southwestwater.co.uk

SOUTH WEST WATER

SOUTH WEST WATER

SOUTH WEST WATER LIMITED

REGULATORY ACCOUNTS
FOR THE YEAR ENDED
31 MARCH 2011

This report is published in accordance with the requirements of the
Water Services Regulation Authority

REGISTERED OFFICE: Peninsula House, Rydon Lane, Exeter EX2 7HR
REGISTERED IN ENGLAND NO 2366665

REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2011

CONTENTS

DIRECTORS, REGISTERED OFFICE AND AUDITORS

Chairman	K G Harvey
Chief Executive	C Loughlin
Operations Director	S C Bird
Finance & Regulatory Director	S J Davy
Customer Relations & Business Development Director	M S Read
Non-Executive Directors	Lord Taylor of Goss Moor M J Hagen (appointed 1 September 2010)
Secretary	K D Woodier
Registered Office	Peninsula House Rydon Lane Exeter EX2 7HR
Auditors	PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors 31 Great George Street Bristol BS1 5QD
Registered Number	2366665

SOUTH WEST WATER

OPERATING AND FINANCIAL REVIEW

At the end of the K4 period (2005 - 2010) South West Water reported that it had a solid platform in place for continued success during the new K5 period (2010 – 2015). 2010/11 has seen the company already benefit from that robust position to deliver a strong start to K5 both financially and operationally with improved standards of customer service.

BUSINESS AND STRATEGY

South West Water is the licensed water and sewerage service provider for Devon, Cornwall and parts of Dorset and Somerset. The company serves a region of nearly 10,300 square kilometres with over 1.65 million residents. In recent years over 45 million visitor nights have been recorded as spent in the region. On average each day it distributes over 420 Megalitres (Ml) of treated water and disposes of around 517 Ml of waste water each day through an asset base comprising:

Distribution mains	15,101 km
Sewers	9,328 km
Impounding reservoirs	14
Water treatment works	39
Waste water treatment works - including 60 works with ultra violet treatment and three with membrane filtration	636
Intermittent discharges - including 1,001 combined sewer overflows	1,638

Because of the region's topography we use more assets per customer than any of the other water and sewerage companies in the UK. How we operate these assets is monitored by the Environment Agency against a range of measures of performance. We aim to deliver a service that represents high quality and reliability to customers and also complies with environmental standards.

South West Water has achieved much since privatisation, and the improvements in our services are clear:

	1995	2011
Overall customer satisfaction with services	49%	80%
Drinking water compliance	99.56%	99.97%
Waste water treatment works compliant with standards	81%	93%
Leakage	145 Ml/day	84 Ml/day
Properties at risk of being flooded with sewage	0.081%	0.005%
Domestic customers on a metered supply	8%	71%

Our Strategic Direction Statement sets out our aspirations and outlines some of the challenges we face in pursuing this vision over a 25 year period.

Customers have told us in no uncertain terms that the very least they expect from us, whatever the impacts of climate change, is a supply of water that they can use without worrying about its quality or reliability. Neither do they want the environment to be damaged by our activities. At the same time, they are concerned about the level of bills. Sustainable solutions are needed which meet statutory obligations and also adapt to the effects of climate change. This will involve new ways of thinking and working, and the regulatory framework will need to develop further to ensure appropriate incentives are provided to encourage these sustainable solutions.

OPERATING AND FINANCIAL REVIEW (continued)

We involved a wide range of stakeholders in developing our Strategic Direction Statement and the business plans for the K5 period that evolved from it. Their involvement is essential as, against the background of a complex policy and regulatory context for the water industry, our stakeholders have diverse remits and differing requirements which we need to understand and balance in our strategy and plans. Engagement with stakeholders through a quadripartite process ensured structured discussions with the Environment Agency, Natural England, the Consumer Council for Water and the Drinking Water Inspectorate, allowing us to understand and discuss the sometimes competing requirements of our key stakeholders. We also ran workshop sessions with regulatory bodies, groups of business customers, environmental organisations and customers. This has led to our confidence that our K5 Business Plan represents appropriate balances between customer service standards, environment impact, investment needs and the aim to keep the cost of customer bills as low as possible.

As a result, the clear 25 year vision of 'Pure Water, Pure Service and Pure Environment', which is at the heart of our Strategic Direction Statement aims to strike the right balance between investing to improve our services, financeability and, importantly, customer affordability.

The vision defines the following aspirations for South West Water:

- Pure Water – investment in maintaining our assets to give our customers the highest quality drinking water
- Pure Service – improving the services that customers experience
- Pure Environment – delivering sustainable sewerage services for the region's benefit.

The Strategic Direction Statement also describes the ways in which we aim to deliver the specific outputs set out in our business plans:

Sustainability:

- working in partnership with other organisations to manage responsibly river catchment, estuaries and coastline, improving the environment and protecting raw water quality
- delivering quality improvements to rivers, bathing waters, shellfish waters and groundwaters, when there is sound scientific evidence of the need, in the most cost effective and sustainable way possible
- meeting carbon reduction targets.

Efficiency:

- consistently being amongst the most efficient companies in the industry
- expending remote site operation and control of our networks without compromising service.

Investors and debt providers:

- giving a fair return for their investment from a soundly financed business.

South West Water expects to create value through delivering the regulatory contract agreed with Ofwat. The contract scope is reviewed every five years. As well as determining outputs, Ofwat sets prices to enable efficient companies to earn a required rate of return on their assets.

In the new regulatory period starting in April 2010 Ofwat has assumed that the equity cost of capital for all companies will be 7.1% real after tax with an overall weighted average cost of capital of 4.5% real after tax.

OPERATING AND FINANCIAL REVIEW (continued)

REGULATORY & COMPETITIVE ENVIRONMENT

COMPETITION

Customers using more than 50Ml of water per year can contract with alternative suppliers for water supply. South West Water has 37 customers in this category, whose aggregate water charges account for approximately 1.5% of its total water and sewerage revenue, or 3.2% of its water revenue. No single customer accounts for more than 1% of revenue.

Legislation will be required for any further significant extension of competition in the water and sewerage markets. A Government Water White paper is expected to be published in late Autumn 2011 which may lead to future legislative changes.

Defra have published a consultation on water affordability and fairness measures building on the findings and recommendations of the independent Walker Review of charging for household water and sewerage services and further analysis by Ofwat on options for tackling high water bills in the South West. The consultation closed on 17 June 2011 and any final policies will be included in the Water White paper expected in late 2011.

South West Water has welcomed the Government's response to the Walker Review of charging for household water and sewerage services. The Government proposal to fund a cut from 2013/14 in the average bill of all customers will be especially well received alongside proposals to target help at those in most need by pegging the 'Water Sure' tariff to the lower national average metered bill and allowing us to develop our own social tariff. We will continue to work closely with Government and its regulators throughout the consultation phase to examine the practicality of all options to aid customers.

PRICE CAP REGULATION

Ofwat regulates charges by determining the maximum increase in charges which a company can impose in any year. The water regulator conducts a Periodic Review and sets price limits every five years. Prices are set by reference to inflation as measured by the Retail Price Index (RPI) plus an adjustment factor known as 'K' which is specific for each company.

The 'K' factors for the period 2010 to 2015 for South West Water were determined by Ofwat in its Final Determination in November 2009 and are:

Year	'K' factor %
2010/11	1.1
2011/12	3.4
2012/13	2.5
2013/14	1.3
2014/15	1.1
Average	1.9

The 2009 Final Determination provided for total capital expenditure of £705 million (2007/08 prices on a UK Generally Accepted Accounting Principles basis) over the K5 period.

OPERATING AND FINANCIAL REVIEW (continued)

LEGISLATIVE DRIVERS

The water industry in the UK is subject to substantial national and EU regulation. This places significant statutory obligations on South West Water with regard to, amongst other things, the quantity of water abstracted, and the quality and quantity of waste water discharged. Examples of relevant EU directives include the Drinking Water Directive, the Habitats Directive, the Urban Waste Water Treatment Directive and the updated Bathing Water Directive.

The Water Framework Directive was incorporated into UK law in 2003. It provides a framework for the protection of and improvement in the quality of water resources, together with the promotion of sustainable water consumption. To comply with the Water Framework Directive, EU member states will have to achieve the challenging target of 'good status' for groundwater, rivers, estuarine waters and coastal waters, in three six-year cycles, the first running from 2009 to 2015. The Final River Basin Management Plan, published by the Environment Agency in December 2009, confirmed that the Plan's implications are unlikely to require changes to South West Water's assets at least until 2015, due to the successful delivery of a wide range of river, estuarine and coastal water environmental improvements by the company since 1989.

Regulations laid before Parliament in April 2011 to allow for the transfer of private sewers and lateral drains are due to come into effect from 1 October 2011. South West Water has operational plans in place to manage the transfer. A procurement process with suppliers to deliver the service to customers is underway. Incremental operating and capital costs efficiently incurred will be funded by future adjustments to price limits.

CLIMATE CHANGE

South West Water is working closely with many organisations to assess the implications of climate change for water supply and waste water services. Adaptation and mitigation plans are being developed which will involve innovative approaches and new methods of influencing catchment behaviour upstream of its water supply systems, in sewered areas and downstream of its waste water systems to protect the wider environment.

The Company's final Water Resources Plan for the next 25 years was published in the summer of 2009 and was approved by Defra. It includes information relating to rainfall and temperature variations. The plan includes allowances for demand changes associated with climate change. Predictive models are in place to address uncertainty. Infrastructure developments have been identified, the timing of which can be adjusted if the expected rate of climate change alters. Increasingly efficient and careful use of water play a major part in adapting to the expected effects.

KEY PERFORMANCE INDICATORS (KPIs)

Key Performance Indicators (KPIs) – Pure Water

In 2010/11, South West Water abstracted 164,611 Megalitres (Ml) of raw water from its 87 licensed abstraction locations which have a total licensed volume of 375,971 Ml. The abstraction sources are reservoirs and rivers, accounting for 93.0% of supplies, with 7.0% drawn from groundwater aquifers.

Drinking Water Compliance

Tap water quality, as measured by Mean Zonal Compliance, is the Drinking Water Inspectorate's preferred method for water quality assessment. In 2010 the result remained very high at 99.97% (2009: 99.98%).

OPERATING AND FINANCIAL REVIEW (continued)

Key Performance Indicators – Pure Service

Service Incentive Mechanism (SIM)

SIM has been introduced for reporting purposes during 2010/11 as a replacement for the Overall Performance Assessment (OPA). Incentives associated with this measure will use results reported from 2011/12 onwards. The SIM evaluation is split between a quantitative and qualitative element.

South West Water's emphasis on excellent service is delivering tangible improvements for customers and is reflected in reducing levels of contacts (particularly repeat contacts). Customer satisfaction levels are rising. Service improvements undertaken in the past two years to reduce customer complaints are delivering results, with complaint levels falling for the second year running (written complaints down a quarter from 2009/10).

During 2010/11, the company further focused resources to respond to customer contacts which resulted in reductions in both "calls abandoned" (down from 7.4% to 5.1%), and in "calls that encounter an engaged tone" (down by 0.32% to 0.17%).

Key Performance Indicators – Pure Environment

The Company recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by its activities. The Company is subject to significant regulation and must comply with the high standards set by the Environment Agency. The Pennon Group has a long established environmental policy, as set out in its annual Corporate Responsibility Report, which is available on www.pennon-group.co.uk.

Waste Water Treatment Compliance

The percentage of population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2010 was 99.55% (2009: 99.70%).

This consistently high performance is within the reference levels used to assess stable serviceability for this group of assets and contributes to South West Water's region having the highest percentage length of high quality rivers in England.

Incidents and Prosecutions

There was one Category 1, and five Category 2 (serious pollution) incidents in 2010. This compares with two Category 2 incidents in 2009. The total number of category 1 to 3 waste water pollution incidents in 2010 was 132 (2009: 106). 34% of all incidents in 2010 were self-identified and reported.

The increase in the total category 1,2 and 3 incidents for 2010 is clearly disappointing for 2010. However, the Category 1 incident recorded in the year was very unusual for the Company and is the first one since reliable records began. Category 2 incidents rose slightly but remain in low numbers at levels similar to previous years and much better than those experienced in previous regulatory investment periods.

During the year the company was convicted on five occasions for environmental offences and fined a total of £29,000 (2009/10: four convictions and fines of £11,500).

The company always self-reports incidents it becomes aware of and co-operates fully with any investigation undertaken by the relevant regulatory authority. After each pollution incident, including incidents leading to prosecution, the company takes such steps as are necessary to ensure that the incident will not be repeated and also seeks to ensure that lessons learned are widely disseminated throughout the company.

OPERATING AND FINANCIAL REVIEW (continued)

Bathing Water Performance

Compliance with the mandatory EU bathing water standard was 96.5% in the 2010 calendar year, the same level it was in 2009. 90.3% met the EU guideline (or excellent) standard. This is an improvement on last year's results when 84% met this standard. All the region's 18 Blue Flag beaches retained their European excellent status and 4 other local beaches could also reapply, having returned to excellent status.

Key Performance Indicators – Financial and Business

Growth in Regulatory Capital Value

Regulatory Capital Value (RCV) is the financial base used by Ofwat to allow a rate of return and set prices at each Periodic Review. The RCV at 31 March 2011 amounted to £2,703.5m, which represents an increase of 3.2% in the year. (The RCV at 31 March 2010 was £2,555m after adjustment for AMP4 log up/down and other final determination adjustments compared to unadjusted year end value of £2,621m).

Net debt decreased by £4.4m to £1,542.8m, with the gearing ratio in relation to year-end RCV of £2,703.5m moving to 57.1% from 60.6%.

The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by the water regulator.

Operating Profit

South West Water achieved an operating profit (on a UK GAAP basis) of £187.3m in 2010/11, down £1.7m from 2009/10. Results for 2010/11 reflected the industry-wide reduction in the allowed rate of return for the K5 period.

Key Performance Indicators – Health and Safety Performance

The health, safety and welfare of the company's employees remain paramount in all its activities. The company has a health and safety strategy which focuses on providing strong leadership, engaging with employees, building competence and measuring performance. These principles are promoted by a health and safety steering group comprising a cross section of directors, managers and employee representatives.

Occupational health and safety are key elements of the company's risk management and internal control processes. We continue to pursue initiatives to improve further the welfare of the company's employees through the provision of training on and promotion of good health and practices.

RIDDOR incidents per 1,000 employees totalled 20 in 2010 (2009: 13). Analysis has shown that behavioural and cultural factors are often a significant contributory factor to RIDDOR incidents occurring: a major behavioural safety programme badged 'TAP' (Think, Act, Prevent) has been launched and targets a substantial reduction in the number of accidents and RIDDOR incidents.

OPERATING AND FINANCIAL REVIEW (continued)

CORPORATE RESPONSIBILITY

Governance and Internal Control

The Board of Directors generally meets eleven times a year to review both non-financial and financial data. The Group control environment is set out in the annual report of Pennon Group Plc.

Formal risk assessment is undertaken quarterly. As part of Pennon Group Plc, the Company's controls and risk management are subject to assessment by the Pennon Group Plc internal audit functions and reviewed by the Pennon Group Plc Audit Committee.

The Company is aware of its responsibilities for effective reporting of financial and non-financial data. Data is reviewed regularly at Board level and, in addition, special meetings are held with the Reporter and Auditor.

As well as the risk management policy of the Company there is an established internal control framework which comprises:

(a) a clearly defined structure which delegates an appropriate level of authority, responsibility and accountability, including responsibility for internal financial control, to management
(b) a comprehensive budgeting and reporting function with an annual budget approved by the Board of Directors, which also monitors monthly achieved results and updated forecasts for the year against the budget
(c) documented financial control procedures. Managers are required to confirm annually that they have adequate financial controls in operation and to report all material areas of financial risk. Compliance with procedures is reviewed by the Group's internal audit function
(d) an investment appraisal process for evaluating proposals for all major capital expenditure and acquisitions, with defined levels of approval and a system for monitoring the progress of capital projects
(e) a process of signing off all non-financial information included in returns to Ofwat.

Customer, Community and Employees

Customers

South West Water has consulted with customers about its priorities for K5 and this feedback has been central to the development of its customer service improvement plans to deliver its Pure Water, Pure Service and Pure Environment vision.

Providing help and support to customers in need is at the heart of the Company's service strategy and accordingly the company remains an industry leader in the provision of Priority Services to vulnerable customers. We provide Priority Services to customers who need extra help, for example the elderly, disabled, and those requiring large print / Braille bills or help in reading their meter.

Where customers have medical conditions necessitating a constant water supply, we arrange for water to be delivered in the event of interruptions to supply.

Our Priority Services Register is promoted in doctors' and dentists' surgeries and at Citizens Advice Bureaux and at 31 March 2011, we had 7,897 customers on the register.

Our aim, as set out in the Strategic Direction Statement, is to treat customers appropriately to their circumstances, especially with regard to affordability and debt.

OPERATING AND FINANCIAL REVIEW (continued)

During the year we have been enthusiastic to promote practical ways to help customers struggling to pay their water bills and have introduced several new initiatives to provide additional options and support for customers. The initiatives are:

- WaterCare Scheme which has helped over 8,000 with long term debt problems. This offers benefits entitlement and tariff checks, water audit and free water-saving devices
- Restart Scheme helping nearly 6,000 customers to reduce their debt by incentivising customers towards a pattern of making regular payments
- Fresh Start Fund, managed by an independent Board, for one-off hardship cases
- targeted campaign to promote and support low income customers who would benefit from metering
- 5,000 free leak alarms fitted in the year for vulnerable customers wary of metering
- training and administration resource over five years for Citizens Advice Bureau staff
- doorstep debt advisors to provide advice and access to support schemes
- Watersure tariff: more than 9,800 households are on this tariff, one third of the national total.

Affordability and fairness
We have been working closely with Ofwat and Defra on providing the appropriate advice to the Government, supported by the extensive research and analysis we have undertaken, to address the issues on affordability and fairness for customers in the South West raised in the independent Walker Review.

In the consultation paper 'Affordable water: a consultation on the Government's proposals following the Walker Review of Charging' the Government indicated that public funding will be available to address the charging fairness for our customers that has arisen as a result of three per cent of the population funding the cleaning up of 30% of the nation's bathing waters since 1989. We are keen to continue to work closely with the Government to examine the practicality of options to help customers.

Water efficiency
We work in a number of ways to promote water efficiency both to domestic and business customers, which include:

- guidance to customers via our free phone water conservation helpline and company website
- provision of water audits
- educational materials for and talks given to schools
- promotion of discounted water butts for the region's gardeners.

14,198 free meters were installed in 2010/11. At 31 March 2011 71% of domestic premises were metered.

The company meets regularly with the Consumer Council for Water (CCWater), which champions the interests of water customers. It regularly consults with CCWater and other stakeholders such as pensioners' forums and Citizens Advice, prior to introducing major changes or initiatives.

The company continues to support business customers through water efficiency reviews, waste minimisation projects, providing advice for water management plans and by highlighting opportunities for reduction, re-use or alternative sources of supply. An education programme for schools has also been developed this year to extend the spread and reach of this work.

Business customers continue to have access to a secure online system which tracks and displays consumption on their sites. South West Water's 'Business Accounts Online' also offers a water efficiency calculator with a free water audit.

No single customer accounts for more than 1% of revenue.

OPERATING AND FINANCIAL REVIEW (continued)

Community and Sponsorship

We are committed to being a good neighbour and a trusted partner in the communities we serve. Our annual Community Sponsorship is targeted at community projects and organisations which are linked to water, benefit the environment or promote youth participation. During 2010/11, £79,761 was allocated to a wide range of projects across the region.

We contributed £10,000 towards the management costs of the Keep Britain Tidy Beachcare Project. This pilot project is aimed at reducing beach litter on Cornwall's beaches by involving communities.

In September 2010 we opened Mary Tavy hydro electric power station and Brokenbury waste water treatment works, Torbay to the public under the Heritage Open Days initiative.

Our employees continue to fundraise for WaterAid, raising £39,200 during 2010/11.

We are developing a programme of employee volunteering to engage with local communities. This encompasses working with schools, whereby employees will educate children about the water cycle and WaterAid. Other employees will visit Exmoor to help maintain the dam structures which have been put in place as part of the Mires restoration project.

South West Lakes Trust manages the majority of inland waters in Devon, Cornwall and on Exmoor.

The Trust celebrated its tenth birthday in 2010, and received the Queen’s Award for Enterprise in the Sustainable Development category. The Trust has significantly improved the recreational facilities at many sites, whilst retaining opportunities for quiet relaxation at others.

Employees

South West Water's people strategy continues to focus on recruiting and developing individuals who can support the delivery of the Company's Pure vision, enabling the provision of a high quality service to customers and the achievement of operational efficiencies.

Employee involvement and participation in all aspects of business and organisational change is encouraged and supported through the Company's staff council, and craft and industrial consultative forums.

The safety of staff is paramount, and our Occupational Health and Safety strategy focuses on providing strong leadership, engagement with employees, building competence and measuring performance. These principles are promoted by a health and safety steering group comprising a cross-section of directors, managers and employee representatives. All members of the Executive Management Team and Senior Managers take part in two health and safety site audits per year. We provide training and promote a health and safety culture. During 2010/11 we have been addressing short term absence, musculo-skeletal problems and mental wellbeing in conjunction with our Occupational Health Advisor.

The company holds the ‘Investor in People’ (IIP) Silver Status, which represents the achievement of a high standard in IIP evidence requirements.

Our employees are the foundation of our success. It is one of our core values that people matter, and we have programmes in place both to support their progress and to assure their safety at work. Examples of these include the formation of a ‘Management Academy’ to develop business, management and personal skills to help our managers become more effective leaders, a Post Graduate Certificate in Management developed with the University of Exeter’s Business School, and the ‘GROW’ staff development programme providing training in personal growth and business strategy.

OPERATING AND FINANCIAL REVIEW (continued)

As part of the Company's GROW programme, an eight-strong team of South West Water staff raised over £12,000 for the Prince's Trust Million Makers Challenge in six months. The money will help young, disadvantaged people get into work, education or training.

Staff and partners who deliver above and beyond what is required in their day-to-day jobs are eligible to be nominated for the Company's Pure Award scheme in three categories – Pure Water, Pure Service and a Pure Environment. Around 50 staff and partners were recognised for their additional contributions in this way last year.

The company conducts employee surveys, and one was completed in 2010/11. The survey asked general questions on how employees felt about their everyday role, their manager and the company as a whole. A few more specific questions were asked, proposed by an employee focus group which was convened to help draw up the survey.

The survey identified a number of strong, positive themes:

- a strong passion and belief in the services we provide for each other and our customers
- a belief our work is important
- the confidence we have the skills to perform our jobs well
- a strong loyalty to South West Water.

Employee Survey Action Groups – with teams of employees representing all parts of the company - were established to explore opportunities for improvement and drive implementation across all areas of the company.

The Company as a 'good employer' has been introducing a number of 'Family Friendly' policies, which exceed statutory requirements. All employees are entitled to participate in a Pennon Group Sharesave Scheme and a Pennon Group Share Incentive Plan, both of which are all-employee plans where performance conditions do not apply.

The Company remains committed to a non-discriminatory employment policy, making every reasonable effort to ensure that no current or future employee is disadvantaged because of age, gender, religion, colour, ethnic origin, marital status, sexual orientation or disability. In particular, the Company welcomes applications for employment from disabled persons and makes special arrangements and adjustments as necessary to ensure that disabled applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible, the opportunity is taken to re-train people who become disabled during their employment in order to maintain their employment within the Company.

Key Relationships

Regulators and others

The company has a wide range of contacts with our environmental and regulatory stakeholders involving many different functions within the company. We also have central processes in place so that we can be confident that stakeholder contacts are dealing with the people most able to assist them, that consultations and information requests are handled in the most efficient manner and that information given to stakeholders is of high quality and consistent.

We have provided extensive input to the debates about how economic regulation for the sector should be developed and the role of market reform in those developments. Key themes for us have been:

- regulatory mechanisms should encourage and reward innovation and sustainability
- reduction in the regulatory burden at the same time as protecting customer interests
- market reform proposals must make sense in terms of customer service, prices and cost benefit analysis.

OPERATING AND FINANCIAL REVIEW (continued)

We also contribute to national policy on developing issues through its membership of Water UK, the industry trade body. The Company works with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the Company's activities is maintained.

Procurement and Suppliers

South West Water's procurement strategy is focused on partnering and strategic alliances with 60 key suppliers who account for the large majority of expenditure. Regular meetings are held to manage performance, encourage sustainable business activity and to identify and deliver continuous improvement opportunities for reducing costs further whilst improving performance and service levels.

We include all aspects of sustainability in our procurement processes and this is a central theme of our procurement strategy for our supply chains and support of the regional economy. With the start of the K5 regulatory period we introduced an innovative 'mixed economy' model to source our capital programme. This means using a significant number of smaller local contractors to provide specialised services as well as long term relationships with more major supply chain partners.

Our supplier assessment covers environmental, social and financial sustainability including suppliers' approaches to occupational health and safety, working conditions in the supply chain, corporate governance, sustainability of their products and services and attitudes to natural capital and the environment. We aim to work with the best companies whose forward thinking approach to sustainability gives reassurance that their environmental, social and ethical risks are minimised. This approach also supports our business continuity objectives and our key and strategic supplier risk review methodology.

No supplier (revenue) accounts for more than 5% of the turnover and South West Water sources all its purchases from competitive markets.

Payments to suppliers

It is the Company's payment policy for the year ending 31 March 2011 to follow the Code of The Better Payment Practice Group on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code may be obtained from The Better Payment Practice Group's website at www.payontime.co.uk. Trade creditors at 31 March 2011 represented 30 days of the amount invoiced by suppliers during the year (2010: 26).

OPERATING AND FINANCIAL REVIEW (continued)

PRINCIPAL RISKS AND UNCERTAINTIES

The following are identified as the principal risks and uncertainties facing the Company:

Risk	Mitigation
REGULATORY	
Failure to deliver the capital investment programme	The company has a track record of delivering its capital programme in accordance with regulatory requirements and progress is regularly monitored and reviewed.
Failure to deliver operating cost savings implicit in the regulatory review	In line with its track record, the company remains confident of delivering the assumed operating cost savings. A major restructuring programme is currently being implemented to contribute towards the additional efficiencies required for the K5 period.
Regulatory compliance	As a regulated business we are subject to numerous and changing obligations with which we must comply. We pay particular attention to management of risks in these areas, particularly in relation to changing legal and regulatory requirements.
Uncertainty arising from market and other regulatory reforms	The company continues to consider and evaluate developments and proposals in relation to development of competition as part of its risk management and business strategic planning processes. Legislation will be required for any further extension of competition in the water and sewerage markets. The company evaluates proposals for regulatory reform and contributes fully to consultations and other forms of dialogue with regulators and stakeholders in order to effectively convey its views.
ECONOMIC DOWNTURN	
Non-recovery of customer debt and affordability	In addition to existing strategies, which are kept under review, South West Water continues to implement new initiatives to improve and secure cash collection, including the use of property charging orders. The accounts of major customers are kept under close review. Provision was made in the K5 Final Determination for companies to make an application for an Interim Determination in the event of household bad debts being significantly above the amount allowed by the Water Regulator due to worsening economic circumstances in the Company's operating area. We have worked with the Government on the findings of the Walker Report and have promoted fairness for South West Water bill payers and actively sought to introduce and promote practical measures to help customers struggling to pay their water bills.

SOUTH WEST WATER

OPERATING AND FINANCIAL REVIEW (continued)

Risk	**Mitigation**
Financial loss arising from the insolvency of a major supplier or contractor	The company does not have material exposure to payment before receipt of goods and services. The company uses a third party credit monitoring service to identify changes in major suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.
FUTURE ENVIRONMENTAL REGULATION / QUALITY STANDARDS / CHANGE IN LEGISLATION	
Environmental regulations and quality standards could increase the Company's costs	These issues are addressed through the five year regulatory price review mechanism.
Legislation for adoption of private sewers	Regulations laid before Parliament to allow for the transfer of private sewers and lateral drains will come into effect from 1 October 2011. South West Water has operational plans in place to manage the transfer. A procurement process with suppliers to deliver the service to customers is under way. Incremental operating and capital costs efficiently incurred will be funded by future adjustments to price limits.
Climate change	The Company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters which are anticipated.
FINANCING	
The Company may be unable to raise sufficient funds to finance its functions	Pennon Group and the Company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year.
Pension costs may increase due to factors outside the company's control	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements.
Poor investment performance may affect the defined benefit scheme assets and increase the pension scheme deficit	Employee and employer contributions are kept under review and have been increased. Further contributions of £16.6m were made in the year. Pension trustees keep investment policy under review and use professional investment advisers.

OPERATING AND FINANCIAL REVIEW (continued)

Risk	Mitigation
GOVERNMENT CUT-BACKS	
Reduced revenue and demand associated with government and local authority cut-backs	The employment market in the South West is more reliant on the public sector than most other parts of the country so there is the potential for reduced revenue and demand from both public sector bodies and employees made redundant. However, the risk is mitigated by the regulatory Revenue Correction Mechanism, whereby shortfalls in revenue in one five year regulatory pricing period are adjusted for in the following period.
OPERATIONS	
Water resource adequacy	The Company has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures. In particular, South West Water prepares a new Water Resources Plan every five years and reviews it annually for a range of climate change and demand scenarios. The Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.
Contamination to water supplies	The Company has established procedures and controls in place, as well as contingency plans and incident management procedures. It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.
Operational failures	Due to the nature of our business we continue to face risks arising during the normal course of our business, including risk of failure of our assets, processes or systems which could otherwise impact on the health, safety and security of our people or customers, or on our financial position and our reputation. The Company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets.

The Directors have established a formal framework for the identification and monitoring of both operational and financial risks arising from the Company's activities.

OPERATING AND FINANCIAL REVIEW (continued)

FINANCIAL REVIEW

Financial Results

Turnover

Appointed business turnover for the year increased by 1.3% from £438.6m to £444.3m as a result of tariff increases, increased demand and new connections, offset by the effects of customers switching. Within this, turnover from main water and sewerage charges, including large user revenues, was £434.6m (2010: £428.3m). Approved tariff increases, including the 1.1% K factor, amounted to £8.0m. 5,500 new customer connections contributed £2.1m of additional turnover in main charges.

Measured demand was 1.3% higher than last year, following flat demand in the prior year. The effect of higher demand was to increase turnover by £3.8m. The increased demand was largely driven by household consumption as a result of the good weather in the early part of the year rather than an increase in all customers underlying consumption.

The effect of meter option switchers was to reduce turnover by £6.9m, benefiting 14,198 customers (2010: 17,890 customers) by, on average, £423 each (2010: £380). 71% of South West Water's domestic customers are now metered (2010: 68%).

Appointed business turnover at £444.3m was in line with the re-priced 2009 Final Determination figure of £445.6m.

Operating Costs

Total appointed business historic cost operating costs, including depreciation, rose from £251.1m to £259.0m.

The key increases have been:
- price increases, including inflation, in particular higher business rates and higher pension current service costs. Leaving aside these specific increases, other costs increased by an implied average inflation rate of 2.8% on prior year base costs, a level below the average RPI for the year of 5.0%
- additional costs for new capital schemes
- additional maintenance costs associated with leakage and sump cleaning arising from changing nature of the work.

Offset by:
- operating cost efficiencies achieved of £8.4m
- increased property disposals.

Total historical cost depreciation charges increased by £2.5m from £72.9m to £75.4m reflecting the impact of the Company's capital expenditure programme, with the infrastructure renewals charge increasing from £28.1m to £29.7m.

The company's restructuring programme continued in the year with £4.0m charged to the profit & loss account (2009/10: £5.0m).

Atypical costs of £7.6m were broadly in line with the previous year (£6.5m) and have been affected by the level of restructuring costs in each of the years. Other cost items taken into account were those associated with the extreme winter weather in December, bad debt costs associated with the slow economic recovery, an increase in the take-up of affordability measures and the cost of completing regulatory customer service action plans and voluntary outputs.

OPERATING AND FINANCIAL REVIEW (continued)

A strong start has been made towards achieving the step change targeted for operating cost reductions. The company is seeking to front-end load delivery of 2.8% efficiencies per annum targeted for K5. £8.4m, equal to 5.8% p.a. of operating cost efficiencies were delivered in 2010/11. This is being achieved through:

- changing operational ways of working
- right-sourcing and innovative contracting arrangements
- energy procurement and reduced energy usage
- rationalisation of administration and support services.

Despite the continuing difficulties in the property market, profit on property disposals in the year contributed £1.6m (2009/10: £1.0m).

The pension cost charged to the profit & loss account is lower than Final Determination figures due to the adoption of FRS17 in the regulatory accounts. The FRS17 charge does not include deficit contribution payments which are recognised through reserves rather than through the profit and loss account, in line with accounting standards. The difference was £6.9m in the year. Payments to the pension scheme in 2010/11 included £16.6m in respect of deficit recovery payments. During the year the actuarial valuation at 31 March 2010 was concluded, with the resulting schedule of payments agreed between the company and the pension fund trustees.

The charge for bad and doubtful debts increased in the year by £0.8m from £12.6m to £13.4m. During the year £7.2m (2009/10: £5.9m) of debts were written off against the provision, of which £1.0m (2009/10: £0.9m) related to the Company's Restart programme, a customer affordability initiative.

There have been no changes of policy in respect of current cost depreciation and the infrastructure renewals charge. In accordance with regulatory accounting guidelines the current cost revaluation of fixed assets undertaken as at 31 March 2008 (and reflected in the 2009 Final Determination) has been incorporated into the 2010/11 results. The current cost depreciation charge at £92.5m is lower than the prior year by £3.9m, reflecting revisions to estimated remaining asset lives included within the full revaluation at 31 March 2008.

The infrastructure renewals charge is in line with the average of the past 5 years and projections for the next 10 years, consistent with projections used at Final Determination, as deemed appropriate by the Company and in line with regulatory accounting guidelines.

Investment

Capital expenditure in the year was £134.9m (including £25.6m of infrastructure renewals expenditure) compared to £152.1m in 2009/10.

£61.5m was invested in water supply improvements including water mains renovation and water treatment works enhancement.

Significant investments on filtration at Drift and Tottiford water treatment works and Lopwell raw water pumping station were made.

A mixture of mains rehabilitation, mains cleaning and distribution operational maintenance systems (DOMS) has delivered an output of 4.4 discoloured water contacts per 1,000 population against the Final Determination target for 2010/11 of 9 per 1,000 population. Process innovations have allowed us to already exceed the 2014/15 target of 7 per 1,000 population.

The flood resilience scheme at Pynes water treatment works has been delivered ahead of schedule and secures the supplies for c.32,000 properties from a 1:100 year flood return period, including the impact of forecast climate change.

OPERATING AND FINANCIAL REVIEW (continued)

This has been our 14th consecutive year without water restrictions and no water restrictions are envisaged in Summer 2011.

Capital investment in the year for the waste water business totalled £73.4m.

Delivery of schemes and lower numbers of new properties being added to the DG5 register meant that the number of 1 in 10 and 2 in 10 properties at risk from sewer flooding was 38 (2009/10: 47) compared to the 47 anticipated in the Final Determination.

Three studies into Integrated Urban Drainage Management have commenced in Truro, Torrington and Plymouth.

Additional sewer flooding outputs at Cowick Lane, Exeter and Rogues Roost, Liverton were completed as voluntary undertakings. Six odour control outputs advanced from future investment cycles were also completed in 2010/11 on this basis.

Targeted investment in capital maintenance programmes ensured that serviceability was assessed as 'stable' for all the company's areas of service.

Expenditure on PUROS (Phased Utilisation of Remote Operating Systems) was £4.0m. The PUROS programme is a key contributor to support the company's strategy of delivering Pure Water, Pure Service and Pure Environment by aiming to contribute sustainable cost reductions and better service through the delivery of:

- remotely managed networks and assets
- a flexible, mobile enabled, multi-skilled workforce
- central control of people, assets and information.

Benefits are achieved through the prioritisation of responses, improving field staff productivity, and improving the quality and consistency of telemetry and other data.

Taxation

The overall tax charge for the appointed business for the year increased by £3.7m from £18.6m to £22.3m.

Within the tax charge the current corporation tax charge decreased by £6.9m, from £30.4m to £23.5m, the main reasons for the decrease being the release of corporation tax provisions no longer required.

The charge for deferred tax was increased by £10.6m from a credit of £11.8m in 2009/10 to a credit of £1.2m in 2010/11. The main reason is the effect of the change in rate of corporation tax for future years.

Financing

Net interest payable decreased by £3.2m from £64.1m to £60.9m. The Company gained from favourable movements on LIBOR and swaps compared to the previous year, net of higher interest charges on the index linked-bond due to higher RPI, and interest receivable on cash deposits was lower due to lower interest rates prevailing.

There was a marginal decrease in net debt from £1,547.2m to £1,542.8m. The inflow is largely attributable to lower capital expenditure and interest payable offset by additional tax payments and pension contributions in the period.

Pennon Group and the Company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year.

OPERATING AND FINANCIAL REVIEW (continued)

The Treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintain reasonable headroom for contingencies and manage interest rate risk. It operates within policies approved by the Board and does not undertake any speculative trading activity.

Funding facilities are in place to cover both medium and long term requirements, including loans from the European Investment Bank. In addition, short term facilities exist with a range of financial institutions.

Short term facilities in place at 31 March 2011 and not utilised totalled £120.0m (2010: £110.0m). In addition the company has short-term uncommitted bank facilities of £60.0m (2010: £60.0m).

Derivatives, usually interest rate swaps, are used to manage the mix of fixed and floating rate debt, following the Pennon Group treasury policy that at least 50% of South West Water's debt is fixed for a regulatory period. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and do not, therefore, constitute an exposure for the Company.

The balance sheet value of net derivative liabilities moved from £17.7m to £17.4m at 31 March 2011. The movement is taken to reserves through the Statement of Total Recognised Gains and Losses.

South West Water has approximately 24% of its debt index-linked.

South West Water has entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on Regulatory Capital Value) and interest cover.

Redemption penalties included in the facility documentation can be invoked if debt facilities are redeemed early. The redemption penalties vary in each facility.

The financial covenants included in the Company's debt facilities are monitored on a regular basis. The financial covenants accepted by the Company include a provision to re-test the covenants applying frozen GAAP accounting standards. This is to protect the Company from changes in accounting standards that may have a detrimental impact on the financial covenant testing methodology.

South West Water's debt to Regulatory Capital Value (RCV) was 57.1% at 31 March 2011 (2009/10: 60.6%), within Ofwat's 'optimum range' of 55% - 65%.

The Board regularly monitors the Company's expected financial requirements for the next 12 months. These will be met from existing cash balances, loan facilities and cash flows for the coming year.

The Company has considerable financial resources and operates in a relatively stable, regulated business environment. Consequently the Directors believe that the Company is well positioned to manage its business risks successfully despite the current economic conditions.

Dividends and reserves

Dividends totalling £58.4m (2010: £54.4m) were paid to the parent undertaking, representing a base dividend for 2010/11. The dividend was calculated with reference to the projections in the 2009 Final Determination.

The Company has established a dividend policy, which involves the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholder's investment and the cost of capital
- a further level of growth funded by efficiency out-performance
- consistency with the assumptions made by Ofwat in setting prices for the K5 period.

OPERATING AND FINANCIAL REVIEW (continued)

Dividend payments are designed to ensure that key financial ratios are not prejudiced and that the ability of the Appointee to finance its appointed business is not impaired.

FUTURE DEVELOPMENTS

A key factor affecting the Company's performance for K5 is the 2009 Periodic Review completed in November 2009 when Ofwat set water company charges for the years 2010-2015 giving ‘K’ price increases of 1.1%, 3.4%, 2.5%, 1.3% and 1.1% for 2010-2015 (an average of 1.9% p.a. over the five years). It also determined the investment outputs to be delivered by the Company over this period.

Key points of the 2009 Final Determination are as follows:

- a cost of capital of 4.5% (real, post tax basis) applicable to the whole industry
- ‘K’ price increases (above RPI inflation) averaging 1.9% per annum over the five years
- a capital programme of around £705m at 2007/08 prices
- a Capital Incentive Scheme (CIS) score of 105 (water) and 110 (sewerage), in line with the industry average
- operating efficiency improvements of 2.8% per annum, comparable with K4 delivery
- over the period 2010-2015 average bills decreasing by 1% before inflation
- capital investment priorities, including protection and maintenance of the improvements made over the last 20 years, further improvements to meet EU Directives and their corresponding UK legislation, achievement of operating cost savings and delivery of projects to increase our levels of renewable energy generation and to improve sustainability of the Company’s activities.

Regulations laid before Parliament to allow for the transfer of private sewers and lateral drains will come into effect from 1 October 2011. South West Water has operational plans in place to manage the transfer. A procurement process with suppliers to deliver the service to customers is under way. Incremental operating and capital costs efficiently incurred will be funded by future adjustments to price limits.

As demonstrated by the financial and operational results outlined for 2010/11 the company has embraced the challenges above and is well placed to continue to do so in the future.

Focus for K5

The focus for K5 is to continue to strike the right balance for investors, customers and other stakeholders. The company has already delivered substantial efficiencies over the last two decades and will continue to focus on delivering further efficiency whilst satisfying its regulatory demands and improving services to its customers.

The South West Water strategy:

- targets outperformance of the regulatory contract
- continues to rigorously control costs
- delivers investment through increased capital maintenance that will secure operating cost savings and protect the service improvements made over the last 20 years whilst preparing for future increased investment requirements.

DIRECTORS' RESPONSIBILITY STATEMENT FOR THE REGULATORY ACCOUNTS

Statement of directors' responsibilities for regulatory information

Further to the requirements of company law, the Directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat.

This additionally requires the directors to:

- confirm that, in their opinion, the company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months
- confirm that, in their opinion, the company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the company
- confirm that, in their opinion, the company has contracts with any associate company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the company's obligations as a water and sewerage undertaker
- report to Ofwat changes in the company's activities which may be material in relation to the company's ability to finance its regulated activities
- undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length and
- keep proper accounting records which comply with Condition F.

These responsibilities are additional to those already set out in the statutory financial statements.

In the case of each of the persons who are directors at the time when the report is approved under Section 418 of the Companies Act 2006 the following applies:

a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

b) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

DIRECTORS' CERTIFICATES TO THE WATER SERVICES REGULATION AUTHORITY

LICENCE OF APPOINTMENT - STATEMENT RELATING TO CONDITION K

At 31 March 2011 the Company had sufficient rights and assets to comply with the requirements of paragraph 3.1 of Condition K of the Licence from the Secretary of State for the Environment.

LICENCE OF APPOINTMENT - STATEMENT RELATING TO CONDITION F

The Board of Directors of South West Water Limited has resolved that a Certificate be issued to the Water Services Regulation Authority confirming:-

(1) that in the opinion of the Directors, the Company 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 the Company's obligations under the Appointment); and

(2) that in the opinion of the Directors, the Company 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.

In making this declaration, the Directors have taken into account:-

- the net worth of the company and the strength of key performance indicators as shown in the audited accounts for the year ended 31 March 2011 and the company's business plan for 2011/12 and the remaining K period
- borrowing facilities which include significant committed undrawn bank facilities
- parental support provided by the holding company which will provide financial support to the company to enable it to meet its liabilities as they fall due
- the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners
- the company's employment policies and strategy.

The Directors also declare that in their opinion all contracts entered into with any Associated Company, include all necessary provisions and requirements concerning the standard of service to be supplied to the company to ensure that it is able to meet all its obligations as a water and sewerage undertaker, as required in Section 6A.2A(3) of Condition F of the Instrument of Appointment. This opinion has been formed following examination of the documents in question

C Loughlin
Chief Executive

10 June 2011

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY (THE AUTHORITY, REFERED TO AS THE "WRSA") AND THE DIRECTORS OF SOUTH WEST WATER LIMITED

We have audited the regulatory accounts of South West Water Limited ("the Company") for the year ended 31 March 2011 on pages 28 to 85 (the "Regulatory Accounts") which comprise:

- the regulatory historical cost accounting statements, comprising the historical cost profit and loss account, the historical cost balance sheet, the historical cost cash flow statement, the historical cost statement of total recognised gains and losses and the reconciliation between statutory accounts and the historical cost Regulatory Accounts and the related notes; and

- 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 including the Statement of Accounting Policies.

These Regulatory Accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the Statement of Accounting Policies.

This report is made, on terms that have been agreed, solely to the Company and 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 and sewage undertaker under the Water Industry Act 1991 ("Condition F"). 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 Condition F 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 WRSA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the WSRA, the Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 23, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Regulatory Accounts

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts sufficient to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Regulatory Accounts. In addition, we read all the financial and non-financial information in the Regulatory Accounts to identify material inconsistencies with the audited Regulatory Accounts. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY(THE AUTHORITY, REFERED TO AS THE "WRSA") AND THE DIRECTORS OF SOUTH WEST WATER LIMITED (continued)

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, 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 International Standards on Auditing (UK & Ireland).

Opinion on Regulatory Accounts

In our opinion the Regulatory Accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 33, the state of the Company's affairs at 31 March 2011 on an historical cost and current cost basis, and its historical cost and current cost profit and its historical cost and current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies.

Basis of preparation

Without modifying our opinion, we draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Condition F, 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 and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP") or International Financial Reporting Standards as adopted by the European Union ("IFRS"). Financial information other than that prepared on the basis of UK GAAP/IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on page 28 and 64 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 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 disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 65.

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts.

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY (THE AUTHORITY, REFERED TO AS THE "WRSA") AND THE DIRECTORS OF SOUTH WEST WATER LIMITED (continued)

Other matters

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 WRSA's purposes. Accordingly we make no such assessment.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2011 on which we reported on 24 June 2011, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol

10 June 2011

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2011

	Notes	**Total 2011 £m**	Total 2010 £m
Turnover	1(b) & 2	**450.7**	446.0
Operating costs	3	**(189.7)**	(185.1)
Depreciation	4	**(75.3)**	(72.9)
Profit on disposal of fixed assets		**1.6**	1.0
Operating Profit		**187.3**	189.0
Other income		**0.6**	0.8
Net interest payable	5	**(60.9)**	(64.1)
Profit on Ordinary Activities Before Taxation		**127.0**	125.7
Tax on profit on ordinary activities	6	**(22.5)**	(18.9)
Profit on Ordinary Activities After Taxation		**104.5**	106.8
Dividends	7	**(58.4)**	(54.4)
Retained profit for financial year		**46.1**	52.4

HISTORICAL COST STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES for the year ended 31 March 2011

	Notes	**2011 £m**	2010 £m
Profit on Ordinary Activities After Taxation		**104.5**	106.8
Actuarial gain/(loss) recognised in the pension scheme	22	**0.3**	(32.8)
Movement on deferred tax relating to pension scheme	25	**(1.7)**	9.2
Movement on hedging reserve	25	**0.2**	(1.2)
Total gains recognised since last annual report		**103.3**	**82.0**

The notes on pages 33 to 64 form part of these historical cost regulatory accounts.

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2011 (continued)

Analysis of historical cost financial information between appointed and non-appointed business

	Appointed Business £m	Non-appointed £m	2011 Total £m	Appointed Business £m	Non-appointed £m	2010 Total £m
Turnover	**444.3**	**6.4**	**450.7**	438.6	7.4	446.0
Operating costs	**(184.3)**	**(5.3)**	**(189.6)**	(178.8)	(6.3)	(185.1)
Depreciation	**(74.7)**	**(0.7)**	**(75.4)**	(72.3)	(0.6)	(72.9)
Operating income	**1.6**	**-**	**1.6**	1.0	-	1.0
Operating Profit	**186.9**	**0.4**	**187.3**	188.5	0.5	189.0
Other income	**0.4**	**0.2**	**0.6**	0.3	0.5	0.8
Net interest payable	**(60.9)**	**-**	**(60.9)**	(64.1)	-	(64.1)
Profit on Ordinary Activities Before Taxation	**126.4**	**0.6**	**127.0**	124.7	1.0	125.7
Tax on profit on ordinary Activities	**(22.3)**	**(0.2)**	**(22.5)**	(18.6)	(0.3)	(18.9)
Profit on Ordinary Activities After Taxation	**104.1**	**0.4**	**104.5**	106.1	0.7	106.8
Dividends	**(58.4)**	**-**	**(58.4)**	(54.4)	-	(54.4)
Retained profit / (loss) for year	**45.7**	**0.4**	**46.1**	51.7	0.7	52.4

The “Appointed Business” comprises those activities which are necessary for the Company to fulfil its function and duties as a water and sewerage undertaker.

The notes on pages 33 to 64 form part of these historical cost regulatory accounts.

HISTORICAL COST BALANCE SHEET
at 31 March 2011

	Notes	2011 £m	2010 £m
Fixed Assets			
Tangible assets	11	**2,428.0**	2,401.3
Investments	12	**3.4**	3.4
		2,431.4	2,404.7
Current Assets			
Derivative financial instruments	19	**0.3**	-
Stocks	13	**3.3**	3.5
Debtors	14	**90.4**	71.0
Investments	15	**301.5**	264.8
Cash at bank and in hand		**0.2**	0.1
Infrastructure renewals prepayment		**4.7**	8.9
		400.4	348.3
Current Liabilities			
Creditors: amount falling due within one year	16	**(202.6)**	(280.9)
Derivative financial instruments	19	**(17.7)**	(17.7)
Net Current Assets		**180.1**	49.7
Total Assets Less Current Liabilities		**2,611.5**	2,454.4
Creditors: amounts falling due after more than one year	17	**(1,784.1)**	(1,656.8)
Provisions for liabilities	20	**(78.6)**	(84.4)
Deferred income	21	**(12.9)**	(14.0)
Net Assets Excluding Pension Liability		**735.9**	699.2
Pension Liability	22	**(50.4)**	(60.0)
Net Assets Including Pension Liability		**685.5**	639.2
Capital and Reserves			
Called-up share capital	23	**150.9**	150.9
Reserves	25	**534.6**	488.3
Capital and Reserves	26	**685.5**	639.2

The notes on pages 33 to 64 form part of these historical cost regulatory accounts.

The historical cost regulatory accounts on pages 28 to 64 were approved by the Board on 10 June 2011 and signed on its behalf by:-

C Loughlin
Chief Executive

S Davy
Finance & Regulatory Director

SOUTH WEST WATER

HISTORICAL COST BALANCE SHEET
at 31 March 2011 (continued)

Analysis of historical cost financial information between appointed and non-appointed business

	Appointed Business £m	**Non-appointed £m**	**2011 Total £m**	Appointed Business £m	Non-appointed £m	2010 Total £m
Fixed Assets						
Tangible assets	**2,428.0**	**-**	**2,428.0**	2,401.3	-	2,401.3
Investments	**3.4**	**-**	**3.4**	3.4	-	3.4
	2,431.4	**-**	**2,431.4**	2,404.7	-	2,404.7
Current Assets						
Derivative financial instruments	**0.3**	**-**	**0.3**	-	-	0.0
Stocks	**3.3**	**-**	**3.3**	3.5	-	3.5
Debtors	**89.3**	**1.1**	**90.4**	69.7	1.3	71.0
Investments	**301.5**	**-**	**301.5**	264.8	-	264.8
Cash at bank and in hand	**-**	**5.6**	**5.6**	-	5.1	5.1
Infrastructure renewals prepayment	**4.7**	**-**	**4.7**	8.9	-	8.9
	399.1	**6.7**	**405.8**	346.9	6.4	353.3
Current Liabilities						
Creditors: amount falling due within one year	**(207.6)**	**(0.4)**	**(208.0)**	(285.4)	(0.5)	(285.9)
Derivative financial intruments	**(17.7)**	**-**	**(17.7)**	(17.7)	-	(17.7)
Net Current Assets	**173.8**	**6.3**	**180.1**	43.8	5.9	49.7
Total Assets Less Current Liabilities	**2,605.2**	**6.3**	**2,611.5**	2,448.5	5.9	2,454.4
Creditors: amount falling due after more than one year	**(1,784.1)**	**-**	**(1,784.1)**	(1,656.8)	-	(1,656.8)
Provisions for liabilities and charges	**(78.6)**	**-**	**(78.6)**	(84.4)	-	(84.4)
Deferred income	**(12.9)**	**-**	**(12.9)**	(14.0)	-	(14.0)
Net Assets Excluding Pension Liability	**729.6**	**6.3**	**735.9**	693.3	5.9	699.2
Pension Liability	**(50.4)**	**-**	**(50.4)**	(60.0)	-	(60.0)
Net Assets Including Pension Liability	**679.2**	**6.3**	**685.5**	633.3	5.9	639.2
Capital and Reserves						
Called-up share capital	**150.9**	**-**	**150.9**	150.9	-	150.9
Profit and loss account	**528.3**	**6.3**	**534.6**	482.4	5.9	488.3
Capital and Reserves	**679.2**	**6.3**	**685.5**	633.3	5.9	639.2

SOUTH WEST WATER

HISTORICAL COST CASH FLOW STATEMENT
for the year ended 31 March 2011

	Notes	**2011 £m**	2010 £m
Net Cash Inflow from Operating Activities	28a	**273.1**	284.9
Returns on Investments and Servicing of Finance	28b	**(52.9)**	(56.4)
Taxation		**(30.6)**	(1.3)
Capital Expenditure and Financial Investment	28b	**(121.5)**	(149.3)
Equity Dividends paid		**(58.4)**	(54.4)
Cash inflow Before Use of Liquid Resources and Financing		**9.7**	23.5
Management of Liquid Resources	28b	**(45.0)**	20.0
Financing	28b	**(25.3)**	(27.2)
(Decrease)/Increase in Cash in Year	28c	**(60.6)**	16.3

The notes on pages 33 to 64 form part of these historical cost regulatory accounts.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1. **Accounting Policies for the year ended 31 March 2011**

These financial statements are “regulatory accounts” prepared in accordance with guidance issued by the Water Services Regulation Authority (Ofwat). They have been prepared under the historical cost convention, as modified by the revaluation of certain financial instruments, and in accordance with applicable accounting standards in the UK except for the dis-application of certain parts of FRS 12 and FRS 15 in relation to infrastructure renewals accounting as described below in note 1(c)(i) and, except for the treatment of grants and contributions on infrastructure assets, with the Companies Act 2006. An explanation of this departure from the requirements of the Companies Act 2006 is given in note 1(e) below. A summary of the more important accounting policies is set out below, together with an explanation of where changes have been made to previous policies on the adoption of new accounting standards in the year.

These financial statements were approved by the Board of Directors on 10 June 2011.

Changes in accounting policies

There have been no changes in accounting policy during the year.

(a) **Consolidated financial statements**

The Company is exempt under the provisions of Section 400 of the Companies Act 2006 from the requirement to produce group financial statements as it is a wholly-owned subsidiary undertaking of Pennon Group Plc which is registered within the European Economic Area and which itself prepares consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

(b) **Turnover**

Turnover comprises charges to customers for water, sewerage and other services excluding value added tax and is derived only from the United Kingdom.

Turnover is not recognised until the service has been provided to the customer.

Turnover relates to charges due in the year, excluding any amounts paid in advance. Turnover for measured charges includes amounts billed plus an estimation of the amounts unbilled at the year end. The accrual for unbilled charges is estimated using a defined methodology reflecting historical consumption, estimated demand trends and current tariffs. Turnover for unmeasured charges is recognised on a time apportioned basis.

Turnover is only recognised when the occupiers name is known. New properties are recognised when reported as connected. Unoccupied properties are identified through physical inspection, mailings and customer contacts. These properties are given a void status within the billing system and turnover is not recognised against these properties.

Charges on income relating to debt recovery costs, which are chargable to customers, are credited to operating costs and charged to the relevant customer account. Turnover is unaffected by these debt recovery costs.

The accounting policy within the statutory accounts recognises infrastructure charges relating to new customers as turnover; however these charges are credited to fixed assets in accordance with the regulatory accounting guidelines.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1. **Accounting Policies (continued)**

(c) **Tangible fixed assets and depreciation**

Tangible fixed assets comprise:-

(i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, pipelines and sea outfalls)

Infrastructure assets comprise a network that, as a whole, is intended to be maintained in perpetuity at a specified level of service by the continuing replacement and refurbishment of its components.

Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network, in accordance with defined standards of service, and to the maintenance of the operating capacity of the network, is treated as capital expenditure on tangible fixed assets and included at cost after deducting grants and contributions.

The infrastructure renewals charge represents the level of annual expenditure required to maintain the operating capacity of the network and is calculated from an independently certified asset management plan. In accordance with Regulatory Accounting Guidelines, the relevant sections of FRS 12 and FRS 15 have been dis-applied in relation to infrastructure renewals accounting, resulting in any cumulative difference between infrastructure renewals charges and actual infrastructure renewals expenditure is held as a prepayment or accrual in the balance sheet.

(ii) other assets (including properties, overground plant and equipment)

Other assets are stated at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:-

Buildings	30 – 60 years
Operational properties	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	4 – 10 years

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

(d) **Leased assets**

Assets held under finance leases are included in the balance sheet as tangible fixed assets at their equivalent capital value and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as a creditor. The interest element of the rental cost is charged against profits, using the actuarial method, over the period of the lease.

Rental costs arising under operating leases are charged against profits in the year they are incurred.

(e) **Grants and contributions**

Grants and contributions receivable in respect of capital expenditure on non-infrastructure assets are included in the balance sheet as deferred income and are released to profits over the depreciable lives of the assets to which they relate.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1. **Accounting Policies (continued)**

(e) **Grants and contributions (continued)**

Grants and contributions receivable relating to infrastructure assets are deducted from the cost of tangible fixed assets. This is not in accordance with the Companies Act 2006 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 2006 is, in the opinion of the Directors, necessary for the financial statements to show a true and fair view as, while a provision is made for depreciation of infrastructure assets, these assets do not have determinable finite lives and therefore no basis exists on which to recognise grants and contributions as deferred income. The effect of this treatment on the value of tangible fixed assets is disclosed in note 11.

Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the profit and loss account.

(f) **Investments**

Listed investments held as current assets are stated at the lower of cost and net realisable value.

Short-dated unlisted securities held as current assets are stated at cost plus accrued income.

(g) **Stocks**

Stocks are stated at the lower of cost and net realisable value.

(h) **Cash and cash deposits**

Cash and cash deposits comprise cash in hand, short-term deposits held at banks and other short-term highly liquid deposits subject to insignificant risk of changes in value. Bank overdrafts are shown within current borrowings.

(i) **Pension costs**

The company operates defined benefit and defined contribution pension schemes through its parent company.

Defined benefit pension scheme assets are measured using bid price. Defined benefit pension scheme liabilities are measured by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term to the liability. The increase in the present value of the liabilities of the Company's defined benefit pension schemes expected to arise from employee service in the period is charged to operating profit. The expected return on scheme assets and the increase during the period in the present value of scheme liabilities, arising from the passage of time, are included in other finance income or cost. Past-service costs are recognised immediately in the profit and loss account.

Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to reserves and recorded in the Statement of Total Recognised Gains and Losses.

Costs of the defined contribution pension scheme are charged to the profit and loss account in the period in which they arise.

1. **Accounting Policies (continued)**

(j) **Share based payments**

The Company operates a number of equity settled, share-based compensation plans for employees. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant.

Fair values are calculated using an appropriate pricing model. Non-market based vesting conditions are adjusted for assumptions as to the number of awards which are expected to vest.

(k) **Research and Development Expenditure**

Research and development expenditure is charged against profits in the year in which it is incurred.

(l) **Taxation**

The tax charge for the year is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date.

Deferred tax is provided in full using the liability method on temporary differences between the tax basis of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future for it to be utilised.

The Company corporation tax provision of £45m reflects managements estimation of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed with Her Majesty's Revenue and Customs.

(m) **Dividend distributions**

Dividend distributions are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when paid; final dividends when authorised in general meeting by shareholders.

(n) **Derivatives and other financial instruments**

The Company classifies its financial instruments in the following categories.

i) Loans and receivables
All loans and borrowings are initially recognised at cost, being the net fair value of the consideration received. Following initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost.

Gains and losses are recognised in the profit and loss account when the liabilities are derecognised or impaired. Premiums, discounts and other costs and fees are recognised in the profit and loss account through the amortisation process.

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1. **Accounting Policies (continued)**

(n) **Derivatives and other financial instruments (continued)**

ii) Derivative financial instruments

The Company uses derivative financial instruments, principally interest rate swaps, to hedge its risks associated with interest rate fluctuations. Such derivative instruments are initially recorded at cost and subsequently re-measured at fair value for the reported balance sheet.

The gain and loss on re-measurement is taken to the profit and loss account except for cash flow hedges that meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in reserves, and the ineffective portion in the profit and loss account. The gains or losses deferred in reserves in this way are subsequently recognised in the profit and loss account in the same period in which the hedged underlying transaction or firm commitment is recognised in the profit and loss account.

In order to qualify for hedge accounting, the Company is required to document in advance the relationship between the item being hedged and the hedging instrument. The Company is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is re-performed at the end of each reporting period to ensure that the hedge remains highly effective.

(iii) Trade debtors

Trade debtors do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts and the impact of discounting. The allowance for estimated irrecoverable amounts is calculated by applying expected recovery rates to debts outstanding at the end of the accounting period. The expected recovery rates take into account age of the debt, payment history and credit characteristics.

(iv) Trade creditors

Trade creditors are not interest bearing and are stated at their nominal value.

(o) **Fair value estimate**

The fair value of the interest rate swaps is based on the market price of comparable instruments at the balance sheet date if they are publicly traded.

2. **Segmental analysis**

The Directors believe that the whole of the Company's activities constitute a single class of business.

The Company's turnover is wholly generated from within the United Kingdom.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

3. **Operating Costs**

	2011 £m	2010 £m
Manpower costs (note 8)	**40.1**	36.8
Raw materials and consumables	**14.0**	13.8
Rentals under operating leases:-		
Hire of plant and machinery	**1.1**	0.8
Other operating leases	**1.5**	1.4
Research and development expenditure	**0.2**	0.2
Auditors' remuneration	**0.3**	0.2
Other external charges	**85.0**	87.3
Infrastructure renewals charge	**29.7**	28.1
Other operating charges	**17.8**	16.5
	189.7	185.1

Fees payable to the Group's auditors in the year were as follows:-

	2011 £000	2010 £000
Audit services	**120**	108
Audit-related regulatory reporting	**28**	28
Other services	**120**	79
	268	215

Expenses reimbursed to the auditors in relation to the audit of the Company were £14,000 (2010: £14,000).

4 **Depreciation**

	2011 £m	2010 £m
On owned non-infrastructure assets	**55.7**	52.1
On non-infrastructure assets held under finance leases	**20.8**	22.1
	76.5	74.2
Deferred income released to profits	**(1.2)**	(1.3)
	75.3	72.9

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

5. Net Interest Payable

	2011 **£m**	2010 £m
Interest payable:-		
To subsidiary company	**(22.1)**	(10.8)
Bank loans and overdrafts	**(10.2)**	(10.9)
Interest element of finance lease rentals	**(29.4)**	(44.7)
Other finance charges – pension cost (see note 22)	**(19.1)**	(17.5)
Other finance charges	**(2.7)**	-
	(83.5)	(83.9)
Interest receivable:-		
From subsidiary company	**0.1**	0.1
Expected return on pension scheme assets (see note 22)	**19.3**	15.0
Other finance income	**-**	0.7
Other investments (as defined in note 15)	**3.2**	4.0
	22.6	19.8
Net interest payable	**(60.9)**	(64.1)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

6. Tax on Profit on Ordinary Activities

(a) Analysis of charge for year	**2011 £m**	2010 £m
Current tax :		
UK corporation tax at 28% (2010: 28%) :-		
Current year	**35.5**	33.5
Prior year	**(11.8)**	(2.7)
Amounts receivable from Pennon Group companies in respect of surrender of taxable losses and advance corporation tax	**-**	(0.1)
Total current tax (note 6(b))	**23.7**	30.7
Deferred tax :		
Origination and reversal of timing differences	**4.4**	0.1
Increase in discount	**0.2**	(11.9)
Effect of change of rate of corporation tax in future years	**(5.8)**	-
Total deferred tax charged to profit & loss in year (note 20)	**(1.2)**	(11.8)
Tax on profit on ordinary activities	**22.5**	18.9

(b) Factors affecting current tax charge for the year	**2011 £m**	2010 £m
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 28% (2010: 28%)		
The differences are explained below:		
Profit on ordinary activities before tax	**127.0**	125.7
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2010: 28%)	**35.6**	35.2
Tax effects of:		
Expenses not deductible for tax purposes	**0.7**	0.5
Income not charged to profits	**0.8**	0.5
Capital allowances for year in excess of depreciation	**(1.1)**	(3.1)
Other timing differences	**(0.5)**	0.3
Adjustments to tax charge in respect of prior year	**(11.8)**	(2.7)
Current tax charge for the year (note 6(a))	**23.7**	30.7

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

7. Dividends

	2011 £m	2010 £m
Base dividend of 36.04p per share in respect of 2009/10 paid 13 November 2009	-	54.4
Base dividend of 38.69p per ordinary share in respect of 2010/11 paid 25 November 2010	58.4	-
	58.4	54.4

8. Employees and Employment Costs

The average number of persons (including Directors) employed by the Company was:-

	2011 Number	2010 Number
Regulated water and sewerage activities	1,196	1,191

	2011 £m	2010 £m
Employment costs comprise:-		
Wages and salaries	35.0	33.7
Social security costs	2.7	2.7
Share-based payments	1.2	1.3
Pension costs	11.0	9.5
Total employment costs	49.9	47.2
Charged as follows:-		
Manpower costs (note 3)	40.1	36.8
Capital schemes	9.8	10.4
	49.9	47.2

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

9. **Directors' emoluments**	**2011**	2010
	£000	£000
Total emoluments of the Directors of the Company :		
Salary	**658**	611
Fees (non-executive Director)	**48**	3
Performance related	**252**	240
Other emoluments	**141**	132
Total emoluments	**1,099**	986

The performance related payment represents the cash element. In addition Directors receive a conditional award of shares in Pennon Group Plc for a matching amount which is subject to a future service criterion.

Performance related and other emoluments apply to Executive Directors only.

Other emoluments include car benefit and health care, and, in respect of the highest paid Director, a cash payment of 30% of his annual basic salary in lieu of any pension provision by the Company.

The emoluments of the highest paid Director were £506,000 (2010: £466,000).

At 31 March 2011 retirement benefits were accruing to 3 Directors (2010: 3 Directors) under defined benefit pension schemes operated by the parent company.

The highest paid Director did not participate in a company pension scheme.

The Chairman, K G Harvey, is a director of Pennon Group Plc and his remuneration is disclosed in the financial statements of that company.

Background

Directors of South West Water have their remuneration and terms of employment determined by the Remuneration Committee ('the Committee') of Pennon Group Plc, the ultimate holding company. Further details of the operation of this Committee can be found in the financial statements of Pennon Group Plc.

Elements of Remuneration

The remuneration of the Executive Directors comprises salary, payments related to performance against agreed standards, long term incentives, contributory pension provision or a cash alternative, car benefit and health cover.

Payments related to performance against agreed standards

As required by the Water Act 2003 and Regulatory Accounting Guidance from the Water Services Regulation Authority (Ofwat), additional information is given regarding this aspect of remuneration.

SOUTH WEST WATER

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

9. **Directors' emoluments (continued)**

C Loughlin (the highest paid Director) is an Executive Director of Pennon Group Plc and details of the performance related bonus arrangements for him and the amounts paid to him under those arrangements are described in the Directors' remuneration report within the Pennon Group Annual Report and Accounts.

In respect of the other Executive Directors, for the year 2010/11, maximum performance related bonus payments achievable in respect of service as executive directors of South West Water Limited are, expressed as a percentage of salary up to a maximum of 37.5%, as follows:

- I Based on an estimate of the Service Incentive Mechanism (SIM) points to be awarded by Ofwat for 2010/11 0.25% up to a maximum of 2.5% for each position above 10th for the water and sewerage companies. This reflects the importance South West Water attaches to customer service performance.
- ii Up to a maximum of 5% in relation to a series of discrete individual Director's targets for performance on Ofwat DG measures, pollution and waste water measures set by the Environment Agency, drinking water compliance and level of customer debt. Performance under each of these standards reflects customer and stakeholder measures.
- iii 0.5% bonus for each area of service achieving a 'stable' classification of serviceability to a maximum of 2%
- iv A bonus for outperformance of South West Water against its operating cost budget, the maximum bonus of 7.5% being achieved if outperformance is 3% or higher. Cost control and efficiency are key factors in South West Water's long term performance.
- v A bonus for outperformance of South West Water against its budget for profit before tax, the maximum bonus of 5.0% being achieved if outperformance is 5.0% or higher. Profit before tax is a key measure of performance.
- vi A bonus for capital expenditure being below budget, up to a maximum of 3% if expenditure is 2.5% below budget. Cost control and efficiency are key factors in South West Water's long term performance.
- vii A bonus of up to 2.5% if net debt is 1% below budget. Cash control is a key factor in South West Water's long term performance.
- viii Up to a maximum of 10% in relation to personal objectives set for each Director and focused on development and delivery of the Company's strategic objectives.

These arrangements were approved by the Remuneration Committee of Pennon Group Plc on 29 April 2010.

For 2010/11 no Director achieved the maximum bonus available of 37.5% of salary. The actual payments relating to performance against agreed standards amounted to:

	£000	% bonus achieved
S C Bird	48.4	32.73%
S J Davy	44.1	32.05%
M S Read	30.9	32.00%

As set out above, Executive Directors received a conditional award of shares in Pennon Group Plc for a matching value which is subject to future service criteria.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

9. **Directors' emoluments (continued)**

Awards made under the Pennon Group Performance and Co-investment Plan are linked to the Total Shareholder Return of the Pennon Group only. Further details are given in the financial statements of that company.

10. **Directors' Interests**

No Director has held any beneficial interest in the shares of the Company during the year. Messrs K G Harvey and C Loughlin are Directors of Pennon Group Plc and their interests in the shares of Pennon Group Plc are disclosed in the financial statements of that company.

The interests of the other Directors holding office at 31 March 2011 in the shares of Pennon Group Plc at 31 March 2011 and 31 March 2010 were:

(a) Shareholdings

	2011 Ordinary Shares (40.7p each)	2010 Ordinary Shares (40.7p each)
S C Bird	**17,828**	11,828
S J Davy	**11,351**	7,215
M S Read	**55,293**	53,861

(b) Share Incentive Plan

In addition, the Partnership shares held in Pennon Group Plc on behalf of the Directors under the Share Incentive Plan were:

	2011 Ordinary shares (40.7p each)	2010 Ordinary shares (40.7p each)
S J Davy	**905**	624
M S Read	**1,435**	1,133

(c) Sharesave scheme

Options to subscribe for shares in Pennon Group Plc under the all-employee Sharesave Scheme were:

	Options over Ordinary Shares of 40.7p each				
	31 March 2011	Granted in Period	Exercised in Period	Lapsed In Period	31 March 2010
S C Bird	**2,351**	-	-	-	2,351
S J Davy	**2,351**	-	-	-	2,351
M S Read	**3,850**	1,433	2,448	-	4,865

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

10. **Directors' Interests (continued)**

(d) Incentive Bonus Plan

The Directors also had a contingent interest in the shares of Pennon Group Plc under the terms of the Pennon Group Incentive Bonus Plan, described in note 24, as follows :

	Contingent interest in Ordinary Shares of 40.7p each				
	31 March 2011	Granted in Period	Vested in Period	Lapsed In Period	31 March 2010
S C Bird	**21,789**	7,548	-	-	14,241
M S Read	**13,298**	4,444	-	-	8,854
S J Davy	**16,286**	6,558	-	-	9,728

The above represent the maximum number of shares to which the Directors would usually become entitled if they remain employed by the Pennon Group for a further three years from the date of the awards.

This bonus plan operates in conjunction with a Executive Share Option Scheme (ESOS) which means that if the service condition is met, shares awarded under the Incentive Bonus Plan may be forfeited by Directors up to a certain value and instead taken through the ESOS. The aggregate pre-tax value of the awards made under the Incentive Bonus Plan and the ESOS are the same as if they would have been if the Incentive Bonus Plan had operated alone.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Incentive Bonus Plan. A further conditional award of shares will be made in 2011/12 to match the amount of the cash bonus shown in note 9.

(e) Performance and Co-investment Plan

In addition to the above beneficial interests, the Directors had a conditional interest in the shares of Pennon Group Plc under the terms of the Pennon Group Performance and Co-investment Plan, described in note 24, as follows :

	Conditional interest in Ordinary Shares of 40.7p each				
	31 March 2011	Granted in Period	Vested in Period	Lapsed In Period	31 March 2010
S C Bird	**62,708**	21,684	14,648	4,741	60,413
M S Read	**40,936**	14,147	9,549	3,090	39,428
S J Davy	**55,256**	20,146	-	-	35,110

Additional ordinary shares (40.7p each) have been acquired by the Directors since 31 March 2011 as follows as a result of participation in the Pennon Group's Dividend Re-investment plan or the Pennon Group's Share Incentive Plan:

M S Read 286 S J Davy 48

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

11. **Tangible Fixed Assets**

	Freehold land and buildings	Infra-structure assets	Operational properties	Fixed & mobile plant, vehicles and computers	Construc-tion in progress	**Total**
	£m	£m	£m	£m	£m	**£m**
Cost:-						
At 1 April 2010	20.4	1,282.7	627.2	1,114.5	84.8	**3,129.6**
Additions	0.1	13.2	0.3	29.0	66.7	**109.3**
Grants and contributions	-	(4.5)	-	-	-	**(4.5)**
Transfers / reclassifications	0.9	7.1	11.3	30.1	(49.5)	**(0.1)**
Disposals	(0.1)	-	(4.4)	(52.3)	-	**(56.8)**
At 31 March 2011	**21.3**	**1,298.5**	**634.4**	**1,121.3**	**102.0**	**3,177.5**
Depreciation:-						
At 1 April 2010	4.5	-	171.4	552.4	-	**728.3**
Charge for year	0.4	-	11.3	66.1	-	**77.8**
Disposals	(0.1)	-	(4.4)	(52.1)	-	**(56.6)**
At 31 March 2011	**4.8**	**-**	**178.3**	**566.4**	**-**	**749.5**
Net Book Value:-						
At 31 March 2011	**16.5**	**1,298.5**	**456.1**	**554.9**	**102.0**	**2,428.0**
At 31 March 2010	15.9	1,282.7	455.8	562.1	84.8	2,401.3

Out of the total depreciation charge for the Company of £77.8m (2010: £75.5m), the sum of £1.3m (2010: £1.3m) has been charged to capital projects, and £76.5m (2010: £74.2m) against profits.

SOUTH WEST WATER

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

11. **Tangible Fixed Assets (continued)**

Assets held under finance leases included above:-

	Infra-structure assets	Opera-tional properties	Fixed & mobile plant, vehicles and computers	Construction in progress	**Total**
	£m	£m	£m	£m	**£m**
Cost:- At 31 March 2011	368.0	465.0	301.2	0.6	**1,134.8**
Depreciation:- Charge for year	-	7.8	13.0	-	**20.8**
Depreciation:- At 31 March 2011	-	89.2	154.4	-	**243.6**

12. **Fixed Asset Investments**

	Joint Venture £m	Subsidiary Undertakings £m	**Total Investments £m**
At 1 April 2010 and 31 March 2011	0.1	3.3	**3.4**

The Company holds 99,999 (100%) A ordinary shares in Echo South West Limited, a joint venture engaged in customer contact management, established between the Company and Echo Managed Services Limited, a subsidiary of South Staffordshire Group Plc. The proportion of the nominal value of ordinary shares held by the Company remains at 50%. The joint venture in Echo South West Limited ceased operations on 31 March 2008.

The Company has four wholly-owned subsidiaries, Peninsula Properties (Exeter) Limited, Peninsula Leasing Limited, South West Water Finance Plc and Source Collections Limited (formerly Haldon Collections Limited). All companies are incorporated, registered and have their operation in England.

Consolidated financial statements have not been prepared, as explained in note 1(a).

In the opinion of the Directors the total value of investments in subsidiary and joint venture undertakings is not less than the amount at which they are shown in the balance sheet.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

13. **Stocks**

	2011 **£m**	2010 £m
Raw materials and consumables	**3.3**	3.5

14. **Debtors**

	2011 **£m**	2010 £m
Amounts falling due within one year:-		
Trade debtors	**88.0**	80.7
Less: provision for bad debts	**(57.5)**	(51.3)
	30.5	29.4
Amounts owed by subsidiary companies	**3.8**	2.8
Amounts owed by parent undertaking	**0.6**	1.0
Other debtors	**14.8**	6.5
Prepayments and accrued income	**40.7**	31.3
	90.4	71.0

The effective interest rate on loans to subsidiary companies is 2.0% (2010: 4.7%). No interest is charged on trading balances with other group companies.

15. **Current Asset Investments**

	2011 **£m**	2010 £m
Other investments:		
Overnight deposits	**26.0**	81.4
Other short-term deposits	**195.3**	150.2
Other deposits	**80.2**	33.2
	301.5	264.8

Other deposits include £80.2m (2010: £33.2m) of restricted funds to settle long-term liabilities (note 18).

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

16. **Creditors: Amounts Falling Due Within One Year**

	2011 **£m**	2010 £m
Loans: (note 18)		
European Investment Bank loans	**21.1**	14.1
Loan from subsidiary company	**-**	100.0
Bank loans and overdrafts	**23.0**	17.3
	44.1	131.4
Obligations under finance leases (note 18)	**16.3**	23.9
Trade creditors	**17.1**	14.8
Capital creditors	**39.5**	33.8
Amounts owed to subsidiary companies	**17.6**	2.9
Amounts owed to fellow subsidiary undertakings	**0.1**	0.1
Other creditors	**3.9**	5.3
Corporation Tax	**45.0**	51.9
Other taxation and social security	**1.1**	1.3
Accruals and deferred income	**17.9**	15.5
	202.6	280.9

17. **Creditors: Amounts Falling Due After More Than One Year**

	2011 **£m**	2010 £m
Loans: (note 18)		
European Investment Bank loans	**252.5**	273.6
Loan from subsidiary company	**360.8**	218.7
Other loans	**14.7**	-
	628.0	492.3
Obligations under finance leases (note 18)	**1,156.1**	1,164.5
	1,784.1	1,656.8

At the balance sheet date the effective interest rate on loans from subsidiary companies is 7.4% (2010: 4.7%).

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

18. **Loans and Other Borrowings**

	2011 **£m**	2010 £m
Loans		
Repayable:		
Over five years	**521.7**	397.9
Over two and up to five years	**84.8**	73.3
Over one and up to two years	**21.5**	21.1
Falling due after more than one year (note 17)	**628.0**	492.3
Falling due within one year (note 16)	**44.1**	131.4
	672.1	623.7

	2011 **£m**	2010 £m
Obligations under finance leases		
Repayable:		
Over five years	**1,049.1**	1,076.0
Over two and up to five years	**86.9**	72.5
Over one and up to two years	**20.1**	16.0
Falling due after more than one year (note 17)	**1,156.1**	1,164.5
Falling due within one year (note 16)	**16.3**	23.9
	1,172.4	1,188.4

Included above are accrued finance charges arising on obligations under finance leases totalling £130.8m (2010: £135.3m), of which £6.4m (2010: £11.9m) is repayable within one year.

Included above is £0.7m (2010: £7.7m) due to Peninsula Leasing Limited, a subsidiary company, under finance lease agreements of which £0.4m (2010: £7.4m) is repayable within one year.

Loans and obligations under finance leases

Included above are instalment debts, of which any part falls due for payment after five years, and non-instalment debts due after five years:

	2011 **£m**	2010 £m
Loans	**649.5**	506.4
Obligations under finance leases	**1,171.6**	1,180.7
	1,821.1	1,687.1

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

18. **Loans and Other Borrowings (continued)**

The Company has undrawn committed borrowing facilities:

	2011 £m	2010 £m
Floating rate:		
Expiring less than one year	**50.0**	-
Expiring after one year	**70.0**	110.0
	120.0	110.0

In addition, the Company has short-term uncommitted bank facilities of £60.0m (2010: £60.0m).

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0m for certain water and sewerage business tangible fixed assets that are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2016.

During 2007 the period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts comparative to the difference between the original and revised payments due. The accumulated deposits of £32.4m at 31 March 2011 (2010: £24.0m) are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

During 2010 the period for repayment of certain existing leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The deposit at 31 March 2011 of £47.8m (2010: £9.2m) is being held to settle the lease liability at the end of the lease term, subject to rights to release by negotiation with the lessor.

19. **Derivative Financial Instruments**

Numerical financial instruments disclosures are set out below. Additional disclosures are set out in notes 18 and 25.

	2011 £m	2010 £m
Interest rate swaps – cash flow hedges:		
Assets	**0.3**	-
Liabilities	**(17.7)**	(17.6)
Derivatives deemed held for trading		
Liabilities	**-**	(0.1)

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of net borrowings is at fixed rate. At 31 March 2011 59% of net borrowings after the impact of derivatives, was at fixed rate (2010: 73%).

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

19. **Derivative Financial Instruments (continued)**

At 31 March 2011 interest rate swaps to hedge financial liabilities with a notional principal value of £605.0m existed, with a weighted average maturity of 3.9 years (2010: £775.0m, with 4.4 years) to swap from floating to fixed rate. The weighted average interest rate of the swaps was 3.2% (2010: 4.0%).

The amounts above are the fair value of swaps based on the market value of equivalent instruments at the balance sheet date.

20. **Provisions for Liabilities**

	Restruc-turing £m	Deferred Tax £m	**Total £m**
At 1 April 2010	3.1	81.3	**84.4**
Charged/(released) against profits	4.0	(5.4)	**(1.4)**
Utilised during year	(4.4)	-	**(4.4)**
At 31 March 2011	**2.7**	**75.9**	**78.6**

Deferred Taxation

	2011 £m	2010 £m
Accelerated capital allowances	**276.9**	292.2
Other timing differences	**(8.0)**	(2.9)
Undiscounted provision for deferred tax	**268.9**	289.3
Discount	**(193.0)**	(208.0)
Discounted provision for deferred tax	**75.9**	81.3

	£m
Provision at 1 April 2010	**81.3**
Deferred tax credit in profit and loss account for year	**(1.2)**
Deferred tax charge relating to pension liability, recognised against the pension deficit	**(3.7)**
Deferred tax credited to reserves for the year	**(0.5)**
Provision at 31 March 2011	**75.9**

The deferred tax balance has been reduced to recognise the changes in the rate of corporation tax enacted on 27 July 2010 and 29 March 2011 to reduce the rate from 1 April 2011 from 28% to 26%. If the published government proposals to reduce the rate of corporation tax by a further 1% for each financial year until 2014/15 were enacted at the balance sheet date the impact would result in further reductions.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

21. **Deferred Income**

	Grants and contributions £m
At 1 April 2010:	
Amount to be released :	
after more than one year	**14.0**
within one year	**1.2**
	15.2
Additions	**-**
Released to profits	**(1.2)**
At 31 March 2011:	**14.0**
Amount to be released:	
within one year	**(1.1)**
after more than one year	**12.9**

22. **Pensions**

The Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent company. The assets of the group's pension schemes are held in separate trustee administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of schemes' trustees is determined by the schemes' trust documentation. The Group has a policy that one-half of all trustees other than the Chairman are nominated by members of the fund, including current pensioners.

The principal actuarial assumptions at the balance sheet date were :

	2011	2010
	%	%
Expected return of scheme assets	**7.3**	7.4
Rate of increase in pensionable pay	**3.9**	4.1
Rate of increase for present and future pensions	**3.4**	3.6
Rate used to discount schemes' liabilities	**5.5**	5.5
Inflation	**3.4**	3.6

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. The mortality assumption uses a scheme-specific 'medium cohort' basis.

The average life expectancy in years of a member having retired at age 62 on the balance sheet date is projected at:

	2011	2010
Male	**24.9**	22.0
Female	**26.9**	25.4

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22. **Pensions (continued)**

The average life expectancy in years of a future pensioner retiring at age 62 twenty years after the balance sheet date is projected at:

	2011	2010
Male	**25.7**	23.4
Female	**28.2**	26.6

The amounts recognised in the profit and loss account were :

	2011 £m	2010 £m
Current service cost	**(8.6)**	(6.5)
Past service cost	**(2.4)**	(1.2)
Total included within operating costs	**(11.0)**	(7.7)
Expected return on pension scheme's assets	**19.3**	15.0
Interest cost on retirement benefit obligations	**(19.1)**	(17.5)
Total included within net interest payable (note 5)	**0.2**	(2.5)
Total charge	**(10.8)**	(10.2)

The actual return on scheme's assets was an increase of £31.7m (2010: increase of £56.5m).

The amounts recognised in the statement of total recognised gains and losses were :

	2011 £m	2010 £m
Actuarial gains/(losses) recognised in the year	**0.3**	(32.8)

The amounts recognised in the balance sheet were :

	2011 £m	2010 £m
Fair value of schemes' assets	**307.0**	264.3
Present value of defined benefit obligations	**(375.2)**	(347.6)
Deficit in scheme	**(68.2)**	(83.3)
Related deferred tax asset	**17.8**	23.3
Net liability recognised in the balance sheet	**(50.4)**	(60.0)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22. **Pensions (continued)**

The assets in the scheme and the expected long-term rates of return at the year end were:

	Expected return %	**2011 Value £m**	**Fund %**	Expected Return %	2010 Value £m	Fund %
Equities	**8.5**	**176.0**	**57**	8.5	161.8	61
Property	**8.2**	**12.7**	**4**	9.0	16.5	6
Bonds	**4.8**	**91.0**	**30**	5.0	83.9	32
Other	**4.4**	**27.3**	**9**	4.5	2.1	1
		307.0	**100**		264.3	100

Asset values have been reanalysed to show other assets which principally represent cash contributions received from the company towards the year-end which are invested during the subsequent financial year. Comparatives have been restated accordingly.

The expected return on plan assets is determined by considering the long-term returns and the balance between risk and reward on the various categories of investment assets held. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

In conjunction with its investment advisers, the trustees have structured the schemes' assets with the objectives of balancing investment returns and levels of risk. The asset allocation has three main elements:

- holding of bonds which is expected to be less volatile than most other asset classes and reflects the schemes' liabilities.
- a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns.
- investment of a relatively small proportion of the schemes' assets (circa 10%) in alternative asset classes which give the potential for gaining higher returns (property and currency).

Equities held by the scheme are spread between the UK and international markets circa 50% each.

Movements in the balance sheet liability were:-

	2011 £m	2010 £m
At 1 April	**(83.3)**	(51.4)
Profit and loss account	**(10.8)**	(10.2)
Statement of total recognised gains & losses	**0.3**	(32.8)
Regular contributions	**9.0**	1.2
Other employer contributions	**16.6**	9.9
At 31 March	**(68.2)**	(83.3)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22. **Pensions (continued)**

Movements in the fair value of schemes' assets were:

	2011 **£m**	2010 £m
At 1 April	**264.3**	209.9
Expected return on schemes' assets	**19.3**	15.0
Actuarial gains	**12.2**	41.5
Members' contributions	**0.3**	0.2
Benefits paid	**(14.7)**	(13.3)
Company regular contributions	**9.0**	1.1
Other employer contributions	**16.6**	9.9
At 31 March	**307.0**	264.3

Movements in the present value of defined benefit obligations were:

	2011 **£m**	2010 £m
At 1 April	**(347.6)**	(261.3)
Service costs	**(11.0)**	(7.7)
Interest cost	**(19.1)**	(17.5)
Members' contributions	**(0.3)**	(0.2)
Benefits paid	**14.7**	13.3
Actuarial losses	**(11.9)**	(74.2)
At 31 March	**(375.2)**	(347.6)

The Company adopted FRS 17 from 1 April 2004 and the required five year historical data is presented below.

	2011 **£m**	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of schemes' assets	**307.0**	264.3	209.9	255.4	285.5
Present value of defined benefit obligations	**(375.2)**	(347.6)	(261.3)	(277.1)	(320.0)
Net liability recognised	**(68.2)**	(83.3)	(51.4)	(21.7)	(34.5)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**12.4**	41.7	(80.7)	(53.6)	3.2
Percentage of schemes' assets	**4.0%**	15.8%	(38.4)%	(21.0)%	1.1%
Experience (gains)/losses on defined benefit obligations					
Amount (£m)	**(9.7)**	2.8	18.3	(5.8)	(4.4)
Percentage of defined benefit obligations	**(2.6)%**	0.8%	7.0%	(2.1)%	(1.4)%

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22. **Pensions (continued)**

The Company's current service cost during the year was 26.9% of pensionable earnings (2010: 16.4%). The Company's existing defined benefit schemes have been closed to new entrants from 1 April 2008.

In 2008 the Pennon Group completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2007 which resulted in higher future service and deficit recovery contributions. The Group further updated the valuation of the main scheme to 31 March 2009 and the company has made further other contributions in the year totalling £16.6m (2010: £9.9m).

The Pennon Group monitors funding levels on an annual basis.

23. **Called-up Share Capital**

	2011 £m	2010 £m
Authorised, 500,000,000 Ordinary shares of £1 each	**500.0**	500.0
Allotted, called-up and fully paid:- 150,950,000 (2010: 150,950,000) Ordinary shares of £1 each	**150.9**	150.9

24. **Employee share schemes**

The Company operates a number of share plans for the benefit of employees. Details of each plan are set out below.

i) 2006 Sharesave Scheme

An all-employee savings related plan is operated which enables employees, including Directors, to invest up to a maximum of £250 per month for three or five years. These savings can then be used to buy shares in Pennon Group Plc, the parent company, at a price set at a 20% discount to the market value at the start of the savings period at the third, fifth or seventh anniversary of the option being granted. Options expire six months following the exercise date and, except for specific circumstances such as redundancy, lapse if the employee leaves the Pennon Group before the exercise period commences.

Outstanding options to subscribe for Pennon Group Plc shares of 40.7p under the Sharesave Scheme are:

Date granted and subscription price fully paid		Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March **2011**	2010
8 July 2003	177p	2006 - 2010	**-**	39
6 July 2004	200p	2007 - 2011	**52**	52
5 July 2005	270p	2008 - 2012	**19**	176
4 July 2006	358p	2009 - 2013	**91**	94
3 July 2007	522p	2010 - 2014	**51**	178
8 July 2008	517p	2011 - 2015	**131**	148
6 July 2009	386p	2012 - 2016	**731**	800
6 July 2010	431p	2013 - 2017	**296**	-
			1,371	1,487

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24. **Employee share schemes (continued)**

i) 2006 Sharesave Scheme (continued)

The number and weighted average exercise price of Sharesave options:

	2011		2010	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share p**	Number of ordinary shares (thousands)	Weighted average exercise price per share p
At 1 April	**1,487**	**388**	1,365	379
Granted	**299**	**431**	854	386
Exercised	**(315)**	**351**	(460)	289
Expired	**(100)**	**425**	(272)	492
At March	**1,371**	**403**	1,487	388

The weighted average price at the date of exercise of Sharesave options during the year was 478p (2010: 468p). The options outstanding at 31 March 2011 had a weighted average exercise price of 403p (2010: 388p) and a weighted average remaining contractual life of 2.7 years (2010: 2.3 years).

The aggregate fair value of options granted during the year was £0.5m (2010: £0.9m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2011	2010
Weighted average share price	**539p**	482p
Weighted average exercise price	**431p**	386p
Expected volatility	**29.0%**	29.0%
Expected life	**4.1 years**	3.8 years
Risk-free rate	**1.4%**	2.5%
Expected dividend yield	**4.5%**	4.7%

Expected volatility was determined by calculating the historical volatility of the Pennon Group Plc share price over the previous two years.

ii) Performance and Co-investment Plan

Directors and senior management receive a conditional award of ordinary shares in Pennon Group Plc and are also required to hold a substantial personal holding in Pennon Group Plc shares. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24 **Employee share schemes (continued)**

ii) Performance and Co-investment Plan (continued)

The number and exercise price of shares in the Performance and Co-investment Plan are:

	2011		2011	
	Number of ordinary shares (thousands)	**Exercise price per share p**	Number of ordinary shares (thousands)	Exercise price per share p
At 1 April	**393**	**553**	233	598
Granted	**130**	**546**	160	487
Vested	**(85)**	**557**	-	-
Lapsed	**(26)**	**557**	-	-
At 31 March	**412**	**549**	393	553

The awards outstanding at 31 March 2011 had an exercise price of 549p (2010: 553p) and a remaining contractual life of 1.3 years (2010: 1.4 years). The aggregate fair value of awards granted during the year was £0.5m (2010: £0.5m), determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2011	2010
Share price	**546p**	486p
Expected volatility	**29.0%**	29.0%
Risk-free rate	**1.4%**	2.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

iii) Annual Incentive Bonus Plan – Deferred Shares

Awards under this plan to Directors and senior management involve the release of ordinary shares in Pennon Group Plc to participants. There is no performance condition since vesting is usually conditional upon continuous service with the Pennon Group for a period of three years from the award.

The number and weighted average price of shares in the Incentive Bonus Plan are:

	2011		2010	
	Number of ordinary shares (thousands)	**Weighted average price per share p**	Number of ordinary shares (thousands)	Weighted average price per share p
At 1 April	**146**	**551**	118	578
Granted	**61**	**573**	69	476
Vested	**(33)**	**600**	(41)	502
At 31 March	**174**	**550**	146	551

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24. **Employee share schemes (continued)**

The awards outstanding at 31 March 2011 had a weighted average price of 550p (2010: 551p) and a weighted average remaining contractual life of 1.5 years (2010: 1.6 years). The Pennon Group Plc share price at the date of the awards ranged from 473p to 620p.

The aggregate fair value of awards granted during the year was £0.3m (2010: £0.3m), determined from market value. No option pricing issues arise as dividends declared on the shares are receivable by the participants in the scheme.

25. **Reserves**

	Profit and loss account £m	Hedging Reserve £m	Total £m
At 1 April 2010	505.9	(17.6)	488.3
Profit on ordinary activities after taxation	104.5	-	104.5
Dividends paid (note 7)	(58.4)	-	(58.4)
Actuarial gain recognised in the pension scheme	0.3	-	0.3
Movement on deferred tax relating to actuarial loss	(0.1)	-	(0.1)
Share based payments	0.9	-	0.9
Deferred tax recognised directly in equity	0.5	-	0.5
Deferred tax recognised directly in equity relating to the pension deficit (including tax rate changes)	(1.6)	-	(1.6)
Net movement on interest rate swaps	-	0.2	0.2
At 31 March 2011	**552.0**	**(17.4)**	**534.6**

26. **Reconciliation of Movements in Shareholders' Funds**

	2011 £m	2010 £m
Profit on ordinary activities after taxation	**104.5**	106.8
Dividends paid	**(58.4)**	(54.4)
Share-based payments	**0.9**	0.8
Other recognised gains and losses relating to the year	**0.4**	(24.8)
Deferred tax recognised directly in equity	**(1.1)**	(0.2)
Net change in Shareholders' Funds	**46.3**	28.2
Shareholders' Funds as at 1 April	**639.2**	611.0
Shareholders' Funds as at 31 March	**685.5**	639.2

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

27. **Commitments and Contingent Liabilities**

	2011 £m	2010 £m
Capital commitments		
Contracted but not provided	**67.2**	95.6
Commitments under operating leases		
Rentals during the year following the balance sheet date		
Land and buildings leases expiring:-		
within one year	**0.1**	0.1
Between one and five year	**0.1**	0.1
after five years	**1.2**	1.2
	1.4	1.4

	2011 £m	2010 £m
Contingent Liabilities		
Contractors' claims on capital schemes	**0.2**	3.1
Guarantee of borrowings of subsidiary undertaking	**352.3**	300.0
	352.5	303.1

28. **Notes to the Cash Flow Statement**

(a) **Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities**

	2011 £m	2010 £m
Operating profit	**187.3**	189.0
Depreciation charge	**76.5**	74.2
Adjustment for employee share schemes	**1.2**	0.6
Deferred income released to profits	**(1.2)**	(1.3)
Decrease in retirement benefit obligations	**(14.6)**	(3.4)
(Decrease)/Increase in provisions for liabilities and charges	**(0.4)**	2.8
Decrease in stocks	**0.2**	0.6
Decrease in debtors (amounts falling due within and over one year)	**(18.4)**	(6.2)
Decrease in creditors (amounts falling due within and over one year)	**13.8**	0.7
Other income	**0.6**	0.8
Infrastructure renewals charge	**29.7**	28.1
Profit on disposal of tangible fixed assets	**(1.6)**	(1.0)
Net cash inflow from operating activities	**273.1**	284.9

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

28. **Notes to the Cash Flow Statement (continued)**

(b) **Analysis of Cash Flows for Headings Netted in the Cash Flow Statement**

(i) Returns on Investments and Servicing of Finance	**2011 £m**	2010 £m
Interest received	**2.8**	3.7
Interest paid	**(20.0)**	(20.5)
Interest element of finance lease rentals	**(35.7)**	(39.6)
Net cash outflow for returns on investments and servicing of finance	**(52.9)**	(56.4)

(ii) Capital Expenditure and Financial Investment	**2011 £m**	2010 £m
Purchase of tangible fixed assets	**(102.2)**	(130.2)
Grants and contributions: Infrastructure assets	**4.5**	3.4
: Non-infrastructure assets	**-**	-
Receipts from disposal of tangible fixed assets	**1.8**	1.3
Infrastructure renewals expenditure	**(25.6)**	(23.8)
Net cash outflow for capital expenditure and financial investment	**(121.5)**	(149.3)

(iii) Management of Liquid Resources	**2011 £m**	2010 £m
Purchase of current asset investments	**(825.0)**	(590.6)
Sale of current asset investments	**780.0**	610.6
Net cash (outflow)/inflow from management of liquid resources	**(45.0)**	20.0

(iv) Financing	**2011 £m**	2010 £m
Decrease in debt due within one year (other than bank overdrafts)	**(113.7)**	-
Increase /(Decrease) in debt due after more than one year	**146.6**	(14.1)
Finance lease drawdowns	**0.5**	14.4
Capital element of finance lease rental payments	**(12.1)**	(11.3)
Transfers to restricted deposit accounts	**(46.6)**	(16.2)
Net cash outflow from financing	**(25.3)**	(27.2)

28. **Notes to the Cash Flow Statement (continued)**

(c) **Analysis of Net Debt**

	At 1 April 2010 £m	Cash flow £m	Non-cash movements £m	**At 31 March 2011 £m**
Cash at bank and in hand	0.1	0.1	-	**0.2**
Current asset investments:-				
Overnight deposits	81.4	(55.4)	-	**26.0**
Bank overdrafts	(17.3)	(5.3)	-	**(22.6)**
	64.2	(60.6)	-	**3.6**
Restricted deposit accounts	33.2	46.6	0.4	**80.2**
Debt due within one year (other than bank overdrafts)	(114.1)	113.7	(21.1)	**(21.5)**
Debt due after more than one year	(492.3)	(146.6)	10.9	**(628.0)**
Finance lease obligations	(1,188.4)	11.6	4.4	**(1,172.4)**
	(1,761.6)	25.3	(5.4)	**(1,741.7)**
Current asset investments:- other than overnight deposits	150.2	45.0	0.1	**195.3**
	(1,547.2)	9.7	(5.3)	**(1,542.8)**

Non-cash movements include transfers between categories of debt for changing maturities, increased accrued finance charges within finance lease obligations and increased accrued interest on unlisted investments.

(d) **Reconciliation of Net Cash Flow to Movement in Net Debt**

	2011 £m	2010 £m
(Decrease)/Increase in cash in year	**(60.6)**	16.3
Cash inflow from increase in debt and finance leasing	**25.3**	27.3
Cash inflow/(outflow) from decrease in liquid resources	**45.0**	(20.0)
Decrease in net debt arising from cash flows	**9.7**	23.6
Non-cash movements:-		
Decrease in accrued finance charges on finance lease obligations	**4.5**	0.7
Other	**(9.8)**	(0.4)
Decrease in net debt in the year	**4.4**	23.9
Net debt at 1 April	**(1,547.2)**	(1,571.1)
Net debt at 31 March	**(1,542.8)**	(1,547.2)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

29. **Related Party Transactions**

Under FRS8, transactions with other wholly owned subsidiaries of the Pennon Group Plc are not required to be set out herein since the Company is a wholly owned subsidiary within that group.

There were no related party transactions involving Directors during the year.

30. **Parent Company**

The parent company, and ultimate controlling party, is Pennon Group Plc which is registered in England. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

RECONCILIATION BETWEEN STATUTORY IFRS ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS

South West Water prepares its statutory accounts under the historical cost convention in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretation Committee (IFRIC) interpretations, as adopted by the European Union, with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The regulatory accounts contained in this document are prepared on the basis of regulatory accounting guidelines and UK accounting standards. The principal differences between the Company's statutory accounts and its regulatory accounts are set out below.

The 2010 comparative figures have been restated reflecting the application of IFRIC 18 on the Company's statutory accounts. This change resulted in a £2m increase to profit and £2m increase to fixed assets.

Profit and loss account / income statement

	2011 £m	2010 Restated £m
Turnover		
Per statutory accounts	**449.1**	444.5
IFRS: revenue not recognised under IFRS as deemed uncollectible	**5.5**	5.3
Infrastructure charges credited to fixed assets in regulatory accounts	**(3.3)**	(3.0)
Rental income classified as 'other income' in regulatory accounts	**(0.6)**	(0.8)
Per regulatory accounts	**450.7**	446.0
Operating profit		
Per statutory accounts	**189.7**	191.6
Infrastructure charges credited to fixed assets in regulatory accounts	**(3.3)**	(3.0)
Rental income classified as 'other income' in regulatory accounts	**(0.6)**	(0.8)
IFRS: difference between infrastructure renewals charge and depreciation	**(8.3)**	(7.6)
IFRS: capitalisation policy difference (including IFRIC 18)	**9.8**	8.8
Per regulatory accounts	**187.3**	189.0
Profit before tax		
Per statutory accounts	**128.8**	129.5
Infrastructure charges credited to fixed assets in regulatory accounts	**(3.3)**	(3.0)
IFRS: difference between infrastructure renewals charge and depreciation	**(8.3)**	(7.6)
IFRS: capitalisation policy difference (including IFRIC 18)	**9.8**	6.8
Per regulatory accounts	**127.0**	125.7
Taxation		
Tax charge per statutory accounts	**3.7**	30.7
IFRS: difference in deferred tax charge because provision not discounted	**0.2**	(11.9)
IFRS: deferred tax differences on industrial buildings	**(2.1)**	-
IFRS: change in future rates of corporation tax	**18.2**	-
Deferred tax: other timing differences between IFRS and UK GAAP	**2.5**	0.1
Tax charge per regulatory accounts	**22.5**	18.9

RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS (continued)

	2011 £m	2010 £m Restated
Retained Profit		
Profit for year per statutory accounts	**125.1**	98.8
Profit before tax differences as above	**(1.8)**	(3.8)
Taxation differences as above	**(18.8)**	11.8
Dividends (not shown in income statement for IFRS)	**(58.4)**	(54.4)
Retained profit per regulatory accounts	**46.1**	52.4

<u>Balance Sheet</u>

	2011 £m	2010 £m Restated
Tangible assets		
Net book value per statutory accounts	**2,467.8**	2,427.7
Infrastructure charges current year (see operating profit above)	**(3.3)**	(3.0)
Infrastructure charges brought forward	**(35.1)**	(32.1)
IFRS: cumulative impact of adopting IFRIC 18	**(19.5)**	(2.0)
IFRS: difference in infrastructure assets net book value as renewals accounting not used	**5.5**	(2.9)
IFRS: grants and contributions netted against fixed assets	**12.6**	13.6
Net book value per regulatory accounts	**2,428.0**	2,401.3
Current assets		
Per statutory accounts	**395.0**	339.0
Infrastructure prepayment in regulatory accounts	**4.7**	8.9
IFRS: receivables displayed as long-term assets	**0.6**	0.4
Rounding	**0.1**	-
Per regulatory accounts	**400.4**	348.3
Creditors less than one year		
Per statutory accounts	**209.0**	286.5
IFRS: current element of provisions shown in current liabilities	**(2.7)**	(3.1)
IFRS: current element of derivative financial instruments shown in current liabilities	**(4.4)**	(3.6)
IFRS: current element of grants & contributions netted against fixed assets	**0.9**	1.0
IFRS: current element of IFRIC 18 deferred income on adopted assets	**(0.2)**	-
Rounding	**-**	0.1
Per regulatory accounts	**202.6**	280.9
Deferred tax provision		
Per statutory accounts	**284.3**	302.6
IFRS: discounting not permitted	**(193.0)**	(208.0)
IFRS: deferred tax differences on industrial buildings	**(37.8)**	(41.5)
IFRS: deferred tax asset recognised on hedging reserve for statutory accounts but not UK GAAP	**4.6**	4.9
IFRS: deferred tax asset relating to pension fund deficit disclosed within other deferred tax balances rather than netted against deficit	**17.8**	23.3
Per regulatory accounts	**75.9**	81.3

RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS (continued)

	2011 £m	2010 £m Restated
Pension fund deficit		
Per statutory accounts	**68.2**	83.3
IFRS: deferred tax asset relating to pension fund deficit disclosed within other deferred tax balances rather than netted against deficit	**(17.8)**	(23.3)
Per regulatory accounts	**50.4**	60.0
Net assets		
Per statutory accounts	**492.3**	425.8
Opening difference	**213.4**	210.4
Profit before tax difference in year per above	**(1.8)**	(3.8)
Taxation difference in year per above	**(18.8)**	11.8
Less: deferred tax on pension scheme included in above taken to reserves in regulatory accounts	**-**	(0.2)
Less: deferred tax asset recognised on hedging reserve for statutory accounts but not UK GAAP	**0.3**	(4.9)
Rounding	**0.1**	0.1
Net assets per regulatory accounts	**685.5**	639.2

SOUTH WEST WATER

CURRENT COST PROFIT AND LOSS ACCOUNT
FOR THE APPOINTED BUSINESS
for the year ended 31 March 2011

	Notes	**2011**	2010
		£m	£m
Turnover	2	**444.3**	438.6
Current cost operating costs	3	**(276.8)**	(275.3)
Current cost profit on sale of fixed assets	2	**1.8**	1.0
		169.3	164.3
Working capital adjustment		**(0.1)**	0.3
Current Cost Operating Profit		**169.2**	164.6
Other income		**0.4**	0.3
Net interest payable		**(60.9)**	(64.1)
Financing adjustment		**90.0**	73.1
Current Cost Profit Before Taxation		**198.7**	173.9
Tax on profit on ordinary activities:			
- Current tax		**(23.5)**	(30.5)
- Deferred tax		**1.2**	11.9
Current Cost Profit on Ordinary Activities After Taxation		**176.4**	155.3
Dividends		**(58.4)**	(54.4)
Current Cost Surplus Transferred to Reserves		**118.0**	100.9

CURRENT COST BALANCE SHEET
FOR THE APPOINTED BUSINESS
at 31 March 2011

	Notes	**2011 £m**	2010 £m
Fixed Assets			
Tangible fixed assets	4	**9,368.4**	8,533.7
Third party contributions since 1989/90		**(156.3)**	(140.0)
Infrastructure Renewals Prepayment		**4.7**	8.9
Working capital	5	**2.5**	1.6
Net operating assets		**9,219.3**	8,404.2
Cash and investments		**299.7**	263.2
Non-trade debtors		**16.4**	8.6
Non-trade creditors due within one year		**(145.2)**	(234.1)
Creditors due after more than one year		**(1,785.2)**	(1,658.3)
Provisions for liabilities and charges:			
- Deferred tax		**(75.9)**	(81.3)
- Other provisions		**(2.7)**	(3.1)
Net assets excluding pension liability		**7,526.4**	6,699.2
Pension liability		**(50.4)**	(60.0)
Net assets employed including pension liability		**7,476.0**	6,639.2
Capital and Reserves			
Called-up share capital		**150.9**	150.9
Profit and loss account	6a	**561.5**	443.2
Current cost reserve	6b	**6,763.6**	6,045.1
Total Capital and Reserves		**7,476.0**	6,639.2

Approved by the Board on 10 June 2011 and signed on its behalf by:-

C Loughlin
Chief Executive

S Davy
Finance & Regulatory Director

CURRENT COST CASH FLOW STATEMENT
for the year ended 31 March 2011

	Notes	2011 Appointed Business £m	2011 Appointed Business £m	2010 Appointed Business £m	2010 Appointed Business £m
Net cash flow from operating activities	7		**273.6**		283.2
Returns on investment & servicing of finance:					
Interest received		**2.8**		3.7	
Interest paid		**(20.0)**		(20.5)	
Interest in finance lease rentals		**(35.7)**		(39.6)	
Net cash outflow from returns on investment & servicing of finance			**(52.9)**		(56.4)
Taxation			**(30.4)**		(1.0)
Capital expenditure and financial investment:					
Gross cost of purchase of fixed assets		**(102.2)**		(130.2)	
Receipt of grants and contributions		**4.6**		3.4	
Infrastructure renewals expenditure		**(25.6)**		(23.8)	
Disposal of fixed assets		**1.8**		1.3	
Movements on long term loans to group companies		**(0.2)**		0.7	
Net cash outflow from investing activities			**(121.6)**		(148.6)
Acquisitions and disposals			**-**		-
Equity dividends paid			**(58.4)**		(54.4)
Management of liquid resources:					
Disposal or redemption of other liquid assets		**780.0**		610.6	
Purchase of other liquid investments		**(825.0)**		(590.6)	
Net cash (outflow)/inflow from management of liquid resources			**(45.0)**		20.0
Net cash (outflow)/inflow before financing			**(34.7)**		42.8
Financing:					
Capital element in finance lease rentals		**(12.1)**		(11.3)	
New bank loans		**147.5**		-	
Repayment of borrowings		**(160.7)**		(15.9)	
Net cash outflow from financing			**(25.3)**		(27.2)
(Decrease)/Increase in cash and cash equivalents			**(60.0)**		15.6

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

1. **Current Cost Accounting Policies**

(a) **General**

These Financial Statements have been prepared for the Appointed Business of South West Water Limited in accordance with guidance issued by the Water Services Regulation Authority (Ofwat) 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.

The accounting policies used are the same as those adopted in the Historical Cost Regulatory Accounts except as set out below.

(b) **Tangible Fixed Assets**

Assets 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 assets by contributions from third parties and, to the extent that some of those assets would be so funded on replacement, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amounts.

The Periodic Review process provides for a re-assessment of asset valuations through a refinement of asset records as part of the Company's Asset Management Plan (AMP). The current cost gross asset values and depreciation used in the current cost statement for 2010/2011 have been based on data derived from this review.

(i) **Land and Buildings**

Non-specialised operational properties are valued on the basis of open market value for existing use and have been expressed in real terms by indexation using the Retail Prices Index (RPI).

Specialised operational properties are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between Periodic Reviews by adjusting for inflation as measured by changes in RPI. The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below).

(ii) **Infrastructure Assets**

Mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost determined principally on the basis of data provided by the Asset Management Plan.

In the intervening years between Periodic Reviews, values are restated to take account of changes in the general level of inflation as measured by changes in the RPI over the year.

(iii) **Other Fixed Assets**

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

(iv) **Surplus Land**

Surplus land is valued at recoverable amount taking into account that part of any proceeds to be passed on to customers under Condition B of the Licence.

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

1. **Current Cost Accounting Policies (continued)**

(b) **Tangible Fixed Assets (continued)**

(v) **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 and treated as deferred income.

(c) **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.

(i) **Working Capital Adjustment**
This is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors.

(ii) **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.

2. **Analysis of Turnover and Operating Income for the Appointed Business**

		2011			2010	
	Water Services £m	**Sewerage Services £m**	**Appointed Business £m**	Water Services £m	Sewerage Services £m	Appointed Business £m
Turnover						
Measured	**128.8**	**145.3**	**274.1**	123.3	135.9	259.2
Unmeasured	**64.6**	**81.9**	**146.5**	66.9	88.4	155.3
Trade effluent	**-**	**4.1**	**4.1**	-	4.4	4.4
Large user revenues	**6.5**	**7.5**	**14.0**	6.7	7.1	13.8
Third party services	**4.6**	**1.0**	**5.6**	4.7	1.2	5.9
	204.5	**239.8**	**444.3**	201.6	237.0	438.6
Current Cost Profit on Sale of Fixed Assets	**0.9**	**0.9**	**1.8**	0.5	0.5	1.0

The figures for large user revenues include any trade effluent turnover arising from those customers.

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

3. Analysis of Operating Costs and Current Cost Fixed Asset Net Book Values by Service 2011

	WATER SUPPLY			SEWERAGE SERVICES					BUSINESS ACTIVITIES		
	Resources and Treatment £m	Distrib-Ution £m	Water Supply Total £m	Sewerage £m	Sewage Treatment £m	Sludge Treatment and Disposal £m	Sewage Treatment and Disposal Sub Total £m	Sewerage Services Total £m	Customer Services £m	Scientific Services £m	Cost of Regulation £m
Direct Costs											
Employment costs	3.9	3.0	6.9	2.4	6.1	0.7	6.8	9.2			
Power	3.1	3.9	7.0	2.0	8.3	0.8	9.1	11.1			
Agencies	-	-	-	-	-	-	-	-			
Hired and contracted services	1.5	8.3	9.8	1.1	1.9	5.8	7.7	8.8			
Associated companies	-	-	-	-	0.5	-	0.5	0.5			
Materials and consumables	3.1	0.3	3.4	0.4	3.4	1.7	5.1	5.5			
Service charges	4.3	-	4.3	0.7	2.5	-	2.5	3.2			
Other direct costs	0.3	0.7	1.0	0.3	0.6	0.1	0.7	1.0			
Total Direct Costs	16.2	16.2	32.4	6.9	23.3	9.1	32.4	39.3	9.7	3.8	2.6
General & support expenditure	6.8	5.2	12.0	2.3	10.6	3.8	14.4	16.7	2.4	1.0	0.5
Functional Expenditure	23.0	21.4	44.4	9.2	33.9	12.9	46.8	56.0	12.1	4.8	3.1
Business activities			10.9					9.2			
Rates			9.8					5.1			
Doubtful debts			5.8					7.6			
Exceptional Item			-					-			
Service Costs			70.9					77.9			
Third party services			5.3					0.5			
Total Operating Expenditure			76.2					78.4			
Capital Costs											
Infrastructure renewal :											
- expenditure	0.6	12.4	13.0	12.5				12.5			
- (prepayment)/accrual	1.2	1.5	2.7	1.4				1.4			
Current cost depreciation	18.8	13.1	31.9	8.1	47.7	5.3	53.0	61.1			
Business activities capital costs			0.7					0.3			
Amortisation of deferred credits			-0.6					-0.9			
Capital Maintenance excl. Third Party Services			47.7					74.4			
Third party services			-					0.1			
Total Capital Maintenance			47.7					74.5			
Total Operating Costs			123.9					152.9			

	Resources and Treatment £m	Distrib-Ution £m	Water Supply Total £m	Sewerage £m	Sewage Treatment £m	Sludge Treatment and Disposal £m	Sewage Treatment and Disposal Sub Total £m	Sewerage Services Total £m
Total Operating Expenditure above includes Planned and Reactive Maintenance Expenditure of:								
Infrastructure	0.1	11.3	11.4	2.9	-	-	-	2.9
Non Infrastructure	2.8	1.1	3.9	1.7	5.3	0.8	6.1	7.8
			15.3					10.7

	Resources and Treatment £m	Distrib-Ution £m	Water Supply Total £m	Sewerage £m	Sewage Treatment £m	Sludge Treatment and Disposal £m	Sewage Treatment and Disposal Sub Total £m	Sewerage Services Total £m
Current Cost Net Book Values of Fixed Assets								
Service activities	786.2	3,299.1	4,085.3	4,396.1	812.0	70.6	882.6	5,278.7
Business activities			2.1	0.1		0.5	0.5	0.6
Service Totals			4,087.4	4,396.2			883.1	5,279.3
Third party services			-					1.7
Total			4,087.4					5,281.0

The allocation of operating costs within the Company to specific service areas within the appointed business and to the non-appointed business is based on activity analysis and principles which result in both direct and support costs being apportioned.

SOUTH WEST WATER

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

3. Analysis of Operating Costs and Current Cost Fixed Asset Net Book Values by Service 2010

	WATER SUPPLY			SEWERAGE SERVICES					BUSINESS ACTIVITIES		
	Resources and Treatment £m	Distrib-ution £m	Water Supply Total £m	Sewerage £m	Sewage Treatment £m	Sludge Treatment and Disposal £m	Sewage Treatment and Disposal Sub Total £m	Sewerage Services Total £m	Customer Services £m	Scientific Services £m	Cost of Regulation £m
Direct Costs											
Employment costs	4.3	4.1	8.4	0.6	6.2	0.7	6.9	7.5			
Power	2.7	4.1	6.8	1.9	9.1	1.1	10.2	12.1			
Agencies	-	-	-	-	-	-	-	-			
Hired and contracted services	1.0	8.4	9.4	3.0	2.7	5.3	8.0	11.0			
Materials and consumables	3.2	0.4	3.6	0.3	3.0	1.6	4.6	4.9			
Service charges	4.3	0.1	4.4	0.7	2.9	-	2.9	3.6			
Other direct costs	0.3	0.8	1.1	0.2	0.6	0.2	0.8	1.0			
Total Direct Costs	15.8	17.9	33.7	6.7	24.5	8.9	33.4	40.1	10.3	3.3	2.1
General & support expenditure	4.9	5.4	10.3	1.6	8.8	4.2	13.0	14.6	3.7	1.2	0.4
Functional Expenditure	20.7	23.3	44.0	8.3	33.3	13.1	46.4	54.7	14.0	4.5	2.5
Business activities			11.4					9.6			
Rates			8.8					4.1			
Doubtful debts			5.4					7.2			
Exceptional Item			-					-			
Service Costs			69.6					75.6			
Third party services			5.0					0.6			
Total Operating Expenditure			74.6					76.2			
Capital Costs											
Infrastructure renewal :											
- expenditure	1.6	11.8	13.4	10.5				10.5			
- (prepayment)/accrual	0.2	0.4	0.6	3.5	-	-	-	3.5			
Current cost depreciation	19.7	12.6	32.3	9.5	50.0	4.8	54.8	64.3			
Business activities capital costs			0.7					0.3			
Amortisation of deferred credits			-0.5					-0.7			
Capital Maintenance excl. Third Party Services			46.5					77.9			
Third party services			0.0					0.1			
Total Capital Maintenance			46.5					78.0			
Total Operating Costs			121.1					154.2			

Total Operating Expenditure above includes Planned and Reactive Maintenance Expenditure of:								
Infrastructure	0.1	12.4	12.5	2.6	-	-	-	2.6
Non Infrastructure	2.7	1.4	4.1	1.5	4.5	1.4	5.9	7.4
			16.6					10.0

Current Cost Net Book Values of Fixed Assets								
Service activities	683.7	3,025.0	3,708.7	4,055.4	694.2	71.0	765.2	4,820.6
Business activities			2.1	0.1			0.5	0.6
Service Totals			3,710.8	4,055.5			765.7	4,821.2
Third party services			-					1.7
Total			3,710.8					4,822.9

The allocation of operating costs within the Company to specific service areas within the appointed business and to the non-appointed business is based on activity analysis and principles which result in both direct and support costs being apportioned.

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

4a. **Current Cost Analysis of Fixed Assets by Asset Type**

Water Services	Specialised Operational Assets	Non-specialised Operational Properties	Infra-structure Assets	Other Tangible Assets	Total
	£m	£m	£m	£m	£m
Gross Replacement Cost:-					
At 1 April 2010	1,011.2	8.0	3,192.3	105.5	4,317.0
AMP adjustment	67.1	10.3	109.5	(73.6)	113.3
RPI adjustment	57.7	1.0	176.5	1.7	236.9
Disposals	-	-	-	(0.4)	(0.4)
Additions	34.8	-	6.2	6.4	47.4
At 31 March 2011	**1,170.8**	**19.3**	**3,484.5**	**39.6**	**4,714.2**
Depreciation:-					
At 1 April 2010	541.1	7.0	-	58.1	606.2
AMP adjustment	1.1	1.7	-	(45.9)	(43.1)
RPI adjustment	29.0	0.5	-	0.7	30.2
Disposals	-	-	-	(0.4)	(0.4)
Charge for year	29.0	0.6	-	4.3	33.9
At 31 March 2011	**600.2**	**9.8**	**-**	**16.8**	**626.8**
Net Book Value:-					
At 31 March 2011	**570.6**	**9.5**	**3,484.5**	**22.8**	**4,087.4**
.					
At 1 April 2010	470.1	1.0	3,192.3	47.4	3,710.8

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

4b. **Current Cost Analysis of Fixed Assets by Asset Type (continued)**

Sewerage Services	Specialised Operational Assets	Non-specialised Operational Properties	Infra-structure Assets	Other Tangible Assets	Total
	£m	£m	£m	£m	£m
Gross Replacement Cost:-					
At 1 April 2010	1,709.8	17.1	3,965.5	86.2	5,778.6
AMP adjustment	(12.2)	(4.9)	164.1	(47.2)	99.8
RPI adjustment	90.8	0.7	220.8	2.1	314.4
Disposals	(0.2)	-	-	(0.5)	(0.7)
Additions	45.1	-	8.8	7.8	61.7
At 31 March 2011	**1,833.3**	**12.9**	**4,359.2**	**48.4**	**6,253.8**
Depreciation:-					
At 1 April 2010	890.8	7.0	-	57.9	955.7
AMP adjustment	(46.6)	(1.2)	-	(42.9)	(90.7)
RPI adjustment	45.1	0.3	-	0.8	46.2
Disposals	(0.2)	-	-	(0.5)	(0.7)
Charge for year	56.6	0.4	-	5.3	62.3
			-		
At 31 March 2011	**945.7**	**6.5**	**-**	**20.6**	**972.8**
Net Book Value:-					
At 31 March 2011	**887.6**	**6.4**	**4,359.2**	**27.8**	**5,281.0**
At 1 April 2010	819.0	10.1	3,965.5	28.3	4,822.9

SOUTH WEST WATER

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

4c. **Current Cost Analysis of Fixed Assets by Asset Type (continued)**

Total	Specialised Operational Assets £m	Non-specialised Operational Properties £m	Infra-structure Assets £m	Other Tangible Assets £m	**Total £m**
Gross Replacement Cost:-					
At 1 April 2010	2,721.0	25.1	7,157.8	191.7	**10,095.6**
AMP adjustment	54.9	5.4	273.6	(120.8)	**213.1**
RPI adjustment	148.5	1.7	397.3	3.8	**551.3**
Disposals	(0.2)	-	-	(0.9)	**(1.1)**
Additions	79.9	-	15.0	14.2	**109.1**
At 31 March 2011	**3,004.1**	**32.2**	**7,843.7**	**88.0**	**10,968.0**
Depreciation:-					
At 1 April 2010	1,431.9	14.0	-	116.0	**1,561.9**
AMP adjustment	(45.5)	0.5	-	(88.8)	**(133.8)**
RPI adjustment	74.1	0.8	-	1.5	**76.4**
Disposals	(0.2)	-	-	(0.9)	**(1.1)**
Charge for year	85.6	1.0	-	9.6	**96.2**
At 31 March 2011	**1,545.9**	**16.3**	**-**	**37.4**	**1,599.6**
Net Book Value:-					
At 31 March 2011	**1,458.2**	**15.9**	**7,843.7**	**50.6**	**9,368.4**
At 1 April 2010	1,289.1	11.1	7,157.8	75.7	8,533.7

In accordance with the Company's accounting policy, current cost gross asset values and cumulative depreciation were reassessed on 31 March 2008 as part of the Price Review 2009. The revised amounts have been reflected in the regulatory accounts this year.

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

5. **Working Capital**

	2011	2010
	£m	£m
Stocks	**3.3**	3.5
Trade debtors		
- measured household	**8.0**	6.8
- unmeasured household	**12.6**	12.7
- measured non-household	**6.8**	7.8
- unmeasured non-household	**0.3**	0.3
-other	**1.8**	0.4
Measured Income Accrual	**34.5**	28.1
Prepayments and other debtors	**8.9**	4.8
Trade creditors	**(16.8)**	(14.2)
Deferred income - customer advance receipts	**(5.4)**	(5.6)
Capital creditors	**(39.5)**	(33.8)
Accruals and other creditors	**(12.0)**	(9.2)
	2.5	1.6

6. **Reserves**

(a) **Profit and Loss Account**

	£m
At 1 April 2010	**443.2**
Profit on ordinary activities after taxation	**176.4**
Dividends paid	**(58.4)**
Actuarial gain recognised in the pension scheme	**0.3**
Movement on deferred tax recognised directly in equity	**(1.1)**
Share-based payments	**0.9**
Net movement on interest rate swaps	**0.2**
At 31 March 2011	**561.5**

(b) **Current Cost Reserve**

	2011	2010
	£m	£m
At 1 April	**6,045.1**	5,756.9
AMP Adjustment	**346.9**	-
RPI Adjustments:-		
Fixed assets	**474.9**	362.2
Working capital	**0.1**	(0.3)
Financing	**(90.0)**	(73.1)
Grants and third party contributions	**(13.4)**	(0.6)
At 31 March	**6,763.6**	6,045.1

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

7. Notes to the Cash Flow Statement

Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2011	2010
	£m	£m
Current cost operating profit	**169.2**	164.6
Working capital adjustment	**0.1**	(0.3)
Increase in working capital	**(6.5)**	(5.7)
Receipts from other income	**0.4**	0.3
Current cost depreciation	**92.5**	96.6
Current cost profit on sale of fixed assets	**(1.8)**	(1.0)
Intrastructure renewals charge	**29.7**	28.1
Movement in provisions	**(10.0)**	0.6
Net cash flow from operating activites	**273.6**	283.2

8. Analysis of Net Debt

	Interest rate risk profile			
	Fixed rate	Floating rate	Index linked	**Total**
Maturity Profile	£m	£m	£m	**£m**
Less than one year	30.3	30.0	0.1	**60.4**
Between one and two years	31.3	10.2	0.1	**41.6**
Between two and five years	121.3	49.9	0.5	**171.7**
Between five and twenty years	313.2	83.0	32.8	**429.0**
In more than twenty years	500.7	311.0	330.1	**1,141.8**
Borrowings (excluding preference shares)	996.8	484.1	363.6	**1,844.5**
Preference share capital				**-**
Total Borrowings (including overdraft of £22.6m)				**1,844.5**
Cash				**(0.2)**
Short term deposits				**(301.5)**
Net Debt				**1,542.8**

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

9. Regulatory Capital Value

	Note	**2011 £m**
Opening RCV for the year (indexed by RPI)	(a)	**2,690**
Capital Expenditure	(a)	**135**
Infrastructure renewals expenditure		**29**
Grants and contributions		**(6)**
Depreciation		**(101)**
Infrastructure renewals charge		**(30)**
Outperformance of Regulatory Assumptions (5 years in arrears)		**(14)**
Closing RCV carried forward	(a)	**2,703**
Average regulatory capital value		**2,628**

(a) The table shows the RCV used in setting the price limits for 2010/11. The differences between the assumptions for the component parts such as capital expenditure shown above and the actual amounts do not affect the price limits in the current review period. Capital efficiencies achieved in the current price setting period have been taken into account in the calculation of the RCV used to set prices for the next review period. Other adjustments to the RCV used for the next review period have been agreed with Ofwat through the process of logging up / logging down of capital expenditure. The opening RCV for the year shown above is inflated from the closing RCV for the previous year by RPI, after adjustment for AMP4 log up/down and other final determination adjustments.

ADDITIONAL INFORMATION REQUIRED UNDER CONDITION F OF THE COMPANY'S LICENCE

(i) **Statement of compliance with condition F and RAG 5.04**

It is confirmed that to the best of the directors' knowledge, all transactions between the Appointed Business and Associated Companies have been disclosed and that these transactions have been conducted at arm's length and that cross subsidy is not occurring.

(ii) **Sales of services between the Appointed Business and Associated Companies**

(a) Services supplied to the appointee by associated companies:

Nature of transaction	Company	Turnover of associated company £m	Terms of supply	Value £m
Group expenses	Pennon Group Plc	8.2	Recharge of appropriate costs	3.7
Dry waste and sludge transport	Viridor Waste Group	712.0	Competitive letting/ other market testing	0.6
Property sales	Peninsula Properties (Exeter) Limited	0.2	Other market testing	0.2
Insurance premiums	Peninsula Insurance Ltd	1.3	Other market testing	0.4
				4.9

(b) Services supplied by the appointee to associated companies:

Nature of transaction	Company	Terms of supply	Value £m
Administrative services	Pennon Group Plc	Recharge of appropriate costs	0.5
Tankered waste & trade effluent charges	Viridor Waste Group	Commercial at arms length.	0.8
Other services	Various	Recharge of appropriate costs	0.3
			1.6

SOUTH WEST WATER

ADDITIONAL INFORMATION REQUIRED UNDER CONDITION F OF THE COMPANY'S LICENCE (Continued)

(iii) **Dividends Paid to Associated Companies**

The Company has established a dividend policy which involves the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholders' investment and the cost of capital.
- a further level of growth funded by efficiency out-performance.
- consistency with the assumptions made by Ofwat in setting prices for the K4 period.

Dividend payments ensure that key financial ratios are not prejudiced and that the ability of the Appointee to finance its Appointed Business is not impaired.

Dividends totalling £58.4m (2010: £54.4m) were paid to the parent undertaking, representing a base dividend for 2010/11. These dividends were calculated with reference to the projections in the Final Determination 09.

(iv) **Borrowings from Associated Companies**

Company	Principal Amount £m	Repayment date	Interest rate %
South West Water Finance Plc: loan notes 2040	132.1	2040	6.83% (fixed until July 2040)
South West Water Finance Plc: index-linked bond 2057	220.2	2057	RPI + 1.99%
Peninsula Leasing Limited: Finance leases in respect of motor vehicles	0.7	2011/12 to 2013/14	6.06%

ADDITIONAL INFORMATION REQUIRED UNDER CONDITION F OF THE COMPANY'S LICENCE (Continued)

(v) **Loans to Associated Companies**

Company	Principal £m	Repayment date	Interest rate %	Interest received £m
Peninsula Leasing Limited	1.0	2011/12 to 2013/14	Variable	0.1

(vi) **Guarantees**

(i) The Company has provided guarantees to third party lenders in respect of loans and finance leases extended to its subsidiary, South West Water Finance Plc (£352.3m at 31 March 2011). The funds raised were lent to the Company on 'back to back' terms, as described in section (iv) above.

ADDITIONAL INFORMATION REQUIRED UNDER CONDITION F OF THE COMPANY'S LICENCE (Continued)

(vii) **The role of South West Water Ltd's Directors in associated companies**

The Company has taken a conscious decision to minimise the role of its Directors on the boards of associated companies and hence avoid the potential risk of conflict of interest.

Apart from the roles of the Non-executive Chairman and Company Secretary, and that of the Chief Executive on the Board of the parent company, the only cross-directorships are that of the Chief Executive on the Boards of Peninsula Water Ltd, Echo South West Ltd and South West Water Finance Plc, S J Davy on the Boards of Peninsula Leasing Ltd, Peninsula Properties (Exeter) Ltd, South West Water Finance Plc and Source Collections Limited (Formally Haldon CollectionsLimited) and M S Read on the Boards of Echo South West Ltd and Source Collections Limited.

Full details are provided in the following table:

Name	Position in appointed business	Associated company	Position in associated company
K G Harvey	Chairman	Pennon Group Plc Viridor Waste Ltd Viridor Limited Peninsula Trustees Ltd Pennon Pension Trustees Ltd	Chairman Chairman Chairman Chairman Chairman
C Loughlin	Chief Executive	Pennon Group Plc Peninsula Water Limited Echo South West Limited South West Water Finance Plc	Director Chairman Director Director
K D Woodier*	Company Secretary	Echo South West Limited Peninsula Properties (Exeter) Limited Peninsula Leasing Limited Pennon Group Plc Peninsula Water Limited Viridor Waste Ltd Viridor Waste Suffolk Ltd Viridor Waste (Thames) Limited Viridor Limited South West Water Finance Plc Pennon Pension Trustees Ltd Peninsula Trustees Ltd	Secretary Secretary Director/Secretary Secretary Secretary Secretary Secretary Secretary Secretary Director/Secretary Director Secretary
S C Bird	Operations Director	Peninsula Trustees Ltd Pennon Pension Trustees Ltd	Director Director
S J Davy	Finance & Regulatory Director	Peninsula Leasing Limited Peninsula Properties (Exeter) Limited South West Water Finance Plc Source Collections Limited	Director Director Director Director
M S Read	Customer Relations & Business Development Director	Echo South West Limited Source Collections Limited	Director Director
H C B Shapland	Gen. Manager	Peninsula Properties (Exeter) Limited	Director

* Mr K D Woodier, in his capacity as Company Secretary for the Pennon Group, is a Director and / or Secretary for most companies in the Pennon Group in addition to South West Water and its subsidiaries. He does not participate in the executive management of South West Water Limited and its subsidiaries.

ADDITIONAL INFORMATION REQUIRED UNDER CONDITION F OF THE COMPANY'S LICENCE (Continued)

(viii) **Methodology for Allocating Costs Between Services (Note 3)**

Direct operating and capital costs are incurred directly by specific service and have not required allocation. Indirect costs are allocated on either a causal link basis or according to local managers' assessments.