficient use of water. Consequently, the Company is not able to generate increased profits by promoting more usage of water on a measured basis. Therefore, KPIs are mainly based on the control of operating costs and cash flows. Amongst others, the following KPIs are utilised by management:

- operating costs v budget
- operating profit v budget
- net cash flow v budget
- capital expenditure v budget (in categories and in total)
- historic trends on debtor days and debt segments
- employee costs (including employee numbers and variable employees costs) v budget

There are three important KPIs relating to cash flow. Referring to the £35 million loan from Artesian Finance, Dee Valley Water has entered into a number of financial covenants with the lender. These are:

(1) Regulatory Asset Ratio - The balance outstanding on the Artesian loan, plus other borrowings, less cash balances, divided by the Company's Regulatory Capital Value as published by Ofwat. The covenant level is a maximum of 85%.

(2) Cash-Based Interest Cover Ratio - Operating cash flow divided by interest paid. This ratio has a minimum covenant level of 1.5.

(3) Operating Account Reserve - Cash and overdraft facilities less assessed working capital requirement. The covenant level for this indicator is >0.

The Company has a committed undrawn overdraft facility of £3 million.

The most recent report to the lender, dated 31 March 2006 and covering the period up to 31 March 2008, showed no actual or potential breach of any of the above three financial covenants.

#### Employees

The Company's aim is to create a safe working environment for all employees and to encourage a culture of openness, honesty and mutual respect in which colleagues can constructively challenge and ask questions. The Company offers equal opportunities to all.

**DEE VALLEY WATER PLC**

**DIRECTORS' REPORT (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

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**Performance measures**

The Company monitors measures and investigates all accidents in the workplace and these are discussed with employee representatives at quarterly meetings of the Health and Safety Committee.

Employees' attendance at work is monitored as a measure of general health and morale/motivation.

**Performance in the year**

The total number of days lost in the year owing to accidents amounted to 148.

Employee absences owing to reported ill health during the year amounted to 3.4% of the total days worked.

On behalf of the board

B Bellis  
**Director**  
3 July 2006

## **DEE VALLEY WATER PLC**

### **INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF DEE VALLEY WATER PLC**

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We have audited the Regulatory Accounts of Dee Valley Water plc for the year ended 31st March 2006 on pages 9 to 35 which comprise:

- (a) the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet; and
- (b) the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements including the statement of accounting policies.

This report is made, on terms that have been agreed, solely to the company and the Water Services Regulation Authority ("the WSRA") in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under the Water Industry Act 1991 (the Regulatory Licence). Our audit work has been undertaken so that we might state to the company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation under the company's Instrument of Appointment to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the WSRA, for our audit work, for this report, or for the opinions we have formed.

#### **Basis of preparation**

The Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the company. There are differences between United Kingdom Generally Accepted Accounting Principles (UK GAAP) and the basis of preparation of information provided in the regulatory accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

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

The nature, form and content of Regulatory Accounts are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no assessment.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 1.

**INDEPENDENT AUDITORS' REPORT (continued)  
TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF DEE  
VALLEY WATER PLC**

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Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the "Basis of audit opinion", below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 11 to 13 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointees' accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05, and Regulatory Accounting Guideline 4.02.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the performance review, the notes on regulatory information, and the additional information required by the licence.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, 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 Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the company (our "Statutory" audit) was made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985.

## DEE VALLEY WATER PLC

### INDEPENDENT AUDITORS' REPORT (continued) TO THE WATER SERVICES REGULATION AUTHORITY AND DIRECTORS OF DEE VALLEY WATER PLC

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Our Statutory audit work was undertaken so that we might state to the company's members those matters we are required to state to them in a Statutory auditors' report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the company and the company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 9 and 10 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disappplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given in note 25.

#### **Opinion**

In our opinion the Regulatory Accounts of the company for the year ended 31 March 2006 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 15 to 14, the state of the company's affairs at 31 March 2006 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

In respect of this information we report that in our opinion:

- (a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;
- (b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA;
- (c) the regulatory historical cost accounting statements on pages 9 and 10 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA;
- (d) the regulatory current cost accounting statements on pages 11 to 13 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA.

**Saffery Champness**

3 July 2006

Chartered Accountants  
Registered Auditors

Lion House  
Red Lion Street  
London  
WC1R 4GB

DEE VALLEY WATER PLC

**HISTORIC COST PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2006**

		Appointed 2006	Non appointed 2006	Total 2006	Appointed 2005 as restated	Non appointed 2005 as restated	Total 2005 as restated
	Notes	£000	£000	£000	£000	£000	£000
<b>Turnover</b>	<b>3</b>	18,287	84	18,371	16,827	1	16,828
Operating costs		(13,201)	(27)	(13,228)	(11,332)	(72)	(11,404)
<b>Operating profit</b>		5,086	57	5,143	5,495	(71)	5,424
Other income		(236)	1,244	1,008	32	1,210	1,242
Other interest receivable and similar income	<b>7</b>	596	-	596	577	-	577
Interest payable and similar charges	<b>8</b>	(2,519)	-	(2,519)	(2,513)	-	(2,513)
<b>Historic cost profit before taxation</b>		2,927	1,301	4,228	3,591	1,139	4,730
Taxation	<b>9</b>	(919)	(408)	(1,327)	(851)	(342)	(1,193)
<b>Historic cost profit after taxation</b>		2,008	893	2,901	2,740	797	3,537
Dividends	<b>10</b>	(1,273)	(830)	(2,103)	(1,296)	(765)	(2,061)
		735	63	798	1,444	32	1,476
Actuarial gain on defined benefit pension scheme		465	-	465	204	-	204
<b>Historic cost profit retained</b>		1,200	63	1,263	1,648	32	1,680

DEE VALLEY WATER PLC

HISTORIC COST BALANCE SHEET  
AS AT 31 MARCH 2006

		Appointed	Non	Total	Appointed	Non	Total
		2006	appointed	2006	2005	appointed	2005
		£000	2006	£000	as restated	as restated	as restated
	Notes	£000	£000	£000	£000	£000	£000
<b>Fixed assets</b>							
Tangible assets		47,632	-	47,632	46,017	59	46,076
<b>Current assets</b>							
Stocks	13	115	-	115	173	-	173
Debtors: amounts falling due within one year	14	4,029	-	4,029	4,862	-	4,862
Short term investments		16,208	243	16,451	15,565	243	15,808
Cash at bank and in hand		-	760	760	-	571	571
		20,352	1,003	21,355	20,600	814	21,414
<b>Creditors: amounts falling due within one year</b>	15	(7,974)	(408)	(8,382)	(8,825)	(342)	(9,167)
<b>Net current assets/(liabilities)</b>		12,378	595	12,973	11,775	472	12,247
<b>Total assets less current liabilities</b>		60,010	595	60,605	57,792	531	58,323
<b>Creditors: amounts falling due after more than one year</b>	16	(41,904)	-	(41,904)	(40,814)	-	(40,814)
<b>Provisions for liabilities and charges</b>	17	(9,710)	-	(9,710)	(9,779)	-	(9,779)
		8,396	595	8,991	7,199	531	7,730
<b>Capital and reserves</b>							
Called up share capital		240	-	240	240	-	240
Other reserves		614	-	614	614	-	614
Profit and loss account		7,542	595	8,137	6,345	531	6,876
		8,396	595	8,991	7,199	531	7,730

**DEE VALLEY WATER PLC****CURRENT COST PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2006**

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		<b>2006</b>	<b>2005</b>
	<b>Notes</b>	<b>£000</b>	<b>as restated £000</b>
<b>Turnover</b>	<b>3</b>	18,287	16,827
Operating costs	<b>4 / 5</b>	(14,604)	(12,653)
Working capital adjustment		80	135
<b>Current cost operating profit</b>	<b>6</b>	3,763	4,309
Other income	<b>3</b>	(475)	32
Other interest receivable and similar income	<b>7</b>	596	577
Interest payable and similar charges	<b>8</b>	(2,519)	(2,513)
Financing adjustment		(622)	(762)
<b>Current cost profit before taxation</b>		743	1,643
Taxation	<b>9</b>	(919)	(851)
<b>Current cost profit/(loss) attributable to shareholders</b>		(176)	792
Dividends	<b>10</b>	(1,273)	(1,296)
		(1,449)	(504)
Actuarial gain on defined benefit pension scheme		465	204
<b>Current cost loss retained</b>		(984)	(300)

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**DEE VALLEY WATER PLC**

**CURRENT COST BALANCE SHEET  
AS AT 31 MARCH 2006**

		<b>2006</b>	<b>2005</b>
	<b>Notes</b>	<b>£000</b>	<b>as restated £000</b>
<b>Fixed assets</b>			
Tangible assets	<b>11</b>	368,749	359,521
Third party contributions since 1989-90		(13,065)	(12,100)
		<u>355,684</u>	<u>347,421</u>
Working capital	<b>12</b>	5,405	3,977
<b>Net operating assets</b>		<u>361,089</u>	<u>351,398</u>
Cash and investments		4,130	4,354
Non-trade debtors		342	593
Non-trade creditors due within one year		(1,096)	(799)
Creditors due after one year		(38,909)	(37,819)
Deferred tax provision	<b>17</b>	(7,653)	(7,280)
Pension liability	<b>17</b>	(2,057)	(2,499)
<b>Net assets employed</b>		<u><u>315,846</u></u>	<u><u>307,948</u></u>
<b>Capital and reserves</b>			
Called up share capital		240	240
Current cost reserve	<b>19</b>	328,618	319,736
Other reserves		614	614
Profit and loss account		(13,626)	(12,642)
<b>Total capital and reserves</b>		<u><u>315,846</u></u>	<u><u>307,948</u></u>

DEE VALLEY WATER PLC

**CURRENT COST CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2006**

	<b>Appointed</b>	<b>Non</b>	<b>Total</b>	<b>Appointed</b>	<b>Non</b>	<b>Total</b>
	<b>2006</b>	<b>appointed</b>	<b>2006</b>	<b>2005</b>	<b>appointed</b>	<b>2005</b>
	<b>£000</b>	<b>2006</b>	<b>£000</b>	<b>£000</b>	<b>2005</b>	<b>£000</b>
<b>Net cash flow from operating activities</b>	7,667	1,360	9,027	8,112	1,139	9,251
Interest received	260	-	260	311	-	311
Interest paid	(1,429)	-	(1,429)	(1,403)	-	(1,403)
<b>Net cash outflow for returns on investments and servicing of finance</b>	<u>(1,169)</u>	<u>-</u>	<u>(1,169)</u>	<u>(1,092)</u>	<u>-</u>	<u>(1,092)</u>
<b>Taxation</b>	<u>(270)</u>	<u>(341)</u>	<u>(611)</u>	<u>(403)</u>	<u>(321)</u>	<u>(724)</u>
<b>Capital expenditure</b>						
Payments to acquire tangible assets	(4,053)	-	(4,053)	(5,430)	-	(5,430)
Receipt of grants and contributions	675	-	675	679	-	679
Infrastructure renewals expenditure	(1,816)	-	(1,816)	(1,927)	-	(1,927)
Receipts from sales of tangible assets	15	-	15	78	-	78
<b>Net cash outflow for capital expenditure</b>	<u>(5,179)</u>	<u>-</u>	<u>(5,179)</u>	<u>(6,600)</u>	<u>-</u>	<u>(6,600)</u>
<b>Equity dividends paid</b>	<u>(1,273)</u>	<u>(830)</u>	<u>(2,103)</u>	<u>(1,295)</u>	<u>(765)</u>	<u>(2,060)</u>
<b>Net cash outflow before management of liquid resources and financing</b>	(224)	189	(35)	(1,278)	53	(1,225)
<b>Management of liquid resources</b>						
Current asset investments	220	-	220	1,199	-	1,199
<b>(Decrease)/increase in cash</b>	<u>(4)</u>	<u>189</u>	<u>185</u>	<u>(79)</u>	<u>53</u>	<u>(26)</u>

**DEE VALLEY WATER PLC**

**NOTES TO THE CURRENT COST CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2006**

**1 Reconciliation of current cost operating profit to net cash inflow  
from operating activities**

	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>as restated £000</b>
Current cost operating profit	3,763	4,309
Working capital adjustment	(80)	(135)
Change in stocks	58	(28)
Receipts from other income	19	32
Current cost depreciation	2,885	2,424
Profit on disposal	-	(43)
Decrease/(increase) in debtors	254	(583)
Increase/(decrease) in creditors	(1,271)	72
Infrastructure renewals expenditure	1,816	1,927
Movement in pension scheme liability	223	137
	<u>7,667</u>	<u>8,112</u>
<b>Net cash flow from operating activities</b>	<u><u>7,667</u></u>	<u><u>8,112</u></u>

**2 Analysis of net debt**

	<b>1 April 2005</b>	<b>Cash flow</b>	<b>Other non- cash changes</b>	<b>31 March 2006</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Net cash:				
Bank overdrafts	(867)	(4)	-	(871)
Liquid resources:				
Current asset investments	5,221	(220)	-	5,001
Debts falling due within one year	-	-	-	-
Debts falling due after one year	(37,819)	-	(1,090)	(38,909)
	<u>(33,465)</u>	<u>(224)</u>	<u>(1,090)</u>	<u>(34,779)</u>
<b>Net debt</b>	<u><u>(33,465)</u></u>	<u><u>(224)</u></u>	<u><u>(1,090)</u></u>	<u><u>(34,779)</u></u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2006**

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**1 Current cost accounting policies**

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

They measure profitability on the basis of real financial capital maintenance in the context of assets which are valued at their current cost value to the business with the exception of assets acquired prior to 31 March 1990.

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

**1.1 Tangible fixed assets**

Assets acquired prior to 31 March 1990 and in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for the possible funding of future replacements of pre 31 March 1990 assets by contributions from third parties and to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amounts.

**Land and buildings**

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

**Infrastructure assets**

Mains, impounding and pumped raw water storage reservoirs are valued at replacement cost determined principally on the basis of data provided by the Asset Management Plan ('AMP').

A process of continuing refinement of assets records is expected to produce adjustments to existing values when periodic reviews of the AMP takes place. In the intervening years, values are restated to take account of the changes in the general level of inflation as measured by changes in the RPI over the year.

**Other fixed assets**

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

**Grants and other third party contributions**

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

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

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**1 Current cost accounting policies**

**(continued)**

**1.2 Real financial capital maintenance adjustments**

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

**Working capital adjustment**

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

**Depreciation adjustment**

This is the difference between depreciation based on the current cost value of assets in these accounts and depreciation charged in arriving at historical cost profit.

**Financing adjustment**

This is calculated by applying the change in the RPI over the year to the opening balance of net finance which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

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

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

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

**1.4 Dividend policy**

In arriving at the level of dividend, the Company has a number of objectives:-

1. The total paid and proposed must not result in any breach of the financial covenant agreed with the Company's loan provider. These covenants effectively place an upper limit on the cash which can be paid in dividends
2. The total amount paid in the 5 year review period should not exceed the amount allowed by the Determination.
3. The policy objective is to provide for a continuing and smooth upwards progression, whilst taking into account the demands of a fluctuating capital programme, and the variations in regulatory capital value over the 5 year review period.

Thus the Company's stated policy is to ensure continuing real growth throughout the current review period.

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

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**2 Extract from historic cost accounting policies**

**2.1 Turnover**

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

**2.2 Tangible fixed assets and depreciation**

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

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

Infrastructure assets - 5 to 25 years

Mobile plant, vehicles and equipment - 3 to 20 years

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

**2.3 Infrastructure assets**

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

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

This accounting policy is not in accordance with FRS12 and differs from that now adopted within the published statutory accounts of the Company. Following the introduction of FRS12 and in accordance with FRS15, expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service is treated in the statutory accounts of the Company as an addition and included at cost after deducting grants and contributions.

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

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

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

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

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

**2.4 Grants and contributions**

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

**2.5 Stock**

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

**2.6 Pensions**

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

**2.7 Taxation**

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

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

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

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

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

**DEE VALLEY WATER PLC**

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

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

	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>as restated £000</b>
<b>Turnover</b>		
Measured	9,478	8,166
Unmeasured	8,745	8,517
Other sources	64	144
Total turnover	<u>18,287</u>	<u>16,827</u>
<b>Operating income</b>		
Current cost (loss)/profit on disposal of assets	(494)	-
Other operating income	19	32
Total operating income	<u>(475)</u>	<u>32</u>
<b>Working capital adjustment</b>	<u>80</u>	<u>135</u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

**4 Activity costing analysis for the year ended 31 March 2006**

	Service analysis			Business analysis		
	Water resource & treat	Water distbn	Water supply sub-tot	Customer services	Scientific services	Cost of regulation
<b>Direct costs</b>						
Employment costs	582	655	1,237			
Power	476	493	969			
Agencies	-	-	-			
Hired and contracted services	97	33	130			
Associated companies	-	-	-			
Materials and consumables	365	106	471			
Service charges NRA	677	-	677			
Bulk supply imports	33	-	33			
Other direct costs	127	8	135			
<b>Total direct costs</b>	<b>2,357</b>	<b>1,295</b>	<b>3,652</b>	<b>695</b>	<b>314</b>	<b>226</b>
General and support expenditure	1,385	832	2,217	252	106	-
<b>Functional expenditure</b>	<b>3,742</b>	<b>2,127</b>	<b>5,869</b>	<b>947</b>	<b>420</b>	<b>226</b>
<b>Total business activities</b>						
Local authority rates			962			
Doubtful debts			215			
Exceptional items			-			
Total Opex less third party services			8,639			
Third party services - opex			131			
<b>Total operating expenditure</b>			<b>8,770</b>			
<b>Capital costs</b>						
Infrastructure renewals expenditure	129	1,625	1,816			
Movement in infrastructure renewals prepayment	-	1,133	1,133			
Current cost depreciation (allocated)	1,913	443	2,356			
Amortisation of deferred credits			-			
Amortisation of intangible assets			-			
Business activities current cost depreciation			529			
Capital maintenance excluding third party services			5,834			
Third party services - capital maintenance			-			
<b>Total capital maintenance</b>			<b>5,834</b>			
<b>TOTAL OPERATING COSTS</b>			<b>14,604</b>			
<b>CCA (MEA) values</b>						
Service activities	93,779	312,487	406,266			
Business activities			6,249			
Water supply total			412,515			
Services for third parties			-			
<b>Total</b>			<b>412,515</b>			

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

**5 Activity costing analysis for the year ended 31 March 2005**

	Service analysis			Business analysis		
	Water resource & treat	Water distbn	Water supply sub-tot	Customer services	Scientific services	Cost of regulation
<b>Direct costs</b>						
Employment costs	515	658	1,173			
Power	320	342	662			
Hired and contracted services	94	38	132			
Materials and consumables	337	123	460			
Service charges NRA	639	-	639			
Bulk supply imports	38	-	38			
Other direct costs	118	11	129			
<b>Total direct costs</b>	<u>2,061</u>	<u>1,172</u>	<u>3,233</u>	<u>734</u>	<u>332</u>	<u>216</u>
General and support expenditure	1,215	757	1,972	237	99	-
<b>Functional expenditure</b>	<u>3,276</u>	<u>1,929</u>	<u>5,205</u>	<u>971</u>	<u>431</u>	<u>216</u>
<b>Total business activities</b>						
Local authority rates			1,175			
Doubtful debts			103			
Total Opex less third party services			<u>8,101</u>			
Third party services - opex			157			
<b>Total operating expenditure</b>			<u>8,258</u>			
<b>Capital costs</b>						
Infrastructure renewals expenditure	282	1,589	1,927			
Movement in infrastructure renewals prepayment	-	(312)	(312)			
Current cost depreciation (allocated)	1,696	395	2,091			
Amortisation of deferred credits			-			
Amortisation of intangible assets			-			
Business activities current cost depreciation			333			
Capital maintenance excluding third party services			<u>4,039</u>			
Third party services - capital maintenance			-			
<b>Total capital maintenance</b>			<u>4,039</u>			
<b>TOTAL OPERATING COSTS</b>			<u>12,297</u>			
A prior year adjustment has been made following the implementation of FRS 17. As a result total operating costs shown on page 8 have increased by £356k over those shown above.						
<b>CCA (MEA) values</b>						
Service activities	91,101	303,389	394,490			
Business activities			5,968			
Water supply total			<u>400,458</u>			
Services for third parties			-			
Total			<u>400,458</u>			

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

<b>6 Operating profit</b>	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>£000</b>
Current cost operating profit is stated after charging:		
Depreciation of tangible assets	2,885	2,315
Operating lease rentals	612	612
Auditors' remuneration	18	18
Remuneration of auditors for non-audit work	40	53
	<u>          </u>	<u>          </u>
<b>7 Other interest receivable and similar income</b>	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>£000</b>
Bank and other interest	260	311
Interest received from group companies	336	266
	<u>          </u>	<u>          </u>
	596	577
	<u>          </u>	<u>          </u>
<b>8 Interest payable</b>	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>£000</b>
On bank overdrafts	4	5
Loan interest	1,425	1,389
Loan indexation	1,090	1,110
On overdue tax	-	9
	<u>          </u>	<u>          </u>
	2,519	2,513
	<u>          </u>	<u>          </u>
<b>9 Taxation</b>	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>as restated</b>
		<b>£000</b>
<b>Domestic current year tax</b>		
U.K. corporation tax	754	573
Adjustment for prior years	(8)	(141)
Payment in respect of group relief	-	114
	<u>          </u>	<u>          </u>
<b>Current tax charge</b>	746	546
<b>Deferred tax</b>		
Deferred tax charge	173	305
	<u>          </u>	<u>          </u>
	919	851
	<u>          </u>	<u>          </u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

10 Dividends paid	2006	2005
	£000	as restated £000
Current year interim - ordinary	416	429
Prior year final - ordinary	857	867
	<u>1,273</u>	<u>1,296</u>

11 Tangible fixed assets	Infrastructure assets	Operational assets	Other tangible assets	Total
	£000	£000	£000	£000
<b>Gross replacement cost</b>				
At 1 April 2005	315,761	83,077	1,824	400,662
RPI adjustment	7,576	1,996	44	9,616
Additions	425	3,573	55	4,053
Disposals	-	(1,731)	(85)	(1,816)
At 31 March 2006	<u>323,762</u>	<u>86,915</u>	<u>1,838</u>	<u>412,515</u>
<b>Depreciation</b>				
At 1 April 2005	-	40,383	758	41,141
RPI adjustment	-	969	18	987
On disposals	-	(1,178)	(69)	(1,247)
Charge for the year	-	2,589	296	2,885
At 31 March 2006	<u>-</u>	<u>42,763</u>	<u>1,003</u>	<u>43,766</u>
<b>Net book value</b>				
At 31 March 2006	<u>323,762</u>	<u>44,152</u>	<u>835</u>	<u>368,749</u>
At 31 March 2005	<u>315,761</u>	<u>42,694</u>	<u>1,066</u>	<u>359,521</u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

<b>12 Working capital</b>		<b>2006</b>	<b>2005</b>
	<b>Note</b>	<b>£000</b>	<b>as restated £000</b>
Stocks	<b>13</b>	115	173
Trade debtors		2,609	2,052
Trade creditors		(4,875)	(6,294)
Infrastructure renewals prepayment		993	2,126
Other accruals		(363)	(321)
Trade payments in advance		(1,258)	(1,080)
Payroll related taxes and social security		(127)	(131)
Other short term group debtors		8,212	7,348
Prepayments and other debtors		99	104
		<u>5,405</u>	<u>3,977</u>
		<u><u>5,405</u></u>	<u><u>3,977</u></u>
<b>13 Stocks</b>		<b>2006</b>	<b>2005</b>
		<b>£000</b>	<b>£000</b>
Raw materials and consumables		115	173
		<u>115</u>	<u>173</u>
		<u><u>115</u></u>	<u><u>173</u></u>
<b>14 Debtors</b>		<b>2006</b>	<b>2005</b>
		<b>£000</b>	<b>as restated £000</b>
Trade debtors		2,851	2,390
Corporation tax		-	111
Other debtors		1,079	2,258
Prepayments and accrued income		99	103
		<u>4,029</u>	<u>4,862</u>
		<u><u>4,029</u></u>	<u><u>4,862</u></u>

DEE VALLEY WATER PLC

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

15 Creditors: amounts falling due within one year

	2006 £000	2006 £000	2006 £000	2005 £000 as restated
	Appointed	Non appointed	Total	Total
Bank loans and overdrafts	871	-	871	867
Trade creditors	4,875	-	4,875	6,294
Corporation tax	527	408	935	504
Other taxes and social security costs	127	-	127	131
Other creditors	36	-	36	53
Accruals and deferred income	1,538	-	1,538	1,318
	<u>7,974</u>	<u>408</u>	<u>8,382</u>	<u>9,167</u>

16 Creditors: amounts falling due after more than one year

	2006 £000	2005 £000
3 1/2% undated irredeemable debentures	114	114
Index linked bank loan	38,795	37,705
Amounts owed to parent and fellow subsidiary undertakings	2,995	2,995
	<u>41,904</u>	<u>40,814</u>

17 Provisions for liabilities and charges

	Pension obligations (see note 18) £	Deferred taxation £	Total £000
Balance at 1 April 2005	2,499	7,280	9,779
Movement	(442)	373	(69)
Balance at 31 March 2006	<u>2,057</u>	<u>7,653</u>	<u>9,710</u>

Deferred taxation provided in the regulatory accounts is as follows:

	2006 £000	2005 £000
Accelerated capital allowances	8,270	8,030
Pension liability	(617)	(750)
	<u>7,653</u>	<u>7,280</u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

**18 Pension costs**

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

The formal actuarial valuation as at 1st April 2005 has been updated to the accounting date by an independent qualified actuary in accordance with FRS17. AS required by FRS17, the value of the defined benefit liabilities has been measured using the projected unit method.

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

<b>Assumptions (per annum)</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Retail price inflation	3.0% pa	2.9% pa	2.5% pa
Discount rate	5.0% pa	5.4% pa	5.5% pa
Pension increases in payment (RPI)	3.0% pa	2.9% pa	2.9% pa
Pension increases in payment (LPI)	3.0% pa	2.7% pa	2.7% pa
General salary increases	5.0% pa	4.9% pa	4.9% pa
Life expectancy of a male aged 60 at balance sheet date	25.6 yrs	25.5 yrs	24.3 yrs
<b>Assets Distribution</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Equities	19,794	15,958	15,900
Bonds	18,271	16,764	14,593
Cash	-	72	(15)
	<u>38,065</u>	<u>32,794</u>	<u>30,478</u>
<b>Expected Returns</b>			
Equities	7.4% pa	7.7% pa	7.9% pa
Bonds	4.3% pa	4.7% pa	4.7% pa
<b>Balance sheet</b>			
	<b>£000</b>	<b>£000</b>	<b>£000</b>
Present value of defined benefit obligation	40,122	35,293	33,131
Fair value of assets	(38,065)	(32,794)	(30,478)
	<u>2,057</u>	<u>2,499</u>	<u>2,653</u>
Less: deferred tax	(617)	(750)	(796)
	<u>1,440</u>	<u>1,749</u>	<u>1,857</u>

During the year to 31st March 2006, the Group contributed £432,000 (2005 - £430,000) to the Scheme. Future employer contribution rates are currently 19% (2006 - 9.7%) of pensionable remuneration for members on the "open" scale and 25% (2006 - 18.5%) of pensionable remuneration for members on the "closed" scale of benefits.

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

**18 Pension costs (continued)**

The deficit under FRS17 moved over the period as follows:

	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>£000</b>
Deficit at start of year	(2,499)	(2,653)
Current service cost (employee and employer)	(872)	(796)
Contributions (employee and employer)	556	554
Other net finance income	103	110
Actuarial gain	655	286
	<u>          </u>	<u>          </u>
Deficit at end of year	<u>(2,057)</u>	<u>(2,499)</u>

The amounts recognised in operating profit are as follows:

Current service cost (employer's part only)	748	672
Interest cost	1,896	1,811
Expected return on assets	(1,999)	(1,921)
	<u>          </u>	<u>          </u>
Total expense included in operating profit	<u>645</u>	<u>562</u>

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

Actual return less expected return on scheme assets	3,972	1,026
Experience gains/(losses) arising on scheme's liabilities	(12)	719
Loss owing to changes in assumptions underlying the FRS17 value of scheme liabilities	(3,305)	(1,459)
	<u>          </u>	<u>          </u>
	<u>655</u>	<u>286</u>

The history of experience gains and losses is:

	<b>2006</b>	<b>2005</b>
Actual return less expected return on scheme assets (£000)	3,972	1,026
Percentage of scheme's assets	10%	3%
Experience gains/(losses) arising on scheme's liabilities (£000)	(12)	719
Percentage of the FRS17 value of the scheme's liabilities	0%	2%
Total amount recognised in the STRGL (£000)	655	286
Percentage of the FRS17 value of the scheme's liabilities	2%	2%

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

<b>19 Movement on current cost reserve</b>	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>£000</b>
Balance at 1 April 2005	319,736	252,048
RPI adjustments		
Fixed assets	8,630	11,041
Working capital	(80)	(135)
Financing	622	762
Third party contributions	(290)	(354)
AMP adjustment	-	56,374
<b>Balance at 31 March 2006</b>	<b>328,618</b>	<b>319,736</b>

**20 Regulatory capital value**

	<b>£000</b>
Opening regulatory capital value as at 1 April 2005	50,404
Capital expenditure (excluding infrastructure renewals)	8,686
Infrastructure renewals expenditure	1,802
Infrastructure renewals charge	(1,702)
Grants and contributions	(456)
Current cost depreciation	(3,318)
Outperformance of regulatory assumptions (5 years in arrears)	(695)
<b>Closing regulatory capital value at 31 March 2006</b>	<b>54,722</b>
<b>Average regulatory capital value for the year</b>	<b>51,929</b>

**Explanatory note**

The table above shows the Regulatory Capital Value (R.C.V) as calculated by the Water Services Regulation Authority (WRSA) as part of the price setting process for the 2004 Final Determination of price limits. The R.C.V represents the capital base for the Company (as defined by the WRSA) on which it is allowed to earn a return at the WRSA's defined cost of capital.

The closing R.C.V as at 31 March 2005 has been restated by the WRSA adjusting for indexation and other adjusting items arising in the previous 5 year review period.

The revised opening R.C.V is then adjusted to take account of new investments (net of capital contributions received) and the current cost depreciation charge for the year, as allowed in the 2004 Final determination of price limits.

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

**20 Regulatory capital value**

There is also a further adjustment made to reflect past out-performance of regulatory assumptions for the previous price setting period. This relates to capital efficiencies which were achieved in the 2003/04 financial year and have been retained by the Company for 5 years, under the WRSA approach to R.C.V.s.

Any differences in actual capital expenditure and depreciation charges from those allowed in the 2004 Final determination will not affect price limits in the current period. These differences, including any capital efficiencies achieved, will be taken into account in the calculation of the R.C.V for the next price review period from 2101 onwards.

<b>21 Directors' emoluments</b>	<b>2006</b>	<b>2005</b>
	<b>£000</b>	<b>£000</b>
Emoluments for qualifying services	259	254
	<u>          </u>	<u>          </u>

The number of directors for whom retirement benefits are accruing under defined benefit schemes amounted to 2 (2005- 2).

Emoluments for qualifying services	107	102
Accrued pension at the end of the year	53	51
Accrued lump sum at the end of the year	159	152
	<u>          </u>	<u>          </u>

Given the nature of the Company's business, the Remuneration Committee does not feel it appropriate to link director's pay with standards of performance.

**22 Employees**

**Number of employees**

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

	<b>2006</b>	<b>2005</b>
	<b>Number</b>	<b>Number</b>
Administration	76	89
Operations	91	92
	<u>          </u>	<u>          </u>
	167	181
	<u>          </u>	<u>          </u>

**Employment costs**

	<b>£000</b>	<b>£000</b>
Wages and salaries	4,116	4,273
Social security costs	356	367
Other pension costs	670	220
	<u>          </u>	<u>          </u>
	5,142	4,860
	<u>          </u>	<u>          </u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 31 MARCH 2006**

**23 Current cost profit and loss account for appointed business - five year rolling summary**

The summary below is presented in 2005/06 prices, restating prior year figures using the specified average Retail Price Index (RPI).

	<b>01/02</b>	<b>02/03</b>	<b>03/04</b>	<b>04/05</b>	<b>05/06</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Turnover	18,099	17,632	17,557	17,265	18,287
Current cost operating costs	(12,802)	(14,306)	(13,387)	(12,982)	(14,604)
Operating income	-	-	(35)	-	-
Working capital adjustment	(17)	(49)	79	139	80
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Current cost operating profit	5,279	3,277	4,214	4,421	3,763
Other income	182	62	38	33	(475)
Net interest	144	(1,211)	(2,273)	(1,986)	(1,923)
Financing adjustment	(246)	(773)	(562)	(782)	(622)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Current cost profit before taxation	5,358	1,355	1,417	1,686	743
Taxation	(1,887)	(955)	(1,719)	(873)	(919)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Dividends	3,471	400	(302)	813	(176)
	(10,176)	(1,358)	(1,365)	(1,330)	(1,273)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Current cost loss retained</b>	<b>(6,705)</b>	<b>(958)</b>	<b>(1,666)</b>	<b>(517)</b>	<b>(1,449)</b>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

**24 Current cost balance sheet for appointed business - five year rolling summary**

The summary below is presented in 2005/06 prices, restating prior year figures using the specified average Retail Price Index (RPI).

	<b>01/02</b>	<b>02/03</b>	<b>03/04</b>	<b>04/05</b>	<b>05/06</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Tangible fixed assets	296,636	301,292	305,846	368,869	368,749
Third party contributions since 1989-90	(9,741)	(10,745)	(11,707)	(12,415)	(13,065)
Working capital	(20,100)	3,819	2,689	4,080	5,405
	<u>266,795</u>	<u>294,366</u>	<u>296,829</u>	<u>360,534</u>	<u>361,089</u>
<b>Net operating assets</b>				<b>Restated</b>	
Cash and investments	(259)	8,134	5,959	4,467	4,130
Non trade debtors	128	1,261	1,351	608	342
Non trade creditors	(3,873)	(637)	(931)	(820)	(1,096)
Creditors due after more than one year	(4,274)	(38,754)	(38,831)	(38,802)	(38,909)
Provisions for liabilities and charges	(5,574)	(5,540)	(8,485)	(7,469)	(7,653)
Pension liability	-	-	-	(2,564)	(2,057)
Dividends payable	(1,972)	(905)	(917)	-	-
	<u>250,971</u>	<u>257,924</u>	<u>254,975</u>	<u>315,955</u>	<u>315,846</u>
<b>Net assets employed</b>					
<b>Capital and reserves</b>					
Called up share capital	267	261	253	246	240
Profit and loss account	(8,251)	(9,037)	(12,545)	(12,971)	(13,626)
Current cost reserve	258,272	266,033	266,617	328,049	328,618
Other reserves	683	668	649	630	614
	<u>250,971</u>	<u>257,924</u>	<u>254,975</u>	<u>315,955</u>	<u>315,846</u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

**25 Historic cost balance sheet reconciliation to statutory accounts**

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

	<b>£000</b>
<b>Debtors</b>	
At 31 March 2006 per Regulatory Accounts	4,029
Less: Measured income accrual not included in Statutory accounts	(830)
Less: Infrastructure renewals prepayment	(979)
Add: Short term loans to group companies	10,605
	<u>12,825</u>
At 31 March 2006 per Statutory accounts	<u>12,825</u>
<b>Tangible fixed assets</b>	
<b>Cost</b>	
At 31 March 2006 per Regulatory Accounts	108,352
Adjustment to opening balance	2,112
Adjustment to infrastructure renewals expenditure capitalised in the year	(1,133)
	<u>109,331</u>
At 31 March 2006 per Statutory Accounts	<u>109,331</u>
<b>Depreciation</b>	
At 31 March 2006 per Regulatory Accounts	46,850
Adjustment to opening balance	2,072
Adjustment to depreciation charge for IRE	(648)
	<u>48,274</u>
At 31 March 2006 per Statutory Accounts	<u>48,274</u>
<b>Net book value</b>	
At 31 March 2006 per Regulatory Accounts	47,632
Adjustment for infrastructure renewals accounting	(445)
	<u>47,187</u>
At 31 March 2006 per Statutory Accounts	<u>47,187</u>

**NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006**

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**26 Financial review and commentary**

**Operating performance for the appointed business**

During the reporting period turnover increased by 8.8%, reflecting the charge increases effective from 1 April 2005. The restated turnover figures for 2005/05 include an accrual for unbilled measured revenues.

Operating expenditure as defined by notes 4 and 5 increased by 6.2%. Electricity increases of over 40% were compensated by efficiency savings in other operating costs.

Historic cost depreciation rose by 30% and current cost depreciation by 18%. The infrastructure renewals charge increased by 83%, reflecting the increasing programme of renewals expenditure over the next 15 years.

Negative 'other income' represents the book value of treatment assets written off having been replaced by new plant.

Historic cost operating profits decreased by 4.7%. Due to higher current cost depreciation charges, current cost profits before taxation decreased by 12.7%.

**Financing**

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

The most recent report to the lender dated 31 March 2006 and covering the period up to 31 March 2008 showed no actual or potential breach of any covenants.

**Taxation**

The tax charge includes a deferred tax charge calculated on an undiscounted basis, in accordance with Ofwat guidance. The discounted provision continues to be used as the basis of charge in the statutory accounts.

The Regulatory Capital Value (as calculated by the WRSA in 2005/06 prices) at 31 March 2006 was £54.7 million. The post tax return on the Regulatory Capital Value was 4.85%.

**Dividends**

Dividends paid by the appointed business during 2005/06 amounted to £1.273 million.

**Five year rolling summaries**

The five year rolling summaries, notes 23 and 24, give the financial results for the last five years in real terms, that is after adjusting for the effects of inflation. In addition the 2004/05 figures have been restated to take into account prior year adjustments relating to accrued income, the FRS17 requirements relating to pensions and the FRS21 requirements relating to dividends.

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

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**26 Financial review and commentary**

**(continued)**

**Five year rolling summaries (continued)**

After adjusting for the exceptional item of £1.062 million in 2003, operating costs increased during the period 2001/02 to 2003/04. The reduction in 2004/05 was mainly due to decreased current cost depreciation, as a result of incorporating the ANP4 revaluation in the 2004/05 accounts.

2005/06 cost increases have been reviewed in the foregoing comments on operating performance.

Dividends demonstrate the effect of the balance sheet restructuring referred to above. The dividend payment of £10 million in 2001/02 was necessary to facilitate the restructuring.

The current cost balance sheet highlights the introduction of the index linked loan in 2002/03, the provision for undiscounted deferred tax in 2003/04, the revaluation of fixed assets and the introduction of the FRS17 pension liability in 2004/05.

**27 Report on RAG5 Transfer Pricing**

**Summary**

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

At this time there were 2 major business elements leading to inter-company transactions:

The Energy business ceased to trade during 2002/3 and as a consequence, transactions relating to the energy business have declined significantly. During 2005/6 costs charged to the energy business relate to Dee Valley Water plc personnel undertaking cash collection activities relating to the remaining Energy company debtors.

Dee Valley Services Ltd provided a contracting service under a term contract with Dee Valley Water plc, which expired in May 2003. Dee Valley Water plc did not award a new term contract. The contracting work is now being carried out 'in house' by Dee Valley Water plc. No transactions have arisen between Dee Valley Water plc and Dee Valley Services Ltd in 2005/6.

The only inter-company transactions in the year has been the management charge made by Dee Valley Water plc to the energy business for debt collection and related activities.

NOTES TO THE REGULATORY FINANCIAL STATEMENTS (continued)  
FOR THE YEAR ENDED 31 MARCH 2006

27 Report on RAG 5 Transfer Pricing

(continued)

**Split between Appointed and Non-Appointed activities**

Billing commission

The main source of non-appointed revenues remains billing commissions. Sewerage is billed and collected on behalf of Dwr Cymru and United Utilities. From the beginning of 2005/6 Wrexham County Borough Council have ceased to collect on behalf of Dee Valley Water plc. Commissions are still payable to Flintshire County Council for collection of council house charges. Costs are allocated on the basis of marginal cost, which works out at approximately 10% of the Customer Services departmental costs.

Other activities

Fishing licences and charges for services such as charges for 'search data' provided to Dwr Cymru make up the remaining non-appointed activities. The associated costs are separately identified.

**Conclusion**

The volume of intercompany transactions has diminished to virtually nothing. Costs apportionment is only necessary between appointed and non-appointed elements of the business.

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

28 Transactions with Associated Companies

The table below sets out the transactions with associated companies

Associated Company	Description	Terms of supply	Associates	Trade
			Annual Turnover £000	Value £000
North Wales Gas Ltd	Support services provided to North Wales Gas Ltd by Dee Valley Water plc	Cost	-	2

At 31 March 2006 there is inter-group indebtedness due to Dee Valley plc of £10,605,215 (2005 - £10,319,588) and Wrexham Water plc is indebted to Dee Valley Water plc for £2,995,600 (2005 - £2,995,600)