Registered no: 02366661 (England and Wales)

Thames Water Utilities Limited

Annual report and financial statements

For the year ended 31 March 2012

Annual report and financial statements for the year ended 31 March 2012

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Directors and advisors at 31 March 2012

Directors

Sir Peter Mason KBE (Chairman)
M W Baggs
E Beckley
C R Deacon
S R Eaves
G I W Parsons
D J Shah OBE
Y Shi
S J Siddall
M S W Stanley
R E Verrion
L Webb

Independent non-executive directors

Dame D M Hutton CBE
M J Pavia
E C Richards

Registered auditor

KPMG Audit Plc
Chartered Accountants
15 Canada Square
London
E14 5GL

Company Secretary & registered office

J E Hanson
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

About us

Our mission

We provide the essential service that is at the heart of daily life, health and enjoyment.

Our vision

If customers had a choice, they would choose Thames Water.

Our customer experience

Customers choose Thames Water because:

- They **trust** us
- We are **easy** to do business with
- We really **care**

Facts and figures

Our business

- UK's largest water and wastewater services provider.
- 14m customers.
- Over 4,500 employees.
- One of the providers offering best value, with customers paying an average of 93p a day.

Water services

- 9m clean water customers in London and the Thames Valley.
- An average of 2,600m litres of drinking water supplied per day.
- Operation and maintenance of 100 water treatment works, 30 raw water reservoirs, 288 pumping stations and 235 clean water service reservoirs.
- Our tap water costs less than a tenth of a penny per litre.
- Drinking water quality is meeting 99.98% of stringent tests.
- Carry out over 400,000 water quality tests undertaken each year to meet stringent UK and European standards.

Sewerage services

- 14m wastewater customers.
- 350 sewerage treatment works ("STW") treating an average of more than 4,000m litres per day.
- 109,000 km of sewers, 2,530 pumping stations and 1.2m manholes.
- Two sludge-powered generators and 19 combined heat and power plants generating 176 GWh of renewable electricity.
- All wastewater treatment facilities are currently operating within Environment Agency ("EA") compliance guidelines.

Thames Water Utilities Limited

About us

Financial information

- Turnover increased by 4.4% to £1,694.9m (2011: 1,623.1m).
- Underlying profit before tax (profit before tax excluding exceptional item) fell by 12.6% to £182.2m (2011: £208.5m).
- Closing Regulatory Capital Value ("RCV") for the year is £10,005m (2011: £8,849m).
- Senior debt/RCV ratio was 78.3% (trigger point 85%).

Operational performance

Highlights

- For the second year running the Company delivered over £1bn of capital investment in its network and plants, including the development of the Thames Tunnel.
- Leakage reduced 28 Mld to 637 Mld compared to last year and beat the target set by the Water Services Regulatory Authority ("Ofwat") for the year by 36 Mld.
- The Company's drinking water quality was 99.98%, whilst sewerage treatment compliance was 100%.
- Continuing reduction in greenhouse gas emissions, with CO_2e emissions 16% lower than two decades ago and generating 14% of the Company's own power.
- Charitable donations of £1,019,340 partly through the shareholders' Ten for Ten initiatives, which started in 2009.
- Health and safety: the number of reportable accidents fell to an Accident Incident Rate of 0.33 per 1,000 employees, a 48% improvement since the start of Asset Management Period 5.
- The Company's Transforming Thames programme started to deliver its Work, Asset Management and Information ("WAMI") programme, Metering Outsourcing and introduced new working patterns and associated terms and conditions for staff.
- The Company introduced certain changes to the Thames Water Pension scheme whereby the defined benefit provision is now based on a Career Average Revalued Earnings basis instead of a Final Salary basis.
- The Company successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

Lowlights

- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction has deteriorated to 62.61 (2011: 65.20).
- Pollution incidents (sewerage) have increased to 3.76 incidents per 1,000 km (2011: 2.67).
- Customer bad debt provisioning increased in the year reflecting the economic recession.
- Two employees of the Company's contractors suffered fatal injuries in two separate incidents.

Awards

- The Company was awarded the Utility Industry Achievement Award for staff development.
- The Company received two awards from the Institute of Civil Engineers for its early work on the Lee Tunnel.

Thames Water Utilities Limited

Chairman's introduction

Satisfactory operational and financial performance have again been features of the last year for Thames Water. It has also been a period of significant and ongoing challenges, to which Thames Water Utilities Limited ("the Company") continues to respond robustly.

Two consecutive dry winters forced the introduction of a temporary use ban across much of southern and eastern England, and the Thames Valley was no exception.

This was not a measure the Company took lightly, but one that was unfortunately necessary in order to minimise the likelihood of more severe restrictions at a later stage, if the drought continues.

Against this background, it is all the more satisfying that the Company has achieved its leakage target for the sixth successive year, and by a significant margin.

This has been just one aspect of the prudent management of water resources, which has included the use of the Company's desalination plant in east London, in response to the drought, to supplement water resources.

The wise use of water is particularly important at a time when the Company faces its second major challenge: the staging of the 2012 Olympic and Paralympic Games ("the London 2012 games") in London.

The provision of water and sewerage services will clearly play a vital part in the successful staging of the London 2012 games. The Company has also been planning carefully to mitigate the inevitable disruption to streetworks activity.

The capital will clearly be the centre of attention this summer. It is also the focus for two huge engineering schemes, which are a major centre of activity for the Company; the Lee Tunnel and the Thames Tunnel.

I am pleased to report that, after some years of discussion and planning, work is finally under way to significantly reduce overflows of sewage into London's major rivers.

Although frequently overshadowed by discussions of the Thames Tunnel, the Lee Tunnel will be the largest and deepest tunnel beneath the capital. The tunnel boring machine that has started excavating, and is due to emerge in Abbey Mills, east London in late 2013.

The Company also made good progress on the planning of the Thames Tunnel with Government support. February saw the completion of the second phase of planning consultation on this huge project, which will involve 24 major construction sites across the city.

The Government recognised the Thames Tunnel's importance by including the project in the Chancellor's National Infrastructure Plan and safeguarded certain key sites.

Elsewhere in London, another major wastewater scheme began to take shape at Deephams STW, in Edmonton, where a major upgrade is needed to meet new environmental standards set by the EA.

The year ended 31 March 2012 was the second year of the current five-year investment period. It naturally saw the Company accelerating much of the work that began in 2011, and starting to record some significant achievements.

Work is nearing completion, for example, on the first of a series of major improvement projects at the Company's five biggest STW, to improve both their capacity the quality of treated effluent they discharge to the tidal Thames.

I am pleased to say that our 350 STW once again continued their record of 100% compliance with the strict standards set by the EA.

One area of concern was a rise in the number of serious pollution cases, which senior management is working hard to address.

Chairman's introduction

Another significant challenge is the area of customer satisfaction. The way the Company handles queries and complaints is rated poorly when compared with the rest of the sector, and this remains an area where it is striving to improve.

On the drinking water side of the business, the Company again reported excellent performance. In 2012, 99.98% of samples taken at customers' taps complied with stringent national and European standards. This was a slight improvement on the year before, and saw the Company maintain supplies that are among the best-quality in the UK.

The continuing high performance across the business was, of course, made possible by good management. This is being further enhanced by a major development programme, for which the Company last December received the Staff Development Award at the Utility Industry Achievement Awards. To date, more than 700 managers have completed the programme.

During the year Luis Abraira, Rosamund Blomfield-Smith and Antonio Santos resigned as non-executive directors, while executive directors Chief Financial Officer Mark Braithwaite and Chief Operating Officer Steve Shine OBE also left the Company. I would like to thank them all for their valuable contributions. We have also welcomed Mark's replacement, Stuart Siddall, and non-executive directors Simon Eaves, Yaping Shi and Lincoln Webb, bringing with them extensive experience.

I would like to note my thanks to staff across Thames Water for their achievements during the year.

Sir Peter Mason KBE
Chairman
7 June 2012

Thames Water Utilities Limited

Chief Executive Officer's Business review

The following business review forms part of the Directors' report.

Business review

Introduction

Unless otherwise stated, all current year data included in this review is for the year ended 31 March 2012 ("2012").

Nature of business

Background

The Company is the largest supplier of water and provider of sewerage services in the UK, based on the number of customers served. It is one of 10 companies currently holding appointments as water and sewerage undertakers[1] in England and Wales, with a further 11 companies holding appointments as water only undertakers.

In total, the area served by the Company occupies approximately 13,331 km^2 and encompasses more than 9% of the area of England and Wales. This includes London and extends as far as Cirencester in the west, Dartford in the east, Banbury in the north and Haslemere in the south. This area has a population of about 14m people, which represents nearly a quarter of the total population of England and Wales. In approximate terms, the Company supplies 3.6m properties (just over 8.8m people) with water, and collects sewage from 5.1m properties (about 14m people), representing 97% of households in its sewerage region.

The Annual Performance Report 2011/12, which incorporates the Corporate Responsibility Report, does not form part of this report. It provides further information regarding the Company's regulatory and operational performance and will be available on the Company's dedicated website: www.thameswater.co.uk/cps from 15 July 2012.

[1] A company that has been appointed to provide water and/or sewerage services to customers in England and Wales is known as an "undertaker". The Company's Instrument of Appointment - usually referred to as "the Licence" - was issued by the Secretary of State for the Environment in August 1989

Chief Executive Officer's Business review (continued)

During the last year, the Company continued its satisfactory performance against its targets.

Highlights

- Delivering over £1bn of investment in the year, bringing the total for the first two years of Asset Management Period 5 ("AMP5") to over £2bn, in line with the Company's capital programme to deliver £4.9bn of investment during AMP5.
- Delivering all of the Company's key regulatory outputs, ensuring that the condition of its assets is maintained.
- The Company reduced leakage to 637 Mld, a reduction of 28 Mld (4.2%) compared to 665 Mld in the prior period, and beat its target for the year by 36 Mld.
- The Company's drinking water quality improved slightly to 99.98% (2011: 99.97%)
- The Company achieved 100% sewage treatment compliance against strict standards set by the EA.
- In November 2011, the Company opened its Old Ford water recycling plant on the edge of the Olympic Park in East London, which will supplement the supply of water for the London 2012 games.
- Greenhouse gas emissions were 16% lower than two decades ago, despite the Company serving 3m more customers amd meeting higher standards in many areas of operation.
- In addition, 14% of the Company's electricity was generated from renewable energy from burning methane gas from sewage at 22 of its larger STW's. The Company also installed solar power arrays at 3 of its main sites and 28 smaller sites. The Company is now one of the largest solar power generators in the UK.
- The Company was awarded the Utility Industry Achievement Award for staff development in the year.
- The Company's Transforming Thames programme is delivering its WAMI programme, a new contract that covers all metering services and introduced new working patterns and associated terms and conditions for staff.
- The Company introduced changes to the Thames Water Pension scheme whereby the defined benefit provision from 1 May 2011 is now based on a Career Average Revalued Earnings basis ("CARE") and no longer on a Final Salary basis.
- The Company successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

Lowlights

- It is with deep regret that the Company has to report the death of two contractors who suffered fatal injuries in two separate incidents is a major concern to the Company. The health and safety of both the Company's, and its contractors' employees continues to be the Company's number one priority.
- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction has deteriorated to 62.61 (2011: 65.20).

Thames Water Utilities Limited

Chief Executive Officer's Business review (continued)

Lowlights (continued)

- The number of pollution incidents from by the Company's sewerage system increased in comparison to last year, with 75 more incidents recorded. This gave a total of 268 pollution incidents, 20 of which were considered to be serious. An incident in the River Crane resulted in the death of fish along approximately a 12km stretch of the river. The Company responded as quickly as it could to clean up the river, and has made a voluntary commitment to the ongoing programme of restoration, to be delivered through the Crane Valley Partnership. Spillages from the Company's sewer network are unacceptable and the Company is working harder to try to avoid them.

  In response to this pollution performance, the Company has already improved many aspects of its business processes. Key to the ongoing performance improvement is the creation of an Event Learning role to learn from each incident so that the Company can work to avoid similar events in the future.

- The bad debt charge has increased to £70.6m in the year (2011: £38.4m) due to collection difficulties and customers' ability to pay as a result of the economic recession.

Financial results

Financial Key Performance Indicators (KPIs)

	The Company			**The regulated business**		
Performance Measure	**Year to 31 March 2012 £m**	Year to 31 March 2011 £m	% Change	**Year to 31 March 2012 £m**	Year to 31 March 2011 £m	% Change
Turnover	**1,694.9**	1,623.1	4.4	**1,670.9**	1,600.0	4.4
Operating expenditure [2]	**675.4**	629.6	(7.3)	**665.8**	627.1	(6.2)
Operating profit [3]	**643.9**	600.2	7.3	**634.4**	598.1	6.1
Underlying profit before tax [4]	**182.2**	208.5	(12.6)	**169.0**	195.7	(13.6)
Total capital expenditure (see note 10)[4]	**1,063.8**	1,006.6	5.7	**1,056.1**	1,003.0	5.3

The following commentary is in respect of the Company.

[2] Operating expenditure: operating costs, see note 3, page 75 (£1,051.0m) , excluding exceptional item of £40.0m relating to a pension curtailment gain, depreciation on owned assets (£276.5m), depreciation on assets held under finance leases (£9.6m) and the Infrastructure Renewals Charge ("IRC") (£129.5m).

[3] Operating profit: turnover less operating costs for the Company but excluding profit on sale of fixed assets. For the regulated business, operating profit includes profit on sale of assets.

[4] Underlying profit before tax: Profit before tax, excluding exceptional item (pre-tax).

[4] Total capital expenditure: total expenditure on tangible fixed assets net of contributions received, see note 10 to the financial statements. Regulatory capital expenditure, in addition includes maintenance non infrastructure income.

Chief Executive Officer's Business review (continued)

Financial results (continued)

Turnover

Turnover for the year was £71.8m (4.4%) higher than the prior year at £1,694.9m (2011: £1,623.1m), reflecting real increases in price ("K"), (see page 130), as agreed with Ofwat, together with increases linked to the Retail Price Index ("RPI").

Operating expenditure

Operating expenditure, excluding exceptional item, depreciation and IRC, see note 3 page 75, for the year has increased by £45.8m (7.3%) to £675.4m (2011: £629.6m) compared to the prior year. This increase is as a result of inflationary pressures with average RPI of 4.8%, increased provisioning for bad debts, caused by the economic climate, and higher than inflationary power price increases, partly offset by an operating network contract claim settlement and continued operational efficiencies.

Net interest payable

Net interest payable of £423.2m (2011: £398.3m) increased by £24.9m (6.3%) principally reflecting the higher internal interest payable due to the increase in net debt.

Underlying profit before tax

Underlying profit before tax has reduced by £26.3m (12.6%) to £182.2m (2011: £208.5m). This reduction is due to the increase in operating costs, increase in depreciation and Infrastructure Renewals Charge and interest costs as a result of substantial investment in the network of pipes, sewers and other facilities offset by increase in turnover described above.

Capital expenditure

2012 has been a successful year for the delivery of capital investment by the Company, for the second year of AMP5, with over £1bn was invested in delivering all of its capital regulatory outputs, whilst delivering efficiencies of over £80.0m against its five year business plan. The Company is on track to deliver its required investment programme of £4.9bn over this regulatory period.

Treasury policy

The Company's treasury operations are managed centrally by a small specialist team, which operates with the delegated authority of, and under policies approved by, the Board of Directors. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. The key objectives of the funding strategy are defined by the regulatory regime within which the Company operates and are intended to ensure that it meets all funding related requirements under the terms of its Licence. This includes maintaining cash reserves and access to undrawn committed bank facilities sufficient to fund at least 12 months net cash flow (as discussed on page 32 - Company dividend policy - extends this to a 15 month period) and to maintain an investment grade credit rating (see "Debt financing" section below) as set out in Condition F of the Licence.

A key objective of treasury policy is to ensure compliance with financial covenants, including interest cover and gearing ratios, maintain liquidity and a balanced debt maturity profile, and ensure that at least 85% of the interest cost within the Securitisation Group, (being Thames Water Utilities Holdings Limited, the Company, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited) is based on either fixed or RPI-linked interest rates.

Chief Executive Officer's Business review (continued)

Financial risk management

The Company's Executive Team ("the Executive"), receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The operation of the Treasury function is governed by policies and procedures, which set out guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk, interest rate risk and exchange rate risk.

Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk arising from the primary financial instruments used to finance the Company's activities. Matching of assets and liabilities in foreign currencies is also applied wherever practicable. The Company actively maintains a broad portfolio of debt, diversified by source and maturity and designed to ensure the Company has sufficient available funds for operations.

The Company is exposed to commodity price risk, especially energy price risk, as a result of its operations. The Company aims to manage its risk by fixing contract prices where possible.

Financing

The Company had committed facilities in place with a syndicate of relationship banks to the value of £1,200.0m; all of which were undrawn at 31 March 2012. In addition, due to pre-funding activity undertaken in the final quarter of the year, the Company had £622.1m of cash and current asset investment as at 31 March 2012, consisting of cash at bank, short-term deposits with highly rated banks or triple A rated money market funds. This balance together with the undrawn facilities, will provide the Company with the necessary liquidity to fund the operation of the business for at least the next fifteen months.

Debt financing

Debt financing is raised by the Company or through the Company's wholly owned subsidiary, Thames Water Utilities Cayman Finance Limited. Previously, debt had been raised through Thames Water Utilities Finance Limited, another wholly owned subsidiary.

Moody's Investor Service ("Moody's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited, A3 long term with stable outlook and Class B.debt at Baa3 with stable outlook. Moody's also issues a Corporate Family Rating for the Securitisation Group of companies, which stands at Baa1, with stable outlook. Standard and Poor's Rating Services ("Standard and Poor's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited at A- and Class B debt at BBB. Accordingly, the Company maintains an investment grade issuer credit rating in accordance with the requirements of its Licence.

Capital structure

Key features of the Company's capital structure are as follows:·

- All debt issued by the Securitisation Group is documented pursuant to a Common Terms Agreement as part of the Whole Business Securitisation entered into in August 2007.

- Net debt issued by the Securitisation Group Class A ratio of net debt to RCV is limited to 75%.

Chief Executive Officer's Business review (continued)

Capital structure (continued)

- Since 1 April 2010, the Company and the Securitisation Group has the option to issue Subordinated Debt ("Class B"). At the same time, there is an increase in the combined Class A and Class B (together "Senior") net Debt/RCV ratio to a maximum of 85%.

- Each Obligor (the companies within the Securitisation Group) had entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited guarantees the obligations of each other Obligor under the finance documents and the Company and its wholly owned subsidiaries guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

- Following an event of default, the documents provide for an automatic 18 month standstill of the claims of the creditors that have entered into the STID.

Insurance

The Company maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors & Officer liability cover.

The insurance coverage has been reviewed and approved by an independent insurance adviser retained to ensure that the Company's insurances;

- are consistent with Good Industry Practice;
- have regard to the risk being covered;
- address the interests of the Company.

Covenant compliance

Under the terms of its finance documents, the Company is required to comply with various covenants such as interest cover and net debt to RCV. These covenants are measured and submitted to the Security Trustee semi-annually and involve both actual data and forecasts. The two main ratios are discussed further below:

Senior adjusted Interest cover ratio (trigger: 1.3x)[5]: For the year to 31 March 2012 the ratio was 1.4x (2011: 2.1x). The movement in the year is partly due to class B debt issuance of £850.0m raised through the Company's subsidiary Thames Water Utilities Cayman Finance Limited.

Whilst actual interest cover has moved closer to the trigger, the Company is satisfied that a trigger will not occur. This is due to the high proportion of the Company's debt being fixed and the certainty and stability of the Company's operating cash flows for 2012/2013, as the income stream has already been determined and the predictable nature of the operating cost cash flows.

Senior Debt/RCV ratio (trigger: 85%)[6]: At 31 March 2012 the ratio was 78.3% (2011: 77.4%). The movement is attributable to the class B debt issuance highlighted above.

There are other variations on these ratios on class A and Senior Debt, which the Company is also required to calculate to show compliance with its covenants. The Company is compliant with these ratios as at 31 March 2012 and is forecast to remain compliant.

[5] A trigger event would lead to lock up which would mean nil distributions outside of the Securitisation Group until resolved to the Security Trustee's satisfaction. Adjusted Interest Cover Ratio is calculated as operating cashflow adjusted for expenditure on depreciation and infrastructure renewals divided by interest paid.

[6] A trigger event would lead to lock up which would mean nil distributions outside of the Securitisation Group until resolved to the Security Trustee's satisfaction.

Thames Water Utilities Limited

Chief Executive Officer's Business review (continued)

Key performance indicators ("KPI's")

Ofwat, in removing the requirement for Water and Sewerage companies ("WaSc") and Water only companies ("WOC") to submit an annual return ("the June Return") to them, they have introduced certain KPI's, which they have developed in consultation with WaSc and WOC.

The table below shows the Company's performance against these KPI's in accordance with the guidance received from Ofwat which require the Company to disclose;

- status (red, amber or green, where indicated);
- unit of measurement;
- actual value

KPI Dashboard

Customer experience			
SIM	62.61		Score
Internal sewer flooding	See note below		Nr of Incidents
Interruptions	0.21		Hours per total properties served
Reliability and availability			
Serviceability water non-infrastructure	Stable		
Serviceability water infrastructure	Stable		
Serviceability sewerage non-infrastructure	Stable		
Serviceability sewerage infrastructure	Stable		
Leakage	637.14		Ml/day
Security of Supply Index (SoSI)	100		Index score
Environmental impact			
Greenhouse gas emissions	741		ktCO2e
	All incidents	Exc consent compliant *	
Pollution incidents (sewerage)	3.78	2.75	Category 1-3 incidents per 1,000 km of sewer
Serious pollution incidents (sewerage)	2.93	2.20	Category 1-2 incidents / 10,000 km of sewer
Pollution incidents (water)	3.17	2.86	Category 1-3 incidents / 10,000 km of main
Discharge permit compliance	99.71%		%
Satisfactory sludge disposal	100%		%
Financial			
Post-tax return on capital	6.34		%
Credit rating	A3		Moody's - Class A debt
	Baa3		Moody's - Class B debt
	Baa1		Moody's - Corporate Family rating
	A-		S&P - Class A debt
	BBB		S&P - Class B debt
Gearing	78.30%		%
Interest cover	1.4		x

Internal sewer flooding is a new metric and the calculation is being finalised in advance of Ofwat's submission deadline for the new KPI dashboard of 15 July 2012.

Chief Executive Officer's Business review (continued)

Key non-financial measures

In addition to the above, the table below shows the Company's performance against its key non-financial measures, which with two exceptions were achieved.

Target area	Target 2011/12	Performance 2011/12	Target achieved
Corporate responsibility programme			
Business in the Community Corporate Responsibility Index	Platinum (>95 per cent)	Platinum (>95%)	✓
Water			
Drinking water quality compliance	99.98%	99.98%	✓
Security of supply (annual average)	100	100	✓
Leakage (Ml/d)	673	637	✓
Properties receiving low pressure	34	3	✓
Wastewater			
Sewage treatment works compliance (LUT)	100%	100%	✓
Properties alleviated from external and internal sewer flooding	-	84 *	Target is to achieve 2,488 by 2015
Serious or significant pollution incidents	Zero	20	×
Satisfactory disposal of sewage sludge	100%	100%	✓
Our wider responsibilities			
Renewable energy generation	197 GWh	176 GWh	×
Health and safety – number of accidents per 1,000 employees	5.37	3.12	✓
Employee volunteering – employees volunteering in schools, the community or charities	15%	18%	✓
Sites of Special Scientific Interest (SSSI) in favourable and unfavourable recovering condition	95%	100%	✓
Suppliers, contractors, and service providers' invoices paid according to agreed terms and conditions (+/- 3 day tolerance)	85%	92%	✓

* Provisional.

Chief Executive Officer's Business review (continued)

Key performance measures - highlights

Below is a summary of some of the key changes in the business that the Company has used to drive its improvement against targets.

Water Service and Environmental Performance

- Between 2005 and 2012, the Company has reduced leakage by 26%. A number of measures have helped to achieve this reduction; replacing old pipes including Victorian mains, trunk main replacement, and water pressure management as well as the Company's new Trunk Minder system as mentioned below. The Company has now met the annual leakage target agreed with Ofwat for the last six years.

- The Company's new Trunk Minder system was introduced to identify a hidden underground leak as soon as it forms, allowing the Company to schedule a repair before a leak has time to wash away the ground around the trunk main and cause a major leak.

- The Company's drinking water quality performance remains high at 99.98% compliance, an improvement on the prior year. Whilst the Company aims to achieve 100% compliance, many of the failures recorded at customers' taps are caused by the condition or maintenance of customers' pipework and fittings. To that extent, 100% compliance is not within the control of the Company. However, the Company will continue to strive to achieve this aim.

- Water efficiency has been a focus of the Company in its campaign to encourage customers to use water wisely. During the last year as a result customers have helped to achieve a daily saving of 6 Mld (2011: 5 Mld).

Sewerage Service and Environmental Performance

- During this year, the Company has increased the capacity of some of its STW's to treat wastewater from an additional 61,000 customers. This increase means that the Company can deal with new housing development for years to come without having to make further investment or seek delays to the building of these houses.

- Reducing the risk of sewer flooding is of the highest importance to both the Company and its customers. In the year, 45* properties were affected by sewer flooding for the first time. The number of properties on the Company's high risk register was 1,529*, an increase of three from the previous year. The Company's investment programme resolved the flooding of 60* properties and the Company will continue to offer flooding mitigation measures to alleviate this most distressing experience.

- The Company again achieved 100% compliance with the EA standards on treated effluent across all of its 350 treatment works.

  * Provisional.

Chief Executive Officer's Business review (continued)

Key performance measures – highlights (continued)

Sewerage Service and Environmental Performance (continued)

- During the year, the Company dealt with 71,050 incidents of sewer blockages including 14,946 across the lengths of private sewers it adopted in October 2011. The Company recognises that this is not the level of performance that it expects to deliver, and is not in line with the Company's plan to reduce the number of these incidents by 2015. The Company aims to improve its performance through the use of new technology such as real time sewer monitors and targeted sewer inspection and maintenance.

- The Company recognises that the environmental damage and public nuisance caused by spillages from its sewer network is unacceptable and works hard to prevent them. The EA categorises pollution incidents on a scale from one (the most serious) to four (no significant environmental impact). In the period, there were 20 incidents that were categorised as Category 1 or 2 by the EA. Clearly, this level is unacceptable and the Company is working hard to improve its performance.

Security of Supply

- The Company has delivered 100% Security of Supply to all its customers.

Customer Service

- Along with other water companies, the Company provides information to Ofwat on the number of complaints it receives, and how well they have been handled. The Company also proactively carries out its own customer satisfaction surveys to gauge where it is performing well and to give the Company an insight into the areas where its customers think that it can do better. Generally customers were more satisfied with the Company's services than the previous year.

- The Company's Customer Assistance Fund provides support for customers who genuinely cannot pay their bills. During the year the fund made donations totalling £1.8m (2011: £1.9m). In addition, £0.3m was provided for exceptional hardship cases and grants were made to nine specialist advice organisations including Citizens Advice to pay for specialist debt advisors.

- The Company has made improvements to its telephony system to make it easier for customers who would prefer to talk to a customer advisor. The Company has also provided a call back facility for customers who do not want to wait in the line during peak call times.

Health and Safety

The Company continues to have a key focus on health and safety. It has developed its 'one-safety hub', a shared facility enabling the Company and its contractors to share best practice in health and safety. In the year, the Company has also reviewed and enhanced its health and safety systems and held further health and safety conferences for the Company's employees and its contractors.

The number of reportable accidents fell to an Accident Incident Rate ("AIR") of 0.33 injuries per 1,000 employees, (2011: 0.50) across the business, a 48% improvement since the start of AMP5.

However, it is with regret that the Company has to report that two employees of its contractors suffered fatal injuries in two separate incidents. The first of these occurred in June 2011 where the contractor was working in an excavation and the Health and Safety Executive are carrying out a full investigation. The second occurred in October 2011, where the contractor was struck by a vehicle when working in a roadway, a driver was charged and convicted of dangerous driving and was sentenced to time in prison.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties

Risk overview

The Company's Risk Management process is integrated within the business, and is designed both to identify emerging risks and to minimise the adverse impact of emerging and existing risks. Each business area is responsible for managing its risks and maintaining a risk register. Significant risks are escalated and reviewed by the Executive and the process is overseen by the Audit & Risk Review Committee ("ARRC"). For more information regarding the role and responsibilities of the ARRC, see pages 56 and 57 of the Corporate governance report.

The Company is exposed to a number of risks and uncertainties that could have a material impact on its long-term performance. These include:

- **Delivery of the Thames Tunnel** – As an innovative solution to the challenge of reducing sewage discharges into the Thames, the design and construction of the Thames Tunnel present a number of major technical and logistical challenges. These include the need to secure a number of construction sites in central London, obtaining planning consents via the process for major projects set out in the Planning Act 2008 and managing the inevitable disruption. As well as the many stakeholder issues, a key challenge is to finance the project, and protect the Company's credit rating. The Government has indicated that it will provide support for the exceptional construction risks involved in the project, but the details of this support and the residual risk to the Company have yet to be resolved.

  Mitigation: The Company is working closely with the Government to agree the funding model and the appropriate organisational structure to deliver and operate the tunnel.

- **Price Review 14 ("PR14") determination** – All UK water and sewerage companies must justify the operating costs and capital investment needed to deliver service to customers in the five-year period from April 2015. Failure to demonstrate the Company's case to Ofwat's satisfaction may mean that it is unable to invest in asset improvements that the Company believes will benefit its customers in the long term or to finance its business plans.

  Mitigation: The Company has assembled a dedicated team to oversee the production of the plan, building on experience gained during previous Price Reviews.

- **Managing increased competition in the water industry** - The Water White Paper issued in December 2011 has signaled plans to implement market competition for business customers, while at the same time providing assurances that the sector needs to remain attractive to investors. The extent and timing of changes remains uncertain. The initial impact will largely be for large users, although there will also be opportunities for the provision of wholesale services.

  Mitigation: The Company is preparing for these changes with a view to taking advantage of the opportunities, and this may require structural change.

- **Employee pension scheme funding** – The Company operates two material defined benefit pension schemes. Whilst the Company has reduced its future exposure by closing the final salary schemes to new entrants, and moving a number of senior employees onto a defined contribution scheme, the Company remains liable for the historic rights earned by past and present employees. Both schemes are currently in deficit on a Gilts valuation basis, whilst agreed deficit repair plans are in place, there is a risk that actuarial assumptions on investment returns or longevity could change and cause increased employer contributions.

  Mitigation: The Company will continue to review investment strategy with the trustee in order to ensure that funding risks are understood and managed.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

- **Failure to maintain adequate funding arrangements** – As at 31 March 2012, the Company has adequate cash at bank and short term deposits of £622.1m (2011: £779.4m) and undrawn committed bank facilities of £1,200.0m (2011: £1,175.0m) in place to provide liquidity as required. The Company will need to renew £450.0m of 364 day committed facilities by August 2012. There remains a risk that credit market conditions will deteriorate against the backdrop of weak economic recovery and falling credit ratings of financial institutions, increasing the cost of raising new debt and refinancing bank facilities. As a regulated utility, the Company does not anticipate a situation where it will be unable to access financing as it would benefit from a flight to quality in poor debt conditions. An increase in the cost of funds may put pressure on key financial covenants (as defined by the Company's capital structure). In addition the impact of a falling RPI rate on the RCV could create further pressure on financial covenant headroom, specifically the ratio of net debt to RCV.

  Mitigation: The Company has an established funding strategy which is reviewed by the Board annually.

- **Customer experience measures** – The measure for customer performance is evolving from quantitative to qualitative criteria. All water companies will need to adapt their processes in order to optimise performance against these new criteria to be measured against Ofwat's SIM. Failure to meet the SIM target for the Company over the remaining years of this regulatory period could lead to a financial penalty in the next regulatory period.

  Mitigation: The Company is working closely with Ofwat to shape the future reporting requirements, and is reviewing internal processes to improve end-to-end customer service.

- **AMP4 sewer flooding programme** – The Company has responded to an information request from Ofwat issued under section 203 of the "Water Industry Act 1991" concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The information requested relates to the level of evidence required to support a judgment that a property is likely to have flooded in the past. Ofwat's investigation into whether the Company complied with the relevant guidance continues and is unlikely to conclude its investigations until at least the third quarter of 2012. If Ofwat concludes the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs which Ofwat determines have not been achieved during the AMP4 period.

  Mitigation: The Company has provided all the information that has been requested to support the numbers claimed and has met with Ofwat on several occasions to discuss their concerns. The Company awaits the conclusion of Ofwat's investigation.

- **Credit rating** – Regulated water and sewerage utilities benefit from strong investment grade credit ratings based on a large asset base, predictable returns and a stable regulatory environment. This could be adversely impacted by Ofwat proposals to amend licence conditions and its further proposals for regulatory reform. The Company's credit rating could also be negatively affected by an agreement on the delivery model for the Thames Tunnel project that exposes the Company to a level of risk beyond that normally associated with a regulated water and sewerage utility company, or by an obligation to deliver a further large capital programme in the next regulatory period ("AMP6"). A downgrade in credit rating would increase borrowing costs and reduce access to long-term debt markets, putting at risk the ability to meet financial covenants. This would therefore increase the likelihood of hitting a "trigger event" under the terms of the whole business securitisation, an event that would lead to a distribution lock up.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

Mitigation: The Company is working to ensure that its Price Review preparations, Thames Tunnel plans and other significant business changes take account of the impact on the credit rating.

- **Drought** – The Thames catchment area has experienced the driest two-year period in recorded history, leading to a temporary use ban to conserve remaining water supplies. Heavy rain during April has alleviated the immediate crisis, but ground water levels remain very low and a further dry winter may cause a more severe drought in 2013.

Mitigation: The Company is managing the drought as a priority operational event. It has mobilised a team that draws on experience across the business. This team is headed by a member of the Executive.

- **The London 2012 games** – London will host the Olympic and Paralympic Games from 27 July 2012. Any operational interruption would cause significant disruption and, with the media present, damage the Company's reputation. Meeting the additional demand for water during a drought will provide further operational challenges.

Mitigation: The Company has worked continuously with the London Organising Committee of the Olympic Games ("LOCOG"), to provide the agreed infrastructure and ensure that it is ready operationally. Operational and communications plans are already in place.

- **Failure to meet regulatory targets** – The Company is required to meet targets set by Ofwat, the EA, the Drinking Water Inspectorate and other regulators. In order to achieve this, the Company must continue to deliver cost and efficiency savings in line with a challenging Final Determination, while maintaining and improving operational performance and the standard of customer service.

Mitigation: Performance against regulatory measures is the subject of regular management review. The new reporting mechanism allows the Company to further align internal and external performance indicators.

- **The effects of climate change and long-term changes in weather patterns** – As the Company continues to supply an increasing population, the effects of climate change could adversely affect its ability to maintain its Security of Supply Index (SoSI) requirements.

Mitigation: The Company has been working on measures to reduce demand, mounting a widespread awareness campaigns and providing free water saving devices, as well as making provision for new sources of potable water and improving the integrity of its network. Together with other water companies and regulators, the Company is actively participating in work to identify the wider water resources needs across South East England.

- **Future changes in laws or regulations** – The Company is not funded by Ofwat for changes in obligations that would affect the whole economy. Consequently the Company may, for example, have to meet the obligations resulting from changes in environmental legislation without recourse to Ofwat.

Mitigation: Changes that are specific to, or are more material for, the water industry may be funded by Ofwat as a relevant change of circumstance. The Company engages actively with regulators where a change is likely, to ensure the implications are understood, and monitors the impact of recent changes to ensure it can demonstrate the case for additional funding where it is justified.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

- **Failure of a major asset** – A failure at one of the Company's major assets could significantly impact the safety of its workforce and the public, as well as interrupting supply to customers and breaching environmental and regulatory targets. The impact would be both financial and reputational.

  Mitigation: The Company has a specific compliance process to manage each of the identified risks.

- **Impact of low inflation or deflation** – In return for their capital investment in assets, regulated water companies earn a return on their RCV, which is adjusted by the RPI. In times of low inflation or deflation, the return on this investment will decrease relative to the cost of funding, reducing cash flow and shareholder value.

  Mitigation: In order to protect the Company from these impacts, around half of the Company's debt is indexed to RPI, either directly in the underlying debt instrument, or by use of RPI swaps.

Transforming Thames

The Transforming Thames programme has continued, with the focus on improving customer service, improving the Company's health and safety performance, enhancing its data and the way it is used to make business decisions and driving operational efficiency.

Key efficiency projects have moved to the delivery phase. This includes the WAMI programme, which began phased deployment in November 2011. This programme is implementing a fully integrated work and asset management approach across the business, using a SAP platform, to drive a more effective and efficient service for customers. Rollout to circa 4,000 users will continue through 2012. The benefits from this project include better data capture at source enabling better business decisions, improved customer diagnostics enabling first time resolution and more efficient work planning enabling better productivity in the field. Overall, this will enable an improved customer experience.

New working patterns and associated terms and conditions have been negotiated for all field-based operatives, better allowing the Company to meet customer demand and map resources to those demand patterns. These new working patterns were implemented on 1 April 2012.

The Customer Service improvement programme has been developed based around the principle of 10 key aspirational promises for customers. This, when delivered, will enable the Company's performance to be successfully measured by SIM.

All managers in the field continue to be supported by Change Managers, who are experienced in the sustainable delivery of business change. They provide coaching support to teams, ensuring that the transformation programme is understood, employees are fully engaged in the process and that the appropriate measures are developed to track progress and success.

Following extensive consultation with employees and with the agreement of the pension fund trustees the Company has changed certain provisions in respect of the Thames Water Pension Scheme ("TWPS") for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011, new employees of the Company have been offered participation in the Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life Assurance Limited ("Standard Life"). All senior managers have now moved to this scheme.

Chief Executive Officer's Business review (continued)

Transforming Thames (continued)

For existing members of the TWPS, certain provisions have changed that will affect future benefits to its members. Principally, the defined benefit provision with effect from 1 May 2011 will be on a CARE basis and no longer on a Final Salary basis.

The Company has demonstrated continuing improvement, whilst implementing the transformation programme, in both operational and financial performance, thus providing a strong platform for the future.

Looking further ahead

It is over 20 years since the water industry was privatised. Since then much has changed - costs of service are lower, performance is better and the industry has delivered significant quality improvements. However, with the Company continuing to face challenges including climate change, population growth and new quality improvements, to name a few. The industry and the Company must ensure they can meet these challenges, including the immediate demands of dealing with a drought.

The regulation of the sector going forward will be critical to its ability to meet the challenges of the future.

There is increasing clarity. In November 2011 Ofwat published early proposals for its PR14 and in December 2011, the Government published its long awaited Water White Paper and moved to expand the existing business retail market. During 2012, the Company expects Ofwat to further refine its approach to PR14 and Government to publish a draft water bill, primarily focused on enabling a retail market for all business customers.

Looking further ahead, the Company will need to be flexible and ready for any change to the regulatory environment. However, through this period of change there are some constant underlying requirements. The Company will need to ensure that;

- high performance is maintained and it capitalises on opportunities for further improvements;
- it delivers what customers want at the right price, in the right place and at the right time;
- it offers value for money at an affordable price.

A key challenge in this process will be the delivery of the proposed Thames Tunnel. The Company is working closely with all stakeholders to ensure this is delivered by the most appropriate means possible.

The Company is always looking ahead to understand the future environment and ensuring that it takes the right actions today to protect the future.

Strategic Direction Statement

In 2007, the Company published a Strategic Direction Statement setting out priorities for the next 25 years. As part of its strategic business planning, the Company is working to review and update its long term plans, building on the wants and needs of customers and challenges as diverse as future population growth and climate change.

Water resources and Drought

In August 2009, Department for Environment, Food and Rural Affairs ("Defra") called for a public inquiry into the Company's draft 25 year Water Resources Management Plan. The inquiry completed in August 2010 and the Inspector's report recommended additional work in a number of areas including the assessment of long-term solutions for supply security.

Chief Executive Officer's Business review (continued)

Looking further ahead (continued)

Water resources and Drought (continued)

Defra issued instructions to the Company to complete the plan in line with the Inspector's report and advice from the EA. This work has now been completed and the Company has consulted further on its plan. No significant issues have been raised and The Secretary of State is now considering the Final Plan and will make a decision in 2012, following advice from the EA.

Following the driest two years since records began, the Company, along with six other companies in the South East of England, gave notice to customers on 12 March 2012 of a temporary water use ban. From 5 April 2012, it was prohibited to draw water through a hosepipe or similar equipment, or fill or maintain a domestic swimming pool, paddling pool or ornamental fountain. The Company will continue to closely monitor the situation over the coming months and further drought management measures may be required to secure supply. The impact of a third successive dry winter cannot be discounted and, should this arise, it will have an impact of the Company's management of its water resources.

The Government's Water White Paper drew attention to the future threats to the security of water supplies. As part of a response to this threat they propose to reform the abstraction regime and anticipate a new regime in place by no earlier than 2020. In the medium term it is encouraging Ofwat and the EA to consider incentives for companies to improve the sustainability of their water abstraction in a sustainable manner.

Transfer of private sewers

On 1 July 2011, the "Water Industry Schemes for Adoptions of Private Sewers 2011" came into force, whereby all privately owned sewers and lateral drains built before 1 July 2011 and connected to an existing public sewer became the responsibility of sewerage undertakers with effect from 1 October 2011.

As a result, approximately 40,000 km of privately owned sewers and lateral drains were transferred on 1 October 2011 to the Company, an increase of 60% in the sewer network for which the Company is now responsible.

A second transfer scheme for those privately owned sewers built after 1 July 2011 was originally scheduled for April 2012, but has been postponed with a new date to be agreed. Private pumping stations connected to the transferred pipework will transfer between 1 October 2011 and 1 October 2016. The Company is currently drawing up its programme for progressive adoption over this five year period.

At PR09, Ofwat did not fund companies for the costs of the private sewers or pumping stations transfer. Instead, the Company will be examining the case for submitting an Interim Determination of K ("IDoK") application to Ofwat before September 2013 to enable it to recover the additional costs incurred.

Business Retail Competition

Currently only 30,000 of approximately 1.2m business customers in England and Wales have a choice of retail supplier. In Scotland all business customers have had a choice since 2008. The Government's 2011 Water White Paper proposed to introduce a draft bill in 2012 to bring about choice in England for all business customers. There is currently however no timetable for this change.

The Paper ruled out mandatory legal separation of companies' retail functions and the expansion of retail competition to households. However, companies will be expected to demonstrate arms length dealing with their retail arms and Ofwat has powers to enforce non-discrimination including powers to refer companies to the Competition Commission for structural remedies.

Chief Executive Officer's Business review (continued)

Looking further ahead (continued)

Affordability and recession

The Company currently has the second lowest combined bill out of the Water and Sewerage Companies ("WaSCs"). However, the Company also has the highest proportion of income deprived households. In the last ten years industry bad debt levels have risen by 10% per annum, which may be illustrative of a rise in affordability issues and recession. In addition, specific future bill increases for projects such as the Thames Tunnel will have an impact on customer's ability to pay. Ensuring that the Company invests only where it has its customers support will be necessary to keep bills as low as possible.

Relationships and resources

Employees

This financial year has been challenging, with the largest ever five year capital investment programme being in its second year, continued transformation of the Company's business processes and the challenge of a potential drought combined with preparation for the London 2012 games. The Company's employees have continued to demonstrate high commitment and increased engagement levels throughout the year, supported by the "Passionate About People" strategy.

This strategy was updated in 2011 in line with business requirements to give an increased focus on supporting the organisational change and transformation across the Company, alongside getting the best out of its people by giving them the right support and development. The implementation of the Company's 'Passionate About People' approach continues to engender a positive working environment, which focuses on performance, contribution and values diversity and inclusion.

Overall staff turnover in the current year was 7.95%, reducing from 9.58% in the previous year.

The Company's sickness rate during the year was 2.53% (2011: 2.75%). The Company has an attendance management policy in place with the overall aim of reducing and managing sickness absence and, in particular, long term sickness.

The Company is committed to effective talent management and runs regular Talking Talent reviews to assess performance and potential across the Company. These reviews support effective learning and development interventions and focus on ensuring the Company has the future talent to deliver its business strategy. The Company continues to invest in its core leadership development programmes, future talent pipeline programmes (including apprentices and graduates) and to develop the technical and business skills of its employees.

During this year, the following key people initiatives have been delivered to support the business strategy;

- development and negotiation of working patterns, terms and conditions changes to ensure they are modern, meet the needs of the customer and the business and are in line with the market;
- development of an approach to career paths to ensure that technical roles are identified, have a clear path through the organisation and are appropriately awarded;
- recruitment routes to market and career pages developed to drive employer brand ensuring that the Company is an employer of choice;
- implementation of procedure changes for legislative updates including agency workers regulations, abolition of the normal retirement age and new paternity rights;
- support for occupational health to improve management of long term absence and to develop a strategy to deal with stress;
- the continued focus on employee engagement across the Company, resulting in a year on year increase in employee engagement, as measured through its annual employee survey;

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Employees (continued)

- new intakes to the Company's Graduate, Apprentice and Bursary future talent pipeline programmes;
- continued roll out of the Company's core "Foundation, Advanced and Strategic Leadership development" programmes;
- Continued Performance and Development reviews for all employees linked to the annual pay review;
- people plans for all areas of the business.

The Company is committed to the training and development of all of its employees who undertook 14,301 (2011: 12,355) formal training days in 2012. These figures exclude WAMI training, sponsorship for further and higher education, roadshows, conferences, NVQ coaching & assessment and Manager briefings.

Stakeholders

The continuation of work to determine the preferred route and sites for the Thames Tunnel was once again the focus of much of the Company's work with stakeholders. In addition to the second major round of public consultation on the project, the Company continued to attend community and residents' groups and public meetings, as well as arranging briefings with local authorities, Members of Parliament and other stakeholders. The Company also arranged interim customer consultation activities in advance of the start of the second phase of public consultation, where new sites had emerged since the first stage of the process.

The Company has continued to host the Thames Tunnel Forum, held approximately quarterly, to brief stakeholders on progress and seek their views on its proposals. This successful format is now also being used for the proposed Deephams STW Upgrade in North East London. The Company also contributed to the Thames Tunnel commission established by a group of London Councils for the purpose of reviewing the alternatives to our proposals for the Thames Tunnel and reported its findings on 31 October 2011.

In addition to one to one briefing with MPs on issues of local interest, the Company hosted a series of roundtable discussions with Parliamentarians and London Assembly Members, to outline its plans on strategic issues and seek their feedback on the Company's approach. Topics discussed included market reforms in the water industry and the management of water resources.

The Company hosted several visits for customers and stakeholders to its sites during the course of the year, providing opportunities for them to see the Company's work first hand, and to mark significant project milestones. These included hosting a visit for Defra's water quality department at the historic Abbey Mills pumping station in November 2011and an event to celebrate the lowering of the Lee Tunnel Boring Machine in December of that year.

The Company was also pleased to host two visits for Secretary of State for the Environment, Caroline Spelman MP. The first involved a review of the Company's innovation activities and a tour of the Lee Tunnel site and desalination plant at the Company's Beckton facility; while the second event was hosted to mark the opening of the Old Ford Water Treatment Works, constructed to provide wastewater treated to non-potable standards for irrigation and toilet flushing on the Olympic Park.

The Company played an active role in Parliamentary inquiries, submitting written evidence to the Environment, Food and Rural Affairs Select Committee's examination of the Government's water white paper, *Water for Life*, and giving oral evidence to a House of Lords EU Sub Committee inquiry into European water legislation. During the year representatives from the Company gave evidence to an Environment, Food and Rural Affairs ("EFRA") committee on the Wastewater National Policy statement.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Stakeholders (continued)

The last year has seen the Company play an increasingly active role in bringing together regulators and stakeholders to develop joint approaches to challenges such as urban drainage and water resources. The Company hosted a seminar and workshop in December to examine with stakeholders how to increase the uptake of sustainable drainage systems, and in March 2012 held the Company's inaugural quarterly Water Resource Forum, sharing a platform with Defra, Ofwat and the EA.

During 2012, the Company has also sought to influence public policy through its presence at seminars and conferences. A speech was delivered by a representative of the Company on water scarcity at October's *Water 2011* conference; while presentations by the Company on water resources and industry reform were made at the *Future of Utilities* event held in March 2012.

At a regional and local Government level, the Company continued to strengthen ties with the authorities it serves. At a pan-London level, the Company worked closely with the Greater London Authority ("GLA"), London Assembly and the Mayor on a variety of issues. This has included working with the Mayor on his streetworks Code of Conduct, and liaising with the Assembly's Environment Committee, hosting a visit for members to the Company's Beckton site and contributing to the Committee's work to determine priorities for 2013. The Company has also been active members of the GLA London Waterways' Commission established to oversee the navigable waterways in London.

At a local level, the Company worked closely with many of the 100 local authorities it serves across the region, seeking to ensure the Company's operational activities and investment projects were delivered with the minimum of disruption. The Company attended several formal Scrutiny and Public Meetings, giving evidence at meetings and responding to questions and feedback from councillors, officers and the public.

The Company has delivered a number of stakeholder training sessions for its directors and senior managers to ensure that there is a consistency of approach to external engagement.

Public consultations and research

The focus on public consultations work has again increased this year. The Company has a number of major projects either underway or proposed, which has led to its highest level of public consultation activity to date. The Company recognise that these major projects have an adverse impact on a large number of its stakeholders and customers and endeavour to ensure the Company's plans reflect their views where it is possible to do so.

The Company's approach to consultation includes independently-facilitated stakeholder workshops; individual discussions with MPs and other stakeholders, surveys, focus groups and independently-hosted online consultations.

The Company has committed to early proactive and transparent consultation on the Thames Tunnel. Consultation activities have followed best practice principles and have been carried out in accordance with the Government's "Code of Practice" and recommended best practice guidance.

The second phase of consultation on the proposed Thames Tunnel ran for 14 weeks from November 2011 to February 2012, and involved a greater level of detail than 2011's first phase. The feedback from the two phases is informing final proposals on the construction of the project, while providing an opportunity to address concerns about the potential adverse effects on local communities, businesses and the environment. A report on the second phase of consultation was published on 17 May 2012.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Public consultations and research (continued)

Other consultations this year included a consultation on the Company's revised Water Resources Management Plan 2009, which ran from December 2011 to January 2012. A programme of engagement with regulators and stakeholders for the Water Resources Management Plan 2014 is now well underway. Following research into customers' expectations during drought periods, the Company held a public consultation on its draft Drought Plan, from December 2011 to February 2012.

The Company is proposing a major upgrade to its Deephams STW, which serves approximately 900,000 people in North East London, to improve significantly the quality of the treated wastewater returned to the Salmon's Brook, a tributary to the River Lee. During 2011, a quarterly Stakeholder Forum was established to bring together key stakeholders to share information about the project and answer their questions and concerns, and to seek feedback on the Company's proposals.

A first phase of public consultation is planned for summer 2012 to examine the choice of preferred site and treatment technologies for the STW upgrade, as well as the other options that have been considered. A second phase of public consultation is planned in 2013.

The Company has also held deliberative workshops and focus groups with customers, at which it has provided background information on its work, in order to deepen their understanding of the business and help them to give more informed views. The topics covered have included the Company's approach to the PR14, drought, water efficiency, bill design, communications materials on the Thames Tunnel project, the transfer of private sewers to WaSc, research with business customers and customer strategy and brand and reputation research.

The Company's continuing commitment to customer engagement will help it understand the wants and needs of its customers and ensure it has (as far as possible) developed Company plans in accordance with their wishes. However, the Company needs to understand, and test, customers' views is growing all the time and is engaging with customers more in some of the strategic decisions the Company faces. In addition the Company is also seeking their views on elements of the Company's investment programme. With this in mind, the Company has regularly used its 2,000 strong customer panel to help it better understand its customers' needs and preferences.

The Company is a corporate member of the Consultation Institute and follow Cabinet Office best practice guidelines for consultation, aiming to make the process as open and transparent as possible.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Involving customers in price setting

A great deal of change has occurred this year following the publication in August 2011 of Ofwat's customer engagement policy statement: *Involving customers in price setting.* This document sets out Ofwat's approach to customer engagement in the price setting process ahead of the 2014 Price Review, and underlines the importance of customer support in determining the acceptability of companies' business plans. Specifically, it details a "three-tiered approach" to enable customers to engage in different ways and to influence the service they receive and the price they pay;

- "Direct, local engagement" to take account of customer views on local priorities and issues that could have a significant impact on the service customers receive;
- establishment of the Company's "customer challenge group" to consider evidence of direct customer engagement, and to ensure that the Company's plans reflect a balanced understanding of customer views;
- creation of a "customer advisory panel" by Ofwat to inform sector-wide assumptions such as the cost of capital, and provisions for pensions and energy.

The Company took full account of the direction and guidance within Ofwat's policy statement in developing its programme of customer engagement activities to inform the Company's strategy and business plan. The first phase of this programme began in September 2011 with a qualitative study of domestic and business customers to understand the relative priorities they placed on different elements of their service. This study was used to inform the development of a quantitative survey in November 2011, which explored the relative values customers placed on improvements or deteriorations to the levels of service they currently receive.

Further phases of research and engagement are ongoing and being planned for 2012 and 2013, and will be scrutinised by the newly formed Customer Challenge Group, (see below) ahead of their implementation, to inform the development of the Company's long term strategy and business plan.

The Company established its Customer Challenge Group – in line with Ofwat's policy statement – and the Group met for the first time in February 2012 and will meet throughout the period leading to the 2014 price review. The Group has an independent Chair and Vice Chair, and its members include industry regulators, domestic and business customer representatives and other key stakeholders. The role of the Group is to challenge the Company as it develops its customer engagement and research plans, and on the Company's interpretation of customers' views and how these have been reflected in its strategy and business plan. The Group will provide a report to Ofwat alongside the Company's business plan on its customer and stakeholder engagement process, and the content of its strategy and business plan.

Streetworks

The Company played an active role in developing new approaches to managing the impact of streetworks, responding to consultations on Lane Rental Regulations and Guidance published by the Department for Transport and Transport for London's Lane Rental Scheme consultation. The Company also participated in workshops facilitated by the Department for Transport and Transport for London to develop proposed Lane Rental schemes.

The Company sought to communicate its approach to streetworks with key stakeholders proactively. Prior to the start of the winter, during which the need to carry out leak repairs is at its greatest, highways authorities were approached to ensure a collaborative approach to tackling leakage and minimising disruption.

The drought has increased the need to ensure leaks are tackled quickly and efficiently, and highways authorities have been asked to, and have helpfully provided, support for the Company's work in this area.

Chief Executive Officer's Business review (continued)

Key suppliers and contractors

In 2012 the Company spent in excess of £1.1bn on construction, goods and services with a range of suppliers and contractors (2011: in excess of £1.4bn). Approximately 23 key suppliers (2011: 31) were engaged with a spend greater than £10m each. The Company's policy is to establish trading arrangements, which are made following an open non-discriminatory, competitive bidding process. Procurement processes reflect the Company's corporate responsibility commitments and, where applicable, comply with the requirements of the Utilities Contracts Regulations 2006 (as amended).

Research and development

The Company's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. Research and development deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP5 and also provide specialist technical support to the business. Expenditure on research and development totalled £3.9m for the year (2011: £3.4m).

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Energy efficiency and renewable energy

The Company is committed to reducing its contribution to the causes of climate change and its voluntary target is to achieve by 2015 a challenging 20% reduction in greenhouse gas ("GHG") emissions (compared to 1990 levels) for scope 1 and scope 2 emissions.[7]

The Company's total GHG emissions (Scope 1, 2 and 3) reported for 2012 were 746,000 tonnes (2011: 780,436 tonnes) of carbon emissions ("CO_2e"). The Company's approach to reporting GHG emissions is consistent with the Department of Energy and Climate Change ("Decc"), Defra guidance and Ofwat reporting requirements. During the year, the Company's reported emissions decreased, largely due to a reduction in imported electricity consumption. Coupled to this was a reduction in the Emission Factor ("EF") for grid electricity. This followed a change in the methodology that Defra used to calculate the EF which now accounts for imported electricity into the UK

Last year the Company consumed 1,171 Gigawatt hours ("GWh") of electricity, of which 166 GWh was renewable electricity generated at the Company's operational sites - around 14% of the Company's total electricity use. The Company produced 85 GWh of heat energy which displaced the need to consume natural gas. This generation of renewable electricity and heat helped reduce the Company's overall GHG emissions.

The Company continues to work hard to understand and reduce its carbon footprint. During 2012 it has;

- increased renewable energy generation capacity by 10.9 MW including 6 MW of biogas engines at Riverside STW, and 4.9 MW of photovoltaics (solar power) at 31 sites;
- increased metering of its gas and electricity use (covering 100% and 99.6% of use respectively) so that the Company can measure its energy consumption more accurately;
- started a programme to save 8 GWh in energy use by making air blowers (used in the sewage treatment process) more efficient;

[7] Scope 1 emissions are those direct emissions associated with the operation of the business. Scope 2 emissions are the indirect emissions associated with the consumption of grid electricity. However, this is reliant on the Government redefining grid emissions.

Chief Executive Officer's Business review (continued)

Energy efficiency and renewable energy (continued)

- prioritised the Company's pump efficiency programme on raw water pumps in light of drought conditions. These are pumps that take river water to supply its storage reservoirs;

- introduced an energy and carbon engagement programme for employees working at the Company's head office. Metering on each floor of the building allows detailed energy monitoring;

- installed a dryer at Slough STW, which dries the sewage sludge to produce a granule material that can be used as a renewable fuel;

- installed new lighting and motion sensors at 6 operational sites.

Looking to the future, there are a number of significant challenges facing the business in terms of reducing the Company's GHG emissions. The Company's activities are very closely linked to the weather. For example adverse conditions require the need to pump more water, and drought conditions force the use of water treatment by desalination. Both of these scenarios are electricity intensive – with the consequence of increased GHG emissions. Additional upward pressures on energy consumption and GHG emissions that the Company cannot control include new obligations (including the adoption of private sewers and the construction of the Tideway Tunnels) and population growth.

However, there are responses that the Company can influence, including energy efficiency, effective energy procurement and the generation of renewable energy. The Company therefore needs constantly to innovate in the management of its energy consumption and GHG emission to ensure they are kept as low as possible. However, changes in Government policy such as the Carbon Reduction Commitment becoming a tax rather than an incentivised cap and trade scheme, and proposed changes to the Feed-in Tariff Scheme have made effective planning and delivery much more difficult.

Social and community

Corporate Responsibility

The Company is committed to engaging positively with the communities it serves and to minimise the impact of its activities. The Company is pleased to report that it has been awarded a 'Platinum' ranking in the Business in the Community Corporate Responsibility Index, having undergone a rigorous reporting process across the Company's Corporate Responsibility and sustainability working practices.

Community Investment

The Company's updated strategy was approved by the Board and a brief version is available to view on the website http://www.thameswater.co.uk/cps/rde/xchg/corp/hs.xsl/8276.htm The strategy encompasses feedback from customer research and stakeholders that the core themes for activities should include environment and wildlife improvements, education, access to sites and charitable giving. Volunteering opportunities in respect of each of these themes are available. The Company also signed up to support Love Where You Live, a Keep Britain Tidy initiative looking after the local environment.

Open Days

A programme of Open Days on the Company's sites was delivered with events for visitors at Slough, Swindon and Maple Lodge STW's and Coppermills water treatment works. The Company also took part in London Open House where eight of its heritage sites were opened to the public. Around 1,600 customers and visitors took part in these events which included tours conducted by more than 100 Thames Water volunteer staff.

Chief Executive Officer's Business review (continued)

Social and community (continued)

Community Initiatives

The Creekside Education centre based on the Thames foreshore in Deptford was opened in May 2011 and has seen 3,735 students, community members and volunteers come and learn about both tidal ecology and key water messages.

The Company has committed to its adoption of Fobney Island, the Fobney Wetland Park along the River Kennet on the edge of Reading, Berkshire. The aim of the project was to provide £200,000 of financial support, technical expertise and employee volunteers. To date, the work has created seasonal wetland areas to reconnect the five hectares of floodplain on the island with the River Kennet. In March 2012, a rare Little Ringed Plover was spotted on the new wetland.

Another five students at the University of East London who are benefiting from the Company's Engineering Bursary completed their summer placements. The first two students who have been supported since 2009 are due to graduate this year.

The Company has started a new project "Sustainable Urban Drainage for schools" to install ten new urban wetlands in school grounds. The aim of the project is to educate students and the wider community on sustainable drainage and ecology, working with project partners the EA and Wildfowl and Wetlands Trust. The focus of the project will be Pymmes Brook, a tributary of the River Lee running through Enfield, Barnet and Haringey.

Working in partnership with the National Trust, the Company provided funding and technical expertise for the newly opened Living Green Centre within Morden Hall Park. The contribution was to provide key water efficiency messages and assist with the development of London's first Archimedes Screw on the weir, which will generate electricity for the Centre.

Education

The Company's educational facilities for school visits continue to take shape with the modular classrooms delivered to Didcot STW's and Slough STW's in January and February 2012 respectively. The classroom at Hogsmill STW's has been completed and the site tour route at Rye Meads sewerage treatment treatment works has been agreed. The first school visits to these new facilities are expected to take place in September 2012.

The Company continued to support the skills agenda by delivering talks and activities based around engineering, including two Network Challenge events in the London Boroughs of Hounslow and Southwark, and careers fairs across the region to educate young people about roles in the water industry.

Working with the London Tideway Tunnels Team, the Company signed up staff volunteers to deliver talks and promote a competition to 1,100 pupils at Newham primary schools to name the Lee Tunnel Boring Machine, which was lowered at the Lee Tunnel site at Beckton in December. Local schoolboy, Ryan Waters, from Maryland Primary School in Newham, won the competition to name the Boring Machine with his chosen name "Busy Lizzie".

Volunteer speakers from the Company continue to promote key messages around the water cycle, saving water and the responsible disposal of waste – promoting Bin It Don't Block It – through the popular Community Speaker Programme. During the last year 58 talks were given across the Company's region reaching a total audience of 6,258.

The programme was boosted in March with the Drought Speaker Programme, tackling the current drought situation. More than 90 employee volunteers came forward to deliver presentations and hand out leaflets to schools and community groups focusing on the drought.

Chief Executive Officer's Business review (continued)

Social and community (continued)

Employee engagement

The Company aims to provide a positive environment where its people are actively engaged and understand their role in the business so they can maximise their contribution.

To measure this, the Company runs an annual employee engagement survey, which gives staff the chance to confidentially provide their honest views on what it is like to work for Thames Water, their team and their manager. Called the Q12 survey, it is run by Gallup and is now in its sixth year.

The Company has seen a year-on-year improvement in employee engagement. This improvement comes against a backdrop of continued organisational change.

The Company intends to enhance the survey in June 2012 to measure staff's views on our customer service, leadership and health and safety.

Over the past year the percentage of staff who volunteered to help community projects was 18%, an increase of 50% on the previous year. The Company entitles each member of staff to two days volunteering leave per year, under its Time to Give scheme, to encourage participation in community, education and fundraising events.

The Company continues to work in partnership with local and regional organisations to promote environmental and community volunteering. Key events in the annual calendar include River Thames clean-ups, working with Thames 21, and the Thames Water-sponsored Reading RESCUE to tidy riverside and urban spaces in and around the town.

In addition, employee volunteers took part in team build projects to improve community spaces. Activities included coppicing and woodland management with Wiltshire Wildlife Trust, painting school halls and improving gardens and grounds at local charity and community organisations.

Charitable donations

Over the year the Company donated a total of £1,019,340 (2011: £723,576) to good causes through both the Charities Committee and direct donations, including the Company's principal charity, WaterAid. Over £700,000 of this amount is a continuation of the shareholders' commitment through the Company's Ten for Ten initiative made in 2009.

The Thames Water Charities Committee met quarterly to consider applications from external charitable organisations seeking funding and to authorise matched funding for employee fundraising. In 2012, the Committee donated £79,401 to 21 charities via grants which supported the Company's criteria of either "water and the environment" or '"water and health". An example of applications received is one from the Ahoy Centre to donate towards the purchase of two second hand Thames Cutter boats for use by local children and disabled rowers on the Thames in Deptford.

The Company's employees raised £99,718 (2011: £76,805) for various charities throughout the year which the Charities Committee matched funded with £89,401 (2011: £59,376).

Employees also participated in the Company's-promoted charity events to raise funds and awareness for local and national charities. A highlight was the support for Sport Relief in March 2012 where 149 staff took calls at the Company' offices in Reading and Swindon.

More than 100 guests attended the Company's annual Service of Remembrance at Ashford Common Water Treatment Works. An additional service was held at Mogden STW which included the rededication of the site's memorial garden. Charitable donations were made to the Royal British Legion and SSAFA (Soldiers, Sailors, Airmen and Families Association).

Chief Executive Officer's Business review (continued)

Social and community (continued)

WaterAid

The Company also continues to support its principal charity, WaterAid (www.wateraid.org) which celebrated its 30th birthday in 2011. Employees at all levels are involved through a variety of activities from fundraising to speaking to schools and community groups about the charity.

At a senior level, the Thames Water WaterAid Steering Committee, which sets fundraising targets and strategy each year, met regularly to review progress and recognise achievements. The Company is also pleased to report that in addition to the charitable donations listed above, over £600,000 was raised through corporate sponsorship for 2012 beating the fundraising target of £500,000. Half of this funding is for Thames 4 Bangladesh, a four year campaign aimed at helping four of the country's towns with improving their access to clean water and improving sanitation.

Martin Baggs
Chief Executive Officer
7 June 2012

Thames Water Utilities Limited

Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2012. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies.

Principal activities and likely future developments

The principal activities of the Company (Registered number: 02366661) are the supply of water and the collection and treatment of sewage, serving approximately 14m customers in London and the Thames Valley.

Business review

The information, which complies with the Operating and Financial Review ("OFR") requirements of the Companies Act 2006, can be found within the Chief Executive Officer's Business review on pages 6 to 31. The Company chose not to produce a voluntary OFR as these requirements are satisfied by the Chief Executive Officer's Business review. The Chief Executive Officer's Business review (which forms part of the Directors' report) comprises an analysis of the development and performance of the business and includes an assessment of future prospects, information about research and development activities; see page 27, details of important events that have occurred since 31 March 2012 and Key Performance Indicators ("KPIs"), see pages 8, 12 and 13.

Details of parent and subsidiary undertakings are given in notes 11 and 28 to the Financial statements, on page 82 and 98 respectively, and the Company has no branches outside the United Kingdom.

Results and dividends

The profit and loss account on page 61 gives the Company's financial results for the year.

The Company paid interim dividends totalling £279.5m during the year (2011: £271.4m).

The Company's dividend policy is:

- To pay a progressive dividend commensurate with the long-term returns and business performance, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants.

Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that:

- Sufficient liquidity is maintained to enable the business to meet its financial obligations for 15 months.

- Post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

The Board does not recommend a final dividend (2011: £nil), however, the Board has proposed further interim dividend's, see note 9, page 80.

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Thames Water Utilities Limited

Directors' report (continued)

Directors

Details of the directors who served from 1 April 2011 to the date of this report are shown below. The constitution of the Board is covered in more detail in the Company's Corporate governance report, which can be found on pages 53 to 58.

All Board members from 1 April 2011 to 31 March 2012 inclusive were non-executive directors ("NEDs") throughout the period, with the exception of Martin Baggs (Chief Executive Officer), Stephen Shine OBE (Chief Operating Officer) and Stuart Siddall (Chief Financial Officer) who replaced Mark Braithwaite as Chief Financial Officer on 20 September 2011 upon his resignation.

Directors serving from 1 April 2011 to the date of signing of this report are as follows:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
L F Abraira	4 August 2011	19 January 2012
M W Baggs		
E Beckley		
R Blomfield-Smith		21 November 2011
M W Braithwaite		20 September 2011
C R Deacon		
S R Eaves	20 January 2012	
Dame D M Hutton CBE		
G I W Parsons		
M J Pavia		
E C Richards		
A F C DeP Santos		4 August 2011
D J Shah OBE		
Y Shi	19 January 2012	
S F Shine OBE		30 March 2012
S J Siddall	20 September 2011	
M S W Stanley		
R Verrion		
L Webb	21 November 2011	

The following directors have formally appointed alternate directors to represent them when they are unavailable:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
S R Eaves	20 January 2012		M C Hill	20 January 2012	
G I W Parsons			E Beckley	11 November 2011	
A F C DeP Santos		4 August 2011	M C Guerreiro		4 August 2011
D J Shah OBE			L Webb		21 November 2011
			K Roseke	31 January 2012	
Y Shi	19 January 2012		F Sheng	29 February 2012	
R Verrion			S Kolenc		
L Webb	21 November 2011		C Pham	21 November 2011	

Material financial instruments

Financial risk management is covered on page 10 of the Chief Executive Officer's Business review.

Directors' report (continued)

Research and development activities

This has been covered in the Chief Executive Officer's Business review on page 27.

Employee involvement

The Chief Executive Officer ("CEO") and the Executive team hold quarterly management briefings with managers to provide the opportunity to discuss performance and how the Company can continue to move forward. Internal publications ("Management toolkit" and "The Source") provide ongoing support for the changes and transformation happening across the Company. This is in addition to the further improvement of the Company's corporate and local communication channels that deliver regular communication, information and updates to employees. Corporate channels include Company-wide Team Talk briefings, a weekly e-brief containing a message from the CEO, the Company's internal portal web pages and specific priority news updates and managers' key information.

Formal consultation with employees is undertaken in partnership with the recognised Trade Unions. Consultation with management level employees typically takes place on an individual basis, except in the case of changes that affect whole areas of the business. In these circumstances, consultation takes place on a Company-wide basis with employee representatives being elected for the relevant area.

All staff are involved in both the Company's employee engagement programme ("Q12") and annual Performance and Development Review ("PDR") process.

Each year the Company encourages all employees to participate in its annual employee engagement survey. In June 2011, the date of the last survey, 70% of the Company's employees participated and employee engagement improved again year on year. This programme also involves circa 100 volunteer employee engagement champions from around the Company who support making the Company a great place to work. It allows all employees to give their opinions and enables managers and teams to take action on key issues identified.

Corporate and Business Unit objectives are agreed by the Executive Team, communicated and cascaded through the Company and included in the annual PDR for all employees. In addition, relevant department and team objectives are cascaded and inform employees' personal objectives which, in turn, are agreed with each employee's manager and reviewed regularly. This process is intended to ensure that all employees are aligned to Company objectives and to ensure that all employees understand where they are adding value.

Employment of disabled persons

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. The Company has policies and procedures in place that aim to ensure that both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through disability and attendance management policies, support and development is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

Policy and practice on payment of creditors

The Company's policy is to pay all suppliers, contractors and service providers according to pre-agreed terms. During the year under review, the average amount due to trade creditors represented 60 days (2011: 63 days) purchases received from these creditors.

Directors' report (continued)

Market value of land and buildings

The directors have considered the market value of the group's land and buildings and are satisfied that their market value is not less than their net book value.

Political and charitable donations and expenditure

No political donations were made by the Company (2011: £nil). The Company made charitable donations totalling £1,019,340 (2011: £723,576). Details of these charitable donations are;

- £743,759 (2011: £316,807) to Ten for Ten projects, of which £512,121 went to various educational and recreational projects and £231,638 to the Thames Water Trust Fund for income deprived families;
- £118,680 (2011: £106,000) to the Charities Aid Foundation;
- £61,129 (2011: £58,021) to the Company's principal charity, WaterAid;
- £60,000 (2011: £60,000) to Thames 21, a range of charities which assist in cleaning rivers and streams within the Thames Valley;
- £35,772 (2011: £182,748) of other donations.

In addition, fund raising activities by employees and contractors raised £99,718, to which the Company added matched funding of £89,401 (included in the donations shown above).

Going concern

The directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements. Further information is set out in note 1 "Basis of preparation" on page 66.

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors and for the benefit of other persons who are directors of associated companies and these remain in force at the date of this report.

Thames Water Utilities Limited

Directors' report (continued)

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG Audit Plc will therefore continue in office.

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Martin Baggs
Chief Executive Officer

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

Statement of directors' responsibilities in respect of the Annual report and the financial statements

The directors are responsible for preparing the Annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently.

- Make judgements and estimates that are reasonable and prudent.

- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Thames Water Utilities Limited

Directors' remuneration report

The directors' remuneration report is unaudited as it is not a statutory requirement to do so. However, the Company provides this information in accordance with its regulatory licence.

In this section of the report the Company describes how the Chairman, Executive Directors and Non-Executive Directors are remunerated. The report discloses the total remuneration awarded for services to the Group, the element of this awarded for services to the Company and the element that relates to regulatory performance.

Compensation & Human Resources Committee

The Company operates a Compensation & Human Resources Committee ("the Committee") which broadly functions as both remuneration and a nomination committee. The Committee comprises four Non-Executive Directors, one of whom is independent, and is chaired by Sir Peter Mason KBE. The other members are Michael Pavia (independent Non-Executive Director), Martin Stanley and Christopher Deacon.

The Committee's responsibilities include, but are not limited to, making recommendations to the Board on the Company's executive remuneration policy and directors' terms of appointment. During the year, the Committee advised the Board of Directors and received advice and input from various Directors and specialist staff within the Company, including the CEO and the Director of Human Resources (both of whom are invited to attend from time to time). No individuals are involved in the determination of their own remuneration.

Activities of Compensation & Human Resources Committee

The Committee meets four times in each year in February, May, September and November. Recurrent remuneration matters are scheduled for the February and May meetings with Board sign off in June. Activities for the year were as follows:-

Meeting	Activities
February 2011	• Setting bonus plan for 2011/12
May 2011	• Reviewing performance against targets 2010/11 • Reviewing salaries for Senior Executives 2011
June 2011	• Board meeting to approve bonus payments 2010/11, payments made July 2011 • Board meeting to approve salary reviews for Senior Executives, increases effective July 2011
February 2012	• Setting bonus plans for 2012/13
May 2012	• Reviewing performance against targets 2011/12 and resulting payments to be made July 2012 • Reviewing salaries for Senior Executives 2012, increases effective July 2012
June 2012	• Board to approve pay and bonus payouts.

To ensure that the Company's remuneration practices are competitive, the Committee has access to detailed external research on market data and trends from PricewaterhouseCoopers LLP.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Remuneration policy

The Committee bases its decision-making with respect to remuneration policy on a number of underlying principles, which can be summarised as follows;

- arrangements should attract, retain, motivate and reward high calibre directors and executives;
- packages should be aligned with the interests of the Group's stakeholders, in particular its shareholders and its customers;
- packages should be commensurate with those provided by other companies of similar size and complexity, taking into account individual contribution and experience;
- policy should establish firm links between an executive's performance and remuneration and between the Group's performance and the executive's total remuneration;
- packages should include a mix of basic salary plus performance related incentives. Further detail is included within the bonus section on page 42 which indicates how Directors' pay is linked to standards of performance.

The Committee considers carefully the blend of remuneration linked to regulatory performance and remuneration linked to other performance measures in order to produce well balanced short-term and long-term incentive plans. These arrangements are designed to incentivise value creation and a high quality service to customers and are aligned with both the internal remuneration policy and external corporate governance requirements.

The Committee will continue to review arrangements regularly to ensure that they remain effective and appropriate to the Company's circumstances and prospects, and to monitor the level of potential awards.

Summary of remuneration and overview for the year to March 2012

The remuneration of the Executive Directors is linked to the performance of the Company and the Group and their own personal performance.

Since the acquisition of the Company by Kemble Water Holdings Limited in 2006 the Company's operational performance has improved significantly with tangible benefits that are important to its customers. This strong performance has been demonstrated again in 2011/12 with the achievement of the following operational results;

- delivering all of the Company's key regulatory outputs, ensuring that the condition of its assets is maintained;
- maintaining 100 per cent compliance with the EA's effluent consents at all 350 of our sewerage treatment treatment works for the fifth year in a row;
- delivering over £1bn of capital investment in its network and plants, including the Thames Tunnel, for the second year running;
- reducing leakage by 26 Mld to 639 Mld compared to last year and beat the target set by Ofwat for the year by 34 Mld;
- meeting stringent UK and European standards for the Company's drinking water quality at 99.98% which remains among the best in the country;
- continuing to reduce greenhouse gas omissions with CO_2 emissions 16% lower than two decades ago and generating 14% of our own power;
- continuing to improve health and safety with the number of reportable accidents falling to an Accident Incident Rate of 0.33 per 1,000 employees, a 48% improvement since the start of AMP5;
- adopting 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

The Company also undertook a number of significant change programmes to ensure that it continued to transform the business whilst providing an excellent and efficient service to its customers and delivering strong operational and financial performance.

Directors' remuneration report (continued)

Summary of remuneration and overview for the year to March 2012 (continued)

During the year the Company began implementing WAMI, enabling real time scheduling and workflow capabilities, alongside successfully implementing working patterns for 2,000 employees, improving flexibility to respond to the needs of customers and assets.

A summary of remuneration for 2011/12 is as follows;

- Stephen Shine, Chief Operating Officer (COO) received an increase in salary of 3%. No other Executive Director received a salary increase;
- annual bonus payments for the year 2011/12 reflected strong Company performance and delivery of key strategic initiatives. This resulted in total payouts relating to services to the Group of 87.7% of maximum for Martin Baggs, Chief Executive Officer (CEO), 90.2% of maximum for Stuart Siddall, Chief Financial Officer (CFO), and 87.7% of maximum for Stephen Shine, COO;
- payment of the 2008 Long Term Incentive Plan (LTIP) in July 2011 as a result of the cumulative Group financial results over the last three years with payment levels of 100% of salary for Stephen Shine, COO, and Mark Braithwaite, Former Chief Financial Officer (FCFO). A Long Term Incentive Plan is offered to ensure that Executive Directors are incentivised to deliver long term, sustainable performance over a period of several years and is separate from a bonus which rewards in-year performance. Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

There have been no significant changes to remuneration policy for 2012/13. Points to note for 2012/13 are as follows;

- reweighting of performance conditions in the annual bonus with greater focus on strategic and operational challenges and individual performance;
- toughening of financial performance measures and lower payments for achievement of targets;
- payment of the 2009 LTIP in July 2012 as a result of the cumulative Group financial results over the last two years with payouts of 68% and 49% of salary for Stephen Shine, COO, and Mark Braithwaite, FCFO, respectively.

There have been various changes to the board over 2011/12 as outlined in the Corporate governance report on pages 53 and 54. Changes to the Executive Directors were the departure of Stephen Shine, COO at the end of the year and Mark Braithwaite, FCFO on 20 September 2011 and the appointment of Stuart Siddall to the Board as CFO on 20 September 2011. These changes have reduced the number of Executive Directors from three to two.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Remuneration of Executive Directors

The remuneration arrangements for Executive Directors are summarised below.

Element	Description	Level 2011/12	Level 2012/13
Base salary	Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year.	Salary increases for 2011/12 range from 0% to 3% for Executive Directors.	Salary increases for 2012/13 yet to be confirmed.
Annual bonus	The performance conditions are selected to motivate Executive Directors to achieve the Company's key financial, operational and strategic objectives through a combination of financial, corporate and personal performance targets. Structured to reward significant improvement in the Group's financial and operational performance.	• Target award of 75.375% of base salary for 2011/12 awards. • Maximum award of 112.5% of base salary.	• Target award of 56.25% of base salary for 2012/13 awards. • Maximum award of 112.5% of base salary.
Long term incentive plan (LTIP)	Plan rewards performance over 2010-15 (AMP5), with deferred payouts over 2013-17. Vesting is conditional on the following performance conditions:- • Financial performance (40%); • Sustainability (40%); and • Regulatory and customer (20%).	• Annual target award of 75% of base salary. • Annual maximum award of 150% of base salary.	• Annual target award of 75% of base salary. • Annual maximum award of 150% of base salary.
Pensions	Provide competitive cost effective saving benefits for employees.	Contribution of 25% of base salary for Executive Directors.	Contribution of 25% of base salary for Executive Directors.
Benefits	The Executive Directors received a car allowance, private medical insurance, life assurance, Group Income Protection and 25 days holiday.		

The following table summarises the total cash elements of the package of the Executive Directors and their value as a percentage of salary. The table also shows the proportion of these payments related to variable and long term performance.

Components of Executive Director remuneration	**2011/12**		**2012/13**	
	Value (% salary)		**Value (% salary)**	
	Target performance	**Maximum performance**	**Target performance**	**Maximum performance**
Salary	100%		100%	
Pension	25%		25%	
Bonus	75.375%	112.5%	56.25%	112.5%
LTIP	75%	150%	75%	150%
Total	**275.375%**	**387.5%**	**256.25%**	**387.5%**
Variable pay – Bonus and LTIP (% total)	55%	68%	51%	68%
Long-term pay - LTIP and Pension (% total)	36%	45%	39%	45%

Directors' remuneration report (continued)

Base salaries and benefits

Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year. Base salaries are a fixed sum payable monthly.

Stephen Shine, COO, received a 3% pay increase on 1 July 2011; no other Executive Directors received a pay increase during 2011/12. The average pay increase for employees across the Company was 3% for this period.

Executive director	Salary at 31 March 2012 or leaving date if sooner
Martin Baggs, CEO	£425,000
Stuart Siddall, CFO[1]	£300,000
Stephen Shine, COO[2]	£310,000
Mark Braithwaite, FCFO[3]	£300,000

[1]Stuart Siddall was appointed on 20 September 2012
[2]Stephen Shine resigned with effect from 31 March 2012
[3]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

Bonuses

Executive Directors are eligible to participate in an annual bonus scheme, which is designed to motivate them to achieve the Company's key financial, operational and strategic objectives through a combination of financial and personal performance targets.

The amount of any annual incentive award is determined by performance against set targets and is at the discretion of the Committee. The Committee reserves the right to reduce bonus payments if overall Group performance does not warrant payment. The Board believes that this is the most appropriate means of aligning directors' remuneration to performance.

Executive Directors' annual bonus plan measures 2011/12

The 2011/12 annual bonus plan aimed to reward significant improvement in the Group's financial performance whilst recognising individual performance. The maximum level of award for the 2011/12 scheme for Executive Directors is 112.5% of salary. Financial measures make up 75% of the bonus opportunity with personal performance measures making up the remaining 25%.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Executive Directors' annual bonus plan measures 2011/12 (continued)

The financial targets were selected as being the most critical for the organisation during 2011/12. The personal performance element of the bonus is based on the performance of the Executive Directors against their key business objectives which link to the Groups overall key operational and strategic objectives including employee engagement, leakage, customer service and health & safety.

Performance measure		Weight for 2011/12 (as % of maximum)	2011/12 achievement (% of maximum bonus)		
			Martin Baggs, CEO	Stuart Siddall, CFO[1]	Stephen Shine, COO[2]
Financial measures	Regulated net capital expenditure	18.75%	18.75%		
	Regulated Net Operating expenditure	18.75%	15.4%		
	Group Cashflow before funding	18.75%	18.75%		
	Group Earnings Before Interest Tax Depreciation & Amortisation (EBITDA)	18.75%	14.8%		
Personal performance		25%	20.00%	22.50%	20.00%
Overall (% maximum)		100%	87.7%	90.2%	87.7%
Payout for 2011/12			**£418,359**	**£162,389**	**£305,156**

[1]As a new joiner on 20 September 2011, Stuart Siddall's bonus has been pro-rated for the part-year in service
[2]Stephen Shine resigned with effect from 31 March 2012 having completed the full performance year and was eligible for the 2011/12 bonus payment
Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

There was a requirement that all related regulatory outputs must be achieved for the net capital expenditure measure to pay out. These were achieved and the capital expenditure element paid out in full. Furthermore, there was a financial underpin on the personal element of the 2011/12 bonus whereby no payment would be made against the personal element of the annual bonus unless the Group cashflow before funding threshold target was achieved, which was attained.

The payments under this scheme will be made in July 2012.

Executive Directors' annual bonus plan measures 2012/13

The 2012/13 annual bonus plan will follow the overall structure of the 2011/12 plan however some elements will be restructured and the target bonus has been lowered to 56.25% of salary from 75.375% in 2011/12 for the Executive Directors. The maximum bonus opportunities will be unchanged at 112.5% of salary.

The proportion of the bonus element previously determined by financial performance will be reduced and a new group of performance measures linked to the achievement of key corporate challenges will be introduced. This has been done to focus Executive Directors' attention on a number of key corporate challenges and includes metrics such as management of the drought, the Olympics response and stabilisation of customer service.

The proportion of the bonus payable based on financial performance has been reduced from 75% of maximum for the 2011/12 bonus to 33.33% of maximum for the 2012/13 bonus.

Directors' remuneration report (continued)

Executive Directors' annual bonus plan measures 2012/13 (continued)

As a result of these changes, the structure of the bonus plan for 2012/13 for the Executive Directors will be as follows:-

Performance measure		**Weight for 2012/13 (as % of maximum)**
Financial measures	Regulated net capital expenditure efficiency	11.11%
	Cashflow before funding	11.11%
	EBITDA	11.11%
Corporate challenges		33.33%
Personal performance		33.34%
Overall (% maximum)		**100.00%**

As in the 2011/12 bonus, the related regulatory outputs must be achieved before the capital expenditure efficiency measure will pay out. The financial underpin on the personal element of the bonus will continue to be a Group cashflow before funding target.

Long Term Incentive Plans ("LTIP")

In order to focus executives on long term, sustained performance and to aid retention, the Company's Executive Directors and Senior Management are from time to time invited to participate in an LTIP.

The LTIP 2008 and LTIP 2009 were three year plans with a performance related payout at the end of the vesting period. The LTIP 2008 vested in July 2011 and the LTIP 2009 vests in July 2012, following Board approval of the audited accounts.

The current plan, the LTIP 2010, is a multiple year plan, with the performance period running from July 2010 to July 2015 and payouts being made in each year from July 2013 to July 2017.

Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

LTIP 2008

A LTIP commenced in 2008, in which Steve Shine, COO, and Mark Braithwaite, FCFO, participated. The plan performance period ran from 1 April 2008 to 31 March 2011 with payments made in July 2011. The plan was based on four cumulative financial measures, being Group EBITDA, Group cash flow before funding, distributions and Group capital expenditure. These measures were selected as being critical for the Group.

Payment was made in full under this scheme as all four measures were achieved over each of the three financial years which formed the performance period. No payment would have been made under the plan if one or more measures had not been achieved. None of the targets were linked specifically to regulatory performance.

The value of awards vested is shown in the LTIP award tables on page 51.

Directors' remuneration report (continued)

LTIP 2009

A LTIP was offered covering the period 1 April 2009 to 31 March 2012 in which Steve Shine, COO, and Mark Braithwaite, FCFO, participated. Following Board approval of the audited accounts, payments will be made in July 2012, pro-rata to the length of service during the performance period. The plan is based on the Company's performance against the following measures between 1 April 2010 and 31 March 2012:-

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financial targets over AMP5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP5. This includes: • strategic initiatives around improving operating efficiency, for example WAMI and SCADA; • Developing a successful business plan for AMP6; • meeting key milestones including reaching Ofwat efficiency bandings; • improving employee engagement scores; and • improving health & safety standards.	40%
Regulatory and customer	Improving the Company's scores under Ofwat's core measures of SIM and Operational Performance Assessment ("OPA").	20%

The performance measures are reviewed annually taking relevant economic factors in to account. The value of the awards for the LTIP payable is shown in the LTIP award tables on page 51.

Directors' remuneration report (continued)

LTIP 2010

A new five year LTIP was introduced in 2010 for the Executive Directors and senior managers in key strategic positions across the Company. The performance period of the plan runs from 1 April 2010 to 31 March 2015. The plan focuses on the key objectives for the next regulatory period which are critical to the Company's business plan as follows:-

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financials over AMP5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP5. This includes: • strategic initiatives around improving operating efficiency, for example WAMI and SCADA; • Developing a successful business plan for AMP6; • meeting key milestones including reaching Ofwat efficiency bandings; • improving employee engagement scores; and improving health & safety standards.	40%
Regulatory and customer	Improving the Company's scores under Ofwat's core measures of SIM and OPA.	20%

The performance measures are reviewed annually taking relevant economic factors into account.

The plan is a five year plan where participants at the Executive Director level were granted five times their annual target award of 75% of basic salary in 2010. No further grants will be made to participants over the performance period.

For threshold performance, half the award will vest, rising to two times the award for maximum performance. If performance does not reach the threshold level for any of the targets, no payment will be made under the plan.

Under normal circumstances 20% of the total award can be released each year from July 2013 to July 2017 based on performance achieved as follows:

- 20% of the award will be paid in July 2013, based on performance from March 2010 to March 2013;
- 20% of the award will be paid out in July 2014, based on performance from March 2010 to March 2014;
- the remaining 60% of the award will vest in March 2015 based on performance from March 2010 to March 2015 and will be paid out in three equal tranches over July 2015 – July 2017.

In exceptional circumstances the payouts in 2016 and 2017 may be reduced, for example in the event of a material deterioration in financial performance or a significant fall in service after the AMP5 period. In addition, the Committee has the discretion not to pay under the regulatory and customer area if failure to meet targets in any area leads to regulatory action.

Directors' remuneration report (continued)

LTIP 2010 (continued)

New joiners after 1 April 2010 will be eligible to participate in the LTIP 2010 at the discretion of the Committee. For new joiners, the first payment from the LTIP will be made on the next vesting date following completion of two years service. This payment will be pro-rated based on the part year service. No amount will be received if there is less than two years service for that award and awards are not pro-rated where the new joiner has served over 3 years of the performance period.

Pro-rating also applies to good leavers and is subject to the Committee's discretion and was applied to both Mark Braithwaite (FCFO) and Steve Shine (COO).

The value of the awards payable under the LTIP is shown on page 51.

Pensions

Each Executive Director is eligible to receive payments into pension worth 25% of base salary. The Committee has agreed that where Executives' accumulated pension rights are already in excess of the Lifetime Allowance, a cash payment in lieu of this payment to pension may be made. No element of bonus or LTIP is pensionable.

- Martin Baggs, CEO, participates in the Company Defined Contribution pension scheme and receives contributions of 25% of base salary. Company contributions for the year were £106,250 (2011: £106,250).
- Stuart Siddall, CFO, receives a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £40,057 (2011: nil).
- Stephen Shine, COO, received a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £76,875 (2011: £75,000).
- Mark Braithwaite, FCFO, received a contribution of 25% of salary into a personal pension scheme. Company contributions for the year were £14,743 (2011: £75,000).

Stephen Shine and Mark Braithwaite are deferred members of the Company defined benefit pension scheme which is closed to future accrual. Further details are shown in the defined benefit pension entitlements table on page 52. No other Executive Directors are, or were, members of the scheme.

Non-Executive Directors' fees

The Chairman and Non-Executive Directors receive a fixed fee for their duties which reflects their responsibilities and time commitments. They are not entitled to any annual bonus, long term incentives, pension benefits or benefits in kind.

The Chairman receives an annual fee of £300,000 and Non-Executive Directors receive an annual fee of £45,000. Michael Pavia receives an additional annual fee of £10,000 for his role as Chairman, Audit & Risk Review Committee. Fees are reviewed regularly by the Committee and no individuals are involved in the determination of their own remuneration.

Further details of the Chairman and Non-Executive Directors' remuneration are set out in the emoluments table on page 49.

Service contracts

Reflecting current market practice, the Executive Directors do not hold service contracts that provide for a notice period longer than one year. It is not the Committee's intention to recommend the appointment of any new Executive Directors with contracts that provide for a longer notice period.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Service contracts (continued)

The Committee endorses the principle of mitigation of loss on early termination of a service contract and generally seeks to achieve that objective where possible and appropriate. In the event that the Company wished to terminate an Executive Director's contract other than in circumstances where the Company is entitled to summarily dismiss an Executive Director, it would need to give either 12 months' notice or make a payment in lieu of salary. For Non-Executive Directors, no compensation is payable on the event of early termination.

Executive Directors	Contract start date as Executive Director	Service period	Notice period
Martin Baggs, CEO	5 March 2010	n/a	6 months by employee, 12 months by company
Stuart Siddall, CFO	20 September 2011	n/a	12 months by both sides
Stephen Shine, COO[1]	24 May 2007	n/a	12 months by both sides
Mark Braithwaite, FCFO[2]	31 August 2007	n/a	12 months by both sides

[1]Stephen Shine resigned with effect from 31 March 2012.
[2]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

	Initial Contract start date	Length of Each Period of Appointment	Expiry Date of Current Contract
Chairman			
Sir Peter Mason	01 December 2006	3 years	9 June 2014
Independent Non-Executive Directors			
Dame Deirdre Hutton	22 July 2010	3 years	21 July 2015
Michael Pavia	01 December 2006	3 years	21 July 2015
Edward Richards	22 July 2010	3 years	21 July 2015
Non-Executive Directors			
Luis Abraira[1]	04 August 2011	n/a	n/a
Edward Beckley	26 March 2008	n/a	n/a
Rosamund Blomfield-Smith[2]	14 February 2008	n/a	n/a
Christopher Deacon	01 December 2006	n/a	n/a
Simon Eaves	20 January 2012	n/a	n/a
Gordon Parsons	10 June 2010	n/a	n/a
Antonio Santos[3]	01 January 2011	n/a	n/a
Dipesh Shah	15 October 2007	n/a	n/a
Yaping Shi	19 January 2012	n/a	n/a
Martin Stanley	01 December 2006	n/a	n/a
Robert Verrion	01 January 2011	n/a	n/a
Lincoln Webb	21 November 2011	n/a	n/a

[1]Luis Abraira resigned with effect from 19 January 2012.
[2]Rosamund Blomfield-Smith resigned with effect from 21 November 2011.
[3]Antonio Santos resigned with effect from 4 August 2011.

The Chairman and Independent Non-Executive Directors have fixed appointment periods; the other Non-Executive Directors do not as they are appointed and can be removed without notice by the shareholders of the Company in line with the Shareholder Agreements.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Emoluments table (Excluding LTIPs)

	Directors' salaries / fees £'000	Benefits in kind £'000	Allowances £'000	Pension Allowance £'000	Annual cash bonus £'000	**Group Total year to 31 March 2012 £'000**	Group Total year to 31 March 2011 £'000	**Company Total Year to 31 March 2012 £'000**	Company Total Year to 31 March 2011 £'000
Executive Directors									
M Baggs [1]	425	2.3	51	-	418	**896**	956	**627**	669
S Siddall[2]	160	-	7	40	162	**369**	n/a	**258**	n/a
S Shine [3]	308	2.3	17	77	305	**709**	618	**638**	556
M Braithwaite [4,5]	59	0.4	9	-	-	**68**	622	**48**	435
Chairman									
Sir P Mason	300	-	-	-	-	**300**	275	**180**	165
Independent Non-Executive Directors									
P Dyer	-	-	-	-	-	**-**	45	**-**	45
Dame D Hutton	45	-	-	-	-	**45**	31	**45**	31
M Pavia	55	-	-	-	-	**55**	55	**55**	55
E Richards	45	-	-	-	-	**45**	33	**45**	-
W Smit	-	-	-	-	-	**-**	19	**-**	19
Non-Executive Directors									
L Abraira[6]	11	-	-	-	-	**11**	35	**-**	-
E Beckley	45	-	-	-	-	**45**	45	**-**	-
R Blomfield-Smith[7,8]	46	-	-	-	-	**46**	45	**30**	45
C Deacon[9]	107	-	-	-	-	**107**	81	**-**	-
R Gadsby	-	-	-	-	-	**-**	45	**-**	-
S Eaves[10]	11	-	-	-	-	**11**	-	**-**	-
G Parsons	45	-	-	-	-	**45**	45	**-**	-
K Roseka	-	-	-	-	-	**-**	34	**-**	-
A Santos[11]	23	-	-	-	-	**23**	11	**-**	-
D Shah	45	-	-	-	-	**45**	34	**-**	-
Y Shi[12]	11					**11**	-	**-**	-
M Stanley	45	-	-	-	-	**45**	45	**-**	-
R Verrion	45	-	-	-	-	**45**	11	**-**	-
L Webb[13]	22	-	-	-	-	**22**	-	**-**	-
Total	**1,853**	**5**	**84**	**117**	**885**	**2,944**	3,085	**1,926**	2,020

The Group is Kemble Water Holdings Limited and the Company refers to TWUL.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Emoluments table (Excluding LTIPs) (continued)

[1]Allowances for Martin Baggs comprise £15,000 car allowance and £36,000 housing allowance.
[2]Stuart Siddall was appointed on 20 September 2011.
[3]Stephen Shine resigned with effect from 31 March 2012.
[4]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.
[5]Allowances for Mark Braithwaite comprise £2,462 car allowance and £6,234 in lieu of leave.
[6]Luis Abraira was appointed on 4 August 2011 and resigned with effect from 19 January 2012.
[7]Rosamund Blomfield-Smith resigned with effect from 21 November 2011.
[8]Fees shown include a consultancy fee of £15,750 (2011: £nil) for work on the Tideway Improvements project borne by Thames Water Limited. This arrangement commenced following resignation as a Director.
[9] Fees shown include a consultancy fee of £61,666 (2011: £40,000) for work on the Tideway Improvements project borne by Thames Water Limited.
[10]Simon Eaves was appointed on 20 January 2012.
[11]Antonio Santos resigned with effect from 4 August 2011.
[12]Yaping Shi was appointed on 19 January 2011.
[13]Lincoln Webb was appointed 21 November 2011.

The remuneration of the Company's directors as shown in note 5, page 76 of the financial statements of £2,681,000 include £1,926,000 as shown in the above table, and 2009 and 2010 LTIP's accrued in the year of £668,000 together with pension contributions of £87,000.

The following table sets out the proportion of the bonus which is attributable to regulatory performance for 2012:-

Executive Directors	Proportion determined by regulatory performance
Martin Baggs, CEO	£146,426
Stuart Siddall, CFO	£56,836
Stephen Shine, COO	£137,320

Thames Water Utilities Limited

Directors' remuneration report (continued)

Long term incentive awards

The following table sets out the awards under the LTIP 2008, LTIP 2009 and unvested awards under the LTIP 2010. The potential values shown are the maximum cash levels attainable subject to the performance conditions set out on pages 44 to 47. The expected value shows the level of vesting anticipated based on estimates of current performance, and in the case of the LTIP 2010 will only be payable if performance continues at the same level and if the Executive remains employed at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

Performance period	Date of potential payment	Individual	Potential value of awards held at 31 March 2011 £'000	Potential value of awards granted during the year £'000	Value of awards vesting during the year £'000	Value of awards lapsed during the year £'000	Potential value of awards held at 31 March 2012 £'000	**Group Expected value of awards held at 31 March 2012[1] £'000**	Company-related Expected value of awards held at 31 March 2012 £'000
LTIP 2010									
1 April 2010 – 31 March 2013	July 2013	M Baggs	638	-	-	-	638	**446**	312
		S Shine	450	-	-	-	450	**315**	284
		M Braithwaite	450	-	-	450	-	-	-
1 April 2010 – 31 March 2014	July 2014	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	264	-	-	264	**185**	129
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
1 April 2010 – 31 March 2015	July 2015	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
	July 2016	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
	July 2017	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
LTIP 2009									
1 April 2010 – 31 March 2012	July 2012	S Shine	300	-	-	-	300	**203[2]**	182[2]
		M Braithwaite	300	-	-	-	300	**146[2]**	102[2]
LTIP 2008									
1 April 2008 – 31 March 2011	July 2011	S Shine	300	-	300[3]	-	**-**	**-**	-
		M Braithwaite	300	-	300[3]	-	**-**	**-**	-

[1]Based on performance to date
[2]Expected values shown will be paid in July 2012 following Board approval of the audited accounts
[3]Paid in July 2011

The expected value of the awards attributed to the Company relate fully to regulatory performance.

The amounts shown in the above table are the total amounts that potentially will vest on maturity. The amount accrued in the year are shown in note 5, page 76 of the financial statements.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Defined benefit pensions

Stephen Shine, COO, and Mark Braithwaite, FCFO, were deferred members (with effect from 31 March 2011) of the Company's defined benefit pension scheme, TWPS, which has a normal retirement age of 65 and an accrual rate of 1/80th of basic salary. As deferred members of the scheme no contributions were made in to the scheme during the year by either the Executives or the Company. However, as deferred members their benefits continued to accrue and the transfer values, calculated in line with "Actuarial Guidance note GN11" are set out below:

£	Age	Accrued pension entitlement at 31 March 2011	Accrued pension entitlement at 31 March 2012	Additional pension earned during the period	Transfer value of accrued pension at 31 March 2011	Transfer value of accrued pension at 31 March 2012
Mark Braithwaite	46	21,642	22,430	788	198,498	284,493
Stephen Shine	55	33,498	34,881	1,383	420,601	550,869

As deferred members of the TWPS, the Executives could choose to retire early from age 63, or from age 55 with the consent of the Company. In these circumstances the benefits payable would be actuarially reduced to take account of early payment.

Pension benefits in retirement are increased annually in line with RPI with a cap of 2.5%.

There is also a spouse's pension, payable in the event of the death of the Executive, of 50% of the member's pension, plus children's pensions payable at a rate of one quarter of the spouse's pension for each of up to 4 children.

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Sir Peter Mason, KBE
Chairman, Compensation and HR committee

Corporate governance report

Compliance Regime

The term "corporate governance" is generally taken to refer to the supervision of the way in which a company is run and how the risks to its business are managed. It embraces, *inter alia*, regulation, corporate structure and the function of the Board of Directors and its committees.

The Company's directors, shareholder and the shareholders of the ultimate parent company are committed to maintaining high standards of corporate governance. Under the terms of its Licence from Ofwat, the Company is required to have particular regard to the UK Corporate Governance Code (the "Code"), which is something that generally applies only to companies whose shares are listed on the London Stock Exchange. The Code acknowledges that departure from its provisions may be justifiable in particular circumstances and requires that companies explain those departures. As the Company is a wholly-owned subsidiary in a privately-owned group, the operations of which are governed by a shareholders' agreement, the Board considers that a significant number of the provisions of the Code are not directly applicable:

The areas where the code is not followed are set out in the following paragraphs, with accompanying explanation of the Company's practice being provided.

The Company does not appoint a Senior independent non-executive director as it is considered unnecessary as all shareholders have direct representation on the Board and therefore access to the Chairman, Chief Executive Officer and Chief Financial Officer.

The Chairman did not schedule meetings with the NED's, without the Executive directors in attendance and nor was the Chairman's performance appraised by the NED's as the Chairman is not considered independent, as stated below. Following the Board effectiveness review (see below), the Chairman intends to hold meetings with the NED's without the executive directors in attendance during 2012/13.

The Board

The Board is confident that it acts independently and that it takes decisions objectively in the best interests of the Company. It also believes that it has demonstrated its commitment to ensuring that the Company's obligations to its stakeholders are understood and met, and that the necessary financial and management resources and systems of planning and internal control, are in place to fulfil these obligations. Supported by the CEO and the Executive, the Board continues to take positive action towards regenerating the Company's values and standards and establishing a clear strategic direction for the future.

Matters on which decisions are reserved to the Board and the authority given to the CEO and his Executive team are set out in the schedule of delegated authority ("SODA") approved by the Board.

The Board of Directors is appointed in accordance with the shareholders' agreement and comprise 2 Executive Directors, 10 NED's (including the Chairman) and 3 independent NED's (see Directors report for appointment details of individual directors). The NED's are nominated and appointed by the shareholders of Kemble Water Holdings Limited in accordance with the terms of the shareholders' agreement and are therefore not determined to be independent.

The directors have specialist knowledge of the water industry and other regulated utilities. The Board and Ofwat consider that Michael Pavia (former Chief Financial Officer of the London Electricity Group), Edward Richards (Chief Executive of Ofcom) and Dame Deirdre Hutton (Chair, UK Civil Aviation Authority) are independent NED's.

Corporate governance report (continued)

The Board (continued)

The Board is chaired by Sir Peter Mason, KBE. Sir Peter has had a long and distinguished career in the engineering and construction industries, including Private Finance Initiatives and design and project management. He has also held several public service appointments, primarily with the Department for Trade and Industry (now part of the Department for Business Innovation and Skills). Sir Peter's external appointments include, non–executive director of BAE Systems plc, Spie S.A. and Subsea 7 S.A. Sir Peter is considered not to be independent and neither was he upon his appointment. Sir Peter's responsibilities as Chairman include leadership of the Board, ensuring its effectiveness, setting its agenda and ensuring effective communication with the Company's shareholder. Additionally, he is responsible for ensuring that the directors receive accurate, timely and clear information and that constructive relations exist between the Board and the Executive.

The Board met 5 times during the year with additional conference calls to update the Board on operational matters between formal meetings, where necessary.

All directors are entitled to attend Board meetings either in person or by telephone and are also entitled to attend and observe Committee meetings. Certain members of the senior management team will also attend Board and Committee meetings by invitation.

Newly appointed directors are offered a comprehensive briefing on the Company and its business. Training is also provided for directors on their roles and their legal obligations to ensure they are fully conversant with their responsibilities as directors.

All directors have sufficient resources and access to independent professional advice, at the Company's expense, in order to discharge their responsibilities as directors. Additionally, all directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are complied with. The appointment and removal of the Company Secretary is a matter reserved for the Board.

A Board effectiveness review was carried out in February 2012. This involved the use of a questionnaire to all directors and covered a range of issues around Board and committee processes, Board roles and responsibilities. The findings of the review were considered by the Board at the 1 March 2012 Board meeting with several changes being made as a result. Typically the Company engages the services of an external Board evaluation consultant two years out of three. In between the external evaluations they are conducted internally.

The Company has in place appropriate insurance cover in respect of legal action against its Directors.

Corporate governance report (continued)

Committees of the Board

The five standing committees of the Board are as follows:

- Audit and Risk Review ("ARRC")
- Regulatory
- Health, Safety and Environment
- Compensation and HR
- Customer Service

Each committee has written terms of reference and the collective function of the Committees is to exercise oversight on behalf of the Board and to provide advice to the Board. Other committees are formed as and when required to deal with specific matters, for example the Thames Tideway Tunnel Project.

See page 56 for details and members of each committee of the Board.

Corporate governance report (continued)

Committees of the Board (continued)

Membership of the committees throughout the year ended 31 March 2012 is set out below.

Audit and Risk Review Committee	M Pavia (Chairman), G I W Parsons R Blomfield-Smith (resigned 21.11.11) R Verrion (appointed 8.9.11)
Regulatory Committee	G I W Parsons (Chairman) E Beckley, E C Richards D Shah
Health, Safety and Environment Committee	G I W Parsons (Chairman) Dame D M Hutton D Shah
Compensation and HR Committee	Sir P J Mason (Chairman) M Stanley C Deacon M Pavia
Customer Service Committee (Formed 3 March 2011)	Dame D M Hutton (Chairman) G I W Parsons E C Richards R Verrion
Tideway Tunnel Committee	Sir P J Mason (Chairman) E Beckley G I W Parsons D Shah M Pavia

The Audit and Risk Review Committee

The composition of the ARRC and its terms of reference are governed by the shareholders agreement and comprises two NED's and one independent NED, Michael Pavia, who is the Committee Chairman.

Corporate governance report (continued)

The Audit and Risk Review Committee (continued)

The Board reviews risk management arrangements and the effectiveness of the Company's internal control systems through the work of the ARRC. The primary objectives of the ARRC are:

(i) the preservation of good financial practices throughout the Company;
(ii) ensuring that robust controls are in place to support the integrity of those practices;
(iii) reviewing risk management processes;
(iv) reviewing the Company's interim and annual financial statements, and the Annual Performance Report to Ofwat;
(v) the provision, by way of (amongst other things) meetings, of a line of communication between the Board and external auditor.

The ARRC also reviews the Company's procedure for handling allegations from whistleblowers as set out in the Company's Honest and Ethical Behaviour Policy. Any whistleblowing events are brought to the attention of the ARRC and are promptly investigated by the Head of Internal Audit.

Auditor's independence and objectivity

The ARRC monitors regularly the non-audit services provided to the Company by the external auditor. The auditor does not:

- Self review.
- Make management decisions for the Company.
- Have a mutuality of financial interest with the Company.
- Act in the role of advocate for the Company.

The ARRC regularly meets with the external auditor in private. Approval of the ARRC is required for any services provided by the external auditor for which the fee is likely to be in excess of £100,000.

Details of the fees paid to the external auditor during the year ended 31 March 2012 for audit and non-audit services are set out in note 3 to the financial statements on page 75 of this Annual report and financial statements.

Internal control

The Board has overall responsibility for the Company's system of internal control. This is designed to manage rather than eliminate the risk of failure to meet business objectives and can only provide reasonable, not absolute assurance, against material misstatement or loss.

The key features of the system of internal control and risk management are as follows:

- A control environment with clearly defined organisational structures operating within a framework of policies and procedures covering every aspect of the business.
- Comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years.
- Regular monitoring of risks and control systems throughout the year, supported by the use of risk registers.
- A self-certification process whereby management is required to confirm that the system of internal control is operating effectively.
- An internal audit function providing independent scrutiny of internal control systems and risk management procedures.
- A review of reports produced by internal and external audit.

Corporate governance report (continued)

Internal control (continued)

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of:

- Regular presentations to the ARRC and Executive by heads of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks.
- Reports of significant changes to the Company's overall risk profile, which are also reported to the ARRC.
- Standing reports from the Internal Audit Department to the ARRC.
- Reports to the ARRC on the results of the self-certification process and independent reports thereon by the Internal Audit Department.
- An annual review of the effectiveness of the Company's systems of risk management and internal control by the Board

Independent Auditor's Report to the Members of Thames Water Utilities Limited

We have audited the financial statements of Thames Water Utilities Limited for the year ended 31 March 2012 set out on pages 33 to 68. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 37, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the financial statements:

- Give a true and fair view of the state of the Company's affairs as at 31 March 2012 and of its profit for the year then ended.
- Have been properly prepared in accordance with UK Generally Accepted Accounting Practice, and
- Have been prepared in accordance with the requirements of the Companies Act 2006.

Independent Auditor's Report to the Members of Thames Water Utilities Limited (continued)

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- Adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or

- The financial statements are not in agreement with the accounting records and returns; or

- Certain disclosures of directors' remuneration specified by law are not made; or

- We have not received all the information and explanations we require for our audit.

Paul Johnson (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
7 June 2012

Thames Water Utilities Limited

Profit and loss account for the year ended 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Turnover		**1,694.9**	1,623.1
Operating costs before exceptional item		**(1,091.0)**	(1,022.9)
Exceptional item: pension curtailment gain	3/26	**40.0**	-
Operating costs	3	**(1,051.0)**	(1,022.9)
Operating profit		**643.9**	600.2
Profit on sale of fixed assets	4	**3.9**	10.9
Interest payable and similar charges	6	**(504.7)**	(462.1)
Interest receivable	7	**81.5**	63.8
		(423.2)	(398.3)
Other finance expense	26	**(2.4)**	(4.3)
Profit on ordinary activities before taxation		**222.2**	208.5
Taxation credit on profit on ordinary activities	8	**25.0**	16.7
Profit for the financial year	21	**247.2**	225.2

There are no differences between the profit on ordinary activities before taxation for the periods as stated above and their historical cost equivalents.

All amounts above relate to continuing operations.

Statement of total recognised gains and losses for the year ended 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Profit for the financial year		**247.2**	225.2
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Deferred tax relief/(charge) relating to actuarial loss		**21.4**	(3.2)
Total recognised gains in the year		**174.2**	220.9

Thames Water Utilities Limited

Balance sheet as at 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Fixed assets			
Tangible assets	10	**8,788.3**	8,145.2
Investments	11	**0.1**	0.1
		8,788.4	8,145.3
Current assets			
Stocks	12	**9.6**	8.2
Debtors: amounts falling due within one year	13	**647.9**	621.9
Debtors: amounts falling due after more than one year	14	**2,015.0**	1,865.0
		2,662.9	2,486.9
Investments	17	**619.4**	775.8
Cash at bank and in hand	17	**2.7**	3.6
		3,294.6	3,274.5
Creditors: amounts falling due within one year	15	**(1,460.4)**	(1,016.3)
Net current assets		**1,834.2**	2,258.2
Total assets less current liabilities		**10,622.6**	10,403.5
Creditors: amounts falling due after more than one year	16	**(8,050.2)**	(7,748.7)
Provisions for liabilities and charges	18	**(1,052.6)**	(1,054.3)
Net assets excluding net pension liabilities		**1,519.8**	1,600.5
Net pension liabilities			
– total of defined benefit schemes			
With net liabilities		**(144.4)**	(122.7)
With net assets		**25.2**	28.1
	26	**(119.2)**	(94.6)
Net assets including pension liabilities		**1,400.6**	1,505.9
Capital and reserves			
Called-up share capital	19	**1,029.0**	1,029.0
Share premium account	20	**100.0**	100.0
Profit and loss account	21	**271.6**	376.9
Total shareholder's funds	22	**1,400.6**	1,505.9

The notes on pages 66 to 98 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Stuart Siddall
Chief Financial Officer

Company registered number: 02366661.

Thames Water Utilities Limited

Cash flow statement for the year ended 31 March

	Note	**31 March 2012 £m**	31 March 2011 £m
Net cash inflow from operating activities	(a)	**924.7**	943.1
Returns on investments and servicing of finance			
Interest received		**106.1**	110.4
Interest paid		**(354.1)**	(269.3)
Interest element in finance lease payments		**(6.9)**	(6.5)
Net cash outflow from returns on investments and servicing of finance		**(254.9)**	(165.4)
Taxation		**79.6**	(26.0)
Capital expenditure and financial investment			
Gross cost of purchased fixed assets		**(993.6)**	(793.8)
Infrastructure renewals expenditure		**(176.8)**	(107.7)
Receipt of grants and contributions		**44.3**	41.0
Movement on long term loans to group companies		**(150.0)**	(685.0)
Sale proceeds of fixed assets	(d)	**8.8**	11.5
Net cash outflow for capital expenditure and financial investment		**(1,267.3)**	(1,534.0)
Equity dividends paid	9	**(279.5)**	(271.4)
		(797.4)	(1,053.7)
Management of liquid resources			
Decrease/(increase) in current asset investments	(b) & (c)	**156.4**	(202.6)
Net cash outflow before financing		**(641.0)**	(1,256.3)
Financing			
Capital element in finance lease payment		**(7.8)**	(8.6)
New loans		**657.1**	1,807.6
Repayment of loans		**(9.2)**	(545.0)
Net cash inflow from financing	(b) & (c)	**640.1**	1,254.0
Decrease in cash	(b) & (c)	**(0.9)**	(2.3)

Interest received of £106.1m includes £24.4m received from Thames Water Utilities Holdings Limited which is not included in the adjusted interest cover ratio calculations as defined in the Chief Executive's Report on page 11.

Thames Water Utilities Limited

Notes to the cash flow statement for the year ended 31 March

(a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	**31 March 2012 £m**	31 March 2011 £m
Operating profit		**643.9**	600.2
Depreciation (infrastructure renewals charge)	3	**129.5**	132.4
Depreciation (non infrastructure)	3	**286.1**	260.9
Difference between pension charge and cash contributions		**(68.1)**	(26.8)
Increase in stocks		**(1.3)**	(0.6)
Increase in debtors and prepaid expenses		**(36.3)**	(12.2)
(Decrease)/increase in creditors and accrued expenses		**(14.4)**	2.3
(Decrease)/Increase in provisions		**(0.9)**	0.5
Release of deferred income		**(13.8)**	(13.6)
Net cash inflow from operating activities		**924.7**	943.1

(b) Reconciliation of net cash flow to movement in net debt

	Note	**31 March 2012 £m**	31 March 2011 £m
Decrease in cash in the year		**(0.9)**	(2.3)
Cash (outflow)/inflow from increase in liquid resources		**(156.4)**	202.6
Cash inflow from movement in net debt and financing		**(640.1)**	(1,254.0)
Increase in net debt resulting from cash flows		**(797.4)**	(1,053.7)
Non-cash increase in net debt		**(182.3)**	(192.7)
Total increase in net debt		**(979.7)**	(1,246.4)
Opening net debt		**(6,795.8)**	(5,549.4)
Closing net debt	(c)	**(7,775.5)**	(6,795.8)

The non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 ‘Capital instruments’.

Notes to the cash flow statement for the year ended 31 March (continued)

(c) Analysis of movement in net debt

	As at 1 April 2011 £m	Cash flow £m	Other non-cash movements £m	**As at 31 March 2012 £m**
Cash at bank and in hand	3.6	(0.9)	-	**2.7**
Current asset investments	775.8	(156.4)	-	**619.4**
	779.4	(157.3)	-	**622.1**
Debt due within one year	(7.6)	(462.4)	-	**(470.0)**
Debt due after more than one year	(7,372.5)	(185.5)	(182.3)	**(7,740.3)**
Finance leases	(195.1)	7.8	-	**(187.3)**
	(7,575.2)	(640.1)	(182.3)	**(8,397.6)**
Total	(6,795.8)	(797.4)	(182.3)	**(7,775.5)**

(d) Profit on disposal of fixed assets

The proceeds received regarding the profit on the sale of fixed assets for the year ending 31 March 2012 of £8.8m (2011: £11.5m) have been included within Capital expenditure and financial investment.

Notes to the Financial statements for the year ended 31 March

1 Principal accounting policies

The following accounting policies have been applied consistently in dealing with items, which are considered material to the financial statements, except as noted below.

Basis of preparation

The financial statements are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions, with the Companies Act 2006. An explanation of this departure from the requirements of the Act is given in note 1(b) below.

The Company has not prepared consolidated group financial statements, as permitted under section 400 of the Companies Act 2006. The Company and its subsidiaries are included in the consolidated financial statements of its ultimate parent company Kemble Water Holdings Limited, a company registered in the United Kingdom.

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive Officer's Business review on pages 6 to 31. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Chief Executive Officer's Business review on pages 9 to 11. The Chief Executive Officer's Business review also includes details of the Company's Treasury policy, capital structure and financial risk management.

Day to day working capital requirements are funded by the business. During the year £657.1m, net of bond issuance costs, of new debt were secured and there is no current requirement to raise additional finance to meet future project obligations. There are also cash balances of £629.6m and committed facilities with a group of banks of £1,200m, which are only likely to be used on rare occasions. Of the £1,200m, £450m 364 day facilities are due for renewal by August 2012 with the remainder maturing in September 2016. The current economic conditions create uncertainty particularly over (a) the level of revenue earned from regulatory activities; (b) the increased occurrence of bad debts; and (c) the availability of bank finance in the foreseeable future. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate within the level of its current facilities for 15 months. However, the Company plans to meet its capital programme requirements by raising new debt.

The directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements.

Changes to accounting policies

The same accounting policies used for the year ended 31 March 2011 have been applied in these financial statements.

Changes in accounting estimates

During the year the Company modified the way in which it calculates its provision for bad debts and extended the calculation to cover accrued (unbilled) income. The calculation also uses a number of estimates and assumptions that were updated in line with the collections that the Company is achieving in the current economic climate.

As a result the Company's bad debt charge has increased by £70.6m (2011: £38.4m).

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

Changes in accounting assumptions relating to pensions

Following extensive consultation with employees and with the agreement of the pension fund trustees the Company has changed certain provisions in respect of the TWPS for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011 new employees of the Company have been offered participation in the DCSPS managed through Standard Life. All senior managers have moved to this scheme from the defined benefit scheme.

For existing members of the TWPS, certain provisions have changed that will affect future benefits to its members. Principally, the defined benefit provision from 1 May 2011 will be on a Career Average Revalued Earnings ("CARE") basis and no longer on a Final Salary basis.

As a result of the above change to a CARE basis a curtailment gain of £40.0m has been recorded within these financial statements and has been classified as an exceptional item, see note 3 page 75 and note 26 page 94. The directors consider that due to the materiality and one-off nature of this curtailment gain, it is appropriate to classify this as an exceptional item in order to show a true and fair view of the Company's underlying performance. The tax charge on this exceptional item is £9.6m.

Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below.

(a) Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided and are recognised in accordance with FRS 5 "Reporting the Substance of Transactions". No adjustment is made to reduce revenue by an estimated bad debt charge to reflect the fair value as this is not deemed material. Where relevant, revenue includes an estimate of the sales value of water supplied and waste water charges to customers between the date of the last meter reading and the period end, exclusive of value added tax. The estimated usage is based upon historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period for which the revision to the estimates is determined. For customers who do not have a meter, the receivable billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as favourable operating costs when payment is received in both the statutory and regulatory accounts. The Company currently does not have any charges on income; any outstanding revenue is recovered in the normal course of business. All water and sewerage charges billed to customers are recognised as income at the time they are billed and apportioned over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

1 Principal accounting policies (continued)

(a) Revenue recognition (continued)

Where there is a change of customer in an unmeasured property but the Company cannot confirm the name, a bill is raised in the name of "The Occupier". The Company does not raise billing in the name of the Occupier for metered accounts. However, an unmeasured bill in the name of the Occupier will be cancelled and rebilled once the Company has confirmation of the customer's name. If confirmation is not received the bill is cancelled and the property is classified as empty.

Where a property is classified as empty, an empty property process is followed to verify when the property becomes occupied and/or obtain the name of the customer. The status is established with the customer at point of contact, if the property is not chargeable after 10 weeks the unfurnished / unoccupied state is confirmed visually. The empty property process comprises a number of steps. If these steps confirm that a property appears to be empty then the supply may be turned off. The property will only cease to be classified as empty when a named customer is identified and billed. The Company does not recognise income in respect of empty properties. If the Company has turned off the supply of water at the mains to a property at a customer's request then water supply charges are not payable. A customer may request the supply to be turned off in instances such as the property is to be demolished or where a house previously converted into flats (and additional supplies made) to be converted back into a house.

With regard to new properties, an estimate is made of the sales value of water supplied and waste water charges to customers between the date of connection and the period end.

The Company recognises all revenue at the time of delivery. Should the Company consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned. Payments received in advance of delivery are recorded as deferred revenue.

(b) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers and pumped raw water storage reservoirs and sludge pipelines), and other assets (including land, buildings, properties, over ground plant and equipment).

Directly attributable costs are capitalised within fixed assets. These costs include employee costs and other internal costs that are incremental to the business due to the scale and nature of the capital implementation programme of the Company. Interest costs are not capitalised.

The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively.

The carrying values of fixed assets are also reviewed for impairment where there has been a trigger event by assessing the present value of estimated future cash flows and net realisable value compared with net book value. The calculation of estimated future cash flows and residual values is based on the directors' best estimates of future prices, output and costs and is therefore subjective.

- **Infrastructure assets**

Infrastructure assets comprise a network of below ground systems. In the UK Water and Waste regulated business, all expenditure on infrastructure assets is capitalised at cost, whilst the planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as Infrastructure Renewals Charge ("IRC") within depreciation.

Following the completion of the Company's assessment of the infrastructure renewals expenditure requirement to the end of AMP 7 for the Final Business Plan, the Company considers that it would be appropriate to reflect in its regulatory and statutory accounts an infrastructure renewals charge consistent with its expenditure plans for the AMP 5 to AMP 7 (2010-2025) periods.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

b) Tangible fixed assets (continued)

- **Capital contributions**

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 1 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, which is accordingly accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. As infrastructure assets are accounted under renewals accounting, related capital contributions are not recognised in the profit and loss account.

The financial effect of this departure is disclosed in note 10.

Where material, contributions received towards the cost of other assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

- **Other assets**

All other assets, comprising plant and equipment and land and buildings, are stated at cost less accumulated depreciation.

Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Freehold land is not depreciated and assets in the course of construction are not depreciated until they are commissioned. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated useful lives, down to zero, based on management's judgement and experience, which are principally as follows:

Buildings	15 - 60 years
Operational structures	30 - 100 years
Other operational assets	5 - 40 years
Fixtures, fittings, vehicles and computers	3 - 7 years
Fixed and mobile plant	3 - 40 years

Depreciation methods, residual values and useful lives are re-assessed annually and, if necessary, changes are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account.

(c) Impairment of tangible fixed assets

Fixed assets are assessed for impairment whenever there is an indication of impairment to determine whether any assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(c) Impairment of tangible fixed assets (continued)

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of non-current assets is recognised in the profit and loss account within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the profit and loss account and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

(d) Stocks

Stocks are stated at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(e) Taxation

The tax expense represents the sum of current tax and deferred tax.

- **Current taxation**

Current taxation, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Taxable profit differs from the profit on ordinary activities before tax as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

- **Deferred taxation**

Deferred taxation is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes, which have arisen but not reversed by the balance sheet, except as otherwise required by FRS 19 “Deferred tax”.

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

Deferred taxation is measured at the tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with via the Statement of total recognised gains and losses.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(f) Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

- **Finance leases**

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease.

The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease to the first break clause.

- **Operating leases**

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

(g) Pension and other post retirement benefits

The Company operates two large defined benefit pension schemes. The Company accounts for these schemes in accordance with FRS 17 “Retirement Benefits”. These schemes are independently, administered funds, for the substantial majority of the Company’s employees. Actuarial valuations are carried out as determined by the pension scheme trustees using the projected unit credit method for both pension schemes at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. The Company believes that the assumptions utilised in recording obligations under the two schemes are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions. For any intervening reporting period, the actuaries review the continuing appropriateness of the contribution rates (a complete actuarial valuation is performed every three years). Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the assets and liabilities of the schemes are recognised as a surplus (to the extent that the surplus is recoverable) or obligation in the balance sheet.

The cost of providing pension benefits to employees is included in the profit and loss account within the cost of employee benefits. The difference between the expected return on scheme assets and interest on scheme liabilities are included within other finance income/expense in the profit and loss account.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and are presented in the Statement of total recognised gains and losses.

In addition to the defined benefit schemes, the Company operates a Defined Contribution Stakeholder Pension Scheme (“DCSPS”), managed through Standard Life Assurance Limited (“Standard Life”). From 1 April 2011 the DCSPS is the only scheme to which new entrants to the Company will be eligible. The Company’s Extended Leadership Team of executives have also joined this scheme from 1 April 2011 and are no longer active members of a defined benefit arrangement.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued

(g) Pension and other post retirement benefits

The Company also operates two closed defined contribution pension schemes. The Company has no further payment obligations for these schemes. However, defined funds for individuals are held within these schemes.

(h) Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange current at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling using the rate of exchange current at the balance sheet date. Gains and losses arising on retranslation are included in the profit and loss account for the year.

(i) Cash and cash equivalents

Cash includes cash at bank and in hand, deposits, and short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

(j) Provision for doubtful debts

At each reporting date, the Company evaluates the collectability of trade receivables and records provisions for doubtful receivables based on experience. These provisions are based on, amongst other things, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

At each reporting date, the Company evaluates the value of cancellations that will occur in the future against turnover booked, and not be rebilled. The provision is based on history of cancellations and subsequent rebills, which could affect operating results positively or negatively.

(k) Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

- **Borrowings**

Interest bearing bank loans and overdrafts are recorded as the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis in the profit and loss using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

- **Financial instruments and derivatives**

Interest rate swap agreements and financial futures are used to manage interest rate exposure. While the Company enters into currency swaps to manage its exposure to fluctuations in exchange rates, the Company does not use derivative financial instruments for speculative purposes.

The Company currently does not apply FRS 26 ”Financial Instruments: Recognition and Measurement”, and accordingly the disclosure requirements of FRS 29 ”Financial Instruments: Disclosures” are not applicable.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

- **Financial instruments and derivatives (continued)**

Therefore, the presentation requirements of FRS 25 “Financial Instruments: Presentation” have been applied. However, certain voluntary disclosures have been prepared to aid understanding and comparability with prior year.

Foreign currency and interest rate swaps are all in hedging relationships and are accounted for on an amortised cost basis. Swaps are included within the appropriate caption in note 17.

(l) Accruals and deferred income

Grants and contributions receivable in respect of depreciating fixed assets are treated as deferred income, which is credited to the profit and loss account over the estimated economic lives of the related assets.

(m) Research and development

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

(n) Accounting for provisions and contingencies

The Company is subject to a number of claims that are incidental to the normal conduct of its business. These relate to and include commercial and contractual claims, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience.

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Insurance provisions are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts. Provisions are recorded in the balance sheet at their full value and are not therefore discounted.

(o) Related party disclosures

The Company has taken advantage of the exemption under paragraph 3(c) from the provisions of FRS 8 ”Related party disclosures”, which requires the disclosure of the details of material transactions with other wholly owned subsidiaries within the Kemble Water Holdings Limited Group, on the grounds that it is a wholly owned subsidiary of Kemble Water Holdings Limited, a company registered in the United Kingdom.

(p) Dividends

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(r) LTIPS and bonus

Cash based LTIPS awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the schemes applicable taken into account the duration of the individual scheme and the assumptions used to award payments.

Bonus payments are accrued in the year based on targets assessed at the beginning of each year and paid in the following year when actual performance is measured against the targets set.

2 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

3 Operating costs

Analysis of operating costs by type of expense:

	Note	**31 March 2012 £m**	31 March 2011 £m
Staff costs excluding exceptional item	5	**199.4**	207.5
Exceptional item – pension curtailment gain *	26	**(40.0)**	-
Materials and consumables		**155.6**	136.6
Other operating charges		**476.4**	433.7
Depreciation:			
Owned assets (infrastructure renewals charge)	10	**129.5**	132.4
Owned assets (non-infrastructure)	10	**276.5**	251.3
Assets held under finance leases (non-infrastructure)	10	**9.6**	9.6
Rental under operating leases:			
Hire of plant and machinery		**10.0**	9.3
Other		**5.7**	5.4
Research and development		**3.9**	3.4
Other operating income		**(7.1)**	(7.3)
Foreign currency loss		**-**	0.9
		1,219.5	1,182.8
Own work capitalised (staff and other costs)		**(168.5)**	(159.9)
		1,051.0	1,022.9

* During the period a curtailment gain of £40.0m arising from changes to certain provisions, in respect of the Thames Water Pension Scheme, which came into effect on 1 May 2011, has been classified as an exceptional item. This gain arose as a result of changes to scheme benefits, which have reduced future liabilities. The directors consider that due to the materiality and one-off nature of this curtailment gain, it is appropriate to classify this as an exceptional item in order to show a true and fair view of the Company's underlying performance. The tax charge on this exceptional item is £9.6m. This exceptional item had a £nil cash flow impact.

Amounts receivable by the Company's auditor in is shown below in respect of the following services to the Company:

Fees payable to the auditor:	**31 March 2012 £'000**	31 March 2011 £'000
Fees payable to the Company's auditor for the audit of the Company's accounts	**229**	213
Fees payable to the Company's auditor and its associates for other services:		
Other services pursuant to legislation	**71**	78
Other services relating to taxation	**25**	18
Other services relating to information technology	**118**	-
All other services	**2,084**	241
Total aggregate remuneration	**2,527**	550

Fees for all other services above include £1.9m in respect of advice on the Thames Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG following a competitive tendering process in line with the Company's procurement processes.

No other fees were payable to KPMG Audit Plc in respect of this Company in this year or the prior year.

Notes to the Financial statements for the year ended 31 March (continued)

4 Profit on sale of fixed assets

	31 March 2012 £m	31 March 2011 £m
Profit on disposal of fixed assets	**3.9**	10.9
Taxation charge attributable, included in the current tax (credit)/charge for the period – note 8	**1.6**	2.0

5 Information regarding directors and employees

Aggregate directors' emoluments:

	31 March 2012 £'000	31 March 2011 £'000
Salary	**1,083**	1,092
Pension	**184**	89
Bonus	**681**	875
LTIPs	**667**	1,106
Other benefits	**66**	65
Total aggregate emoluments	**2,681**	3,227

Included in the table above, is £2,365,237 (2011: £2,911,903) for the executive directors for their services to the Company. In addition, the executive directors received total remuneration of £775,545 (2011: £883,112) for their services to other companies within the Group.

At 31 March 2012 £2,171 is accruing to 2 directors (2011: £45,031 for 2 directors) under the Group's defined benefit scheme in respect of services to the Company. In addition, the Company contributed £131,675 (2011: £nil) either as a cash supplement or into a personal pension scheme for 3 directors (2011: nil directors).

At 31 March 2012 £74,375 is accruing to 1 director (2011: £79,495 for 1 director) under a defined contribution scheme.

Highest paid director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid director in respect of work done for the Company during the year were £1,021,837 (2011: £1,168,425) and accrued pension under a defined contribution scheme was £74,375 (2011: £79,495, defined benefit scheme). In addition, emoluments of £437,930 (2011: £500,753) were paid to the highest paid director for services to other companies within the Group.

Details of Long Term Incentive Plans ("LTIP") can be found within the Directors' remuneration report on pages 44 to 47

Notes to the Financial statements for the year ended 31 March (continued)

5 Information regarding directors and employees (continued)

Employee information

The average number of persons employed by the Company, including executive directors, during the year, analysed by category, was as follows:

	31 March 2012 Number	31 March 2011 Number
Support	**323**	331
Operations	**4,228**	4,555
Total employee numbers	**4,551**	4,886

Employment costs excluding exceptional item (see note 3, page 75) but including executive directors' remuneration were:

	Note	**31 March 2012 £m**	31 March 2011 £m
Salaries and wages		**166.3**	167.1
Social security costs		**15.8**	13.7
Pension costs – defined benefit scheme	26	**16.4**	25.2
Pension costs – defined contribution scheme	26	**1.4**	0.2
Severance costs		**1.3**	3.1
Total		**201.2**	209.3
Employment costs included within research and development		**(1.8)**	(1.8)
Net employment costs		**199.4**	207.5

In addition, £9.3m (2011: £10.9m) of employment costs were charged directly to capital projects.

6 Interest payable and similar charges

	31 March 2012 £m	31 March 2011 £m
Bank loans, overdrafts and other loans:		
Group undertakings:		
Internal interest expense	**(288.3)**	(234.1)
RPI accretion on loans	**(123.8)**	(118.7)
Amortisation of debt issue costs	**(4.8)**	(5.2)
Bank and other loans:		
External interest expense	**(21.1)**	(28.7)
RPI accretion on loans	**(58.5)**	(69.1)
Amortisation of debt issue costs	**(1.4)**	(0.7)
Finance charges in respect of finance leases	**(6.8)**	(5.6)
Interest payable and similar charges	**(504.7)**	(462.1)

Notes to the Financial statements for the year ended 31 March (continued)

7 Interest receivable

	31 March 2012 £m	31 March 2011 £m
Interest receivable:		
Group loans	**39.4**	24.4
Other loans	**7.8**	3.7
Net swaps receivable	**34.3**	35.7
Interest receivable	**81.5**	63.8

Amounts receivable on swaps relate to interest rates taken out to hedge rates on borrowings. See note 17, page 86.

The net interest receivable/(payable) on swaps is the aggregate effect of all swaps held in the Company.

8 Taxation

(a) Analysis of charge in the year

	Note	31 March 2012 £m	31 March 2011 £m
Current tax:			
Amounts payable in respect of corporation tax for the year		**-**	4.8
Adjustment in respect of prior years		**(38.3)**	(4.3)
Total current tax (credit)/charge	8(b)	**(38.3)**	0.5
Deferred tax:			
Origination and reversal of timing differences		**43.8**	50.1
Adjustments in respect of prior years		**33.1**	2.1
Impact on deferred tax of tax rate change to 24% (2011: 26%)		**(80.7)**	(74.8)
Deferred tax credit	18	**(3.8)**	(22.6)
Timing difference on pension cost charge	26	**17.1**	5.4
Total deferred tax charge/(credit)		**13.3**	(17.2)
Taxation credit on profit on ordinary activities		**(25.0)**	(16.7)

For an explanation of the impact on deferred tax of the tax rate change to 24% (2011: 26%), see caption - (b) Factors affecting the current tax charge for the year on the following page.

8 Taxation (continued)

(b) Factors affecting the current tax charge for the year

The current tax (credit)/charge is based upon UK corporation tax at 26% (2011: 28%).

The tax (credit)/charge for the year is lower (2011: lower) than the standard rate of corporation tax in the UK (26%), (2011: 28%). The differences are explained below:

	31 March 2012 £m	31 March 2011 £m
Profit on ordinary activities before tax	**222.2**	208.5
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011: 28%)	**57.8**	58.4
Effects of:		
Disallowable expenditure less non taxable income	**3.1**	1.9
Capital allowances for the year in excess of depreciation and other timing differences	**(43.8)**	(50.1)
Pension cost charge lower than pension cost relief	**(17.1)**	(5.4)
Adjustments to tax charge in respect of prior years	**(38.3)**	(4.3)
Current tax (credit)/charge for the year	**(38.3)**	0.5

(c) Factors affecting tax charge for the year

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012. The financial statements for the year reflect these changes, a credit of £80.7m was taken to the profit and loss account and a charge of £3.1m was taken to reserves.

On 23 March 2011 the Chancellor announced the reduction in the main rate of UK corporation tax to 26% with effect from 1 April 2011. This change became substantively enacted on 29 March 2011 and therefore the effect of the rate reduction created a reduction in the deferred tax liability for the prior period of £74.8m, which has been included in the figures above.

The overall effect of the further reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £80.8m.

Notes to the Financial statements for the year ended 31 March (continued)

9 Dividends

The aggregate amount of dividends comprises:	Note	**31 March 2012 £m**	31 March 2011 £m
Dividends paid in respect of prior year but not recognised as liabilities in that year:			
Second interim paid: nil (2011: 2.7p) per ordinary share		**-**	28.2
Third interim paid: nil (2011: 7.3p) per ordinary share		**-**	75.0
Fourth interim paid: 2.4p (2011: nil) per ordinary share		**24.4**	-
Interim dividends paid in respect of the current year:			
First interim paid: 10.2p (2011: 5.6p) per ordinary share		**105.1**	57.3
Second interim paid: 4.9p (2011: 7.3p) per ordinary share		**50.0**	75.1
Third interim paid: 9.7p (2011: 3.5p) per ordinary share		**100.0**	35.8
	21 & 22	**279.5**	271.4

The interim dividend of £24.4m in respect of the year ended 31 March 2011 was paid to Thames Water Utilities Holdings Limited and was used to settle inter-company interest owing to Thames Water Utilities Limited.

Interim dividend distributions are analysed below:

	31 March 2012 £m	31 March 2011 £m
Intra group debt service distribution	**79.5**	121.4
External dividend distributions	**165.1**	115.1
External interest on Kemble Water Eurobond plc debt	**34.9**	34.9
	200.0	150.0
	279.5	271.4

Post balance sheet event

On 7 June 2012 the directors approved a fourth interim dividend of £201.4m (19.6p per ordinary share) in respect of the year ended 31 March 2012. This interim dividend will be paid to Thames Water Utilities Holdings Limited ("TWUHL") on 27 June 2012, and will be used as follows;

- On the same day, TWUHL will use £39.4m to settle its inter-company interest balance payable to TWUL;
- On the same day, TWUHL will pass the remaining £162.0m up the Group structure to be used as detailed below;
    - Thames Water Limited will receive from TWUHL £40.0m and will use this to settle an inter-company balance relating to group relief payments;
    - Subsidiaries of the Group will use £47.5m to settle interest on the Group's external debt, including a payment of £17.5m on Kemble Water Eurobond plc's debt.
    - The remaining £74.5m will be paid as a dividend to the shareholder's of KWHL.

10 Tangible fixed assets

	Land and buildings	Plant and equipment	Infrastructure assets	Assets in course of construction	Total
	£m	£m	£m	£m	£m
Cost					
At 1 April 2011	2,516.6	4,416.1	4,649.6	1,188.6	12,770.9
Additions	-	-	-	1,095.9	1,095.9
Transfers between items	74.6	376.5	318.7	(769.8)	-
Disposals	-	(24.5)	(0.3)	-	(24.8)
At 31 March 2012	**2,591.2**	**4,768.1**	**4,968.0**	**1,514.7**	**13,842.0**
Capital contributions					
At 1 April 2011	-	-	631.2	-	631.2
Additions	-	-	32.1	-	32.1
At 31 March 2012	**-**	**-**	**663.3**	**-**	**663.3**
Depreciation					
At 1 April 2011	638.3	2,283.1	1,073.1	-	3,994.5
Provided during the year	40.9	245.2	129.5	-	415.6
Disposals	-	(19.7)	-	-	(19.7)
At 31 March 2012	**679.2**	**2,508.6**	**1,202.6**	**-**	**4,390.4**
Net book value					
At 31 March 2012	**1,912.0**	**2,259.5**	**3,102.1**	**1,514.7**	**8,788.3**
At 31 March 2011	1,878.3	2,133.0	2,945.3	1,188.6	8,145.2

The Company adopted approximately 40,000 km of private sewers and lateral drains on 1 October 2011, which had a historical net book value of £nil due to no payment was made and there are no current economic benefits to the Company on adoption. For its current cost equivalent, see note 4b on page 119 of the regulatory accounts within this report.

The net book value of land and buildings is analysed as follows:

	31 March 2012 £m	31 March 2011 £m
Freehold land and buildings	**1,901.7**	1,867.7
Leasehold – over 50 years	**7.6**	7.8
Leasehold – under 50 years	**2.7**	2.8
	1,912.0	1,878.3

Depreciation has not been charged on freehold land stated in the financial statements at cost of £120.3m (2011: £117.1m).

10 Tangible fixed assets (continued)

Details of the Company's tangible fixed assets, which are held under finance leases, are:

	Total £m
Cost	
At 1 April 2011 and 31 March 2012	**263.2**
Depreciation	
At 1 April 2011	136.8
Provided during the year	9.6
At 31 March 2012	**146.4**
Net book value	
At 31 March 2012	**116.8**
At 31 March 2011	126.4

11 Fixed asset investments

	31 March 2012 £m	31 March 2011 £m
Cost of shares in subsidiaries	**0.1**	0.1

At 31 March 2012 the Company held the allotted share capital of the following undertakings:

Name of undertaking	**Nominal value and class of shares held**	**Proportion of nominal value of issued shares held**	**Activity**
Thames Water Utilities Finance Limited	£1 Ordinary	100%	Finance Company
Thames Water Utilities Cayman Finance Holdings Limited	$1 Ordinary	100%	Finance Company

Thames Water Utilities Finance Limited was incorporated and registered in Great Britain. Thames Water Utilities Cayman Finance Holdings Limited was incorporated and registered in the Cayman Islands and resident in the United Kingdom for tax.

At 31 March 2012 Thames Water Utilities Finance Limited had net liabilities of £70.7m (2011: liabilities £43.2m) and incurred a loss for the year ended 31 March 2012 of £27.5m (2011: loss £11.1m).

At 31 March 2012 Thames Water Utilities Cayman Finance Holdings Limited had net assets of £1 (2011: £1). No profit or loss had been made in the year (2011: £nil).

Notes to the Financial statements for the year ended 31 March (continued)

12 Stocks

	31 March 2012 £m	31 March 2011 £m
Raw materials and consumables	**9.6**	8.2

13 Debtors: amounts falling due within one year

	31 March 2012 £m	31 March 2011 £m
Trade debtors	**254.8**	267.6
Amounts owed by group undertakings		
- Interest	**39.4**	24.4
- Non interest	**40.4**	0.4
Amounts receivable in respect of corporation tax	**-**	12.3
Amounts receivable in respect of group relief	**-**	28.0
Other debtors	**70.5**	65.2
Insurance claims receivable	**56.8**	53.7
Prepayments and accrued income	**186.0**	170.3
	647.9	621.9

Prepayments and accrued income as at 31 March 2012 includes water and wastewater income not yet billed of £146.7m (2011: £137.9m).

Amounts owed by group undertakings are comprised of:

- Interest receivable of £39.4m (2011: £24.4m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking, on a loan of £2,015.0m (2011: £1,865.0m), of which £39.4m (2011: £24.4m) is included within debtors: amounts falling due within one year and £nil (2011: £nil) within debtors: amounts falling due after more than one year.

- All other amounts are unsecured, interest free and payable on demand.

14 Debtors: amounts falling due after more than one year

	31 March 2012 £m	31 March 2011 £m
Amounts owed by group undertakings	**2,015.0**	1,865.0

Amounts owed by group undertakings are comprised of:

- An unsecured loan of £2,015.0m (2011: £1,865.0m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking. The directors do not anticipate any repayment of principal within the next twelve months.

  Interest is charged at the London Inter-bank Offered rate ("LIBOR") + 0.35%.

Notes to the Financial statements for the year ended 31 March (continued)

15 Creditors: amounts falling due within one year

	31 March 2012 £m	31 March 2011 £m
Obligations under finance leases	**56.5**	7.9
Trade creditors:		
- Operating	**280.7**	254.4
- Capital	**243.0**	332.3
Amounts owed to group undertakings:		
- Secured loan amounts (see below)	**470.0**	7.6
- Interest	**126.8**	129.2
- Non interest	**8.9**	-
Amounts payable in respect of group relief	**0.9**	-
Other taxation and social security payable	**4.6**	3.7
Accruals and deferred income	**269.0**	281.2
	1,460.4	1,016.3

Accruals and deferred income includes £82.0m (2011: £81.8m) of receipts in advance relating to amounts received from customers for water and wastewater charges in respect of the following year.

16 Creditors: amounts falling due after more than one year

	31 March 2012 £m	31 March 2011 £m
Secured bank loans	**666.9**	573.4
Obligations under finance leases	**130.8**	187.2
Amounts owed to group undertakings: secured loan amounts (see below)	**7,073.4**	6,799.1
Accruals and deferred income	**179.1**	189.0
	8,050.2	7,748.7

Amounts owed to group undertakings for secured loans for the year ended 31 March 2012 are shown net of external cross currency and index linked swaps.

	31 March 2012 £m	31 March 2011 £m
Amounts owed to group undertakings are:		
Inter-company secured loans		
- Within one year	**417.1**	15.0
- After more than one year	**6,939.8**	6,672.6
	7,356.9	6,687.6
Non-loan amounts due within one year		
- Interest	**126.8**	129.2
- Non interest	**8.9**	-
	7,492.6	6,816.8

16 Creditors: amounts falling due after more than one year (continued)

Inter-company secured loans for the year ended 31 March 2012 as shown in the above table represent the liability of the Company owed to group undertakings as detailed below and do not include the effect of derivatives held within the Company.

Secured bank loans

Each Obligor (the companies within the Securitisation Group) has entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited will guarantee the obligations of each other Obligor under the finance documents and the Company and its wholly-owned subsidiaries will guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

Amounts due to group undertakings in respect of non-interest amounts are unsecured, interest free and payable on demand.

Loan amounts owed to group undertakings include:

- £2,747.2m (2011: £2,699.7m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking, of which £nil (2011: £15.0m) is included within creditors due within one year and £2,747.2m (2011: £2,684.7m) within creditors due after more than one year.

- £4,623.0m (2011: £4,001.5m) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking, of which £417.1m (2011: £nil) is included within creditors due within one year and £4,205.9m (2011: £4,001.5m) within creditors due after more than one year.

Details of maturity of loans falling due after more than one year are detailed in note 17.

17 Financial instruments

FRS 25 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities.

Funding and treasury policy

The Company's treasury operations are managed centrally by a small specialist team within the Thames Water Group reporting directly to the Chief Financial Officer. The treasury team manages the financing (including debt, interest costs and foreign exchange) for the Group. Treasury policy is focussed on efficient and effective management of cash and financial resources within the Group.

The Company's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance Limited and Thames Water Utilities Cayman Finance Limited is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

Derivative financial instruments, including cross currency swaps, interest rate swaps and index-linked swaps, are employed to manage the currency interest rate and inflation risks arising from the primary financial instruments used to finance the Company's activities.

Short-term debtors and creditors have been excluded from the financial instruments disclosures.

Interest rate risk profile of financial liabilities and assets

After taking into account the Company's interest rate and currency swaps, the interest rate risk profile of the Company's financial liabilities and assets is as follows:

17 Financial instruments (continued)

Financial liabilities

	Total at floating rates		Total at fixed rates		Total at RPI linked rates		Total book value	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Bank loans and overdraft								
- £ Sterling	**132.3**	122.1	**17.7**	27.9	**516.8**	423.4	**666.8**	573.4
Other loans and finance leases *								
- £ Sterling	**316.0**	323.8	**3,680.2**	3,208.2	**3,734.6**	3,469.8	**7,730.8**	7,001.8
	448.3	445.9	**3,697.9**	3,236.1	**4,251.4**	3,893.2	**8,397.6**	7,575.2

	Weighted average interest rate at fixed rate and RPI linked debt		Weighted average period until maturity for which rate is fixed at fixed rate and RPI linked debt	
	2012 %	2011 %	**2012 Years**	2011 Years
Bank loans and overdraft				
- £ Sterling	**2.0**	2.2	**12.9**	14.1
Other loans and finance leases *				
- £ Sterling	**3.6**	3.7	**22.1**	24.1
	3.6	3.6	**22.1**	23.5

Within the above table, 'total at RPI linked rates' are now shown as a separate category. Previously these were included within the 'total at fixed rates' category. The directors consider that this reclassification is appropriate reflecting the amount of financial liabilities held as RPI linked bonds. Total financial liabilities remain unchanged as a result of this reclassification.

* Includes inter-company debt.

The Company's interest rate and cross currency swaps convert £nil (2011: £27.9m) of floating rate borrowing to fixed rate and £235.0m (2011: £235.0m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £1,646.0m (2011: £632.8m) of foreign currency borrowing through conversion to Sterling. Index linked swaps of £894.1m (2011: £894.1m) swapped inter-company fixed rate debt to index linked debt. All swaps are included at their notional amount. Total accretion on the index linked swaps is £132.0m (2011: £92.0m).

Short-term floating rate loans bear interest at rates linked to LIBOR. Base rate is the benchmark rate for all cash at bank.

	Total at floating rates		Total at book value	
	31 March 2012 £m	31 March 2011 £m	**31 March 2012 £m**	31 March 2011 £m
Short term deposits	**619.4**	775.8	**619.4**	775.8
Cash in bank and in hand	**2.7**	3.6	**2.7**	3.6
	622.1	779.4	**622.1**	779.4

The total in the table above should be treated as available cash for covenant calculation purposes.

Notes to the Financial statements for the year ended 31 March (continued)

17 Financial instruments (continued)

Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book value		Fair value	
	31 March 2012 £m	31 March 2011 £m	**31 March 2012 £m**	31 March 2011 £m
Primary financial instruments				
Financial assets:				
- Short term deposits	**619.4**	775.8	**619.4**	775.8
- Cash at bank and in hand	**2.7**	3.6	**2.7**	3.6
Financial liabilities:				
- Bank loans	**(666.9)**	(573.4)	**(666.9)**	(580.8)
- Other loans and finance leases *	**(7,544.2)**	(6,881.0)	**(8,162.0)**	(6,944.4)
Derivative financial instruments				
- Interest rate swaps	**-**	-	**(93.0)**	(25.3)
- Cross currency swaps	**(54.5)**	(28.8)	**(90.3)**	(32.1)
- Index linked swaps	**(132.0)**	(92.0)	**(279.9)**	(206.3)
Total	**(7,775.5)**	(6,795.8)	**(8,670.0)**	(7,009.5)

* Includes inter-company debt.

Thames Water Utilities Limited does not itself hold bonds.

Other loans include bonds issued by group undertakings and external providers, which are publicly traded and loaned to Thames Water Utilities Limited. Fair values for these have been calculated using the 31 March 2012 quoted prices.

Mark-to-market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowings and all derivative financial instruments.

17 Financial instruments (continued)

Maturities	31 March 2012 £m	31 March 2011 £m
Bank loans and overdrafts		
- After more than five years	**666.9**	573.4
	666.9	573.4
Other loans including inter-company		
- Within one year	**470.0**	7.6
- Between one and two years	**-**	469.9
- Between two and five years	**734.3**	299.9
- After more than five years	**6,339.1**	6,029.3
	7,543.4	6,806.7
Finance leases		
- Within one year	**56.5**	7.9
- Between one and two years	**28.1**	56.5
- Between two and five years	**80.2**	93.3
- After more than five years	**22.5**	37.4
	187.3	195.1
Total borrowing	**8,397.6**	7,575.2

Loans are repayable between 2012 and 2062.

Loans wholly repayable after more than five years, excluding finance leases are:

	31 March 2012 £m	31 March 2011 £m
Bank loans	**666.9**	573.4
Other loans including inter-company	**6,399.1**	6,029.2
	7,066.0	6,602.6

Other listed secured loans repayable to Group undertakings in order of maturity include:

€500m 6.13% Fixed rate bond due 2013.	£600m 5.13% Fixed rate bond due 2037.
$156m 3 month US$ libor + 0.95% floating rate bond due 2015.	20bn Yen 3.28% Fixed rate bond due 2038.
£200m 4.90% Fixed rate bond due 2015.	£50m 3.85% Index linked bond due 2040.
€500m 3.25% Fixed rate bond due 2016.	£500m 5.5% Fixed rate bond due 2041.
£400m 7.24% Fixed rate bond due 2018.	£50m 1.98% Index linked bond due 2042.
£200m 5.05% Fixed rate bond due 2020.	£55m 2.09% Index linked bond due 2042.
£225m 6.59% Fixed rate bond due 2021.	£40m 1.97% Index linked bond due 2045.
£175m 3.38% Index linked bond due 2021.	£100m 1.85% Index linked bond due 2047.
£75m 1.35% Index linked bond due 2021.	£200m 1.82% Index linked bond due 2049.
£550m 5.38% Fixed rate bond due 2025 (note 1).	£300m 1.68% Index linked bond due 2053.
£330m 6.75% Fixed rate bond due 2028.	£300m 1.68% Index linked bond due 2055.
£300m 5.75% Fixed rate bond due 2030 (note 2).	£200m 1.77% Index linked bond due 2057.
£200m 6.50% Fixed rate bond due 2032.	£350m 1.76% Index linked bond due 2062.

Notes to the Financial statements for the year ended 31 March (continued)

17 Financial instruments (continued)

Maturities (continued)

Note 1: £550m Class B bond issued on a fixed coupon basis until 21 July 2017, when the bond resets to floating rate interest at LIBOR plus margin.

Note 2: £300m Class B bond issued on a fixed coupon basis until 13 September 2022, when the bond resets to floating rate interest at LIBOR plus margin.

See note 16, page 84 for details of secured bank loans.

Loans repayable by instalments after more than five years hence are:

	31 March 2012 £m	31 March 2011 £m
Finance leases	**22.5**	37.4

The ranges of interest rates on outstanding loans are 0.21% to 8.35% (2011: 0.78% to 8.35%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

Borrowing facilities

At 31 March 2012 the Company had access to committed facilities of £1,200.0m (2011: £1,175.0m) of which £nil (2011: £nil) had been drawn at the balance sheet date, through its subsidiary company Thames Water Utilities Cayman Finance Limited.

18 Provisions for liabilities and charges

	Deferred tax £m	**Insurance liabilities £m**	**Restructuring £m**	**Other £m**	**Total £m**
At beginning of the year	972.9	53.7	1.8	25.9	1,054.3
Utilised during the year	-	-	(2.6)	(0.1)	(2.7)
(Credit)/charge to profit and loss for the year	(3.8)	3.1	1.3	0.4	1.0
At end of the year	**969.1**	**56.8**	**0.5**	**26.2**	**1,052.6**

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012, the combined total of these changes of £80.7m is reflected in the above table.

The overall effect of the further reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £80.8m.

The insurance provision is in respect of insurance claims notified. A debtor in respect of these obligations is included in note 13 (see page 83) representing the reimbursement value from captive and third party insurance companies.

18 Provisions for liabilities and charges (continued)

The restructuring provision principally relates to severance costs as a result of the Company's restructuring and reorganisation. This provision is expected to be utilised over the next year.

Other provisions principally relate to a number of legal claims against the Company and represents Management's best estimate of the value of settlement and costs. It is estimated that some claims will be settled in more than one year.

The elements of deferred tax are as follows:

	Note	**31 March 2012 £m**	31 March 2011 £m
Accelerated capital allowances		**978.4**	979.6
Tax losses carried forward		**(2.6)**	-
Other timing differences		**(6.7)**	(6.7)
		969.1	972.9
Total deferred tax provision:			
Included above		**969.1**	972.9
Deferred tax asset recognised on pension deficit	26	**(37.2)**	(33.2)
		931.9	939.7

At 31 March 2012 there are no amounts of deferred tax unprovided for (2011: £nil).

The pension liability per note 26 is shown net of deferred tax.

19 Called up share capital

	31 March 2012 £m	31 March 2011 £m
Allotted, called up and fully paid		
1,029,050,000 ordinary shares of £1 each	**1,029.0**	1,029.0

20 Share premium account

	31 March 2012 £m	31 March 2011 £m
At 1 April and 31 March	**100.0**	100.0

Premium of 25p on issue of 400,000,000 £1 ordinary shares.

Notes to the Financial statements for the year ended 31 March (continued)

21 Profit and loss account

	Note	**31 March 2012 £m**	31 March 2011 £m
At the beginning of the year		**376.9**	427.4
Profit for the year		**247.2**	225.2
Dividends paid	9	**(279.5)**	(271.4)
Retained loss		**(32.3)**	(46.2)
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Movement on deferred tax relating to pension scheme		**21.4**	(3.2)
At the end of the year		**271.6**	376.9

22 Reconciliation of movements in shareholder's funds

	Note	**31 March 2012 £m**	31 March 2011 £m
At the beginning of the year		**1,505.9**	1,556.4
Profit for the year		**247.2**	225.2
Dividends paid	9	**(279.5)**	(271.4)
Retained loss		**(32.3)**	(46.2)
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Movement on deferred tax relating to pension scheme		**21.4**	(3.2)
		(105.3)	(50.5)
At the end of the year		**1,400.6**	1,505.9

23 Capital commitments

	31 March 2012 £m	31 March 2011 £m
Contracted for but not provided	**1,035.5**	1,517.2

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth.

24 Contingencies

There are claims arising in the normal course of business, which are in the process of negotiation.

The Company has set aside amounts considered appropriate for all legal and similar claims as per note 18.

Notes to the Financial statements for the year ended 31 March (continued)

24 Contingencies (continued)

Contingent liabilities

Following the Company's submission of its June Return in June 2010, Ofwat raised concerns about data reported to it in connection with the Company's delivery of its AMP4 hydraulic flooding programme including specifically in relation to the use of hydraulic modelling to support the identification of properties for inclusion in the June Return.

Ofwat issued a notice under Section 203 of the Water Industry Act 1991 on 9 June 2011 to formally request additional information. The Company response was made on 29 July 2011, with supplementary responses on 7 October 2011 and 18 November 2011. The Company had a meeting with Ofwat on 28 February 2012 to discuss any residual concerns which it may have in more detail.

In May 2012, Ofwat notified the Company that it had formally transferred the case to an internal Ofwat casework team through its gateway process to continue with the investigation. Ofwat has indicated that this formal transfer does not prejudge the outcome of the investigation and is a procedural step. Ofwat has further indicated that it is unlikely to conclude its investigations until at least the third quarter of 2012.

If Ofwat concludes that the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs, which Ofwat determines have not been achieved during the AMP4 period. Any such potential financial impact cannot yet be quantified and, as such, no provision has been made within these accounts.

25 Operating leases

At 31 March 2012 the Company was committed to making the following annual payments in respect of non-cancellable operating leases:

	31 March 2012		31 March 2011	
	Land and buildings	**Other**	Land and buildings	Other
	£m	**£m**	£m	£m
Leases which expire:				
- Within one year	**0.1**	**-**	-	-
- In the second to fifth year inclusive	**0.6**	**0.2**	0.2	1.5
- Over five years	**5.9**	**1.2**	6.2	-
	6.6	**1.4**	6.4	1.5

See note 17 ‘Financial instruments’ on page 88 for further information regarding obligations under finance leases.

26 Pension schemes

Pension arrangements for the majority of the Company’s employees are of the defined benefit type, funded through two Group pension schemes; TWPS and Thames Water Mirror Image Pension Scheme (“TWMIPS”) (see table below for details of each schemes’ respective deficit or surplus), covering employees within the Thames Water Group, whose assets are held separately from those of the Group in independently administered funds.

26 Pension schemes (continued)

The defined benefit arrangements were closed to new employees from 1 April 2011. From this date, new employees have been offered membership of a defined contribution scheme managed through Standard Life; see note 1, page 67. Contributions to the scheme are charged to the profit and loss account in the period to which they relate.

Contributions to the defined contribution pension scheme in the year were £1.4m (2011: £0.2m).

The Company's defined benefit pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes' assets and liabilities are included with those of other companies in the Group. The Company contributes the vast majority of the contributions into the schemes and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. Accordingly, the directors have decided it is appropriate to recognise the net deficit of the two Group pension schemes within these financial statements.

The service cost of the Company, as included in the profit and loss account, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial period.

In addition to the cost of the UK Pension arrangements, the Company operates arrangements under which it augments benefits on retirement in certain circumstances of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 March 2012 payments amounted to £1.5m (2011: £2.1m).

The latest full actuarial valuation was undertaken as at 31 December 2010 on behalf of the pension Trustee's by Aon Hewitt Limited ("Hewitt") (the independent and professionally qualified consulting actuaries to the schemes). This valuation has been updated at 31 March 2012 by Mercer Limited ("Mercer"), independent and professionally qualified consulting actuaries, using revised assumptions that are consistent with the requirements of FRS 17 and shown in this note to the accounts.

Thames Water Group has taken advice from Mercer in respect of the funding position of the Group pension schemes.

Net liability by pension schemes before deferred tax

	31 March 2012 £m	31 March 2011 £m
Thames Water Pension Scheme:		
Deficit in scheme	**(190.0)**	(165.8)
Thames Water Mirror Image Pension Scheme:		
Surplus in scheme	**73.5**	59.6
Impact of irrecoverable surplus	**(39.9)**	(21.6)
	33.6	38.0
Liability before deferred tax asset	**(156.4)**	(127.8)

The TWPS net liability is £144.4m (2011: £122.7m) after deferred tax credit, and TWMIPS net asset is £25.2m (2011: £28.1m) after deferred tax charge as disclosed on the balance sheet on page 62.

The Company has recognised a surplus in the TWMIPS to the extent that it may possibly be able to recover it by paying a reduced rate of contributions in the future. The recognisable surplus has been calculated in accordance with FRS 17 as the present value of the current service cost projected over the future working lifetime of all active members of the scheme, using the assumptions adopted at 31 March 2012.

26 Pension schemes (continued)

Reconciliation of funded status to balance sheet:

	31 March 2012 £m	31 March 2011 £m
Fair value of scheme assets	**1,540.0**	1,403.8
Present value of scheme liabilities	**(1,656.5)**	(1,510.0)
Deficit in scheme	**(116.5)**	(106.2)
Impact of irrecoverable surplus	**(39.9)**	(21.6)
Liability recognised on the balance sheet	**(156.4)**	(127.8)
Deferred tax asset	**37.2**	33.2
Net pension liability	**(119.2)**	(94.6)

The assumptions used in the valuation of assets and liabilities of the schemes are the same for both schemes; see page 96, therefore the following tables are for the combined values for both schemes.

Movement in the present value of scheme liabilities:

	31 March 2012 £m	31 March 2011 £m
Opening present value of scheme liabilities	**1,510.0**	1,466.6
Current service cost: Thames Water Utilities Limited	**16.4**	25.2
Current service cost: Other Thames Water Group participating companies	**0.1**	0.2
Interest cost	**79.7**	81.2
Contribution by scheme participants	**0.2**	0.3
Curtailment gain on changes to scheme benefits	**(40.0)**	-
Actuarial losses on scheme liabilities	**153.7**	32.1
Actuarial gain from changes in inflation assumptions	**-**	(37.6)
Net benefit paid out	**(65.1)**	(60.1)
Termination pension cost	**1.5**	2.1
Closing present value of scheme liabilities	**1,656.5**	1,510.0

Movement in fair value of scheme assets:

	31 March 2012 £m	31 March 2011 £m
Opening fair value of scheme assets	**1,403.8**	1,317.4
Expected return on scheme assets	**77.3**	76.9
Actuarial gains on scheme assets	**77.6**	14.1
Contributions by the employer	**44.6**	52.0
Contributions by Other Thames Water Group participating companies	**0.1**	0.2
Contribution of section 75 debt payment	**-**	0.9
Contributions by scheme participants	**0.2**	0.3
Termination pension costs	**1.5**	2.1
Net benefits paid out	**(65.1)**	(60.1)
Closing fair value of scheme assets	**1,540.0**	1,403.8

26 Pension schemes (continued)

(Income)/expense recognised in the profit and loss account:

	31 March 2012 £m	31 March 2011 £m
Current service cost	**16.4**	25.2
Exceptional item – pension curtailment gain	**(40.0)**	-
Interest cost	**79.7**	81.2
Expected return on scheme assets	**(77.3)**	(76.9)
Total (income)/expense recognised in the profit and loss account	**(21.2)**	29.5

The (income)/expense is recognised in the following line items in the profit and loss account:

	31 March 2012 £m	31 March 2011 £m
Operating costs: staff (income)/costs	**(23.6)**	25.2
Other finance expense	**2.4**	4.3
Total (income)/expense charged in the profit and loss account	**(21.2)**	29.5

Analysis of amount recognised in the Statement of total recognised gains and losses:

	31 March 2012 £m	31 March 2011 £m
Actual return less expected return on pension scheme assets	**77.6**	14.1
Changes in assumptions underlying the present value of scheme liabilities	**(153.7)**	(32.1)
Changes in inflation assumption – CPI from RPI	**-**	37.6
Contribution of section 75 debt payment	**-**	0.9
Adjustment relating to irrecoverable surplus	**(18.3)**	(21.6)
Actuarial loss recognised in the Statement of total recognised gains and losses	**(94.4)**	(1.1)
Cumulative amount of losses recognised in the Statement of total recognised gains and losses	**(404.8)**	(310.4)

26 Pension schemes (continued)

Fair value of scheme assets and return on these assets:

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the average expected long-term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following table:

	31 March 2012		31 March 2011	
	Long-term expected rate of return	**Value £m**	Long-term expected rate of return	Value £m
Equities	**7.11%**	**533.0**	8.4%	473.2
Bonds	**4.63%**	**32.9**	5.5%	101.3
Gilts	**1.86-3.11%**	**774.3**	4.15-4.40%	638.8
Property	**6.11%**	**103.3**	7.4%	90.6
Other assets	**3.11%**	**96.5**	4.4%	99.9
Weighted average expected long-term rate of return/total fair value of assets	**4.6%**	**1,540.0**	5.9%	1,403.8

The Company employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

The main financial assumptions used for FRS 17 purposes are as follows:

	31 March 2012	31 March 2011
Price inflation – RPI	**3.1%**	3.5%
Price inflation – CPI	**2.4%**	3.0%
CARE revaluation (CPI max 2.5%)	**2.4%**	-
Salary increases - TWPS	**n/a**	4.5%
Salary increases - TWMIPS	**3.6%**	4.0%
Pension increases – RPI	**3.1%**	3.5%
Pension increases – CPI	**2.4%**	3.0%
Discount rate for scheme liabilities	**4.65%**	5.5%

26 Pension schemes (continued)

In valuing the liabilities of the pension schemes at 31 March 2012, mortality assumptions have been made as indicated below. These mortality assumptions are based on the recent actual mortality experience of members within the schemes and the assumptions also allow for future improvements to mortality rates.

	31 March 2012	31 March 2011
TWPS members who joined before/after 1 January 1995		
Life expectancy for a male pensioner from age 60	**27**	26
Life expectancy for a female pensioner from age 60	**29**	28
Life expectancy from age 60 for a male pensioner currently aged 40	**29**	28
Life expectancy from age 60 for a female pensioner currently aged 40	**31**	29
TWMIPS		
Life expectancy for a male pensioner from age 60	**26**	24
Life expectancy for a female pensioner from age 60	**28**	26
Life expectancy from age 60 for a male pensioner currently aged 40	**28**	26
Life expectancy from age 60 for a female pensioner currently aged 40	**30**	28

History of fair value of assets, present value of liabilities, (deficit)/surplus in scheme and experience gains and losses:

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 March 2008 £m
Fair value of scheme assets	**1,540.0**	1,403.8	1,317.4	1,040.3	1,214.8
Present value of scheme liabilities	**(1,656.5)**	(1,510.0)	(1,466.6)	(1,105.4)	(1,098.9)
(Deficit)/surplus in scheme	**(116.5)**	(106.2)	(149.2)	(65.1)	115.9

Experience adjustments:

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 March 2008 £m
Experience gains/(losses) on scheme assets:					
Amounts	**77.6**	14.1	220.6	(250.4)	(102.7)
Percentage of scheme assets	**5.0%**	1.0%	16.7%	24.1%	8.5%
Experience losses on scheme liabilities:					
Amounts	**(11.0)**	-	-	(44.3)	(5.4)
Percentage of scheme liabilities	**1%**	-	-	4.0%	0.5%
Total amount recognised in the Statement of total gains and losses:					
Amounts	**(94.4)**	(2.0)	(105.4)	(133.0)	3.9
Percentage of present value of scheme liabilities	**5.7%**	0.1%	7.2%	12.0%	0.4%

The Kemble Water Holdings Limited Group expects to contribute approximately £42.3m to the defined benefit schemes in the next financial year.

Notes to the Financial statements for the year ended 31 March (continued)

27 Off-balance sheet arrangements

The Company is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included on its balance sheet. The principal off-balance sheet arrangements are listed below:

- Operating leases (see note 25)
- Outsourcing contracts

In respect of outsourcing contracts, the Company has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include IT support, Legal Services, Supply Chain, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material impact on the financial position of the Group.

28 Intermediate and ultimate parent company and controlling party

Thames Water Utilities Holdings Limited, a company incorporated in the United Kingdom, is the immediate parent company.

Kemble Water Finance Limited, a company incorporated in the United Kingdom, is an intermediate parent company and the smallest group to consolidate these financial statements.

The directors consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the largest group to consolidate these financial statements.

Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water Group, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Kemble Water Holdings Limited is owned by a consortium of investors led by Macquarie European Infrastructure Funds LP and Macquarie European Infrastructure Fund II LP ("MEIF 1 & 2"). The directors do not consider there to be an ultimate parent or controlling party. Kemble Water Holdings Limited is the largest group to consolidate these financial statements.

MEIF 1 and 2 are wholesale investment funds in which the investors are largely pension funds and institutional investors. On behalf of these investors, MEIF 1 and 2 make long-term investments in infrastructure and related businesses located across Europe, aiming to deliver sustainable cash yields and moderate capital growth from diversified portfolios of quality infrastructure investments.

MEIF 1 & 2 are managed by Macquarie Infrastructure and Real Assets (Europe) Limited ("MIRAEL"). MIRAEL is a wholly owned member of the Macquarie Group, and is authorised and regulated by the Financial Services Authority. MIRAEL is resourced by executives of the Macquarie Infrastructure and Real Assets division of Macquarie Group.

Thames Water Utilities Limited

Regulatory accounts and required regulatory information

Explanatory note

The regulatory accounts and required regulatory information on pages 99 to 105 are provided to comply with Condition F of the Instrument of Appointment of Thames Water Utilities Limited as a water and sewerage undertaker under the Water Industry Act 1991.

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines ("RAG") issued by Ofwat.

There are differences between UK Generally Accepted Accounting Practice and the RAG. Where different treatments are specified under each, the RAG take precedence.

A glossary of regulatory terms is shown on pages 130 to 131.

The regulatory financial statements should be read in conjunction with the statutory Annual report and financial statements ("AR&A"). The AR&A include the Chief Executive Officer's business review (pages 6 to 31). In addition, the Directors' report (pages 32 to 36) includes a statement as to the disclosure of information to the auditor (page 35), the dividend policy of the Company which also applies to the appointed business (page 32) and information in respect of the Company's charitable donations (page 35). In addition, the Directors' remuneration report (pages 38 to 52) includes information linking their remuneration with standards of regulatory performance.

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 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 to 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.
- Keep proper accounting records, which comply with Condition F and RAG 5.04.

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

Ring fencing

In the opinion of the directors, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year. This relates to the availability of rights and assets in the event of a special administration order.

Regulatory accounts and required regulatory information (continued)

Regulatory historical cost profit and loss account for the year ended 31 March

	2012			2011		
	Appointed business £m	**Non-Appointed business £m**	**Total £m**	Appointed business £m	Non-Appointed business £m	Total £m
Turnover (Note 2, page 114)	**1,670.9**	**24.0**	**1,694.9**	1,600.0	23.1	1,623.1
Operating costs	**(795.3)**	**(9.6)**	**(804.9)**	(752.9)	(9.1)	(762.0)
Historical cost depreciation *	**(285.1)**	**(1.0)**	**(286.1)**	(259.9)	(1.0)	(260.9)
Operating income	**43.9**	**-**	**43.9**	10.9	-	10.9
Operating profit	**634.4**	**13.4**	**647.8**	598.1	13.0	611.1
Other expense	**(2.4)**	**-**	**(2.4)**	(4.3)	-	(4.3)
Net interest payable	**(423.0)**	**(0.2)**	**(423.2)**	(398.1)	(0.2)	(398.3)
Profit on ordinary activities before taxation	**209.0**	**13.2**	**222.2**	195.7	12.8	208.5
Taxation:						
- Current tax	**41.3**	**(3.0)**	**38.3**	3.2	(3.7)	(0.5)
- Deferred tax	**(12.9)**	**(0.4)**	**(13.3)**	17.2	-	17.2
	28.4	**(3.4)**	**25.0**	20.4	(3.7)	16.7
Profit for the year	**237.4**	**9.8**	**247.2**	216.1	9.1	225.2
Dividend	**(269.7)**	**(9.8)**	**(279.5)**	(262.3)	(9.1)	(271.4)
Retained loss for the year	**(32.3)**	**-**	**(32.3)**	(46.2)	-	(46.2)

* The historical cost depreciation has been analysed separately in order to comply with the presentational requirements of RAG 3.06

Statement of total recognised gains and losses (historical cost accounting) for the appointed business for the year ended 31 March

	31 March 2012	31 March 2011
	£m	£m
Profit for the year	**237.4**	216.1
Actuarial loss on pension schemes	**(94.4)**	(1.1)
Deferred tax relief/(charge) relating to actuarial loss	**21.4**	(3.2)
Total recognised gains in the year	**164.4**	211.8

Thames Water Utilities Limited

Regulatory accounts and required regulatory information (continued)

Regulatory historical cost balance sheet at 31 March

	2012			2011		
	Appointed business £m	**Non-Appointed business £m**	**Total £m**	Appointed business £m	Non-Appointed business £m	Total £m
Fixed assets						
Tangible assets	**8,747.7**	**7.7**	**8,755.4**	8,154.1	8.1	8,162.2
Investments – loan to group company	**2,015.0**	**-**	**2,015.0**	1,865.0	-	1,865.0
Investments - other	**0.1**	**-**	**0.1**	0.1	-	0.1
Total fixed assets	**10,762.8**	**7.7**	**10,770.5**	10,019.2	8.1	10,027.3
Current assets						
Stocks	**9.6**	**-**	**9.6**	8.2	-	8.2
Debtors: amounts falling due within one year	**647.9**	**-**	**647.9**	621.9	-	621.9
Infrastructure renewals prepayment	**32.9**	**-**	**32.9**	-	-	-
Cash at bank and in hand	**2.7**	**-**	**2.7**	3.6	-	3.6
Short term deposits	**619.4**	**-**	**619.4**	775.8	-	775.8
Total current assets	**1,312.5**	**-**	**1,312.5**	1,409.5	-	1,409.5
Creditors: amounts falling due within one year:						
Creditors	**(919.4)**	**(7.3)**	**(926.7)**	(986.0)	(8.1)	(994.1)
Borrowings	**(526.5)**	**-**	**(526.5)**	(15.5)	-	(15.5)
Infrastructure renewals accrual	**-**	**-**	**-**	(17.0)	-	(17.0)
Total creditors	**(1,445.9)**	**(7.3)**	**(1,453.2)**	(1,018.5)	(8.1)	(1,026.6)
Net current (liabilities)/asset	**(133.4)**	**(7.3)**	**(140.7)**	391.0	(8.1)	382.9
Total assets less current liabilities	**10,629.4**	**0.4**	**10,629.8**	10,410.2	-	10,410.2
Creditors: amounts falling due after more than one year:						
Borrowings	**(7,871.1)**	**-**	**(7,871.1)**	(7,559.7)	-	(7,559.7)
Other creditors	**(49.3)**	**-**	**(49.3)**	(52.7)	-	(52.7)
Total creditors	**(7,920.4)**	**-**	**(7,920.4)**	(7,612.4)	-	(7,612.4)
Provisions for liabilities and charges:						
Deferred tax provision	**(968.7)**	**(0.4)**	**(969.1)**	(972.9)	-	(972.9)
Deferred income – grants and contributions	**(137.0)**	**-**	**(137.0)**	(143.0)	-	(143.0)
Other provisions	**(83.5)**	**-**	**(83.5)**	(81.4)	-	(81.4)
Post employment liabilities	**(119.2)**	**-**	**(119.2)**	(94.6)	-	(94.6)
Net assets employed	**1,400.6**	**-**	**1,400.6**	1,505.9	-	1,505.9
Capital and reserves						
Called-up share capital	**1,029.0**	**-**	**1,029.0**	1,029.0	-	1,029.0
Share premium	**100.0**	**-**	**100.0**	100.0	-	100.0
Profit and loss account	**271.6**	**-**	**271.6**	376.9	-	376.9
Capital and reserves	**1,400.6**	**-**	**1,400.6**	1,505.9	-	1,505.9

Regulatory accounts and required regulatory information (continued)

Historical cost reconciliation between statutory and regulatory accounts at 31 March

	2012 Statutory UK GAAP £m	2012 Regulatory RAG 3 £m	Explanation
Profit and loss account			
Operating costs	**(1,051.0)**	**(804.9)**	The difference of £246.1m is due to the reporting of historic cost depreciation (£286.1m cost) as a separate category in the regulatory accounts and the exceptional item (£40.0m credit) in respect of the one off benefit arising from changes to the pension schemes, which is reported within operating income within the regulatory accounts in accordance with paragraph 2.1.33 of RAG 3.06.
Profit on sale of fixed assets	**3.9**	**-**	The difference of £3.9m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as 'operating income' for regulatory accounts.
Operating income	**-**	**43.9**	Profit on sale of fixed assets of £3.9m together with the exceptional item of £40.0m as reported above are disclosed within operating income in the regulatory accounts.
Operating profit	**643.9**	**647.8**	The difference of £3.9m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as 'operating income' for regulatory accounts.
Profit before taxation	**222.2**	**222.2**	Profit before taxation is unaffected by this re-classification.

Regulatory accounts and required regulatory information (continued)

Historical cost reconciliation between statutory and regulatory accounts at 31 March (continued)

	2012 Statutory UK GAAP £m	2012 Regulatory RAG 3 £m	Explanation
Balance sheet			
Fixed assets			
Tangible fixed assets (net book value)	**8,788.3**	**8,755.4**	The difference of £32.9m is due to the infrastructure renewals prepayment (2011: £17.0m accrual) as this is excluded from the fixed assets net book value in the regulatory accounts. This is in line with RAG 3.06 as FRS 15 is not applied for infrastructure renewals accounting for regulatory accounting purposes. For more detail see page 106.
Investments – loan to group company	**-**	**2,015.0**	A loan to the immediate parent company, Thames Water Utilities Holdings Limited is classified within this category within the regulatory accounts but disclosed as a debtor: amounts falling due after more than one year in the statutory accounts.
Debtors : amount falling due after more than one year	**2,015.0**	**-**	As above.
Current Assets			
Infrastructure renewals prepayment	**-**	**32.9**	The difference of £32.9m reflects the reclassification of infrastructure renewals accrual described above.
Short-term and long-term creditors			
Deferred income – grants and contributions:	**(137.0)**	**-**	Deferred grants and contributions of £137.0m (2011: £143.0.m) within the statutory accounts are analysed between creditors: amounts falling due within one year (£7.2m) and creditors: amounts falling due after more than one year (£129.8m). This is in contrast to the regulatory accounts, which shows total deferred grants and contributions within provisions for liabilities and charges.
Provision for liabilities and charges	**-**	**(137.0)**	As above.

Regulatory accounts and required regulatory information (continued)

Additional information required by the licence

Basis of preparation

In accordance with Condition F of the Instrument of Appointment, these regulatory financial statements have been prepared to show separately in respect of the appointed business, non-appointed business and total business, a profit and loss account and balance sheet prepared on a historical cost basis.

In accordance with the requirements of FRS 18, the directors review the Company's accounting policies to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view.

The financial statements have been prepared in accordance with the historical cost convention and, except for the classification of profit on the sale of fixed assets as explained in note (a) below, the treatment of infrastructure renewals expenditure as explained in note (b) below and the treatment of certain capital contributions as explained in note (c) below, have been prepared in accordance with the Companies Act 2006. The departures from applicable UK Accounting Standards are necessary to comply with regulatory reporting requirements laid down by Ofwat.

Changes to accounting policies

The same accounting policies as those used for the year ended 31 March 2012 have been applied in these financial statements.

(a) Profit on sale of fixed assets

Profit and loss on sale of fixed assets has been included within operating profit, as operating income, in accordance with RAG 3. This represents a departure from FRS 3 as adopted in the Company's 31 March 2012 statutory financial statements in which profit and loss on sale of fixed assets are shown after operating profit.

(b) Infrastructure renewals expenditure

Infrastructure renewals expenditure ("IRE") has been accounted for in accordance with RAG 3.06 in these financial statements and is consistent with the reporting of IRE in the Company's regulatory historical cost financial statements for the year ended 31 March 2012. Accordingly, IRE net of depreciation has been included within debtors.

The Company's statutory financial statements disclose IRE net of depreciation in accordance with FRS 15 "Tangible Fixed Assets" which requires this amount to be included within fixed assets. Within these regulatory historic cost financial statements, the Company in accordance with RAG 3.06 reports IRE net of depreciation within debtors in the regulatory historic cost financial statements for the year ended 31 March 2012.

Reconciliation to the tangible fixed assets shown in the statutory financial statements with the regulatory historical cost financial statements is shown on page 106.

(c) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, with the latter accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. Accordingly, related capital contributions would not be recognised in the profit and loss account.

Regulatory accounts and required regulatory information (continued)

Basis of preparation (continued)

(d) Allocation of costs

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

Direct costs attributable to the provision of services other than the Appointed Business are separately allocated and identified as “Non-Appointed”. Indirect costs, relating to non-appointed activities, are recovered as a fixed percentage of direct costs based upon the analysis of operating costs.

(e) Revenue

There are no differences between the accounting policy for revenue under the statutory accounts and the policy for the regulatory accounts.

Regulatory accounts and required regulatory information (continued)

Reconciliation of tangible fixed assets shown in the statutory financial statements and their regulatory financial equivalents:

	Other assets £m	Infra-structure assets £m	Total £m
Cost			
At 31 March 2012 as per statutory accounts (FRS 15)	8,874.0	4,968.0	13,842.0
Infrastructure renewals expenditure capitalised in previous years	-	(1,057.0)	(1,057.0)
Infrastructure renewals expenditure capitalised in the year	-	(179.4)	(179.4)
Disposals in prior years	-	0.9	0.9
Cost at 31 March 2012 per regulatory accounts (RAG 3)	**8,874.0**	**3,732.5**	**12,606.5**
Capital contributions			
Contributions at 31 March 2012 as per statutory accounts (FRS 15)	-	663.3	663.3
Contributions at 31 March 2012 as per regulatory accounts (RAG 3)	**-**	**663.3**	**663.3**
Depreciation			
At 31 March 2012 as per statutory accounts (FRS 15)	3,187.8	1,202.6	4,390.4
Infrastructure renewals charge in previous years	-	(1,074.0)	(1,074.0)
Infrastructure renewals charge in the year	-	(129.5)	(129.5)
Disposals in prior years	-	0.9	0.9
Depreciation at 31 March 2012 per regulatory accounts (RAG 3)	**3,187.8**	**-**	**3,187.8**
Net book value			
At 31 March 2012 as per statutory accounts (FRS 15)	5,686.2	3,102.1	8,788.3
Adjustment for infrastructure renewals accounting (see below)	-	(32.9)	(32.9)
At 31 March 2012 per regulatory accounts (RAG 3)	**5,686.2**	**3,069.2**	**8,755.4**

Adjustment for infrastructure renewals accounting:

	Infrastructure assets £m
RAG 3 net infrastructure renewals reclassification:	
Infrastructure renewals accrual at 31 March 2011	(17.0)
Infrastructure renewals expenditure capitalised in the year	179.4
Infrastructure renewals charge in the year	(129.5)
Infrastructure renewals prepayment at 31 March 2012	**32.9**

Regulatory accounts and required regulatory information (continued)

Regulatory current cost profit and loss account for the appointed business for the year ended 31 March

	Note	**31 March 2012 £m**	31 March 2011 £m
Turnover	2	**1,670.9**	1,600.0
Current cost operating costs	3	**(1,177.5)**	(1,100.8)
Operating income ***(i)***	2	**44.3**	(1.5)
Working capital adjustment	2	**20.1**	13.0
Current cost operating profit		**557.8**	510.7
Net interest		**(425.4)**	(402.4)
Financing adjustment		**41.0**	119.2
Current cost profit on ordinary activities before taxation		**173.4**	227.5
Taxation:			
- Current tax		**41.3**	3.2
- Deferred tax		**(12.9)**	17.2
Current cost profit attributable to shareholder's		**201.8**	247.9
Dividends		**(269.7)**	(262.3)
Current cost loss retained		**(67.9)**	(14.4)

(i) Includes £40.0m relating to the exceptional item, see the Historic cost reconciliation between the statutory and regulatory accounts on page 102.

Regulatory accounts and required regulatory information (continued)

Regulatory current cost balance sheet for the appointed business at 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Fixed assets			
Tangible assets	4c	**94,326.0**	71,775.3
Third party contributions since 31 March 1990		**(20.579.1)**	(1,008.5)
		73,746.9	70,766.8
Working capital	5	**(339.7)**	(418.9)
Cash		**2.7**	3.6
Short term deposits		**619.4**	775.8
Infrastructure renewals accrual		**32.9**	(17.0)
Net operating assets		**74,062.2**	71,110.3
Non operating assets and liabilities			
Borrowings		**(526.5)**	(15.5)
Non-trade debtors		**207.1**	171.8
Non-trade creditors due within one year		**(129.3)**	(121.1)
Investment – loan to group company		**2,015.0**	1,865.0
Investments – other		**0.1**	0.1
Corporation tax receivable		**-**	12.3
Total non operating assets and liabilities		**1,566.4**	1,912.6
Creditors: amounts falling due after more than one year			
Borrowings		**(7,871.1)**	(7,559.7)
Other creditors		**(49.3)**	(52.7)
Total creditors falling due after more than one year		**(7,920.4)**	(7,612.4)
Provisions for liabilities and charges			
Deferred tax provision		**(968.7)**	(972.9)
Post employment liability		**(119.2)**	(94.6)
Other provisions		**(83.5)**	(81.4)
Total provisions		**(1,171.4)**	(1,148.9)
Net assets		**66,536.8**	64,261.6
Capital and reserves			
Called up share capital		**1,029.0**	1,029.0
Share premium		**100.0**	100.0
Profit and loss account		**(925.1)**	(783.9)
Current cost reserve	6	**66,332.9**	63,916.5
Total capital and reserves		**66,536.8**	64,261.6

The notes on pages 110 to 122 form part of these regulatory current cost financial statements.

The regulatory current cost financial statements were approved by the Board of Directors on 7 June 2012.

Regulatory accounts and required regulatory information (continued)

Regulatory current cost statement of cash flows for the year ended 31 March

	Notes	2012 Appointed business	2012 Non-Appointed business	2012 Total	2011 Appointed business	2011 Non-Appointed business	2011 Total
		£m	£m	£m	£m	£m	£m
Net cash inflow from operating activities	(a)	**913.3**	**14.0**	**927.3**	929.9	13.2	943.1
Returns on investments and servicing of finance							
Interest received		**106.1**	**-**	**106.1**	110.4	-	110.4
Interest paid		**(353.9)**	**(0.2)**	**(354.1)**	(269.1)	(0.2)	(269.3)
Interest element of finance lease payments		**(6.9)**	**-**	**(6.9)**	(6.5)	-	(6.5)
Net cash outflow from returns on investments and servicing of finance		**(254.7)**	**(0.2)**	**(254.9)**	(165.2)	(0.2)	(165.4)
Taxation received/(paid)		**83.0**	**(3.4)**	**79.6**	(22.3)	(3.7)	(26.0)
Capital expenditure and financial investment							
Gross cost of purchased fixed assets		**(993.0)**	**(0.6)**	**(993.6)**	(793.6)	(0.2)	(793.8)
Infrastructure renewals expenditure		**(179.4)**	**-**	**(179.4)**	(107.7)	-	(107.7)
Receipt of grants and contributions		**44.3**	**-**	**44.3**	41.0	-	41.0
Movement on long term loans to group companies		**(150.0)**	**-**	**(150.0)**	(685.0)	-	(685.0)
Disposal of fixed assets		**8.8**	**-**	**8.8**	11.5	-	11.5
Net cash outflow from investing activities		**(1,269.3)**	**(0.6)**	**(1,269.9)**	(1,533.8)	(0.2)	(1,534.0)
Equity dividends paid		**(269.7)**	**(9.8)**	**(279.5)**	(262.3)	(9.1)	(271.4)
Management of liquid resources							
Net cash outflow/(inflow) from management of liquid resources		**156.4**	**-**	**156.4**	(202.6)	-	(202.6)
Net cash outflow before financing		**(641.0)**	**-**	**(641.0)**	(1,256.3)	-	(1,256.3)
Financing							
Capital element in finance lease payment		**(7.8)**	**-**	**(7.8)**	(8.6)	-	(8.6)
New loans		**657.1**	**-**	**657.1**	1,807.6	-	1,807.6
Repayment of loans		**(9.2)**	**-**	**(9.2)**	(545.0)	-	(545.0)
Net cash inflow from financing	**(b)**	**640.1**	**-**	**640.1**	1,254.0	-	1,254.0
Decrease) in cash	**(b)**	**(0.9)**	**-**	**(0.9)**	(2.3)	-	(2.3)

Regulatory accounts and required regulatory information (continued)

Notes to regulatory current cost statement of cash flows for the year ended 31 March

(a) Reconciliation of current cost operating profit to net cash flow from operating activities for the appointed business

	31 March 2012 £m	31 March 2011 £m
Current cost operating profit	**557.8**	510.7
Working capital adjustment	**(20.1)**	(13.0)
Movement in working capital (excluding short term capital creditors)	**10.1**	25.7
Current cost depreciation (net of deferred income)	**375.5**	341.3
Current cost (profit)/loss on sale of fixed assets	**(4.3)**	1.5
Current cost exceptional item	**(40.0)**	-
Infrastructure renewals charge	**129.5**	132.4
Difference between pension charge and cash contributions	**(68.1)**	(26.8)
Other non-cash items (including provisions)	**(27.1)**	(41.9)
Net cash flow from operating activities	**913.3**	929.9

(b) Reconciliation of net cash flow to movement in net debt for the Appointed business

	Note	**31 March 2012 £m**	31 March 2011 £m
Decrease in cash in the period		**(0.9)**	(2.3)
Cash (outflow)/inflow from increase in liquid resources		**(156.4)**	202.6
Cash inflow from movement in net debt and financing		**(640.1)**	(1,254.0)
Increase in net debt resulting from cash flows		**(797.4)**	(1,053.7)
Non-cash increase in net debt		**(182.3)**	(192.7)
Total increase in net debt		**(979.7)**	(1,246.4)
Opening net debt		**(6,795.8)**	(5,549.4)
Closing net debt	7	**(7,775.5)**	(6,795.8)

Non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 ”Capital instruments”.

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March

1 Current cost accounting policies

These financial statements have been prepared in accordance with guidance issued by the Water Services Regulation Authority for modified real term financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of which assets are valued at their current cost value to the business.

These financial statements have been prepared in accordance with applicable RAG. In respect of cost allocations, the Company has continued to allocate costs by cost centre as in previous years rather than on an activity based method, which is the preferred system under RAG 3.06.

The principal current cost accounting policies used are the same as those adopted in the regulatory historical cost financial statements, except as set out below.

Changes to accounting policies

The accounting policies used for the year ended 31 March 2011 have been applied in these financial statements, except as noted below.

The Company undertook a review of its current cost assets in line with Ofwat's Accounting Separation guidance. Accordingly, the Company has reclassified certain assets and their related depreciation between asset types and between water and sewerage services.

The net book values have not been affected by this review.

(a) Valuation bases for determining the current cost of fixed assets

(i) Review of asset valuations

In accordance with Ofwat's guidelines RD12/07, the Company undertook a review of the modern equivalent asset ("MEA"), values as at 31 March 2009 as one aspect of the 2009 Periodic Review. This involved a comprehensive review of the asset stock at the time, as well as the unit costs underpinning the valuations. In accordance with RD12/07 companies were given the option to report the results of the revaluation in the regulatory accounts either in 2010 or 2011. The Company has therefore applied the results of the revaluation in the regulatory accounts in 2012. Accordingly, MEA net book values for the prior period increased by £16,448.5m; see note 6, on page 121.

(ii) Adoption of private sewers and lateral drains

In accordance with the "Water Industry Schemes for Adoptions of Private Sewers 2011", the Company adopted private sewers and lateral drains on 1 October 2011.

These have been valued as specified in RAG 1.10.9 in the Company's current cost balance sheet at £18.8bn, as at 31 March 2011 prices, within "Tangible fixed assets", with a corresponding contribution of £18.8bn being reflected within "Third party contributions since 31 March 1990". The adoption has £nil effect on the Company's net assets, see note 4b page 119. The current cost value of these adopted assets as at 31 March 2012 was £19.5bn.

The Company estimated the current cost of the adoption of private sewers and lateral drains by using the length of the network adopted, deemed to be 40,000 km, and is after the application of assumptions on surface covering, location and diameter of sewer.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

(a) Valuation bases for determining the current cost of fixed assets (continued)

(ii) Tangible fixed assets

The assets have been valued in accordance with RAG 1.04, on an MEA basis. Depreciation is charged over the estimated remaining economic life of the asset. Infrastructure assets are not depreciated.

Additions during the year are taken at their historical cost values. Disposals are stated at the value of the replacement assets.

- **Land and buildings**

Non-specialised operational properties are valued on the basis of estimated open market value for existing use at 31 March 1991, indexed since that date by the movement in the RPI, except for certain properties which have been valued at 31 March 1995 by professionally qualified employees of the Company.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually, between periodic reviews of replacement costs, by adjusting for inflation as measured by changes in the RPI.

- **Infrastructure assets**

Mains, sewers, impounding and pumped raw water storage reservoirs, and sludge pipelines are stated at their MEA value, in the manner described above. Due to the nature of these assets, the MEA value is calculated based on the length of sewer or pipe, or the capacity of the asset.

Following the repeal of Section 24 of the Public Health Act 1936 by the Water Act 1989, the Company assumed responsibility for the maintenance and operation of a significant length of additional sewers. The Company has estimated the length of these pipes in order to include their asset values in these accounts. The value is £6,480m (2011: £6,183m) based upon a pipe length of 19,000km (2011: 19,000km). Adjustments may be required to those estimates in future years as more accurate information becomes available.

- **Specialised/non-specialised assets**

Specialised operational assets include those assets, used routinely in operating the business, which are directly attributable to water supply or sewerage services.

Non-specialised assets are those assets used routinely within the business, which cannot be directly attributed to either part of the business.

- **Surplus land**

Surplus land is valued at recoverable amounts less, where appropriate, that part of any proceeds to be passed on to customers under Condition B of the Licence.

(iii) Capital contributions

All third party capital contributions received since 31 March 1990 are carried forward as deferred income to the extent that any balance has not been credited to revenue, or deducted from net operating assets in the case of infrastructure assets. The balance carried forward is restated in accordance with the change in the RPI for the year.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

(b) Real finance capital maintenance adjustments

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

(i) Depreciation adjustment - this is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historical cost profit.

(ii) Working capital adjustment - this is calculated by applying the change in the RPI over the year to the working capital of the Company at the beginning of the year.

(iii) Disposal of fixed assets adjustment - this is the difference between the book values of realised assets in the current cost financial statements and in the historical cost financial statements.

(iv) 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, but excluding index rate linked debt and the deferred tax provision.

(c) Operating costs

In note 3, direct costs incurred with associated companies are less than 20% of the total operating costs of the business before interest and tax. Therefore the costs have been allocated across the appropriate headings in accordance with RAG 3.06.

Regulatory accounts and required regulatory information (continued)

2 Analysis of turnover, operating income and working capital adjustment for the appointed business

	2012			2011		
	Water supply £m	**Sewerage services £m**	**Appointed business £m**	Water supply £m	Sewerage services £m	Appointed business £m
Turnover						
Unmeasured - household	**468.7**	**448.4**	**917.1**	461.5	422.1	883.6
Unmeasured – non - household	**6.6**	**5.0**	**11.6**	6.5	4.1	10.6
Total unmeasured	**475.3**	**453.4**	**928.7**	468.0	426.2	894.2
Measured - household	**174.1**	**205.1**	**379.2**	167.2	184.5	351.7
Measured – non - household	**157.5**	**117.5**	**275.0**	158.0	110.5	268.5
Total measured	**331.6**	**322.6**	**654.2**	325.2	295.0	620.2
Trade effluent	**-**	**6.6**	**6.6**	-	4.5	4.5
Large user and special agreement	**32.6**	**24.9**	**57.5**	33.5	23.1	56.6
Rechargeable works	**2.7**	**5.7**	**8.4**	2.1	6.6	8.7
Bulk supplies/inter-company payments	**3.0**	**-**	**3.0**	2.9	-	2.9
Third party services (excl. non-potable water)	**5.7**	**5.7**	**11.4**	5.0	6.6	11.6
Other sources	**6.2**	**6.3**	**12.5**	5.4	7.5	12.9
Total turnover	**851.4**	**819.5**	**1,670.9**	837.1	762.9	1,600.0
Operating income						
Current cost profit on disposal fixed assets	**1.8**	**2.5**	**4.3**	(0.8)	(0.7)	(1.5)
Working capital adjustment						
Working capital adjustment	**10.2**	**9.9**	**20.1**	6.8	6.2	13.0
Revenue correction mechanism						
Net revenue movement out of the tariff basket	**(1.6)**	**(0.4)**	**(2.0)**	0.4	0.8	1.2

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

3 Operating costs and associated fixed asset book values for year ended 31 March 2012

3a Water Services

£m	Water resources	Raw water distribution	Water treatment	Treated water distribution	Total
Direct costs					
Employment costs	2.0	1.7	9.7	23.6	**37.0**
Power	6.3	1.6	7.8	29.7	**45.4**
Hired and contracted services	1.9	2.1	7.3	30.4	**41.7**
Materials and consumables	0.1		11.6	0.1	**11.8**
Service charges	17.3				**17.3**
Bulk supply imports					
Other direct costs			0.4	5.6	**6.0**
Total direct costs	**27.6**	**5.4**	**36.8**	**89.4**	**159.2**
Operating expenditure					
General and support expenditure	7.0	4.2	1.1	53.0	**65.3**
Scientific services		1.0	2.4	0.1	**3.5**
Other business activities	0.1	0.1	0.3	0.6	**1.1**
Total business activities	**0.1**	**1.1**	**2.7**	**0.7**	**4.6**
Local Authority rates	1.5	1.8	2.8	25.2	**31.3**
Exceptional items	(0.9)	(0.8)	(4.6)	(10.5)	**(16.8)**
Total opex less third party services	**35.3**	**11.7**	**38.8**	**157.8**	**243.6**
Third party services - opex	0.2		0.7	0.4	**1.3**
Total operating expenditure	**35.5**	**11.7**	**39.5**	**158.2**	**244.9**
Capital maintenance					
Infrastructure renewals charge (excluding third party services)	3.4	7.8		67.0	**78.2**
Current cost depreciation	14.1	3.2	89.9	44.9	**152.1**
Amortisation of deferred credits	(0.1)	(0.1)	(0.3)	(1.4)	**(1.9)**
Business activities current cost depreciation	0.1		0.4	0.3	**0.8**
Total capital maintenance	**17.5**	**10.9**	**90.0**	**110.8**	**229.2**
Total operating costs	**53.0**	**22.6**	**129.5**	**269.0**	**474.1**
Memorandum - included in above					
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure		0.3		54.1	**54.4**
Reactive and planned maintenance non-infrastructure	0.7		2.7		**3.5**
	0.7	**0.3**	**2.7**	**54.1**	**57.9**

Regulatory accounts and required regulatory information (continued)

3b Retail Services

£m	Household	Household general & support memo	Non-household	Non-household general & support memo	Total
Direct costs					
Billing	13.0	2.1	2.3	0.4	**15.3**
Payment handling, remittance and cash handling	5.9	0.8	0.2	0.1	**6.1**
Debt management	15.2	1.9	1.7	0.2	**16.9**
Doubtful debts	60.6		10.0		**70.6**
Charitable trust donations	2.0				**2.0**
Vulnerable customer schemes	0.1				**0.1**
Non network customer enquiries and complaints	9.2	1.2	1.3	0.1	**10.5**
Meter reading	5.0	0.5	2.3	0.4	**7.3**
Meter maintenance/installation non capex					
Network customer enquiries and complaints	4.2	0.4	0.8	0.1	**5.0**
Disconnections	0.2				**0.2**
Demand side water efficiency initiatives	1.4	0.2	1.3	0.1	**2.7**
Services to developers			0.3	0.4	**0.3**
Support for trade effluent compliance			0.8	0.1	**0.8**
Customer side leaks	2.3	0.5	0.4	0.1	**2.7**
Other direct costs	0.2		0.2		**0.4**
Total direct costs	**119.3**	**7.6**	**21.6**	**2.0**	**140.9**
Operating expenditure					
General and support expenditure	7.6		2.0		**9.6**
Scientific services					
Other business activities					
Total business activities					
Local Authority rates	0.4		0.1		**0.5**
Exceptional items	(6.7)		(1.3)		**(8.0)**
Total operating expenditure	**120.6**		**22.4**		**143.0**
Capital maintenance					
Current cost depreciation	16.0		3.3		**19.3**
Total operating costs	**136.6**		**25.7**		**162.3**

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

3 Operating costs and associated fixed asset book values for year ended 31 March 2012 (continued)

3c Sewerage Services

£m	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Total
Direct costs					
Employment costs	8.4	17.2	5.5	1.0	**32.1**
Power	7.1	26.2	1.8		**35.1**
Hired and contracted services	34.2	26.4	17.2	19.1	**96.9**
Materials and consumables	0.7	9.7	7.6		**18.0**
Service charges	2.1	3.4			**5.5**
Other direct costs	1.8	1.1	0.3		**3.2**
Total direct costs	**54.3**	**84.0**	**32.4**	**20.1**	**190.8**
Operating expenditure					
General and support expenditure	11.0	8.9	3.1	3.6	**26.6**
Scientific services		0.9	0.3		**1.2**
Other business activities	0.4	0.5	0.2	0.1	**1.2**
Total business activities	**0.4**	**1.4**	**0.5**	**0.1**	**2.4**
Local Authority rates		26.0	9.1	1.2	**36.3**
Exceptional items	(4.0)	(8.1)	(2.6)	(0.5)	**(15.2)**
Total opex less third party services	**61.7**	**112.2**	**42.5**	**24.5**	**240.9**
Third party services - opex	1.0	1.7	0.3	0.7	**3.7**
Total operating expenditure	**62.7**	**113.9**	**42.8**	**25.2**	**244.6**
Capital maintenance					
Infrastructure renewals charge (excluding third party services)	51.3				**51.3**
Current cost depreciation	47.0	130.1	32.8	1.5	**211.4**
Amortisation of deferred credits	(6.5)	(0.6)	(0.1)		**(7.2)**
Business activities current cost depreciation	0.1	0.6	0.1	0.2	**1.0**
Total capital maintenance	**91.9**	**130.1**	**32.8**	**1.7**	**256.5**
Total operating costs	**154.6**	**244.0**	**75.6**	**26.9**	**501.1**
Memorandum - included in above					
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure	17.3				**17.3**
Reactive and planned maintenance non-infrastructure	6.7	11.7	5.8		**24.2**
	24.0	**11.7**	**5.8**		**41.5**

Summary of operating costs

	Water services	Sewerage Services	Retail	Total
Total operating expenditure	244.9	244.6	143.0	632.5
IRC	78.2	51.3		129.5
Amortisation of deferred credits	(1.9)	(7.2)		(9.1)
Depreciation	152.9	212.4	19.3	384.6
Total operating costs including exceptional item	474.1	501.1	162.3	1,137.5
Exceptional item included in Other operating income, see page 107	16.8	15.2	8.0	40.0
Total operating costs	**490.9**	**516.3**	**170.3**	**1,177.5**

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type as at 31 March 2012

4a Water Services

	Water Resources				Raw Water Distribution				Water Treatment				Treated Water Distribution				
£m	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Total
GROSS REPLACEMENT COST																	
Gross replacement cost at 1 April	520.5	374.2	0.5	**895.2**	797.6	56.1		**853.7**	0.4	2,649.0	1.4	**2,650.8**	10,550.5	1,557.9	0.4	**12,108.8**	**16,508.5**
Reclassification	(4.6)			**(4.6)**	377.1			**377.1**					(372.5)			**(372.5)**	
RPI adjustment	18.4	13.4		**31.8**	41.9	2.0		**43.9**		94.6	0.1	**94.7**	363.3	55.6		**418.9**	**589.3**
Disposals		(4.4)		**(4.4)**		(0.5)		**(0.5)**		(56.9)	(2.4)	**(59.3)**	(48.6)	(54.2)		**(102.8)**	**(167.0)**
Additions		10.0	0.1	**10.1**		0.8		**0.8**	(0.2)	80.8	2.1	**82.7**	25.0	56.3	1.5	**82.8**	**176.4**
Gross replacement cost at 31 March	**534.3**	**393.2**	**0.6**	**928.1**	**1,216.6**	**58.4**		**1,275.0**	**0.2**	**2,767.5**	**1.2**	**2,768.9**	**10,517.7**	**1,615.6**	**1.9**	**12,135.2**	**17,107.2**
DEPRECIATION																	
Depreciation at 1 April		198.9		**198.9**		30.2		**30.2**		1,402.5	0.9	**1,403.4**		698.2		**698.2**	**2,330.7**
RPI adjustment		7.1		**7.1**		1.1		**1.1**		50.1		**50.1**		24.9		**24.9**	**83.2**
Disposals		(4.4)		**(4.4)**		(0.5)		**(0.5)**		(52.6)	(2.4)	**(55.0)**		(54.2)		**(54.2)**	**(114.1)**
Charge for year		14.2		**14.2**		3.2		**3.2**		88.7	1.7	**90.4**		45.1	0.1	**45.2**	**153.0**
Depreciation at 31 March		**215.8**		**215.8**		**34.0**		**34.0**		**1,488.7**	**0.2**	**1,488.9**		**714.0**	**0.1**	**714.1**	**2,452.7**
Net book amount at 31 March 2012	**534.3**	**177.4**	**0.6**	**712.3**	**1,216.6**	**24.4**		**1,241.0**	**0.2**	**1,278.8**	**1.0**	**1,280.0**	**10,517.7**	**901.6**	**1.8**	**11,421.1**	**14,654.5**
Net book amount at 31 March 2011	520.5	175.3	0.5	696.3	797.6	25.9		823.5	0.4	1,246.5	0.5	1,247.4	10,550.5	859.7	0.4	11,410.6	14,177.8

Note: The disposal of £48.6m (2011: £80.2m) of infrastructure assets within Treated water distribution, shown above, relates to the MEA value of the length of main abandoned as a result of the Victorian mains replacement programme. The corresponding entry, shown in note 6 is against the current cost reserve.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type as at 31 March 2012 (continued)

4b Sewerage Services

	Sewage collection				Sewage treatment				Sludge treatment				Sludge disposal				
£m	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Total
Gross replacement cost																	
Gross replacement cost at 1 April	53,945.1	2,055.8	9.2	**56,010.1**	2.1	4,696.9	1.7	**4,700.7**	21.9	1,276.0	1.1	**1,299.0**		142.6	1.8	**144.4**	**62,154.2**
AMP adjustment	18,836.7			**18,836.7**													**18,836.7**
Reclassification adjustment					19.1	460.7		**479.8**	(19.1)	(405.3)		**(424.4)**		(55.4)		**(55.4)**	
RPI adjustment	2,598.3	73.4	0.3	**2,672.0**	0.8	184.0	0.1	**184.9**	0.1	31.1		**31.2**		3.1	0.1	**3.2**	**2,891.3**
Disposals		(19.7)	(0.6)	**(20.3)**		(105.4)		**(105.4)**		(30.4)	0.2	**(30.2)**		0.1	(0.2)	**(0.1)**	**(156.0)**
Additions	130.0	76.5		**206.5**	0.1	378.3	1.0	**379.4**		95.8	3.3	**99.1**		10.2		**10.2**	**695.2**
Gross replacement cost at 31 March	**75,510.1**	**2,186.0**	**8.9**	**77,705.0**	**22.1**	**5,614.5**	**2.8**	**5,639.4**	**2.9**	**967.2**	**4.6**	**974.7**		**100.6**	**1.7**	**102.3**	**84,421.4**
Depreciation																	
Depreciation at 1 April		1,186.6	3.0	**1,189.6**		2,777.9	0.2	**2,778.1**		628.4	(0.9)	**627.5**		52.1	1.3	**53.4**	**4,648.6**
Reclassification adjustment						233.6		**233.6**		(201.2)	0.2	**(201.0)**		(32.4)	(0.2)	**(32.6)**	**(0.0)**
RPI adjustment		42.4	0.1	**42.5**		107.5		**107.5**		15.3		**15.3**		0.7		**0.7**	**166.0**
Disposals		(19.7)	(0.5)	**(20.2)**		(105.4)		**(105.4)**		(30.4)	0.1	**(30.3)**		0.1	(0.2)	**(0.1)**	**(156.0)**
Charge for year		46.6	0.6	**47.2**		130.2	0.4	**130.6**		32.4	0.5	**32.9**		1.5	0.2	**1.7**	**212.4**
Depreciation at 31 March		**1,255.9**	**3.2**	**1,259.1**		**3,143.8**	**0.6**	**3,144.4**		**444.5**	**(0.1)**	**444.4**		**22.0**	**1.1**	**23.1**	**4,871.0**
Net book amount at 31 March 2012	**75,510.1**	**930.1**	**5.7**	**76,445.9**	**22.1**	**2,470.7**	**2.2**	**2,495.0**	**2.9**	**522.7**	**4.7**	**530.3**		**78.6**	**0.6**	**79.2**	**79,550.4**
Net book amount at 31 March 2011	53,945.1	869.2	6.2	54,820.5	2.1	1,919.0	1.5	1,922.6	21.9	647.6	2.0	671.5		90.5	0.5	91.0	57,505.6

The AMP adjustment of £18.8bn relates to the adoption of private sewers and lateral drains on 1 October 2011 and represents the current cost value of these assets as at 31 March 2011 prices. See “Adoption of private sewers and lateral drains” within note 1, page 111.

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type at 31 March 2012 (continued)

4c Retail

	Household				Non-household					
£m	**Infrastructure**	**Operational**	**Other tangible**	**Total**	**Infrastructure**	**Operational**	**Other tangible**	**Total**	**Total**	**Grand Total**
Gross replacement cost										
Gross replacement cost at 1 April		255.7	18.1	**273.8**		52.4	3.7	**56.1**	**329.9**	**78,992.6**
AMP adjustment										**18,836.7**
RPI adjustment		9.2	0.6	**9.8**		1.9	0.1	**2.0**	**11.8**	**3,492.4**
Disposals		(11.0)	(0.3)	**(11.3)**		(2.2)	(0.1)	**(2.3)**	**(13.6)**	**(336.6)**
Additions		37.3		**37.3**		7.6		**7.6**	**44.9**	**916.5**
Gross replacement cost at 31 March		**291.2**	**18.4**	**309.6**		**59.7**	**3.7**	**63.4**	**373.0**	**101,901.6**
Depreciation										
Depreciation at 1 April		195.5	1.9	**197.4**		40.0	0.4	**40.4**	**237.8**	**7,217.1**
RPI adjustment		7.0	0.1	**7.1**		1.4		**1.4**	**8.5**	**257.6**
Disposals		(11.0)	(0.3)	**(11.3)**		(2.2)	(0.1)	**(2.3)**	**(13.6)**	**(283.7)**
Charge for year		15.9	0.0	**15.9**		3.3		**3.3**	**19.2**	**384.6**
Depreciation at 31 March		**207.4**	**1.7**	**209.1**		**42.5**	**0.3**	**42.8**	**251.9**	**7,575.6**
Net book amount at 31 March 2012		**83.8**	**16.7**	**100.5**		**17.2**	**3.4**	**20.6**	**121.1**	**94,326.0**
Net book amount at 31 March 2011		60.2	16.2	76.4		12.3	3.3	15.6	**92.0**	**71,775.3**

Grand total represents the total of Water Services, Sewerage Services and Retail.

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Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

5 Current cost working capital

	31 March 2012 £m	31 March 2011 £m
Stocks	**9.6**	8.2
Trade debtors:		
- Measured household	**77.0**	78.7
- Unmeasured household	**115.2**	121.1
- Measured non-household	**39.9**	46.0
- Unmeasured non-household	**1.7**	1.9
- Other	**21.0**	19.9
Measured income accrual	**146.7**	136.1
Prepayments and other debtors	**39.3**	34.1
Trade creditors	**(280.7)**	(254.4)
Deferred income – customer advance receipts	**(87.8)**	(86.4)
Capital creditors	**(243.0)**	(332.3)
Accruals and other creditors	**(178.6)**	(191.8)
Total working capital	**(339.7)**	(418.9)

6 Movement on current cost reserve

	31 March 2012 £m	31 March 2011 £m
Balance at 1 April	**63,916.5**	44,110.5
RPI adjustments:		
- Fixed assets *	**3,234.8**	3,619.1
- Working capital	**(20.1)**	(13.0)
- Financing	**(41.0)**	(119.2)
- Grant and third party contributions *	**(710.3)**	(49.2)
- Mains replacement adjustment (see note 4a)	**(48.6)**	(80.2)
- AMP adjustment **	**-**	16,448.5
- Other	**1.6**	-
Balance at 31 March	**66,332.9**	63,916.5

* RPI adjustments for fixed assets include £672.5m relating to the adoption of private sewers and lateral drains on 1 October 2011, with a similar value shown within Grants and third party contributions.

** Please see “Review of asset valuations” on page 111 for details of the AMP adjustment made in the prior period.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

7 Net debt analysis

March 2012:

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Maturity profile				
Less than one year	(285.3)	(241.2)	-	(526.5)
Between one and two years	(17.9)	(10.2)	-	(28.1)
Between two and five years	(675.1)	(139.4)	-	(814.5)
Between five and twenty years	(2,375.2)	(157.5)	(1,190.7)	(3,723.4)
In more than twenty years	(344.4)	100.0	(3,060.7)	(3,305.1)
Total borrowings	(3,697.9)	(448.3)	(4,251.4)	(8,397.6)
Cash	2.7	-	-	2.7
Short term deposits	619.4	-	-	619.4
Net debt	**(3,075.8)**	**(448.3)**	**(4,251.4)**	**(7,775.5)**

All values in the above tables are post cross currency rate swaps, interest rate swaps and index-linked swaps.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March

Regulatory Capital Value (RCV)

	2012 £m
Opening RCV (March 2011 prices)	8,849
Indexation to year end (March 2012 prices)	316
Opening RCV at year end prices	9,165
Capital expenditure (excluding infrastructure renewals expenditure)	1,293
Infrastructure renewals expenditure	180
Grants and contributions	(27)
Depreciation	(408)
Infrastructure renewals charge	(148)
Out performance of past regulatory assumptions	(50)
Closing RCV (March 2012 prices)	**10,005**
Average RCV (2011/2012 year average prices)	**9,447**

The figures quoted reflect those used by Ofwat at the 2009 Periodic Review to set prices for 2011/2012, as confirmed by Ofwat in their RCV update on 18 April 2012. All costs have been indexed to March 2012 prices (RPI index) except for the average RCV, which is shown at year average prices (RPI index) in accordance with Ofwat's convention.

Differences between the figures shown above and actual costs/income will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation at the next price review through operation of the Capital Incentive Scheme.

RAG 5 Intra-group trade

During the year there were no contracts in excess of 0.5% (£8.4m) of the Company's turnover with any subsidiary of the Thames Water group of companies.

Dividends paid to associated undertakings

During the year, the Company paid interim dividends totalling £279.5m (2011: £271.4m) to Thames Water Utilities Holdings Limited. Full disclosure of these dividends are provided in note 9 on page 80 of the statutory section of these financial statements

Transfer of assets by of to the appointee

There was no transfer of assets or liabilities by or to the Company in excess of the materiality limit (2011: £nil).

Supplementary regulatory information for the year ended 31 March (continued)

Borrowings and sums lent

All borrowings from the Company's wholly owned subsidiaries are as follows for the year ended 31 March 2012:

Instrument	Amount borrowed	Total book value *
Thames Water Utilities Cayman Limited		
€500m 6.13% Fixed rate bond due 2013.	417.1	417.1
$156m 3 month US$ libor + 0.95% floating rate bond due 2015.	97.4	97.4
€500m 3.25% Fixed rate bond due 2016.	417.1	417.1
£400m 7.24% Fixed rate bond due 2018.	400.0	398.5
$150m USPP Fixed rate bond due 2019.	93.7	93.7
£75m 1.35% Index linked bond due 2021.		
€113m 2.30% CPI index linked bond due 2022.	94.3	94.7
$150m USPP Fixed rate bond due 2022.	93.7	93.7
$200m USPP Fixed rate bond due 2024.	124.9	124.9
£550m 5.38% Fixed rate bond due 2025.	550.0	546.2
$250m USPP Fixed rate bond due 2027.	156.1	156.1
£300m 5.75% Fixed rate bond due 2030.	300.0	296.6
20bn Yen 3.28% Fixed rate bond due 2038.	152.0	152.0
£50m 3.85% Index linked bond due 2040.	50.0	55.0
£500m 5.5% Fixed rate bond due 2041.	500.0	488.6
£50m 1.98% Index linked bond due 2042.	50.0	57.7
£55m 2.09% Index linked bond due 2042.	55.0	61.3
£40m 1.97% Index linked bond due 2045.	40.0	42.5
£100m 1.85% Index linked bond due 2047.	100.0	115.5
£200m 1.82% Index linked bond due 2049.	200.0	230.4
£200m 1.77% Index linked bond due 2057.	200.0	230.4
£350m 1.76% Index linked bond due 2062.	350.0	403.2
Total	**4,441.3**	**4,572.6**
Thames Water Finance Limited		
£200m 4.90% Fixed rate bond due 2015.	200.0	200.0
£200m 5.05% Fixed rate bond due 2020.	200.0	200.0
£175m 3.38% Index linked bond due 2021.	175.0	236.1
£225m 6.59% Fixed rate bond due 2021.	225.0	225.0
£330m 6.75% Fixed rate bond due 2028.	330.0	327.8
£200m 6.50% Fixed rate bond due 2032.	200.0	198.0
£600m 5.13% Fixed rate bond due 2037.	600.0	596.4
£300m 1.68% Index linked bond due 2053.	300.0	364.8
£300m 1.68% Index linked bond due 2055.	300.0	364.8
Total	**2,530.0**	**2,712.9**
Grand total	**6,971.3**	**7,285.5**

* Total book value includes interest accretion of index linked bonds and unamortized bond fees.

See page 84 for analysis of the above amounts owed to group undertakings within one year and after more than one year.

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

TWUCL and TWUFL lend the proceeds of the external borrowings on to the Company, net of derivatives of £71.4m. Under these arrangements the Company owes TWUCL £4,623.0m and TWUFL £2,747.2m.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March (continued)

RAG 5 Directors' interests information

Listed below are details of directorships held by Thames Water Utilities Limited directors at 31 March 2012 in associated companies that have traded with the regulated business during the year.

Directorships held in Associated Companies

The following directors held directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
L F Abraira	4 August 2011	19 January 2012
E Beckley		
R Blomfield-Smith		21 November 2011
C R Deacon		
S R Eaves	20 January 2012	
G I W Parsons		
A F C DeP Santos		4 August 2011
D J Shah OBE		
Y Shi	19 January 2012	
M S W Stanley		
R Verrion		
L Webb	21 November 2011	

The following directors have formally appointed alternate directors to represent them when they are unavailable. These alternate directors also held alternate directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
S R Eaves	20 January 2012		M C Hill	20 January 2012	
G I W Parsons			E Beckley	11 November 2011	
A F C DeP Santos		4 August 2011	M C Guerreiro		4 August 2011
D J Shah OBE			L Webb		21 November 2011
			K Roseke	31 January 2012	
Y Shi	19 January 2012		F Sheng	29 February 2012	
R Verrion			S Kolenc		
L Webb	21 November 2011		C Pham	21 November 2011	

Thames Water Utilities Limited conducts its appointed business so as to ensure arm's length trading and avoidance of cross-subsidy in the spirit of Condition F of the Instrument of Appointment.

No directorships are held by Thames Water Utilities Limited directors in circumstances, which might in practice, result in conflicts of interest in intra-group trading relationships.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March (continued)

Directors' Certificate under Condition F6A of the Company's Appointment

This is to certify that at their meeting on 7 June 2012 the directors of Thames Water Utilities Limited ("the Appointee") resolved as follows:

- That, in the opinion of the directors', the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment(s)).

- That, in the opinion of the directors, the Appointee will, for at least the next 12 months, have available to it:

  (a) Management resources.
  (b) Systems of planning and internal control.

  Which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1(1).

- That, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

The main factors the directors have taken into account in issuing the Directors' Certificate under condition F6A of the Company's appointment are:

- That the processes and systems of internal control operated as expected.

- That the Appointee operated as if it was substantially the Appointee's sole business and that the Appointee was a separate public limited company.

- That financial resources and facilities are adequate to enable the Appointee to meet its regulatory obligations.

- The net worth of the Company and the strength of the Company's key performance indicators as shown on page 8 of the Chief Executive Officer's Business review.

- The strong investment grade ratings as shown on page 10 of the Chief Executive Officer's Business review.

- Borrowing facilities, which include significant undrawn bank facilities.

- The outcome of the 2009 regulatory price review for the five year period to 31 March 2015 and its impact on the appointee's business plans.

S Siddall
Chief Financial Officer
7 June 2012

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited

We have audited the Regulatory Accounts of Thames Water Utilities Limited for the year ended 31 March 2012 on pages 99 to 125 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; 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 to the current cost financial statements, 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 sewerage undertaker under the Water Industry Act 1991. 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 37, 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 and the Directors of Thames Water Utilities 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 104 to 105 and 111 to 113, the state of the Company's affairs at 31 March 2012 on an historical cost and current cost basis, and its historical cost and current cost profit and its 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 of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Financial information other than that prepared on the basis of UK GAAP 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 pages 100 and 101 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 102.

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 and the Directors of Thames Water Utilities 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 WSRA'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 2012 on which we report, 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.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
London
7 June 2012

Notes:

1. The maintenance and integrity of the Company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions

Thames Water Utilities Limited

Glossary of regulatory terms

AMP adjustment – The revision in the real value of fixed assets arising periodically from improved information in the five-year Asset Management Plan process.

Appointed Business – The appointed business comprises the regulated activities of the Company which are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading – Trading in which the Company treats the other party, usually an associate company on the same basis as an external party.

Asset Management Plan (AMP) – A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP4 covers the investment period April 2005 to March 2010 AMP5 covers the investment period April 2010 to March 2015.

Associate company – Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the Company and its associated companies to be disclosed subject to specified materiality considerations.

Capital Incentive Scheme ("CIS") – This will be the new capital expenditure incentive mechanism introduced by Ofwat to take effect in AMP 5. Under this mechanism Ofwat sets a baseline capital expenditure plan, which they believe companies should be able to deliver. Companies are rewarded or penalised during the AMP 5 for submitting a business plan, which is lower or higher than the baseline respectively. Companies will then be further rewarded or penalised at the start of AMP 6 for underspending or overspending against that business plan.

CIS will apply to capital expenditure only, not to operational expenditure and will not apply to large projects such as the Lee Tunnel.

Final determination – The conclusion of discussions on the scale and content of the asset management plan for the forthcoming five-year AMP period. It is accompanied by a determination of the allowable K factor for the forthcoming AMP.

Financing adjustment – The impact of RPI on the real value of net finance for the business.

K factor – The annual increase, set by Ofwat, in charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula RPI + or – 'K' + 'U'. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers and 'U' is the amount of 'K' not taken up by a company in previous years.

Licence – The Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Thames Water Utilities Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Glossary of regulatory terms (continued)

Modern Equivalent Asset (MEA) – The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing, or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up to date new asset with the same service capability allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset, and is stated gross of third-party contributions.

Non-appointed business – The non-appointed business activities of the Company are activities for which the Company as a water and sewerage undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the Company (for example, the use of underground assets for cable television).

Ofwat – The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic Regulator of the water industry.

Periodic Review (PR) – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits an Asset Management Plan covering the five-year period for which Ofwat will determine prices (the K factor – see above).

Price limit – The name given to the combination of the RPI and K.

Regulatory Accounting Guidelines (RAG) – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (RCV) – The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Retail Price Index (RPI) – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (SIM) – Ofwat's measure of customer satisfaction based on surveys of customers who have contacted the Company and the number of contacts received which express dissatisfaction.

Third-party contributions since 1989/90 – Grants and third-party contributions received in respect of infrastructure assets and any deferred income relating to grants and third-party contributions for non-infrastructure assets.

Working capital – The aggregate of stocks, trade debtors and trade creditors, if material.

Working capital adjustment – The impact of RPI on the real value of working capital to the business.

Thames Water Utilities Limited

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Registered no: 02366661 (England and Wales)

Thames Water Utilities Limited

Annual report and financial statements

For the year ended 31 March 2012

Annual report and financial statements for the year ended 31 March 2012

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Directors and advisors at 31 March 2012

Directors

Sir Peter Mason KBE (Chairman)
M W Baggs
E Beckley
C R Deacon
S R Eaves
G I W Parsons
D J Shah OBE
Y Shi
S J Siddall
M S W Stanley
R E Verrion
L Webb

Independent non-executive directors

Dame D M Hutton CBE
M J Pavia
E C Richards

Registered auditor

KPMG Audit Plc
Chartered Accountants
15 Canada Square
London
E14 5GL

Company Secretary & registered office

J E Hanson
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

About us

Our mission

We provide the essential service that is at the heart of daily life, health and enjoyment.

Our vision

If customers had a choice, they would choose Thames Water.

Our customer experience

Customers choose Thames Water because:

- They **trust** us
- We are **easy** to do business with
- We really **care**

Facts and figures

Our business

- UK's largest water and wastewater services provider.
- 14m customers.
- Over 4,500 employees.
- One of the providers offering best value, with customers paying an average of 93p a day.

Water services

- 9m clean water customers in London and the Thames Valley.
- An average of 2,600m litres of drinking water supplied per day.
- Operation and maintenance of 100 water treatment works, 30 raw water reservoirs, 288 pumping stations and 235 clean water service reservoirs.
- Our tap water costs less than a tenth of a penny per litre.
- Drinking water quality is meeting 99.98% of stringent tests.
- Carry out over 400,000 water quality tests undertaken each year to meet stringent UK and European standards.

Sewerage services

- 14m wastewater customers.
- 350 sewerage treatment works ("STW") treating an average of more than 4,000m litres per day.
- 109,000 km of sewers, 2,530 pumping stations and 1.2m manholes.
- Two sludge-powered generators and 19 combined heat and power plants generating 176 GWh of renewable electricity.
- All wastewater treatment facilities are currently operating within Environment Agency ("EA") compliance guidelines.

Thames Water Utilities Limited

About us

Financial information

- Turnover increased by 4.4% to £1,694.9m (2011: 1,623.1m).
- Underlying profit before tax (profit before tax excluding exceptional item) fell by 12.6% to £182.2m (2011: £208.5m).
- Closing Regulatory Capital Value ("RCV") for the year is £10,005m (2011: £8,849m).
- Senior debt/RCV ratio was 78.3% (trigger point 85%).

Operational performance

Highlights

- For the second year running the Company delivered over £1bn of capital investment in its network and plants, including the development of the Thames Tunnel.
- Leakage reduced 28 Mld to 637 Mld compared to last year and beat the target set by the Water Services Regulatory Authority ("Ofwat") for the year by 36 Mld.
- The Company's drinking water quality was 99.98%, whilst sewerage treatment compliance was 100%.
- Continuing reduction in greenhouse gas emissions, with CO_2e emissions 16% lower than two decades ago and generating 14% of the Company's own power.
- Charitable donations of £1,019,340 partly through the shareholders' Ten for Ten initiatives, which started in 2009.
- Health and safety: the number of reportable accidents fell to an Accident Incident Rate of 0.33 per 1,000 employees, a 48% improvement since the start of Asset Management Period 5.
- The Company's Transforming Thames programme started to deliver its Work, Asset Management and Information ("WAMI") programme, Metering Outsourcing and introduced new working patterns and associated terms and conditions for staff.
- The Company introduced certain changes to the Thames Water Pension scheme whereby the defined benefit provision is now based on a Career Average Revalued Earnings basis instead of a Final Salary basis.
- The Company successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

Lowlights

- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction has deteriorated to 62.61 (2011: 65.20).
- Pollution incidents (sewerage) have increased to 3.76 incidents per 1,000 km (2011: 2.67).
- Customer bad debt provisioning increased in the year reflecting the economic recession.
- Two employees of the Company's contractors suffered fatal injuries in two separate incidents.

Awards

- The Company was awarded the Utility Industry Achievement Award for staff development.
- The Company received two awards from the Institute of Civil Engineers for its early work on the Lee Tunnel.

Thames Water Utilities Limited

Chairman's introduction

Satisfactory operational and financial performance have again been features of the last year for Thames Water. It has also been a period of significant and ongoing challenges, to which Thames Water Utilities Limited ("the Company") continues to respond robustly.

Two consecutive dry winters forced the introduction of a temporary use ban across much of southern and eastern England, and the Thames Valley was no exception.

This was not a measure the Company took lightly, but one that was unfortunately necessary in order to minimise the likelihood of more severe restrictions at a later stage, if the drought continues.

Against this background, it is all the more satisfying that the Company has achieved its leakage target for the sixth successive year, and by a significant margin.

This has been just one aspect of the prudent management of water resources, which has included the use of the Company's desalination plant in east London, in response to the drought, to supplement water resources.

The wise use of water is particularly important at a time when the Company faces its second major challenge: the staging of the 2012 Olympic and Paralympic Games ("the London 2012 games") in London.

The provision of water and sewerage services will clearly play a vital part in the successful staging of the London 2012 games. The Company has also been planning carefully to mitigate the inevitable disruption to streetworks activity.

The capital will clearly be the centre of attention this summer. It is also the focus for two huge engineering schemes, which are a major centre of activity for the Company; the Lee Tunnel and the Thames Tunnel.

I am pleased to report that, after some years of discussion and planning, work is finally under way to significantly reduce overflows of sewage into London's major rivers.

Although frequently overshadowed by discussions of the Thames Tunnel, the Lee Tunnel will be the largest and deepest tunnel beneath the capital. The tunnel boring machine that has started excavating, and is due to emerge in Abbey Mills, east London in late 2013.

The Company also made good progress on the planning of the Thames Tunnel with Government support. February saw the completion of the second phase of planning consultation on this huge project, which will involve 24 major construction sites across the city.

The Government recognised the Thames Tunnel's importance by including the project in the Chancellor's National Infrastructure Plan and safeguarded certain key sites.

Elsewhere in London, another major wastewater scheme began to take shape at Deephams STW, in Edmonton, where a major upgrade is needed to meet new environmental standards set by the EA.

The year ended 31 March 2012 was the second year of the current five-year investment period. It naturally saw the Company accelerating much of the work that began in 2011, and starting to record some significant achievements.

Work is nearing completion, for example, on the first of a series of major improvement projects at the Company's five biggest STW, to improve both their capacity the quality of treated effluent they discharge to the tidal Thames.

I am pleased to say that our 350 STW once again continued their record of 100% compliance with the strict standards set by the EA.

One area of concern was a rise in the number of serious pollution cases, which senior management is working hard to address.

Thames Water Utilities Limited

Chairman's introduction

Another significant challenge is the area of customer satisfaction. The way the Company handles queries and complaints is rated poorly when compared with the rest of the sector, and this remains an area where it is striving to improve.

On the drinking water side of the business, the Company again reported excellent performance. In 2012, 99.98% of samples taken at customers' taps complied with stringent national and European standards. This was a slight improvement on the year before, and saw the Company maintain supplies that are among the best-quality in the UK.

The continuing high performance across the business was, of course, made possible by good management. This is being further enhanced by a major development programme, for which the Company last December received the Staff Development Award at the Utility Industry Achievement Awards. To date, more than 700 managers have completed the programme.

During the year Luis Abraira, Rosamund Blomfield-Smith and Antonio Santos resigned as non-executive directors, while executive directors Chief Financial Officer Mark Braithwaite and Chief Operating Officer Steve Shine OBE also left the Company. I would like to thank them all for their valuable contributions. We have also welcomed Mark's replacement, Stuart Siddall, and non-executive directors Simon Eaves, Yaping Shi and Lincoln Webb, bringing with them extensive experience.

I would like to note my thanks to staff across Thames Water for their achievements during the year.

Sir Peter Mason KBE
Chairman
7 June 2012

Thames Water Utilities Limited

Chief Executive Officer's Business review

The following business review forms part of the Directors' report.

Business review

Introduction

Unless otherwise stated, all current year data included in this review is for the year ended 31 March 2012 ("2012").

Nature of business

Background

The Company is the largest supplier of water and provider of sewerage services in the UK, based on the number of customers served. It is one of 10 companies currently holding appointments as water and sewerage undertakers[1] in England and Wales, with a further 11 companies holding appointments as water only undertakers.

In total, the area served by the Company occupies approximately 13,331 km^2 and encompasses more than 9% of the area of England and Wales. This includes London and extends as far as Cirencester in the west, Dartford in the east, Banbury in the north and Haslemere in the south. This area has a population of about 14m people, which represents nearly a quarter of the total population of England and Wales. In approximate terms, the Company supplies 3.6m properties (just over 8.8m people) with water, and collects sewage from 5.1m properties (about 14m people), representing 97% of households in its sewerage region.

The Annual Performance Report 2011/12, which incorporates the Corporate Responsibility Report, does not form part of this report. It provides further information regarding the Company's regulatory and operational performance and will be available on the Company's dedicated website: www.thameswater.co.uk/cps from 15 July 2012.

[1] A company that has been appointed to provide water and/or sewerage services to customers in England and Wales is known as an "undertaker". The Company's Instrument of Appointment - usually referred to as "the Licence" - was issued by the Secretary of State for the Environment in August 1989

Chief Executive Officer's Business review (continued)

During the last year, the Company continued its satisfactory performance against its targets.

Highlights

- Delivering over £1bn of investment in the year, bringing the total for the first two years of Asset Management Period 5 ("AMP5") to over £2bn, in line with the Company's capital programme to deliver £4.9bn of investment during AMP5.
- Delivering all of the Company's key regulatory outputs, ensuring that the condition of its assets is maintained.
- The Company reduced leakage to 637 Mld, a reduction of 28 Mld (4.2%) compared to 665 Mld in the prior period, and beat its target for the year by 36 Mld.
- The Company's drinking water quality improved slightly to 99.98% (2011: 99.97%)
- The Company achieved 100% sewage treatment compliance against strict standards set by the EA.
- In November 2011, the Company opened its Old Ford water recycling plant on the edge of the Olympic Park in East London, which will supplement the supply of water for the London 2012 games.
- Greenhouse gas emissions were 16% lower than two decades ago, despite the Company serving 3m more customers amd meeting higher standards in many areas of operation.
- In addition, 14% of the Company's electricity was generated from renewable energy from burning methane gas from sewage at 22 of its larger STW's. The Company also installed solar power arrays at 3 of its main sites and 28 smaller sites. The Company is now one of the largest solar power generators in the UK.
- The Company was awarded the Utility Industry Achievement Award for staff development in the year.
- The Company's Transforming Thames programme is delivering its WAMI programme, a new contract that covers all metering services and introduced new working patterns and associated terms and conditions for staff.
- The Company introduced changes to the Thames Water Pension scheme whereby the defined benefit provision from 1 May 2011 is now based on a Career Average Revalued Earnings basis ("CARE") and no longer on a Final Salary basis.
- The Company successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

Lowlights

- It is with deep regret that the Company has to report the death of two contractors who suffered fatal injuries in two separate incidents is a major concern to the Company. The health and safety of both the Company's, and its contractors' employees continues to be the Company's number one priority.
- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction has deteriorated to 62.61 (2011: 65.20).

Thames Water Utilities Limited

Chief Executive Officer's Business review (continued)

Lowlights (continued)

- The number of pollution incidents from by the Company's sewerage system increased in comparison to last year, with 75 more incidents recorded. This gave a total of 268 pollution incidents, 20 of which were considered to be serious. An incident in the River Crane resulted in the death of fish along approximately a 12km stretch of the river. The Company responded as quickly as it could to clean up the river, and has made a voluntary commitment to the ongoing programme of restoration, to be delivered through the Crane Valley Partnership. Spillages from the Company's sewer network are unacceptable and the Company is working harder to try to avoid them.

  In response to this pollution performance, the Company has already improved many aspects of its business processes. Key to the ongoing performance improvement is the creation of an Event Learning role to learn from each incident so that the Company can work to avoid similar events in the future.

- The bad debt charge has increased to £70.6m in the year (2011: £38.4m) due to collection difficulties and customers' ability to pay as a result of the economic recession.

Financial results

Financial Key Performance Indicators (KPIs)

	The Company			**The regulated business**		
Performance Measure	**Year to 31 March 2012 £m**	Year to 31 March 2011 £m	% Change	**Year to 31 March 2012 £m**	Year to 31 March 2011 £m	% Change
Turnover	**1,694.9**	1,623.1	4.4	**1,670.9**	1,600.0	4.4
Operating expenditure [2]	**675.4**	629.6	(7.3)	**665.8**	627.1	(6.2)
Operating profit [3]	**643.9**	600.2	7.3	**634.4**	598.1	6.1
Underlying profit before tax [4]	**182.2**	208.5	(12.6)	**169.0**	195.7	(13.6)
Total capital expenditure (see note 10)[4]	**1,063.8**	1,006.6	5.7	**1,056.1**	1,003.0	5.3

The following commentary is in respect of the Company.

[2] Operating expenditure: operating costs, see note 3, page 75 (£1,051.0m) , excluding exceptional item of £40.0m relating to a pension curtailment gain, depreciation on owned assets (£276.5m), depreciation on assets held under finance leases (£9.6m) and the Infrastructure Renewals Charge ("IRC") (£129.5m).

[3] Operating profit: turnover less operating costs for the Company but excluding profit on sale of fixed assets. For the regulated business, operating profit includes profit on sale of assets.

[4] Underlying profit before tax: Profit before tax, excluding exceptional item (pre-tax).

[4] Total capital expenditure: total expenditure on tangible fixed assets net of contributions received, see note 10 to the financial statements. Regulatory capital expenditure, in addition includes maintenance non infrastructure income.

Chief Executive Officer's Business review (continued)

Financial results (continued)

Turnover

Turnover for the year was £71.8m (4.4%) higher than the prior year at £1,694.9m (2011: £1,623.1m), reflecting real increases in price ("K"), (see page 130), as agreed with Ofwat, together with increases linked to the Retail Price Index ("RPI").

Operating expenditure

Operating expenditure, excluding exceptional item, depreciation and IRC, see note 3 page 75, for the year has increased by £45.8m (7.3%) to £675.4m (2011: £629.6m) compared to the prior year. This increase is as a result of inflationary pressures with average RPI of 4.8%, increased provisioning for bad debts, caused by the economic climate, and higher than inflationary power price increases, partly offset by an operating network contract claim settlement and continued operational efficiencies.

Net interest payable

Net interest payable of £423.2m (2011: £398.3m) increased by £24.9m (6.3%) principally reflecting the higher internal interest payable due to the increase in net debt.

Underlying profit before tax

Underlying profit before tax has reduced by £26.3m (12.6%) to £182.2m (2011: £208.5m). This reduction is due to the increase in operating costs, increase in depreciation and Infrastructure Renewals Charge and interest costs as a result of substantial investment in the network of pipes, sewers and other facilities offset by increase in turnover described above.

Capital expenditure

2012 has been a successful year for the delivery of capital investment by the Company, for the second year of AMP5, with over £1bn was invested in delivering all of its capital regulatory outputs, whilst delivering efficiencies of over £80.0m against its five year business plan. The Company is on track to deliver its required investment programme of £4.9bn over this regulatory period.

Treasury policy

The Company's treasury operations are managed centrally by a small specialist team, which operates with the delegated authority of, and under policies approved by, the Board of Directors. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. The key objectives of the funding strategy are defined by the regulatory regime within which the Company operates and are intended to ensure that it meets all funding related requirements under the terms of its Licence. This includes maintaining cash reserves and access to undrawn committed bank facilities sufficient to fund at least 12 months net cash flow (as discussed on page 32 - Company dividend policy - extends this to a 15 month period) and to maintain an investment grade credit rating (see "Debt financing" section below) as set out in Condition F of the Licence.

A key objective of treasury policy is to ensure compliance with financial covenants, including interest cover and gearing ratios, maintain liquidity and a balanced debt maturity profile, and ensure that at least 85% of the interest cost within the Securitisation Group, (being Thames Water Utilities Holdings Limited, the Company, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited) is based on either fixed or RPI-linked interest rates.

Chief Executive Officer's Business review (continued)

Financial risk management

The Company's Executive Team ("the Executive"), receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The operation of the Treasury function is governed by policies and procedures, which set out guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk, interest rate risk and exchange rate risk.

Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk arising from the primary financial instruments used to finance the Company's activities. Matching of assets and liabilities in foreign currencies is also applied wherever practicable. The Company actively maintains a broad portfolio of debt, diversified by source and maturity and designed to ensure the Company has sufficient available funds for operations.

The Company is exposed to commodity price risk, especially energy price risk, as a result of its operations. The Company aims to manage its risk by fixing contract prices where possible.

Financing

The Company had committed facilities in place with a syndicate of relationship banks to the value of £1,200.0m; all of which were undrawn at 31 March 2012. In addition, due to pre-funding activity undertaken in the final quarter of the year, the Company had £622.1m of cash and current asset investment as at 31 March 2012, consisting of cash at bank, short-term deposits with highly rated banks or triple A rated money market funds. This balance together with the undrawn facilities, will provide the Company with the necessary liquidity to fund the operation of the business for at least the next fifteen months.

Debt financing

Debt financing is raised by the Company or through the Company's wholly owned subsidiary, Thames Water Utilities Cayman Finance Limited. Previously, debt had been raised through Thames Water Utilities Finance Limited, another wholly owned subsidiary.

Moody's Investor Service ("Moody's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited, A3 long term with stable outlook and Class B.debt at Baa3 with stable outlook. Moody's also issues a Corporate Family Rating for the Securitisation Group of companies, which stands at Baa1, with stable outlook. Standard and Poor's Rating Services ("Standard and Poor's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited at A- and Class B debt at BBB. Accordingly, the Company maintains an investment grade issuer credit rating in accordance with the requirements of its Licence.

Capital structure

Key features of the Company's capital structure are as follows:·

- All debt issued by the Securitisation Group is documented pursuant to a Common Terms Agreement as part of the Whole Business Securitisation entered into in August 2007.

- Net debt issued by the Securitisation Group Class A ratio of net debt to RCV is limited to 75%.

Chief Executive Officer's Business review (continued)

Capital structure (continued)

- Since 1 April 2010, the Company and the Securitisation Group has the option to issue Subordinated Debt ("Class B"). At the same time, there is an increase in the combined Class A and Class B (together "Senior") net Debt/RCV ratio to a maximum of 85%.

- Each Obligor (the companies within the Securitisation Group) had entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited guarantees the obligations of each other Obligor under the finance documents and the Company and its wholly owned subsidiaries guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

- Following an event of default, the documents provide for an automatic 18 month standstill of the claims of the creditors that have entered into the STID.

Insurance

The Company maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors & Officer liability cover.

The insurance coverage has been reviewed and approved by an independent insurance adviser retained to ensure that the Company's insurances;

- are consistent with Good Industry Practice;
- have regard to the risk being covered;
- address the interests of the Company.

Covenant compliance

Under the terms of its finance documents, the Company is required to comply with various covenants such as interest cover and net debt to RCV. These covenants are measured and submitted to the Security Trustee semi-annually and involve both actual data and forecasts. The two main ratios are discussed further below:

Senior adjusted Interest cover ratio (trigger: 1.3x)[5]: For the year to 31 March 2012 the ratio was 1.4x (2011: 2.1x). The movement in the year is partly due to class B debt issuance of £850.0m raised through the Company's subsidiary Thames Water Utilities Cayman Finance Limited.

Whilst actual interest cover has moved closer to the trigger, the Company is satisfied that a trigger will not occur. This is due to the high proportion of the Company's debt being fixed and the certainty and stability of the Company's operating cash flows for 2012/2013, as the income stream has already been determined and the predictable nature of the operating cost cash flows.

Senior Debt/RCV ratio (trigger: 85%)[6]: At 31 March 2012 the ratio was 78.3% (2011: 77.4%). The movement is attributable to the class B debt issuance highlighted above.

There are other variations on these ratios on class A and Senior Debt, which the Company is also required to calculate to show compliance with its covenants. The Company is compliant with these ratios as at 31 March 2012 and is forecast to remain compliant.

[5] A trigger event would lead to lock up which would mean nil distributions outside of the Securitisation Group until resolved to the Security Trustee's satisfaction. Adjusted Interest Cover Ratio is calculated as operating cashflow adjusted for expenditure on depreciation and infrastructure renewals divided by interest paid.

[6] A trigger event would lead to lock up which would mean nil distributions outside of the Securitisation Group until resolved to the Security Trustee's satisfaction.

Thames Water Utilities Limited

Chief Executive Officer's Business review (continued)

Key performance indicators ("KPI's")

Ofwat, in removing the requirement for Water and Sewerage companies ("WaSc") and Water only companies ("WOC") to submit an annual return ("the June Return") to them, they have introduced certain KPI's, which they have developed in consultation with WaSc and WOC.

The table below shows the Company's performance against these KPI's in accordance with the guidance received from Ofwat which require the Company to disclose;

- status (red, amber or green, where indicated);
- unit of measurement;
- actual value

KPI Dashboard

Customer experience			
SIM	62.61		Score
Internal sewer flooding	See note below		Nr of Incidents
Interruptions	0.21		Hours per total properties served
Reliability and availability			
Serviceability water non-infrastructure	Stable		
Serviceability water infrastructure	Stable		
Serviceability sewerage non-infrastructure	Stable		
Serviceability sewerage infrastructure	Stable		
Leakage	637.14		Ml/day
Security of Supply Index (SoSI)	100		Index score
Environmental impact			
Greenhouse gas emissions	741		ktCO2e
	All incidents	Exc consent compliant *	
Pollution incidents (sewerage)	3.78	2.75	Category 1-3 incidents per 1,000 km of sewer
Serious pollution incidents (sewerage)	2.93	2.20	Category 1-2 incidents / 10,000 km of sewer
Pollution incidents (water)	3.17	2.86	Category 1-3 incidents / 10,000 km of main
Discharge permit compliance	99.71%		%
Satisfactory sludge disposal	100%		%
Financial			
Post-tax return on capital	6.34		%
Credit rating	A3		Moody's - Class A debt
	Baa3		Moody's - Class B debt
	Baa1		Moody's - Corporate Family rating
	A-		S&P - Class A debt
	BBB		S&P - Class B debt
Gearing	78.30%		%
Interest cover	1.4		x

Internal sewer flooding is a new metric and the calculation is being finalised in advance of Ofwat's submission deadline for the new KPI dashboard of 15 July 2012.

Chief Executive Officer's Business review (continued)

Key non-financial measures

In addition to the above, the table below shows the Company's performance against its key non-financial measures, which with two exceptions were achieved.

Target area	Target 2011/12	Performance 2011/12	Target achieved
Corporate responsibility programme			
Business in the Community Corporate Responsibility Index	Platinum (>95 per cent)	Platinum (>95%)	✓
Water			
Drinking water quality compliance	99.98%	99.98%	✓
Security of supply (annual average)	100	100	✓
Leakage (Ml/d)	673	637	✓
Properties receiving low pressure	34	3	✓
Wastewater			
Sewage treatment works compliance (LUT)	100%	100%	✓
Properties alleviated from external and internal sewer flooding	-	84 *	Target is to achieve 2,488 by 2015
Serious or significant pollution incidents	Zero	20	×
Satisfactory disposal of sewage sludge	100%	100%	✓
Our wider responsibilities			
Renewable energy generation	197 GWh	176 GWh	×
Health and safety – number of accidents per 1,000 employees	5.37	3.12	✓
Employee volunteering – employees volunteering in schools, the community or charities	15%	18%	✓
Sites of Special Scientific Interest (SSSI) in favourable and unfavourable recovering condition	95%	100%	✓
Suppliers, contractors, and service providers' invoices paid according to agreed terms and conditions (+/- 3 day tolerance)	85%	92%	✓

* Provisional.

Chief Executive Officer's Business review (continued)

Key performance measures - highlights

Below is a summary of some of the key changes in the business that the Company has used to drive its improvement against targets.

Water Service and Environmental Performance

- Between 2005 and 2012, the Company has reduced leakage by 26%. A number of measures have helped to achieve this reduction; replacing old pipes including Victorian mains, trunk main replacement, and water pressure management as well as the Company's new Trunk Minder system as mentioned below. The Company has now met the annual leakage target agreed with Ofwat for the last six years.

- The Company's new Trunk Minder system was introduced to identify a hidden underground leak as soon as it forms, allowing the Company to schedule a repair before a leak has time to wash away the ground around the trunk main and cause a major leak.

- The Company's drinking water quality performance remains high at 99.98% compliance, an improvement on the prior year. Whilst the Company aims to achieve 100% compliance, many of the failures recorded at customers' taps are caused by the condition or maintenance of customers' pipework and fittings. To that extent, 100% compliance is not within the control of the Company. However, the Company will continue to strive to achieve this aim.

- Water efficiency has been a focus of the Company in its campaign to encourage customers to use water wisely. During the last year as a result customers have helped to achieve a daily saving of 6 Mld (2011: 5 Mld).

Sewerage Service and Environmental Performance

- During this year, the Company has increased the capacity of some of its STW's to treat wastewater from an additional 61,000 customers. This increase means that the Company can deal with new housing development for years to come without having to make further investment or seek delays to the building of these houses.

- Reducing the risk of sewer flooding is of the highest importance to both the Company and its customers. In the year, 45* properties were affected by sewer flooding for the first time. The number of properties on the Company's high risk register was 1,529*, an increase of three from the previous year. The Company's investment programme resolved the flooding of 60* properties and the Company will continue to offer flooding mitigation measures to alleviate this most distressing experience.

- The Company again achieved 100% compliance with the EA standards on treated effluent across all of its 350 treatment works.

  * Provisional.

Chief Executive Officer's Business review (continued)

Key performance measures – highlights (continued)

Sewerage Service and Environmental Performance (continued)

- During the year, the Company dealt with 71,050 incidents of sewer blockages including 14,946 across the lengths of private sewers it adopted in October 2011. The Company recognises that this is not the level of performance that it expects to deliver, and is not in line with the Company's plan to reduce the number of these incidents by 2015. The Company aims to improve its performance through the use of new technology such as real time sewer monitors and targeted sewer inspection and maintenance.

- The Company recognises that the environmental damage and public nuisance caused by spillages from its sewer network is unacceptable and works hard to prevent them. The EA categorises pollution incidents on a scale from one (the most serious) to four (no significant environmental impact). In the period, there were 20 incidents that were categorised as Category 1 or 2 by the EA. Clearly, this level is unacceptable and the Company is working hard to improve its performance.

Security of Supply

- The Company has delivered 100% Security of Supply to all its customers.

Customer Service

- Along with other water companies, the Company provides information to Ofwat on the number of complaints it receives, and how well they have been handled. The Company also proactively carries out its own customer satisfaction surveys to gauge where it is performing well and to give the Company an insight into the areas where its customers think that it can do better. Generally customers were more satisfied with the Company's services than the previous year.

- The Company's Customer Assistance Fund provides support for customers who genuinely cannot pay their bills. During the year the fund made donations totalling £1.8m (2011: £1.9m). In addition, £0.3m was provided for exceptional hardship cases and grants were made to nine specialist advice organisations including Citizens Advice to pay for specialist debt advisors.

- The Company has made improvements to its telephony system to make it easier for customers who would prefer to talk to a customer advisor. The Company has also provided a call back facility for customers who do not want to wait in the line during peak call times.

Health and Safety

The Company continues to have a key focus on health and safety. It has developed its 'one-safety hub', a shared facility enabling the Company and its contractors to share best practice in health and safety. In the year, the Company has also reviewed and enhanced its health and safety systems and held further health and safety conferences for the Company's employees and its contractors.

The number of reportable accidents fell to an Accident Incident Rate ("AIR") of 0.33 injuries per 1,000 employees, (2011: 0.50) across the business, a 48% improvement since the start of AMP5.

However, it is with regret that the Company has to report that two employees of its contractors suffered fatal injuries in two separate incidents. The first of these occurred in June 2011 where the contractor was working in an excavation and the Health and Safety Executive are carrying out a full investigation. The second occurred in October 2011, where the contractor was struck by a vehicle when working in a roadway, a driver was charged and convicted of dangerous driving and was sentenced to time in prison.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties

Risk overview

The Company's Risk Management process is integrated within the business, and is designed both to identify emerging risks and to minimise the adverse impact of emerging and existing risks. Each business area is responsible for managing its risks and maintaining a risk register. Significant risks are escalated and reviewed by the Executive and the process is overseen by the Audit & Risk Review Committee ("ARRC"). For more information regarding the role and responsibilities of the ARRC, see pages 56 and 57 of the Corporate governance report.

The Company is exposed to a number of risks and uncertainties that could have a material impact on its long-term performance. These include:

- **Delivery of the Thames Tunnel** – As an innovative solution to the challenge of reducing sewage discharges into the Thames, the design and construction of the Thames Tunnel present a number of major technical and logistical challenges. These include the need to secure a number of construction sites in central London, obtaining planning consents via the process for major projects set out in the Planning Act 2008 and managing the inevitable disruption. As well as the many stakeholder issues, a key challenge is to finance the project, and protect the Company's credit rating. The Government has indicated that it will provide support for the exceptional construction risks involved in the project, but the details of this support and the residual risk to the Company have yet to be resolved.

  Mitigation: The Company is working closely with the Government to agree the funding model and the appropriate organisational structure to deliver and operate the tunnel.

- **Price Review 14 ("PR14") determination** – All UK water and sewerage companies must justify the operating costs and capital investment needed to deliver service to customers in the five-year period from April 2015. Failure to demonstrate the Company's case to Ofwat's satisfaction may mean that it is unable to invest in asset improvements that the Company believes will benefit its customers in the long term or to finance its business plans.

  Mitigation: The Company has assembled a dedicated team to oversee the production of the plan, building on experience gained during previous Price Reviews.

- **Managing increased competition in the water industry** - The Water White Paper issued in December 2011 has signaled plans to implement market competition for business customers, while at the same time providing assurances that the sector needs to remain attractive to investors. The extent and timing of changes remains uncertain. The initial impact will largely be for large users, although there will also be opportunities for the provision of wholesale services.

  Mitigation: The Company is preparing for these changes with a view to taking advantage of the opportunities, and this may require structural change.

- **Employee pension scheme funding** – The Company operates two material defined benefit pension schemes. Whilst the Company has reduced its future exposure by closing the final salary schemes to new entrants, and moving a number of senior employees onto a defined contribution scheme, the Company remains liable for the historic rights earned by past and present employees. Both schemes are currently in deficit on a Gilts valuation basis, whilst agreed deficit repair plans are in place, there is a risk that actuarial assumptions on investment returns or longevity could change and cause increased employer contributions.

  Mitigation: The Company will continue to review investment strategy with the trustee in order to ensure that funding risks are understood and managed.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

- **Failure to maintain adequate funding arrangements** – As at 31 March 2012, the Company has adequate cash at bank and short term deposits of £622.1m (2011: £779.4m) and undrawn committed bank facilities of £1,200.0m (2011: £1,175.0m) in place to provide liquidity as required. The Company will need to renew £450.0m of 364 day committed facilities by August 2012. There remains a risk that credit market conditions will deteriorate against the backdrop of weak economic recovery and falling credit ratings of financial institutions, increasing the cost of raising new debt and refinancing bank facilities. As a regulated utility, the Company does not anticipate a situation where it will be unable to access financing as it would benefit from a flight to quality in poor debt conditions. An increase in the cost of funds may put pressure on key financial covenants (as defined by the Company's capital structure). In addition the impact of a falling RPI rate on the RCV could create further pressure on financial covenant headroom, specifically the ratio of net debt to RCV.

  Mitigation: The Company has an established funding strategy which is reviewed by the Board annually.

- **Customer experience measures** – The measure for customer performance is evolving from quantitative to qualitative criteria. All water companies will need to adapt their processes in order to optimise performance against these new criteria to be measured against Ofwat's SIM. Failure to meet the SIM target for the Company over the remaining years of this regulatory period could lead to a financial penalty in the next regulatory period.

  Mitigation: The Company is working closely with Ofwat to shape the future reporting requirements, and is reviewing internal processes to improve end-to-end customer service.

- **AMP4 sewer flooding programme** – The Company has responded to an information request from Ofwat issued under section 203 of the "Water Industry Act 1991" concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The information requested relates to the level of evidence required to support a judgment that a property is likely to have flooded in the past. Ofwat's investigation into whether the Company complied with the relevant guidance continues and is unlikely to conclude its investigations until at least the third quarter of 2012. If Ofwat concludes the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs which Ofwat determines have not been achieved during the AMP4 period.

  Mitigation: The Company has provided all the information that has been requested to support the numbers claimed and has met with Ofwat on several occasions to discuss their concerns. The Company awaits the conclusion of Ofwat's investigation.

- **Credit rating** – Regulated water and sewerage utilities benefit from strong investment grade credit ratings based on a large asset base, predictable returns and a stable regulatory environment. This could be adversely impacted by Ofwat proposals to amend licence conditions and its further proposals for regulatory reform. The Company's credit rating could also be negatively affected by an agreement on the delivery model for the Thames Tunnel project that exposes the Company to a level of risk beyond that normally associated with a regulated water and sewerage utility company, or by an obligation to deliver a further large capital programme in the next regulatory period ("AMP6"). A downgrade in credit rating would increase borrowing costs and reduce access to long-term debt markets, putting at risk the ability to meet financial covenants. This would therefore increase the likelihood of hitting a "trigger event" under the terms of the whole business securitisation, an event that would lead to a distribution lock up.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

Mitigation: The Company is working to ensure that its Price Review preparations, Thames Tunnel plans and other significant business changes take account of the impact on the credit rating.

- **Drought** – The Thames catchment area has experienced the driest two-year period in recorded history, leading to a temporary use ban to conserve remaining water supplies. Heavy rain during April has alleviated the immediate crisis, but ground water levels remain very low and a further dry winter may cause a more severe drought in 2013.

Mitigation: The Company is managing the drought as a priority operational event. It has mobilised a team that draws on experience across the business. This team is headed by a member of the Executive.

- **The London 2012 games** – London will host the Olympic and Paralympic Games from 27 July 2012. Any operational interruption would cause significant disruption and, with the media present, damage the Company's reputation. Meeting the additional demand for water during a drought will provide further operational challenges.

Mitigation: The Company has worked continuously with the London Organising Committee of the Olympic Games ("LOCOG"), to provide the agreed infrastructure and ensure that it is ready operationally. Operational and communications plans are already in place.

- **Failure to meet regulatory targets** – The Company is required to meet targets set by Ofwat, the EA, the Drinking Water Inspectorate and other regulators. In order to achieve this, the Company must continue to deliver cost and efficiency savings in line with a challenging Final Determination, while maintaining and improving operational performance and the standard of customer service.

Mitigation: Performance against regulatory measures is the subject of regular management review. The new reporting mechanism allows the Company to further align internal and external performance indicators.

- **The effects of climate change and long-term changes in weather patterns** – As the Company continues to supply an increasing population, the effects of climate change could adversely affect its ability to maintain its Security of Supply Index (SoSI) requirements.

Mitigation: The Company has been working on measures to reduce demand, mounting a widespread awareness campaigns and providing free water saving devices, as well as making provision for new sources of potable water and improving the integrity of its network. Together with other water companies and regulators, the Company is actively participating in work to identify the wider water resources needs across South East England.

- **Future changes in laws or regulations** – The Company is not funded by Ofwat for changes in obligations that would affect the whole economy. Consequently the Company may, for example, have to meet the obligations resulting from changes in environmental legislation without recourse to Ofwat.

Mitigation: Changes that are specific to, or are more material for, the water industry may be funded by Ofwat as a relevant change of circumstance. The Company engages actively with regulators where a change is likely, to ensure the implications are understood, and monitors the impact of recent changes to ensure it can demonstrate the case for additional funding where it is justified.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

- **Failure of a major asset** – A failure at one of the Company's major assets could significantly impact the safety of its workforce and the public, as well as interrupting supply to customers and breaching environmental and regulatory targets. The impact would be both financial and reputational.

  Mitigation: The Company has a specific compliance process to manage each of the identified risks.

- **Impact of low inflation or deflation** – In return for their capital investment in assets, regulated water companies earn a return on their RCV, which is adjusted by the RPI. In times of low inflation or deflation, the return on this investment will decrease relative to the cost of funding, reducing cash flow and shareholder value.

  Mitigation: In order to protect the Company from these impacts, around half of the Company's debt is indexed to RPI, either directly in the underlying debt instrument, or by use of RPI swaps.

Transforming Thames

The Transforming Thames programme has continued, with the focus on improving customer service, improving the Company's health and safety performance, enhancing its data and the way it is used to make business decisions and driving operational efficiency.

Key efficiency projects have moved to the delivery phase. This includes the WAMI programme, which began phased deployment in November 2011. This programme is implementing a fully integrated work and asset management approach across the business, using a SAP platform, to drive a more effective and efficient service for customers. Rollout to circa 4,000 users will continue through 2012. The benefits from this project include better data capture at source enabling better business decisions, improved customer diagnostics enabling first time resolution and more efficient work planning enabling better productivity in the field. Overall, this will enable an improved customer experience.

New working patterns and associated terms and conditions have been negotiated for all field-based operatives, better allowing the Company to meet customer demand and map resources to those demand patterns. These new working patterns were implemented on 1 April 2012.

The Customer Service improvement programme has been developed based around the principle of 10 key aspirational promises for customers. This, when delivered, will enable the Company's performance to be successfully measured by SIM.

All managers in the field continue to be supported by Change Managers, who are experienced in the sustainable delivery of business change. They provide coaching support to teams, ensuring that the transformation programme is understood, employees are fully engaged in the process and that the appropriate measures are developed to track progress and success.

Following extensive consultation with employees and with the agreement of the pension fund trustees the Company has changed certain provisions in respect of the Thames Water Pension Scheme ("TWPS") for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011, new employees of the Company have been offered participation in the Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life Assurance Limited ("Standard Life"). All senior managers have now moved to this scheme.

Chief Executive Officer's Business review (continued)

Transforming Thames (continued)

For existing members of the TWPS, certain provisions have changed that will affect future benefits to its members. Principally, the defined benefit provision with effect from 1 May 2011 will be on a CARE basis and no longer on a Final Salary basis.

The Company has demonstrated continuing improvement, whilst implementing the transformation programme, in both operational and financial performance, thus providing a strong platform for the future.

Looking further ahead

It is over 20 years since the water industry was privatised. Since then much has changed - costs of service are lower, performance is better and the industry has delivered significant quality improvements. However, with the Company continuing to face challenges including climate change, population growth and new quality improvements, to name a few. The industry and the Company must ensure they can meet these challenges, including the immediate demands of dealing with a drought.

The regulation of the sector going forward will be critical to its ability to meet the challenges of the future.

There is increasing clarity. In November 2011 Ofwat published early proposals for its PR14 and in December 2011, the Government published its long awaited Water White Paper and moved to expand the existing business retail market. During 2012, the Company expects Ofwat to further refine its approach to PR14 and Government to publish a draft water bill, primarily focused on enabling a retail market for all business customers.

Looking further ahead, the Company will need to be flexible and ready for any change to the regulatory environment. However, through this period of change there are some constant underlying requirements. The Company will need to ensure that;

- high performance is maintained and it capitalises on opportunities for further improvements;
- it delivers what customers want at the right price, in the right place and at the right time;
- it offers value for money at an affordable price.

A key challenge in this process will be the delivery of the proposed Thames Tunnel. The Company is working closely with all stakeholders to ensure this is delivered by the most appropriate means possible.

The Company is always looking ahead to understand the future environment and ensuring that it takes the right actions today to protect the future.

Strategic Direction Statement

In 2007, the Company published a Strategic Direction Statement setting out priorities for the next 25 years. As part of its strategic business planning, the Company is working to review and update its long term plans, building on the wants and needs of customers and challenges as diverse as future population growth and climate change.

Water resources and Drought

In August 2009, Department for Environment, Food and Rural Affairs ("Defra") called for a public inquiry into the Company's draft 25 year Water Resources Management Plan. The inquiry completed in August 2010 and the Inspector's report recommended additional work in a number of areas including the assessment of long-term solutions for supply security.

Chief Executive Officer's Business review (continued)

Looking further ahead (continued)

Water resources and Drought (continued)

Defra issued instructions to the Company to complete the plan in line with the Inspector's report and advice from the EA. This work has now been completed and the Company has consulted further on its plan. No significant issues have been raised and The Secretary of State is now considering the Final Plan and will make a decision in 2012, following advice from the EA.

Following the driest two years since records began, the Company, along with six other companies in the South East of England, gave notice to customers on 12 March 2012 of a temporary water use ban. From 5 April 2012, it was prohibited to draw water through a hosepipe or similar equipment, or fill or maintain a domestic swimming pool, paddling pool or ornamental fountain. The Company will continue to closely monitor the situation over the coming months and further drought management measures may be required to secure supply. The impact of a third successive dry winter cannot be discounted and, should this arise, it will have an impact of the Company's management of its water resources.

The Government's Water White Paper drew attention to the future threats to the security of water supplies. As part of a response to this threat they propose to reform the abstraction regime and anticipate a new regime in place by no earlier than 2020. In the medium term it is encouraging Ofwat and the EA to consider incentives for companies to improve the sustainability of their water abstraction in a sustainable manner.

Transfer of private sewers

On 1 July 2011, the "Water Industry Schemes for Adoptions of Private Sewers 2011" came into force, whereby all privately owned sewers and lateral drains built before 1 July 2011 and connected to an existing public sewer became the responsibility of sewerage undertakers with effect from 1 October 2011.

As a result, approximately 40,000 km of privately owned sewers and lateral drains were transferred on 1 October 2011 to the Company, an increase of 60% in the sewer network for which the Company is now responsible.

A second transfer scheme for those privately owned sewers built after 1 July 2011 was originally scheduled for April 2012, but has been postponed with a new date to be agreed. Private pumping stations connected to the transferred pipework will transfer between 1 October 2011 and 1 October 2016. The Company is currently drawing up its programme for progressive adoption over this five year period.

At PR09, Ofwat did not fund companies for the costs of the private sewers or pumping stations transfer. Instead, the Company will be examining the case for submitting an Interim Determination of K ("IDoK") application to Ofwat before September 2013 to enable it to recover the additional costs incurred.

Business Retail Competition

Currently only 30,000 of approximately 1.2m business customers in England and Wales have a choice of retail supplier. In Scotland all business customers have had a choice since 2008. The Government's 2011 Water White Paper proposed to introduce a draft bill in 2012 to bring about choice in England for all business customers. There is currently however no timetable for this change.

The Paper ruled out mandatory legal separation of companies' retail functions and the expansion of retail competition to households. However, companies will be expected to demonstrate arms length dealing with their retail arms and Ofwat has powers to enforce non-discrimination including powers to refer companies to the Competition Commission for structural remedies.

Chief Executive Officer's Business review (continued)

Looking further ahead (continued)

Affordability and recession

The Company currently has the second lowest combined bill out of the Water and Sewerage Companies ("WaSCs"). However, the Company also has the highest proportion of income deprived households. In the last ten years industry bad debt levels have risen by 10% per annum, which may be illustrative of a rise in affordability issues and recession. In addition, specific future bill increases for projects such as the Thames Tunnel will have an impact on customer's ability to pay. Ensuring that the Company invests only where it has its customers support will be necessary to keep bills as low as possible.

Relationships and resources

Employees

This financial year has been challenging, with the largest ever five year capital investment programme being in its second year, continued transformation of the Company's business processes and the challenge of a potential drought combined with preparation for the London 2012 games. The Company's employees have continued to demonstrate high commitment and increased engagement levels throughout the year, supported by the "Passionate About People" strategy.

This strategy was updated in 2011 in line with business requirements to give an increased focus on supporting the organisational change and transformation across the Company, alongside getting the best out of its people by giving them the right support and development. The implementation of the Company's 'Passionate About People' approach continues to engender a positive working environment, which focuses on performance, contribution and values diversity and inclusion.

Overall staff turnover in the current year was 7.95%, reducing from 9.58% in the previous year.

The Company's sickness rate during the year was 2.53% (2011: 2.75%). The Company has an attendance management policy in place with the overall aim of reducing and managing sickness absence and, in particular, long term sickness.

The Company is committed to effective talent management and runs regular Talking Talent reviews to assess performance and potential across the Company. These reviews support effective learning and development interventions and focus on ensuring the Company has the future talent to deliver its business strategy. The Company continues to invest in its core leadership development programmes, future talent pipeline programmes (including apprentices and graduates) and to develop the technical and business skills of its employees.

During this year, the following key people initiatives have been delivered to support the business strategy;

- development and negotiation of working patterns, terms and conditions changes to ensure they are modern, meet the needs of the customer and the business and are in line with the market;
- development of an approach to career paths to ensure that technical roles are identified, have a clear path through the organisation and are appropriately awarded;
- recruitment routes to market and career pages developed to drive employer brand ensuring that the Company is an employer of choice;
- implementation of procedure changes for legislative updates including agency workers regulations, abolition of the normal retirement age and new paternity rights;
- support for occupational health to improve management of long term absence and to develop a strategy to deal with stress;
- the continued focus on employee engagement across the Company, resulting in a year on year increase in employee engagement, as measured through its annual employee survey;

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Employees (continued)

- new intakes to the Company's Graduate, Apprentice and Bursary future talent pipeline programmes;
- continued roll out of the Company's core "Foundation, Advanced and Strategic Leadership development" programmes;
- Continued Performance and Development reviews for all employees linked to the annual pay review;
- people plans for all areas of the business.

The Company is committed to the training and development of all of its employees who undertook 14,301 (2011: 12,355) formal training days in 2012. These figures exclude WAMI training, sponsorship for further and higher education, roadshows, conferences, NVQ coaching & assessment and Manager briefings.

Stakeholders

The continuation of work to determine the preferred route and sites for the Thames Tunnel was once again the focus of much of the Company's work with stakeholders. In addition to the second major round of public consultation on the project, the Company continued to attend community and residents' groups and public meetings, as well as arranging briefings with local authorities, Members of Parliament and other stakeholders. The Company also arranged interim customer consultation activities in advance of the start of the second phase of public consultation, where new sites had emerged since the first stage of the process.

The Company has continued to host the Thames Tunnel Forum, held approximately quarterly, to brief stakeholders on progress and seek their views on its proposals. This successful format is now also being used for the proposed Deephams STW Upgrade in North East London. The Company also contributed to the Thames Tunnel commission established by a group of London Councils for the purpose of reviewing the alternatives to our proposals for the Thames Tunnel and reported its findings on 31 October 2011.

In addition to one to one briefing with MPs on issues of local interest, the Company hosted a series of roundtable discussions with Parliamentarians and London Assembly Members, to outline its plans on strategic issues and seek their feedback on the Company's approach. Topics discussed included market reforms in the water industry and the management of water resources.

The Company hosted several visits for customers and stakeholders to its sites during the course of the year, providing opportunities for them to see the Company's work first hand, and to mark significant project milestones. These included hosting a visit for Defra's water quality department at the historic Abbey Mills pumping station in November 2011and an event to celebrate the lowering of the Lee Tunnel Boring Machine in December of that year.

The Company was also pleased to host two visits for Secretary of State for the Environment, Caroline Spelman MP. The first involved a review of the Company's innovation activities and a tour of the Lee Tunnel site and desalination plant at the Company's Beckton facility; while the second event was hosted to mark the opening of the Old Ford Water Treatment Works, constructed to provide wastewater treated to non-potable standards for irrigation and toilet flushing on the Olympic Park.

The Company played an active role in Parliamentary inquiries, submitting written evidence to the Environment, Food and Rural Affairs Select Committee's examination of the Government's water white paper, *Water for Life*, and giving oral evidence to a House of Lords EU Sub Committee inquiry into European water legislation. During the year representatives from the Company gave evidence to an Environment, Food and Rural Affairs ("EFRA") committee on the Wastewater National Policy statement.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Stakeholders (continued)

The last year has seen the Company play an increasingly active role in bringing together regulators and stakeholders to develop joint approaches to challenges such as urban drainage and water resources. The Company hosted a seminar and workshop in December to examine with stakeholders how to increase the uptake of sustainable drainage systems, and in March 2012 held the Company's inaugural quarterly Water Resource Forum, sharing a platform with Defra, Ofwat and the EA.

During 2012, the Company has also sought to influence public policy through its presence at seminars and conferences. A speech was delivered by a representative of the Company on water scarcity at October's *Water 2011* conference; while presentations by the Company on water resources and industry reform were made at the *Future of Utilities* event held in March 2012.

At a regional and local Government level, the Company continued to strengthen ties with the authorities it serves. At a pan-London level, the Company worked closely with the Greater London Authority ("GLA"), London Assembly and the Mayor on a variety of issues. This has included working with the Mayor on his streetworks Code of Conduct, and liaising with the Assembly's Environment Committee, hosting a visit for members to the Company's Beckton site and contributing to the Committee's work to determine priorities for 2013. The Company has also been active members of the GLA London Waterways' Commission established to oversee the navigable waterways in London.

At a local level, the Company worked closely with many of the 100 local authorities it serves across the region, seeking to ensure the Company's operational activities and investment projects were delivered with the minimum of disruption. The Company attended several formal Scrutiny and Public Meetings, giving evidence at meetings and responding to questions and feedback from councillors, officers and the public.

The Company has delivered a number of stakeholder training sessions for its directors and senior managers to ensure that there is a consistency of approach to external engagement.

Public consultations and research

The focus on public consultations work has again increased this year. The Company has a number of major projects either underway or proposed, which has led to its highest level of public consultation activity to date. The Company recognise that these major projects have an adverse impact on a large number of its stakeholders and customers and endeavour to ensure the Company's plans reflect their views where it is possible to do so.

The Company's approach to consultation includes independently-facilitated stakeholder workshops; individual discussions with MPs and other stakeholders, surveys, focus groups and independently-hosted online consultations.

The Company has committed to early proactive and transparent consultation on the Thames Tunnel. Consultation activities have followed best practice principles and have been carried out in accordance with the Government's "Code of Practice" and recommended best practice guidance.

The second phase of consultation on the proposed Thames Tunnel ran for 14 weeks from November 2011 to February 2012, and involved a greater level of detail than 2011's first phase. The feedback from the two phases is informing final proposals on the construction of the project, while providing an opportunity to address concerns about the potential adverse effects on local communities, businesses and the environment. A report on the second phase of consultation was published on 17 May 2012.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Public consultations and research (continued)

Other consultations this year included a consultation on the Company's revised Water Resources Management Plan 2009, which ran from December 2011 to January 2012. A programme of engagement with regulators and stakeholders for the Water Resources Management Plan 2014 is now well underway. Following research into customers' expectations during drought periods, the Company held a public consultation on its draft Drought Plan, from December 2011 to February 2012.

The Company is proposing a major upgrade to its Deephams STW, which serves approximately 900,000 people in North East London, to improve significantly the quality of the treated wastewater returned to the Salmon's Brook, a tributary to the River Lee. During 2011, a quarterly Stakeholder Forum was established to bring together key stakeholders to share information about the project and answer their questions and concerns, and to seek feedback on the Company's proposals.

A first phase of public consultation is planned for summer 2012 to examine the choice of preferred site and treatment technologies for the STW upgrade, as well as the other options that have been considered. A second phase of public consultation is planned in 2013.

The Company has also held deliberative workshops and focus groups with customers, at which it has provided background information on its work, in order to deepen their understanding of the business and help them to give more informed views. The topics covered have included the Company's approach to the PR14, drought, water efficiency, bill design, communications materials on the Thames Tunnel project, the transfer of private sewers to WaSc, research with business customers and customer strategy and brand and reputation research.

The Company's continuing commitment to customer engagement will help it understand the wants and needs of its customers and ensure it has (as far as possible) developed Company plans in accordance with their wishes. However, the Company needs to understand, and test, customers' views is growing all the time and is engaging with customers more in some of the strategic decisions the Company faces. In addition the Company is also seeking their views on elements of the Company's investment programme. With this in mind, the Company has regularly used its 2,000 strong customer panel to help it better understand its customers' needs and preferences.

The Company is a corporate member of the Consultation Institute and follow Cabinet Office best practice guidelines for consultation, aiming to make the process as open and transparent as possible.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Involving customers in price setting

A great deal of change has occurred this year following the publication in August 2011 of Ofwat's customer engagement policy statement: *Involving customers in price setting.* This document sets out Ofwat's approach to customer engagement in the price setting process ahead of the 2014 Price Review, and underlines the importance of customer support in determining the acceptability of companies' business plans. Specifically, it details a "three-tiered approach" to enable customers to engage in different ways and to influence the service they receive and the price they pay;

- "Direct, local engagement" to take account of customer views on local priorities and issues that could have a significant impact on the service customers receive;
- establishment of the Company's "customer challenge group" to consider evidence of direct customer engagement, and to ensure that the Company's plans reflect a balanced understanding of customer views;
- creation of a "customer advisory panel" by Ofwat to inform sector-wide assumptions such as the cost of capital, and provisions for pensions and energy.

The Company took full account of the direction and guidance within Ofwat's policy statement in developing its programme of customer engagement activities to inform the Company's strategy and business plan. The first phase of this programme began in September 2011 with a qualitative study of domestic and business customers to understand the relative priorities they placed on different elements of their service. This study was used to inform the development of a quantitative survey in November 2011, which explored the relative values customers placed on improvements or deteriorations to the levels of service they currently receive.

Further phases of research and engagement are ongoing and being planned for 2012 and 2013, and will be scrutinised by the newly formed Customer Challenge Group, (see below) ahead of their implementation, to inform the development of the Company's long term strategy and business plan.

The Company established its Customer Challenge Group – in line with Ofwat's policy statement – and the Group met for the first time in February 2012 and will meet throughout the period leading to the 2014 price review. The Group has an independent Chair and Vice Chair, and its members include industry regulators, domestic and business customer representatives and other key stakeholders. The role of the Group is to challenge the Company as it develops its customer engagement and research plans, and on the Company's interpretation of customers' views and how these have been reflected in its strategy and business plan. The Group will provide a report to Ofwat alongside the Company's business plan on its customer and stakeholder engagement process, and the content of its strategy and business plan.

Streetworks

The Company played an active role in developing new approaches to managing the impact of streetworks, responding to consultations on Lane Rental Regulations and Guidance published by the Department for Transport and Transport for London's Lane Rental Scheme consultation. The Company also participated in workshops facilitated by the Department for Transport and Transport for London to develop proposed Lane Rental schemes.

The Company sought to communicate its approach to streetworks with key stakeholders proactively. Prior to the start of the winter, during which the need to carry out leak repairs is at its greatest, highways authorities were approached to ensure a collaborative approach to tackling leakage and minimising disruption.

The drought has increased the need to ensure leaks are tackled quickly and efficiently, and highways authorities have been asked to, and have helpfully provided, support for the Company's work in this area.

Chief Executive Officer's Business review (continued)

Key suppliers and contractors

In 2012 the Company spent in excess of £1.1bn on construction, goods and services with a range of suppliers and contractors (2011: in excess of £1.4bn). Approximately 23 key suppliers (2011: 31) were engaged with a spend greater than £10m each. The Company's policy is to establish trading arrangements, which are made following an open non-discriminatory, competitive bidding process. Procurement processes reflect the Company's corporate responsibility commitments and, where applicable, comply with the requirements of the Utilities Contracts Regulations 2006 (as amended).

Research and development

The Company's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. Research and development deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP5 and also provide specialist technical support to the business. Expenditure on research and development totalled £3.9m for the year (2011: £3.4m).

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Energy efficiency and renewable energy

The Company is committed to reducing its contribution to the causes of climate change and its voluntary target is to achieve by 2015 a challenging 20% reduction in greenhouse gas ("GHG") emissions (compared to 1990 levels) for scope 1 and scope 2 emissions.[7]

The Company's total GHG emissions (Scope 1, 2 and 3) reported for 2012 were 746,000 tonnes (2011: 780,436 tonnes) of carbon emissions ("CO_2e"). The Company's approach to reporting GHG emissions is consistent with the Department of Energy and Climate Change ("Decc"), Defra guidance and Ofwat reporting requirements. During the year, the Company's reported emissions decreased, largely due to a reduction in imported electricity consumption. Coupled to this was a reduction in the Emission Factor ("EF") for grid electricity. This followed a change in the methodology that Defra used to calculate the EF which now accounts for imported electricity into the UK

Last year the Company consumed 1,171 Gigawatt hours ("GWh") of electricity, of which 166 GWh was renewable electricity generated at the Company's operational sites - around 14% of the Company's total electricity use. The Company produced 85 GWh of heat energy which displaced the need to consume natural gas. This generation of renewable electricity and heat helped reduce the Company's overall GHG emissions.

The Company continues to work hard to understand and reduce its carbon footprint. During 2012 it has;

- increased renewable energy generation capacity by 10.9 MW including 6 MW of biogas engines at Riverside STW, and 4.9 MW of photovoltaics (solar power) at 31 sites;
- increased metering of its gas and electricity use (covering 100% and 99.6% of use respectively) so that the Company can measure its energy consumption more accurately;
- started a programme to save 8 GWh in energy use by making air blowers (used in the sewage treatment process) more efficient;

[7] Scope 1 emissions are those direct emissions associated with the operation of the business. Scope 2 emissions are the indirect emissions associated with the consumption of grid electricity. However, this is reliant on the Government redefining grid emissions.

Chief Executive Officer's Business review (continued)

Energy efficiency and renewable energy (continued)

- prioritised the Company's pump efficiency programme on raw water pumps in light of drought conditions. These are pumps that take river water to supply its storage reservoirs;

- introduced an energy and carbon engagement programme for employees working at the Company's head office. Metering on each floor of the building allows detailed energy monitoring;

- installed a dryer at Slough STW, which dries the sewage sludge to produce a granule material that can be used as a renewable fuel;

- installed new lighting and motion sensors at 6 operational sites.

Looking to the future, there are a number of significant challenges facing the business in terms of reducing the Company's GHG emissions. The Company's activities are very closely linked to the weather. For example adverse conditions require the need to pump more water, and drought conditions force the use of water treatment by desalination. Both of these scenarios are electricity intensive – with the consequence of increased GHG emissions. Additional upward pressures on energy consumption and GHG emissions that the Company cannot control include new obligations (including the adoption of private sewers and the construction of the Tideway Tunnels) and population growth.

However, there are responses that the Company can influence, including energy efficiency, effective energy procurement and the generation of renewable energy. The Company therefore needs constantly to innovate in the management of its energy consumption and GHG emission to ensure they are kept as low as possible. However, changes in Government policy such as the Carbon Reduction Commitment becoming a tax rather than an incentivised cap and trade scheme, and proposed changes to the Feed-in Tariff Scheme have made effective planning and delivery much more difficult.

Social and community

Corporate Responsibility

The Company is committed to engaging positively with the communities it serves and to minimise the impact of its activities. The Company is pleased to report that it has been awarded a 'Platinum' ranking in the Business in the Community Corporate Responsibility Index, having undergone a rigorous reporting process across the Company's Corporate Responsibility and sustainability working practices.

Community Investment

The Company's updated strategy was approved by the Board and a brief version is available to view on the website http://www.thameswater.co.uk/cps/rde/xchg/corp/hs.xsl/8276.htm The strategy encompasses feedback from customer research and stakeholders that the core themes for activities should include environment and wildlife improvements, education, access to sites and charitable giving. Volunteering opportunities in respect of each of these themes are available. The Company also signed up to support Love Where You Live, a Keep Britain Tidy initiative looking after the local environment.

Open Days

A programme of Open Days on the Company's sites was delivered with events for visitors at Slough, Swindon and Maple Lodge STW's and Coppermills water treatment works. The Company also took part in London Open House where eight of its heritage sites were opened to the public. Around 1,600 customers and visitors took part in these events which included tours conducted by more than 100 Thames Water volunteer staff.

Chief Executive Officer's Business review (continued)

Social and community (continued)

Community Initiatives

The Creekside Education centre based on the Thames foreshore in Deptford was opened in May 2011 and has seen 3,735 students, community members and volunteers come and learn about both tidal ecology and key water messages.

The Company has committed to its adoption of Fobney Island, the Fobney Wetland Park along the River Kennet on the edge of Reading, Berkshire. The aim of the project was to provide £200,000 of financial support, technical expertise and employee volunteers. To date, the work has created seasonal wetland areas to reconnect the five hectares of floodplain on the island with the River Kennet. In March 2012, a rare Little Ringed Plover was spotted on the new wetland.

Another five students at the University of East London who are benefiting from the Company's Engineering Bursary completed their summer placements. The first two students who have been supported since 2009 are due to graduate this year.

The Company has started a new project "Sustainable Urban Drainage for schools" to install ten new urban wetlands in school grounds. The aim of the project is to educate students and the wider community on sustainable drainage and ecology, working with project partners the EA and Wildfowl and Wetlands Trust. The focus of the project will be Pymmes Brook, a tributary of the River Lee running through Enfield, Barnet and Haringey.

Working in partnership with the National Trust, the Company provided funding and technical expertise for the newly opened Living Green Centre within Morden Hall Park. The contribution was to provide key water efficiency messages and assist with the development of London's first Archimedes Screw on the weir, which will generate electricity for the Centre.

Education

The Company's educational facilities for school visits continue to take shape with the modular classrooms delivered to Didcot STW's and Slough STW's in January and February 2012 respectively. The classroom at Hogsmill STW's has been completed and the site tour route at Rye Meads sewerage treatment treatment works has been agreed. The first school visits to these new facilities are expected to take place in September 2012.

The Company continued to support the skills agenda by delivering talks and activities based around engineering, including two Network Challenge events in the London Boroughs of Hounslow and Southwark, and careers fairs across the region to educate young people about roles in the water industry.

Working with the London Tideway Tunnels Team, the Company signed up staff volunteers to deliver talks and promote a competition to 1,100 pupils at Newham primary schools to name the Lee Tunnel Boring Machine, which was lowered at the Lee Tunnel site at Beckton in December. Local schoolboy, Ryan Waters, from Maryland Primary School in Newham, won the competition to name the Boring Machine with his chosen name "Busy Lizzie".

Volunteer speakers from the Company continue to promote key messages around the water cycle, saving water and the responsible disposal of waste – promoting Bin It Don't Block It – through the popular Community Speaker Programme. During the last year 58 talks were given across the Company's region reaching a total audience of 6,258.

The programme was boosted in March with the Drought Speaker Programme, tackling the current drought situation. More than 90 employee volunteers came forward to deliver presentations and hand out leaflets to schools and community groups focusing on the drought.

Chief Executive Officer's Business review (continued)

Social and community (continued)

Employee engagement

The Company aims to provide a positive environment where its people are actively engaged and understand their role in the business so they can maximise their contribution.

To measure this, the Company runs an annual employee engagement survey, which gives staff the chance to confidentially provide their honest views on what it is like to work for Thames Water, their team and their manager. Called the Q12 survey, it is run by Gallup and is now in its sixth year.

The Company has seen a year-on-year improvement in employee engagement. This improvement comes against a backdrop of continued organisational change.

The Company intends to enhance the survey in June 2012 to measure staff's views on our customer service, leadership and health and safety.

Over the past year the percentage of staff who volunteered to help community projects was 18%, an increase of 50% on the previous year. The Company entitles each member of staff to two days volunteering leave per year, under its Time to Give scheme, to encourage participation in community, education and fundraising events.

The Company continues to work in partnership with local and regional organisations to promote environmental and community volunteering. Key events in the annual calendar include River Thames clean-ups, working with Thames 21, and the Thames Water-sponsored Reading RESCUE to tidy riverside and urban spaces in and around the town.

In addition, employee volunteers took part in team build projects to improve community spaces. Activities included coppicing and woodland management with Wiltshire Wildlife Trust, painting school halls and improving gardens and grounds at local charity and community organisations.

Charitable donations

Over the year the Company donated a total of £1,019,340 (2011: £723,576) to good causes through both the Charities Committee and direct donations, including the Company's principal charity, WaterAid. Over £700,000 of this amount is a continuation of the shareholders' commitment through the Company's Ten for Ten initiative made in 2009.

The Thames Water Charities Committee met quarterly to consider applications from external charitable organisations seeking funding and to authorise matched funding for employee fundraising. In 2012, the Committee donated £79,401 to 21 charities via grants which supported the Company's criteria of either "water and the environment" or '"water and health". An example of applications received is one from the Ahoy Centre to donate towards the purchase of two second hand Thames Cutter boats for use by local children and disabled rowers on the Thames in Deptford.

The Company's employees raised £99,718 (2011: £76,805) for various charities throughout the year which the Charities Committee matched funded with £89,401 (2011: £59,376).

Employees also participated in the Company's-promoted charity events to raise funds and awareness for local and national charities. A highlight was the support for Sport Relief in March 2012 where 149 staff took calls at the Company' offices in Reading and Swindon.

More than 100 guests attended the Company's annual Service of Remembrance at Ashford Common Water Treatment Works. An additional service was held at Mogden STW which included the rededication of the site's memorial garden. Charitable donations were made to the Royal British Legion and SSAFA (Soldiers, Sailors, Airmen and Families Association).

Chief Executive Officer's Business review (continued)

Social and community (continued)

WaterAid

The Company also continues to support its principal charity, WaterAid (www.wateraid.org) which celebrated its 30th birthday in 2011. Employees at all levels are involved through a variety of activities from fundraising to speaking to schools and community groups about the charity.

At a senior level, the Thames Water WaterAid Steering Committee, which sets fundraising targets and strategy each year, met regularly to review progress and recognise achievements. The Company is also pleased to report that in addition to the charitable donations listed above, over £600,000 was raised through corporate sponsorship for 2012 beating the fundraising target of £500,000. Half of this funding is for Thames 4 Bangladesh, a four year campaign aimed at helping four of the country's towns with improving their access to clean water and improving sanitation.

Martin Baggs
Chief Executive Officer
7 June 2012

Thames Water Utilities Limited

Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2012. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies.

Principal activities and likely future developments

The principal activities of the Company (Registered number: 02366661) are the supply of water and the collection and treatment of sewage, serving approximately 14m customers in London and the Thames Valley.

Business review

The information, which complies with the Operating and Financial Review ("OFR") requirements of the Companies Act 2006, can be found within the Chief Executive Officer's Business review on pages 6 to 31. The Company chose not to produce a voluntary OFR as these requirements are satisfied by the Chief Executive Officer's Business review. The Chief Executive Officer's Business review (which forms part of the Directors' report) comprises an analysis of the development and performance of the business and includes an assessment of future prospects, information about research and development activities; see page 27, details of important events that have occurred since 31 March 2012 and Key Performance Indicators ("KPIs"), see pages 8, 12 and 13.

Details of parent and subsidiary undertakings are given in notes 11 and 28 to the Financial statements, on page 82 and 98 respectively, and the Company has no branches outside the United Kingdom.

Results and dividends

The profit and loss account on page 61 gives the Company's financial results for the year.

The Company paid interim dividends totalling £279.5m during the year (2011: £271.4m).

The Company's dividend policy is:

- To pay a progressive dividend commensurate with the long-term returns and business performance, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants.

Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that:

- Sufficient liquidity is maintained to enable the business to meet its financial obligations for 15 months.

- Post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

The Board does not recommend a final dividend (2011: £nil), however, the Board has proposed further interim dividend's, see note 9, page 80.

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Thames Water Utilities Limited

Directors' report (continued)

Directors

Details of the directors who served from 1 April 2011 to the date of this report are shown below. The constitution of the Board is covered in more detail in the Company's Corporate governance report, which can be found on pages 53 to 58.

All Board members from 1 April 2011 to 31 March 2012 inclusive were non-executive directors ("NEDs") throughout the period, with the exception of Martin Baggs (Chief Executive Officer), Stephen Shine OBE (Chief Operating Officer) and Stuart Siddall (Chief Financial Officer) who replaced Mark Braithwaite as Chief Financial Officer on 20 September 2011 upon his resignation.

Directors serving from 1 April 2011 to the date of signing of this report are as follows:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
L F Abraira	4 August 2011	19 January 2012
M W Baggs		
E Beckley		
R Blomfield-Smith		21 November 2011
M W Braithwaite		20 September 2011
C R Deacon		
S R Eaves	20 January 2012	
Dame D M Hutton CBE		
G I W Parsons		
M J Pavia		
E C Richards		
A F C DeP Santos		4 August 2011
D J Shah OBE		
Y Shi	19 January 2012	
S F Shine OBE		30 March 2012
S J Siddall	20 September 2011	
M S W Stanley		
R Verrion		
L Webb	21 November 2011	

The following directors have formally appointed alternate directors to represent them when they are unavailable:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
S R Eaves	20 January 2012		M C Hill	20 January 2012	
G I W Parsons			E Beckley	11 November 2011	
A F C DeP Santos		4 August 2011	M C Guerreiro		4 August 2011
D J Shah OBE			L Webb		21 November 2011
			K Roseke	31 January 2012	
Y Shi	19 January 2012		F Sheng	29 February 2012	
R Verrion			S Kolenc		
L Webb	21 November 2011		C Pham	21 November 2011	

Material financial instruments

Financial risk management is covered on page 10 of the Chief Executive Officer's Business review.

Directors' report (continued)

Research and development activities

This has been covered in the Chief Executive Officer's Business review on page 27.

Employee involvement

The Chief Executive Officer ("CEO") and the Executive team hold quarterly management briefings with managers to provide the opportunity to discuss performance and how the Company can continue to move forward. Internal publications ("Management toolkit" and "The Source") provide ongoing support for the changes and transformation happening across the Company. This is in addition to the further improvement of the Company's corporate and local communication channels that deliver regular communication, information and updates to employees. Corporate channels include Company-wide Team Talk briefings, a weekly e-brief containing a message from the CEO, the Company's internal portal web pages and specific priority news updates and managers' key information.

Formal consultation with employees is undertaken in partnership with the recognised Trade Unions. Consultation with management level employees typically takes place on an individual basis, except in the case of changes that affect whole areas of the business. In these circumstances, consultation takes place on a Company-wide basis with employee representatives being elected for the relevant area.

All staff are involved in both the Company's employee engagement programme ("Q12") and annual Performance and Development Review ("PDR") process.

Each year the Company encourages all employees to participate in its annual employee engagement survey. In June 2011, the date of the last survey, 70% of the Company's employees participated and employee engagement improved again year on year. This programme also involves circa 100 volunteer employee engagement champions from around the Company who support making the Company a great place to work. It allows all employees to give their opinions and enables managers and teams to take action on key issues identified.

Corporate and Business Unit objectives are agreed by the Executive Team, communicated and cascaded through the Company and included in the annual PDR for all employees. In addition, relevant department and team objectives are cascaded and inform employees' personal objectives which, in turn, are agreed with each employee's manager and reviewed regularly. This process is intended to ensure that all employees are aligned to Company objectives and to ensure that all employees understand where they are adding value.

Employment of disabled persons

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. The Company has policies and procedures in place that aim to ensure that both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through disability and attendance management policies, support and development is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

Policy and practice on payment of creditors

The Company's policy is to pay all suppliers, contractors and service providers according to pre-agreed terms. During the year under review, the average amount due to trade creditors represented 60 days (2011: 63 days) purchases received from these creditors.

Directors' report (continued)

Market value of land and buildings

The directors have considered the market value of the group's land and buildings and are satisfied that their market value is not less than their net book value.

Political and charitable donations and expenditure

No political donations were made by the Company (2011: £nil). The Company made charitable donations totalling £1,019,340 (2011: £723,576). Details of these charitable donations are;

- £743,759 (2011: £316,807) to Ten for Ten projects, of which £512,121 went to various educational and recreational projects and £231,638 to the Thames Water Trust Fund for income deprived families;
- £118,680 (2011: £106,000) to the Charities Aid Foundation;
- £61,129 (2011: £58,021) to the Company's principal charity, WaterAid;
- £60,000 (2011: £60,000) to Thames 21, a range of charities which assist in cleaning rivers and streams within the Thames Valley;
- £35,772 (2011: £182,748) of other donations.

In addition, fund raising activities by employees and contractors raised £99,718, to which the Company added matched funding of £89,401 (included in the donations shown above).

Going concern

The directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements. Further information is set out in note 1 "Basis of preparation" on page 66.

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors and for the benefit of other persons who are directors of associated companies and these remain in force at the date of this report.

Thames Water Utilities Limited

Directors' report (continued)

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG Audit Plc will therefore continue in office.

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Martin Baggs
Chief Executive Officer

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

Statement of directors' responsibilities in respect of the Annual report and the financial statements

The directors are responsible for preparing the Annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently.

- Make judgements and estimates that are reasonable and prudent.

- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Thames Water Utilities Limited

Directors' remuneration report

The directors' remuneration report is unaudited as it is not a statutory requirement to do so. However, the Company provides this information in accordance with its regulatory licence.

In this section of the report the Company describes how the Chairman, Executive Directors and Non-Executive Directors are remunerated. The report discloses the total remuneration awarded for services to the Group, the element of this awarded for services to the Company and the element that relates to regulatory performance.

Compensation & Human Resources Committee

The Company operates a Compensation & Human Resources Committee ("the Committee") which broadly functions as both remuneration and a nomination committee. The Committee comprises four Non-Executive Directors, one of whom is independent, and is chaired by Sir Peter Mason KBE. The other members are Michael Pavia (independent Non-Executive Director), Martin Stanley and Christopher Deacon.

The Committee's responsibilities include, but are not limited to, making recommendations to the Board on the Company's executive remuneration policy and directors' terms of appointment. During the year, the Committee advised the Board of Directors and received advice and input from various Directors and specialist staff within the Company, including the CEO and the Director of Human Resources (both of whom are invited to attend from time to time). No individuals are involved in the determination of their own remuneration.

Activities of Compensation & Human Resources Committee

The Committee meets four times in each year in February, May, September and November. Recurrent remuneration matters are scheduled for the February and May meetings with Board sign off in June. Activities for the year were as follows:-

Meeting	Activities
February 2011	• Setting bonus plan for 2011/12
May 2011	• Reviewing performance against targets 2010/11 • Reviewing salaries for Senior Executives 2011
June 2011	• Board meeting to approve bonus payments 2010/11, payments made July 2011 • Board meeting to approve salary reviews for Senior Executives, increases effective July 2011
February 2012	• Setting bonus plans for 2012/13
May 2012	• Reviewing performance against targets 2011/12 and resulting payments to be made July 2012 • Reviewing salaries for Senior Executives 2012, increases effective July 2012
June 2012	• Board to approve pay and bonus payouts.

To ensure that the Company's remuneration practices are competitive, the Committee has access to detailed external research on market data and trends from PricewaterhouseCoopers LLP.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Remuneration policy

The Committee bases its decision-making with respect to remuneration policy on a number of underlying principles, which can be summarised as follows;

- arrangements should attract, retain, motivate and reward high calibre directors and executives;
- packages should be aligned with the interests of the Group's stakeholders, in particular its shareholders and its customers;
- packages should be commensurate with those provided by other companies of similar size and complexity, taking into account individual contribution and experience;
- policy should establish firm links between an executive's performance and remuneration and between the Group's performance and the executive's total remuneration;
- packages should include a mix of basic salary plus performance related incentives. Further detail is included within the bonus section on page 42 which indicates how Directors' pay is linked to standards of performance.

The Committee considers carefully the blend of remuneration linked to regulatory performance and remuneration linked to other performance measures in order to produce well balanced short-term and long-term incentive plans. These arrangements are designed to incentivise value creation and a high quality service to customers and are aligned with both the internal remuneration policy and external corporate governance requirements.

The Committee will continue to review arrangements regularly to ensure that they remain effective and appropriate to the Company's circumstances and prospects, and to monitor the level of potential awards.

Summary of remuneration and overview for the year to March 2012

The remuneration of the Executive Directors is linked to the performance of the Company and the Group and their own personal performance.

Since the acquisition of the Company by Kemble Water Holdings Limited in 2006 the Company's operational performance has improved significantly with tangible benefits that are important to its customers. This strong performance has been demonstrated again in 2011/12 with the achievement of the following operational results;

- delivering all of the Company's key regulatory outputs, ensuring that the condition of its assets is maintained;
- maintaining 100 per cent compliance with the EA's effluent consents at all 350 of our sewerage treatment treatment works for the fifth year in a row;
- delivering over £1bn of capital investment in its network and plants, including the Thames Tunnel, for the second year running;
- reducing leakage by 26 Mld to 639 Mld compared to last year and beat the target set by Ofwat for the year by 34 Mld;
- meeting stringent UK and European standards for the Company's drinking water quality at 99.98% which remains among the best in the country;
- continuing to reduce greenhouse gas omissions with CO_2 emissions 16% lower than two decades ago and generating 14% of our own power;
- continuing to improve health and safety with the number of reportable accidents falling to an Accident Incident Rate of 0.33 per 1,000 employees, a 48% improvement since the start of AMP5;
- adopting 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

The Company also undertook a number of significant change programmes to ensure that it continued to transform the business whilst providing an excellent and efficient service to its customers and delivering strong operational and financial performance.

Directors' remuneration report (continued)

Summary of remuneration and overview for the year to March 2012 (continued)

During the year the Company began implementing WAMI, enabling real time scheduling and workflow capabilities, alongside successfully implementing working patterns for 2,000 employees, improving flexibility to respond to the needs of customers and assets.

A summary of remuneration for 2011/12 is as follows;

- Stephen Shine, Chief Operating Officer (COO) received an increase in salary of 3%. No other Executive Director received a salary increase;
- annual bonus payments for the year 2011/12 reflected strong Company performance and delivery of key strategic initiatives. This resulted in total payouts relating to services to the Group of 87.7% of maximum for Martin Baggs, Chief Executive Officer (CEO), 90.2% of maximum for Stuart Siddall, Chief Financial Officer (CFO), and 87.7% of maximum for Stephen Shine, COO;
- payment of the 2008 Long Term Incentive Plan (LTIP) in July 2011 as a result of the cumulative Group financial results over the last three years with payment levels of 100% of salary for Stephen Shine, COO, and Mark Braithwaite, Former Chief Financial Officer (FCFO). A Long Term Incentive Plan is offered to ensure that Executive Directors are incentivised to deliver long term, sustainable performance over a period of several years and is separate from a bonus which rewards in-year performance. Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

There have been no significant changes to remuneration policy for 2012/13. Points to note for 2012/13 are as follows;

- reweighting of performance conditions in the annual bonus with greater focus on strategic and operational challenges and individual performance;
- toughening of financial performance measures and lower payments for achievement of targets;
- payment of the 2009 LTIP in July 2012 as a result of the cumulative Group financial results over the last two years with payouts of 68% and 49% of salary for Stephen Shine, COO, and Mark Braithwaite, FCFO, respectively.

There have been various changes to the board over 2011/12 as outlined in the Corporate governance report on pages 53 and 54. Changes to the Executive Directors were the departure of Stephen Shine, COO at the end of the year and Mark Braithwaite, FCFO on 20 September 2011 and the appointment of Stuart Siddall to the Board as CFO on 20 September 2011. These changes have reduced the number of Executive Directors from three to two.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Remuneration of Executive Directors

The remuneration arrangements for Executive Directors are summarised below.

Element	Description	Level 2011/12	Level 2012/13
Base salary	Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year.	Salary increases for 2011/12 range from 0% to 3% for Executive Directors.	Salary increases for 2012/13 yet to be confirmed.
Annual bonus	The performance conditions are selected to motivate Executive Directors to achieve the Company's key financial, operational and strategic objectives through a combination of financial, corporate and personal performance targets. Structured to reward significant improvement in the Group's financial and operational performance.	• Target award of 75.375% of base salary for 2011/12 awards. • Maximum award of 112.5% of base salary.	• Target award of 56.25% of base salary for 2012/13 awards. • Maximum award of 112.5% of base salary.
Long term incentive plan (LTIP)	Plan rewards performance over 2010-15 (AMP5), with deferred payouts over 2013-17. Vesting is conditional on the following performance conditions:- • Financial performance (40%); • Sustainability (40%); and • Regulatory and customer (20%).	• Annual target award of 75% of base salary. • Annual maximum award of 150% of base salary.	• Annual target award of 75% of base salary. • Annual maximum award of 150% of base salary.
Pensions	Provide competitive cost effective saving benefits for employees.	Contribution of 25% of base salary for Executive Directors.	Contribution of 25% of base salary for Executive Directors.
Benefits	The Executive Directors received a car allowance, private medical insurance, life assurance, Group Income Protection and 25 days holiday.		

The following table summarises the total cash elements of the package of the Executive Directors and their value as a percentage of salary. The table also shows the proportion of these payments related to variable and long term performance.

Components of Executive Director remuneration	**2011/12**		**2012/13**	
	Value (% salary)		**Value (% salary)**	
	Target performance	**Maximum performance**	**Target performance**	**Maximum performance**
Salary	100%		100%	
Pension	25%		25%	
Bonus	75.375%	112.5%	56.25%	112.5%
LTIP	75%	150%	75%	150%
Total	**275.375%**	**387.5%**	**256.25%**	**387.5%**
Variable pay – Bonus and LTIP (% total)	55%	68%	51%	68%
Long-term pay - LTIP and Pension (% total)	36%	45%	39%	45%

Directors' remuneration report (continued)

Base salaries and benefits

Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year. Base salaries are a fixed sum payable monthly.

Stephen Shine, COO, received a 3% pay increase on 1 July 2011; no other Executive Directors received a pay increase during 2011/12. The average pay increase for employees across the Company was 3% for this period.

Executive director	Salary at 31 March 2012 or leaving date if sooner
Martin Baggs, CEO	£425,000
Stuart Siddall, CFO[1]	£300,000
Stephen Shine, COO[2]	£310,000
Mark Braithwaite, FCFO[3]	£300,000

[1]Stuart Siddall was appointed on 20 September 2012
[2]Stephen Shine resigned with effect from 31 March 2012
[3]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

Bonuses

Executive Directors are eligible to participate in an annual bonus scheme, which is designed to motivate them to achieve the Company's key financial, operational and strategic objectives through a combination of financial and personal performance targets.

The amount of any annual incentive award is determined by performance against set targets and is at the discretion of the Committee. The Committee reserves the right to reduce bonus payments if overall Group performance does not warrant payment. The Board believes that this is the most appropriate means of aligning directors' remuneration to performance.

Executive Directors' annual bonus plan measures 2011/12

The 2011/12 annual bonus plan aimed to reward significant improvement in the Group's financial performance whilst recognising individual performance. The maximum level of award for the 2011/12 scheme for Executive Directors is 112.5% of salary. Financial measures make up 75% of the bonus opportunity with personal performance measures making up the remaining 25%.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Executive Directors' annual bonus plan measures 2011/12 (continued)

The financial targets were selected as being the most critical for the organisation during 2011/12. The personal performance element of the bonus is based on the performance of the Executive Directors against their key business objectives which link to the Groups overall key operational and strategic objectives including employee engagement, leakage, customer service and health & safety.

Performance measure		Weight for 2011/12 (as % of maximum)	2011/12 achievement (% of maximum bonus)		
			Martin Baggs, CEO	Stuart Siddall, CFO[1]	Stephen Shine, COO[2]
Financial measures	Regulated net capital expenditure	18.75%	18.75%		
	Regulated Net Operating expenditure	18.75%	15.4%		
	Group Cashflow before funding	18.75%	18.75%		
	Group Earnings Before Interest Tax Depreciation & Amortisation (EBITDA)	18.75%	14.8%		
Personal performance		25%	20.00%	22.50%	20.00%
Overall (% maximum)		100%	87.7%	90.2%	87.7%
Payout for 2011/12			**£418,359**	**£162,389**	**£305,156**

[1]As a new joiner on 20 September 2011, Stuart Siddall's bonus has been pro-rated for the part-year in service
[2]Stephen Shine resigned with effect from 31 March 2012 having completed the full performance year and was eligible for the 2011/12 bonus payment
Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

There was a requirement that all related regulatory outputs must be achieved for the net capital expenditure measure to pay out. These were achieved and the capital expenditure element paid out in full. Furthermore, there was a financial underpin on the personal element of the 2011/12 bonus whereby no payment would be made against the personal element of the annual bonus unless the Group cashflow before funding threshold target was achieved, which was attained.

The payments under this scheme will be made in July 2012.

Executive Directors' annual bonus plan measures 2012/13

The 2012/13 annual bonus plan will follow the overall structure of the 2011/12 plan however some elements will be restructured and the target bonus has been lowered to 56.25% of salary from 75.375% in 2011/12 for the Executive Directors. The maximum bonus opportunities will be unchanged at 112.5% of salary.

The proportion of the bonus element previously determined by financial performance will be reduced and a new group of performance measures linked to the achievement of key corporate challenges will be introduced. This has been done to focus Executive Directors' attention on a number of key corporate challenges and includes metrics such as management of the drought, the Olympics response and stabilisation of customer service.

The proportion of the bonus payable based on financial performance has been reduced from 75% of maximum for the 2011/12 bonus to 33.33% of maximum for the 2012/13 bonus.

Directors' remuneration report (continued)

Executive Directors' annual bonus plan measures 2012/13 (continued)

As a result of these changes, the structure of the bonus plan for 2012/13 for the Executive Directors will be as follows:-

Performance measure		**Weight for 2012/13 (as % of maximum)**
Financial measures	Regulated net capital expenditure efficiency	11.11%
	Cashflow before funding	11.11%
	EBITDA	11.11%
Corporate challenges		33.33%
Personal performance		33.34%
Overall (% maximum)		**100.00%**

As in the 2011/12 bonus, the related regulatory outputs must be achieved before the capital expenditure efficiency measure will pay out. The financial underpin on the personal element of the bonus will continue to be a Group cashflow before funding target.

Long Term Incentive Plans ("LTIP")

In order to focus executives on long term, sustained performance and to aid retention, the Company's Executive Directors and Senior Management are from time to time invited to participate in an LTIP.

The LTIP 2008 and LTIP 2009 were three year plans with a performance related payout at the end of the vesting period. The LTIP 2008 vested in July 2011 and the LTIP 2009 vests in July 2012, following Board approval of the audited accounts.

The current plan, the LTIP 2010, is a multiple year plan, with the performance period running from July 2010 to July 2015 and payouts being made in each year from July 2013 to July 2017.

Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

LTIP 2008

A LTIP commenced in 2008, in which Steve Shine, COO, and Mark Braithwaite, FCFO, participated. The plan performance period ran from 1 April 2008 to 31 March 2011 with payments made in July 2011. The plan was based on four cumulative financial measures, being Group EBITDA, Group cash flow before funding, distributions and Group capital expenditure. These measures were selected as being critical for the Group.

Payment was made in full under this scheme as all four measures were achieved over each of the three financial years which formed the performance period. No payment would have been made under the plan if one or more measures had not been achieved. None of the targets were linked specifically to regulatory performance.

The value of awards vested is shown in the LTIP award tables on page 51.

Directors' remuneration report (continued)

LTIP 2009

A LTIP was offered covering the period 1 April 2009 to 31 March 2012 in which Steve Shine, COO, and Mark Braithwaite, FCFO, participated. Following Board approval of the audited accounts, payments will be made in July 2012, pro-rata to the length of service during the performance period. The plan is based on the Company's performance against the following measures between 1 April 2010 and 31 March 2012:-

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financial targets over AMP5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP5. This includes: • strategic initiatives around improving operating efficiency, for example WAMI and SCADA; • Developing a successful business plan for AMP6; • meeting key milestones including reaching Ofwat efficiency bandings; • improving employee engagement scores; and • improving health & safety standards.	40%
Regulatory and customer	Improving the Company's scores under Ofwat's core measures of SIM and Operational Performance Assessment ("OPA").	20%

The performance measures are reviewed annually taking relevant economic factors in to account. The value of the awards for the LTIP payable is shown in the LTIP award tables on page 51.

Directors' remuneration report (continued)

LTIP 2010

A new five year LTIP was introduced in 2010 for the Executive Directors and senior managers in key strategic positions across the Company. The performance period of the plan runs from 1 April 2010 to 31 March 2015. The plan focuses on the key objectives for the next regulatory period which are critical to the Company's business plan as follows:-

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financials over AMP5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP5. This includes: • strategic initiatives around improving operating efficiency, for example WAMI and SCADA; • Developing a successful business plan for AMP6; • meeting key milestones including reaching Ofwat efficiency bandings; • improving employee engagement scores; and improving health & safety standards.	40%
Regulatory and customer	Improving the Company's scores under Ofwat's core measures of SIM and OPA.	20%

The performance measures are reviewed annually taking relevant economic factors into account.

The plan is a five year plan where participants at the Executive Director level were granted five times their annual target award of 75% of basic salary in 2010. No further grants will be made to participants over the performance period.

For threshold performance, half the award will vest, rising to two times the award for maximum performance. If performance does not reach the threshold level for any of the targets, no payment will be made under the plan.

Under normal circumstances 20% of the total award can be released each year from July 2013 to July 2017 based on performance achieved as follows:

- 20% of the award will be paid in July 2013, based on performance from March 2010 to March 2013;
- 20% of the award will be paid out in July 2014, based on performance from March 2010 to March 2014;
- the remaining 60% of the award will vest in March 2015 based on performance from March 2010 to March 2015 and will be paid out in three equal tranches over July 2015 – July 2017.

In exceptional circumstances the payouts in 2016 and 2017 may be reduced, for example in the event of a material deterioration in financial performance or a significant fall in service after the AMP5 period. In addition, the Committee has the discretion not to pay under the regulatory and customer area if failure to meet targets in any area leads to regulatory action.

Directors' remuneration report (continued)

LTIP 2010 (continued)

New joiners after 1 April 2010 will be eligible to participate in the LTIP 2010 at the discretion of the Committee. For new joiners, the first payment from the LTIP will be made on the next vesting date following completion of two years service. This payment will be pro-rated based on the part year service. No amount will be received if there is less than two years service for that award and awards are not pro-rated where the new joiner has served over 3 years of the performance period.

Pro-rating also applies to good leavers and is subject to the Committee's discretion and was applied to both Mark Braithwaite (FCFO) and Steve Shine (COO).

The value of the awards payable under the LTIP is shown on page 51.

Pensions

Each Executive Director is eligible to receive payments into pension worth 25% of base salary. The Committee has agreed that where Executives' accumulated pension rights are already in excess of the Lifetime Allowance, a cash payment in lieu of this payment to pension may be made. No element of bonus or LTIP is pensionable.

- Martin Baggs, CEO, participates in the Company Defined Contribution pension scheme and receives contributions of 25% of base salary. Company contributions for the year were £106,250 (2011: £106,250).
- Stuart Siddall, CFO, receives a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £40,057 (2011: nil).
- Stephen Shine, COO, received a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £76,875 (2011: £75,000).
- Mark Braithwaite, FCFO, received a contribution of 25% of salary into a personal pension scheme. Company contributions for the year were £14,743 (2011: £75,000).

Stephen Shine and Mark Braithwaite are deferred members of the Company defined benefit pension scheme which is closed to future accrual. Further details are shown in the defined benefit pension entitlements table on page 52. No other Executive Directors are, or were, members of the scheme.

Non-Executive Directors' fees

The Chairman and Non-Executive Directors receive a fixed fee for their duties which reflects their responsibilities and time commitments. They are not entitled to any annual bonus, long term incentives, pension benefits or benefits in kind.

The Chairman receives an annual fee of £300,000 and Non-Executive Directors receive an annual fee of £45,000. Michael Pavia receives an additional annual fee of £10,000 for his role as Chairman, Audit & Risk Review Committee. Fees are reviewed regularly by the Committee and no individuals are involved in the determination of their own remuneration.

Further details of the Chairman and Non-Executive Directors' remuneration are set out in the emoluments table on page 49.

Service contracts

Reflecting current market practice, the Executive Directors do not hold service contracts that provide for a notice period longer than one year. It is not the Committee's intention to recommend the appointment of any new Executive Directors with contracts that provide for a longer notice period.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Service contracts (continued)

The Committee endorses the principle of mitigation of loss on early termination of a service contract and generally seeks to achieve that objective where possible and appropriate. In the event that the Company wished to terminate an Executive Director's contract other than in circumstances where the Company is entitled to summarily dismiss an Executive Director, it would need to give either 12 months' notice or make a payment in lieu of salary. For Non-Executive Directors, no compensation is payable on the event of early termination.

Executive Directors	Contract start date as Executive Director	Service period	Notice period
Martin Baggs, CEO	5 March 2010	n/a	6 months by employee, 12 months by company
Stuart Siddall, CFO	20 September 2011	n/a	12 months by both sides
Stephen Shine, COO[1]	24 May 2007	n/a	12 months by both sides
Mark Braithwaite, FCFO[2]	31 August 2007	n/a	12 months by both sides

[1]Stephen Shine resigned with effect from 31 March 2012.
[2]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

	Initial Contract start date	Length of Each Period of Appointment	Expiry Date of Current Contract
Chairman			
Sir Peter Mason	01 December 2006	3 years	9 June 2014
Independent Non-Executive Directors			
Dame Deirdre Hutton	22 July 2010	3 years	21 July 2015
Michael Pavia	01 December 2006	3 years	21 July 2015
Edward Richards	22 July 2010	3 years	21 July 2015
Non-Executive Directors			
Luis Abraira[1]	04 August 2011	n/a	n/a
Edward Beckley	26 March 2008	n/a	n/a
Rosamund Blomfield-Smith[2]	14 February 2008	n/a	n/a
Christopher Deacon	01 December 2006	n/a	n/a
Simon Eaves	20 January 2012	n/a	n/a
Gordon Parsons	10 June 2010	n/a	n/a
Antonio Santos[3]	01 January 2011	n/a	n/a
Dipesh Shah	15 October 2007	n/a	n/a
Yaping Shi	19 January 2012	n/a	n/a
Martin Stanley	01 December 2006	n/a	n/a
Robert Verrion	01 January 2011	n/a	n/a
Lincoln Webb	21 November 2011	n/a	n/a

[1]Luis Abraira resigned with effect from 19 January 2012.
[2]Rosamund Blomfield-Smith resigned with effect from 21 November 2011.
[3]Antonio Santos resigned with effect from 4 August 2011.

The Chairman and Independent Non-Executive Directors have fixed appointment periods; the other Non-Executive Directors do not as they are appointed and can be removed without notice by the shareholders of the Company in line with the Shareholder Agreements.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Emoluments table (Excluding LTIPs)

	Directors' salaries / fees £'000	Benefits in kind £'000	Allowances £'000	Pension Allowance £'000	Annual cash bonus £'000	**Group Total year to 31 March 2012 £'000**	Group Total year to 31 March 2011 £'000	**Company Total Year to 31 March 2012 £'000**	Company Total Year to 31 March 2011 £'000
Executive Directors									
M Baggs [1]	425	2.3	51	-	418	**896**	956	**627**	669
S Siddall[2]	160	-	7	40	162	**369**	n/a	**258**	n/a
S Shine [3]	308	2.3	17	77	305	**709**	618	**638**	556
M Braithwaite [4,5]	59	0.4	9	-	-	**68**	622	**48**	435
Chairman									
Sir P Mason	300	-	-	-	-	**300**	275	**180**	165
Independent Non-Executive Directors									
P Dyer	-	-	-	-	-	**-**	45	**-**	45
Dame D Hutton	45	-	-	-	-	**45**	31	**45**	31
M Pavia	55	-	-	-	-	**55**	55	**55**	55
E Richards	45	-	-	-	-	**45**	33	**45**	-
W Smit	-	-	-	-	-	**-**	19	**-**	19
Non-Executive Directors									
L Abraira[6]	11	-	-	-	-	**11**	35	**-**	-
E Beckley	45	-	-	-	-	**45**	45	**-**	-
R Blomfield-Smith[7,8]	46	-	-	-	-	**46**	45	**30**	45
C Deacon[9]	107	-	-	-	-	**107**	81	**-**	-
R Gadsby	-	-	-	-	-	**-**	45	**-**	-
S Eaves[10]	11	-	-	-	-	**11**	-	**-**	-
G Parsons	45	-	-	-	-	**45**	45	**-**	-
K Roseka	-	-	-	-	-	**-**	34	**-**	-
A Santos[11]	23	-	-	-	-	**23**	11	**-**	-
D Shah	45	-	-	-	-	**45**	34	**-**	-
Y Shi[12]	11					**11**	-	**-**	-
M Stanley	45	-	-	-	-	**45**	45	**-**	-
R Verrion	45	-	-	-	-	**45**	11	**-**	-
L Webb[13]	22	-	-	-	-	**22**	-	**-**	-
Total	**1,853**	**5**	**84**	**117**	**885**	**2,944**	3,085	**1,926**	2,020

The Group is Kemble Water Holdings Limited and the Company refers to TWUL.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Emoluments table (Excluding LTIPs) (continued)

[1]Allowances for Martin Baggs comprise £15,000 car allowance and £36,000 housing allowance.
[2]Stuart Siddall was appointed on 20 September 2011.
[3]Stephen Shine resigned with effect from 31 March 2012.
[4]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.
[5]Allowances for Mark Braithwaite comprise £2,462 car allowance and £6,234 in lieu of leave.
[6]Luis Abraira was appointed on 4 August 2011 and resigned with effect from 19 January 2012.
[7]Rosamund Blomfield-Smith resigned with effect from 21 November 2011.
[8]Fees shown include a consultancy fee of £15,750 (2011: £nil) for work on the Tideway Improvements project borne by Thames Water Limited. This arrangement commenced following resignation as a Director.
[9] Fees shown include a consultancy fee of £61,666 (2011: £40,000) for work on the Tideway Improvements project borne by Thames Water Limited.
[10]Simon Eaves was appointed on 20 January 2012.
[11]Antonio Santos resigned with effect from 4 August 2011.
[12]Yaping Shi was appointed on 19 January 2011.
[13]Lincoln Webb was appointed 21 November 2011.

The remuneration of the Company's directors as shown in note 5, page 76 of the financial statements of £2,681,000 include £1,926,000 as shown in the above table, and 2009 and 2010 LTIP's accrued in the year of £668,000 together with pension contributions of £87,000.

The following table sets out the proportion of the bonus which is attributable to regulatory performance for 2012:-

Executive Directors	Proportion determined by regulatory performance
Martin Baggs, CEO	£146,426
Stuart Siddall, CFO	£56,836
Stephen Shine, COO	£137,320

Thames Water Utilities Limited

Directors' remuneration report (continued)

Long term incentive awards

The following table sets out the awards under the LTIP 2008, LTIP 2009 and unvested awards under the LTIP 2010. The potential values shown are the maximum cash levels attainable subject to the performance conditions set out on pages 44 to 47. The expected value shows the level of vesting anticipated based on estimates of current performance, and in the case of the LTIP 2010 will only be payable if performance continues at the same level and if the Executive remains employed at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

Performance period	Date of potential payment	Individual	Potential value of awards held at 31 March 2011 £'000	Potential value of awards granted during the year £'000	Value of awards vesting during the year £'000	Value of awards lapsed during the year £'000	Potential value of awards held at 31 March 2012 £'000	**Group Expected value of awards held at 31 March 2012[1] £'000**	Company-related Expected value of awards held at 31 March 2012 £'000
LTIP 2010									
1 April 2010 – 31 March 2013	July 2013	M Baggs	638	-	-	-	638	**446**	312
		S Shine	450	-	-	-	450	**315**	284
		M Braithwaite	450	-	-	450	-	-	-
1 April 2010 – 31 March 2014	July 2014	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	264	-	-	264	**185**	129
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
1 April 2010 – 31 March 2015	July 2015	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
	July 2016	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
	July 2017	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
LTIP 2009									
1 April 2010 – 31 March 2012	July 2012	S Shine	300	-	-	-	300	**203[2]**	182[2]
		M Braithwaite	300	-	-	-	300	**146[2]**	102[2]
LTIP 2008									
1 April 2008 – 31 March 2011	July 2011	S Shine	300	-	300[3]	-	**-**	**-**	-
		M Braithwaite	300	-	300[3]	-	**-**	**-**	-

[1]Based on performance to date
[2]Expected values shown will be paid in July 2012 following Board approval of the audited accounts
[3]Paid in July 2011

The expected value of the awards attributed to the Company relate fully to regulatory performance.

The amounts shown in the above table are the total amounts that potentially will vest on maturity. The amount accrued in the year are shown in note 5, page 76 of the financial statements.

Directors' remuneration report (continued)

Defined benefit pensions

Stephen Shine, COO, and Mark Braithwaite, FCFO, were deferred members (with effect from 31 March 2011) of the Company's defined benefit pension scheme, TWPS, which has a normal retirement age of 65 and an accrual rate of 1/80th of basic salary. As deferred members of the scheme no contributions were made in to the scheme during the year by either the Executives or the Company. However, as deferred members their benefits continued to accrue and the transfer values, calculated in line with "Actuarial Guidance note GN11" are set out below:

£	Age	Accrued pension entitlement at 31 March 2011	Accrued pension entitlement at 31 March 2012	Additional pension earned during the period	Transfer value of accrued pension at 31 March 2011	Transfer value of accrued pension at 31 March 2012
Mark Braithwaite	46	21,642	22,430	788	198,498	284,493
Stephen Shine	55	33,498	34,881	1,383	420,601	550,869

As deferred members of the TWPS, the Executives could choose to retire early from age 63, or from age 55 with the consent of the Company. In these circumstances the benefits payable would be actuarially reduced to take account of early payment.

Pension benefits in retirement are increased annually in line with RPI with a cap of 2.5%.

There is also a spouse's pension, payable in the event of the death of the Executive, of 50% of the member's pension, plus children's pensions payable at a rate of one quarter of the spouse's pension for each of up to 4 children.

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Sir Peter Mason, KBE
Chairman, Compensation and HR committee

Corporate governance report

Compliance Regime

The term "corporate governance" is generally taken to refer to the supervision of the way in which a company is run and how the risks to its business are managed. It embraces, *inter alia*, regulation, corporate structure and the function of the Board of Directors and its committees.

The Company's directors, shareholder and the shareholders of the ultimate parent company are committed to maintaining high standards of corporate governance. Under the terms of its Licence from Ofwat, the Company is required to have particular regard to the UK Corporate Governance Code (the "Code"), which is something that generally applies only to companies whose shares are listed on the London Stock Exchange. The Code acknowledges that departure from its provisions may be justifiable in particular circumstances and requires that companies explain those departures. As the Company is a wholly-owned subsidiary in a privately-owned group, the operations of which are governed by a shareholders' agreement, the Board considers that a significant number of the provisions of the Code are not directly applicable:

The areas where the code is not followed are set out in the following paragraphs, with accompanying explanation of the Company's practice being provided.

The Company does not appoint a Senior independent non-executive director as it is considered unnecessary as all shareholders have direct representation on the Board and therefore access to the Chairman, Chief Executive Officer and Chief Financial Officer.

The Chairman did not schedule meetings with the NED's, without the Executive directors in attendance and nor was the Chairman's performance appraised by the NED's as the Chairman is not considered independent, as stated below. Following the Board effectiveness review (see below), the Chairman intends to hold meetings with the NED's without the executive directors in attendance during 2012/13.

The Board

The Board is confident that it acts independently and that it takes decisions objectively in the best interests of the Company. It also believes that it has demonstrated its commitment to ensuring that the Company's obligations to its stakeholders are understood and met, and that the necessary financial and management resources and systems of planning and internal control, are in place to fulfil these obligations. Supported by the CEO and the Executive, the Board continues to take positive action towards regenerating the Company's values and standards and establishing a clear strategic direction for the future.

Matters on which decisions are reserved to the Board and the authority given to the CEO and his Executive team are set out in the schedule of delegated authority ("SODA") approved by the Board.

The Board of Directors is appointed in accordance with the shareholders' agreement and comprise 2 Executive Directors, 10 NED's (including the Chairman) and 3 independent NED's (see Directors report for appointment details of individual directors). The NED's are nominated and appointed by the shareholders of Kemble Water Holdings Limited in accordance with the terms of the shareholders' agreement and are therefore not determined to be independent.

The directors have specialist knowledge of the water industry and other regulated utilities. The Board and Ofwat consider that Michael Pavia (former Chief Financial Officer of the London Electricity Group), Edward Richards (Chief Executive of Ofcom) and Dame Deirdre Hutton (Chair, UK Civil Aviation Authority) are independent NED's.

Corporate governance report (continued)

The Board (continued)

The Board is chaired by Sir Peter Mason, KBE. Sir Peter has had a long and distinguished career in the engineering and construction industries, including Private Finance Initiatives and design and project management. He has also held several public service appointments, primarily with the Department for Trade and Industry (now part of the Department for Business Innovation and Skills). Sir Peter's external appointments include, non–executive director of BAE Systems plc, Spie S.A. and Subsea 7 S.A. Sir Peter is considered not to be independent and neither was he upon his appointment. Sir Peter's responsibilities as Chairman include leadership of the Board, ensuring its effectiveness, setting its agenda and ensuring effective communication with the Company's shareholder. Additionally, he is responsible for ensuring that the directors receive accurate, timely and clear information and that constructive relations exist between the Board and the Executive.

The Board met 5 times during the year with additional conference calls to update the Board on operational matters between formal meetings, where necessary.

All directors are entitled to attend Board meetings either in person or by telephone and are also entitled to attend and observe Committee meetings. Certain members of the senior management team will also attend Board and Committee meetings by invitation.

Newly appointed directors are offered a comprehensive briefing on the Company and its business. Training is also provided for directors on their roles and their legal obligations to ensure they are fully conversant with their responsibilities as directors.

All directors have sufficient resources and access to independent professional advice, at the Company's expense, in order to discharge their responsibilities as directors. Additionally, all directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are complied with. The appointment and removal of the Company Secretary is a matter reserved for the Board.

A Board effectiveness review was carried out in February 2012. This involved the use of a questionnaire to all directors and covered a range of issues around Board and committee processes, Board roles and responsibilities. The findings of the review were considered by the Board at the 1 March 2012 Board meeting with several changes being made as a result. Typically the Company engages the services of an external Board evaluation consultant two years out of three. In between the external evaluations they are conducted internally.

The Company has in place appropriate insurance cover in respect of legal action against its Directors.

Corporate governance report (continued)

Committees of the Board

The five standing committees of the Board are as follows:

- Audit and Risk Review ("ARRC")
- Regulatory
- Health, Safety and Environment
- Compensation and HR
- Customer Service

Each committee has written terms of reference and the collective function of the Committees is to exercise oversight on behalf of the Board and to provide advice to the Board. Other committees are formed as and when required to deal with specific matters, for example the Thames Tideway Tunnel Project.

See page 56 for details and members of each committee of the Board.

Corporate governance report (continued)

Committees of the Board (continued)

Membership of the committees throughout the year ended 31 March 2012 is set out below.

Audit and Risk Review Committee	M Pavia (Chairman), G I W Parsons R Blomfield-Smith (resigned 21.11.11) R Verrion (appointed 8.9.11)
Regulatory Committee	G I W Parsons (Chairman) E Beckley, E C Richards D Shah
Health, Safety and Environment Committee	G I W Parsons (Chairman) Dame D M Hutton D Shah
Compensation and HR Committee	Sir P J Mason (Chairman) M Stanley C Deacon M Pavia
Customer Service Committee (Formed 3 March 2011)	Dame D M Hutton (Chairman) G I W Parsons E C Richards R Verrion
Tideway Tunnel Committee	Sir P J Mason (Chairman) E Beckley G I W Parsons D Shah M Pavia

The Audit and Risk Review Committee

The composition of the ARRC and its terms of reference are governed by the shareholders agreement and comprises two NED's and one independent NED, Michael Pavia, who is the Committee Chairman.

Corporate governance report (continued)

The Audit and Risk Review Committee (continued)

The Board reviews risk management arrangements and the effectiveness of the Company's internal control systems through the work of the ARRC. The primary objectives of the ARRC are:

(i) the preservation of good financial practices throughout the Company;
(ii) ensuring that robust controls are in place to support the integrity of those practices;
(iii) reviewing risk management processes;
(iv) reviewing the Company's interim and annual financial statements, and the Annual Performance Report to Ofwat;
(v) the provision, by way of (amongst other things) meetings, of a line of communication between the Board and external auditor.

The ARRC also reviews the Company's procedure for handling allegations from whistleblowers as set out in the Company's Honest and Ethical Behaviour Policy. Any whistleblowing events are brought to the attention of the ARRC and are promptly investigated by the Head of Internal Audit.

Auditor's independence and objectivity

The ARRC monitors regularly the non-audit services provided to the Company by the external auditor. The auditor does not:

- Self review.
- Make management decisions for the Company.
- Have a mutuality of financial interest with the Company.
- Act in the role of advocate for the Company.

The ARRC regularly meets with the external auditor in private. Approval of the ARRC is required for any services provided by the external auditor for which the fee is likely to be in excess of £100,000.

Details of the fees paid to the external auditor during the year ended 31 March 2012 for audit and non-audit services are set out in note 3 to the financial statements on page 75 of this Annual report and financial statements.

Internal control

The Board has overall responsibility for the Company's system of internal control. This is designed to manage rather than eliminate the risk of failure to meet business objectives and can only provide reasonable, not absolute assurance, against material misstatement or loss.

The key features of the system of internal control and risk management are as follows:

- A control environment with clearly defined organisational structures operating within a framework of policies and procedures covering every aspect of the business.
- Comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years.
- Regular monitoring of risks and control systems throughout the year, supported by the use of risk registers.
- A self-certification process whereby management is required to confirm that the system of internal control is operating effectively.
- An internal audit function providing independent scrutiny of internal control systems and risk management procedures.
- A review of reports produced by internal and external audit.

Corporate governance report (continued)

Internal control (continued)

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of:

- Regular presentations to the ARRC and Executive by heads of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks.
- Reports of significant changes to the Company's overall risk profile, which are also reported to the ARRC.
- Standing reports from the Internal Audit Department to the ARRC.
- Reports to the ARRC on the results of the self-certification process and independent reports thereon by the Internal Audit Department.
- An annual review of the effectiveness of the Company's systems of risk management and internal control by the Board

Independent Auditor's Report to the Members of Thames Water Utilities Limited

We have audited the financial statements of Thames Water Utilities Limited for the year ended 31 March 2012 set out on pages 33 to 68. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 37, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the financial statements:

- Give a true and fair view of the state of the Company's affairs as at 31 March 2012 and of its profit for the year then ended.
- Have been properly prepared in accordance with UK Generally Accepted Accounting Practice, and
- Have been prepared in accordance with the requirements of the Companies Act 2006.

Independent Auditor's Report to the Members of Thames Water Utilities Limited (continued)

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

• Adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or

• The financial statements are not in agreement with the accounting records and returns; or

• Certain disclosures of directors' remuneration specified by law are not made; or

• We have not received all the information and explanations we require for our audit.

Paul Johnson (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
7 June 2012

Thames Water Utilities Limited

Profit and loss account for the year ended 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Turnover		**1,694.9**	1,623.1
Operating costs before exceptional item		**(1,091.0)**	(1,022.9)
Exceptional item: pension curtailment gain	3/26	**40.0**	-
Operating costs	3	**(1,051.0)**	(1,022.9)
Operating profit		**643.9**	600.2
Profit on sale of fixed assets	4	**3.9**	10.9
Interest payable and similar charges	6	**(504.7)**	(462.1)
Interest receivable	7	**81.5**	63.8
		(423.2)	(398.3)
Other finance expense	26	**(2.4)**	(4.3)
Profit on ordinary activities before taxation		**222.2**	208.5
Taxation credit on profit on ordinary activities	8	**25.0**	16.7
Profit for the financial year	21	**247.2**	225.2

There are no differences between the profit on ordinary activities before taxation for the periods as stated above and their historical cost equivalents.

All amounts above relate to continuing operations.

Statement of total recognised gains and losses for the year ended 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Profit for the financial year		**247.2**	225.2
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Deferred tax relief/(charge) relating to actuarial loss		**21.4**	(3.2)
Total recognised gains in the year		**174.2**	220.9

Thames Water Utilities Limited

Balance sheet as at 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Fixed assets			
Tangible assets	10	**8,788.3**	8,145.2
Investments	11	**0.1**	0.1
		8,788.4	8,145.3
Current assets			
Stocks	12	**9.6**	8.2
Debtors: amounts falling due within one year	13	**647.9**	621.9
Debtors: amounts falling due after more than one year	14	**2,015.0**	1,865.0
		2,662.9	2,486.9
Investments	17	**619.4**	775.8
Cash at bank and in hand	17	**2.7**	3.6
		3,294.6	3,274.5
Creditors: amounts falling due within one year	15	**(1,460.4)**	(1,016.3)
Net current assets		**1,834.2**	2,258.2
Total assets less current liabilities		**10,622.6**	10,403.5
Creditors: amounts falling due after more than one year	16	**(8,050.2)**	(7,748.7)
Provisions for liabilities and charges	18	**(1,052.6)**	(1,054.3)
Net assets excluding net pension liabilities		**1,519.8**	1,600.5
Net pension liabilities			
– total of defined benefit schemes			
With net liabilities		**(144.4)**	(122.7)
With net assets		**25.2**	28.1
	26	**(119.2)**	(94.6)
Net assets including pension liabilities		**1,400.6**	1,505.9
Capital and reserves			
Called-up share capital	19	**1,029.0**	1,029.0
Share premium account	20	**100.0**	100.0
Profit and loss account	21	**271.6**	376.9
Total shareholder's funds	22	**1,400.6**	1,505.9

The notes on pages 66 to 98 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Stuart Siddall
Chief Financial Officer

Company registered number: 02366661.

Thames Water Utilities Limited

Cash flow statement for the year ended 31 March

	Note	**31 March 2012 £m**	31 March 2011 £m
Net cash inflow from operating activities	(a)	**924.7**	943.1
Returns on investments and servicing of finance			
Interest received		**106.1**	110.4
Interest paid		**(354.1)**	(269.3)
Interest element in finance lease payments		**(6.9)**	(6.5)
Net cash outflow from returns on investments and servicing of finance		**(254.9)**	(165.4)
Taxation		**79.6**	(26.0)
Capital expenditure and financial investment			
Gross cost of purchased fixed assets		**(993.6)**	(793.8)
Infrastructure renewals expenditure		**(176.8)**	(107.7)
Receipt of grants and contributions		**44.3**	41.0
Movement on long term loans to group companies		**(150.0)**	(685.0)
Sale proceeds of fixed assets	(d)	**8.8**	11.5
Net cash outflow for capital expenditure and financial investment		**(1,267.3)**	(1,534.0)
Equity dividends paid	9	**(279.5)**	(271.4)
		(797.4)	(1,053.7)
Management of liquid resources			
Decrease/(increase) in current asset investments	(b) & (c)	**156.4**	(202.6)
Net cash outflow before financing		**(641.0)**	(1,256.3)
Financing			
Capital element in finance lease payment		**(7.8)**	(8.6)
New loans		**657.1**	1,807.6
Repayment of loans		**(9.2)**	(545.0)
Net cash inflow from financing	(b) & (c)	**640.1**	1,254.0
Decrease in cash	(b) & (c)	**(0.9)**	(2.3)

Interest received of £106.1m includes £24.4m received from Thames Water Utilities Holdings Limited which is not included in the adjusted interest cover ratio calculations as defined in the Chief Executive's Report on page 11.

Thames Water Utilities Limited

Notes to the cash flow statement for the year ended 31 March

(a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	**31 March 2012 £m**	31 March 2011 £m
Operating profit		**643.9**	600.2
Depreciation (infrastructure renewals charge)	3	**129.5**	132.4
Depreciation (non infrastructure)	3	**286.1**	260.9
Difference between pension charge and cash contributions		**(68.1)**	(26.8)
Increase in stocks		**(1.3)**	(0.6)
Increase in debtors and prepaid expenses		**(36.3)**	(12.2)
(Decrease)/increase in creditors and accrued expenses		**(14.4)**	2.3
(Decrease)/Increase in provisions		**(0.9)**	0.5
Release of deferred income		**(13.8)**	(13.6)
Net cash inflow from operating activities		**924.7**	943.1

(b) Reconciliation of net cash flow to movement in net debt

	Note	**31 March 2012 £m**	31 March 2011 £m
Decrease in cash in the year		**(0.9)**	(2.3)
Cash (outflow)/inflow from increase in liquid resources		**(156.4)**	202.6
Cash inflow from movement in net debt and financing		**(640.1)**	(1,254.0)
Increase in net debt resulting from cash flows		**(797.4)**	(1,053.7)
Non-cash increase in net debt		**(182.3)**	(192.7)
Total increase in net debt		**(979.7)**	(1,246.4)
Opening net debt		**(6,795.8)**	(5,549.4)
Closing net debt	(c)	**(7,775.5)**	(6,795.8)

The non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 ‘Capital instruments’.

Notes to the cash flow statement for the year ended 31 March (continued)

(c) Analysis of movement in net debt

	As at 1 April 2011 £m	Cash flow £m	Other non-cash movements £m	**As at 31 March 2012 £m**
Cash at bank and in hand	3.6	(0.9)	-	**2.7**
Current asset investments	775.8	(156.4)	-	**619.4**
	779.4	(157.3)	-	**622.1**
Debt due within one year	(7.6)	(462.4)	-	**(470.0)**
Debt due after more than one year	(7,372.5)	(185.5)	(182.3)	**(7,740.3)**
Finance leases	(195.1)	7.8	-	**(187.3)**
	(7,575.2)	(640.1)	(182.3)	**(8,397.6)**
Total	(6,795.8)	(797.4)	(182.3)	**(7,775.5)**

(d) Profit on disposal of fixed assets

The proceeds received regarding the profit on the sale of fixed assets for the year ending 31 March 2012 of £8.8m (2011: £11.5m) have been included within Capital expenditure and financial investment.

Notes to the Financial statements for the year ended 31 March

1 Principal accounting policies

The following accounting policies have been applied consistently in dealing with items, which are considered material to the financial statements, except as noted below.

Basis of preparation

The financial statements are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions, with the Companies Act 2006. An explanation of this departure from the requirements of the Act is given in note 1(b) below.

The Company has not prepared consolidated group financial statements, as permitted under section 400 of the Companies Act 2006. The Company and its subsidiaries are included in the consolidated financial statements of its ultimate parent company Kemble Water Holdings Limited, a company registered in the United Kingdom.

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive Officer's Business review on pages 6 to 31. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Chief Executive Officer's Business review on pages 9 to 11. The Chief Executive Officer's Business review also includes details of the Company's Treasury policy, capital structure and financial risk management.

Day to day working capital requirements are funded by the business. During the year £657.1m, net of bond issuance costs, of new debt were secured and there is no current requirement to raise additional finance to meet future project obligations. There are also cash balances of £629.6m and committed facilities with a group of banks of £1,200m, which are only likely to be used on rare occasions. Of the £1,200m, £450m 364 day facilities are due for renewal by August 2012 with the remainder maturing in September 2016. The current economic conditions create uncertainty particularly over (a) the level of revenue earned from regulatory activities; (b) the increased occurrence of bad debts; and (c) the availability of bank finance in the foreseeable future. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate within the level of its current facilities for 15 months. However, the Company plans to meet its capital programme requirements by raising new debt.

The directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements.

Changes to accounting policies

The same accounting policies used for the year ended 31 March 2011 have been applied in these financial statements.

Changes in accounting estimates

During the year the Company modified the way in which it calculates its provision for bad debts and extended the calculation to cover accrued (unbilled) income. The calculation also uses a number of estimates and assumptions that were updated in line with the collections that the Company is achieving in the current economic climate.

As a result the Company's bad debt charge has increased by £70.6m (2011: £38.4m).

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

Changes in accounting assumptions relating to pensions

Following extensive consultation with employees and with the agreement of the pension fund trustees the Company has changed certain provisions in respect of the TWPS for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011 new employees of the Company have been offered participation in the DCSPS managed through Standard Life. All senior managers have moved to this scheme from the defined benefit scheme.

For existing members of the TWPS, certain provisions have changed that will affect future benefits to its members. Principally, the defined benefit provision from 1 May 2011 will be on a Career Average Revalued Earnings ("CARE") basis and no longer on a Final Salary basis.

As a result of the above change to a CARE basis a curtailment gain of £40.0m has been recorded within these financial statements and has been classified as an exceptional item, see note 3 page 75 and note 26 page 94. The directors consider that due to the materiality and one-off nature of this curtailment gain, it is appropriate to classify this as an exceptional item in order to show a true and fair view of the Company's underlying performance. The tax charge on this exceptional item is £9.6m.

Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below.

(a) Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided and are recognised in accordance with FRS 5 "Reporting the Substance of Transactions". No adjustment is made to reduce revenue by an estimated bad debt charge to reflect the fair value as this is not deemed material. Where relevant, revenue includes an estimate of the sales value of water supplied and waste water charges to customers between the date of the last meter reading and the period end, exclusive of value added tax. The estimated usage is based upon historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period for which the revision to the estimates is determined. For customers who do not have a meter, the receivable billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as favourable operating costs when payment is received in both the statutory and regulatory accounts. The Company currently does not have any charges on income; any outstanding revenue is recovered in the normal course of business. All water and sewerage charges billed to customers are recognised as income at the time they are billed and apportioned over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

1 Principal accounting policies (continued)

(a) Revenue recognition (continued)

Where there is a change of customer in an unmeasured property but the Company cannot confirm the name, a bill is raised in the name of "The Occupier". The Company does not raise billing in the name of the Occupier for metered accounts. However, an unmeasured bill in the name of the Occupier will be cancelled and rebilled once the Company has confirmation of the customer's name. If confirmation is not received the bill is cancelled and the property is classified as empty.

Where a property is classified as empty, an empty property process is followed to verify when the property becomes occupied and/or obtain the name of the customer. The status is established with the customer at point of contact, if the property is not chargeable after 10 weeks the unfurnished / unoccupied state is confirmed visually. The empty property process comprises a number of steps. If these steps confirm that a property appears to be empty then the supply may be turned off. The property will only cease to be classified as empty when a named customer is identified and billed. The Company does not recognise income in respect of empty properties. If the Company has turned off the supply of water at the mains to a property at a customer's request then water supply charges are not payable. A customer may request the supply to be turned off in instances such as the property is to be demolished or where a house previously converted into flats (and additional supplies made) to be converted back into a house.

With regard to new properties, an estimate is made of the sales value of water supplied and waste water charges to customers between the date of connection and the period end.

The Company recognises all revenue at the time of delivery. Should the Company consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned. Payments received in advance of delivery are recorded as deferred revenue.

(b) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers and pumped raw water storage reservoirs and sludge pipelines), and other assets (including land, buildings, properties, over ground plant and equipment).

Directly attributable costs are capitalised within fixed assets. These costs include employee costs and other internal costs that are incremental to the business due to the scale and nature of the capital implementation programme of the Company. Interest costs are not capitalised.

The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively.

The carrying values of fixed assets are also reviewed for impairment where there has been a trigger event by assessing the present value of estimated future cash flows and net realisable value compared with net book value. The calculation of estimated future cash flows and residual values is based on the directors' best estimates of future prices, output and costs and is therefore subjective.

- **Infrastructure assets**

Infrastructure assets comprise a network of below ground systems. In the UK Water and Waste regulated business, all expenditure on infrastructure assets is capitalised at cost, whilst the planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as Infrastructure Renewals Charge ("IRC") within depreciation.

Following the completion of the Company's assessment of the infrastructure renewals expenditure requirement to the end of AMP 7 for the Final Business Plan, the Company considers that it would be appropriate to reflect in its regulatory and statutory accounts an infrastructure renewals charge consistent with its expenditure plans for the AMP 5 to AMP 7 (2010-2025) periods.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

b) Tangible fixed assets (continued)

- **Capital contributions**

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 1 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, which is accordingly accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. As infrastructure assets are accounted under renewals accounting, related capital contributions are not recognised in the profit and loss account.

The financial effect of this departure is disclosed in note 10.

Where material, contributions received towards the cost of other assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

- **Other assets**

All other assets, comprising plant and equipment and land and buildings, are stated at cost less accumulated depreciation.

Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Freehold land is not depreciated and assets in the course of construction are not depreciated until they are commissioned. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated useful lives, down to zero, based on management's judgement and experience, which are principally as follows:

Buildings	15 - 60 years
Operational structures	30 - 100 years
Other operational assets	5 - 40 years
Fixtures, fittings, vehicles and computers	3 - 7 years
Fixed and mobile plant	3 - 40 years

Depreciation methods, residual values and useful lives are re-assessed annually and, if necessary, changes are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account.

(c) Impairment of tangible fixed assets

Fixed assets are assessed for impairment whenever there is an indication of impairment to determine whether any assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(c) Impairment of tangible fixed assets (continued)

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of non-current assets is recognised in the profit and loss account within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the profit and loss account and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

(d) Stocks

Stocks are stated at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(e) Taxation

The tax expense represents the sum of current tax and deferred tax.

- **Current taxation**

Current taxation, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Taxable profit differs from the profit on ordinary activities before tax as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

- **Deferred taxation**

Deferred taxation is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes, which have arisen but not reversed by the balance sheet, except as otherwise required by FRS 19 “Deferred tax”.

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

Deferred taxation is measured at the tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with via the Statement of total recognised gains and losses.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(f) Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

- **Finance leases**

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease.

The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease to the first break clause.

- **Operating leases**

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

(g) Pension and other post retirement benefits

The Company operates two large defined benefit pension schemes. The Company accounts for these schemes in accordance with FRS 17 “Retirement Benefits”. These schemes are independently, administered funds, for the substantial majority of the Company’s employees. Actuarial valuations are carried out as determined by the pension scheme trustees using the projected unit credit method for both pension schemes at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. The Company believes that the assumptions utilised in recording obligations under the two schemes are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions. For any intervening reporting period, the actuaries review the continuing appropriateness of the contribution rates (a complete actuarial valuation is performed every three years). Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the assets and liabilities of the schemes are recognised as a surplus (to the extent that the surplus is recoverable) or obligation in the balance sheet.

The cost of providing pension benefits to employees is included in the profit and loss account within the cost of employee benefits. The difference between the expected return on scheme assets and interest on scheme liabilities are included within other finance income/expense in the profit and loss account.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and are presented in the Statement of total recognised gains and losses.

In addition to the defined benefit schemes, the Company operates a Defined Contribution Stakeholder Pension Scheme (“DCSPS”), managed through Standard Life Assurance Limited (“Standard Life”). From 1 April 2011 the DCSPS is the only scheme to which new entrants to the Company will be eligible. The Company’s Extended Leadership Team of executives have also joined this scheme from 1 April 2011 and are no longer active members of a defined benefit arrangement.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued

(g) Pension and other post retirement benefits

The Company also operates two closed defined contribution pension schemes. The Company has no further payment obligations for these schemes. However, defined funds for individuals are held within these schemes.

(h) Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange current at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling using the rate of exchange current at the balance sheet date. Gains and losses arising on retranslation are included in the profit and loss account for the year.

(i) Cash and cash equivalents

Cash includes cash at bank and in hand, deposits, and short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

(j) Provision for doubtful debts

At each reporting date, the Company evaluates the collectability of trade receivables and records provisions for doubtful receivables based on experience. These provisions are based on, amongst other things, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

At each reporting date, the Company evaluates the value of cancellations that will occur in the future against turnover booked, and not be rebilled. The provision is based on history of cancellations and subsequent rebills, which could affect operating results positively or negatively.

(k) Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

- **Borrowings**

Interest bearing bank loans and overdrafts are recorded as the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis in the profit and loss using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

- **Financial instruments and derivatives**

Interest rate swap agreements and financial futures are used to manage interest rate exposure. While the Company enters into currency swaps to manage its exposure to fluctuations in exchange rates, the Company does not use derivative financial instruments for speculative purposes.

The Company currently does not apply FRS 26 ”Financial Instruments: Recognition and Measurement”, and accordingly the disclosure requirements of FRS 29 ”Financial Instruments: Disclosures” are not applicable.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

- **Financial instruments and derivatives (continued)**

Therefore, the presentation requirements of FRS 25 “Financial Instruments: Presentation” have been applied. However, certain voluntary disclosures have been prepared to aid understanding and comparability with prior year.

Foreign currency and interest rate swaps are all in hedging relationships and are accounted for on an amortised cost basis. Swaps are included within the appropriate caption in note 17.

(l) Accruals and deferred income

Grants and contributions receivable in respect of depreciating fixed assets are treated as deferred income, which is credited to the profit and loss account over the estimated economic lives of the related assets.

(m) Research and development

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

(n) Accounting for provisions and contingencies

The Company is subject to a number of claims that are incidental to the normal conduct of its business. These relate to and include commercial and contractual claims, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience.

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Insurance provisions are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts. Provisions are recorded in the balance sheet at their full value and are not therefore discounted.

(o) Related party disclosures

The Company has taken advantage of the exemption under paragraph 3(c) from the provisions of FRS 8 ”Related party disclosures”, which requires the disclosure of the details of material transactions with other wholly owned subsidiaries within the Kemble Water Holdings Limited Group, on the grounds that it is a wholly owned subsidiary of Kemble Water Holdings Limited, a company registered in the United Kingdom.

(p) Dividends

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(r) LTIPS and bonus

Cash based LTIPS awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the schemes applicable taken into account the duration of the individual scheme and the assumptions used to award payments.

Bonus payments are accrued in the year based on targets assessed at the beginning of each year and paid in the following year when actual performance is measured against the targets set.

2 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

3 Operating costs

Analysis of operating costs by type of expense:

	Note	**31 March 2012 £m**	31 March 2011 £m
Staff costs excluding exceptional item	5	**199.4**	207.5
Exceptional item – pension curtailment gain *	26	**(40.0)**	-
Materials and consumables		**155.6**	136.6
Other operating charges		**476.4**	433.7
Depreciation:			
Owned assets (infrastructure renewals charge)	10	**129.5**	132.4
Owned assets (non-infrastructure)	10	**276.5**	251.3
Assets held under finance leases (non-infrastructure)	10	**9.6**	9.6
Rental under operating leases:			
Hire of plant and machinery		**10.0**	9.3
Other		**5.7**	5.4
Research and development		**3.9**	3.4
Other operating income		**(7.1)**	(7.3)
Foreign currency loss		**-**	0.9
		1,219.5	1,182.8
Own work capitalised (staff and other costs)		**(168.5)**	(159.9)
		1,051.0	1,022.9

* During the period a curtailment gain of £40.0m arising from changes to certain provisions, in respect of the Thames Water Pension Scheme, which came into effect on 1 May 2011, has been classified as an exceptional item. This gain arose as a result of changes to scheme benefits, which have reduced future liabilities. The directors consider that due to the materiality and one-off nature of this curtailment gain, it is appropriate to classify this as an exceptional item in order to show a true and fair view of the Company's underlying performance. The tax charge on this exceptional item is £9.6m. This exceptional item had a £nil cash flow impact.

Amounts receivable by the Company's auditor in is shown below in respect of the following services to the Company:

Fees payable to the auditor:	**31 March 2012 £'000**	31 March 2011 £'000
Fees payable to the Company's auditor for the audit of the Company's accounts	**229**	213
Fees payable to the Company's auditor and its associates for other services:		
Other services pursuant to legislation	**71**	78
Other services relating to taxation	**25**	18
Other services relating to information technology	**118**	-
All other services	**2,084**	241
Total aggregate remuneration	**2,527**	550

Fees for all other services above include £1.9m in respect of advice on the Thames Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG following a competitive tendering process in line with the Company's procurement processes.

No other fees were payable to KPMG Audit Plc in respect of this Company in this year or the prior year.

Notes to the Financial statements for the year ended 31 March (continued)

4 Profit on sale of fixed assets

	31 March 2012 £m	31 March 2011 £m
Profit on disposal of fixed assets	**3.9**	10.9
Taxation charge attributable, included in the current tax (credit)/charge for the period – note 8	**1.6**	2.0

5 Information regarding directors and employees

Aggregate directors' emoluments:

	31 March 2012 £'000	31 March 2011 £'000
Salary	**1,083**	1,092
Pension	**184**	89
Bonus	**681**	875
LTIPs	**667**	1,106
Other benefits	**66**	65
Total aggregate emoluments	**2,681**	3,227

Included in the table above, is £2,365,237 (2011: £2,911,903) for the executive directors for their services to the Company. In addition, the executive directors received total remuneration of £775,545 (2011: £883,112) for their services to other companies within the Group.

At 31 March 2012 £2,171 is accruing to 2 directors (2011: £45,031 for 2 directors) under the Group's defined benefit scheme in respect of services to the Company. In addition, the Company contributed £131,675 (2011: £nil) either as a cash supplement or into a personal pension scheme for 3 directors (2011: nil directors).

At 31 March 2012 £74,375 is accruing to 1 director (2011: £79,495 for 1 director) under a defined contribution scheme.

Highest paid director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid director in respect of work done for the Company during the year were £1,021,837 (2011: £1,168,425) and accrued pension under a defined contribution scheme was £74,375 (2011: £79,495, defined benefit scheme). In addition, emoluments of £437,930 (2011: £500,753) were paid to the highest paid director for services to other companies within the Group.

Details of Long Term Incentive Plans ("LTIP") can be found within the Directors' remuneration report on pages 44 to 47

Notes to the Financial statements for the year ended 31 March (continued)

5 Information regarding directors and employees (continued)

Employee information

The average number of persons employed by the Company, including executive directors, during the year, analysed by category, was as follows:

	31 March 2012 Number	31 March 2011 Number
Support	**323**	331
Operations	**4,228**	4,555
Total employee numbers	**4,551**	4,886

Employment costs excluding exceptional item (see note 3, page 75) but including executive directors' remuneration were:

	Note	**31 March 2012 £m**	31 March 2011 £m
Salaries and wages		**166.3**	167.1
Social security costs		**15.8**	13.7
Pension costs – defined benefit scheme	26	**16.4**	25.2
Pension costs – defined contribution scheme	26	**1.4**	0.2
Severance costs		**1.3**	3.1
Total		**201.2**	209.3
Employment costs included within research and development		**(1.8)**	(1.8)
Net employment costs		**199.4**	207.5

In addition, £9.3m (2011: £10.9m) of employment costs were charged directly to capital projects.

6 Interest payable and similar charges

	31 March 2012 £m	31 March 2011 £m
Bank loans, overdrafts and other loans:		
Group undertakings:		
Internal interest expense	**(288.3)**	(234.1)
RPI accretion on loans	**(123.8)**	(118.7)
Amortisation of debt issue costs	**(4.8)**	(5.2)
Bank and other loans:		
External interest expense	**(21.1)**	(28.7)
RPI accretion on loans	**(58.5)**	(69.1)
Amortisation of debt issue costs	**(1.4)**	(0.7)
Finance charges in respect of finance leases	**(6.8)**	(5.6)
Interest payable and similar charges	**(504.7)**	(462.1)

Notes to the Financial statements for the year ended 31 March (continued)

7 Interest receivable

	31 March 2012 £m	31 March 2011 £m
Interest receivable:		
Group loans	**39.4**	24.4
Other loans	**7.8**	3.7
Net swaps receivable	**34.3**	35.7
Interest receivable	**81.5**	63.8

Amounts receivable on swaps relate to interest rates taken out to hedge rates on borrowings. See note 17, page 86.

The net interest receivable/(payable) on swaps is the aggregate effect of all swaps held in the Company.

8 Taxation

(a) Analysis of charge in the year

	Note	31 March 2012 £m	31 March 2011 £m
Current tax:			
Amounts payable in respect of corporation tax for the year		**-**	4.8
Adjustment in respect of prior years		**(38.3)**	(4.3)
Total current tax (credit)/charge	8(b)	**(38.3)**	0.5
Deferred tax:			
Origination and reversal of timing differences		**43.8**	50.1
Adjustments in respect of prior years		**33.1**	2.1
Impact on deferred tax of tax rate change to 24% (2011: 26%)		**(80.7)**	(74.8)
Deferred tax credit	18	**(3.8)**	(22.6)
Timing difference on pension cost charge	26	**17.1**	5.4
Total deferred tax charge/(credit)		**13.3**	(17.2)
Taxation credit on profit on ordinary activities		**(25.0)**	(16.7)

For an explanation of the impact on deferred tax of the tax rate change to 24% (2011: 26%), see caption - (b) Factors affecting the current tax charge for the year on the following page.

8 Taxation (continued)

(b) Factors affecting the current tax charge for the year

The current tax (credit)/charge is based upon UK corporation tax at 26% (2011: 28%).

The tax (credit)/charge for the year is lower (2011: lower) than the standard rate of corporation tax in the UK (26%), (2011: 28%). The differences are explained below:

	31 March 2012 £m	31 March 2011 £m
Profit on ordinary activities before tax	**222.2**	208.5
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011: 28%)	**57.8**	58.4
Effects of:		
Disallowable expenditure less non taxable income	**3.1**	1.9
Capital allowances for the year in excess of depreciation and other timing differences	**(43.8)**	(50.1)
Pension cost charge lower than pension cost relief	**(17.1)**	(5.4)
Adjustments to tax charge in respect of prior years	**(38.3)**	(4.3)
Current tax (credit)/charge for the year	**(38.3)**	0.5

(c) Factors affecting tax charge for the year

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012. The financial statements for the year reflect these changes, a credit of £80.7m was taken to the profit and loss account and a charge of £3.1m was taken to reserves.

On 23 March 2011 the Chancellor announced the reduction in the main rate of UK corporation tax to 26% with effect from 1 April 2011. This change became substantively enacted on 29 March 2011 and therefore the effect of the rate reduction created a reduction in the deferred tax liability for the prior period of £74.8m, which has been included in the figures above.

The overall effect of the further reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £80.8m.

Notes to the Financial statements for the year ended 31 March (continued)

9 Dividends

The aggregate amount of dividends comprises:	Note	**31 March 2012 £m**	31 March 2011 £m
Dividends paid in respect of prior year but not recognised as liabilities in that year:			
Second interim paid: nil (2011: 2.7p) per ordinary share		**-**	28.2
Third interim paid: nil (2011: 7.3p) per ordinary share		**-**	75.0
Fourth interim paid: 2.4p (2011: nil) per ordinary share		**24.4**	-
Interim dividends paid in respect of the current year:			
First interim paid: 10.2p (2011: 5.6p) per ordinary share		**105.1**	57.3
Second interim paid: 4.9p (2011: 7.3p) per ordinary share		**50.0**	75.1
Third interim paid: 9.7p (2011: 3.5p) per ordinary share		**100.0**	35.8
	21 & 22	**279.5**	271.4

The interim dividend of £24.4m in respect of the year ended 31 March 2011 was paid to Thames Water Utilities Holdings Limited and was used to settle inter-company interest owing to Thames Water Utilities Limited.

Interim dividend distributions are analysed below:

	31 March 2012 £m	31 March 2011 £m
Intra group debt service distribution	**79.5**	121.4
External dividend distributions	**165.1**	115.1
External interest on Kemble Water Eurobond plc debt	**34.9**	34.9
	200.0	150.0
	279.5	271.4

Post balance sheet event

On 7 June 2012 the directors approved a fourth interim dividend of £201.4m (19.6p per ordinary share) in respect of the year ended 31 March 2012. This interim dividend will be paid to Thames Water Utilities Holdings Limited ("TWUHL") on 27 June 2012, and will be used as follows;

- On the same day, TWUHL will use £39.4m to settle its inter-company interest balance payable to TWUL;
- On the same day, TWUHL will pass the remaining £162.0m up the Group structure to be used as detailed below;
    - Thames Water Limited will receive from TWUHL £40.0m and will use this to settle an inter-company balance relating to group relief payments;
    - Subsidiaries of the Group will use £47.5m to settle interest on the Group's external debt, including a payment of £17.5m on Kemble Water Eurobond plc's debt.
    - The remaining £74.5m will be paid as a dividend to the shareholder's of KWHL.

10 Tangible fixed assets

	Land and buildings	Plant and equipment	Infrastructure assets	Assets in course of construction	Total
	£m	£m	£m	£m	£m
Cost					
At 1 April 2011	2,516.6	4,416.1	4,649.6	1,188.6	12,770.9
Additions	-	-	-	1,095.9	1,095.9
Transfers between items	74.6	376.5	318.7	(769.8)	-
Disposals	-	(24.5)	(0.3)	-	(24.8)
At 31 March 2012	**2,591.2**	**4,768.1**	**4,968.0**	**1,514.7**	**13,842.0**
Capital contributions					
At 1 April 2011	-	-	631.2	-	631.2
Additions	-	-	32.1	-	32.1
At 31 March 2012	**-**	**-**	**663.3**	**-**	**663.3**
Depreciation					
At 1 April 2011	638.3	2,283.1	1,073.1	-	3,994.5
Provided during the year	40.9	245.2	129.5	-	415.6
Disposals	-	(19.7)	-	-	(19.7)
At 31 March 2012	**679.2**	**2,508.6**	**1,202.6**	**-**	**4,390.4**
Net book value					
At 31 March 2012	**1,912.0**	**2,259.5**	**3,102.1**	**1,514.7**	**8,788.3**
At 31 March 2011	1,878.3	2,133.0	2,945.3	1,188.6	8,145.2

The Company adopted approximately 40,000 km of private sewers and lateral drains on 1 October 2011, which had a historical net book value of £nil due to no payment was made and there are no current economic benefits to the Company on adoption. For its current cost equivalent, see note 4b on page 119 of the regulatory accounts within this report.

The net book value of land and buildings is analysed as follows:

	31 March 2012 £m	31 March 2011 £m
Freehold land and buildings	**1,901.7**	1,867.7
Leasehold – over 50 years	**7.6**	7.8
Leasehold – under 50 years	**2.7**	2.8
	1,912.0	1,878.3

Depreciation has not been charged on freehold land stated in the financial statements at cost of £120.3m (2011: £117.1m).

10 Tangible fixed assets (continued)

Details of the Company's tangible fixed assets, which are held under finance leases, are:

	Total £m
Cost	
At 1 April 2011 and 31 March 2012	**263.2**
Depreciation	
At 1 April 2011	136.8
Provided during the year	9.6
At 31 March 2012	**146.4**
Net book value	
At 31 March 2012	**116.8**
At 31 March 2011	126.4

11 Fixed asset investments

	31 March 2012 £m	31 March 2011 £m
Cost of shares in subsidiaries	**0.1**	0.1

At 31 March 2012 the Company held the allotted share capital of the following undertakings:

Name of undertaking	**Nominal value and class of shares held**	**Proportion of nominal value of issued shares held**	**Activity**
Thames Water Utilities Finance Limited	£1 Ordinary	100%	Finance Company
Thames Water Utilities Cayman Finance Holdings Limited	$1 Ordinary	100%	Finance Company

Thames Water Utilities Finance Limited was incorporated and registered in Great Britain. Thames Water Utilities Cayman Finance Holdings Limited was incorporated and registered in the Cayman Islands and resident in the United Kingdom for tax.

At 31 March 2012 Thames Water Utilities Finance Limited had net liabilities of £70.7m (2011: liabilities £43.2m) and incurred a loss for the year ended 31 March 2012 of £27.5m (2011: loss £11.1m).

At 31 March 2012 Thames Water Utilities Cayman Finance Holdings Limited had net assets of £1 (2011: £1). No profit or loss had been made in the year (2011: £nil).

Notes to the Financial statements for the year ended 31 March (continued)

12 Stocks

	31 March 2012 £m	31 March 2011 £m
Raw materials and consumables	**9.6**	8.2

13 Debtors: amounts falling due within one year

	31 March 2012 £m	31 March 2011 £m
Trade debtors	**254.8**	267.6
Amounts owed by group undertakings		
- Interest	**39.4**	24.4
- Non interest	**40.4**	0.4
Amounts receivable in respect of corporation tax	**-**	12.3
Amounts receivable in respect of group relief	**-**	28.0
Other debtors	**70.5**	65.2
Insurance claims receivable	**56.8**	53.7
Prepayments and accrued income	**186.0**	170.3
	647.9	621.9

Prepayments and accrued income as at 31 March 2012 includes water and wastewater income not yet billed of £146.7m (2011: £137.9m).

Amounts owed by group undertakings are comprised of:

- Interest receivable of £39.4m (2011: £24.4m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking, on a loan of £2,015.0m (2011: £1,865.0m), of which £39.4m (2011: £24.4m) is included within debtors: amounts falling due within one year and £nil (2011: £nil) within debtors: amounts falling due after more than one year.

- All other amounts are unsecured, interest free and payable on demand.

14 Debtors: amounts falling due after more than one year

	31 March 2012 £m	31 March 2011 £m
Amounts owed by group undertakings	**2,015.0**	1,865.0

Amounts owed by group undertakings are comprised of:

- An unsecured loan of £2,015.0m (2011: £1,865.0m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking. The directors do not anticipate any repayment of principal within the next twelve months.

  Interest is charged at the London Inter-bank Offered rate ("LIBOR") + 0.35%.

Notes to the Financial statements for the year ended 31 March (continued)

15 Creditors: amounts falling due within one year

	31 March 2012 £m	31 March 2011 £m
Obligations under finance leases	**56.5**	7.9
Trade creditors:		
- Operating	**280.7**	254.4
- Capital	**243.0**	332.3
Amounts owed to group undertakings:		
- Secured loan amounts (see below)	**470.0**	7.6
- Interest	**126.8**	129.2
- Non interest	**8.9**	-
Amounts payable in respect of group relief	**0.9**	-
Other taxation and social security payable	**4.6**	3.7
Accruals and deferred income	**269.0**	281.2
	1,460.4	1,016.3

Accruals and deferred income includes £82.0m (2011: £81.8m) of receipts in advance relating to amounts received from customers for water and wastewater charges in respect of the following year.

16 Creditors: amounts falling due after more than one year

	31 March 2012 £m	31 March 2011 £m
Secured bank loans	**666.9**	573.4
Obligations under finance leases	**130.8**	187.2
Amounts owed to group undertakings: secured loan amounts (see below)	**7,073.4**	6,799.1
Accruals and deferred income	**179.1**	189.0
	8,050.2	7,748.7

Amounts owed to group undertakings for secured loans for the year ended 31 March 2012 are shown net of external cross currency and index linked swaps.

	31 March 2012 £m	31 March 2011 £m
Amounts owed to group undertakings are:		
Inter-company secured loans		
- Within one year	**417.1**	15.0
- After more than one year	**6,939.8**	6,672.6
	7,356.9	6,687.6
Non-loan amounts due within one year		
- Interest	**126.8**	129.2
- Non interest	**8.9**	-
	7,492.6	6,816.8

16 Creditors: amounts falling due after more than one year (continued)

Inter-company secured loans for the year ended 31 March 2012 as shown in the above table represent the liability of the Company owed to group undertakings as detailed below and do not include the effect of derivatives held within the Company.

Secured bank loans

Each Obligor (the companies within the Securitisation Group) has entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited will guarantee the obligations of each other Obligor under the finance documents and the Company and its wholly-owned subsidiaries will guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

Amounts due to group undertakings in respect of non-interest amounts are unsecured, interest free and payable on demand.

Loan amounts owed to group undertakings include:

- £2,747.2m (2011: £2,699.7m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking, of which £nil (2011: £15.0m) is included within creditors due within one year and £2,747.2m (2011: £2,684.7m) within creditors due after more than one year.

- £4,623.0m (2011: £4,001.5m) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking, of which £417.1m (2011: £nil) is included within creditors due within one year and £4,205.9m (2011: £4,001.5m) within creditors due after more than one year.

Details of maturity of loans falling due after more than one year are detailed in note 17.

17 Financial instruments

FRS 25 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities.

Funding and treasury policy

The Company's treasury operations are managed centrally by a small specialist team within the Thames Water Group reporting directly to the Chief Financial Officer. The treasury team manages the financing (including debt, interest costs and foreign exchange) for the Group. Treasury policy is focussed on efficient and effective management of cash and financial resources within the Group.

The Company's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance Limited and Thames Water Utilities Cayman Finance Limited is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

Derivative financial instruments, including cross currency swaps, interest rate swaps and index-linked swaps, are employed to manage the currency interest rate and inflation risks arising from the primary financial instruments used to finance the Company's activities.

Short-term debtors and creditors have been excluded from the financial instruments disclosures.

Interest rate risk profile of financial liabilities and assets

After taking into account the Company's interest rate and currency swaps, the interest rate risk profile of the Company's financial liabilities and assets is as follows:

17 Financial instruments (continued)

Financial liabilities

	Total at floating rates		Total at fixed rates		Total at RPI linked rates		Total book value	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Bank loans and overdraft								
- £ Sterling	**132.3**	122.1	**17.7**	27.9	**516.8**	423.4	**666.8**	573.4
Other loans and finance leases *								
- £ Sterling	**316.0**	323.8	**3,680.2**	3,208.2	**3,734.6**	3,469.8	**7,730.8**	7,001.8
	448.3	445.9	**3,697.9**	3,236.1	**4,251.4**	3,893.2	**8,397.6**	7,575.2

	Weighted average interest rate at fixed rate and RPI linked debt		Weighted average period until maturity for which rate is fixed at fixed rate and RPI linked debt	
	2012 %	2011 %	**2012 Years**	2011 Years
Bank loans and overdraft				
- £ Sterling	**2.0**	2.2	**12.9**	14.1
Other loans and finance leases *				
- £ Sterling	**3.6**	3.7	**22.1**	24.1
	3.6	3.6	**22.1**	23.5

Within the above table, 'total at RPI linked rates' are now shown as a separate category. Previously these were included within the 'total at fixed rates' category. The directors consider that this reclassification is appropriate reflecting the amount of financial liabilities held as RPI linked bonds. Total financial liabilities remain unchanged as a result of this reclassification.

* Includes inter-company debt.

The Company's interest rate and cross currency swaps convert £nil (2011: £27.9m) of floating rate borrowing to fixed rate and £235.0m (2011: £235.0m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £1,646.0m (2011: £632.8m) of foreign currency borrowing through conversion to Sterling. Index linked swaps of £894.1m (2011: £894.1m) swapped inter-company fixed rate debt to index linked debt. All swaps are included at their notional amount. Total accretion on the index linked swaps is £132.0m (2011: £92.0m).

Short-term floating rate loans bear interest at rates linked to LIBOR. Base rate is the benchmark rate for all cash at bank.

	Total at floating rates		Total at book value	
	31 March 2012 £m	31 March 2011 £m	**31 March 2012 £m**	31 March 2011 £m
Short term deposits	**619.4**	775.8	**619.4**	775.8
Cash in bank and in hand	**2.7**	3.6	**2.7**	3.6
	622.1	779.4	**622.1**	779.4

The total in the table above should be treated as available cash for covenant calculation purposes.

Notes to the Financial statements for the year ended 31 March (continued)

17 Financial instruments (continued)

Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book value		Fair value	
	31 March 2012 £m	31 March 2011 £m	**31 March 2012 £m**	31 March 2011 £m
Primary financial instruments				
Financial assets:				
- Short term deposits	**619.4**	775.8	**619.4**	775.8
- Cash at bank and in hand	**2.7**	3.6	**2.7**	3.6
Financial liabilities:				
- Bank loans	**(666.9)**	(573.4)	**(666.9)**	(580.8)
- Other loans and finance leases *	**(7,544.2)**	(6,881.0)	**(8,162.0)**	(6,944.4)
Derivative financial instruments				
- Interest rate swaps	**-**	-	**(93.0)**	(25.3)
- Cross currency swaps	**(54.5)**	(28.8)	**(90.3)**	(32.1)
- Index linked swaps	**(132.0)**	(92.0)	**(279.9)**	(206.3)
Total	**(7,775.5)**	(6,795.8)	**(8,670.0)**	(7,009.5)

* Includes inter-company debt.

Thames Water Utilities Limited does not itself hold bonds.

Other loans include bonds issued by group undertakings and external providers, which are publicly traded and loaned to Thames Water Utilities Limited. Fair values for these have been calculated using the 31 March 2012 quoted prices.

Mark-to-market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowings and all derivative financial instruments.

17 Financial instruments (continued)

Maturities	31 March 2012 £m	31 March 2011 £m
Bank loans and overdrafts		
- After more than five years	**666.9**	573.4
	666.9	573.4
Other loans including inter-company		
- Within one year	**470.0**	7.6
- Between one and two years	**-**	469.9
- Between two and five years	**734.3**	299.9
- After more than five years	**6,339.1**	6,029.3
	7,543.4	6,806.7
Finance leases		
- Within one year	**56.5**	7.9
- Between one and two years	**28.1**	56.5
- Between two and five years	**80.2**	93.3
- After more than five years	**22.5**	37.4
	187.3	195.1
Total borrowing	**8,397.6**	7,575.2

Loans are repayable between 2012 and 2062.

Loans wholly repayable after more than five years, excluding finance leases are:

	31 March 2012 £m	31 March 2011 £m
Bank loans	**666.9**	573.4
Other loans including inter-company	**6,399.1**	6,029.2
	7,066.0	6,602.6

Other listed secured loans repayable to Group undertakings in order of maturity include:

€500m 6.13% Fixed rate bond due 2013.	£600m 5.13% Fixed rate bond due 2037.
$156m 3 month US$ libor + 0.95% floating rate bond due 2015.	20bn Yen 3.28% Fixed rate bond due 2038.
£200m 4.90% Fixed rate bond due 2015.	£50m 3.85% Index linked bond due 2040.
€500m 3.25% Fixed rate bond due 2016.	£500m 5.5% Fixed rate bond due 2041.
£400m 7.24% Fixed rate bond due 2018.	£50m 1.98% Index linked bond due 2042.
£200m 5.05% Fixed rate bond due 2020.	£55m 2.09% Index linked bond due 2042.
£225m 6.59% Fixed rate bond due 2021.	£40m 1.97% Index linked bond due 2045.
£175m 3.38% Index linked bond due 2021.	£100m 1.85% Index linked bond due 2047.
£75m 1.35% Index linked bond due 2021.	£200m 1.82% Index linked bond due 2049.
£550m 5.38% Fixed rate bond due 2025 (note 1).	£300m 1.68% Index linked bond due 2053.
£330m 6.75% Fixed rate bond due 2028.	£300m 1.68% Index linked bond due 2055.
£300m 5.75% Fixed rate bond due 2030 (note 2).	£200m 1.77% Index linked bond due 2057.
£200m 6.50% Fixed rate bond due 2032.	£350m 1.76% Index linked bond due 2062.

Notes to the Financial statements for the year ended 31 March (continued)

17 Financial instruments (continued)

Maturities (continued)

Note 1: £550m Class B bond issued on a fixed coupon basis until 21 July 2017, when the bond resets to floating rate interest at LIBOR plus margin.

Note 2: £300m Class B bond issued on a fixed coupon basis until 13 September 2022, when the bond resets to floating rate interest at LIBOR plus margin.

See note 16, page 84 for details of secured bank loans.

Loans repayable by instalments after more than five years hence are:

	31 March 2012 £m	31 March 2011 £m
Finance leases	**22.5**	37.4

The ranges of interest rates on outstanding loans are 0.21% to 8.35% (2011: 0.78% to 8.35%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

Borrowing facilities

At 31 March 2012 the Company had access to committed facilities of £1,200.0m (2011: £1,175.0m) of which £nil (2011: £nil) had been drawn at the balance sheet date, through its subsidiary company Thames Water Utilities Cayman Finance Limited.

18 Provisions for liabilities and charges

	Deferred tax £m	**Insurance liabilities £m**	**Restructuring £m**	**Other £m**	**Total £m**
At beginning of the year	972.9	53.7	1.8	25.9	1,054.3
Utilised during the year	-	-	(2.6)	(0.1)	(2.7)
(Credit)/charge to profit and loss for the year	(3.8)	3.1	1.3	0.4	1.0
At end of the year	**969.1**	**56.8**	**0.5**	**26.2**	**1,052.6**

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012, the combined total of these changes of £80.7m is reflected in the above table.

The overall effect of the further reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £80.8m.

The insurance provision is in respect of insurance claims notified. A debtor in respect of these obligations is included in note 13 (see page 83) representing the reimbursement value from captive and third party insurance companies.

18 Provisions for liabilities and charges (continued)

The restructuring provision principally relates to severance costs as a result of the Company's restructuring and reorganisation. This provision is expected to be utilised over the next year.

Other provisions principally relate to a number of legal claims against the Company and represents Management's best estimate of the value of settlement and costs. It is estimated that some claims will be settled in more than one year.

The elements of deferred tax are as follows:

	Note	**31 March 2012 £m**	31 March 2011 £m
Accelerated capital allowances		**978.4**	979.6
Tax losses carried forward		**(2.6)**	-
Other timing differences		**(6.7)**	(6.7)
		969.1	972.9
Total deferred tax provision:			
Included above		**969.1**	972.9
Deferred tax asset recognised on pension deficit	26	**(37.2)**	(33.2)
		931.9	939.7

At 31 March 2012 there are no amounts of deferred tax unprovided for (2011: £nil).

The pension liability per note 26 is shown net of deferred tax.

19 Called up share capital

	31 March 2012 £m	31 March 2011 £m
Allotted, called up and fully paid		
1,029,050,000 ordinary shares of £1 each	**1,029.0**	1,029.0

20 Share premium account

	31 March 2012 £m	31 March 2011 £m
At 1 April and 31 March	**100.0**	100.0

Premium of 25p on issue of 400,000,000 £1 ordinary shares.

Notes to the Financial statements for the year ended 31 March (continued)

21 Profit and loss account

	Note	**31 March 2012 £m**	31 March 2011 £m
At the beginning of the year		**376.9**	427.4
Profit for the year		**247.2**	225.2
Dividends paid	9	**(279.5)**	(271.4)
Retained loss		**(32.3)**	(46.2)
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Movement on deferred tax relating to pension scheme		**21.4**	(3.2)
At the end of the year		**271.6**	376.9

22 Reconciliation of movements in shareholder's funds

	Note	**31 March 2012 £m**	31 March 2011 £m
At the beginning of the year		**1,505.9**	1,556.4
Profit for the year		**247.2**	225.2
Dividends paid	9	**(279.5)**	(271.4)
Retained loss		**(32.3)**	(46.2)
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Movement on deferred tax relating to pension scheme		**21.4**	(3.2)
		(105.3)	(50.5)
At the end of the year		**1,400.6**	1,505.9

23 Capital commitments

	31 March 2012 £m	31 March 2011 £m
Contracted for but not provided	**1,035.5**	1,517.2

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth.

24 Contingencies

There are claims arising in the normal course of business, which are in the process of negotiation.

The Company has set aside amounts considered appropriate for all legal and similar claims as per note 18.

Notes to the Financial statements for the year ended 31 March (continued)

24 Contingencies (continued)

Contingent liabilities

Following the Company's submission of its June Return in June 2010, Ofwat raised concerns about data reported to it in connection with the Company's delivery of its AMP4 hydraulic flooding programme including specifically in relation to the use of hydraulic modelling to support the identification of properties for inclusion in the June Return.

Ofwat issued a notice under Section 203 of the Water Industry Act 1991 on 9 June 2011 to formally request additional information. The Company response was made on 29 July 2011, with supplementary responses on 7 October 2011 and 18 November 2011. The Company had a meeting with Ofwat on 28 February 2012 to discuss any residual concerns which it may have in more detail.

In May 2012, Ofwat notified the Company that it had formally transferred the case to an internal Ofwat casework team through its gateway process to continue with the investigation. Ofwat has indicated that this formal transfer does not prejudge the outcome of the investigation and is a procedural step. Ofwat has further indicated that it is unlikely to conclude its investigations until at least the third quarter of 2012.

If Ofwat concludes that the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs, which Ofwat determines have not been achieved during the AMP4 period. Any such potential financial impact cannot yet be quantified and, as such, no provision has been made within these accounts.

25 Operating leases

At 31 March 2012 the Company was committed to making the following annual payments in respect of non-cancellable operating leases:

	31 March 2012		31 March 2011	
	Land and buildings	**Other**	Land and buildings	Other
	£m	**£m**	£m	£m
Leases which expire:				
- Within one year	**0.1**	**-**	-	-
- In the second to fifth year inclusive	**0.6**	**0.2**	0.2	1.5
- Over five years	**5.9**	**1.2**	6.2	-
	6.6	**1.4**	6.4	1.5

See note 17 ‘Financial instruments’ on page 88 for further information regarding obligations under finance leases.

26 Pension schemes

Pension arrangements for the majority of the Company’s employees are of the defined benefit type, funded through two Group pension schemes; TWPS and Thames Water Mirror Image Pension Scheme (“TWMIPS”) (see table below for details of each schemes’ respective deficit or surplus), covering employees within the Thames Water Group, whose assets are held separately from those of the Group in independently administered funds.

26 Pension schemes (continued)

The defined benefit arrangements were closed to new employees from 1 April 2011. From this date, new employees have been offered membership of a defined contribution scheme managed through Standard Life; see note 1, page 67. Contributions to the scheme are charged to the profit and loss account in the period to which they relate.

Contributions to the defined contribution pension scheme in the year were £1.4m (2011: £0.2m).

The Company's defined benefit pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes' assets and liabilities are included with those of other companies in the Group. The Company contributes the vast majority of the contributions into the schemes and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. Accordingly, the directors have decided it is appropriate to recognise the net deficit of the two Group pension schemes within these financial statements.

The service cost of the Company, as included in the profit and loss account, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial period.

In addition to the cost of the UK Pension arrangements, the Company operates arrangements under which it augments benefits on retirement in certain circumstances of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 March 2012 payments amounted to £1.5m (2011: £2.1m).

The latest full actuarial valuation was undertaken as at 31 December 2010 on behalf of the pension Trustee's by Aon Hewitt Limited ("Hewitt") (the independent and professionally qualified consulting actuaries to the schemes). This valuation has been updated at 31 March 2012 by Mercer Limited ("Mercer"), independent and professionally qualified consulting actuaries, using revised assumptions that are consistent with the requirements of FRS 17 and shown in this note to the accounts.

Thames Water Group has taken advice from Mercer in respect of the funding position of the Group pension schemes.

Net liability by pension schemes before deferred tax

	31 March 2012 £m	31 March 2011 £m
Thames Water Pension Scheme:		
Deficit in scheme	**(190.0)**	(165.8)
Thames Water Mirror Image Pension Scheme:		
Surplus in scheme	**73.5**	59.6
Impact of irrecoverable surplus	**(39.9)**	(21.6)
	33.6	38.0
Liability before deferred tax asset	**(156.4)**	(127.8)

The TWPS net liability is £144.4m (2011: £122.7m) after deferred tax credit, and TWMIPS net asset is £25.2m (2011: £28.1m) after deferred tax charge as disclosed on the balance sheet on page 62.

The Company has recognised a surplus in the TWMIPS to the extent that it may possibly be able to recover it by paying a reduced rate of contributions in the future. The recognisable surplus has been calculated in accordance with FRS 17 as the present value of the current service cost projected over the future working lifetime of all active members of the scheme, using the assumptions adopted at 31 March 2012.

26 Pension schemes (continued)

Reconciliation of funded status to balance sheet:

	31 March 2012 £m	31 March 2011 £m
Fair value of scheme assets	**1,540.0**	1,403.8
Present value of scheme liabilities	**(1,656.5)**	(1,510.0)
Deficit in scheme	**(116.5)**	(106.2)
Impact of irrecoverable surplus	**(39.9)**	(21.6)
Liability recognised on the balance sheet	**(156.4)**	(127.8)
Deferred tax asset	**37.2**	33.2
Net pension liability	**(119.2)**	(94.6)

The assumptions used in the valuation of assets and liabilities of the schemes are the same for both schemes; see page 96, therefore the following tables are for the combined values for both schemes.

Movement in the present value of scheme liabilities:

	31 March 2012 £m	31 March 2011 £m
Opening present value of scheme liabilities	**1,510.0**	1,466.6
Current service cost: Thames Water Utilities Limited	**16.4**	25.2
Current service cost: Other Thames Water Group participating companies	**0.1**	0.2
Interest cost	**79.7**	81.2
Contribution by scheme participants	**0.2**	0.3
Curtailment gain on changes to scheme benefits	**(40.0)**	-
Actuarial losses on scheme liabilities	**153.7**	32.1
Actuarial gain from changes in inflation assumptions	**-**	(37.6)
Net benefit paid out	**(65.1)**	(60.1)
Termination pension cost	**1.5**	2.1
Closing present value of scheme liabilities	**1,656.5**	1,510.0

Movement in fair value of scheme assets:

	31 March 2012 £m	31 March 2011 £m
Opening fair value of scheme assets	**1,403.8**	1,317.4
Expected return on scheme assets	**77.3**	76.9
Actuarial gains on scheme assets	**77.6**	14.1
Contributions by the employer	**44.6**	52.0
Contributions by Other Thames Water Group participating companies	**0.1**	0.2
Contribution of section 75 debt payment	**-**	0.9
Contributions by scheme participants	**0.2**	0.3
Termination pension costs	**1.5**	2.1
Net benefits paid out	**(65.1)**	(60.1)
Closing fair value of scheme assets	**1,540.0**	1,403.8

26 Pension schemes (continued)

(Income)/expense recognised in the profit and loss account:

	31 March 2012 £m	31 March 2011 £m
Current service cost	**16.4**	25.2
Exceptional item – pension curtailment gain	**(40.0)**	-
Interest cost	**79.7**	81.2
Expected return on scheme assets	**(77.3)**	(76.9)
Total (income)/expense recognised in the profit and loss account	**(21.2)**	29.5

The (income)/expense is recognised in the following line items in the profit and loss account:

	31 March 2012 £m	31 March 2011 £m
Operating costs: staff (income)/costs	**(23.6)**	25.2
Other finance expense	**2.4**	4.3
Total (income)/expense charged in the profit and loss account	**(21.2)**	29.5

Analysis of amount recognised in the Statement of total recognised gains and losses:

	31 March 2012 £m	31 March 2011 £m
Actual return less expected return on pension scheme assets	**77.6**	14.1
Changes in assumptions underlying the present value of scheme liabilities	**(153.7)**	(32.1)
Changes in inflation assumption – CPI from RPI	**-**	37.6
Contribution of section 75 debt payment	**-**	0.9
Adjustment relating to irrecoverable surplus	**(18.3)**	(21.6)
Actuarial loss recognised in the Statement of total recognised gains and losses	**(94.4)**	(1.1)
Cumulative amount of losses recognised in the Statement of total recognised gains and losses	**(404.8)**	(310.4)

26 Pension schemes (continued)

Fair value of scheme assets and return on these assets:

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the average expected long-term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following table:

	31 March 2012		31 March 2011	
	Long-term expected rate of return	**Value £m**	Long-term expected rate of return	Value £m
Equities	**7.11%**	**533.0**	8.4%	473.2
Bonds	**4.63%**	**32.9**	5.5%	101.3
Gilts	**1.86-3.11%**	**774.3**	4.15-4.40%	638.8
Property	**6.11%**	**103.3**	7.4%	90.6
Other assets	**3.11%**	**96.5**	4.4%	99.9
Weighted average expected long-term rate of return/total fair value of assets	**4.6%**	**1,540.0**	5.9%	1,403.8

The Company employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

The main financial assumptions used for FRS 17 purposes are as follows:

	31 March 2012	31 March 2011
Price inflation – RPI	**3.1%**	3.5%
Price inflation – CPI	**2.4%**	3.0%
CARE revaluation (CPI max 2.5%)	**2.4%**	-
Salary increases - TWPS	**n/a**	4.5%
Salary increases - TWMIPS	**3.6%**	4.0%
Pension increases – RPI	**3.1%**	3.5%
Pension increases – CPI	**2.4%**	3.0%
Discount rate for scheme liabilities	**4.65%**	5.5%

26 Pension schemes (continued)

In valuing the liabilities of the pension schemes at 31 March 2012, mortality assumptions have been made as indicated below. These mortality assumptions are based on the recent actual mortality experience of members within the schemes and the assumptions also allow for future improvements to mortality rates.

	31 March 2012	31 March 2011
TWPS members who joined before/after 1 January 1995		
Life expectancy for a male pensioner from age 60	**27**	26
Life expectancy for a female pensioner from age 60	**29**	28
Life expectancy from age 60 for a male pensioner currently aged 40	**29**	28
Life expectancy from age 60 for a female pensioner currently aged 40	**31**	29
TWMIPS		
Life expectancy for a male pensioner from age 60	**26**	24
Life expectancy for a female pensioner from age 60	**28**	26
Life expectancy from age 60 for a male pensioner currently aged 40	**28**	26
Life expectancy from age 60 for a female pensioner currently aged 40	**30**	28

History of fair value of assets, present value of liabilities, (deficit)/surplus in scheme and experience gains and losses:

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 March 2008 £m
Fair value of scheme assets	**1,540.0**	1,403.8	1,317.4	1,040.3	1,214.8
Present value of scheme liabilities	**(1,656.5)**	(1,510.0)	(1,466.6)	(1,105.4)	(1,098.9)
(Deficit)/surplus in scheme	**(116.5)**	(106.2)	(149.2)	(65.1)	115.9

Experience adjustments:

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 March 2008 £m
Experience gains/(losses) on scheme assets:					
Amounts	**77.6**	14.1	220.6	(250.4)	(102.7)
Percentage of scheme assets	**5.0%**	1.0%	16.7%	24.1%	8.5%
Experience losses on scheme liabilities:					
Amounts	**(11.0)**	-	-	(44.3)	(5.4)
Percentage of scheme liabilities	**1%**	-	-	4.0%	0.5%
Total amount recognised in the Statement of total gains and losses:					
Amounts	**(94.4)**	(2.0)	(105.4)	(133.0)	3.9
Percentage of present value of scheme liabilities	**5.7%**	0.1%	7.2%	12.0%	0.4%

The Kemble Water Holdings Limited Group expects to contribute approximately £42.3m to the defined benefit schemes in the next financial year.

Notes to the Financial statements for the year ended 31 March (continued)

27 Off-balance sheet arrangements

The Company is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included on its balance sheet. The principal off-balance sheet arrangements are listed below:

- Operating leases (see note 25)
- Outsourcing contracts

In respect of outsourcing contracts, the Company has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include IT support, Legal Services, Supply Chain, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material impact on the financial position of the Group.

28 Intermediate and ultimate parent company and controlling party

Thames Water Utilities Holdings Limited, a company incorporated in the United Kingdom, is the immediate parent company.

Kemble Water Finance Limited, a company incorporated in the United Kingdom, is an intermediate parent company and the smallest group to consolidate these financial statements.

The directors consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the largest group to consolidate these financial statements.

Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water Group, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Kemble Water Holdings Limited is owned by a consortium of investors led by Macquarie European Infrastructure Funds LP and Macquarie European Infrastructure Fund II LP ("MEIF 1 & 2"). The directors do not consider there to be an ultimate parent or controlling party. Kemble Water Holdings Limited is the largest group to consolidate these financial statements.

MEIF 1 and 2 are wholesale investment funds in which the investors are largely pension funds and institutional investors. On behalf of these investors, MEIF 1 and 2 make long-term investments in infrastructure and related businesses located across Europe, aiming to deliver sustainable cash yields and moderate capital growth from diversified portfolios of quality infrastructure investments.

MEIF 1 & 2 are managed by Macquarie Infrastructure and Real Assets (Europe) Limited ("MIRAEL"). MIRAEL is a wholly owned member of the Macquarie Group, and is authorised and regulated by the Financial Services Authority. MIRAEL is resourced by executives of the Macquarie Infrastructure and Real Assets division of Macquarie Group.

Thames Water Utilities Limited

Regulatory accounts and required regulatory information

Explanatory note

The regulatory accounts and required regulatory information on pages 99 to 105 are provided to comply with Condition F of the Instrument of Appointment of Thames Water Utilities Limited as a water and sewerage undertaker under the Water Industry Act 1991.

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines ("RAG") issued by Ofwat.

There are differences between UK Generally Accepted Accounting Practice and the RAG. Where different treatments are specified under each, the RAG take precedence.

A glossary of regulatory terms is shown on pages 130 to 131.

The regulatory financial statements should be read in conjunction with the statutory Annual report and financial statements ("AR&A"). The AR&A include the Chief Executive Officer's business review (pages 6 to 31). In addition, the Directors' report (pages 32 to 36) includes a statement as to the disclosure of information to the auditor (page 35), the dividend policy of the Company which also applies to the appointed business (page 32) and information in respect of the Company's charitable donations (page 35). In addition, the Directors' remuneration report (pages 38 to 52) includes information linking their remuneration with standards of regulatory performance.

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 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 to 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.
- Keep proper accounting records, which comply with Condition F and RAG 5.04.

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

Ring fencing

In the opinion of the directors, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year. This relates to the availability of rights and assets in the event of a special administration order.

Regulatory accounts and required regulatory information (continued)

Regulatory historical cost profit and loss account for the year ended 31 March

	2012			2011		
	Appointed business £m	**Non-Appointed business £m**	**Total £m**	Appointed business £m	Non-Appointed business £m	Total £m
Turnover (Note 2, page 114)	**1,670.9**	**24.0**	**1,694.9**	1,600.0	23.1	1,623.1
Operating costs	**(795.3)**	**(9.6)**	**(804.9)**	(752.9)	(9.1)	(762.0)
Historical cost depreciation *	**(285.1)**	**(1.0)**	**(286.1)**	(259.9)	(1.0)	(260.9)
Operating income	**43.9**	**-**	**43.9**	10.9	-	10.9
Operating profit	**634.4**	**13.4**	**647.8**	598.1	13.0	611.1
Other expense	**(2.4)**	**-**	**(2.4)**	(4.3)	-	(4.3)
Net interest payable	**(423.0)**	**(0.2)**	**(423.2)**	(398.1)	(0.2)	(398.3)
Profit on ordinary activities before taxation	**209.0**	**13.2**	**222.2**	195.7	12.8	208.5
Taxation:						
- Current tax	**41.3**	**(3.0)**	**38.3**	3.2	(3.7)	(0.5)
- Deferred tax	**(12.9)**	**(0.4)**	**(13.3)**	17.2	-	17.2
	28.4	**(3.4)**	**25.0**	20.4	(3.7)	16.7
Profit for the year	**237.4**	**9.8**	**247.2**	216.1	9.1	225.2
Dividend	**(269.7)**	**(9.8)**	**(279.5)**	(262.3)	(9.1)	(271.4)
Retained loss for the year	**(32.3)**	**-**	**(32.3)**	(46.2)	-	(46.2)

* The historical cost depreciation has been analysed separately in order to comply with the presentational requirements of RAG 3.06

Statement of total recognised gains and losses (historical cost accounting) for the appointed business for the year ended 31 March

	31 March 2012	31 March 2011
	£m	£m
Profit for the year	**237.4**	216.1
Actuarial loss on pension schemes	**(94.4)**	(1.1)
Deferred tax relief/(charge) relating to actuarial loss	**21.4**	(3.2)
Total recognised gains in the year	**164.4**	211.8

Thames Water Utilities Limited

Regulatory accounts and required regulatory information (continued)

Regulatory historical cost balance sheet at 31 March

	2012			2011		
	Appointed business £m	**Non-Appointed business £m**	**Total £m**	Appointed business £m	Non-Appointed business £m	Total £m
Fixed assets						
Tangible assets	**8,747.7**	**7.7**	**8,755.4**	8,154.1	8.1	8,162.2
Investments – loan to group company	**2,015.0**	**-**	**2,015.0**	1,865.0	-	1,865.0
Investments - other	**0.1**	**-**	**0.1**	0.1	-	0.1
Total fixed assets	**10,762.8**	**7.7**	**10,770.5**	10,019.2	8.1	10,027.3
Current assets						
Stocks	**9.6**	**-**	**9.6**	8.2	-	8.2
Debtors: amounts falling due within one year	**647.9**	**-**	**647.9**	621.9	-	621.9
Infrastructure renewals prepayment	**32.9**	**-**	**32.9**	-	-	-
Cash at bank and in hand	**2.7**	**-**	**2.7**	3.6	-	3.6
Short term deposits	**619.4**	**-**	**619.4**	775.8	-	775.8
Total current assets	**1,312.5**	**-**	**1,312.5**	1,409.5	-	1,409.5
Creditors: amounts falling due within one year:						
Creditors	**(919.4)**	**(7.3)**	**(926.7)**	(986.0)	(8.1)	(994.1)
Borrowings	**(526.5)**	**-**	**(526.5)**	(15.5)	-	(15.5)
Infrastructure renewals accrual	**-**	**-**	**-**	(17.0)	-	(17.0)
Total creditors	**(1,445.9)**	**(7.3)**	**(1,453.2)**	(1,018.5)	(8.1)	(1,026.6)
Net current (liabilities)/asset	**(133.4)**	**(7.3)**	**(140.7)**	391.0	(8.1)	382.9
Total assets less current liabilities	**10,629.4**	**0.4**	**10,629.8**	10,410.2	-	10,410.2
Creditors: amounts falling due after more than one year:						
Borrowings	**(7,871.1)**	**-**	**(7,871.1)**	(7,559.7)	-	(7,559.7)
Other creditors	**(49.3)**	**-**	**(49.3)**	(52.7)	-	(52.7)
Total creditors	**(7,920.4)**	**-**	**(7,920.4)**	(7,612.4)	-	(7,612.4)
Provisions for liabilities and charges:						
Deferred tax provision	**(968.7)**	**(0.4)**	**(969.1)**	(972.9)	-	(972.9)
Deferred income – grants and contributions	**(137.0)**	**-**	**(137.0)**	(143.0)	-	(143.0)
Other provisions	**(83.5)**	**-**	**(83.5)**	(81.4)	-	(81.4)
Post employment liabilities	**(119.2)**	**-**	**(119.2)**	(94.6)	-	(94.6)
Net assets employed	**1,400.6**	**-**	**1,400.6**	1,505.9	-	1,505.9
Capital and reserves						
Called-up share capital	**1,029.0**	**-**	**1,029.0**	1,029.0	-	1,029.0
Share premium	**100.0**	**-**	**100.0**	100.0	-	100.0
Profit and loss account	**271.6**	**-**	**271.6**	376.9	-	376.9
Capital and reserves	**1,400.6**	**-**	**1,400.6**	1,505.9	-	1,505.9

Regulatory accounts and required regulatory information (continued)

Historical cost reconciliation between statutory and regulatory accounts at 31 March

	2012 Statutory UK GAAP £m	2012 Regulatory RAG 3 £m	Explanation
Profit and loss account			
Operating costs	**(1,051.0)**	**(804.9)**	The difference of £246.1m is due to the reporting of historic cost depreciation (£286.1m cost) as a separate category in the regulatory accounts and the exceptional item (£40.0m credit) in respect of the one off benefit arising from changes to the pension schemes, which is reported within operating income within the regulatory accounts in accordance with paragraph 2.1.33 of RAG 3.06.
Profit on sale of fixed assets	**3.9**	**-**	The difference of £3.9m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as 'operating income' for regulatory accounts.
Operating income	**-**	**43.9**	Profit on sale of fixed assets of £3.9m together with the exceptional item of £40.0m as reported above are disclosed within operating income in the regulatory accounts.
Operating profit	**643.9**	**647.8**	The difference of £3.9m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as 'operating income' for regulatory accounts.
Profit before taxation	**222.2**	**222.2**	Profit before taxation is unaffected by this re-classification.

Regulatory accounts and required regulatory information (continued)

Historical cost reconciliation between statutory and regulatory accounts at 31 March (continued)

	2012 Statutory UK GAAP £m	2012 Regulatory RAG 3 £m	Explanation
Balance sheet			
Fixed assets			
Tangible fixed assets (net book value)	**8,788.3**	**8,755.4**	The difference of £32.9m is due to the infrastructure renewals prepayment (2011: £17.0m accrual) as this is excluded from the fixed assets net book value in the regulatory accounts. This is in line with RAG 3.06 as FRS 15 is not applied for infrastructure renewals accounting for regulatory accounting purposes. For more detail see page 106.
Investments – loan to group company	**-**	**2,015.0**	A loan to the immediate parent company, Thames Water Utilities Holdings Limited is classified within this category within the regulatory accounts but disclosed as a debtor: amounts falling due after more than one year in the statutory accounts.
Debtors : amount falling due after more than one year	**2,015.0**	**-**	As above.
Current Assets			
Infrastructure renewals prepayment	**-**	**32.9**	The difference of £32.9m reflects the reclassification of infrastructure renewals accrual described above.
Short-term and long-term creditors			
Deferred income – grants and contributions:	**(137.0)**	**-**	Deferred grants and contributions of £137.0m (2011: £143.0.m) within the statutory accounts are analysed between creditors: amounts falling due within one year (£7.2m) and creditors: amounts falling due after more than one year (£129.8m). This is in contrast to the regulatory accounts, which shows total deferred grants and contributions within provisions for liabilities and charges.
Provision for liabilities and charges	**-**	**(137.0)**	As above.

Regulatory accounts and required regulatory information (continued)

Additional information required by the licence

Basis of preparation

In accordance with Condition F of the Instrument of Appointment, these regulatory financial statements have been prepared to show separately in respect of the appointed business, non-appointed business and total business, a profit and loss account and balance sheet prepared on a historical cost basis.

In accordance with the requirements of FRS 18, the directors review the Company's accounting policies to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view.

The financial statements have been prepared in accordance with the historical cost convention and, except for the classification of profit on the sale of fixed assets as explained in note (a) below, the treatment of infrastructure renewals expenditure as explained in note (b) below and the treatment of certain capital contributions as explained in note (c) below, have been prepared in accordance with the Companies Act 2006. The departures from applicable UK Accounting Standards are necessary to comply with regulatory reporting requirements laid down by Ofwat.

Changes to accounting policies

The same accounting policies as those used for the year ended 31 March 2012 have been applied in these financial statements.

(a) Profit on sale of fixed assets

Profit and loss on sale of fixed assets has been included within operating profit, as operating income, in accordance with RAG 3. This represents a departure from FRS 3 as adopted in the Company's 31 March 2012 statutory financial statements in which profit and loss on sale of fixed assets are shown after operating profit.

(b) Infrastructure renewals expenditure

Infrastructure renewals expenditure ("IRE") has been accounted for in accordance with RAG 3.06 in these financial statements and is consistent with the reporting of IRE in the Company's regulatory historical cost financial statements for the year ended 31 March 2012. Accordingly, IRE net of depreciation has been included within debtors.

The Company's statutory financial statements disclose IRE net of depreciation in accordance with FRS 15 "Tangible Fixed Assets" which requires this amount to be included within fixed assets. Within these regulatory historic cost financial statements, the Company in accordance with RAG 3.06 reports IRE net of depreciation within debtors in the regulatory historic cost financial statements for the year ended 31 March 2012.

Reconciliation to the tangible fixed assets shown in the statutory financial statements with the regulatory historical cost financial statements is shown on page 106.

(c) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, with the latter accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. Accordingly, related capital contributions would not be recognised in the profit and loss account.

Regulatory accounts and required regulatory information (continued)

Basis of preparation (continued)

(d) Allocation of costs

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

Direct costs attributable to the provision of services other than the Appointed Business are separately allocated and identified as “Non-Appointed”. Indirect costs, relating to non-appointed activities, are recovered as a fixed percentage of direct costs based upon the analysis of operating costs.

(e) Revenue

There are no differences between the accounting policy for revenue under the statutory accounts and the policy for the regulatory accounts.

Regulatory accounts and required regulatory information (continued)

Reconciliation of tangible fixed assets shown in the statutory financial statements and their regulatory financial equivalents:

	Other assets £m	Infra-structure assets £m	Total £m
Cost			
At 31 March 2012 as per statutory accounts (FRS 15)	8,874.0	4,968.0	13,842.0
Infrastructure renewals expenditure capitalised in previous years	-	(1,057.0)	(1,057.0)
Infrastructure renewals expenditure capitalised in the year	-	(179.4)	(179.4)
Disposals in prior years	-	0.9	0.9
Cost at 31 March 2012 per regulatory accounts (RAG 3)	**8,874.0**	**3,732.5**	**12,606.5**
Capital contributions			
Contributions at 31 March 2012 as per statutory accounts (FRS 15)	-	663.3	663.3
Contributions at 31 March 2012 as per regulatory accounts (RAG 3)	**-**	**663.3**	**663.3**
Depreciation			
At 31 March 2012 as per statutory accounts (FRS 15)	3,187.8	1,202.6	4,390.4
Infrastructure renewals charge in previous years	-	(1,074.0)	(1,074.0)
Infrastructure renewals charge in the year	-	(129.5)	(129.5)
Disposals in prior years	-	0.9	0.9
Depreciation at 31 March 2012 per regulatory accounts (RAG 3)	**3,187.8**	**-**	**3,187.8**
Net book value			
At 31 March 2012 as per statutory accounts (FRS 15)	5,686.2	3,102.1	8,788.3
Adjustment for infrastructure renewals accounting (see below)	-	(32.9)	(32.9)
At 31 March 2012 per regulatory accounts (RAG 3)	**5,686.2**	**3,069.2**	**8,755.4**

Adjustment for infrastructure renewals accounting:

	Infrastructure assets £m
RAG 3 net infrastructure renewals reclassification:	
Infrastructure renewals accrual at 31 March 2011	(17.0)
Infrastructure renewals expenditure capitalised in the year	179.4
Infrastructure renewals charge in the year	(129.5)
Infrastructure renewals prepayment at 31 March 2012	**32.9**

Regulatory accounts and required regulatory information (continued)

Regulatory current cost profit and loss account for the appointed business for the year ended 31 March

	Note	**31 March 2012 £m**	31 March 2011 £m
Turnover	2	**1,670.9**	1,600.0
Current cost operating costs	3	**(1,177.5)**	(1,100.8)
Operating income ***(i)***	2	**44.3**	(1.5)
Working capital adjustment	2	**20.1**	13.0
Current cost operating profit		**557.8**	510.7
Net interest		**(425.4)**	(402.4)
Financing adjustment		**41.0**	119.2
Current cost profit on ordinary activities before taxation		**173.4**	227.5
Taxation:			
- Current tax		**41.3**	3.2
- Deferred tax		**(12.9)**	17.2
Current cost profit attributable to shareholder's		**201.8**	247.9
Dividends		**(269.7)**	(262.3)
Current cost loss retained		**(67.9)**	(14.4)

(i) Includes £40.0m relating to the exceptional item, see the Historic cost reconciliation between the statutory and regulatory accounts on page 102.

Regulatory accounts and required regulatory information (continued)

Regulatory current cost balance sheet for the appointed business at 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Fixed assets			
Tangible assets	4c	**94,326.0**	71,775.3
Third party contributions since 31 March 1990		**(20.579.1)**	(1,008.5)
		73,746.9	70,766.8
Working capital	5	**(339.7)**	(418.9)
Cash		**2.7**	3.6
Short term deposits		**619.4**	775.8
Infrastructure renewals accrual		**32.9**	(17.0)
Net operating assets		**74,062.2**	71,110.3
Non operating assets and liabilities			
Borrowings		**(526.5)**	(15.5)
Non-trade debtors		**207.1**	171.8
Non-trade creditors due within one year		**(129.3)**	(121.1)
Investment – loan to group company		**2,015.0**	1,865.0
Investments – other		**0.1**	0.1
Corporation tax receivable		**-**	12.3
Total non operating assets and liabilities		**1,566.4**	1,912.6
Creditors: amounts falling due after more than one year			
Borrowings		**(7,871.1)**	(7,559.7)
Other creditors		**(49.3)**	(52.7)
Total creditors falling due after more than one year		**(7,920.4)**	(7,612.4)
Provisions for liabilities and charges			
Deferred tax provision		**(968.7)**	(972.9)
Post employment liability		**(119.2)**	(94.6)
Other provisions		**(83.5)**	(81.4)
Total provisions		**(1,171.4)**	(1,148.9)
Net assets		**66,536.8**	64,261.6
Capital and reserves			
Called up share capital		**1,029.0**	1,029.0
Share premium		**100.0**	100.0
Profit and loss account		**(925.1)**	(783.9)
Current cost reserve	6	**66,332.9**	63,916.5
Total capital and reserves		**66,536.8**	64,261.6

The notes on pages 110 to 122 form part of these regulatory current cost financial statements.

The regulatory current cost financial statements were approved by the Board of Directors on 7 June 2012.

Regulatory accounts and required regulatory information (continued)

Regulatory current cost statement of cash flows for the year ended 31 March

	Notes	2012 Appointed business	2012 Non-Appointed business	2012 Total	2011 Appointed business	2011 Non-Appointed business	2011 Total
		£m	£m	£m	£m	£m	£m
Net cash inflow from operating activities	(a)	**913.3**	**14.0**	**927.3**	929.9	13.2	943.1
Returns on investments and servicing of finance							
Interest received		**106.1**	**-**	**106.1**	110.4	-	110.4
Interest paid		**(353.9)**	**(0.2)**	**(354.1)**	(269.1)	(0.2)	(269.3)
Interest element of finance lease payments		**(6.9)**	**-**	**(6.9)**	(6.5)	-	(6.5)
Net cash outflow from returns on investments and servicing of finance		**(254.7)**	**(0.2)**	**(254.9)**	(165.2)	(0.2)	(165.4)
Taxation received/(paid)		**83.0**	**(3.4)**	**79.6**	(22.3)	(3.7)	(26.0)
Capital expenditure and financial investment							
Gross cost of purchased fixed assets		**(993.0)**	**(0.6)**	**(993.6)**	(793.6)	(0.2)	(793.8)
Infrastructure renewals expenditure		**(179.4)**	**-**	**(179.4)**	(107.7)	-	(107.7)
Receipt of grants and contributions		**44.3**	**-**	**44.3**	41.0	-	41.0
Movement on long term loans to group companies		**(150.0)**	**-**	**(150.0)**	(685.0)	-	(685.0)
Disposal of fixed assets		**8.8**	**-**	**8.8**	11.5	-	11.5
Net cash outflow from investing activities		**(1,269.3)**	**(0.6)**	**(1,269.9)**	(1,533.8)	(0.2)	(1,534.0)
Equity dividends paid		**(269.7)**	**(9.8)**	**(279.5)**	(262.3)	(9.1)	(271.4)
Management of liquid resources							
Net cash outflow/(inflow) from management of liquid resources		**156.4**	**-**	**156.4**	(202.6)	-	(202.6)
Net cash outflow before financing		**(641.0)**	**-**	**(641.0)**	(1,256.3)	-	(1,256.3)
Financing							
Capital element in finance lease payment		**(7.8)**	**-**	**(7.8)**	(8.6)	-	(8.6)
New loans		**657.1**	**-**	**657.1**	1,807.6	-	1,807.6
Repayment of loans		**(9.2)**	**-**	**(9.2)**	(545.0)	-	(545.0)
Net cash inflow from financing	**(b)**	**640.1**	**-**	**640.1**	1,254.0	-	1,254.0
Decrease) in cash	**(b)**	**(0.9)**	**-**	**(0.9)**	(2.3)	-	(2.3)

Regulatory accounts and required regulatory information (continued)

Notes to regulatory current cost statement of cash flows for the year ended 31 March

(a) Reconciliation of current cost operating profit to net cash flow from operating activities for the appointed business

	31 March 2012 £m	31 March 2011 £m
Current cost operating profit	**557.8**	510.7
Working capital adjustment	**(20.1)**	(13.0)
Movement in working capital (excluding short term capital creditors)	**10.1**	25.7
Current cost depreciation (net of deferred income)	**375.5**	341.3
Current cost (profit)/loss on sale of fixed assets	**(4.3)**	1.5
Current cost exceptional item	**(40.0)**	-
Infrastructure renewals charge	**129.5**	132.4
Difference between pension charge and cash contributions	**(68.1)**	(26.8)
Other non-cash items (including provisions)	**(27.1)**	(41.9)
Net cash flow from operating activities	**913.3**	929.9

(b) Reconciliation of net cash flow to movement in net debt for the Appointed business

	Note	**31 March 2012 £m**	31 March 2011 £m
Decrease in cash in the period		**(0.9)**	(2.3)
Cash (outflow)/inflow from increase in liquid resources		**(156.4)**	202.6
Cash inflow from movement in net debt and financing		**(640.1)**	(1,254.0)
Increase in net debt resulting from cash flows		**(797.4)**	(1,053.7)
Non-cash increase in net debt		**(182.3)**	(192.7)
Total increase in net debt		**(979.7)**	(1,246.4)
Opening net debt		**(6,795.8)**	(5,549.4)
Closing net debt	7	**(7,775.5)**	(6,795.8)

Non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 ”Capital instruments”.

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March

1 Current cost accounting policies

These financial statements have been prepared in accordance with guidance issued by the Water Services Regulation Authority for modified real term financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of which assets are valued at their current cost value to the business.

These financial statements have been prepared in accordance with applicable RAG. In respect of cost allocations, the Company has continued to allocate costs by cost centre as in previous years rather than on an activity based method, which is the preferred system under RAG 3.06.

The principal current cost accounting policies used are the same as those adopted in the regulatory historical cost financial statements, except as set out below.

Changes to accounting policies

The accounting policies used for the year ended 31 March 2011 have been applied in these financial statements, except as noted below.

The Company undertook a review of its current cost assets in line with Ofwat's Accounting Separation guidance. Accordingly, the Company has reclassified certain assets and their related depreciation between asset types and between water and sewerage services.

The net book values have not been affected by this review.

(a) Valuation bases for determining the current cost of fixed assets

(i) Review of asset valuations

In accordance with Ofwat's guidelines RD12/07, the Company undertook a review of the modern equivalent asset ("MEA"), values as at 31 March 2009 as one aspect of the 2009 Periodic Review. This involved a comprehensive review of the asset stock at the time, as well as the unit costs underpinning the valuations. In accordance with RD12/07 companies were given the option to report the results of the revaluation in the regulatory accounts either in 2010 or 2011. The Company has therefore applied the results of the revaluation in the regulatory accounts in 2012. Accordingly, MEA net book values for the prior period increased by £16,448.5m; see note 6, on page 121.

(ii) Adoption of private sewers and lateral drains

In accordance with the "Water Industry Schemes for Adoptions of Private Sewers 2011", the Company adopted private sewers and lateral drains on 1 October 2011.

These have been valued as specified in RAG 1.10.9 in the Company's current cost balance sheet at £18.8bn, as at 31 March 2011 prices, within "Tangible fixed assets", with a corresponding contribution of £18.8bn being reflected within "Third party contributions since 31 March 1990". The adoption has £nil effect on the Company's net assets, see note 4b page 119. The current cost value of these adopted assets as at 31 March 2012 was £19.5bn.

The Company estimated the current cost of the adoption of private sewers and lateral drains by using the length of the network adopted, deemed to be 40,000 km, and is after the application of assumptions on surface covering, location and diameter of sewer.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

(a) Valuation bases for determining the current cost of fixed assets (continued)

(ii) Tangible fixed assets

The assets have been valued in accordance with RAG 1.04, on an MEA basis. Depreciation is charged over the estimated remaining economic life of the asset. Infrastructure assets are not depreciated.

Additions during the year are taken at their historical cost values. Disposals are stated at the value of the replacement assets.

- **Land and buildings**

Non-specialised operational properties are valued on the basis of estimated open market value for existing use at 31 March 1991, indexed since that date by the movement in the RPI, except for certain properties which have been valued at 31 March 1995 by professionally qualified employees of the Company.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually, between periodic reviews of replacement costs, by adjusting for inflation as measured by changes in the RPI.

- **Infrastructure assets**

Mains, sewers, impounding and pumped raw water storage reservoirs, and sludge pipelines are stated at their MEA value, in the manner described above. Due to the nature of these assets, the MEA value is calculated based on the length of sewer or pipe, or the capacity of the asset.

Following the repeal of Section 24 of the Public Health Act 1936 by the Water Act 1989, the Company assumed responsibility for the maintenance and operation of a significant length of additional sewers. The Company has estimated the length of these pipes in order to include their asset values in these accounts. The value is £6,480m (2011: £6,183m) based upon a pipe length of 19,000km (2011: 19,000km). Adjustments may be required to those estimates in future years as more accurate information becomes available.

- **Specialised/non-specialised assets**

Specialised operational assets include those assets, used routinely in operating the business, which are directly attributable to water supply or sewerage services.

Non-specialised assets are those assets used routinely within the business, which cannot be directly attributed to either part of the business.

- **Surplus land**

Surplus land is valued at recoverable amounts less, where appropriate, that part of any proceeds to be passed on to customers under Condition B of the Licence.

(iii) Capital contributions

All third party capital contributions received since 31 March 1990 are carried forward as deferred income to the extent that any balance has not been credited to revenue, or deducted from net operating assets in the case of infrastructure assets. The balance carried forward is restated in accordance with the change in the RPI for the year.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

(b) Real finance capital maintenance adjustments

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

(i) Depreciation adjustment - this is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historical cost profit.

(ii) Working capital adjustment - this is calculated by applying the change in the RPI over the year to the working capital of the Company at the beginning of the year.

(iii) Disposal of fixed assets adjustment - this is the difference between the book values of realised assets in the current cost financial statements and in the historical cost financial statements.

(iv) 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, but excluding index rate linked debt and the deferred tax provision.

(c) Operating costs

In note 3, direct costs incurred with associated companies are less than 20% of the total operating costs of the business before interest and tax. Therefore the costs have been allocated across the appropriate headings in accordance with RAG 3.06.

Regulatory accounts and required regulatory information (continued)

2 Analysis of turnover, operating income and working capital adjustment for the appointed business

	2012			2011		
	Water supply £m	**Sewerage services £m**	**Appointed business £m**	Water supply £m	Sewerage services £m	Appointed business £m
Turnover						
Unmeasured - household	**468.7**	**448.4**	**917.1**	461.5	422.1	883.6
Unmeasured – non - household	**6.6**	**5.0**	**11.6**	6.5	4.1	10.6
Total unmeasured	**475.3**	**453.4**	**928.7**	468.0	426.2	894.2
Measured - household	**174.1**	**205.1**	**379.2**	167.2	184.5	351.7
Measured – non - household	**157.5**	**117.5**	**275.0**	158.0	110.5	268.5
Total measured	**331.6**	**322.6**	**654.2**	325.2	295.0	620.2
Trade effluent	**-**	**6.6**	**6.6**	-	4.5	4.5
Large user and special agreement	**32.6**	**24.9**	**57.5**	33.5	23.1	56.6
Rechargeable works	**2.7**	**5.7**	**8.4**	2.1	6.6	8.7
Bulk supplies/inter-company payments	**3.0**	**-**	**3.0**	2.9	-	2.9
Third party services (excl. non-potable water)	**5.7**	**5.7**	**11.4**	5.0	6.6	11.6
Other sources	**6.2**	**6.3**	**12.5**	5.4	7.5	12.9
Total turnover	**851.4**	**819.5**	**1,670.9**	837.1	762.9	1,600.0
Operating income						
Current cost profit on disposal fixed assets	**1.8**	**2.5**	**4.3**	(0.8)	(0.7)	(1.5)
Working capital adjustment						
Working capital adjustment	**10.2**	**9.9**	**20.1**	6.8	6.2	13.0
Revenue correction mechanism						
Net revenue movement out of the tariff basket	**(1.6)**	**(0.4)**	**(2.0)**	0.4	0.8	1.2

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

3 Operating costs and associated fixed asset book values for year ended 31 March 2012

3a Water Services

£m	Water resources	Raw water distribution	Water treatment	Treated water distribution	Total
Direct costs					
Employment costs	2.0	1.7	9.7	23.6	**37.0**
Power	6.3	1.6	7.8	29.7	**45.4**
Hired and contracted services	1.9	2.1	7.3	30.4	**41.7**
Materials and consumables	0.1		11.6	0.1	**11.8**
Service charges	17.3				**17.3**
Bulk supply imports					
Other direct costs			0.4	5.6	**6.0**
Total direct costs	**27.6**	**5.4**	**36.8**	**89.4**	**159.2**
Operating expenditure					
General and support expenditure	7.0	4.2	1.1	53.0	**65.3**
Scientific services		1.0	2.4	0.1	**3.5**
Other business activities	0.1	0.1	0.3	0.6	**1.1**
Total business activities	**0.1**	**1.1**	**2.7**	**0.7**	**4.6**
Local Authority rates	1.5	1.8	2.8	25.2	**31.3**
Exceptional items	(0.9)	(0.8)	(4.6)	(10.5)	**(16.8)**
Total opex less third party services	**35.3**	**11.7**	**38.8**	**157.8**	**243.6**
Third party services - opex	0.2		0.7	0.4	**1.3**
Total operating expenditure	**35.5**	**11.7**	**39.5**	**158.2**	**244.9**
Capital maintenance					
Infrastructure renewals charge (excluding third party services)	3.4	7.8		67.0	**78.2**
Current cost depreciation	14.1	3.2	89.9	44.9	**152.1**
Amortisation of deferred credits	(0.1)	(0.1)	(0.3)	(1.4)	**(1.9)**
Business activities current cost depreciation	0.1		0.4	0.3	**0.8**
Total capital maintenance	**17.5**	**10.9**	**90.0**	**110.8**	**229.2**
Total operating costs	**53.0**	**22.6**	**129.5**	**269.0**	**474.1**
Memorandum - included in above					
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure		0.3		54.1	**54.4**
Reactive and planned maintenance non-infrastructure	0.7		2.7		**3.5**
	0.7	**0.3**	**2.7**	**54.1**	**57.9**

Regulatory accounts and required regulatory information (continued)

3b Retail Services

£m	Household	Household general & support memo	Non-household	Non-household general & support memo	Total
Direct costs					
Billing	13.0	2.1	2.3	0.4	**15.3**
Payment handling, remittance and cash handling	5.9	0.8	0.2	0.1	**6.1**
Debt management	15.2	1.9	1.7	0.2	**16.9**
Doubtful debts	60.6		10.0		**70.6**
Charitable trust donations	2.0				**2.0**
Vulnerable customer schemes	0.1				**0.1**
Non network customer enquiries and complaints	9.2	1.2	1.3	0.1	**10.5**
Meter reading	5.0	0.5	2.3	0.4	**7.3**
Meter maintenance/installation non capex					
Network customer enquiries and complaints	4.2	0.4	0.8	0.1	**5.0**
Disconnections	0.2				**0.2**
Demand side water efficiency initiatives	1.4	0.2	1.3	0.1	**2.7**
Services to developers			0.3	0.4	**0.3**
Support for trade effluent compliance			0.8	0.1	**0.8**
Customer side leaks	2.3	0.5	0.4	0.1	**2.7**
Other direct costs	0.2		0.2		**0.4**
Total direct costs	**119.3**	**7.6**	**21.6**	**2.0**	**140.9**
Operating expenditure					
General and support expenditure	7.6		2.0		**9.6**
Scientific services					
Other business activities					
Total business activities					
Local Authority rates	0.4		0.1		**0.5**
Exceptional items	(6.7)		(1.3)		**(8.0)**
Total operating expenditure	**120.6**		**22.4**		**143.0**
Capital maintenance					
Current cost depreciation	16.0		3.3		**19.3**
Total operating costs	**136.6**		**25.7**		**162.3**

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

3 Operating costs and associated fixed asset book values for year ended 31 March 2012 (continued)

3c Sewerage Services

£m	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Total
Direct costs					
Employment costs	8.4	17.2	5.5	1.0	**32.1**
Power	7.1	26.2	1.8		**35.1**
Hired and contracted services	34.2	26.4	17.2	19.1	**96.9**
Materials and consumables	0.7	9.7	7.6		**18.0**
Service charges	2.1	3.4			**5.5**
Other direct costs	1.8	1.1	0.3		**3.2**
Total direct costs	**54.3**	**84.0**	**32.4**	**20.1**	**190.8**
Operating expenditure					
General and support expenditure	11.0	8.9	3.1	3.6	**26.6**
Scientific services		0.9	0.3		**1.2**
Other business activities	0.4	0.5	0.2	0.1	**1.2**
Total business activities	**0.4**	**1.4**	**0.5**	**0.1**	**2.4**
Local Authority rates		26.0	9.1	1.2	**36.3**
Exceptional items	(4.0)	(8.1)	(2.6)	(0.5)	**(15.2)**
Total opex less third party services	**61.7**	**112.2**	**42.5**	**24.5**	**240.9**
Third party services - opex	1.0	1.7	0.3	0.7	**3.7**
Total operating expenditure	**62.7**	**113.9**	**42.8**	**25.2**	**244.6**
Capital maintenance					
Infrastructure renewals charge (excluding third party services)	51.3				**51.3**
Current cost depreciation	47.0	130.1	32.8	1.5	**211.4**
Amortisation of deferred credits	(6.5)	(0.6)	(0.1)		**(7.2)**
Business activities current cost depreciation	0.1	0.6	0.1	0.2	**1.0**
Total capital maintenance	**91.9**	**130.1**	**32.8**	**1.7**	**256.5**
Total operating costs	**154.6**	**244.0**	**75.6**	**26.9**	**501.1**
Memorandum - included in above					
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure	17.3				**17.3**
Reactive and planned maintenance non-infrastructure	6.7	11.7	5.8		**24.2**
	24.0	**11.7**	**5.8**		**41.5**

Summary of operating costs

	Water services	Sewerage Services	Retail	Total
Total operating expenditure	244.9	244.6	143.0	632.5
IRC	78.2	51.3		129.5
Amortisation of deferred credits	(1.9)	(7.2)		(9.1)
Depreciation	152.9	212.4	19.3	384.6
Total operating costs including exceptional item	474.1	501.1	162.3	1,137.5
Exceptional item included in Other operating income, see page 107	16.8	15.2	8.0	40.0
Total operating costs	**490.9**	**516.3**	**170.3**	**1,177.5**

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type as at 31 March 2012

4a Water Services

	Water Resources				Raw Water Distribution				Water Treatment				Treated Water Distribution				
£m	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Total
GROSS REPLACEMENT COST																	
Gross replacement cost at 1 April	520.5	374.2	0.5	**895.2**	797.6	56.1		**853.7**	0.4	2,649.0	1.4	**2,650.8**	10,550.5	1,557.9	0.4	**12,108.8**	**16,508.5**
Reclassification	(4.6)			**(4.6)**	377.1			**377.1**					(372.5)			**(372.5)**	
RPI adjustment	18.4	13.4		**31.8**	41.9	2.0		**43.9**		94.6	0.1	**94.7**	363.3	55.6		**418.9**	**589.3**
Disposals		(4.4)		**(4.4)**		(0.5)		**(0.5)**		(56.9)	(2.4)	**(59.3)**	(48.6)	(54.2)		**(102.8)**	**(167.0)**
Additions		10.0	0.1	**10.1**		0.8		**0.8**	(0.2)	80.8	2.1	**82.7**	25.0	56.3	1.5	**82.8**	**176.4**
Gross replacement cost at 31 March	**534.3**	**393.2**	**0.6**	**928.1**	**1,216.6**	**58.4**		**1,275.0**	**0.2**	**2,767.5**	**1.2**	**2,768.9**	**10,517.7**	**1,615.6**	**1.9**	**12,135.2**	**17,107.2**
DEPRECIATION																	
Depreciation at 1 April		198.9		**198.9**		30.2		**30.2**		1,402.5	0.9	**1,403.4**		698.2		**698.2**	**2,330.7**
RPI adjustment		7.1		**7.1**		1.1		**1.1**		50.1		**50.1**		24.9		**24.9**	**83.2**
Disposals		(4.4)		**(4.4)**		(0.5)		**(0.5)**		(52.6)	(2.4)	**(55.0)**		(54.2)		**(54.2)**	**(114.1)**
Charge for year		14.2		**14.2**		3.2		**3.2**		88.7	1.7	**90.4**		45.1	0.1	**45.2**	**153.0**
Depreciation at 31 March		**215.8**		**215.8**		**34.0**		**34.0**		**1,488.7**	**0.2**	**1,488.9**		**714.0**	**0.1**	**714.1**	**2,452.7**
Net book amount at 31 March 2012	**534.3**	**177.4**	**0.6**	**712.3**	**1,216.6**	**24.4**		**1,241.0**	**0.2**	**1,278.8**	**1.0**	**1,280.0**	**10,517.7**	**901.6**	**1.8**	**11,421.1**	**14,654.5**
Net book amount at 31 March 2011	520.5	175.3	0.5	696.3	797.6	25.9		823.5	0.4	1,246.5	0.5	1,247.4	10,550.5	859.7	0.4	11,410.6	14,177.8

Note: The disposal of £48.6m (2011: £80.2m) of infrastructure assets within Treated water distribution, shown above, relates to the MEA value of the length of main abandoned as a result of the Victorian mains replacement programme. The corresponding entry, shown in note 6 is against the current cost reserve.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type as at 31 March 2012 (continued)

4b Sewerage Services

	Sewage collection				Sewage treatment				Sludge treatment				Sludge disposal				
£m	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Total
Gross replacement cost																	
Gross replacement cost at 1 April	53,945.1	2,055.8	9.2	**56,010.1**	2.1	4,696.9	1.7	**4,700.7**	21.9	1,276.0	1.1	**1,299.0**		142.6	1.8	**144.4**	**62,154.2**
AMP adjustment	18,836.7			**18,836.7**													**18,836.7**
Reclassification adjustment					19.1	460.7		**479.8**	(19.1)	(405.3)		**(424.4)**		(55.4)		**(55.4)**	
RPI adjustment	2,598.3	73.4	0.3	**2,672.0**	0.8	184.0	0.1	**184.9**	0.1	31.1		**31.2**		3.1	0.1	**3.2**	**2,891.3**
Disposals		(19.7)	(0.6)	**(20.3)**		(105.4)		**(105.4)**		(30.4)	0.2	**(30.2)**		0.1	(0.2)	**(0.1)**	**(156.0)**
Additions	130.0	76.5		**206.5**	0.1	378.3	1.0	**379.4**		95.8	3.3	**99.1**		10.2		**10.2**	**695.2**
Gross replacement cost at 31 March	**75,510.1**	**2,186.0**	**8.9**	**77,705.0**	**22.1**	**5,614.5**	**2.8**	**5,639.4**	**2.9**	**967.2**	**4.6**	**974.7**		**100.6**	**1.7**	**102.3**	**84,421.4**
Depreciation																	
Depreciation at 1 April		1,186.6	3.0	**1,189.6**		2,777.9	0.2	**2,778.1**		628.4	(0.9)	**627.5**		52.1	1.3	**53.4**	**4,648.6**
Reclassification adjustment						233.6		**233.6**		(201.2)	0.2	**(201.0)**		(32.4)	(0.2)	**(32.6)**	**(0.0)**
RPI adjustment		42.4	0.1	**42.5**		107.5		**107.5**		15.3		**15.3**		0.7		**0.7**	**166.0**
Disposals		(19.7)	(0.5)	**(20.2)**		(105.4)		**(105.4)**		(30.4)	0.1	**(30.3)**		0.1	(0.2)	**(0.1)**	**(156.0)**
Charge for year		46.6	0.6	**47.2**		130.2	0.4	**130.6**		32.4	0.5	**32.9**		1.5	0.2	**1.7**	**212.4**
Depreciation at 31 March		**1,255.9**	**3.2**	**1,259.1**		**3,143.8**	**0.6**	**3,144.4**		**444.5**	**(0.1)**	**444.4**		**22.0**	**1.1**	**23.1**	**4,871.0**
Net book amount at 31 March 2012	**75,510.1**	**930.1**	**5.7**	**76,445.9**	**22.1**	**2,470.7**	**2.2**	**2,495.0**	**2.9**	**522.7**	**4.7**	**530.3**		**78.6**	**0.6**	**79.2**	**79,550.4**
Net book amount at 31 March 2011	53,945.1	869.2	6.2	54,820.5	2.1	1,919.0	1.5	1,922.6	21.9	647.6	2.0	671.5		90.5	0.5	91.0	57,505.6

The AMP adjustment of £18.8bn relates to the adoption of private sewers and lateral drains on 1 October 2011 and represents the current cost value of these assets as at 31 March 2011 prices. See “Adoption of private sewers and lateral drains” within note 1, page 111.

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type at 31 March 2012 (continued)

4c Retail

	Household				Non-household					
£m	**Infrastructure**	**Operational**	**Other tangible**	**Total**	**Infrastructure**	**Operational**	**Other tangible**	**Total**	**Total**	**Grand Total**
Gross replacement cost										
Gross replacement cost at 1 April		255.7	18.1	**273.8**		52.4	3.7	**56.1**	**329.9**	**78,992.6**
AMP adjustment										**18,836.7**
RPI adjustment		9.2	0.6	**9.8**		1.9	0.1	**2.0**	**11.8**	**3,492.4**
Disposals		(11.0)	(0.3)	**(11.3)**		(2.2)	(0.1)	**(2.3)**	**(13.6)**	**(336.6)**
Additions		37.3		**37.3**		7.6		**7.6**	**44.9**	**916.5**
Gross replacement cost at 31 March		**291.2**	**18.4**	**309.6**		**59.7**	**3.7**	**63.4**	**373.0**	**101,901.6**
Depreciation										
Depreciation at 1 April		195.5	1.9	**197.4**		40.0	0.4	**40.4**	**237.8**	**7,217.1**
RPI adjustment		7.0	0.1	**7.1**		1.4		**1.4**	**8.5**	**257.6**
Disposals		(11.0)	(0.3)	**(11.3)**		(2.2)	(0.1)	**(2.3)**	**(13.6)**	**(283.7)**
Charge for year		15.9	0.0	**15.9**		3.3		**3.3**	**19.2**	**384.6**
Depreciation at 31 March		**207.4**	**1.7**	**209.1**		**42.5**	**0.3**	**42.8**	**251.9**	**7,575.6**
Net book amount at 31 March 2012		**83.8**	**16.7**	**100.5**		**17.2**	**3.4**	**20.6**	**121.1**	**94,326.0**
Net book amount at 31 March 2011		60.2	16.2	76.4		12.3	3.3	15.6	**92.0**	**71,775.3**

Grand total represents the total of Water Services, Sewerage Services and Retail.

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Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

5 Current cost working capital

	31 March 2012 £m	31 March 2011 £m
Stocks	**9.6**	8.2
Trade debtors:		
- Measured household	**77.0**	78.7
- Unmeasured household	**115.2**	121.1
- Measured non-household	**39.9**	46.0
- Unmeasured non-household	**1.7**	1.9
- Other	**21.0**	19.9
Measured income accrual	**146.7**	136.1
Prepayments and other debtors	**39.3**	34.1
Trade creditors	**(280.7)**	(254.4)
Deferred income – customer advance receipts	**(87.8)**	(86.4)
Capital creditors	**(243.0)**	(332.3)
Accruals and other creditors	**(178.6)**	(191.8)
Total working capital	**(339.7)**	(418.9)

6 Movement on current cost reserve

	31 March 2012 £m	31 March 2011 £m
Balance at 1 April	**63,916.5**	44,110.5
RPI adjustments:		
- Fixed assets *	**3,234.8**	3,619.1
- Working capital	**(20.1)**	(13.0)
- Financing	**(41.0)**	(119.2)
- Grant and third party contributions *	**(710.3)**	(49.2)
- Mains replacement adjustment (see note 4a)	**(48.6)**	(80.2)
- AMP adjustment **	**-**	16,448.5
- Other	**1.6**	-
Balance at 31 March	**66,332.9**	63,916.5

* RPI adjustments for fixed assets include £672.5m relating to the adoption of private sewers and lateral drains on 1 October 2011, with a similar value shown within Grants and third party contributions.

** Please see “Review of asset valuations” on page 111 for details of the AMP adjustment made in the prior period.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

7 Net debt analysis

March 2012:

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Maturity profile				
Less than one year	(285.3)	(241.2)	-	(526.5)
Between one and two years	(17.9)	(10.2)	-	(28.1)
Between two and five years	(675.1)	(139.4)	-	(814.5)
Between five and twenty years	(2,375.2)	(157.5)	(1,190.7)	(3,723.4)
In more than twenty years	(344.4)	100.0	(3,060.7)	(3,305.1)
Total borrowings	(3,697.9)	(448.3)	(4,251.4)	(8,397.6)
Cash	2.7	-	-	2.7
Short term deposits	619.4	-	-	619.4
Net debt	**(3,075.8)**	**(448.3)**	**(4,251.4)**	**(7,775.5)**

All values in the above tables are post cross currency rate swaps, interest rate swaps and index-linked swaps.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March

Regulatory Capital Value (RCV)

	2012 £m
Opening RCV (March 2011 prices)	8,849
Indexation to year end (March 2012 prices)	316
Opening RCV at year end prices	9,165
Capital expenditure (excluding infrastructure renewals expenditure)	1,293
Infrastructure renewals expenditure	180
Grants and contributions	(27)
Depreciation	(408)
Infrastructure renewals charge	(148)
Out performance of past regulatory assumptions	(50)
Closing RCV (March 2012 prices)	**10,005**
Average RCV (2011/2012 year average prices)	**9,447**

The figures quoted reflect those used by Ofwat at the 2009 Periodic Review to set prices for 2011/2012, as confirmed by Ofwat in their RCV update on 18 April 2012. All costs have been indexed to March 2012 prices (RPI index) except for the average RCV, which is shown at year average prices (RPI index) in accordance with Ofwat's convention.

Differences between the figures shown above and actual costs/income will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation at the next price review through operation of the Capital Incentive Scheme.

RAG 5 Intra-group trade

During the year there were no contracts in excess of 0.5% (£8.4m) of the Company's turnover with any subsidiary of the Thames Water group of companies.

Dividends paid to associated undertakings

During the year, the Company paid interim dividends totalling £279.5m (2011: £271.4m) to Thames Water Utilities Holdings Limited. Full disclosure of these dividends are provided in note 9 on page 80 of the statutory section of these financial statements

Transfer of assets by of to the appointee

There was no transfer of assets or liabilities by or to the Company in excess of the materiality limit (2011: £nil).

Supplementary regulatory information for the year ended 31 March (continued)

Borrowings and sums lent

All borrowings from the Company's wholly owned subsidiaries are as follows for the year ended 31 March 2012:

Instrument	Amount borrowed	Total book value *
Thames Water Utilities Cayman Limited		
€500m 6.13% Fixed rate bond due 2013.	417.1	417.1
$156m 3 month US$ libor + 0.95% floating rate bond due 2015.	97.4	97.4
€500m 3.25% Fixed rate bond due 2016.	417.1	417.1
£400m 7.24% Fixed rate bond due 2018.	400.0	398.5
$150m USPP Fixed rate bond due 2019.	93.7	93.7
£75m 1.35% Index linked bond due 2021.		
€113m 2.30% CPI index linked bond due 2022.	94.3	94.7
$150m USPP Fixed rate bond due 2022.	93.7	93.7
$200m USPP Fixed rate bond due 2024.	124.9	124.9
£550m 5.38% Fixed rate bond due 2025.	550.0	546.2
$250m USPP Fixed rate bond due 2027.	156.1	156.1
£300m 5.75% Fixed rate bond due 2030.	300.0	296.6
20bn Yen 3.28% Fixed rate bond due 2038.	152.0	152.0
£50m 3.85% Index linked bond due 2040.	50.0	55.0
£500m 5.5% Fixed rate bond due 2041.	500.0	488.6
£50m 1.98% Index linked bond due 2042.	50.0	57.7
£55m 2.09% Index linked bond due 2042.	55.0	61.3
£40m 1.97% Index linked bond due 2045.	40.0	42.5
£100m 1.85% Index linked bond due 2047.	100.0	115.5
£200m 1.82% Index linked bond due 2049.	200.0	230.4
£200m 1.77% Index linked bond due 2057.	200.0	230.4
£350m 1.76% Index linked bond due 2062.	350.0	403.2
Total	**4,441.3**	**4,572.6**
Thames Water Finance Limited		
£200m 4.90% Fixed rate bond due 2015.	200.0	200.0
£200m 5.05% Fixed rate bond due 2020.	200.0	200.0
£175m 3.38% Index linked bond due 2021.	175.0	236.1
£225m 6.59% Fixed rate bond due 2021.	225.0	225.0
£330m 6.75% Fixed rate bond due 2028.	330.0	327.8
£200m 6.50% Fixed rate bond due 2032.	200.0	198.0
£600m 5.13% Fixed rate bond due 2037.	600.0	596.4
£300m 1.68% Index linked bond due 2053.	300.0	364.8
£300m 1.68% Index linked bond due 2055.	300.0	364.8
Total	**2,530.0**	**2,712.9**
Grand total	**6,971.3**	**7,285.5**

* Total book value includes interest accretion of index linked bonds and unamortized bond fees.

See page 84 for analysis of the above amounts owed to group undertakings within one year and after more than one year.

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

TWUCL and TWUFL lend the proceeds of the external borrowings on to the Company, net of derivatives of £71.4m. Under these arrangements the Company owes TWUCL £4,623.0m and TWUFL £2,747.2m.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March (continued)

RAG 5 Directors' interests information

Listed below are details of directorships held by Thames Water Utilities Limited directors at 31 March 2012 in associated companies that have traded with the regulated business during the year.

Directorships held in Associated Companies

The following directors held directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
L F Abraira	4 August 2011	19 January 2012
E Beckley		
R Blomfield-Smith		21 November 2011
C R Deacon		
S R Eaves	20 January 2012	
G I W Parsons		
A F C DeP Santos		4 August 2011
D J Shah OBE		
Y Shi	19 January 2012	
M S W Stanley		
R Verrion		
L Webb	21 November 2011	

The following directors have formally appointed alternate directors to represent them when they are unavailable. These alternate directors also held alternate directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
S R Eaves	20 January 2012		M C Hill	20 January 2012	
G I W Parsons			E Beckley	11 November 2011	
A F C DeP Santos		4 August 2011	M C Guerreiro		4 August 2011
D J Shah OBE			L Webb		21 November 2011
			K Roseke	31 January 2012	
Y Shi	19 January 2012		F Sheng	29 February 2012	
R Verrion			S Kolenc		
L Webb	21 November 2011		C Pham	21 November 2011	

Thames Water Utilities Limited conducts its appointed business so as to ensure arm's length trading and avoidance of cross-subsidy in the spirit of Condition F of the Instrument of Appointment.

No directorships are held by Thames Water Utilities Limited directors in circumstances, which might in practice, result in conflicts of interest in intra-group trading relationships.

Supplementary regulatory information for the year ended 31 March (continued)

Directors' Certificate under Condition F6A of the Company's Appointment

This is to certify that at their meeting on 7 June 2012 the directors of Thames Water Utilities Limited ("the Appointee") resolved as follows:

- That, in the opinion of the directors', the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment(s)).

- That, in the opinion of the directors, the Appointee will, for at least the next 12 months, have available to it:

  (a) Management resources.
  (b) Systems of planning and internal control.

  Which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1(1).

- That, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

The main factors the directors have taken into account in issuing the Directors' Certificate under condition F6A of the Company's appointment are:

- That the processes and systems of internal control operated as expected.

- That the Appointee operated as if it was substantially the Appointee's sole business and that the Appointee was a separate public limited company.

- That financial resources and facilities are adequate to enable the Appointee to meet its regulatory obligations.

- The net worth of the Company and the strength of the Company's key performance indicators as shown on page 8 of the Chief Executive Officer's Business review.

- The strong investment grade ratings as shown on page 10 of the Chief Executive Officer's Business review.

- Borrowing facilities, which include significant undrawn bank facilities.

- The outcome of the 2009 regulatory price review for the five year period to 31 March 2015 and its impact on the appointee's business plans.

S Siddall
Chief Financial Officer
7 June 2012

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited

We have audited the Regulatory Accounts of Thames Water Utilities Limited for the year ended 31 March 2012 on pages 99 to 125 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; 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 to the current cost financial statements, 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 sewerage undertaker under the Water Industry Act 1991. 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 37, 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 and the Directors of Thames Water Utilities 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 104 to 105 and 111 to 113, the state of the Company's affairs at 31 March 2012 on an historical cost and current cost basis, and its historical cost and current cost profit and its 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 of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Financial information other than that prepared on the basis of UK GAAP 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 pages 100 and 101 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 102.

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 and the Directors of Thames Water Utilities 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 WSRA'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 2012 on which we report, 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.

KPMG Audit Plc
Chartered Accountants
London
7 June 2012

Notes:

1. The maintenance and integrity of the Company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions

Thames Water Utilities Limited

Glossary of regulatory terms

AMP adjustment – The revision in the real value of fixed assets arising periodically from improved information in the five-year Asset Management Plan process.

Appointed Business – The appointed business comprises the regulated activities of the Company which are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading – Trading in which the Company treats the other party, usually an associate company on the same basis as an external party.

Asset Management Plan (AMP) – A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP4 covers the investment period April 2005 to March 2010 AMP5 covers the investment period April 2010 to March 2015.

Associate company – Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the Company and its associated companies to be disclosed subject to specified materiality considerations.

Capital Incentive Scheme ("CIS") – This will be the new capital expenditure incentive mechanism introduced by Ofwat to take effect in AMP 5. Under this mechanism Ofwat sets a baseline capital expenditure plan, which they believe companies should be able to deliver. Companies are rewarded or penalised during the AMP 5 for submitting a business plan, which is lower or higher than the baseline respectively. Companies will then be further rewarded or penalised at the start of AMP 6 for underspending or overspending against that business plan.

CIS will apply to capital expenditure only, not to operational expenditure and will not apply to large projects such as the Lee Tunnel.

Final determination – The conclusion of discussions on the scale and content of the asset management plan for the forthcoming five-year AMP period. It is accompanied by a determination of the allowable K factor for the forthcoming AMP.

Financing adjustment – The impact of RPI on the real value of net finance for the business.

K factor – The annual increase, set by Ofwat, in charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula RPI + or – 'K' + 'U'. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers and 'U' is the amount of 'K' not taken up by a company in previous years.

Licence – The Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Thames Water Utilities Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Glossary of regulatory terms (continued)

Modern Equivalent Asset (MEA) – The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing, or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up to date new asset with the same service capability allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset, and is stated gross of third-party contributions.

Non-appointed business – The non-appointed business activities of the Company are activities for which the Company as a water and sewerage undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the Company (for example, the use of underground assets for cable television).

Ofwat – The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic Regulator of the water industry.

Periodic Review (PR) – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits an Asset Management Plan covering the five-year period for which Ofwat will determine prices (the K factor – see above).

Price limit – The name given to the combination of the RPI and K.

Regulatory Accounting Guidelines (RAG) – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (RCV) – The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Retail Price Index (RPI) – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (SIM) – Ofwat's measure of customer satisfaction based on surveys of customers who have contacted the Company and the number of contacts received which express dissatisfaction.

Third-party contributions since 1989/90 – Grants and third-party contributions received in respect of infrastructure assets and any deferred income relating to grants and third-party contributions for non-infrastructure assets.

Working capital – The aggregate of stocks, trade debtors and trade creditors, if material.

Working capital adjustment – The impact of RPI on the real value of working capital to the business.

Thames Water Utilities Limited

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Registered no: 02366661 (England and Wales)

Thames Water Utilities Limited

Annual report and financial statements

For the year ended 31 March 2012

Annual report and financial statements for the year ended 31 March 2012

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Directors and advisors at 31 March 2012

Directors

Sir Peter Mason KBE (Chairman)
M W Baggs
E Beckley
C R Deacon
S R Eaves
G I W Parsons
D J Shah OBE
Y Shi
S J Siddall
M S W Stanley
R E Verrion
L Webb

Independent non-executive directors

Dame D M Hutton CBE
M J Pavia
E C Richards

Registered auditor

KPMG Audit Plc
Chartered Accountants
15 Canada Square
London
E14 5GL

Company Secretary & registered office

J E Hanson
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

About us

Our mission

We provide the essential service that is at the heart of daily life, health and enjoyment.

Our vision

If customers had a choice, they would choose Thames Water.

Our customer experience

Customers choose Thames Water because:

- They **trust** us
- We are **easy** to do business with
- We really **care**

Facts and figures

Our business

- UK's largest water and wastewater services provider.
- 14m customers.
- Over 4,500 employees.
- One of the providers offering best value, with customers paying an average of 93p a day.

Water services

- 9m clean water customers in London and the Thames Valley.
- An average of 2,600m litres of drinking water supplied per day.
- Operation and maintenance of 100 water treatment works, 30 raw water reservoirs, 288 pumping stations and 235 clean water service reservoirs.
- Our tap water costs less than a tenth of a penny per litre.
- Drinking water quality is meeting 99.98% of stringent tests.
- Carry out over 400,000 water quality tests undertaken each year to meet stringent UK and European standards.

Sewerage services

- 14m wastewater customers.
- 350 sewerage treatment works ("STW") treating an average of more than 4,000m litres per day.
- 109,000 km of sewers, 2,530 pumping stations and 1.2m manholes.
- Two sludge-powered generators and 19 combined heat and power plants generating 176 GWh of renewable electricity.
- All wastewater treatment facilities are currently operating within Environment Agency ("EA") compliance guidelines.

Thames Water Utilities Limited

About us

Financial information

- Turnover increased by 4.4% to £1,694.9m (2011: 1,623.1m).
- Underlying profit before tax (profit before tax excluding exceptional item) fell by 12.6% to £182.2m (2011: £208.5m).
- Closing Regulatory Capital Value ("RCV") for the year is £10,005m (2011: £8,849m).
- Senior debt/RCV ratio was 78.3% (trigger point 85%).

Operational performance

Highlights

- For the second year running the Company delivered over £1bn of capital investment in its network and plants, including the development of the Thames Tunnel.
- Leakage reduced 28 Mld to 637 Mld compared to last year and beat the target set by the Water Services Regulatory Authority ("Ofwat") for the year by 36 Mld.
- The Company's drinking water quality was 99.98%, whilst sewerage treatment compliance was 100%.
- Continuing reduction in greenhouse gas emissions, with CO_2e emissions 16% lower than two decades ago and generating 14% of the Company's own power.
- Charitable donations of £1,019,340 partly through the shareholders' Ten for Ten initiatives, which started in 2009.
- Health and safety: the number of reportable accidents fell to an Accident Incident Rate of 0.33 per 1,000 employees, a 48% improvement since the start of Asset Management Period 5.
- The Company's Transforming Thames programme started to deliver its Work, Asset Management and Information ("WAMI") programme, Metering Outsourcing and introduced new working patterns and associated terms and conditions for staff.
- The Company introduced certain changes to the Thames Water Pension scheme whereby the defined benefit provision is now based on a Career Average Revalued Earnings basis instead of a Final Salary basis.
- The Company successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

Lowlights

- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction has deteriorated to 62.61 (2011: 65.20).
- Pollution incidents (sewerage) have increased to 3.76 incidents per 1,000 km (2011: 2.67).
- Customer bad debt provisioning increased in the year reflecting the economic recession.
- Two employees of the Company's contractors suffered fatal injuries in two separate incidents.

Awards

- The Company was awarded the Utility Industry Achievement Award for staff development.
- The Company received two awards from the Institute of Civil Engineers for its early work on the Lee Tunnel.

Thames Water Utilities Limited

Chairman's introduction

Satisfactory operational and financial performance have again been features of the last year for Thames Water. It has also been a period of significant and ongoing challenges, to which Thames Water Utilities Limited ("the Company") continues to respond robustly.

Two consecutive dry winters forced the introduction of a temporary use ban across much of southern and eastern England, and the Thames Valley was no exception.

This was not a measure the Company took lightly, but one that was unfortunately necessary in order to minimise the likelihood of more severe restrictions at a later stage, if the drought continues.

Against this background, it is all the more satisfying that the Company has achieved its leakage target for the sixth successive year, and by a significant margin.

This has been just one aspect of the prudent management of water resources, which has included the use of the Company's desalination plant in east London, in response to the drought, to supplement water resources.

The wise use of water is particularly important at a time when the Company faces its second major challenge: the staging of the 2012 Olympic and Paralympic Games ("the London 2012 games") in London.

The provision of water and sewerage services will clearly play a vital part in the successful staging of the London 2012 games. The Company has also been planning carefully to mitigate the inevitable disruption to streetworks activity.

The capital will clearly be the centre of attention this summer. It is also the focus for two huge engineering schemes, which are a major centre of activity for the Company; the Lee Tunnel and the Thames Tunnel.

I am pleased to report that, after some years of discussion and planning, work is finally under way to significantly reduce overflows of sewage into London's major rivers.

Although frequently overshadowed by discussions of the Thames Tunnel, the Lee Tunnel will be the largest and deepest tunnel beneath the capital. The tunnel boring machine that has started excavating, and is due to emerge in Abbey Mills, east London in late 2013.

The Company also made good progress on the planning of the Thames Tunnel with Government support. February saw the completion of the second phase of planning consultation on this huge project, which will involve 24 major construction sites across the city.

The Government recognised the Thames Tunnel's importance by including the project in the Chancellor's National Infrastructure Plan and safeguarded certain key sites.

Elsewhere in London, another major wastewater scheme began to take shape at Deephams STW, in Edmonton, where a major upgrade is needed to meet new environmental standards set by the EA.

The year ended 31 March 2012 was the second year of the current five-year investment period. It naturally saw the Company accelerating much of the work that began in 2011, and starting to record some significant achievements.

Work is nearing completion, for example, on the first of a series of major improvement projects at the Company's five biggest STW, to improve both their capacity the quality of treated effluent they discharge to the tidal Thames.

I am pleased to say that our 350 STW once again continued their record of 100% compliance with the strict standards set by the EA.

One area of concern was a rise in the number of serious pollution cases, which senior management is working hard to address.

Thames Water Utilities Limited

Chairman's introduction

Another significant challenge is the area of customer satisfaction. The way the Company handles queries and complaints is rated poorly when compared with the rest of the sector, and this remains an area where it is striving to improve.

On the drinking water side of the business, the Company again reported excellent performance. In 2012, 99.98% of samples taken at customers' taps complied with stringent national and European standards. This was a slight improvement on the year before, and saw the Company maintain supplies that are among the best-quality in the UK.

The continuing high performance across the business was, of course, made possible by good management. This is being further enhanced by a major development programme, for which the Company last December received the Staff Development Award at the Utility Industry Achievement Awards. To date, more than 700 managers have completed the programme.

During the year Luis Abraira, Rosamund Blomfield-Smith and Antonio Santos resigned as non-executive directors, while executive directors Chief Financial Officer Mark Braithwaite and Chief Operating Officer Steve Shine OBE also left the Company. I would like to thank them all for their valuable contributions. We have also welcomed Mark's replacement, Stuart Siddall, and non-executive directors Simon Eaves, Yaping Shi and Lincoln Webb, bringing with them extensive experience.

I would like to note my thanks to staff across Thames Water for their achievements during the year.

Sir Peter Mason KBE
Chairman
7 June 2012

Thames Water Utilities Limited

Chief Executive Officer's Business review

The following business review forms part of the Directors' report.

Business review

Introduction

Unless otherwise stated, all current year data included in this review is for the year ended 31 March 2012 ("2012").

Nature of business

Background

The Company is the largest supplier of water and provider of sewerage services in the UK, based on the number of customers served. It is one of 10 companies currently holding appointments as water and sewerage undertakers[1] in England and Wales, with a further 11 companies holding appointments as water only undertakers.

In total, the area served by the Company occupies approximately 13,331 km^2 and encompasses more than 9% of the area of England and Wales. This includes London and extends as far as Cirencester in the west, Dartford in the east, Banbury in the north and Haslemere in the south. This area has a population of about 14m people, which represents nearly a quarter of the total population of England and Wales. In approximate terms, the Company supplies 3.6m properties (just over 8.8m people) with water, and collects sewage from 5.1m properties (about 14m people), representing 97% of households in its sewerage region.

The Annual Performance Report 2011/12, which incorporates the Corporate Responsibility Report, does not form part of this report. It provides further information regarding the Company's regulatory and operational performance and will be available on the Company's dedicated website: www.thameswater.co.uk/cps from 15 July 2012.

[1] A company that has been appointed to provide water and/or sewerage services to customers in England and Wales is known as an "undertaker". The Company's Instrument of Appointment - usually referred to as "the Licence" - was issued by the Secretary of State for the Environment in August 1989

Chief Executive Officer's Business review (continued)

During the last year, the Company continued its satisfactory performance against its targets.

Highlights

- Delivering over £1bn of investment in the year, bringing the total for the first two years of Asset Management Period 5 ("AMP5") to over £2bn, in line with the Company's capital programme to deliver £4.9bn of investment during AMP5.
- Delivering all of the Company's key regulatory outputs, ensuring that the condition of its assets is maintained.
- The Company reduced leakage to 637 Mld, a reduction of 28 Mld (4.2%) compared to 665 Mld in the prior period, and beat its target for the year by 36 Mld.
- The Company's drinking water quality improved slightly to 99.98% (2011: 99.97%)
- The Company achieved 100% sewage treatment compliance against strict standards set by the EA.
- In November 2011, the Company opened its Old Ford water recycling plant on the edge of the Olympic Park in East London, which will supplement the supply of water for the London 2012 games.
- Greenhouse gas emissions were 16% lower than two decades ago, despite the Company serving 3m more customers amd meeting higher standards in many areas of operation.
- In addition, 14% of the Company's electricity was generated from renewable energy from burning methane gas from sewage at 22 of its larger STW's. The Company also installed solar power arrays at 3 of its main sites and 28 smaller sites. The Company is now one of the largest solar power generators in the UK.
- The Company was awarded the Utility Industry Achievement Award for staff development in the year.
- The Company's Transforming Thames programme is delivering its WAMI programme, a new contract that covers all metering services and introduced new working patterns and associated terms and conditions for staff.
- The Company introduced changes to the Thames Water Pension scheme whereby the defined benefit provision from 1 May 2011 is now based on a Career Average Revalued Earnings basis ("CARE") and no longer on a Final Salary basis.
- The Company successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

Lowlights

- It is with deep regret that the Company has to report the death of two contractors who suffered fatal injuries in two separate incidents is a major concern to the Company. The health and safety of both the Company's, and its contractors' employees continues to be the Company's number one priority.
- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction has deteriorated to 62.61 (2011: 65.20).

Thames Water Utilities Limited

Chief Executive Officer's Business review (continued)

Lowlights (continued)

- The number of pollution incidents from by the Company's sewerage system increased in comparison to last year, with 75 more incidents recorded. This gave a total of 268 pollution incidents, 20 of which were considered to be serious. An incident in the River Crane resulted in the death of fish along approximately a 12km stretch of the river. The Company responded as quickly as it could to clean up the river, and has made a voluntary commitment to the ongoing programme of restoration, to be delivered through the Crane Valley Partnership. Spillages from the Company's sewer network are unacceptable and the Company is working harder to try to avoid them.

  In response to this pollution performance, the Company has already improved many aspects of its business processes. Key to the ongoing performance improvement is the creation of an Event Learning role to learn from each incident so that the Company can work to avoid similar events in the future.

- The bad debt charge has increased to £70.6m in the year (2011: £38.4m) due to collection difficulties and customers' ability to pay as a result of the economic recession.

Financial results

Financial Key Performance Indicators (KPIs)

	The Company			**The regulated business**		
Performance Measure	**Year to 31 March 2012 £m**	Year to 31 March 2011 £m	% Change	**Year to 31 March 2012 £m**	Year to 31 March 2011 £m	% Change
Turnover	**1,694.9**	1,623.1	4.4	**1,670.9**	1,600.0	4.4
Operating expenditure [2]	**675.4**	629.6	(7.3)	**665.8**	627.1	(6.2)
Operating profit [3]	**643.9**	600.2	7.3	**634.4**	598.1	6.1
Underlying profit before tax [4]	**182.2**	208.5	(12.6)	**169.0**	195.7	(13.6)
Total capital expenditure (see note 10)[4]	**1,063.8**	1,006.6	5.7	**1,056.1**	1,003.0	5.3

The following commentary is in respect of the Company.

[2] Operating expenditure: operating costs, see note 3, page 75 (£1,051.0m) , excluding exceptional item of £40.0m relating to a pension curtailment gain, depreciation on owned assets (£276.5m), depreciation on assets held under finance leases (£9.6m) and the Infrastructure Renewals Charge ("IRC") (£129.5m).

[3] Operating profit: turnover less operating costs for the Company but excluding profit on sale of fixed assets. For the regulated business, operating profit includes profit on sale of assets.

[4] Underlying profit before tax: Profit before tax, excluding exceptional item (pre-tax).

[4] Total capital expenditure: total expenditure on tangible fixed assets net of contributions received, see note 10 to the financial statements. Regulatory capital expenditure, in addition includes maintenance non infrastructure income.

Chief Executive Officer's Business review (continued)

Financial results (continued)

Turnover

Turnover for the year was £71.8m (4.4%) higher than the prior year at £1,694.9m (2011: £1,623.1m), reflecting real increases in price ("K"), (see page 130), as agreed with Ofwat, together with increases linked to the Retail Price Index ("RPI").

Operating expenditure

Operating expenditure, excluding exceptional item, depreciation and IRC, see note 3 page 75, for the year has increased by £45.8m (7.3%) to £675.4m (2011: £629.6m) compared to the prior year. This increase is as a result of inflationary pressures with average RPI of 4.8%, increased provisioning for bad debts, caused by the economic climate, and higher than inflationary power price increases, partly offset by an operating network contract claim settlement and continued operational efficiencies.

Net interest payable

Net interest payable of £423.2m (2011: £398.3m) increased by £24.9m (6.3%) principally reflecting the higher internal interest payable due to the increase in net debt.

Underlying profit before tax

Underlying profit before tax has reduced by £26.3m (12.6%) to £182.2m (2011: £208.5m). This reduction is due to the increase in operating costs, increase in depreciation and Infrastructure Renewals Charge and interest costs as a result of substantial investment in the network of pipes, sewers and other facilities offset by increase in turnover described above.

Capital expenditure

2012 has been a successful year for the delivery of capital investment by the Company, for the second year of AMP5, with over £1bn was invested in delivering all of its capital regulatory outputs, whilst delivering efficiencies of over £80.0m against its five year business plan. The Company is on track to deliver its required investment programme of £4.9bn over this regulatory period.

Treasury policy

The Company's treasury operations are managed centrally by a small specialist team, which operates with the delegated authority of, and under policies approved by, the Board of Directors. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. The key objectives of the funding strategy are defined by the regulatory regime within which the Company operates and are intended to ensure that it meets all funding related requirements under the terms of its Licence. This includes maintaining cash reserves and access to undrawn committed bank facilities sufficient to fund at least 12 months net cash flow (as discussed on page 32 - Company dividend policy - extends this to a 15 month period) and to maintain an investment grade credit rating (see "Debt financing" section below) as set out in Condition F of the Licence.

A key objective of treasury policy is to ensure compliance with financial covenants, including interest cover and gearing ratios, maintain liquidity and a balanced debt maturity profile, and ensure that at least 85% of the interest cost within the Securitisation Group, (being Thames Water Utilities Holdings Limited, the Company, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited) is based on either fixed or RPI-linked interest rates.

Chief Executive Officer's Business review (continued)

Financial risk management

The Company's Executive Team ("the Executive"), receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The operation of the Treasury function is governed by policies and procedures, which set out guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk, interest rate risk and exchange rate risk.

Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk arising from the primary financial instruments used to finance the Company's activities. Matching of assets and liabilities in foreign currencies is also applied wherever practicable. The Company actively maintains a broad portfolio of debt, diversified by source and maturity and designed to ensure the Company has sufficient available funds for operations.

The Company is exposed to commodity price risk, especially energy price risk, as a result of its operations. The Company aims to manage its risk by fixing contract prices where possible.

Financing

The Company had committed facilities in place with a syndicate of relationship banks to the value of £1,200.0m; all of which were undrawn at 31 March 2012. In addition, due to pre-funding activity undertaken in the final quarter of the year, the Company had £622.1m of cash and current asset investment as at 31 March 2012, consisting of cash at bank, short-term deposits with highly rated banks or triple A rated money market funds. This balance together with the undrawn facilities, will provide the Company with the necessary liquidity to fund the operation of the business for at least the next fifteen months.

Debt financing

Debt financing is raised by the Company or through the Company's wholly owned subsidiary, Thames Water Utilities Cayman Finance Limited. Previously, debt had been raised through Thames Water Utilities Finance Limited, another wholly owned subsidiary.

Moody's Investor Service ("Moody's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited, A3 long term with stable outlook and Class B.debt at Baa3 with stable outlook. Moody's also issues a Corporate Family Rating for the Securitisation Group of companies, which stands at Baa1, with stable outlook. Standard and Poor's Rating Services ("Standard and Poor's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited at A- and Class B debt at BBB. Accordingly, the Company maintains an investment grade issuer credit rating in accordance with the requirements of its Licence.

Capital structure

Key features of the Company's capital structure are as follows:·

- All debt issued by the Securitisation Group is documented pursuant to a Common Terms Agreement as part of the Whole Business Securitisation entered into in August 2007.

- Net debt issued by the Securitisation Group Class A ratio of net debt to RCV is limited to 75%.

Chief Executive Officer's Business review (continued)

Capital structure (continued)

- Since 1 April 2010, the Company and the Securitisation Group has the option to issue Subordinated Debt ("Class B"). At the same time, there is an increase in the combined Class A and Class B (together "Senior") net Debt/RCV ratio to a maximum of 85%.

- Each Obligor (the companies within the Securitisation Group) had entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited guarantees the obligations of each other Obligor under the finance documents and the Company and its wholly owned subsidiaries guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

- Following an event of default, the documents provide for an automatic 18 month standstill of the claims of the creditors that have entered into the STID.

Insurance

The Company maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors & Officer liability cover.

The insurance coverage has been reviewed and approved by an independent insurance adviser retained to ensure that the Company's insurances;

- are consistent with Good Industry Practice;
- have regard to the risk being covered;
- address the interests of the Company.

Covenant compliance

Under the terms of its finance documents, the Company is required to comply with various covenants such as interest cover and net debt to RCV. These covenants are measured and submitted to the Security Trustee semi-annually and involve both actual data and forecasts. The two main ratios are discussed further below:

Senior adjusted Interest cover ratio (trigger: 1.3x)[5]: For the year to 31 March 2012 the ratio was 1.4x (2011: 2.1x). The movement in the year is partly due to class B debt issuance of £850.0m raised through the Company's subsidiary Thames Water Utilities Cayman Finance Limited.

Whilst actual interest cover has moved closer to the trigger, the Company is satisfied that a trigger will not occur. This is due to the high proportion of the Company's debt being fixed and the certainty and stability of the Company's operating cash flows for 2012/2013, as the income stream has already been determined and the predictable nature of the operating cost cash flows.

Senior Debt/RCV ratio (trigger: 85%)[6]: At 31 March 2012 the ratio was 78.3% (2011: 77.4%). The movement is attributable to the class B debt issuance highlighted above.

There are other variations on these ratios on class A and Senior Debt, which the Company is also required to calculate to show compliance with its covenants. The Company is compliant with these ratios as at 31 March 2012 and is forecast to remain compliant.

[5] A trigger event would lead to lock up which would mean nil distributions outside of the Securitisation Group until resolved to the Security Trustee's satisfaction. Adjusted Interest Cover Ratio is calculated as operating cashflow adjusted for expenditure on depreciation and infrastructure renewals divided by interest paid.

[6] A trigger event would lead to lock up which would mean nil distributions outside of the Securitisation Group until resolved to the Security Trustee's satisfaction.

Thames Water Utilities Limited

Chief Executive Officer's Business review (continued)

Key performance indicators ("KPI's")

Ofwat, in removing the requirement for Water and Sewerage companies ("WaSc") and Water only companies ("WOC") to submit an annual return ("the June Return") to them, they have introduced certain KPI's, which they have developed in consultation with WaSc and WOC.

The table below shows the Company's performance against these KPI's in accordance with the guidance received from Ofwat which require the Company to disclose;

- status (red, amber or green, where indicated);
- unit of measurement;
- actual value

KPI Dashboard

Customer experience			
SIM	62.61		Score
Internal sewer flooding	See note below		Nr of Incidents
Interruptions	0.21		Hours per total properties served
Reliability and availability			
Serviceability water non-infrastructure	Stable		
Serviceability water infrastructure	Stable		
Serviceability sewerage non-infrastructure	Stable		
Serviceability sewerage infrastructure	Stable		
Leakage	637.14		Ml/day
Security of Supply Index (SoSI)	100		Index score
Environmental impact			
Greenhouse gas emissions	741		ktCO2e
	All incidents	Exc consent compliant *	
Pollution incidents (sewerage)	3.78	2.75	Category 1-3 incidents per 1,000 km of sewer
Serious pollution incidents (sewerage)	2.93	2.20	Category 1-2 incidents / 10,000 km of sewer
Pollution incidents (water)	3.17	2.86	Category 1-3 incidents / 10,000 km of main
Discharge permit compliance	99.71%		%
Satisfactory sludge disposal	100%		%
Financial			
Post-tax return on capital	6.34		%
Credit rating	A3		Moody's - Class A debt
	Baa3		Moody's - Class B debt
	Baa1		Moody's - Corporate Family rating
	A-		S&P - Class A debt
	BBB		S&P - Class B debt
Gearing	78.30%		%
Interest cover	1.4		x

Internal sewer flooding is a new metric and the calculation is being finalised in advance of Ofwat's submission deadline for the new KPI dashboard of 15 July 2012.

Chief Executive Officer's Business review (continued)

Key non-financial measures

In addition to the above, the table below shows the Company's performance against its key non-financial measures, which with two exceptions were achieved.

Target area	Target 2011/12	Performance 2011/12	Target achieved
Corporate responsibility programme			
Business in the Community Corporate Responsibility Index	Platinum (>95 per cent)	Platinum (>95%)	✓
Water			
Drinking water quality compliance	99.98%	99.98%	✓
Security of supply (annual average)	100	100	✓
Leakage (Ml/d)	673	637	✓
Properties receiving low pressure	34	3	✓
Wastewater			
Sewage treatment works compliance (LUT)	100%	100%	✓
Properties alleviated from external and internal sewer flooding	-	84 *	Target is to achieve 2,488 by 2015
Serious or significant pollution incidents	Zero	20	×
Satisfactory disposal of sewage sludge	100%	100%	✓
Our wider responsibilities			
Renewable energy generation	197 GWh	176 GWh	×
Health and safety – number of accidents per 1,000 employees	5.37	3.12	✓
Employee volunteering – employees volunteering in schools, the community or charities	15%	18%	✓
Sites of Special Scientific Interest (SSSI) in favourable and unfavourable recovering condition	95%	100%	✓
Suppliers, contractors, and service providers' invoices paid according to agreed terms and conditions (+/- 3 day tolerance)	85%	92%	✓

* Provisional.

Chief Executive Officer's Business review (continued)

Key performance measures - highlights

Below is a summary of some of the key changes in the business that the Company has used to drive its improvement against targets.

Water Service and Environmental Performance

- Between 2005 and 2012, the Company has reduced leakage by 26%. A number of measures have helped to achieve this reduction; replacing old pipes including Victorian mains, trunk main replacement, and water pressure management as well as the Company's new Trunk Minder system as mentioned below. The Company has now met the annual leakage target agreed with Ofwat for the last six years.

- The Company's new Trunk Minder system was introduced to identify a hidden underground leak as soon as it forms, allowing the Company to schedule a repair before a leak has time to wash away the ground around the trunk main and cause a major leak.

- The Company's drinking water quality performance remains high at 99.98% compliance, an improvement on the prior year. Whilst the Company aims to achieve 100% compliance, many of the failures recorded at customers' taps are caused by the condition or maintenance of customers' pipework and fittings. To that extent, 100% compliance is not within the control of the Company. However, the Company will continue to strive to achieve this aim.

- Water efficiency has been a focus of the Company in its campaign to encourage customers to use water wisely. During the last year as a result customers have helped to achieve a daily saving of 6 Mld (2011: 5 Mld).

Sewerage Service and Environmental Performance

- During this year, the Company has increased the capacity of some of its STW's to treat wastewater from an additional 61,000 customers. This increase means that the Company can deal with new housing development for years to come without having to make further investment or seek delays to the building of these houses.

- Reducing the risk of sewer flooding is of the highest importance to both the Company and its customers. In the year, 45* properties were affected by sewer flooding for the first time. The number of properties on the Company's high risk register was 1,529*, an increase of three from the previous year. The Company's investment programme resolved the flooding of 60* properties and the Company will continue to offer flooding mitigation measures to alleviate this most distressing experience.

- The Company again achieved 100% compliance with the EA standards on treated effluent across all of its 350 treatment works.

  * Provisional.

Chief Executive Officer's Business review (continued)

Key performance measures – highlights (continued)

Sewerage Service and Environmental Performance (continued)

- During the year, the Company dealt with 71,050 incidents of sewer blockages including 14,946 across the lengths of private sewers it adopted in October 2011. The Company recognises that this is not the level of performance that it expects to deliver, and is not in line with the Company's plan to reduce the number of these incidents by 2015. The Company aims to improve its performance through the use of new technology such as real time sewer monitors and targeted sewer inspection and maintenance.

- The Company recognises that the environmental damage and public nuisance caused by spillages from its sewer network is unacceptable and works hard to prevent them. The EA categorises pollution incidents on a scale from one (the most serious) to four (no significant environmental impact). In the period, there were 20 incidents that were categorised as Category 1 or 2 by the EA. Clearly, this level is unacceptable and the Company is working hard to improve its performance.

Security of Supply

- The Company has delivered 100% Security of Supply to all its customers.

Customer Service

- Along with other water companies, the Company provides information to Ofwat on the number of complaints it receives, and how well they have been handled. The Company also proactively carries out its own customer satisfaction surveys to gauge where it is performing well and to give the Company an insight into the areas where its customers think that it can do better. Generally customers were more satisfied with the Company's services than the previous year.

- The Company's Customer Assistance Fund provides support for customers who genuinely cannot pay their bills. During the year the fund made donations totalling £1.8m (2011: £1.9m). In addition, £0.3m was provided for exceptional hardship cases and grants were made to nine specialist advice organisations including Citizens Advice to pay for specialist debt advisors.

- The Company has made improvements to its telephony system to make it easier for customers who would prefer to talk to a customer advisor. The Company has also provided a call back facility for customers who do not want to wait in the line during peak call times.

Health and Safety

The Company continues to have a key focus on health and safety. It has developed its 'one-safety hub', a shared facility enabling the Company and its contractors to share best practice in health and safety. In the year, the Company has also reviewed and enhanced its health and safety systems and held further health and safety conferences for the Company's employees and its contractors.

The number of reportable accidents fell to an Accident Incident Rate ("AIR") of 0.33 injuries per 1,000 employees, (2011: 0.50) across the business, a 48% improvement since the start of AMP5.

However, it is with regret that the Company has to report that two employees of its contractors suffered fatal injuries in two separate incidents. The first of these occurred in June 2011 where the contractor was working in an excavation and the Health and Safety Executive are carrying out a full investigation. The second occurred in October 2011, where the contractor was struck by a vehicle when working in a roadway, a driver was charged and convicted of dangerous driving and was sentenced to time in prison.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties

Risk overview

The Company's Risk Management process is integrated within the business, and is designed both to identify emerging risks and to minimise the adverse impact of emerging and existing risks. Each business area is responsible for managing its risks and maintaining a risk register. Significant risks are escalated and reviewed by the Executive and the process is overseen by the Audit & Risk Review Committee ("ARRC"). For more information regarding the role and responsibilities of the ARRC, see pages 56 and 57 of the Corporate governance report.

The Company is exposed to a number of risks and uncertainties that could have a material impact on its long-term performance. These include:

- **Delivery of the Thames Tunnel** – As an innovative solution to the challenge of reducing sewage discharges into the Thames, the design and construction of the Thames Tunnel present a number of major technical and logistical challenges. These include the need to secure a number of construction sites in central London, obtaining planning consents via the process for major projects set out in the Planning Act 2008 and managing the inevitable disruption. As well as the many stakeholder issues, a key challenge is to finance the project, and protect the Company's credit rating. The Government has indicated that it will provide support for the exceptional construction risks involved in the project, but the details of this support and the residual risk to the Company have yet to be resolved.

  Mitigation: The Company is working closely with the Government to agree the funding model and the appropriate organisational structure to deliver and operate the tunnel.

- **Price Review 14 ("PR14") determination** – All UK water and sewerage companies must justify the operating costs and capital investment needed to deliver service to customers in the five-year period from April 2015. Failure to demonstrate the Company's case to Ofwat's satisfaction may mean that it is unable to invest in asset improvements that the Company believes will benefit its customers in the long term or to finance its business plans.

  Mitigation: The Company has assembled a dedicated team to oversee the production of the plan, building on experience gained during previous Price Reviews.

- **Managing increased competition in the water industry** - The Water White Paper issued in December 2011 has signaled plans to implement market competition for business customers, while at the same time providing assurances that the sector needs to remain attractive to investors. The extent and timing of changes remains uncertain. The initial impact will largely be for large users, although there will also be opportunities for the provision of wholesale services.

  Mitigation: The Company is preparing for these changes with a view to taking advantage of the opportunities, and this may require structural change.

- **Employee pension scheme funding** – The Company operates two material defined benefit pension schemes. Whilst the Company has reduced its future exposure by closing the final salary schemes to new entrants, and moving a number of senior employees onto a defined contribution scheme, the Company remains liable for the historic rights earned by past and present employees. Both schemes are currently in deficit on a Gilts valuation basis, whilst agreed deficit repair plans are in place, there is a risk that actuarial assumptions on investment returns or longevity could change and cause increased employer contributions.

  Mitigation: The Company will continue to review investment strategy with the trustee in order to ensure that funding risks are understood and managed.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

- **Failure to maintain adequate funding arrangements** – As at 31 March 2012, the Company has adequate cash at bank and short term deposits of £622.1m (2011: £779.4m) and undrawn committed bank facilities of £1,200.0m (2011: £1,175.0m) in place to provide liquidity as required. The Company will need to renew £450.0m of 364 day committed facilities by August 2012. There remains a risk that credit market conditions will deteriorate against the backdrop of weak economic recovery and falling credit ratings of financial institutions, increasing the cost of raising new debt and refinancing bank facilities. As a regulated utility, the Company does not anticipate a situation where it will be unable to access financing as it would benefit from a flight to quality in poor debt conditions. An increase in the cost of funds may put pressure on key financial covenants (as defined by the Company's capital structure). In addition the impact of a falling RPI rate on the RCV could create further pressure on financial covenant headroom, specifically the ratio of net debt to RCV.

  Mitigation: The Company has an established funding strategy which is reviewed by the Board annually.

- **Customer experience measures** – The measure for customer performance is evolving from quantitative to qualitative criteria. All water companies will need to adapt their processes in order to optimise performance against these new criteria to be measured against Ofwat's SIM. Failure to meet the SIM target for the Company over the remaining years of this regulatory period could lead to a financial penalty in the next regulatory period.

  Mitigation: The Company is working closely with Ofwat to shape the future reporting requirements, and is reviewing internal processes to improve end-to-end customer service.

- **AMP4 sewer flooding programme** – The Company has responded to an information request from Ofwat issued under section 203 of the "Water Industry Act 1991" concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The information requested relates to the level of evidence required to support a judgment that a property is likely to have flooded in the past. Ofwat's investigation into whether the Company complied with the relevant guidance continues and is unlikely to conclude its investigations until at least the third quarter of 2012. If Ofwat concludes the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs which Ofwat determines have not been achieved during the AMP4 period.

  Mitigation: The Company has provided all the information that has been requested to support the numbers claimed and has met with Ofwat on several occasions to discuss their concerns. The Company awaits the conclusion of Ofwat's investigation.

- **Credit rating** – Regulated water and sewerage utilities benefit from strong investment grade credit ratings based on a large asset base, predictable returns and a stable regulatory environment. This could be adversely impacted by Ofwat proposals to amend licence conditions and its further proposals for regulatory reform. The Company's credit rating could also be negatively affected by an agreement on the delivery model for the Thames Tunnel project that exposes the Company to a level of risk beyond that normally associated with a regulated water and sewerage utility company, or by an obligation to deliver a further large capital programme in the next regulatory period ("AMP6"). A downgrade in credit rating would increase borrowing costs and reduce access to long-term debt markets, putting at risk the ability to meet financial covenants. This would therefore increase the likelihood of hitting a "trigger event" under the terms of the whole business securitisation, an event that would lead to a distribution lock up.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

Mitigation: The Company is working to ensure that its Price Review preparations, Thames Tunnel plans and other significant business changes take account of the impact on the credit rating.

- **Drought** – The Thames catchment area has experienced the driest two-year period in recorded history, leading to a temporary use ban to conserve remaining water supplies. Heavy rain during April has alleviated the immediate crisis, but ground water levels remain very low and a further dry winter may cause a more severe drought in 2013.

Mitigation: The Company is managing the drought as a priority operational event. It has mobilised a team that draws on experience across the business. This team is headed by a member of the Executive.

- **The London 2012 games** – London will host the Olympic and Paralympic Games from 27 July 2012. Any operational interruption would cause significant disruption and, with the media present, damage the Company's reputation. Meeting the additional demand for water during a drought will provide further operational challenges.

Mitigation: The Company has worked continuously with the London Organising Committee of the Olympic Games ("LOCOG"), to provide the agreed infrastructure and ensure that it is ready operationally. Operational and communications plans are already in place.

- **Failure to meet regulatory targets** – The Company is required to meet targets set by Ofwat, the EA, the Drinking Water Inspectorate and other regulators. In order to achieve this, the Company must continue to deliver cost and efficiency savings in line with a challenging Final Determination, while maintaining and improving operational performance and the standard of customer service.

Mitigation: Performance against regulatory measures is the subject of regular management review. The new reporting mechanism allows the Company to further align internal and external performance indicators.

- **The effects of climate change and long-term changes in weather patterns** – As the Company continues to supply an increasing population, the effects of climate change could adversely affect its ability to maintain its Security of Supply Index (SoSI) requirements.

Mitigation: The Company has been working on measures to reduce demand, mounting a widespread awareness campaigns and providing free water saving devices, as well as making provision for new sources of potable water and improving the integrity of its network. Together with other water companies and regulators, the Company is actively participating in work to identify the wider water resources needs across South East England.

- **Future changes in laws or regulations** – The Company is not funded by Ofwat for changes in obligations that would affect the whole economy. Consequently the Company may, for example, have to meet the obligations resulting from changes in environmental legislation without recourse to Ofwat.

Mitigation: Changes that are specific to, or are more material for, the water industry may be funded by Ofwat as a relevant change of circumstance. The Company engages actively with regulators where a change is likely, to ensure the implications are understood, and monitors the impact of recent changes to ensure it can demonstrate the case for additional funding where it is justified.

Chief Executive Officer's Business review (continued)

Principal risks and uncertainties (continued)

- **Failure of a major asset** – A failure at one of the Company's major assets could significantly impact the safety of its workforce and the public, as well as interrupting supply to customers and breaching environmental and regulatory targets. The impact would be both financial and reputational.

  Mitigation: The Company has a specific compliance process to manage each of the identified risks.

- **Impact of low inflation or deflation** – In return for their capital investment in assets, regulated water companies earn a return on their RCV, which is adjusted by the RPI. In times of low inflation or deflation, the return on this investment will decrease relative to the cost of funding, reducing cash flow and shareholder value.

  Mitigation: In order to protect the Company from these impacts, around half of the Company's debt is indexed to RPI, either directly in the underlying debt instrument, or by use of RPI swaps.

Transforming Thames

The Transforming Thames programme has continued, with the focus on improving customer service, improving the Company's health and safety performance, enhancing its data and the way it is used to make business decisions and driving operational efficiency.

Key efficiency projects have moved to the delivery phase. This includes the WAMI programme, which began phased deployment in November 2011. This programme is implementing a fully integrated work and asset management approach across the business, using a SAP platform, to drive a more effective and efficient service for customers. Rollout to circa 4,000 users will continue through 2012. The benefits from this project include better data capture at source enabling better business decisions, improved customer diagnostics enabling first time resolution and more efficient work planning enabling better productivity in the field. Overall, this will enable an improved customer experience.

New working patterns and associated terms and conditions have been negotiated for all field-based operatives, better allowing the Company to meet customer demand and map resources to those demand patterns. These new working patterns were implemented on 1 April 2012.

The Customer Service improvement programme has been developed based around the principle of 10 key aspirational promises for customers. This, when delivered, will enable the Company's performance to be successfully measured by SIM.

All managers in the field continue to be supported by Change Managers, who are experienced in the sustainable delivery of business change. They provide coaching support to teams, ensuring that the transformation programme is understood, employees are fully engaged in the process and that the appropriate measures are developed to track progress and success.

Following extensive consultation with employees and with the agreement of the pension fund trustees the Company has changed certain provisions in respect of the Thames Water Pension Scheme ("TWPS") for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011, new employees of the Company have been offered participation in the Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life Assurance Limited ("Standard Life"). All senior managers have now moved to this scheme.

Chief Executive Officer's Business review (continued)

Transforming Thames (continued)

For existing members of the TWPS, certain provisions have changed that will affect future benefits to its members. Principally, the defined benefit provision with effect from 1 May 2011 will be on a CARE basis and no longer on a Final Salary basis.

The Company has demonstrated continuing improvement, whilst implementing the transformation programme, in both operational and financial performance, thus providing a strong platform for the future.

Looking further ahead

It is over 20 years since the water industry was privatised. Since then much has changed - costs of service are lower, performance is better and the industry has delivered significant quality improvements. However, with the Company continuing to face challenges including climate change, population growth and new quality improvements, to name a few. The industry and the Company must ensure they can meet these challenges, including the immediate demands of dealing with a drought.

The regulation of the sector going forward will be critical to its ability to meet the challenges of the future.

There is increasing clarity. In November 2011 Ofwat published early proposals for its PR14 and in December 2011, the Government published its long awaited Water White Paper and moved to expand the existing business retail market. During 2012, the Company expects Ofwat to further refine its approach to PR14 and Government to publish a draft water bill, primarily focused on enabling a retail market for all business customers.

Looking further ahead, the Company will need to be flexible and ready for any change to the regulatory environment. However, through this period of change there are some constant underlying requirements. The Company will need to ensure that;

- high performance is maintained and it capitalises on opportunities for further improvements;
- it delivers what customers want at the right price, in the right place and at the right time;
- it offers value for money at an affordable price.

A key challenge in this process will be the delivery of the proposed Thames Tunnel. The Company is working closely with all stakeholders to ensure this is delivered by the most appropriate means possible.

The Company is always looking ahead to understand the future environment and ensuring that it takes the right actions today to protect the future.

Strategic Direction Statement

In 2007, the Company published a Strategic Direction Statement setting out priorities for the next 25 years. As part of its strategic business planning, the Company is working to review and update its long term plans, building on the wants and needs of customers and challenges as diverse as future population growth and climate change.

Water resources and Drought

In August 2009, Department for Environment, Food and Rural Affairs ("Defra") called for a public inquiry into the Company's draft 25 year Water Resources Management Plan. The inquiry completed in August 2010 and the Inspector's report recommended additional work in a number of areas including the assessment of long-term solutions for supply security.

Chief Executive Officer's Business review (continued)

Looking further ahead (continued)

Water resources and Drought (continued)

Defra issued instructions to the Company to complete the plan in line with the Inspector's report and advice from the EA. This work has now been completed and the Company has consulted further on its plan. No significant issues have been raised and The Secretary of State is now considering the Final Plan and will make a decision in 2012, following advice from the EA.

Following the driest two years since records began, the Company, along with six other companies in the South East of England, gave notice to customers on 12 March 2012 of a temporary water use ban. From 5 April 2012, it was prohibited to draw water through a hosepipe or similar equipment, or fill or maintain a domestic swimming pool, paddling pool or ornamental fountain. The Company will continue to closely monitor the situation over the coming months and further drought management measures may be required to secure supply. The impact of a third successive dry winter cannot be discounted and, should this arise, it will have an impact of the Company's management of its water resources.

The Government's Water White Paper drew attention to the future threats to the security of water supplies. As part of a response to this threat they propose to reform the abstraction regime and anticipate a new regime in place by no earlier than 2020. In the medium term it is encouraging Ofwat and the EA to consider incentives for companies to improve the sustainability of their water abstraction in a sustainable manner.

Transfer of private sewers

On 1 July 2011, the "Water Industry Schemes for Adoptions of Private Sewers 2011" came into force, whereby all privately owned sewers and lateral drains built before 1 July 2011 and connected to an existing public sewer became the responsibility of sewerage undertakers with effect from 1 October 2011.

As a result, approximately 40,000 km of privately owned sewers and lateral drains were transferred on 1 October 2011 to the Company, an increase of 60% in the sewer network for which the Company is now responsible.

A second transfer scheme for those privately owned sewers built after 1 July 2011 was originally scheduled for April 2012, but has been postponed with a new date to be agreed. Private pumping stations connected to the transferred pipework will transfer between 1 October 2011 and 1 October 2016. The Company is currently drawing up its programme for progressive adoption over this five year period.

At PR09, Ofwat did not fund companies for the costs of the private sewers or pumping stations transfer. Instead, the Company will be examining the case for submitting an Interim Determination of K ("IDoK") application to Ofwat before September 2013 to enable it to recover the additional costs incurred.

Business Retail Competition

Currently only 30,000 of approximately 1.2m business customers in England and Wales have a choice of retail supplier. In Scotland all business customers have had a choice since 2008. The Government's 2011 Water White Paper proposed to introduce a draft bill in 2012 to bring about choice in England for all business customers. There is currently however no timetable for this change.

The Paper ruled out mandatory legal separation of companies' retail functions and the expansion of retail competition to households. However, companies will be expected to demonstrate arms length dealing with their retail arms and Ofwat has powers to enforce non-discrimination including powers to refer companies to the Competition Commission for structural remedies.

Chief Executive Officer's Business review (continued)

Looking further ahead (continued)

Affordability and recession

The Company currently has the second lowest combined bill out of the Water and Sewerage Companies ("WaSCs"). However, the Company also has the highest proportion of income deprived households. In the last ten years industry bad debt levels have risen by 10% per annum, which may be illustrative of a rise in affordability issues and recession. In addition, specific future bill increases for projects such as the Thames Tunnel will have an impact on customer's ability to pay. Ensuring that the Company invests only where it has its customers support will be necessary to keep bills as low as possible.

Relationships and resources

Employees

This financial year has been challenging, with the largest ever five year capital investment programme being in its second year, continued transformation of the Company's business processes and the challenge of a potential drought combined with preparation for the London 2012 games. The Company's employees have continued to demonstrate high commitment and increased engagement levels throughout the year, supported by the "Passionate About People" strategy.

This strategy was updated in 2011 in line with business requirements to give an increased focus on supporting the organisational change and transformation across the Company, alongside getting the best out of its people by giving them the right support and development. The implementation of the Company's 'Passionate About People' approach continues to engender a positive working environment, which focuses on performance, contribution and values diversity and inclusion.

Overall staff turnover in the current year was 7.95%, reducing from 9.58% in the previous year.

The Company's sickness rate during the year was 2.53% (2011: 2.75%). The Company has an attendance management policy in place with the overall aim of reducing and managing sickness absence and, in particular, long term sickness.

The Company is committed to effective talent management and runs regular Talking Talent reviews to assess performance and potential across the Company. These reviews support effective learning and development interventions and focus on ensuring the Company has the future talent to deliver its business strategy. The Company continues to invest in its core leadership development programmes, future talent pipeline programmes (including apprentices and graduates) and to develop the technical and business skills of its employees.

During this year, the following key people initiatives have been delivered to support the business strategy;

- development and negotiation of working patterns, terms and conditions changes to ensure they are modern, meet the needs of the customer and the business and are in line with the market;
- development of an approach to career paths to ensure that technical roles are identified, have a clear path through the organisation and are appropriately awarded;
- recruitment routes to market and career pages developed to drive employer brand ensuring that the Company is an employer of choice;
- implementation of procedure changes for legislative updates including agency workers regulations, abolition of the normal retirement age and new paternity rights;
- support for occupational health to improve management of long term absence and to develop a strategy to deal with stress;
- the continued focus on employee engagement across the Company, resulting in a year on year increase in employee engagement, as measured through its annual employee survey;

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Employees (continued)

- new intakes to the Company's Graduate, Apprentice and Bursary future talent pipeline programmes;
- continued roll out of the Company's core "Foundation, Advanced and Strategic Leadership development" programmes;
- Continued Performance and Development reviews for all employees linked to the annual pay review;
- people plans for all areas of the business.

The Company is committed to the training and development of all of its employees who undertook 14,301 (2011: 12,355) formal training days in 2012. These figures exclude WAMI training, sponsorship for further and higher education, roadshows, conferences, NVQ coaching & assessment and Manager briefings.

Stakeholders

The continuation of work to determine the preferred route and sites for the Thames Tunnel was once again the focus of much of the Company's work with stakeholders. In addition to the second major round of public consultation on the project, the Company continued to attend community and residents' groups and public meetings, as well as arranging briefings with local authorities, Members of Parliament and other stakeholders. The Company also arranged interim customer consultation activities in advance of the start of the second phase of public consultation, where new sites had emerged since the first stage of the process.

The Company has continued to host the Thames Tunnel Forum, held approximately quarterly, to brief stakeholders on progress and seek their views on its proposals. This successful format is now also being used for the proposed Deephams STW Upgrade in North East London. The Company also contributed to the Thames Tunnel commission established by a group of London Councils for the purpose of reviewing the alternatives to our proposals for the Thames Tunnel and reported its findings on 31 October 2011.

In addition to one to one briefing with MPs on issues of local interest, the Company hosted a series of roundtable discussions with Parliamentarians and London Assembly Members, to outline its plans on strategic issues and seek their feedback on the Company's approach. Topics discussed included market reforms in the water industry and the management of water resources.

The Company hosted several visits for customers and stakeholders to its sites during the course of the year, providing opportunities for them to see the Company's work first hand, and to mark significant project milestones. These included hosting a visit for Defra's water quality department at the historic Abbey Mills pumping station in November 2011and an event to celebrate the lowering of the Lee Tunnel Boring Machine in December of that year.

The Company was also pleased to host two visits for Secretary of State for the Environment, Caroline Spelman MP. The first involved a review of the Company's innovation activities and a tour of the Lee Tunnel site and desalination plant at the Company's Beckton facility; while the second event was hosted to mark the opening of the Old Ford Water Treatment Works, constructed to provide wastewater treated to non-potable standards for irrigation and toilet flushing on the Olympic Park.

The Company played an active role in Parliamentary inquiries, submitting written evidence to the Environment, Food and Rural Affairs Select Committee's examination of the Government's water white paper, *Water for Life*, and giving oral evidence to a House of Lords EU Sub Committee inquiry into European water legislation. During the year representatives from the Company gave evidence to an Environment, Food and Rural Affairs ("EFRA") committee on the Wastewater National Policy statement.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Stakeholders (continued)

The last year has seen the Company play an increasingly active role in bringing together regulators and stakeholders to develop joint approaches to challenges such as urban drainage and water resources. The Company hosted a seminar and workshop in December to examine with stakeholders how to increase the uptake of sustainable drainage systems, and in March 2012 held the Company's inaugural quarterly Water Resource Forum, sharing a platform with Defra, Ofwat and the EA.

During 2012, the Company has also sought to influence public policy through its presence at seminars and conferences. A speech was delivered by a representative of the Company on water scarcity at October's *Water 2011* conference; while presentations by the Company on water resources and industry reform were made at the *Future of Utilities* event held in March 2012.

At a regional and local Government level, the Company continued to strengthen ties with the authorities it serves. At a pan-London level, the Company worked closely with the Greater London Authority ("GLA"), London Assembly and the Mayor on a variety of issues. This has included working with the Mayor on his streetworks Code of Conduct, and liaising with the Assembly's Environment Committee, hosting a visit for members to the Company's Beckton site and contributing to the Committee's work to determine priorities for 2013. The Company has also been active members of the GLA London Waterways' Commission established to oversee the navigable waterways in London.

At a local level, the Company worked closely with many of the 100 local authorities it serves across the region, seeking to ensure the Company's operational activities and investment projects were delivered with the minimum of disruption. The Company attended several formal Scrutiny and Public Meetings, giving evidence at meetings and responding to questions and feedback from councillors, officers and the public.

The Company has delivered a number of stakeholder training sessions for its directors and senior managers to ensure that there is a consistency of approach to external engagement.

Public consultations and research

The focus on public consultations work has again increased this year. The Company has a number of major projects either underway or proposed, which has led to its highest level of public consultation activity to date. The Company recognise that these major projects have an adverse impact on a large number of its stakeholders and customers and endeavour to ensure the Company's plans reflect their views where it is possible to do so.

The Company's approach to consultation includes independently-facilitated stakeholder workshops; individual discussions with MPs and other stakeholders, surveys, focus groups and independently-hosted online consultations.

The Company has committed to early proactive and transparent consultation on the Thames Tunnel. Consultation activities have followed best practice principles and have been carried out in accordance with the Government's "Code of Practice" and recommended best practice guidance.

The second phase of consultation on the proposed Thames Tunnel ran for 14 weeks from November 2011 to February 2012, and involved a greater level of detail than 2011's first phase. The feedback from the two phases is informing final proposals on the construction of the project, while providing an opportunity to address concerns about the potential adverse effects on local communities, businesses and the environment. A report on the second phase of consultation was published on 17 May 2012.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Public consultations and research (continued)

Other consultations this year included a consultation on the Company's revised Water Resources Management Plan 2009, which ran from December 2011 to January 2012. A programme of engagement with regulators and stakeholders for the Water Resources Management Plan 2014 is now well underway. Following research into customers' expectations during drought periods, the Company held a public consultation on its draft Drought Plan, from December 2011 to February 2012.

The Company is proposing a major upgrade to its Deephams STW, which serves approximately 900,000 people in North East London, to improve significantly the quality of the treated wastewater returned to the Salmon's Brook, a tributary to the River Lee. During 2011, a quarterly Stakeholder Forum was established to bring together key stakeholders to share information about the project and answer their questions and concerns, and to seek feedback on the Company's proposals.

A first phase of public consultation is planned for summer 2012 to examine the choice of preferred site and treatment technologies for the STW upgrade, as well as the other options that have been considered. A second phase of public consultation is planned in 2013.

The Company has also held deliberative workshops and focus groups with customers, at which it has provided background information on its work, in order to deepen their understanding of the business and help them to give more informed views. The topics covered have included the Company's approach to the PR14, drought, water efficiency, bill design, communications materials on the Thames Tunnel project, the transfer of private sewers to WaSc, research with business customers and customer strategy and brand and reputation research.

The Company's continuing commitment to customer engagement will help it understand the wants and needs of its customers and ensure it has (as far as possible) developed Company plans in accordance with their wishes. However, the Company needs to understand, and test, customers' views is growing all the time and is engaging with customers more in some of the strategic decisions the Company faces. In addition the Company is also seeking their views on elements of the Company's investment programme. With this in mind, the Company has regularly used its 2,000 strong customer panel to help it better understand its customers' needs and preferences.

The Company is a corporate member of the Consultation Institute and follow Cabinet Office best practice guidelines for consultation, aiming to make the process as open and transparent as possible.

Chief Executive Officer's Business review (continued)

Relationships and resources (continued)

Involving customers in price setting

A great deal of change has occurred this year following the publication in August 2011 of Ofwat's customer engagement policy statement: *Involving customers in price setting.* This document sets out Ofwat's approach to customer engagement in the price setting process ahead of the 2014 Price Review, and underlines the importance of customer support in determining the acceptability of companies' business plans. Specifically, it details a "three-tiered approach" to enable customers to engage in different ways and to influence the service they receive and the price they pay;

- "Direct, local engagement" to take account of customer views on local priorities and issues that could have a significant impact on the service customers receive;
- establishment of the Company's "customer challenge group" to consider evidence of direct customer engagement, and to ensure that the Company's plans reflect a balanced understanding of customer views;
- creation of a "customer advisory panel" by Ofwat to inform sector-wide assumptions such as the cost of capital, and provisions for pensions and energy.

The Company took full account of the direction and guidance within Ofwat's policy statement in developing its programme of customer engagement activities to inform the Company's strategy and business plan. The first phase of this programme began in September 2011 with a qualitative study of domestic and business customers to understand the relative priorities they placed on different elements of their service. This study was used to inform the development of a quantitative survey in November 2011, which explored the relative values customers placed on improvements or deteriorations to the levels of service they currently receive.

Further phases of research and engagement are ongoing and being planned for 2012 and 2013, and will be scrutinised by the newly formed Customer Challenge Group, (see below) ahead of their implementation, to inform the development of the Company's long term strategy and business plan.

The Company established its Customer Challenge Group – in line with Ofwat's policy statement – and the Group met for the first time in February 2012 and will meet throughout the period leading to the 2014 price review. The Group has an independent Chair and Vice Chair, and its members include industry regulators, domestic and business customer representatives and other key stakeholders. The role of the Group is to challenge the Company as it develops its customer engagement and research plans, and on the Company's interpretation of customers' views and how these have been reflected in its strategy and business plan. The Group will provide a report to Ofwat alongside the Company's business plan on its customer and stakeholder engagement process, and the content of its strategy and business plan.

Streetworks

The Company played an active role in developing new approaches to managing the impact of streetworks, responding to consultations on Lane Rental Regulations and Guidance published by the Department for Transport and Transport for London's Lane Rental Scheme consultation. The Company also participated in workshops facilitated by the Department for Transport and Transport for London to develop proposed Lane Rental schemes.

The Company sought to communicate its approach to streetworks with key stakeholders proactively. Prior to the start of the winter, during which the need to carry out leak repairs is at its greatest, highways authorities were approached to ensure a collaborative approach to tackling leakage and minimising disruption.

The drought has increased the need to ensure leaks are tackled quickly and efficiently, and highways authorities have been asked to, and have helpfully provided, support for the Company's work in this area.

Chief Executive Officer's Business review (continued)

Key suppliers and contractors

In 2012 the Company spent in excess of £1.1bn on construction, goods and services with a range of suppliers and contractors (2011: in excess of £1.4bn). Approximately 23 key suppliers (2011: 31) were engaged with a spend greater than £10m each. The Company's policy is to establish trading arrangements, which are made following an open non-discriminatory, competitive bidding process. Procurement processes reflect the Company's corporate responsibility commitments and, where applicable, comply with the requirements of the Utilities Contracts Regulations 2006 (as amended).

Research and development

The Company's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. Research and development deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP5 and also provide specialist technical support to the business. Expenditure on research and development totalled £3.9m for the year (2011: £3.4m).

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Energy efficiency and renewable energy

The Company is committed to reducing its contribution to the causes of climate change and its voluntary target is to achieve by 2015 a challenging 20% reduction in greenhouse gas ("GHG") emissions (compared to 1990 levels) for scope 1 and scope 2 emissions.[7]

The Company's total GHG emissions (Scope 1, 2 and 3) reported for 2012 were 746,000 tonnes (2011: 780,436 tonnes) of carbon emissions ("CO_2e"). The Company's approach to reporting GHG emissions is consistent with the Department of Energy and Climate Change ("Decc"), Defra guidance and Ofwat reporting requirements. During the year, the Company's reported emissions decreased, largely due to a reduction in imported electricity consumption. Coupled to this was a reduction in the Emission Factor ("EF") for grid electricity. This followed a change in the methodology that Defra used to calculate the EF which now accounts for imported electricity into the UK

Last year the Company consumed 1,171 Gigawatt hours ("GWh") of electricity, of which 166 GWh was renewable electricity generated at the Company's operational sites - around 14% of the Company's total electricity use. The Company produced 85 GWh of heat energy which displaced the need to consume natural gas. This generation of renewable electricity and heat helped reduce the Company's overall GHG emissions.

The Company continues to work hard to understand and reduce its carbon footprint. During 2012 it has;

- increased renewable energy generation capacity by 10.9 MW including 6 MW of biogas engines at Riverside STW, and 4.9 MW of photovoltaics (solar power) at 31 sites;
- increased metering of its gas and electricity use (covering 100% and 99.6% of use respectively) so that the Company can measure its energy consumption more accurately;
- started a programme to save 8 GWh in energy use by making air blowers (used in the sewage treatment process) more efficient;

[7] Scope 1 emissions are those direct emissions associated with the operation of the business. Scope 2 emissions are the indirect emissions associated with the consumption of grid electricity. However, this is reliant on the Government redefining grid emissions.

Chief Executive Officer's Business review (continued)

Energy efficiency and renewable energy (continued)

- prioritised the Company's pump efficiency programme on raw water pumps in light of drought conditions. These are pumps that take river water to supply its storage reservoirs;

- introduced an energy and carbon engagement programme for employees working at the Company's head office. Metering on each floor of the building allows detailed energy monitoring;

- installed a dryer at Slough STW, which dries the sewage sludge to produce a granule material that can be used as a renewable fuel;

- installed new lighting and motion sensors at 6 operational sites.

Looking to the future, there are a number of significant challenges facing the business in terms of reducing the Company's GHG emissions. The Company's activities are very closely linked to the weather. For example adverse conditions require the need to pump more water, and drought conditions force the use of water treatment by desalination. Both of these scenarios are electricity intensive – with the consequence of increased GHG emissions. Additional upward pressures on energy consumption and GHG emissions that the Company cannot control include new obligations (including the adoption of private sewers and the construction of the Tideway Tunnels) and population growth.

However, there are responses that the Company can influence, including energy efficiency, effective energy procurement and the generation of renewable energy. The Company therefore needs constantly to innovate in the management of its energy consumption and GHG emission to ensure they are kept as low as possible. However, changes in Government policy such as the Carbon Reduction Commitment becoming a tax rather than an incentivised cap and trade scheme, and proposed changes to the Feed-in Tariff Scheme have made effective planning and delivery much more difficult.

Social and community

Corporate Responsibility

The Company is committed to engaging positively with the communities it serves and to minimise the impact of its activities. The Company is pleased to report that it has been awarded a 'Platinum' ranking in the Business in the Community Corporate Responsibility Index, having undergone a rigorous reporting process across the Company's Corporate Responsibility and sustainability working practices.

Community Investment

The Company's updated strategy was approved by the Board and a brief version is available to view on the website http://www.thameswater.co.uk/cps/rde/xchg/corp/hs.xsl/8276.htm The strategy encompasses feedback from customer research and stakeholders that the core themes for activities should include environment and wildlife improvements, education, access to sites and charitable giving. Volunteering opportunities in respect of each of these themes are available. The Company also signed up to support Love Where You Live, a Keep Britain Tidy initiative looking after the local environment.

Open Days

A programme of Open Days on the Company's sites was delivered with events for visitors at Slough, Swindon and Maple Lodge STW's and Coppermills water treatment works. The Company also took part in London Open House where eight of its heritage sites were opened to the public. Around 1,600 customers and visitors took part in these events which included tours conducted by more than 100 Thames Water volunteer staff.

Chief Executive Officer's Business review (continued)

Social and community (continued)

Community Initiatives

The Creekside Education centre based on the Thames foreshore in Deptford was opened in May 2011 and has seen 3,735 students, community members and volunteers come and learn about both tidal ecology and key water messages.

The Company has committed to its adoption of Fobney Island, the Fobney Wetland Park along the River Kennet on the edge of Reading, Berkshire. The aim of the project was to provide £200,000 of financial support, technical expertise and employee volunteers. To date, the work has created seasonal wetland areas to reconnect the five hectares of floodplain on the island with the River Kennet. In March 2012, a rare Little Ringed Plover was spotted on the new wetland.

Another five students at the University of East London who are benefiting from the Company's Engineering Bursary completed their summer placements. The first two students who have been supported since 2009 are due to graduate this year.

The Company has started a new project "Sustainable Urban Drainage for schools" to install ten new urban wetlands in school grounds. The aim of the project is to educate students and the wider community on sustainable drainage and ecology, working with project partners the EA and Wildfowl and Wetlands Trust. The focus of the project will be Pymmes Brook, a tributary of the River Lee running through Enfield, Barnet and Haringey.

Working in partnership with the National Trust, the Company provided funding and technical expertise for the newly opened Living Green Centre within Morden Hall Park. The contribution was to provide key water efficiency messages and assist with the development of London's first Archimedes Screw on the weir, which will generate electricity for the Centre.

Education

The Company's educational facilities for school visits continue to take shape with the modular classrooms delivered to Didcot STW's and Slough STW's in January and February 2012 respectively. The classroom at Hogsmill STW's has been completed and the site tour route at Rye Meads sewerage treatment treatment works has been agreed. The first school visits to these new facilities are expected to take place in September 2012.

The Company continued to support the skills agenda by delivering talks and activities based around engineering, including two Network Challenge events in the London Boroughs of Hounslow and Southwark, and careers fairs across the region to educate young people about roles in the water industry.

Working with the London Tideway Tunnels Team, the Company signed up staff volunteers to deliver talks and promote a competition to 1,100 pupils at Newham primary schools to name the Lee Tunnel Boring Machine, which was lowered at the Lee Tunnel site at Beckton in December. Local schoolboy, Ryan Waters, from Maryland Primary School in Newham, won the competition to name the Boring Machine with his chosen name "Busy Lizzie".

Volunteer speakers from the Company continue to promote key messages around the water cycle, saving water and the responsible disposal of waste – promoting Bin It Don't Block It – through the popular Community Speaker Programme. During the last year 58 talks were given across the Company's region reaching a total audience of 6,258.

The programme was boosted in March with the Drought Speaker Programme, tackling the current drought situation. More than 90 employee volunteers came forward to deliver presentations and hand out leaflets to schools and community groups focusing on the drought.

Chief Executive Officer's Business review (continued)

Social and community (continued)

Employee engagement

The Company aims to provide a positive environment where its people are actively engaged and understand their role in the business so they can maximise their contribution.

To measure this, the Company runs an annual employee engagement survey, which gives staff the chance to confidentially provide their honest views on what it is like to work for Thames Water, their team and their manager. Called the Q12 survey, it is run by Gallup and is now in its sixth year.

The Company has seen a year-on-year improvement in employee engagement. This improvement comes against a backdrop of continued organisational change.

The Company intends to enhance the survey in June 2012 to measure staff's views on our customer service, leadership and health and safety.

Over the past year the percentage of staff who volunteered to help community projects was 18%, an increase of 50% on the previous year. The Company entitles each member of staff to two days volunteering leave per year, under its Time to Give scheme, to encourage participation in community, education and fundraising events.

The Company continues to work in partnership with local and regional organisations to promote environmental and community volunteering. Key events in the annual calendar include River Thames clean-ups, working with Thames 21, and the Thames Water-sponsored Reading RESCUE to tidy riverside and urban spaces in and around the town.

In addition, employee volunteers took part in team build projects to improve community spaces. Activities included coppicing and woodland management with Wiltshire Wildlife Trust, painting school halls and improving gardens and grounds at local charity and community organisations.

Charitable donations

Over the year the Company donated a total of £1,019,340 (2011: £723,576) to good causes through both the Charities Committee and direct donations, including the Company's principal charity, WaterAid. Over £700,000 of this amount is a continuation of the shareholders' commitment through the Company's Ten for Ten initiative made in 2009.

The Thames Water Charities Committee met quarterly to consider applications from external charitable organisations seeking funding and to authorise matched funding for employee fundraising. In 2012, the Committee donated £79,401 to 21 charities via grants which supported the Company's criteria of either "water and the environment" or '"water and health". An example of applications received is one from the Ahoy Centre to donate towards the purchase of two second hand Thames Cutter boats for use by local children and disabled rowers on the Thames in Deptford.

The Company's employees raised £99,718 (2011: £76,805) for various charities throughout the year which the Charities Committee matched funded with £89,401 (2011: £59,376).

Employees also participated in the Company's-promoted charity events to raise funds and awareness for local and national charities. A highlight was the support for Sport Relief in March 2012 where 149 staff took calls at the Company' offices in Reading and Swindon.

More than 100 guests attended the Company's annual Service of Remembrance at Ashford Common Water Treatment Works. An additional service was held at Mogden STW which included the rededication of the site's memorial garden. Charitable donations were made to the Royal British Legion and SSAFA (Soldiers, Sailors, Airmen and Families Association).

Chief Executive Officer's Business review (continued)

Social and community (continued)

WaterAid

The Company also continues to support its principal charity, WaterAid (www.wateraid.org) which celebrated its 30th birthday in 2011. Employees at all levels are involved through a variety of activities from fundraising to speaking to schools and community groups about the charity.

At a senior level, the Thames Water WaterAid Steering Committee, which sets fundraising targets and strategy each year, met regularly to review progress and recognise achievements. The Company is also pleased to report that in addition to the charitable donations listed above, over £600,000 was raised through corporate sponsorship for 2012 beating the fundraising target of £500,000. Half of this funding is for Thames 4 Bangladesh, a four year campaign aimed at helping four of the country's towns with improving their access to clean water and improving sanitation.

Martin Baggs
Chief Executive Officer
7 June 2012

Thames Water Utilities Limited

Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2012. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies.

Principal activities and likely future developments

The principal activities of the Company (Registered number: 02366661) are the supply of water and the collection and treatment of sewage, serving approximately 14m customers in London and the Thames Valley.

Business review

The information, which complies with the Operating and Financial Review ("OFR") requirements of the Companies Act 2006, can be found within the Chief Executive Officer's Business review on pages 6 to 31. The Company chose not to produce a voluntary OFR as these requirements are satisfied by the Chief Executive Officer's Business review. The Chief Executive Officer's Business review (which forms part of the Directors' report) comprises an analysis of the development and performance of the business and includes an assessment of future prospects, information about research and development activities; see page 27, details of important events that have occurred since 31 March 2012 and Key Performance Indicators ("KPIs"), see pages 8, 12 and 13.

Details of parent and subsidiary undertakings are given in notes 11 and 28 to the Financial statements, on page 82 and 98 respectively, and the Company has no branches outside the United Kingdom.

Results and dividends

The profit and loss account on page 61 gives the Company's financial results for the year.

The Company paid interim dividends totalling £279.5m during the year (2011: £271.4m).

The Company's dividend policy is:

- To pay a progressive dividend commensurate with the long-term returns and business performance, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants.

Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that:

- Sufficient liquidity is maintained to enable the business to meet its financial obligations for 15 months.

- Post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

The Board does not recommend a final dividend (2011: £nil), however, the Board has proposed further interim dividend's, see note 9, page 80.

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Thames Water Utilities Limited

Directors' report (continued)

Directors

Details of the directors who served from 1 April 2011 to the date of this report are shown below. The constitution of the Board is covered in more detail in the Company's Corporate governance report, which can be found on pages 53 to 58.

All Board members from 1 April 2011 to 31 March 2012 inclusive were non-executive directors ("NEDs") throughout the period, with the exception of Martin Baggs (Chief Executive Officer), Stephen Shine OBE (Chief Operating Officer) and Stuart Siddall (Chief Financial Officer) who replaced Mark Braithwaite as Chief Financial Officer on 20 September 2011 upon his resignation.

Directors serving from 1 April 2011 to the date of signing of this report are as follows:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
L F Abraira	4 August 2011	19 January 2012
M W Baggs		
E Beckley		
R Blomfield-Smith		21 November 2011
M W Braithwaite		20 September 2011
C R Deacon		
S R Eaves	20 January 2012	
Dame D M Hutton CBE		
G I W Parsons		
M J Pavia		
E C Richards		
A F C DeP Santos		4 August 2011
D J Shah OBE		
Y Shi	19 January 2012	
S F Shine OBE		30 March 2012
S J Siddall	20 September 2011	
M S W Stanley		
R Verrion		
L Webb	21 November 2011	

The following directors have formally appointed alternate directors to represent them when they are unavailable:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
S R Eaves	20 January 2012		M C Hill	20 January 2012	
G I W Parsons			E Beckley	11 November 2011	
A F C DeP Santos		4 August 2011	M C Guerreiro		4 August 2011
D J Shah OBE			L Webb		21 November 2011
			K Roseke	31 January 2012	
Y Shi	19 January 2012		F Sheng	29 February 2012	
R Verrion			S Kolenc		
L Webb	21 November 2011		C Pham	21 November 2011	

Material financial instruments

Financial risk management is covered on page 10 of the Chief Executive Officer's Business review.

Directors' report (continued)

Research and development activities

This has been covered in the Chief Executive Officer's Business review on page 27.

Employee involvement

The Chief Executive Officer ("CEO") and the Executive team hold quarterly management briefings with managers to provide the opportunity to discuss performance and how the Company can continue to move forward. Internal publications ("Management toolkit" and "The Source") provide ongoing support for the changes and transformation happening across the Company. This is in addition to the further improvement of the Company's corporate and local communication channels that deliver regular communication, information and updates to employees. Corporate channels include Company-wide Team Talk briefings, a weekly e-brief containing a message from the CEO, the Company's internal portal web pages and specific priority news updates and managers' key information.

Formal consultation with employees is undertaken in partnership with the recognised Trade Unions. Consultation with management level employees typically takes place on an individual basis, except in the case of changes that affect whole areas of the business. In these circumstances, consultation takes place on a Company-wide basis with employee representatives being elected for the relevant area.

All staff are involved in both the Company's employee engagement programme ("Q12") and annual Performance and Development Review ("PDR") process.

Each year the Company encourages all employees to participate in its annual employee engagement survey. In June 2011, the date of the last survey, 70% of the Company's employees participated and employee engagement improved again year on year. This programme also involves circa 100 volunteer employee engagement champions from around the Company who support making the Company a great place to work. It allows all employees to give their opinions and enables managers and teams to take action on key issues identified.

Corporate and Business Unit objectives are agreed by the Executive Team, communicated and cascaded through the Company and included in the annual PDR for all employees. In addition, relevant department and team objectives are cascaded and inform employees' personal objectives which, in turn, are agreed with each employee's manager and reviewed regularly. This process is intended to ensure that all employees are aligned to Company objectives and to ensure that all employees understand where they are adding value.

Employment of disabled persons

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. The Company has policies and procedures in place that aim to ensure that both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through disability and attendance management policies, support and development is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

Policy and practice on payment of creditors

The Company's policy is to pay all suppliers, contractors and service providers according to pre-agreed terms. During the year under review, the average amount due to trade creditors represented 60 days (2011: 63 days) purchases received from these creditors.

Directors' report (continued)

Market value of land and buildings

The directors have considered the market value of the group's land and buildings and are satisfied that their market value is not less than their net book value.

Political and charitable donations and expenditure

No political donations were made by the Company (2011: £nil). The Company made charitable donations totalling £1,019,340 (2011: £723,576). Details of these charitable donations are;

- £743,759 (2011: £316,807) to Ten for Ten projects, of which £512,121 went to various educational and recreational projects and £231,638 to the Thames Water Trust Fund for income deprived families;
- £118,680 (2011: £106,000) to the Charities Aid Foundation;
- £61,129 (2011: £58,021) to the Company's principal charity, WaterAid;
- £60,000 (2011: £60,000) to Thames 21, a range of charities which assist in cleaning rivers and streams within the Thames Valley;
- £35,772 (2011: £182,748) of other donations.

In addition, fund raising activities by employees and contractors raised £99,718, to which the Company added matched funding of £89,401 (included in the donations shown above).

Going concern

The directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements. Further information is set out in note 1 "Basis of preparation" on page 66.

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors and for the benefit of other persons who are directors of associated companies and these remain in force at the date of this report.

Thames Water Utilities Limited

Directors' report (continued)

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG Audit Plc will therefore continue in office.

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Martin Baggs
Chief Executive Officer

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

Statement of directors' responsibilities in respect of the Annual report and the financial statements

The directors are responsible for preparing the Annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently.

- Make judgements and estimates that are reasonable and prudent.

- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Thames Water Utilities Limited

Directors' remuneration report

The directors' remuneration report is unaudited as it is not a statutory requirement to do so. However, the Company provides this information in accordance with its regulatory licence.

In this section of the report the Company describes how the Chairman, Executive Directors and Non-Executive Directors are remunerated. The report discloses the total remuneration awarded for services to the Group, the element of this awarded for services to the Company and the element that relates to regulatory performance.

Compensation & Human Resources Committee

The Company operates a Compensation & Human Resources Committee ("the Committee") which broadly functions as both remuneration and a nomination committee. The Committee comprises four Non-Executive Directors, one of whom is independent, and is chaired by Sir Peter Mason KBE. The other members are Michael Pavia (independent Non-Executive Director), Martin Stanley and Christopher Deacon.

The Committee's responsibilities include, but are not limited to, making recommendations to the Board on the Company's executive remuneration policy and directors' terms of appointment. During the year, the Committee advised the Board of Directors and received advice and input from various Directors and specialist staff within the Company, including the CEO and the Director of Human Resources (both of whom are invited to attend from time to time). No individuals are involved in the determination of their own remuneration.

Activities of Compensation & Human Resources Committee

The Committee meets four times in each year in February, May, September and November. Recurrent remuneration matters are scheduled for the February and May meetings with Board sign off in June. Activities for the year were as follows:-

Meeting	Activities
February 2011	• Setting bonus plan for 2011/12
May 2011	• Reviewing performance against targets 2010/11 • Reviewing salaries for Senior Executives 2011
June 2011	• Board meeting to approve bonus payments 2010/11, payments made July 2011 • Board meeting to approve salary reviews for Senior Executives, increases effective July 2011
February 2012	• Setting bonus plans for 2012/13
May 2012	• Reviewing performance against targets 2011/12 and resulting payments to be made July 2012 • Reviewing salaries for Senior Executives 2012, increases effective July 2012
June 2012	• Board to approve pay and bonus payouts.

To ensure that the Company's remuneration practices are competitive, the Committee has access to detailed external research on market data and trends from PricewaterhouseCoopers LLP.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Remuneration policy

The Committee bases its decision-making with respect to remuneration policy on a number of underlying principles, which can be summarised as follows;

- arrangements should attract, retain, motivate and reward high calibre directors and executives;
- packages should be aligned with the interests of the Group's stakeholders, in particular its shareholders and its customers;
- packages should be commensurate with those provided by other companies of similar size and complexity, taking into account individual contribution and experience;
- policy should establish firm links between an executive's performance and remuneration and between the Group's performance and the executive's total remuneration;
- packages should include a mix of basic salary plus performance related incentives. Further detail is included within the bonus section on page 42 which indicates how Directors' pay is linked to standards of performance.

The Committee considers carefully the blend of remuneration linked to regulatory performance and remuneration linked to other performance measures in order to produce well balanced short-term and long-term incentive plans. These arrangements are designed to incentivise value creation and a high quality service to customers and are aligned with both the internal remuneration policy and external corporate governance requirements.

The Committee will continue to review arrangements regularly to ensure that they remain effective and appropriate to the Company's circumstances and prospects, and to monitor the level of potential awards.

Summary of remuneration and overview for the year to March 2012

The remuneration of the Executive Directors is linked to the performance of the Company and the Group and their own personal performance.

Since the acquisition of the Company by Kemble Water Holdings Limited in 2006 the Company's operational performance has improved significantly with tangible benefits that are important to its customers. This strong performance has been demonstrated again in 2011/12 with the achievement of the following operational results;

- delivering all of the Company's key regulatory outputs, ensuring that the condition of its assets is maintained;
- maintaining 100 per cent compliance with the EA's effluent consents at all 350 of our sewerage treatment treatment works for the fifth year in a row;
- delivering over £1bn of capital investment in its network and plants, including the Thames Tunnel, for the second year running;
- reducing leakage by 26 Mld to 639 Mld compared to last year and beat the target set by Ofwat for the year by 34 Mld;
- meeting stringent UK and European standards for the Company's drinking water quality at 99.98% which remains among the best in the country;
- continuing to reduce greenhouse gas omissions with CO_2 emissions 16% lower than two decades ago and generating 14% of our own power;
- continuing to improve health and safety with the number of reportable accidents falling to an Accident Incident Rate of 0.33 per 1,000 employees, a 48% improvement since the start of AMP5;
- adopting 40,000 km of privately owned sewers and lateral drains on 1 October 2011.

The Company also undertook a number of significant change programmes to ensure that it continued to transform the business whilst providing an excellent and efficient service to its customers and delivering strong operational and financial performance.

Directors' remuneration report (continued)

Summary of remuneration and overview for the year to March 2012 (continued)

During the year the Company began implementing WAMI, enabling real time scheduling and workflow capabilities, alongside successfully implementing working patterns for 2,000 employees, improving flexibility to respond to the needs of customers and assets.

A summary of remuneration for 2011/12 is as follows;

- Stephen Shine, Chief Operating Officer (COO) received an increase in salary of 3%. No other Executive Director received a salary increase;
- annual bonus payments for the year 2011/12 reflected strong Company performance and delivery of key strategic initiatives. This resulted in total payouts relating to services to the Group of 87.7% of maximum for Martin Baggs, Chief Executive Officer (CEO), 90.2% of maximum for Stuart Siddall, Chief Financial Officer (CFO), and 87.7% of maximum for Stephen Shine, COO;
- payment of the 2008 Long Term Incentive Plan (LTIP) in July 2011 as a result of the cumulative Group financial results over the last three years with payment levels of 100% of salary for Stephen Shine, COO, and Mark Braithwaite, Former Chief Financial Officer (FCFO). A Long Term Incentive Plan is offered to ensure that Executive Directors are incentivised to deliver long term, sustainable performance over a period of several years and is separate from a bonus which rewards in-year performance. Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

There have been no significant changes to remuneration policy for 2012/13. Points to note for 2012/13 are as follows;

- reweighting of performance conditions in the annual bonus with greater focus on strategic and operational challenges and individual performance;
- toughening of financial performance measures and lower payments for achievement of targets;
- payment of the 2009 LTIP in July 2012 as a result of the cumulative Group financial results over the last two years with payouts of 68% and 49% of salary for Stephen Shine, COO, and Mark Braithwaite, FCFO, respectively.

There have been various changes to the board over 2011/12 as outlined in the Corporate governance report on pages 53 and 54. Changes to the Executive Directors were the departure of Stephen Shine, COO at the end of the year and Mark Braithwaite, FCFO on 20 September 2011 and the appointment of Stuart Siddall to the Board as CFO on 20 September 2011. These changes have reduced the number of Executive Directors from three to two.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Remuneration of Executive Directors

The remuneration arrangements for Executive Directors are summarised below.

Element	Description	Level 2011/12	Level 2012/13
Base salary	Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year.	Salary increases for 2011/12 range from 0% to 3% for Executive Directors.	Salary increases for 2012/13 yet to be confirmed.
Annual bonus	The performance conditions are selected to motivate Executive Directors to achieve the Company's key financial, operational and strategic objectives through a combination of financial, corporate and personal performance targets. Structured to reward significant improvement in the Group's financial and operational performance.	• Target award of 75.375% of base salary for 2011/12 awards. • Maximum award of 112.5% of base salary.	• Target award of 56.25% of base salary for 2012/13 awards. • Maximum award of 112.5% of base salary.
Long term incentive plan (LTIP)	Plan rewards performance over 2010-15 (AMP5), with deferred payouts over 2013-17. Vesting is conditional on the following performance conditions:- • Financial performance (40%); • Sustainability (40%); and • Regulatory and customer (20%).	• Annual target award of 75% of base salary. • Annual maximum award of 150% of base salary.	• Annual target award of 75% of base salary. • Annual maximum award of 150% of base salary.
Pensions	Provide competitive cost effective saving benefits for employees.	Contribution of 25% of base salary for Executive Directors.	Contribution of 25% of base salary for Executive Directors.
Benefits	The Executive Directors received a car allowance, private medical insurance, life assurance, Group Income Protection and 25 days holiday.		

The following table summarises the total cash elements of the package of the Executive Directors and their value as a percentage of salary. The table also shows the proportion of these payments related to variable and long term performance.

Components of Executive Director remuneration	**2011/12**		**2012/13**	
	Value (% salary)		**Value (% salary)**	
	Target performance	**Maximum performance**	**Target performance**	**Maximum performance**
Salary	100%		100%	
Pension	25%		25%	
Bonus	75.375%	112.5%	56.25%	112.5%
LTIP	75%	150%	75%	150%
Total	**275.375%**	**387.5%**	**256.25%**	**387.5%**
Variable pay – Bonus and LTIP (% total)	55%	68%	51%	68%
Long-term pay - LTIP and Pension (% total)	36%	45%	39%	45%

Directors' remuneration report (continued)

Base salaries and benefits

Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year. Base salaries are a fixed sum payable monthly.

Stephen Shine, COO, received a 3% pay increase on 1 July 2011; no other Executive Directors received a pay increase during 2011/12. The average pay increase for employees across the Company was 3% for this period.

Executive director	Salary at 31 March 2012 or leaving date if sooner
Martin Baggs, CEO	£425,000
Stuart Siddall, CFO[1]	£300,000
Stephen Shine, COO[2]	£310,000
Mark Braithwaite, FCFO[3]	£300,000

[1]Stuart Siddall was appointed on 20 September 2012
[2]Stephen Shine resigned with effect from 31 March 2012
[3]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

Bonuses

Executive Directors are eligible to participate in an annual bonus scheme, which is designed to motivate them to achieve the Company's key financial, operational and strategic objectives through a combination of financial and personal performance targets.

The amount of any annual incentive award is determined by performance against set targets and is at the discretion of the Committee. The Committee reserves the right to reduce bonus payments if overall Group performance does not warrant payment. The Board believes that this is the most appropriate means of aligning directors' remuneration to performance.

Executive Directors' annual bonus plan measures 2011/12

The 2011/12 annual bonus plan aimed to reward significant improvement in the Group's financial performance whilst recognising individual performance. The maximum level of award for the 2011/12 scheme for Executive Directors is 112.5% of salary. Financial measures make up 75% of the bonus opportunity with personal performance measures making up the remaining 25%.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Executive Directors' annual bonus plan measures 2011/12 (continued)

The financial targets were selected as being the most critical for the organisation during 2011/12. The personal performance element of the bonus is based on the performance of the Executive Directors against their key business objectives which link to the Groups overall key operational and strategic objectives including employee engagement, leakage, customer service and health & safety.

Performance measure		Weight for 2011/12 (as % of maximum)	2011/12 achievement (% of maximum bonus)		
			Martin Baggs, CEO	Stuart Siddall, CFO[1]	Stephen Shine, COO[2]
Financial measures	Regulated net capital expenditure	18.75%	18.75%		
	Regulated Net Operating expenditure	18.75%	15.4%		
	Group Cashflow before funding	18.75%	18.75%		
	Group Earnings Before Interest Tax Depreciation & Amortisation (EBITDA)	18.75%	14.8%		
Personal performance		25%	20.00%	22.50%	20.00%
Overall (% maximum)		100%	87.7%	90.2%	87.7%
Payout for 2011/12			**£418,359**	**£162,389**	**£305,156**

[1]As a new joiner on 20 September 2011, Stuart Siddall's bonus has been pro-rated for the part-year in service
[2]Stephen Shine resigned with effect from 31 March 2012 having completed the full performance year and was eligible for the 2011/12 bonus payment
Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

There was a requirement that all related regulatory outputs must be achieved for the net capital expenditure measure to pay out. These were achieved and the capital expenditure element paid out in full. Furthermore, there was a financial underpin on the personal element of the 2011/12 bonus whereby no payment would be made against the personal element of the annual bonus unless the Group cashflow before funding threshold target was achieved, which was attained.

The payments under this scheme will be made in July 2012.

Executive Directors' annual bonus plan measures 2012/13

The 2012/13 annual bonus plan will follow the overall structure of the 2011/12 plan however some elements will be restructured and the target bonus has been lowered to 56.25% of salary from 75.375% in 2011/12 for the Executive Directors. The maximum bonus opportunities will be unchanged at 112.5% of salary.

The proportion of the bonus element previously determined by financial performance will be reduced and a new group of performance measures linked to the achievement of key corporate challenges will be introduced. This has been done to focus Executive Directors' attention on a number of key corporate challenges and includes metrics such as management of the drought, the Olympics response and stabilisation of customer service.

The proportion of the bonus payable based on financial performance has been reduced from 75% of maximum for the 2011/12 bonus to 33.33% of maximum for the 2012/13 bonus.

Directors' remuneration report (continued)

Executive Directors' annual bonus plan measures 2012/13 (continued)

As a result of these changes, the structure of the bonus plan for 2012/13 for the Executive Directors will be as follows:-

Performance measure		**Weight for 2012/13 (as % of maximum)**
Financial measures	Regulated net capital expenditure efficiency	11.11%
	Cashflow before funding	11.11%
	EBITDA	11.11%
Corporate challenges		33.33%
Personal performance		33.34%
Overall (% maximum)		**100.00%**

As in the 2011/12 bonus, the related regulatory outputs must be achieved before the capital expenditure efficiency measure will pay out. The financial underpin on the personal element of the bonus will continue to be a Group cashflow before funding target.

Long Term Incentive Plans ("LTIP")

In order to focus executives on long term, sustained performance and to aid retention, the Company's Executive Directors and Senior Management are from time to time invited to participate in an LTIP.

The LTIP 2008 and LTIP 2009 were three year plans with a performance related payout at the end of the vesting period. The LTIP 2008 vested in July 2011 and the LTIP 2009 vests in July 2012, following Board approval of the audited accounts.

The current plan, the LTIP 2010, is a multiple year plan, with the performance period running from July 2010 to July 2015 and payouts being made in each year from July 2013 to July 2017.

Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

LTIP 2008

A LTIP commenced in 2008, in which Steve Shine, COO, and Mark Braithwaite, FCFO, participated. The plan performance period ran from 1 April 2008 to 31 March 2011 with payments made in July 2011. The plan was based on four cumulative financial measures, being Group EBITDA, Group cash flow before funding, distributions and Group capital expenditure. These measures were selected as being critical for the Group.

Payment was made in full under this scheme as all four measures were achieved over each of the three financial years which formed the performance period. No payment would have been made under the plan if one or more measures had not been achieved. None of the targets were linked specifically to regulatory performance.

The value of awards vested is shown in the LTIP award tables on page 51.

Directors' remuneration report (continued)

LTIP 2009

A LTIP was offered covering the period 1 April 2009 to 31 March 2012 in which Steve Shine, COO, and Mark Braithwaite, FCFO, participated. Following Board approval of the audited accounts, payments will be made in July 2012, pro-rata to the length of service during the performance period. The plan is based on the Company's performance against the following measures between 1 April 2010 and 31 March 2012:-

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financial targets over AMP5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP5. This includes: • strategic initiatives around improving operating efficiency, for example WAMI and SCADA; • Developing a successful business plan for AMP6; • meeting key milestones including reaching Ofwat efficiency bandings; • improving employee engagement scores; and • improving health & safety standards.	40%
Regulatory and customer	Improving the Company's scores under Ofwat's core measures of SIM and Operational Performance Assessment ("OPA").	20%

The performance measures are reviewed annually taking relevant economic factors in to account. The value of the awards for the LTIP payable is shown in the LTIP award tables on page 51.

Directors' remuneration report (continued)

LTIP 2010

A new five year LTIP was introduced in 2010 for the Executive Directors and senior managers in key strategic positions across the Company. The performance period of the plan runs from 1 April 2010 to 31 March 2015. The plan focuses on the key objectives for the next regulatory period which are critical to the Company's business plan as follows:-

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financials over AMP5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP5. This includes: • strategic initiatives around improving operating efficiency, for example WAMI and SCADA; • Developing a successful business plan for AMP6; • meeting key milestones including reaching Ofwat efficiency bandings; • improving employee engagement scores; and improving health & safety standards.	40%
Regulatory and customer	Improving the Company's scores under Ofwat's core measures of SIM and OPA.	20%

The performance measures are reviewed annually taking relevant economic factors into account.

The plan is a five year plan where participants at the Executive Director level were granted five times their annual target award of 75% of basic salary in 2010. No further grants will be made to participants over the performance period.

For threshold performance, half the award will vest, rising to two times the award for maximum performance. If performance does not reach the threshold level for any of the targets, no payment will be made under the plan.

Under normal circumstances 20% of the total award can be released each year from July 2013 to July 2017 based on performance achieved as follows:

- 20% of the award will be paid in July 2013, based on performance from March 2010 to March 2013;
- 20% of the award will be paid out in July 2014, based on performance from March 2010 to March 2014;
- the remaining 60% of the award will vest in March 2015 based on performance from March 2010 to March 2015 and will be paid out in three equal tranches over July 2015 – July 2017.

In exceptional circumstances the payouts in 2016 and 2017 may be reduced, for example in the event of a material deterioration in financial performance or a significant fall in service after the AMP5 period. In addition, the Committee has the discretion not to pay under the regulatory and customer area if failure to meet targets in any area leads to regulatory action.

Directors' remuneration report (continued)

LTIP 2010 (continued)

New joiners after 1 April 2010 will be eligible to participate in the LTIP 2010 at the discretion of the Committee. For new joiners, the first payment from the LTIP will be made on the next vesting date following completion of two years service. This payment will be pro-rated based on the part year service. No amount will be received if there is less than two years service for that award and awards are not pro-rated where the new joiner has served over 3 years of the performance period.

Pro-rating also applies to good leavers and is subject to the Committee's discretion and was applied to both Mark Braithwaite (FCFO) and Steve Shine (COO).

The value of the awards payable under the LTIP is shown on page 51.

Pensions

Each Executive Director is eligible to receive payments into pension worth 25% of base salary. The Committee has agreed that where Executives' accumulated pension rights are already in excess of the Lifetime Allowance, a cash payment in lieu of this payment to pension may be made. No element of bonus or LTIP is pensionable.

- Martin Baggs, CEO, participates in the Company Defined Contribution pension scheme and receives contributions of 25% of base salary. Company contributions for the year were £106,250 (2011: £106,250).
- Stuart Siddall, CFO, receives a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £40,057 (2011: nil).
- Stephen Shine, COO, received a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £76,875 (2011: £75,000).
- Mark Braithwaite, FCFO, received a contribution of 25% of salary into a personal pension scheme. Company contributions for the year were £14,743 (2011: £75,000).

Stephen Shine and Mark Braithwaite are deferred members of the Company defined benefit pension scheme which is closed to future accrual. Further details are shown in the defined benefit pension entitlements table on page 52. No other Executive Directors are, or were, members of the scheme.

Non-Executive Directors' fees

The Chairman and Non-Executive Directors receive a fixed fee for their duties which reflects their responsibilities and time commitments. They are not entitled to any annual bonus, long term incentives, pension benefits or benefits in kind.

The Chairman receives an annual fee of £300,000 and Non-Executive Directors receive an annual fee of £45,000. Michael Pavia receives an additional annual fee of £10,000 for his role as Chairman, Audit & Risk Review Committee. Fees are reviewed regularly by the Committee and no individuals are involved in the determination of their own remuneration.

Further details of the Chairman and Non-Executive Directors' remuneration are set out in the emoluments table on page 49.

Service contracts

Reflecting current market practice, the Executive Directors do not hold service contracts that provide for a notice period longer than one year. It is not the Committee's intention to recommend the appointment of any new Executive Directors with contracts that provide for a longer notice period.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Service contracts (continued)

The Committee endorses the principle of mitigation of loss on early termination of a service contract and generally seeks to achieve that objective where possible and appropriate. In the event that the Company wished to terminate an Executive Director's contract other than in circumstances where the Company is entitled to summarily dismiss an Executive Director, it would need to give either 12 months' notice or make a payment in lieu of salary. For Non-Executive Directors, no compensation is payable on the event of early termination.

Executive Directors	Contract start date as Executive Director	Service period	Notice period
Martin Baggs, CEO	5 March 2010	n/a	6 months by employee, 12 months by company
Stuart Siddall, CFO	20 September 2011	n/a	12 months by both sides
Stephen Shine, COO[1]	24 May 2007	n/a	12 months by both sides
Mark Braithwaite, FCFO[2]	31 August 2007	n/a	12 months by both sides

[1]Stephen Shine resigned with effect from 31 March 2012.
[2]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.

	Initial Contract start date	Length of Each Period of Appointment	Expiry Date of Current Contract
Chairman			
Sir Peter Mason	01 December 2006	3 years	9 June 2014
Independent Non-Executive Directors			
Dame Deirdre Hutton	22 July 2010	3 years	21 July 2015
Michael Pavia	01 December 2006	3 years	21 July 2015
Edward Richards	22 July 2010	3 years	21 July 2015
Non-Executive Directors			
Luis Abraira[1]	04 August 2011	n/a	n/a
Edward Beckley	26 March 2008	n/a	n/a
Rosamund Blomfield-Smith[2]	14 February 2008	n/a	n/a
Christopher Deacon	01 December 2006	n/a	n/a
Simon Eaves	20 January 2012	n/a	n/a
Gordon Parsons	10 June 2010	n/a	n/a
Antonio Santos[3]	01 January 2011	n/a	n/a
Dipesh Shah	15 October 2007	n/a	n/a
Yaping Shi	19 January 2012	n/a	n/a
Martin Stanley	01 December 2006	n/a	n/a
Robert Verrion	01 January 2011	n/a	n/a
Lincoln Webb	21 November 2011	n/a	n/a

[1]Luis Abraira resigned with effect from 19 January 2012.
[2]Rosamund Blomfield-Smith resigned with effect from 21 November 2011.
[3]Antonio Santos resigned with effect from 4 August 2011.

The Chairman and Independent Non-Executive Directors have fixed appointment periods; the other Non-Executive Directors do not as they are appointed and can be removed without notice by the shareholders of the Company in line with the Shareholder Agreements.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Emoluments table (Excluding LTIPs)

	Directors' salaries / fees £'000	Benefits in kind £'000	Allowances £'000	Pension Allowance £'000	Annual cash bonus £'000	**Group Total year to 31 March 2012 £'000**	Group Total year to 31 March 2011 £'000	**Company Total Year to 31 March 2012 £'000**	Company Total Year to 31 March 2011 £'000
Executive Directors									
M Baggs [1]	425	2.3	51	-	418	**896**	956	**627**	669
S Siddall[2]	160	-	7	40	162	**369**	n/a	**258**	n/a
S Shine [3]	308	2.3	17	77	305	**709**	618	**638**	556
M Braithwaite [4,5]	59	0.4	9	-	-	**68**	622	**48**	435
Chairman									
Sir P Mason	300	-	-	-	-	**300**	275	**180**	165
Independent Non-Executive Directors									
P Dyer	-	-	-	-	-	**-**	45	**-**	45
Dame D Hutton	45	-	-	-	-	**45**	31	**45**	31
M Pavia	55	-	-	-	-	**55**	55	**55**	55
E Richards	45	-	-	-	-	**45**	33	**45**	-
W Smit	-	-	-	-	-	**-**	19	**-**	19
Non-Executive Directors									
L Abraira[6]	11	-	-	-	-	**11**	35	**-**	-
E Beckley	45	-	-	-	-	**45**	45	**-**	-
R Blomfield-Smith[7,8]	46	-	-	-	-	**46**	45	**30**	45
C Deacon[9]	107	-	-	-	-	**107**	81	**-**	-
R Gadsby	-	-	-	-	-	**-**	45	**-**	-
S Eaves[10]	11	-	-	-	-	**11**	-	**-**	-
G Parsons	45	-	-	-	-	**45**	45	**-**	-
K Roseka	-	-	-	-	-	**-**	34	**-**	-
A Santos[11]	23	-	-	-	-	**23**	11	**-**	-
D Shah	45	-	-	-	-	**45**	34	**-**	-
Y Shi[12]	11					**11**	-	**-**	-
M Stanley	45	-	-	-	-	**45**	45	**-**	-
R Verrion	45	-	-	-	-	**45**	11	**-**	-
L Webb[13]	22	-	-	-	-	**22**	-	**-**	-
Total	**1,853**	**5**	**84**	**117**	**885**	**2,944**	3,085	**1,926**	2,020

The Group is Kemble Water Holdings Limited and the Company refers to TWUL.

Thames Water Utilities Limited

Directors' remuneration report (continued)

Emoluments table (Excluding LTIPs) (continued)

[1]Allowances for Martin Baggs comprise £15,000 car allowance and £36,000 housing allowance.
[2]Stuart Siddall was appointed on 20 September 2011.
[3]Stephen Shine resigned with effect from 31 March 2012.
[4]Mark Braithwaite resigned his employment with effect from 10 June 2011 and from the Board with effect from 20 September 2011.
[5]Allowances for Mark Braithwaite comprise £2,462 car allowance and £6,234 in lieu of leave.
[6]Luis Abraira was appointed on 4 August 2011 and resigned with effect from 19 January 2012.
[7]Rosamund Blomfield-Smith resigned with effect from 21 November 2011.
[8]Fees shown include a consultancy fee of £15,750 (2011: £nil) for work on the Tideway Improvements project borne by Thames Water Limited. This arrangement commenced following resignation as a Director.
[9] Fees shown include a consultancy fee of £61,666 (2011: £40,000) for work on the Tideway Improvements project borne by Thames Water Limited.
[10]Simon Eaves was appointed on 20 January 2012.
[11]Antonio Santos resigned with effect from 4 August 2011.
[12]Yaping Shi was appointed on 19 January 2011.
[13]Lincoln Webb was appointed 21 November 2011.

The remuneration of the Company's directors as shown in note 5, page 76 of the financial statements of £2,681,000 include £1,926,000 as shown in the above table, and 2009 and 2010 LTIP's accrued in the year of £668,000 together with pension contributions of £87,000.

The following table sets out the proportion of the bonus which is attributable to regulatory performance for 2012:-

Executive Directors	Proportion determined by regulatory performance
Martin Baggs, CEO	£146,426
Stuart Siddall, CFO	£56,836
Stephen Shine, COO	£137,320

Thames Water Utilities Limited

Directors' remuneration report (continued)

Long term incentive awards

The following table sets out the awards under the LTIP 2008, LTIP 2009 and unvested awards under the LTIP 2010. The potential values shown are the maximum cash levels attainable subject to the performance conditions set out on pages 44 to 47. The expected value shows the level of vesting anticipated based on estimates of current performance, and in the case of the LTIP 2010 will only be payable if performance continues at the same level and if the Executive remains employed at the end of the performance period unless the Committee exercises their discretion to make a payment in other circumstances.

Performance period	Date of potential payment	Individual	Potential value of awards held at 31 March 2011 £'000	Potential value of awards granted during the year £'000	Value of awards vesting during the year £'000	Value of awards lapsed during the year £'000	Potential value of awards held at 31 March 2012 £'000	**Group Expected value of awards held at 31 March 2012[1] £'000**	Company-related Expected value of awards held at 31 March 2012 £'000
LTIP 2010									
1 April 2010 – 31 March 2013	July 2013	M Baggs	638	-	-	-	638	**446**	312
		S Shine	450	-	-	-	450	**315**	284
		M Braithwaite	450	-	-	450	-	-	-
1 April 2010 – 31 March 2014	July 2014	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	264	-	-	264	**185**	129
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
1 April 2010 – 31 March 2015	July 2015	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
	July 2016	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
	July 2017	M Baggs	638	-	-	-	638	**446**	
		S Siddall	-	450	-	-	450	**315**	221
		S Shine	450	-	-	450	-	**-**	-
		M Braithwaite	450	-	-	450	-	**-**	-
LTIP 2009									
1 April 2010 – 31 March 2012	July 2012	S Shine	300	-	-	-	300	**203[2]**	182[2]
		M Braithwaite	300	-	-	-	300	**146[2]**	102[2]
LTIP 2008									
1 April 2008 – 31 March 2011	July 2011	S Shine	300	-	300[3]	-	**-**	**-**	-
		M Braithwaite	300	-	300[3]	-	**-**	**-**	-

[1]Based on performance to date
[2]Expected values shown will be paid in July 2012 following Board approval of the audited accounts
[3]Paid in July 2011

The expected value of the awards attributed to the Company relate fully to regulatory performance.

The amounts shown in the above table are the total amounts that potentially will vest on maturity. The amount accrued in the year are shown in note 5, page 76 of the financial statements.

Directors' remuneration report (continued)

Defined benefit pensions

Stephen Shine, COO, and Mark Braithwaite, FCFO, were deferred members (with effect from 31 March 2011) of the Company's defined benefit pension scheme, TWPS, which has a normal retirement age of 65 and an accrual rate of 1/80th of basic salary. As deferred members of the scheme no contributions were made in to the scheme during the year by either the Executives or the Company. However, as deferred members their benefits continued to accrue and the transfer values, calculated in line with "Actuarial Guidance note GN11" are set out below:

£	Age	Accrued pension entitlement at 31 March 2011	Accrued pension entitlement at 31 March 2012	Additional pension earned during the period	Transfer value of accrued pension at 31 March 2011	Transfer value of accrued pension at 31 March 2012
Mark Braithwaite	46	21,642	22,430	788	198,498	284,493
Stephen Shine	55	33,498	34,881	1,383	420,601	550,869

As deferred members of the TWPS, the Executives could choose to retire early from age 63, or from age 55 with the consent of the Company. In these circumstances the benefits payable would be actuarially reduced to take account of early payment.

Pension benefits in retirement are increased annually in line with RPI with a cap of 2.5%.

There is also a spouse's pension, payable in the event of the death of the Executive, of 50% of the member's pension, plus children's pensions payable at a rate of one quarter of the spouse's pension for each of up to 4 children.

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Sir Peter Mason, KBE
Chairman, Compensation and HR committee

Corporate governance report

Compliance Regime

The term "corporate governance" is generally taken to refer to the supervision of the way in which a company is run and how the risks to its business are managed. It embraces, *inter alia*, regulation, corporate structure and the function of the Board of Directors and its committees.

The Company's directors, shareholder and the shareholders of the ultimate parent company are committed to maintaining high standards of corporate governance. Under the terms of its Licence from Ofwat, the Company is required to have particular regard to the UK Corporate Governance Code (the "Code"), which is something that generally applies only to companies whose shares are listed on the London Stock Exchange. The Code acknowledges that departure from its provisions may be justifiable in particular circumstances and requires that companies explain those departures. As the Company is a wholly-owned subsidiary in a privately-owned group, the operations of which are governed by a shareholders' agreement, the Board considers that a significant number of the provisions of the Code are not directly applicable:

The areas where the code is not followed are set out in the following paragraphs, with accompanying explanation of the Company's practice being provided.

The Company does not appoint a Senior independent non-executive director as it is considered unnecessary as all shareholders have direct representation on the Board and therefore access to the Chairman, Chief Executive Officer and Chief Financial Officer.

The Chairman did not schedule meetings with the NED's, without the Executive directors in attendance and nor was the Chairman's performance appraised by the NED's as the Chairman is not considered independent, as stated below. Following the Board effectiveness review (see below), the Chairman intends to hold meetings with the NED's without the executive directors in attendance during 2012/13.

The Board

The Board is confident that it acts independently and that it takes decisions objectively in the best interests of the Company. It also believes that it has demonstrated its commitment to ensuring that the Company's obligations to its stakeholders are understood and met, and that the necessary financial and management resources and systems of planning and internal control, are in place to fulfil these obligations. Supported by the CEO and the Executive, the Board continues to take positive action towards regenerating the Company's values and standards and establishing a clear strategic direction for the future.

Matters on which decisions are reserved to the Board and the authority given to the CEO and his Executive team are set out in the schedule of delegated authority ("SODA") approved by the Board.

The Board of Directors is appointed in accordance with the shareholders' agreement and comprise 2 Executive Directors, 10 NED's (including the Chairman) and 3 independent NED's (see Directors report for appointment details of individual directors). The NED's are nominated and appointed by the shareholders of Kemble Water Holdings Limited in accordance with the terms of the shareholders' agreement and are therefore not determined to be independent.

The directors have specialist knowledge of the water industry and other regulated utilities. The Board and Ofwat consider that Michael Pavia (former Chief Financial Officer of the London Electricity Group), Edward Richards (Chief Executive of Ofcom) and Dame Deirdre Hutton (Chair, UK Civil Aviation Authority) are independent NED's.

Corporate governance report (continued)

The Board (continued)

The Board is chaired by Sir Peter Mason, KBE. Sir Peter has had a long and distinguished career in the engineering and construction industries, including Private Finance Initiatives and design and project management. He has also held several public service appointments, primarily with the Department for Trade and Industry (now part of the Department for Business Innovation and Skills). Sir Peter's external appointments include, non–executive director of BAE Systems plc, Spie S.A. and Subsea 7 S.A. Sir Peter is considered not to be independent and neither was he upon his appointment. Sir Peter's responsibilities as Chairman include leadership of the Board, ensuring its effectiveness, setting its agenda and ensuring effective communication with the Company's shareholder. Additionally, he is responsible for ensuring that the directors receive accurate, timely and clear information and that constructive relations exist between the Board and the Executive.

The Board met 5 times during the year with additional conference calls to update the Board on operational matters between formal meetings, where necessary.

All directors are entitled to attend Board meetings either in person or by telephone and are also entitled to attend and observe Committee meetings. Certain members of the senior management team will also attend Board and Committee meetings by invitation.

Newly appointed directors are offered a comprehensive briefing on the Company and its business. Training is also provided for directors on their roles and their legal obligations to ensure they are fully conversant with their responsibilities as directors.

All directors have sufficient resources and access to independent professional advice, at the Company's expense, in order to discharge their responsibilities as directors. Additionally, all directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are complied with. The appointment and removal of the Company Secretary is a matter reserved for the Board.

A Board effectiveness review was carried out in February 2012. This involved the use of a questionnaire to all directors and covered a range of issues around Board and committee processes, Board roles and responsibilities. The findings of the review were considered by the Board at the 1 March 2012 Board meeting with several changes being made as a result. Typically the Company engages the services of an external Board evaluation consultant two years out of three. In between the external evaluations they are conducted internally.

The Company has in place appropriate insurance cover in respect of legal action against its Directors.

Corporate governance report (continued)

Committees of the Board

The five standing committees of the Board are as follows:

- Audit and Risk Review ("ARRC")
- Regulatory
- Health, Safety and Environment
- Compensation and HR
- Customer Service

Each committee has written terms of reference and the collective function of the Committees is to exercise oversight on behalf of the Board and to provide advice to the Board. Other committees are formed as and when required to deal with specific matters, for example the Thames Tideway Tunnel Project.

See page 56 for details and members of each committee of the Board.

Corporate governance report (continued)

Committees of the Board (continued)

Membership of the committees throughout the year ended 31 March 2012 is set out below.

Audit and Risk Review Committee	M Pavia (Chairman), G I W Parsons R Blomfield-Smith (resigned 21.11.11) R Verrion (appointed 8.9.11)
Regulatory Committee	G I W Parsons (Chairman) E Beckley, E C Richards D Shah
Health, Safety and Environment Committee	G I W Parsons (Chairman) Dame D M Hutton D Shah
Compensation and HR Committee	Sir P J Mason (Chairman) M Stanley C Deacon M Pavia
Customer Service Committee (Formed 3 March 2011)	Dame D M Hutton (Chairman) G I W Parsons E C Richards R Verrion
Tideway Tunnel Committee	Sir P J Mason (Chairman) E Beckley G I W Parsons D Shah M Pavia

The Audit and Risk Review Committee

The composition of the ARRC and its terms of reference are governed by the shareholders agreement and comprises two NED's and one independent NED, Michael Pavia, who is the Committee Chairman.

Corporate governance report (continued)

The Audit and Risk Review Committee (continued)

The Board reviews risk management arrangements and the effectiveness of the Company's internal control systems through the work of the ARRC. The primary objectives of the ARRC are:

(i) the preservation of good financial practices throughout the Company;
(ii) ensuring that robust controls are in place to support the integrity of those practices;
(iii) reviewing risk management processes;
(iv) reviewing the Company's interim and annual financial statements, and the Annual Performance Report to Ofwat;
(v) the provision, by way of (amongst other things) meetings, of a line of communication between the Board and external auditor.

The ARRC also reviews the Company's procedure for handling allegations from whistleblowers as set out in the Company's Honest and Ethical Behaviour Policy. Any whistleblowing events are brought to the attention of the ARRC and are promptly investigated by the Head of Internal Audit.

Auditor's independence and objectivity

The ARRC monitors regularly the non-audit services provided to the Company by the external auditor. The auditor does not:

- Self review.
- Make management decisions for the Company.
- Have a mutuality of financial interest with the Company.
- Act in the role of advocate for the Company.

The ARRC regularly meets with the external auditor in private. Approval of the ARRC is required for any services provided by the external auditor for which the fee is likely to be in excess of £100,000.

Details of the fees paid to the external auditor during the year ended 31 March 2012 for audit and non-audit services are set out in note 3 to the financial statements on page 75 of this Annual report and financial statements.

Internal control

The Board has overall responsibility for the Company's system of internal control. This is designed to manage rather than eliminate the risk of failure to meet business objectives and can only provide reasonable, not absolute assurance, against material misstatement or loss.

The key features of the system of internal control and risk management are as follows:

- A control environment with clearly defined organisational structures operating within a framework of policies and procedures covering every aspect of the business.
- Comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years.
- Regular monitoring of risks and control systems throughout the year, supported by the use of risk registers.
- A self-certification process whereby management is required to confirm that the system of internal control is operating effectively.
- An internal audit function providing independent scrutiny of internal control systems and risk management procedures.
- A review of reports produced by internal and external audit.

Corporate governance report (continued)

Internal control (continued)

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of:

- Regular presentations to the ARRC and Executive by heads of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks.
- Reports of significant changes to the Company's overall risk profile, which are also reported to the ARRC.
- Standing reports from the Internal Audit Department to the ARRC.
- Reports to the ARRC on the results of the self-certification process and independent reports thereon by the Internal Audit Department.
- An annual review of the effectiveness of the Company's systems of risk management and internal control by the Board

Independent Auditor's Report to the Members of Thames Water Utilities Limited

We have audited the financial statements of Thames Water Utilities Limited for the year ended 31 March 2012 set out on pages 33 to 68. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 37, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the financial statements:

- Give a true and fair view of the state of the Company's affairs as at 31 March 2012 and of its profit for the year then ended.
- Have been properly prepared in accordance with UK Generally Accepted Accounting Practice, and
- Have been prepared in accordance with the requirements of the Companies Act 2006.

Independent Auditor's Report to the Members of Thames Water Utilities Limited (continued)

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

• Adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or

• The financial statements are not in agreement with the accounting records and returns; or

• Certain disclosures of directors' remuneration specified by law are not made; or

• We have not received all the information and explanations we require for our audit.

Paul Johnson (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
7 June 2012

Thames Water Utilities Limited

Profit and loss account for the year ended 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Turnover		**1,694.9**	1,623.1
Operating costs before exceptional item		**(1,091.0)**	(1,022.9)
Exceptional item: pension curtailment gain	3/26	**40.0**	-
Operating costs	3	**(1,051.0)**	(1,022.9)
Operating profit		**643.9**	600.2
Profit on sale of fixed assets	4	**3.9**	10.9
Interest payable and similar charges	6	**(504.7)**	(462.1)
Interest receivable	7	**81.5**	63.8
		(423.2)	(398.3)
Other finance expense	26	**(2.4)**	(4.3)
Profit on ordinary activities before taxation		**222.2**	208.5
Taxation credit on profit on ordinary activities	8	**25.0**	16.7
Profit for the financial year	21	**247.2**	225.2

There are no differences between the profit on ordinary activities before taxation for the periods as stated above and their historical cost equivalents.

All amounts above relate to continuing operations.

Statement of total recognised gains and losses for the year ended 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Profit for the financial year		**247.2**	225.2
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Deferred tax relief/(charge) relating to actuarial loss		**21.4**	(3.2)
Total recognised gains in the year		**174.2**	220.9

Thames Water Utilities Limited

Balance sheet as at 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Fixed assets			
Tangible assets	10	**8,788.3**	8,145.2
Investments	11	**0.1**	0.1
		8,788.4	8,145.3
Current assets			
Stocks	12	**9.6**	8.2
Debtors: amounts falling due within one year	13	**647.9**	621.9
Debtors: amounts falling due after more than one year	14	**2,015.0**	1,865.0
		2,662.9	2,486.9
Investments	17	**619.4**	775.8
Cash at bank and in hand	17	**2.7**	3.6
		3,294.6	3,274.5
Creditors: amounts falling due within one year	15	**(1,460.4)**	(1,016.3)
Net current assets		**1,834.2**	2,258.2
Total assets less current liabilities		**10,622.6**	10,403.5
Creditors: amounts falling due after more than one year	16	**(8,050.2)**	(7,748.7)
Provisions for liabilities and charges	18	**(1,052.6)**	(1,054.3)
Net assets excluding net pension liabilities		**1,519.8**	1,600.5
Net pension liabilities			
– total of defined benefit schemes			
With net liabilities		**(144.4)**	(122.7)
With net assets		**25.2**	28.1
	26	**(119.2)**	(94.6)
Net assets including pension liabilities		**1,400.6**	1,505.9
Capital and reserves			
Called-up share capital	19	**1,029.0**	1,029.0
Share premium account	20	**100.0**	100.0
Profit and loss account	21	**271.6**	376.9
Total shareholder's funds	22	**1,400.6**	1,505.9

The notes on pages 66 to 98 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 7 June 2012 and signed on its behalf by:

Stuart Siddall
Chief Financial Officer

Company registered number: 02366661.

Thames Water Utilities Limited

Cash flow statement for the year ended 31 March

	Note	**31 March 2012 £m**	31 March 2011 £m
Net cash inflow from operating activities	(a)	**924.7**	943.1
Returns on investments and servicing of finance			
Interest received		**106.1**	110.4
Interest paid		**(354.1)**	(269.3)
Interest element in finance lease payments		**(6.9)**	(6.5)
Net cash outflow from returns on investments and servicing of finance		**(254.9)**	(165.4)
Taxation		**79.6**	(26.0)
Capital expenditure and financial investment			
Gross cost of purchased fixed assets		**(993.6)**	(793.8)
Infrastructure renewals expenditure		**(176.8)**	(107.7)
Receipt of grants and contributions		**44.3**	41.0
Movement on long term loans to group companies		**(150.0)**	(685.0)
Sale proceeds of fixed assets	(d)	**8.8**	11.5
Net cash outflow for capital expenditure and financial investment		**(1,267.3)**	(1,534.0)
Equity dividends paid	9	**(279.5)**	(271.4)
		(797.4)	(1,053.7)
Management of liquid resources			
Decrease/(increase) in current asset investments	(b) & (c)	**156.4**	(202.6)
Net cash outflow before financing		**(641.0)**	(1,256.3)
Financing			
Capital element in finance lease payment		**(7.8)**	(8.6)
New loans		**657.1**	1,807.6
Repayment of loans		**(9.2)**	(545.0)
Net cash inflow from financing	(b) & (c)	**640.1**	1,254.0
Decrease in cash	(b) & (c)	**(0.9)**	(2.3)

Interest received of £106.1m includes £24.4m received from Thames Water Utilities Holdings Limited which is not included in the adjusted interest cover ratio calculations as defined in the Chief Executive's Report on page 11.

Thames Water Utilities Limited

Notes to the cash flow statement for the year ended 31 March

(a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	**31 March 2012 £m**	31 March 2011 £m
Operating profit		**643.9**	600.2
Depreciation (infrastructure renewals charge)	3	**129.5**	132.4
Depreciation (non infrastructure)	3	**286.1**	260.9
Difference between pension charge and cash contributions		**(68.1)**	(26.8)
Increase in stocks		**(1.3)**	(0.6)
Increase in debtors and prepaid expenses		**(36.3)**	(12.2)
(Decrease)/increase in creditors and accrued expenses		**(14.4)**	2.3
(Decrease)/Increase in provisions		**(0.9)**	0.5
Release of deferred income		**(13.8)**	(13.6)
Net cash inflow from operating activities		**924.7**	943.1

(b) Reconciliation of net cash flow to movement in net debt

	Note	**31 March 2012 £m**	31 March 2011 £m
Decrease in cash in the year		**(0.9)**	(2.3)
Cash (outflow)/inflow from increase in liquid resources		**(156.4)**	202.6
Cash inflow from movement in net debt and financing		**(640.1)**	(1,254.0)
Increase in net debt resulting from cash flows		**(797.4)**	(1,053.7)
Non-cash increase in net debt		**(182.3)**	(192.7)
Total increase in net debt		**(979.7)**	(1,246.4)
Opening net debt		**(6,795.8)**	(5,549.4)
Closing net debt	(c)	**(7,775.5)**	(6,795.8)

The non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 ‘Capital instruments’.

Notes to the cash flow statement for the year ended 31 March (continued)

(c) Analysis of movement in net debt

	As at 1 April 2011 £m	Cash flow £m	Other non-cash movements £m	**As at 31 March 2012 £m**
Cash at bank and in hand	3.6	(0.9)	-	**2.7**
Current asset investments	775.8	(156.4)	-	**619.4**
	779.4	(157.3)	-	**622.1**
Debt due within one year	(7.6)	(462.4)	-	**(470.0)**
Debt due after more than one year	(7,372.5)	(185.5)	(182.3)	**(7,740.3)**
Finance leases	(195.1)	7.8	-	**(187.3)**
	(7,575.2)	(640.1)	(182.3)	**(8,397.6)**
Total	(6,795.8)	(797.4)	(182.3)	**(7,775.5)**

(d) Profit on disposal of fixed assets

The proceeds received regarding the profit on the sale of fixed assets for the year ending 31 March 2012 of £8.8m (2011: £11.5m) have been included within Capital expenditure and financial investment.

Notes to the Financial statements for the year ended 31 March

1 Principal accounting policies

The following accounting policies have been applied consistently in dealing with items, which are considered material to the financial statements, except as noted below.

Basis of preparation

The financial statements are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions, with the Companies Act 2006. An explanation of this departure from the requirements of the Act is given in note 1(b) below.

The Company has not prepared consolidated group financial statements, as permitted under section 400 of the Companies Act 2006. The Company and its subsidiaries are included in the consolidated financial statements of its ultimate parent company Kemble Water Holdings Limited, a company registered in the United Kingdom.

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive Officer's Business review on pages 6 to 31. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Chief Executive Officer's Business review on pages 9 to 11. The Chief Executive Officer's Business review also includes details of the Company's Treasury policy, capital structure and financial risk management.

Day to day working capital requirements are funded by the business. During the year £657.1m, net of bond issuance costs, of new debt were secured and there is no current requirement to raise additional finance to meet future project obligations. There are also cash balances of £629.6m and committed facilities with a group of banks of £1,200m, which are only likely to be used on rare occasions. Of the £1,200m, £450m 364 day facilities are due for renewal by August 2012 with the remainder maturing in September 2016. The current economic conditions create uncertainty particularly over (a) the level of revenue earned from regulatory activities; (b) the increased occurrence of bad debts; and (c) the availability of bank finance in the foreseeable future. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate within the level of its current facilities for 15 months. However, the Company plans to meet its capital programme requirements by raising new debt.

The directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements.

Changes to accounting policies

The same accounting policies used for the year ended 31 March 2011 have been applied in these financial statements.

Changes in accounting estimates

During the year the Company modified the way in which it calculates its provision for bad debts and extended the calculation to cover accrued (unbilled) income. The calculation also uses a number of estimates and assumptions that were updated in line with the collections that the Company is achieving in the current economic climate.

As a result the Company's bad debt charge has increased by £70.6m (2011: £38.4m).

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

Changes in accounting assumptions relating to pensions

Following extensive consultation with employees and with the agreement of the pension fund trustees the Company has changed certain provisions in respect of the TWPS for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011 new employees of the Company have been offered participation in the DCSPS managed through Standard Life. All senior managers have moved to this scheme from the defined benefit scheme.

For existing members of the TWPS, certain provisions have changed that will affect future benefits to its members. Principally, the defined benefit provision from 1 May 2011 will be on a Career Average Revalued Earnings ("CARE") basis and no longer on a Final Salary basis.

As a result of the above change to a CARE basis a curtailment gain of £40.0m has been recorded within these financial statements and has been classified as an exceptional item, see note 3 page 75 and note 26 page 94. The directors consider that due to the materiality and one-off nature of this curtailment gain, it is appropriate to classify this as an exceptional item in order to show a true and fair view of the Company's underlying performance. The tax charge on this exceptional item is £9.6m.

Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below.

(a) Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided and are recognised in accordance with FRS 5 "Reporting the Substance of Transactions". No adjustment is made to reduce revenue by an estimated bad debt charge to reflect the fair value as this is not deemed material. Where relevant, revenue includes an estimate of the sales value of water supplied and waste water charges to customers between the date of the last meter reading and the period end, exclusive of value added tax. The estimated usage is based upon historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period for which the revision to the estimates is determined. For customers who do not have a meter, the receivable billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as favourable operating costs when payment is received in both the statutory and regulatory accounts. The Company currently does not have any charges on income; any outstanding revenue is recovered in the normal course of business. All water and sewerage charges billed to customers are recognised as income at the time they are billed and apportioned over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

1 Principal accounting policies (continued)

(a) Revenue recognition (continued)

Where there is a change of customer in an unmeasured property but the Company cannot confirm the name, a bill is raised in the name of "The Occupier". The Company does not raise billing in the name of the Occupier for metered accounts. However, an unmeasured bill in the name of the Occupier will be cancelled and rebilled once the Company has confirmation of the customer's name. If confirmation is not received the bill is cancelled and the property is classified as empty.

Where a property is classified as empty, an empty property process is followed to verify when the property becomes occupied and/or obtain the name of the customer. The status is established with the customer at point of contact, if the property is not chargeable after 10 weeks the unfurnished / unoccupied state is confirmed visually. The empty property process comprises a number of steps. If these steps confirm that a property appears to be empty then the supply may be turned off. The property will only cease to be classified as empty when a named customer is identified and billed. The Company does not recognise income in respect of empty properties. If the Company has turned off the supply of water at the mains to a property at a customer's request then water supply charges are not payable. A customer may request the supply to be turned off in instances such as the property is to be demolished or where a house previously converted into flats (and additional supplies made) to be converted back into a house.

With regard to new properties, an estimate is made of the sales value of water supplied and waste water charges to customers between the date of connection and the period end.

The Company recognises all revenue at the time of delivery. Should the Company consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned. Payments received in advance of delivery are recorded as deferred revenue.

(b) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers and pumped raw water storage reservoirs and sludge pipelines), and other assets (including land, buildings, properties, over ground plant and equipment).

Directly attributable costs are capitalised within fixed assets. These costs include employee costs and other internal costs that are incremental to the business due to the scale and nature of the capital implementation programme of the Company. Interest costs are not capitalised.

The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively.

The carrying values of fixed assets are also reviewed for impairment where there has been a trigger event by assessing the present value of estimated future cash flows and net realisable value compared with net book value. The calculation of estimated future cash flows and residual values is based on the directors' best estimates of future prices, output and costs and is therefore subjective.

- **Infrastructure assets**

Infrastructure assets comprise a network of below ground systems. In the UK Water and Waste regulated business, all expenditure on infrastructure assets is capitalised at cost, whilst the planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as Infrastructure Renewals Charge ("IRC") within depreciation.

Following the completion of the Company's assessment of the infrastructure renewals expenditure requirement to the end of AMP 7 for the Final Business Plan, the Company considers that it would be appropriate to reflect in its regulatory and statutory accounts an infrastructure renewals charge consistent with its expenditure plans for the AMP 5 to AMP 7 (2010-2025) periods.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

b) Tangible fixed assets (continued)

- **Capital contributions**

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 1 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, which is accordingly accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. As infrastructure assets are accounted under renewals accounting, related capital contributions are not recognised in the profit and loss account.

The financial effect of this departure is disclosed in note 10.

Where material, contributions received towards the cost of other assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

- **Other assets**

All other assets, comprising plant and equipment and land and buildings, are stated at cost less accumulated depreciation.

Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Freehold land is not depreciated and assets in the course of construction are not depreciated until they are commissioned. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated useful lives, down to zero, based on management's judgement and experience, which are principally as follows:

Buildings	15 - 60 years
Operational structures	30 - 100 years
Other operational assets	5 - 40 years
Fixtures, fittings, vehicles and computers	3 - 7 years
Fixed and mobile plant	3 - 40 years

Depreciation methods, residual values and useful lives are re-assessed annually and, if necessary, changes are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account.

(c) Impairment of tangible fixed assets

Fixed assets are assessed for impairment whenever there is an indication of impairment to determine whether any assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(c) Impairment of tangible fixed assets (continued)

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of non-current assets is recognised in the profit and loss account within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the profit and loss account and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

(d) Stocks

Stocks are stated at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(e) Taxation

The tax expense represents the sum of current tax and deferred tax.

- **Current taxation**

Current taxation, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Taxable profit differs from the profit on ordinary activities before tax as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

- **Deferred taxation**

Deferred taxation is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes, which have arisen but not reversed by the balance sheet, except as otherwise required by FRS 19 “Deferred tax”.

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

Deferred taxation is measured at the tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with via the Statement of total recognised gains and losses.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(f) Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

- **Finance leases**

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease.

The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease to the first break clause.

- **Operating leases**

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

(g) Pension and other post retirement benefits

The Company operates two large defined benefit pension schemes. The Company accounts for these schemes in accordance with FRS 17 “Retirement Benefits”. These schemes are independently, administered funds, for the substantial majority of the Company’s employees. Actuarial valuations are carried out as determined by the pension scheme trustees using the projected unit credit method for both pension schemes at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. The Company believes that the assumptions utilised in recording obligations under the two schemes are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions. For any intervening reporting period, the actuaries review the continuing appropriateness of the contribution rates (a complete actuarial valuation is performed every three years). Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the assets and liabilities of the schemes are recognised as a surplus (to the extent that the surplus is recoverable) or obligation in the balance sheet.

The cost of providing pension benefits to employees is included in the profit and loss account within the cost of employee benefits. The difference between the expected return on scheme assets and interest on scheme liabilities are included within other finance income/expense in the profit and loss account.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and are presented in the Statement of total recognised gains and losses.

In addition to the defined benefit schemes, the Company operates a Defined Contribution Stakeholder Pension Scheme (“DCSPS”), managed through Standard Life Assurance Limited (“Standard Life”). From 1 April 2011 the DCSPS is the only scheme to which new entrants to the Company will be eligible. The Company’s Extended Leadership Team of executives have also joined this scheme from 1 April 2011 and are no longer active members of a defined benefit arrangement.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued

(g) Pension and other post retirement benefits

The Company also operates two closed defined contribution pension schemes. The Company has no further payment obligations for these schemes. However, defined funds for individuals are held within these schemes.

(h) Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange current at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling using the rate of exchange current at the balance sheet date. Gains and losses arising on retranslation are included in the profit and loss account for the year.

(i) Cash and cash equivalents

Cash includes cash at bank and in hand, deposits, and short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

(j) Provision for doubtful debts

At each reporting date, the Company evaluates the collectability of trade receivables and records provisions for doubtful receivables based on experience. These provisions are based on, amongst other things, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

At each reporting date, the Company evaluates the value of cancellations that will occur in the future against turnover booked, and not be rebilled. The provision is based on history of cancellations and subsequent rebills, which could affect operating results positively or negatively.

(k) Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

- **Borrowings**

Interest bearing bank loans and overdrafts are recorded as the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis in the profit and loss using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

- **Financial instruments and derivatives**

Interest rate swap agreements and financial futures are used to manage interest rate exposure. While the Company enters into currency swaps to manage its exposure to fluctuations in exchange rates, the Company does not use derivative financial instruments for speculative purposes.

The Company currently does not apply FRS 26 ”Financial Instruments: Recognition and Measurement”, and accordingly the disclosure requirements of FRS 29 ”Financial Instruments: Disclosures” are not applicable.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

- **Financial instruments and derivatives (continued)**

Therefore, the presentation requirements of FRS 25 “Financial Instruments: Presentation” have been applied. However, certain voluntary disclosures have been prepared to aid understanding and comparability with prior year.

Foreign currency and interest rate swaps are all in hedging relationships and are accounted for on an amortised cost basis. Swaps are included within the appropriate caption in note 17.

(l) Accruals and deferred income

Grants and contributions receivable in respect of depreciating fixed assets are treated as deferred income, which is credited to the profit and loss account over the estimated economic lives of the related assets.

(m) Research and development

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

(n) Accounting for provisions and contingencies

The Company is subject to a number of claims that are incidental to the normal conduct of its business. These relate to and include commercial and contractual claims, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience.

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Insurance provisions are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts. Provisions are recorded in the balance sheet at their full value and are not therefore discounted.

(o) Related party disclosures

The Company has taken advantage of the exemption under paragraph 3(c) from the provisions of FRS 8 ”Related party disclosures”, which requires the disclosure of the details of material transactions with other wholly owned subsidiaries within the Kemble Water Holdings Limited Group, on the grounds that it is a wholly owned subsidiary of Kemble Water Holdings Limited, a company registered in the United Kingdom.

(p) Dividends

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Notes to the Financial statements for the year ended 31 March (continued)

1 Principal accounting policies (continued)

(r) LTIPS and bonus

Cash based LTIPS awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the schemes applicable taken into account the duration of the individual scheme and the assumptions used to award payments.

Bonus payments are accrued in the year based on targets assessed at the beginning of each year and paid in the following year when actual performance is measured against the targets set.

2 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

3 Operating costs

Analysis of operating costs by type of expense:

	Note	**31 March 2012 £m**	31 March 2011 £m
Staff costs excluding exceptional item	5	**199.4**	207.5
Exceptional item – pension curtailment gain *	26	**(40.0)**	-
Materials and consumables		**155.6**	136.6
Other operating charges		**476.4**	433.7
Depreciation:			
Owned assets (infrastructure renewals charge)	10	**129.5**	132.4
Owned assets (non-infrastructure)	10	**276.5**	251.3
Assets held under finance leases (non-infrastructure)	10	**9.6**	9.6
Rental under operating leases:			
Hire of plant and machinery		**10.0**	9.3
Other		**5.7**	5.4
Research and development		**3.9**	3.4
Other operating income		**(7.1)**	(7.3)
Foreign currency loss		**-**	0.9
		1,219.5	1,182.8
Own work capitalised (staff and other costs)		**(168.5)**	(159.9)
		1,051.0	1,022.9

* During the period a curtailment gain of £40.0m arising from changes to certain provisions, in respect of the Thames Water Pension Scheme, which came into effect on 1 May 2011, has been classified as an exceptional item. This gain arose as a result of changes to scheme benefits, which have reduced future liabilities. The directors consider that due to the materiality and one-off nature of this curtailment gain, it is appropriate to classify this as an exceptional item in order to show a true and fair view of the Company's underlying performance. The tax charge on this exceptional item is £9.6m. This exceptional item had a £nil cash flow impact.

Amounts receivable by the Company's auditor in is shown below in respect of the following services to the Company:

Fees payable to the auditor:	**31 March 2012 £'000**	31 March 2011 £'000
Fees payable to the Company's auditor for the audit of the Company's accounts	**229**	213
Fees payable to the Company's auditor and its associates for other services:		
Other services pursuant to legislation	**71**	78
Other services relating to taxation	**25**	18
Other services relating to information technology	**118**	-
All other services	**2,084**	241
Total aggregate remuneration	**2,527**	550

Fees for all other services above include £1.9m in respect of advice on the Thames Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG following a competitive tendering process in line with the Company's procurement processes.

No other fees were payable to KPMG Audit Plc in respect of this Company in this year or the prior year.

Notes to the Financial statements for the year ended 31 March (continued)

4 Profit on sale of fixed assets

	31 March 2012 £m	31 March 2011 £m
Profit on disposal of fixed assets	**3.9**	10.9
Taxation charge attributable, included in the current tax (credit)/charge for the period – note 8	**1.6**	2.0

5 Information regarding directors and employees

Aggregate directors' emoluments:

	31 March 2012 £'000	31 March 2011 £'000
Salary	**1,083**	1,092
Pension	**184**	89
Bonus	**681**	875
LTIPs	**667**	1,106
Other benefits	**66**	65
Total aggregate emoluments	**2,681**	3,227

Included in the table above, is £2,365,237 (2011: £2,911,903) for the executive directors for their services to the Company. In addition, the executive directors received total remuneration of £775,545 (2011: £883,112) for their services to other companies within the Group.

At 31 March 2012 £2,171 is accruing to 2 directors (2011: £45,031 for 2 directors) under the Group's defined benefit scheme in respect of services to the Company. In addition, the Company contributed £131,675 (2011: £nil) either as a cash supplement or into a personal pension scheme for 3 directors (2011: nil directors).

At 31 March 2012 £74,375 is accruing to 1 director (2011: £79,495 for 1 director) under a defined contribution scheme.

Highest paid director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid director in respect of work done for the Company during the year were £1,021,837 (2011: £1,168,425) and accrued pension under a defined contribution scheme was £74,375 (2011: £79,495, defined benefit scheme). In addition, emoluments of £437,930 (2011: £500,753) were paid to the highest paid director for services to other companies within the Group.

Details of Long Term Incentive Plans ("LTIP") can be found within the Directors' remuneration report on pages 44 to 47

Notes to the Financial statements for the year ended 31 March (continued)

5 Information regarding directors and employees (continued)

Employee information

The average number of persons employed by the Company, including executive directors, during the year, analysed by category, was as follows:

	31 March 2012 Number	31 March 2011 Number
Support	**323**	331
Operations	**4,228**	4,555
Total employee numbers	**4,551**	4,886

Employment costs excluding exceptional item (see note 3, page 75) but including executive directors' remuneration were:

	Note	**31 March 2012 £m**	31 March 2011 £m
Salaries and wages		**166.3**	167.1
Social security costs		**15.8**	13.7
Pension costs – defined benefit scheme	26	**16.4**	25.2
Pension costs – defined contribution scheme	26	**1.4**	0.2
Severance costs		**1.3**	3.1
Total		**201.2**	209.3
Employment costs included within research and development		**(1.8)**	(1.8)
Net employment costs		**199.4**	207.5

In addition, £9.3m (2011: £10.9m) of employment costs were charged directly to capital projects.

6 Interest payable and similar charges

	31 March 2012 £m	31 March 2011 £m
Bank loans, overdrafts and other loans:		
Group undertakings:		
Internal interest expense	**(288.3)**	(234.1)
RPI accretion on loans	**(123.8)**	(118.7)
Amortisation of debt issue costs	**(4.8)**	(5.2)
Bank and other loans:		
External interest expense	**(21.1)**	(28.7)
RPI accretion on loans	**(58.5)**	(69.1)
Amortisation of debt issue costs	**(1.4)**	(0.7)
Finance charges in respect of finance leases	**(6.8)**	(5.6)
Interest payable and similar charges	**(504.7)**	(462.1)

Notes to the Financial statements for the year ended 31 March (continued)

7 Interest receivable

	31 March 2012 £m	31 March 2011 £m
Interest receivable:		
Group loans	**39.4**	24.4
Other loans	**7.8**	3.7
Net swaps receivable	**34.3**	35.7
Interest receivable	**81.5**	63.8

Amounts receivable on swaps relate to interest rates taken out to hedge rates on borrowings. See note 17, page 86.

The net interest receivable/(payable) on swaps is the aggregate effect of all swaps held in the Company.

8 Taxation

(a) Analysis of charge in the year

	Note	31 March 2012 £m	31 March 2011 £m
Current tax:			
Amounts payable in respect of corporation tax for the year		**-**	4.8
Adjustment in respect of prior years		**(38.3)**	(4.3)
Total current tax (credit)/charge	8(b)	**(38.3)**	0.5
Deferred tax:			
Origination and reversal of timing differences		**43.8**	50.1
Adjustments in respect of prior years		**33.1**	2.1
Impact on deferred tax of tax rate change to 24% (2011: 26%)		**(80.7)**	(74.8)
Deferred tax credit	18	**(3.8)**	(22.6)
Timing difference on pension cost charge	26	**17.1**	5.4
Total deferred tax charge/(credit)		**13.3**	(17.2)
Taxation credit on profit on ordinary activities		**(25.0)**	(16.7)

For an explanation of the impact on deferred tax of the tax rate change to 24% (2011: 26%), see caption - (b) Factors affecting the current tax charge for the year on the following page.

8 Taxation (continued)

(b) Factors affecting the current tax charge for the year

The current tax (credit)/charge is based upon UK corporation tax at 26% (2011: 28%).

The tax (credit)/charge for the year is lower (2011: lower) than the standard rate of corporation tax in the UK (26%), (2011: 28%). The differences are explained below:

	31 March 2012 £m	31 March 2011 £m
Profit on ordinary activities before tax	**222.2**	208.5
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011: 28%)	**57.8**	58.4
Effects of:		
Disallowable expenditure less non taxable income	**3.1**	1.9
Capital allowances for the year in excess of depreciation and other timing differences	**(43.8)**	(50.1)
Pension cost charge lower than pension cost relief	**(17.1)**	(5.4)
Adjustments to tax charge in respect of prior years	**(38.3)**	(4.3)
Current tax (credit)/charge for the year	**(38.3)**	0.5

(c) Factors affecting tax charge for the year

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012. The financial statements for the year reflect these changes, a credit of £80.7m was taken to the profit and loss account and a charge of £3.1m was taken to reserves.

On 23 March 2011 the Chancellor announced the reduction in the main rate of UK corporation tax to 26% with effect from 1 April 2011. This change became substantively enacted on 29 March 2011 and therefore the effect of the rate reduction created a reduction in the deferred tax liability for the prior period of £74.8m, which has been included in the figures above.

The overall effect of the further reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £80.8m.

Notes to the Financial statements for the year ended 31 March (continued)

9 Dividends

The aggregate amount of dividends comprises:	Note	**31 March 2012 £m**	31 March 2011 £m
Dividends paid in respect of prior year but not recognised as liabilities in that year:			
Second interim paid: nil (2011: 2.7p) per ordinary share		**-**	28.2
Third interim paid: nil (2011: 7.3p) per ordinary share		**-**	75.0
Fourth interim paid: 2.4p (2011: nil) per ordinary share		**24.4**	-
Interim dividends paid in respect of the current year:			
First interim paid: 10.2p (2011: 5.6p) per ordinary share		**105.1**	57.3
Second interim paid: 4.9p (2011: 7.3p) per ordinary share		**50.0**	75.1
Third interim paid: 9.7p (2011: 3.5p) per ordinary share		**100.0**	35.8
	21 & 22	**279.5**	271.4

The interim dividend of £24.4m in respect of the year ended 31 March 2011 was paid to Thames Water Utilities Holdings Limited and was used to settle inter-company interest owing to Thames Water Utilities Limited.

Interim dividend distributions are analysed below:

	31 March 2012 £m	31 March 2011 £m
Intra group debt service distribution	**79.5**	121.4
External dividend distributions	**165.1**	115.1
External interest on Kemble Water Eurobond plc debt	**34.9**	34.9
	200.0	150.0
	279.5	271.4

Post balance sheet event

On 7 June 2012 the directors approved a fourth interim dividend of £201.4m (19.6p per ordinary share) in respect of the year ended 31 March 2012. This interim dividend will be paid to Thames Water Utilities Holdings Limited ("TWUHL") on 27 June 2012, and will be used as follows;

- On the same day, TWUHL will use £39.4m to settle its inter-company interest balance payable to TWUL;
- On the same day, TWUHL will pass the remaining £162.0m up the Group structure to be used as detailed below;
    - Thames Water Limited will receive from TWUHL £40.0m and will use this to settle an inter-company balance relating to group relief payments;
    - Subsidiaries of the Group will use £47.5m to settle interest on the Group's external debt, including a payment of £17.5m on Kemble Water Eurobond plc's debt.
    - The remaining £74.5m will be paid as a dividend to the shareholder's of KWHL.

10 Tangible fixed assets

	Land and buildings	Plant and equipment	Infrastructure assets	Assets in course of construction	Total
	£m	£m	£m	£m	£m
Cost					
At 1 April 2011	2,516.6	4,416.1	4,649.6	1,188.6	12,770.9
Additions	-	-	-	1,095.9	1,095.9
Transfers between items	74.6	376.5	318.7	(769.8)	-
Disposals	-	(24.5)	(0.3)	-	(24.8)
At 31 March 2012	**2,591.2**	**4,768.1**	**4,968.0**	**1,514.7**	**13,842.0**
Capital contributions					
At 1 April 2011	-	-	631.2	-	631.2
Additions	-	-	32.1	-	32.1
At 31 March 2012	**-**	**-**	**663.3**	**-**	**663.3**
Depreciation					
At 1 April 2011	638.3	2,283.1	1,073.1	-	3,994.5
Provided during the year	40.9	245.2	129.5	-	415.6
Disposals	-	(19.7)	-	-	(19.7)
At 31 March 2012	**679.2**	**2,508.6**	**1,202.6**	**-**	**4,390.4**
Net book value					
At 31 March 2012	**1,912.0**	**2,259.5**	**3,102.1**	**1,514.7**	**8,788.3**
At 31 March 2011	1,878.3	2,133.0	2,945.3	1,188.6	8,145.2

The Company adopted approximately 40,000 km of private sewers and lateral drains on 1 October 2011, which had a historical net book value of £nil due to no payment was made and there are no current economic benefits to the Company on adoption. For its current cost equivalent, see note 4b on page 119 of the regulatory accounts within this report.

The net book value of land and buildings is analysed as follows:

	31 March 2012 £m	31 March 2011 £m
Freehold land and buildings	**1,901.7**	1,867.7
Leasehold – over 50 years	**7.6**	7.8
Leasehold – under 50 years	**2.7**	2.8
	1,912.0	1,878.3

Depreciation has not been charged on freehold land stated in the financial statements at cost of £120.3m (2011: £117.1m).

10 Tangible fixed assets (continued)

Details of the Company's tangible fixed assets, which are held under finance leases, are:

	Total £m
Cost	
At 1 April 2011 and 31 March 2012	**263.2**
Depreciation	
At 1 April 2011	136.8
Provided during the year	9.6
At 31 March 2012	**146.4**
Net book value	
At 31 March 2012	**116.8**
At 31 March 2011	126.4

11 Fixed asset investments

	31 March 2012 £m	31 March 2011 £m
Cost of shares in subsidiaries	**0.1**	0.1

At 31 March 2012 the Company held the allotted share capital of the following undertakings:

Name of undertaking	**Nominal value and class of shares held**	**Proportion of nominal value of issued shares held**	**Activity**
Thames Water Utilities Finance Limited	£1 Ordinary	100%	Finance Company
Thames Water Utilities Cayman Finance Holdings Limited	$1 Ordinary	100%	Finance Company

Thames Water Utilities Finance Limited was incorporated and registered in Great Britain. Thames Water Utilities Cayman Finance Holdings Limited was incorporated and registered in the Cayman Islands and resident in the United Kingdom for tax.

At 31 March 2012 Thames Water Utilities Finance Limited had net liabilities of £70.7m (2011: liabilities £43.2m) and incurred a loss for the year ended 31 March 2012 of £27.5m (2011: loss £11.1m).

At 31 March 2012 Thames Water Utilities Cayman Finance Holdings Limited had net assets of £1 (2011: £1). No profit or loss had been made in the year (2011: £nil).

Notes to the Financial statements for the year ended 31 March (continued)

12 Stocks

	31 March 2012 £m	31 March 2011 £m
Raw materials and consumables	**9.6**	8.2

13 Debtors: amounts falling due within one year

	31 March 2012 £m	31 March 2011 £m
Trade debtors	**254.8**	267.6
Amounts owed by group undertakings		
- Interest	**39.4**	24.4
- Non interest	**40.4**	0.4
Amounts receivable in respect of corporation tax	**-**	12.3
Amounts receivable in respect of group relief	**-**	28.0
Other debtors	**70.5**	65.2
Insurance claims receivable	**56.8**	53.7
Prepayments and accrued income	**186.0**	170.3
	647.9	621.9

Prepayments and accrued income as at 31 March 2012 includes water and wastewater income not yet billed of £146.7m (2011: £137.9m).

Amounts owed by group undertakings are comprised of:

- Interest receivable of £39.4m (2011: £24.4m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking, on a loan of £2,015.0m (2011: £1,865.0m), of which £39.4m (2011: £24.4m) is included within debtors: amounts falling due within one year and £nil (2011: £nil) within debtors: amounts falling due after more than one year.

- All other amounts are unsecured, interest free and payable on demand.

14 Debtors: amounts falling due after more than one year

	31 March 2012 £m	31 March 2011 £m
Amounts owed by group undertakings	**2,015.0**	1,865.0

Amounts owed by group undertakings are comprised of:

- An unsecured loan of £2,015.0m (2011: £1,865.0m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking. The directors do not anticipate any repayment of principal within the next twelve months.

  Interest is charged at the London Inter-bank Offered rate ("LIBOR") + 0.35%.

Notes to the Financial statements for the year ended 31 March (continued)

15 Creditors: amounts falling due within one year

	31 March 2012 £m	31 March 2011 £m
Obligations under finance leases	**56.5**	7.9
Trade creditors:		
- Operating	**280.7**	254.4
- Capital	**243.0**	332.3
Amounts owed to group undertakings:		
- Secured loan amounts (see below)	**470.0**	7.6
- Interest	**126.8**	129.2
- Non interest	**8.9**	-
Amounts payable in respect of group relief	**0.9**	-
Other taxation and social security payable	**4.6**	3.7
Accruals and deferred income	**269.0**	281.2
	1,460.4	1,016.3

Accruals and deferred income includes £82.0m (2011: £81.8m) of receipts in advance relating to amounts received from customers for water and wastewater charges in respect of the following year.

16 Creditors: amounts falling due after more than one year

	31 March 2012 £m	31 March 2011 £m
Secured bank loans	**666.9**	573.4
Obligations under finance leases	**130.8**	187.2
Amounts owed to group undertakings: secured loan amounts (see below)	**7,073.4**	6,799.1
Accruals and deferred income	**179.1**	189.0
	8,050.2	7,748.7

Amounts owed to group undertakings for secured loans for the year ended 31 March 2012 are shown net of external cross currency and index linked swaps.

	31 March 2012 £m	31 March 2011 £m
Amounts owed to group undertakings are:		
Inter-company secured loans		
- Within one year	**417.1**	15.0
- After more than one year	**6,939.8**	6,672.6
	7,356.9	6,687.6
Non-loan amounts due within one year		
- Interest	**126.8**	129.2
- Non interest	**8.9**	-
	7,492.6	6,816.8

16 Creditors: amounts falling due after more than one year (continued)

Inter-company secured loans for the year ended 31 March 2012 as shown in the above table represent the liability of the Company owed to group undertakings as detailed below and do not include the effect of derivatives held within the Company.

Secured bank loans

Each Obligor (the companies within the Securitisation Group) has entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited will guarantee the obligations of each other Obligor under the finance documents and the Company and its wholly-owned subsidiaries will guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

Amounts due to group undertakings in respect of non-interest amounts are unsecured, interest free and payable on demand.

Loan amounts owed to group undertakings include:

- £2,747.2m (2011: £2,699.7m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking, of which £nil (2011: £15.0m) is included within creditors due within one year and £2,747.2m (2011: £2,684.7m) within creditors due after more than one year.

- £4,623.0m (2011: £4,001.5m) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking, of which £417.1m (2011: £nil) is included within creditors due within one year and £4,205.9m (2011: £4,001.5m) within creditors due after more than one year.

Details of maturity of loans falling due after more than one year are detailed in note 17.

17 Financial instruments

FRS 25 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities.

Funding and treasury policy

The Company's treasury operations are managed centrally by a small specialist team within the Thames Water Group reporting directly to the Chief Financial Officer. The treasury team manages the financing (including debt, interest costs and foreign exchange) for the Group. Treasury policy is focussed on efficient and effective management of cash and financial resources within the Group.

The Company's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance Limited and Thames Water Utilities Cayman Finance Limited is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

Derivative financial instruments, including cross currency swaps, interest rate swaps and index-linked swaps, are employed to manage the currency interest rate and inflation risks arising from the primary financial instruments used to finance the Company's activities.

Short-term debtors and creditors have been excluded from the financial instruments disclosures.

Interest rate risk profile of financial liabilities and assets

After taking into account the Company's interest rate and currency swaps, the interest rate risk profile of the Company's financial liabilities and assets is as follows:

17 Financial instruments (continued)

Financial liabilities

	Total at floating rates		Total at fixed rates		Total at RPI linked rates		Total book value	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Bank loans and overdraft								
- £ Sterling	**132.3**	122.1	**17.7**	27.9	**516.8**	423.4	**666.8**	573.4
Other loans and finance leases *								
- £ Sterling	**316.0**	323.8	**3,680.2**	3,208.2	**3,734.6**	3,469.8	**7,730.8**	7,001.8
	448.3	445.9	**3,697.9**	3,236.1	**4,251.4**	3,893.2	**8,397.6**	7,575.2

	Weighted average interest rate at fixed rate and RPI linked debt		Weighted average period until maturity for which rate is fixed at fixed rate and RPI linked debt	
	2012 %	2011 %	**2012 Years**	2011 Years
Bank loans and overdraft				
- £ Sterling	**2.0**	2.2	**12.9**	14.1
Other loans and finance leases *				
- £ Sterling	**3.6**	3.7	**22.1**	24.1
	3.6	3.6	**22.1**	23.5

Within the above table, 'total at RPI linked rates' are now shown as a separate category. Previously these were included within the 'total at fixed rates' category. The directors consider that this reclassification is appropriate reflecting the amount of financial liabilities held as RPI linked bonds. Total financial liabilities remain unchanged as a result of this reclassification.

* Includes inter-company debt.

The Company's interest rate and cross currency swaps convert £nil (2011: £27.9m) of floating rate borrowing to fixed rate and £235.0m (2011: £235.0m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £1,646.0m (2011: £632.8m) of foreign currency borrowing through conversion to Sterling. Index linked swaps of £894.1m (2011: £894.1m) swapped inter-company fixed rate debt to index linked debt. All swaps are included at their notional amount. Total accretion on the index linked swaps is £132.0m (2011: £92.0m).

Short-term floating rate loans bear interest at rates linked to LIBOR. Base rate is the benchmark rate for all cash at bank.

	Total at floating rates		Total at book value	
	31 March 2012 £m	31 March 2011 £m	**31 March 2012 £m**	31 March 2011 £m
Short term deposits	**619.4**	775.8	**619.4**	775.8
Cash in bank and in hand	**2.7**	3.6	**2.7**	3.6
	622.1	779.4	**622.1**	779.4

The total in the table above should be treated as available cash for covenant calculation purposes.

Notes to the Financial statements for the year ended 31 March (continued)

17 Financial instruments (continued)

Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book value		Fair value	
	31 March 2012 £m	31 March 2011 £m	**31 March 2012 £m**	31 March 2011 £m
Primary financial instruments				
Financial assets:				
- Short term deposits	**619.4**	775.8	**619.4**	775.8
- Cash at bank and in hand	**2.7**	3.6	**2.7**	3.6
Financial liabilities:				
- Bank loans	**(666.9)**	(573.4)	**(666.9)**	(580.8)
- Other loans and finance leases *	**(7,544.2)**	(6,881.0)	**(8,162.0)**	(6,944.4)
Derivative financial instruments				
- Interest rate swaps	**-**	-	**(93.0)**	(25.3)
- Cross currency swaps	**(54.5)**	(28.8)	**(90.3)**	(32.1)
- Index linked swaps	**(132.0)**	(92.0)	**(279.9)**	(206.3)
Total	**(7,775.5)**	(6,795.8)	**(8,670.0)**	(7,009.5)

* Includes inter-company debt.

Thames Water Utilities Limited does not itself hold bonds.

Other loans include bonds issued by group undertakings and external providers, which are publicly traded and loaned to Thames Water Utilities Limited. Fair values for these have been calculated using the 31 March 2012 quoted prices.

Mark-to-market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowings and all derivative financial instruments.

17 Financial instruments (continued)

Maturities	31 March 2012 £m	31 March 2011 £m
Bank loans and overdrafts		
- After more than five years	**666.9**	573.4
	666.9	573.4
Other loans including inter-company		
- Within one year	**470.0**	7.6
- Between one and two years	**-**	469.9
- Between two and five years	**734.3**	299.9
- After more than five years	**6,339.1**	6,029.3
	7,543.4	6,806.7
Finance leases		
- Within one year	**56.5**	7.9
- Between one and two years	**28.1**	56.5
- Between two and five years	**80.2**	93.3
- After more than five years	**22.5**	37.4
	187.3	195.1
Total borrowing	**8,397.6**	7,575.2

Loans are repayable between 2012 and 2062.

Loans wholly repayable after more than five years, excluding finance leases are:

	31 March 2012 £m	31 March 2011 £m
Bank loans	**666.9**	573.4
Other loans including inter-company	**6,399.1**	6,029.2
	7,066.0	6,602.6

Other listed secured loans repayable to Group undertakings in order of maturity include:

€500m 6.13% Fixed rate bond due 2013.	£600m 5.13% Fixed rate bond due 2037.
$156m 3 month US$ libor + 0.95% floating rate bond due 2015.	20bn Yen 3.28% Fixed rate bond due 2038.
£200m 4.90% Fixed rate bond due 2015.	£50m 3.85% Index linked bond due 2040.
€500m 3.25% Fixed rate bond due 2016.	£500m 5.5% Fixed rate bond due 2041.
£400m 7.24% Fixed rate bond due 2018.	£50m 1.98% Index linked bond due 2042.
£200m 5.05% Fixed rate bond due 2020.	£55m 2.09% Index linked bond due 2042.
£225m 6.59% Fixed rate bond due 2021.	£40m 1.97% Index linked bond due 2045.
£175m 3.38% Index linked bond due 2021.	£100m 1.85% Index linked bond due 2047.
£75m 1.35% Index linked bond due 2021.	£200m 1.82% Index linked bond due 2049.
£550m 5.38% Fixed rate bond due 2025 (note 1).	£300m 1.68% Index linked bond due 2053.
£330m 6.75% Fixed rate bond due 2028.	£300m 1.68% Index linked bond due 2055.
£300m 5.75% Fixed rate bond due 2030 (note 2).	£200m 1.77% Index linked bond due 2057.
£200m 6.50% Fixed rate bond due 2032.	£350m 1.76% Index linked bond due 2062.

Notes to the Financial statements for the year ended 31 March (continued)

17 Financial instruments (continued)

Maturities (continued)

Note 1: £550m Class B bond issued on a fixed coupon basis until 21 July 2017, when the bond resets to floating rate interest at LIBOR plus margin.

Note 2: £300m Class B bond issued on a fixed coupon basis until 13 September 2022, when the bond resets to floating rate interest at LIBOR plus margin.

See note 16, page 84 for details of secured bank loans.

Loans repayable by instalments after more than five years hence are:

	31 March 2012 £m	31 March 2011 £m
Finance leases	**22.5**	37.4

The ranges of interest rates on outstanding loans are 0.21% to 8.35% (2011: 0.78% to 8.35%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

Borrowing facilities

At 31 March 2012 the Company had access to committed facilities of £1,200.0m (2011: £1,175.0m) of which £nil (2011: £nil) had been drawn at the balance sheet date, through its subsidiary company Thames Water Utilities Cayman Finance Limited.

18 Provisions for liabilities and charges

	Deferred tax £m	**Insurance liabilities £m**	**Restructuring £m**	**Other £m**	**Total £m**
At beginning of the year	972.9	53.7	1.8	25.9	1,054.3
Utilised during the year	-	-	(2.6)	(0.1)	(2.7)
(Credit)/charge to profit and loss for the year	(3.8)	3.1	1.3	0.4	1.0
At end of the year	**969.1**	**56.8**	**0.5**	**26.2**	**1,052.6**

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012, the combined total of these changes of £80.7m is reflected in the above table.

The overall effect of the further reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £80.8m.

The insurance provision is in respect of insurance claims notified. A debtor in respect of these obligations is included in note 13 (see page 83) representing the reimbursement value from captive and third party insurance companies.

18 Provisions for liabilities and charges (continued)

The restructuring provision principally relates to severance costs as a result of the Company's restructuring and reorganisation. This provision is expected to be utilised over the next year.

Other provisions principally relate to a number of legal claims against the Company and represents Management's best estimate of the value of settlement and costs. It is estimated that some claims will be settled in more than one year.

The elements of deferred tax are as follows:

	Note	**31 March 2012 £m**	31 March 2011 £m
Accelerated capital allowances		**978.4**	979.6
Tax losses carried forward		**(2.6)**	-
Other timing differences		**(6.7)**	(6.7)
		969.1	972.9
Total deferred tax provision:			
Included above		**969.1**	972.9
Deferred tax asset recognised on pension deficit	26	**(37.2)**	(33.2)
		931.9	939.7

At 31 March 2012 there are no amounts of deferred tax unprovided for (2011: £nil).

The pension liability per note 26 is shown net of deferred tax.

19 Called up share capital

	31 March 2012 £m	31 March 2011 £m
Allotted, called up and fully paid		
1,029,050,000 ordinary shares of £1 each	**1,029.0**	1,029.0

20 Share premium account

	31 March 2012 £m	31 March 2011 £m
At 1 April and 31 March	**100.0**	100.0

Premium of 25p on issue of 400,000,000 £1 ordinary shares.

Notes to the Financial statements for the year ended 31 March (continued)

21 Profit and loss account

	Note	**31 March 2012 £m**	31 March 2011 £m
At the beginning of the year		**376.9**	427.4
Profit for the year		**247.2**	225.2
Dividends paid	9	**(279.5)**	(271.4)
Retained loss		**(32.3)**	(46.2)
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Movement on deferred tax relating to pension scheme		**21.4**	(3.2)
At the end of the year		**271.6**	376.9

22 Reconciliation of movements in shareholder's funds

	Note	**31 March 2012 £m**	31 March 2011 £m
At the beginning of the year		**1,505.9**	1,556.4
Profit for the year		**247.2**	225.2
Dividends paid	9	**(279.5)**	(271.4)
Retained loss		**(32.3)**	(46.2)
Actuarial loss on pension scheme	26	**(94.4)**	(1.1)
Movement on deferred tax relating to pension scheme		**21.4**	(3.2)
		(105.3)	(50.5)
At the end of the year		**1,400.6**	1,505.9

23 Capital commitments

	31 March 2012 £m	31 March 2011 £m
Contracted for but not provided	**1,035.5**	1,517.2

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth.

24 Contingencies

There are claims arising in the normal course of business, which are in the process of negotiation.

The Company has set aside amounts considered appropriate for all legal and similar claims as per note 18.

Notes to the Financial statements for the year ended 31 March (continued)

24 Contingencies (continued)

Contingent liabilities

Following the Company's submission of its June Return in June 2010, Ofwat raised concerns about data reported to it in connection with the Company's delivery of its AMP4 hydraulic flooding programme including specifically in relation to the use of hydraulic modelling to support the identification of properties for inclusion in the June Return.

Ofwat issued a notice under Section 203 of the Water Industry Act 1991 on 9 June 2011 to formally request additional information. The Company response was made on 29 July 2011, with supplementary responses on 7 October 2011 and 18 November 2011. The Company had a meeting with Ofwat on 28 February 2012 to discuss any residual concerns which it may have in more detail.

In May 2012, Ofwat notified the Company that it had formally transferred the case to an internal Ofwat casework team through its gateway process to continue with the investigation. Ofwat has indicated that this formal transfer does not prejudge the outcome of the investigation and is a procedural step. Ofwat has further indicated that it is unlikely to conclude its investigations until at least the third quarter of 2012.

If Ofwat concludes that the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs, which Ofwat determines have not been achieved during the AMP4 period. Any such potential financial impact cannot yet be quantified and, as such, no provision has been made within these accounts.

25 Operating leases

At 31 March 2012 the Company was committed to making the following annual payments in respect of non-cancellable operating leases:

	31 March 2012		31 March 2011	
	Land and buildings	**Other**	Land and buildings	Other
	£m	**£m**	£m	£m
Leases which expire:				
- Within one year	**0.1**	**-**	-	-
- In the second to fifth year inclusive	**0.6**	**0.2**	0.2	1.5
- Over five years	**5.9**	**1.2**	6.2	-
	6.6	**1.4**	6.4	1.5

See note 17 ‘Financial instruments’ on page 88 for further information regarding obligations under finance leases.

26 Pension schemes

Pension arrangements for the majority of the Company’s employees are of the defined benefit type, funded through two Group pension schemes; TWPS and Thames Water Mirror Image Pension Scheme (“TWMIPS”) (see table below for details of each schemes’ respective deficit or surplus), covering employees within the Thames Water Group, whose assets are held separately from those of the Group in independently administered funds.

26 Pension schemes (continued)

The defined benefit arrangements were closed to new employees from 1 April 2011. From this date, new employees have been offered membership of a defined contribution scheme managed through Standard Life; see note 1, page 67. Contributions to the scheme are charged to the profit and loss account in the period to which they relate.

Contributions to the defined contribution pension scheme in the year were £1.4m (2011: £0.2m).

The Company's defined benefit pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes' assets and liabilities are included with those of other companies in the Group. The Company contributes the vast majority of the contributions into the schemes and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. Accordingly, the directors have decided it is appropriate to recognise the net deficit of the two Group pension schemes within these financial statements.

The service cost of the Company, as included in the profit and loss account, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial period.

In addition to the cost of the UK Pension arrangements, the Company operates arrangements under which it augments benefits on retirement in certain circumstances of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 March 2012 payments amounted to £1.5m (2011: £2.1m).

The latest full actuarial valuation was undertaken as at 31 December 2010 on behalf of the pension Trustee's by Aon Hewitt Limited ("Hewitt") (the independent and professionally qualified consulting actuaries to the schemes). This valuation has been updated at 31 March 2012 by Mercer Limited ("Mercer"), independent and professionally qualified consulting actuaries, using revised assumptions that are consistent with the requirements of FRS 17 and shown in this note to the accounts.

Thames Water Group has taken advice from Mercer in respect of the funding position of the Group pension schemes.

Net liability by pension schemes before deferred tax

	31 March 2012 £m	31 March 2011 £m
Thames Water Pension Scheme:		
Deficit in scheme	**(190.0)**	(165.8)
Thames Water Mirror Image Pension Scheme:		
Surplus in scheme	**73.5**	59.6
Impact of irrecoverable surplus	**(39.9)**	(21.6)
	33.6	38.0
Liability before deferred tax asset	**(156.4)**	(127.8)

The TWPS net liability is £144.4m (2011: £122.7m) after deferred tax credit, and TWMIPS net asset is £25.2m (2011: £28.1m) after deferred tax charge as disclosed on the balance sheet on page 62.

The Company has recognised a surplus in the TWMIPS to the extent that it may possibly be able to recover it by paying a reduced rate of contributions in the future. The recognisable surplus has been calculated in accordance with FRS 17 as the present value of the current service cost projected over the future working lifetime of all active members of the scheme, using the assumptions adopted at 31 March 2012.

26 Pension schemes (continued)

Reconciliation of funded status to balance sheet:

	31 March 2012 £m	31 March 2011 £m
Fair value of scheme assets	**1,540.0**	1,403.8
Present value of scheme liabilities	**(1,656.5)**	(1,510.0)
Deficit in scheme	**(116.5)**	(106.2)
Impact of irrecoverable surplus	**(39.9)**	(21.6)
Liability recognised on the balance sheet	**(156.4)**	(127.8)
Deferred tax asset	**37.2**	33.2
Net pension liability	**(119.2)**	(94.6)

The assumptions used in the valuation of assets and liabilities of the schemes are the same for both schemes; see page 96, therefore the following tables are for the combined values for both schemes.

Movement in the present value of scheme liabilities:

	31 March 2012 £m	31 March 2011 £m
Opening present value of scheme liabilities	**1,510.0**	1,466.6
Current service cost: Thames Water Utilities Limited	**16.4**	25.2
Current service cost: Other Thames Water Group participating companies	**0.1**	0.2
Interest cost	**79.7**	81.2
Contribution by scheme participants	**0.2**	0.3
Curtailment gain on changes to scheme benefits	**(40.0)**	-
Actuarial losses on scheme liabilities	**153.7**	32.1
Actuarial gain from changes in inflation assumptions	**-**	(37.6)
Net benefit paid out	**(65.1)**	(60.1)
Termination pension cost	**1.5**	2.1
Closing present value of scheme liabilities	**1,656.5**	1,510.0

Movement in fair value of scheme assets:

	31 March 2012 £m	31 March 2011 £m
Opening fair value of scheme assets	**1,403.8**	1,317.4
Expected return on scheme assets	**77.3**	76.9
Actuarial gains on scheme assets	**77.6**	14.1
Contributions by the employer	**44.6**	52.0
Contributions by Other Thames Water Group participating companies	**0.1**	0.2
Contribution of section 75 debt payment	**-**	0.9
Contributions by scheme participants	**0.2**	0.3
Termination pension costs	**1.5**	2.1
Net benefits paid out	**(65.1)**	(60.1)
Closing fair value of scheme assets	**1,540.0**	1,403.8

26 Pension schemes (continued)

(Income)/expense recognised in the profit and loss account:

	31 March 2012 £m	31 March 2011 £m
Current service cost	**16.4**	25.2
Exceptional item – pension curtailment gain	**(40.0)**	-
Interest cost	**79.7**	81.2
Expected return on scheme assets	**(77.3)**	(76.9)
Total (income)/expense recognised in the profit and loss account	**(21.2)**	29.5

The (income)/expense is recognised in the following line items in the profit and loss account:

	31 March 2012 £m	31 March 2011 £m
Operating costs: staff (income)/costs	**(23.6)**	25.2
Other finance expense	**2.4**	4.3
Total (income)/expense charged in the profit and loss account	**(21.2)**	29.5

Analysis of amount recognised in the Statement of total recognised gains and losses:

	31 March 2012 £m	31 March 2011 £m
Actual return less expected return on pension scheme assets	**77.6**	14.1
Changes in assumptions underlying the present value of scheme liabilities	**(153.7)**	(32.1)
Changes in inflation assumption – CPI from RPI	**-**	37.6
Contribution of section 75 debt payment	**-**	0.9
Adjustment relating to irrecoverable surplus	**(18.3)**	(21.6)
Actuarial loss recognised in the Statement of total recognised gains and losses	**(94.4)**	(1.1)
Cumulative amount of losses recognised in the Statement of total recognised gains and losses	**(404.8)**	(310.4)

26 Pension schemes (continued)

Fair value of scheme assets and return on these assets:

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the average expected long-term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following table:

	31 March 2012		31 March 2011	
	Long-term expected rate of return	**Value £m**	Long-term expected rate of return	Value £m
Equities	**7.11%**	**533.0**	8.4%	473.2
Bonds	**4.63%**	**32.9**	5.5%	101.3
Gilts	**1.86-3.11%**	**774.3**	4.15-4.40%	638.8
Property	**6.11%**	**103.3**	7.4%	90.6
Other assets	**3.11%**	**96.5**	4.4%	99.9
Weighted average expected long-term rate of return/total fair value of assets	**4.6%**	**1,540.0**	5.9%	1,403.8

The Company employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

The main financial assumptions used for FRS 17 purposes are as follows:

	31 March 2012	31 March 2011
Price inflation – RPI	**3.1%**	3.5%
Price inflation – CPI	**2.4%**	3.0%
CARE revaluation (CPI max 2.5%)	**2.4%**	-
Salary increases - TWPS	**n/a**	4.5%
Salary increases - TWMIPS	**3.6%**	4.0%
Pension increases – RPI	**3.1%**	3.5%
Pension increases – CPI	**2.4%**	3.0%
Discount rate for scheme liabilities	**4.65%**	5.5%

26 Pension schemes (continued)

In valuing the liabilities of the pension schemes at 31 March 2012, mortality assumptions have been made as indicated below. These mortality assumptions are based on the recent actual mortality experience of members within the schemes and the assumptions also allow for future improvements to mortality rates.

	31 March 2012	31 March 2011
TWPS members who joined before/after 1 January 1995		
Life expectancy for a male pensioner from age 60	**27**	26
Life expectancy for a female pensioner from age 60	**29**	28
Life expectancy from age 60 for a male pensioner currently aged 40	**29**	28
Life expectancy from age 60 for a female pensioner currently aged 40	**31**	29
TWMIPS		
Life expectancy for a male pensioner from age 60	**26**	24
Life expectancy for a female pensioner from age 60	**28**	26
Life expectancy from age 60 for a male pensioner currently aged 40	**28**	26
Life expectancy from age 60 for a female pensioner currently aged 40	**30**	28

History of fair value of assets, present value of liabilities, (deficit)/surplus in scheme and experience gains and losses:

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 March 2008 £m
Fair value of scheme assets	**1,540.0**	1,403.8	1,317.4	1,040.3	1,214.8
Present value of scheme liabilities	**(1,656.5)**	(1,510.0)	(1,466.6)	(1,105.4)	(1,098.9)
(Deficit)/surplus in scheme	**(116.5)**	(106.2)	(149.2)	(65.1)	115.9

Experience adjustments:

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 March 2008 £m
Experience gains/(losses) on scheme assets:					
Amounts	**77.6**	14.1	220.6	(250.4)	(102.7)
Percentage of scheme assets	**5.0%**	1.0%	16.7%	24.1%	8.5%
Experience losses on scheme liabilities:					
Amounts	**(11.0)**	-	-	(44.3)	(5.4)
Percentage of scheme liabilities	**1%**	-	-	4.0%	0.5%
Total amount recognised in the Statement of total gains and losses:					
Amounts	**(94.4)**	(2.0)	(105.4)	(133.0)	3.9
Percentage of present value of scheme liabilities	**5.7%**	0.1%	7.2%	12.0%	0.4%

The Kemble Water Holdings Limited Group expects to contribute approximately £42.3m to the defined benefit schemes in the next financial year.

Notes to the Financial statements for the year ended 31 March (continued)

27 Off-balance sheet arrangements

The Company is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included on its balance sheet. The principal off-balance sheet arrangements are listed below:

- Operating leases (see note 25)
- Outsourcing contracts

In respect of outsourcing contracts, the Company has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include IT support, Legal Services, Supply Chain, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material impact on the financial position of the Group.

28 Intermediate and ultimate parent company and controlling party

Thames Water Utilities Holdings Limited, a company incorporated in the United Kingdom, is the immediate parent company.

Kemble Water Finance Limited, a company incorporated in the United Kingdom, is an intermediate parent company and the smallest group to consolidate these financial statements.

The directors consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the largest group to consolidate these financial statements.

Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water Group, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Kemble Water Holdings Limited is owned by a consortium of investors led by Macquarie European Infrastructure Funds LP and Macquarie European Infrastructure Fund II LP ("MEIF 1 & 2"). The directors do not consider there to be an ultimate parent or controlling party. Kemble Water Holdings Limited is the largest group to consolidate these financial statements.

MEIF 1 and 2 are wholesale investment funds in which the investors are largely pension funds and institutional investors. On behalf of these investors, MEIF 1 and 2 make long-term investments in infrastructure and related businesses located across Europe, aiming to deliver sustainable cash yields and moderate capital growth from diversified portfolios of quality infrastructure investments.

MEIF 1 & 2 are managed by Macquarie Infrastructure and Real Assets (Europe) Limited ("MIRAEL"). MIRAEL is a wholly owned member of the Macquarie Group, and is authorised and regulated by the Financial Services Authority. MIRAEL is resourced by executives of the Macquarie Infrastructure and Real Assets division of Macquarie Group.

Thames Water Utilities Limited

Regulatory accounts and required regulatory information

Explanatory note

The regulatory accounts and required regulatory information on pages 99 to 105 are provided to comply with Condition F of the Instrument of Appointment of Thames Water Utilities Limited as a water and sewerage undertaker under the Water Industry Act 1991.

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines ("RAG") issued by Ofwat.

There are differences between UK Generally Accepted Accounting Practice and the RAG. Where different treatments are specified under each, the RAG take precedence.

A glossary of regulatory terms is shown on pages 130 to 131.

The regulatory financial statements should be read in conjunction with the statutory Annual report and financial statements ("AR&A"). The AR&A include the Chief Executive Officer's business review (pages 6 to 31). In addition, the Directors' report (pages 32 to 36) includes a statement as to the disclosure of information to the auditor (page 35), the dividend policy of the Company which also applies to the appointed business (page 32) and information in respect of the Company's charitable donations (page 35). In addition, the Directors' remuneration report (pages 38 to 52) includes information linking their remuneration with standards of regulatory performance.

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 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 to 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.
- Keep proper accounting records, which comply with Condition F and RAG 5.04.

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

Ring fencing

In the opinion of the directors, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year. This relates to the availability of rights and assets in the event of a special administration order.

Regulatory accounts and required regulatory information (continued)

Regulatory historical cost profit and loss account for the year ended 31 March

	2012			2011		
	Appointed business £m	**Non-Appointed business £m**	**Total £m**	Appointed business £m	Non-Appointed business £m	Total £m
Turnover (Note 2, page 114)	**1,670.9**	**24.0**	**1,694.9**	1,600.0	23.1	1,623.1
Operating costs	**(795.3)**	**(9.6)**	**(804.9)**	(752.9)	(9.1)	(762.0)
Historical cost depreciation *	**(285.1)**	**(1.0)**	**(286.1)**	(259.9)	(1.0)	(260.9)
Operating income	**43.9**	**-**	**43.9**	10.9	-	10.9
Operating profit	**634.4**	**13.4**	**647.8**	598.1	13.0	611.1
Other expense	**(2.4)**	**-**	**(2.4)**	(4.3)	-	(4.3)
Net interest payable	**(423.0)**	**(0.2)**	**(423.2)**	(398.1)	(0.2)	(398.3)
Profit on ordinary activities before taxation	**209.0**	**13.2**	**222.2**	195.7	12.8	208.5
Taxation:						
- Current tax	**41.3**	**(3.0)**	**38.3**	3.2	(3.7)	(0.5)
- Deferred tax	**(12.9)**	**(0.4)**	**(13.3)**	17.2	-	17.2
	28.4	**(3.4)**	**25.0**	20.4	(3.7)	16.7
Profit for the year	**237.4**	**9.8**	**247.2**	216.1	9.1	225.2
Dividend	**(269.7)**	**(9.8)**	**(279.5)**	(262.3)	(9.1)	(271.4)
Retained loss for the year	**(32.3)**	**-**	**(32.3)**	(46.2)	-	(46.2)

* The historical cost depreciation has been analysed separately in order to comply with the presentational requirements of RAG 3.06

Statement of total recognised gains and losses (historical cost accounting) for the appointed business for the year ended 31 March

	31 March 2012	31 March 2011
	£m	£m
Profit for the year	**237.4**	216.1
Actuarial loss on pension schemes	**(94.4)**	(1.1)
Deferred tax relief/(charge) relating to actuarial loss	**21.4**	(3.2)
Total recognised gains in the year	**164.4**	211.8

Thames Water Utilities Limited

Regulatory accounts and required regulatory information (continued)

Regulatory historical cost balance sheet at 31 March

	2012			2011		
	Appointed business £m	**Non-Appointed business £m**	**Total £m**	Appointed business £m	Non-Appointed business £m	Total £m
Fixed assets						
Tangible assets	**8,747.7**	**7.7**	**8,755.4**	8,154.1	8.1	8,162.2
Investments – loan to group company	**2,015.0**	**-**	**2,015.0**	1,865.0	-	1,865.0
Investments - other	**0.1**	**-**	**0.1**	0.1	-	0.1
Total fixed assets	**10,762.8**	**7.7**	**10,770.5**	10,019.2	8.1	10,027.3
Current assets						
Stocks	**9.6**	**-**	**9.6**	8.2	-	8.2
Debtors: amounts falling due within one year	**647.9**	**-**	**647.9**	621.9	-	621.9
Infrastructure renewals prepayment	**32.9**	**-**	**32.9**	-	-	-
Cash at bank and in hand	**2.7**	**-**	**2.7**	3.6	-	3.6
Short term deposits	**619.4**	**-**	**619.4**	775.8	-	775.8
Total current assets	**1,312.5**	**-**	**1,312.5**	1,409.5	-	1,409.5
Creditors: amounts falling due within one year:						
Creditors	**(919.4)**	**(7.3)**	**(926.7)**	(986.0)	(8.1)	(994.1)
Borrowings	**(526.5)**	**-**	**(526.5)**	(15.5)	-	(15.5)
Infrastructure renewals accrual	**-**	**-**	**-**	(17.0)	-	(17.0)
Total creditors	**(1,445.9)**	**(7.3)**	**(1,453.2)**	(1,018.5)	(8.1)	(1,026.6)
Net current (liabilities)/asset	**(133.4)**	**(7.3)**	**(140.7)**	391.0	(8.1)	382.9
Total assets less current liabilities	**10,629.4**	**0.4**	**10,629.8**	10,410.2	-	10,410.2
Creditors: amounts falling due after more than one year:						
Borrowings	**(7,871.1)**	**-**	**(7,871.1)**	(7,559.7)	-	(7,559.7)
Other creditors	**(49.3)**	**-**	**(49.3)**	(52.7)	-	(52.7)
Total creditors	**(7,920.4)**	**-**	**(7,920.4)**	(7,612.4)	-	(7,612.4)
Provisions for liabilities and charges:						
Deferred tax provision	**(968.7)**	**(0.4)**	**(969.1)**	(972.9)	-	(972.9)
Deferred income – grants and contributions	**(137.0)**	**-**	**(137.0)**	(143.0)	-	(143.0)
Other provisions	**(83.5)**	**-**	**(83.5)**	(81.4)	-	(81.4)
Post employment liabilities	**(119.2)**	**-**	**(119.2)**	(94.6)	-	(94.6)
Net assets employed	**1,400.6**	**-**	**1,400.6**	1,505.9	-	1,505.9
Capital and reserves						
Called-up share capital	**1,029.0**	**-**	**1,029.0**	1,029.0	-	1,029.0
Share premium	**100.0**	**-**	**100.0**	100.0	-	100.0
Profit and loss account	**271.6**	**-**	**271.6**	376.9	-	376.9
Capital and reserves	**1,400.6**	**-**	**1,400.6**	1,505.9	-	1,505.9

Regulatory accounts and required regulatory information (continued)

Historical cost reconciliation between statutory and regulatory accounts at 31 March

	2012 Statutory UK GAAP £m	2012 Regulatory RAG 3 £m	Explanation
Profit and loss account			
Operating costs	**(1,051.0)**	**(804.9)**	The difference of £246.1m is due to the reporting of historic cost depreciation (£286.1m cost) as a separate category in the regulatory accounts and the exceptional item (£40.0m credit) in respect of the one off benefit arising from changes to the pension schemes, which is reported within operating income within the regulatory accounts in accordance with paragraph 2.1.33 of RAG 3.06.
Profit on sale of fixed assets	**3.9**	**-**	The difference of £3.9m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as 'operating income' for regulatory accounts.
Operating income	**-**	**43.9**	Profit on sale of fixed assets of £3.9m together with the exceptional item of £40.0m as reported above are disclosed within operating income in the regulatory accounts.
Operating profit	**643.9**	**647.8**	The difference of £3.9m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as 'operating income' for regulatory accounts.
Profit before taxation	**222.2**	**222.2**	Profit before taxation is unaffected by this re-classification.

Regulatory accounts and required regulatory information (continued)

Historical cost reconciliation between statutory and regulatory accounts at 31 March (continued)

	2012 Statutory UK GAAP £m	2012 Regulatory RAG 3 £m	Explanation
Balance sheet			
Fixed assets			
Tangible fixed assets (net book value)	**8,788.3**	**8,755.4**	The difference of £32.9m is due to the infrastructure renewals prepayment (2011: £17.0m accrual) as this is excluded from the fixed assets net book value in the regulatory accounts. This is in line with RAG 3.06 as FRS 15 is not applied for infrastructure renewals accounting for regulatory accounting purposes. For more detail see page 106.
Investments – loan to group company	**-**	**2,015.0**	A loan to the immediate parent company, Thames Water Utilities Holdings Limited is classified within this category within the regulatory accounts but disclosed as a debtor: amounts falling due after more than one year in the statutory accounts.
Debtors : amount falling due after more than one year	**2,015.0**	**-**	As above.
Current Assets			
Infrastructure renewals prepayment	**-**	**32.9**	The difference of £32.9m reflects the reclassification of infrastructure renewals accrual described above.
Short-term and long-term creditors			
Deferred income – grants and contributions:	**(137.0)**	**-**	Deferred grants and contributions of £137.0m (2011: £143.0.m) within the statutory accounts are analysed between creditors: amounts falling due within one year (£7.2m) and creditors: amounts falling due after more than one year (£129.8m). This is in contrast to the regulatory accounts, which shows total deferred grants and contributions within provisions for liabilities and charges.
Provision for liabilities and charges	**-**	**(137.0)**	As above.

Regulatory accounts and required regulatory information (continued)

Additional information required by the licence

Basis of preparation

In accordance with Condition F of the Instrument of Appointment, these regulatory financial statements have been prepared to show separately in respect of the appointed business, non-appointed business and total business, a profit and loss account and balance sheet prepared on a historical cost basis.

In accordance with the requirements of FRS 18, the directors review the Company's accounting policies to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view.

The financial statements have been prepared in accordance with the historical cost convention and, except for the classification of profit on the sale of fixed assets as explained in note (a) below, the treatment of infrastructure renewals expenditure as explained in note (b) below and the treatment of certain capital contributions as explained in note (c) below, have been prepared in accordance with the Companies Act 2006. The departures from applicable UK Accounting Standards are necessary to comply with regulatory reporting requirements laid down by Ofwat.

Changes to accounting policies

The same accounting policies as those used for the year ended 31 March 2012 have been applied in these financial statements.

(a) Profit on sale of fixed assets

Profit and loss on sale of fixed assets has been included within operating profit, as operating income, in accordance with RAG 3. This represents a departure from FRS 3 as adopted in the Company's 31 March 2012 statutory financial statements in which profit and loss on sale of fixed assets are shown after operating profit.

(b) Infrastructure renewals expenditure

Infrastructure renewals expenditure ("IRE") has been accounted for in accordance with RAG 3.06 in these financial statements and is consistent with the reporting of IRE in the Company's regulatory historical cost financial statements for the year ended 31 March 2012. Accordingly, IRE net of depreciation has been included within debtors.

The Company's statutory financial statements disclose IRE net of depreciation in accordance with FRS 15 "Tangible Fixed Assets" which requires this amount to be included within fixed assets. Within these regulatory historic cost financial statements, the Company in accordance with RAG 3.06 reports IRE net of depreciation within debtors in the regulatory historic cost financial statements for the year ended 31 March 2012.

Reconciliation to the tangible fixed assets shown in the statutory financial statements with the regulatory historical cost financial statements is shown on page 106.

(c) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, with the latter accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. Accordingly, related capital contributions would not be recognised in the profit and loss account.

Regulatory accounts and required regulatory information (continued)

Basis of preparation (continued)

(d) Allocation of costs

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services.

Direct costs attributable to the provision of services other than the Appointed Business are separately allocated and identified as “Non-Appointed”. Indirect costs, relating to non-appointed activities, are recovered as a fixed percentage of direct costs based upon the analysis of operating costs.

(e) Revenue

There are no differences between the accounting policy for revenue under the statutory accounts and the policy for the regulatory accounts.

Regulatory accounts and required regulatory information (continued)

Reconciliation of tangible fixed assets shown in the statutory financial statements and their regulatory financial equivalents:

	Other assets £m	Infra-structure assets £m	Total £m
Cost			
At 31 March 2012 as per statutory accounts (FRS 15)	8,874.0	4,968.0	13,842.0
Infrastructure renewals expenditure capitalised in previous years	-	(1,057.0)	(1,057.0)
Infrastructure renewals expenditure capitalised in the year	-	(179.4)	(179.4)
Disposals in prior years	-	0.9	0.9
Cost at 31 March 2012 per regulatory accounts (RAG 3)	**8,874.0**	**3,732.5**	**12,606.5**
Capital contributions			
Contributions at 31 March 2012 as per statutory accounts (FRS 15)	-	663.3	663.3
Contributions at 31 March 2012 as per regulatory accounts (RAG 3)	**-**	**663.3**	**663.3**
Depreciation			
At 31 March 2012 as per statutory accounts (FRS 15)	3,187.8	1,202.6	4,390.4
Infrastructure renewals charge in previous years	-	(1,074.0)	(1,074.0)
Infrastructure renewals charge in the year	-	(129.5)	(129.5)
Disposals in prior years	-	0.9	0.9
Depreciation at 31 March 2012 per regulatory accounts (RAG 3)	**3,187.8**	**-**	**3,187.8**
Net book value			
At 31 March 2012 as per statutory accounts (FRS 15)	5,686.2	3,102.1	8,788.3
Adjustment for infrastructure renewals accounting (see below)	-	(32.9)	(32.9)
At 31 March 2012 per regulatory accounts (RAG 3)	**5,686.2**	**3,069.2**	**8,755.4**

Adjustment for infrastructure renewals accounting:

	Infrastructure assets £m
RAG 3 net infrastructure renewals reclassification:	
Infrastructure renewals accrual at 31 March 2011	(17.0)
Infrastructure renewals expenditure capitalised in the year	179.4
Infrastructure renewals charge in the year	(129.5)
Infrastructure renewals prepayment at 31 March 2012	**32.9**

Regulatory accounts and required regulatory information (continued)

Regulatory current cost profit and loss account for the appointed business for the year ended 31 March

	Note	**31 March 2012 £m**	31 March 2011 £m
Turnover	2	**1,670.9**	1,600.0
Current cost operating costs	3	**(1,177.5)**	(1,100.8)
Operating income ***(i)***	2	**44.3**	(1.5)
Working capital adjustment	2	**20.1**	13.0
Current cost operating profit		**557.8**	510.7
Net interest		**(425.4)**	(402.4)
Financing adjustment		**41.0**	119.2
Current cost profit on ordinary activities before taxation		**173.4**	227.5
Taxation:			
- Current tax		**41.3**	3.2
- Deferred tax		**(12.9)**	17.2
Current cost profit attributable to shareholder's		**201.8**	247.9
Dividends		**(269.7)**	(262.3)
Current cost loss retained		**(67.9)**	(14.4)

(i) Includes £40.0m relating to the exceptional item, see the Historic cost reconciliation between the statutory and regulatory accounts on page 102.

Regulatory accounts and required regulatory information (continued)

Regulatory current cost balance sheet for the appointed business at 31 March

	Note	31 March 2012 £m	31 March 2011 £m
Fixed assets			
Tangible assets	4c	**94,326.0**	71,775.3
Third party contributions since 31 March 1990		**(20.579.1)**	(1,008.5)
		73,746.9	70,766.8
Working capital	5	**(339.7)**	(418.9)
Cash		**2.7**	3.6
Short term deposits		**619.4**	775.8
Infrastructure renewals accrual		**32.9**	(17.0)
Net operating assets		**74,062.2**	71,110.3
Non operating assets and liabilities			
Borrowings		**(526.5)**	(15.5)
Non-trade debtors		**207.1**	171.8
Non-trade creditors due within one year		**(129.3)**	(121.1)
Investment – loan to group company		**2,015.0**	1,865.0
Investments – other		**0.1**	0.1
Corporation tax receivable		**-**	12.3
Total non operating assets and liabilities		**1,566.4**	1,912.6
Creditors: amounts falling due after more than one year			
Borrowings		**(7,871.1)**	(7,559.7)
Other creditors		**(49.3)**	(52.7)
Total creditors falling due after more than one year		**(7,920.4)**	(7,612.4)
Provisions for liabilities and charges			
Deferred tax provision		**(968.7)**	(972.9)
Post employment liability		**(119.2)**	(94.6)
Other provisions		**(83.5)**	(81.4)
Total provisions		**(1,171.4)**	(1,148.9)
Net assets		**66,536.8**	64,261.6
Capital and reserves			
Called up share capital		**1,029.0**	1,029.0
Share premium		**100.0**	100.0
Profit and loss account		**(925.1)**	(783.9)
Current cost reserve	6	**66,332.9**	63,916.5
Total capital and reserves		**66,536.8**	64,261.6

The notes on pages 110 to 122 form part of these regulatory current cost financial statements.

The regulatory current cost financial statements were approved by the Board of Directors on 7 June 2012.

Regulatory accounts and required regulatory information (continued)

Regulatory current cost statement of cash flows for the year ended 31 March

	Notes	2012 Appointed business	2012 Non-Appointed business	2012 Total	2011 Appointed business	2011 Non-Appointed business	2011 Total
		£m	£m	£m	£m	£m	£m
Net cash inflow from operating activities	(a)	**913.3**	**14.0**	**927.3**	929.9	13.2	943.1
Returns on investments and servicing of finance							
Interest received		**106.1**	**-**	**106.1**	110.4	-	110.4
Interest paid		**(353.9)**	**(0.2)**	**(354.1)**	(269.1)	(0.2)	(269.3)
Interest element of finance lease payments		**(6.9)**	**-**	**(6.9)**	(6.5)	-	(6.5)
Net cash outflow from returns on investments and servicing of finance		**(254.7)**	**(0.2)**	**(254.9)**	(165.2)	(0.2)	(165.4)
Taxation received/(paid)		**83.0**	**(3.4)**	**79.6**	(22.3)	(3.7)	(26.0)
Capital expenditure and financial investment							
Gross cost of purchased fixed assets		**(993.0)**	**(0.6)**	**(993.6)**	(793.6)	(0.2)	(793.8)
Infrastructure renewals expenditure		**(179.4)**	**-**	**(179.4)**	(107.7)	-	(107.7)
Receipt of grants and contributions		**44.3**	**-**	**44.3**	41.0	-	41.0
Movement on long term loans to group companies		**(150.0)**	**-**	**(150.0)**	(685.0)	-	(685.0)
Disposal of fixed assets		**8.8**	**-**	**8.8**	11.5	-	11.5
Net cash outflow from investing activities		**(1,269.3)**	**(0.6)**	**(1,269.9)**	(1,533.8)	(0.2)	(1,534.0)
Equity dividends paid		**(269.7)**	**(9.8)**	**(279.5)**	(262.3)	(9.1)	(271.4)
Management of liquid resources							
Net cash outflow/(inflow) from management of liquid resources		**156.4**	**-**	**156.4**	(202.6)	-	(202.6)
Net cash outflow before financing		**(641.0)**	**-**	**(641.0)**	(1,256.3)	-	(1,256.3)
Financing							
Capital element in finance lease payment		**(7.8)**	**-**	**(7.8)**	(8.6)	-	(8.6)
New loans		**657.1**	**-**	**657.1**	1,807.6	-	1,807.6
Repayment of loans		**(9.2)**	**-**	**(9.2)**	(545.0)	-	(545.0)
Net cash inflow from financing	**(b)**	**640.1**	**-**	**640.1**	1,254.0	-	1,254.0
Decrease) in cash	**(b)**	**(0.9)**	**-**	**(0.9)**	(2.3)	-	(2.3)

Regulatory accounts and required regulatory information (continued)

Notes to regulatory current cost statement of cash flows for the year ended 31 March

(a) Reconciliation of current cost operating profit to net cash flow from operating activities for the appointed business

	31 March 2012 £m	31 March 2011 £m
Current cost operating profit	**557.8**	510.7
Working capital adjustment	**(20.1)**	(13.0)
Movement in working capital (excluding short term capital creditors)	**10.1**	25.7
Current cost depreciation (net of deferred income)	**375.5**	341.3
Current cost (profit)/loss on sale of fixed assets	**(4.3)**	1.5
Current cost exceptional item	**(40.0)**	-
Infrastructure renewals charge	**129.5**	132.4
Difference between pension charge and cash contributions	**(68.1)**	(26.8)
Other non-cash items (including provisions)	**(27.1)**	(41.9)
Net cash flow from operating activities	**913.3**	929.9

(b) Reconciliation of net cash flow to movement in net debt for the Appointed business

	Note	**31 March 2012 £m**	31 March 2011 £m
Decrease in cash in the period		**(0.9)**	(2.3)
Cash (outflow)/inflow from increase in liquid resources		**(156.4)**	202.6
Cash inflow from movement in net debt and financing		**(640.1)**	(1,254.0)
Increase in net debt resulting from cash flows		**(797.4)**	(1,053.7)
Non-cash increase in net debt		**(182.3)**	(192.7)
Total increase in net debt		**(979.7)**	(1,246.4)
Opening net debt		**(6,795.8)**	(5,549.4)
Closing net debt	7	**(7,775.5)**	(6,795.8)

Non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 ”Capital instruments”.

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March

1 Current cost accounting policies

These financial statements have been prepared in accordance with guidance issued by the Water Services Regulation Authority for modified real term financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of which assets are valued at their current cost value to the business.

These financial statements have been prepared in accordance with applicable RAG. In respect of cost allocations, the Company has continued to allocate costs by cost centre as in previous years rather than on an activity based method, which is the preferred system under RAG 3.06.

The principal current cost accounting policies used are the same as those adopted in the regulatory historical cost financial statements, except as set out below.

Changes to accounting policies

The accounting policies used for the year ended 31 March 2011 have been applied in these financial statements, except as noted below.

The Company undertook a review of its current cost assets in line with Ofwat's Accounting Separation guidance. Accordingly, the Company has reclassified certain assets and their related depreciation between asset types and between water and sewerage services.

The net book values have not been affected by this review.

(a) Valuation bases for determining the current cost of fixed assets

(i) Review of asset valuations

In accordance with Ofwat's guidelines RD12/07, the Company undertook a review of the modern equivalent asset ("MEA"), values as at 31 March 2009 as one aspect of the 2009 Periodic Review. This involved a comprehensive review of the asset stock at the time, as well as the unit costs underpinning the valuations. In accordance with RD12/07 companies were given the option to report the results of the revaluation in the regulatory accounts either in 2010 or 2011. The Company has therefore applied the results of the revaluation in the regulatory accounts in 2012. Accordingly, MEA net book values for the prior period increased by £16,448.5m; see note 6, on page 121.

(ii) Adoption of private sewers and lateral drains

In accordance with the "Water Industry Schemes for Adoptions of Private Sewers 2011", the Company adopted private sewers and lateral drains on 1 October 2011.

These have been valued as specified in RAG 1.10.9 in the Company's current cost balance sheet at £18.8bn, as at 31 March 2011 prices, within "Tangible fixed assets", with a corresponding contribution of £18.8bn being reflected within "Third party contributions since 31 March 1990". The adoption has £nil effect on the Company's net assets, see note 4b page 119. The current cost value of these adopted assets as at 31 March 2012 was £19.5bn.

The Company estimated the current cost of the adoption of private sewers and lateral drains by using the length of the network adopted, deemed to be 40,000 km, and is after the application of assumptions on surface covering, location and diameter of sewer.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

(a) Valuation bases for determining the current cost of fixed assets (continued)

(ii) Tangible fixed assets

The assets have been valued in accordance with RAG 1.04, on an MEA basis. Depreciation is charged over the estimated remaining economic life of the asset. Infrastructure assets are not depreciated.

Additions during the year are taken at their historical cost values. Disposals are stated at the value of the replacement assets.

- **Land and buildings**

Non-specialised operational properties are valued on the basis of estimated open market value for existing use at 31 March 1991, indexed since that date by the movement in the RPI, except for certain properties which have been valued at 31 March 1995 by professionally qualified employees of the Company.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually, between periodic reviews of replacement costs, by adjusting for inflation as measured by changes in the RPI.

- **Infrastructure assets**

Mains, sewers, impounding and pumped raw water storage reservoirs, and sludge pipelines are stated at their MEA value, in the manner described above. Due to the nature of these assets, the MEA value is calculated based on the length of sewer or pipe, or the capacity of the asset.

Following the repeal of Section 24 of the Public Health Act 1936 by the Water Act 1989, the Company assumed responsibility for the maintenance and operation of a significant length of additional sewers. The Company has estimated the length of these pipes in order to include their asset values in these accounts. The value is £6,480m (2011: £6,183m) based upon a pipe length of 19,000km (2011: 19,000km). Adjustments may be required to those estimates in future years as more accurate information becomes available.

- **Specialised/non-specialised assets**

Specialised operational assets include those assets, used routinely in operating the business, which are directly attributable to water supply or sewerage services.

Non-specialised assets are those assets used routinely within the business, which cannot be directly attributed to either part of the business.

- **Surplus land**

Surplus land is valued at recoverable amounts less, where appropriate, that part of any proceeds to be passed on to customers under Condition B of the Licence.

(iii) Capital contributions

All third party capital contributions received since 31 March 1990 are carried forward as deferred income to the extent that any balance has not been credited to revenue, or deducted from net operating assets in the case of infrastructure assets. The balance carried forward is restated in accordance with the change in the RPI for the year.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

(b) Real finance capital maintenance adjustments

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

(i) Depreciation adjustment - this is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historical cost profit.

(ii) Working capital adjustment - this is calculated by applying the change in the RPI over the year to the working capital of the Company at the beginning of the year.

(iii) Disposal of fixed assets adjustment - this is the difference between the book values of realised assets in the current cost financial statements and in the historical cost financial statements.

(iv) 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, but excluding index rate linked debt and the deferred tax provision.

(c) Operating costs

In note 3, direct costs incurred with associated companies are less than 20% of the total operating costs of the business before interest and tax. Therefore the costs have been allocated across the appropriate headings in accordance with RAG 3.06.

Regulatory accounts and required regulatory information (continued)

2 Analysis of turnover, operating income and working capital adjustment for the appointed business

	2012			2011		
	Water supply £m	**Sewerage services £m**	**Appointed business £m**	Water supply £m	Sewerage services £m	Appointed business £m
Turnover						
Unmeasured - household	**468.7**	**448.4**	**917.1**	461.5	422.1	883.6
Unmeasured – non - household	**6.6**	**5.0**	**11.6**	6.5	4.1	10.6
Total unmeasured	**475.3**	**453.4**	**928.7**	468.0	426.2	894.2
Measured - household	**174.1**	**205.1**	**379.2**	167.2	184.5	351.7
Measured – non - household	**157.5**	**117.5**	**275.0**	158.0	110.5	268.5
Total measured	**331.6**	**322.6**	**654.2**	325.2	295.0	620.2
Trade effluent	**-**	**6.6**	**6.6**	-	4.5	4.5
Large user and special agreement	**32.6**	**24.9**	**57.5**	33.5	23.1	56.6
Rechargeable works	**2.7**	**5.7**	**8.4**	2.1	6.6	8.7
Bulk supplies/inter-company payments	**3.0**	**-**	**3.0**	2.9	-	2.9
Third party services (excl. non-potable water)	**5.7**	**5.7**	**11.4**	5.0	6.6	11.6
Other sources	**6.2**	**6.3**	**12.5**	5.4	7.5	12.9
Total turnover	**851.4**	**819.5**	**1,670.9**	837.1	762.9	1,600.0
Operating income						
Current cost profit on disposal fixed assets	**1.8**	**2.5**	**4.3**	(0.8)	(0.7)	(1.5)
Working capital adjustment						
Working capital adjustment	**10.2**	**9.9**	**20.1**	6.8	6.2	13.0
Revenue correction mechanism						
Net revenue movement out of the tariff basket	**(1.6)**	**(0.4)**	**(2.0)**	0.4	0.8	1.2

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

3 Operating costs and associated fixed asset book values for year ended 31 March 2012

3a Water Services

£m	Water resources	Raw water distribution	Water treatment	Treated water distribution	Total
Direct costs					
Employment costs	2.0	1.7	9.7	23.6	**37.0**
Power	6.3	1.6	7.8	29.7	**45.4**
Hired and contracted services	1.9	2.1	7.3	30.4	**41.7**
Materials and consumables	0.1		11.6	0.1	**11.8**
Service charges	17.3				**17.3**
Bulk supply imports					
Other direct costs			0.4	5.6	**6.0**
Total direct costs	**27.6**	**5.4**	**36.8**	**89.4**	**159.2**
Operating expenditure					
General and support expenditure	7.0	4.2	1.1	53.0	**65.3**
Scientific services		1.0	2.4	0.1	**3.5**
Other business activities	0.1	0.1	0.3	0.6	**1.1**
Total business activities	**0.1**	**1.1**	**2.7**	**0.7**	**4.6**
Local Authority rates	1.5	1.8	2.8	25.2	**31.3**
Exceptional items	(0.9)	(0.8)	(4.6)	(10.5)	**(16.8)**
Total opex less third party services	**35.3**	**11.7**	**38.8**	**157.8**	**243.6**
Third party services - opex	0.2		0.7	0.4	**1.3**
Total operating expenditure	**35.5**	**11.7**	**39.5**	**158.2**	**244.9**
Capital maintenance					
Infrastructure renewals charge (excluding third party services)	3.4	7.8		67.0	**78.2**
Current cost depreciation	14.1	3.2	89.9	44.9	**152.1**
Amortisation of deferred credits	(0.1)	(0.1)	(0.3)	(1.4)	**(1.9)**
Business activities current cost depreciation	0.1		0.4	0.3	**0.8**
Total capital maintenance	**17.5**	**10.9**	**90.0**	**110.8**	**229.2**
Total operating costs	**53.0**	**22.6**	**129.5**	**269.0**	**474.1**
Memorandum - included in above					
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure		0.3		54.1	**54.4**
Reactive and planned maintenance non-infrastructure	0.7		2.7		**3.5**
	0.7	**0.3**	**2.7**	**54.1**	**57.9**

Regulatory accounts and required regulatory information (continued)

3b Retail Services

£m	Household	Household general & support memo	Non-household	Non-household general & support memo	Total
Direct costs					
Billing	13.0	2.1	2.3	0.4	**15.3**
Payment handling, remittance and cash handling	5.9	0.8	0.2	0.1	**6.1**
Debt management	15.2	1.9	1.7	0.2	**16.9**
Doubtful debts	60.6		10.0		**70.6**
Charitable trust donations	2.0				**2.0**
Vulnerable customer schemes	0.1				**0.1**
Non network customer enquiries and complaints	9.2	1.2	1.3	0.1	**10.5**
Meter reading	5.0	0.5	2.3	0.4	**7.3**
Meter maintenance/installation non capex					
Network customer enquiries and complaints	4.2	0.4	0.8	0.1	**5.0**
Disconnections	0.2				**0.2**
Demand side water efficiency initiatives	1.4	0.2	1.3	0.1	**2.7**
Services to developers			0.3	0.4	**0.3**
Support for trade effluent compliance			0.8	0.1	**0.8**
Customer side leaks	2.3	0.5	0.4	0.1	**2.7**
Other direct costs	0.2		0.2		**0.4**
Total direct costs	**119.3**	**7.6**	**21.6**	**2.0**	**140.9**
Operating expenditure					
General and support expenditure	7.6		2.0		**9.6**
Scientific services					
Other business activities					
Total business activities					
Local Authority rates	0.4		0.1		**0.5**
Exceptional items	(6.7)		(1.3)		**(8.0)**
Total operating expenditure	**120.6**		**22.4**		**143.0**
Capital maintenance					
Current cost depreciation	16.0		3.3		**19.3**
Total operating costs	**136.6**		**25.7**		**162.3**

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

3 Operating costs and associated fixed asset book values for year ended 31 March 2012 (continued)

3c Sewerage Services

£m	Sewage collection	Sewage treatment	Sludge treatment	Sludge disposal	Total
Direct costs					
Employment costs	8.4	17.2	5.5	1.0	**32.1**
Power	7.1	26.2	1.8		**35.1**
Hired and contracted services	34.2	26.4	17.2	19.1	**96.9**
Materials and consumables	0.7	9.7	7.6		**18.0**
Service charges	2.1	3.4			**5.5**
Other direct costs	1.8	1.1	0.3		**3.2**
Total direct costs	**54.3**	**84.0**	**32.4**	**20.1**	**190.8**
Operating expenditure					
General and support expenditure	11.0	8.9	3.1	3.6	**26.6**
Scientific services		0.9	0.3		**1.2**
Other business activities	0.4	0.5	0.2	0.1	**1.2**
Total business activities	**0.4**	**1.4**	**0.5**	**0.1**	**2.4**
Local Authority rates		26.0	9.1	1.2	**36.3**
Exceptional items	(4.0)	(8.1)	(2.6)	(0.5)	**(15.2)**
Total opex less third party services	**61.7**	**112.2**	**42.5**	**24.5**	**240.9**
Third party services - opex	1.0	1.7	0.3	0.7	**3.7**
Total operating expenditure	**62.7**	**113.9**	**42.8**	**25.2**	**244.6**
Capital maintenance					
Infrastructure renewals charge (excluding third party services)	51.3				**51.3**
Current cost depreciation	47.0	130.1	32.8	1.5	**211.4**
Amortisation of deferred credits	(6.5)	(0.6)	(0.1)		**(7.2)**
Business activities current cost depreciation	0.1	0.6	0.1	0.2	**1.0**
Total capital maintenance	**91.9**	**130.1**	**32.8**	**1.7**	**256.5**
Total operating costs	**154.6**	**244.0**	**75.6**	**26.9**	**501.1**
Memorandum - included in above					
Reactive and planned maintenance (including opex)					
Reactive and planned maintenance infrastructure	17.3				**17.3**
Reactive and planned maintenance non-infrastructure	6.7	11.7	5.8		**24.2**
	24.0	**11.7**	**5.8**		**41.5**

Summary of operating costs

	Water services	Sewerage Services	Retail	Total
Total operating expenditure	244.9	244.6	143.0	632.5
IRC	78.2	51.3		129.5
Amortisation of deferred credits	(1.9)	(7.2)		(9.1)
Depreciation	152.9	212.4	19.3	384.6
Total operating costs including exceptional item	474.1	501.1	162.3	1,137.5
Exceptional item included in Other operating income, see page 107	16.8	15.2	8.0	40.0
Total operating costs	**490.9**	**516.3**	**170.3**	**1,177.5**

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type as at 31 March 2012

4a Water Services

	Water Resources				Raw Water Distribution				Water Treatment				Treated Water Distribution				
£m	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Total
GROSS REPLACEMENT COST																	
Gross replacement cost at 1 April	520.5	374.2	0.5	**895.2**	797.6	56.1		**853.7**	0.4	2,649.0	1.4	**2,650.8**	10,550.5	1,557.9	0.4	**12,108.8**	**16,508.5**
Reclassification	(4.6)			**(4.6)**	377.1			**377.1**					(372.5)			**(372.5)**	
RPI adjustment	18.4	13.4		**31.8**	41.9	2.0		**43.9**		94.6	0.1	**94.7**	363.3	55.6		**418.9**	**589.3**
Disposals		(4.4)		**(4.4)**		(0.5)		**(0.5)**		(56.9)	(2.4)	**(59.3)**	(48.6)	(54.2)		**(102.8)**	**(167.0)**
Additions		10.0	0.1	**10.1**		0.8		**0.8**	(0.2)	80.8	2.1	**82.7**	25.0	56.3	1.5	**82.8**	**176.4**
Gross replacement cost at 31 March	**534.3**	**393.2**	**0.6**	**928.1**	**1,216.6**	**58.4**		**1,275.0**	**0.2**	**2,767.5**	**1.2**	**2,768.9**	**10,517.7**	**1,615.6**	**1.9**	**12,135.2**	**17,107.2**
DEPRECIATION																	
Depreciation at 1 April		198.9		**198.9**		30.2		**30.2**		1,402.5	0.9	**1,403.4**		698.2		**698.2**	**2,330.7**
RPI adjustment		7.1		**7.1**		1.1		**1.1**		50.1		**50.1**		24.9		**24.9**	**83.2**
Disposals		(4.4)		**(4.4)**		(0.5)		**(0.5)**		(52.6)	(2.4)	**(55.0)**		(54.2)		**(54.2)**	**(114.1)**
Charge for year		14.2		**14.2**		3.2		**3.2**		88.7	1.7	**90.4**		45.1	0.1	**45.2**	**153.0**
Depreciation at 31 March		**215.8**		**215.8**		**34.0**		**34.0**		**1,488.7**	**0.2**	**1,488.9**		**714.0**	**0.1**	**714.1**	**2,452.7**
Net book amount at 31 March 2012	**534.3**	**177.4**	**0.6**	**712.3**	**1,216.6**	**24.4**		**1,241.0**	**0.2**	**1,278.8**	**1.0**	**1,280.0**	**10,517.7**	**901.6**	**1.8**	**11,421.1**	**14,654.5**
Net book amount at 31 March 2011	520.5	175.3	0.5	696.3	797.6	25.9		823.5	0.4	1,246.5	0.5	1,247.4	10,550.5	859.7	0.4	11,410.6	14,177.8

Note: The disposal of £48.6m (2011: £80.2m) of infrastructure assets within Treated water distribution, shown above, relates to the MEA value of the length of main abandoned as a result of the Victorian mains replacement programme. The corresponding entry, shown in note 6 is against the current cost reserve.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type as at 31 March 2012 (continued)

4b Sewerage Services

	Sewage collection				Sewage treatment				Sludge treatment				Sludge disposal				
£m	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Infrastructure	Operational	Other tangible	Total	Total
Gross replacement cost																	
Gross replacement cost at 1 April	53,945.1	2,055.8	9.2	**56,010.1**	2.1	4,696.9	1.7	**4,700.7**	21.9	1,276.0	1.1	**1,299.0**		142.6	1.8	**144.4**	**62,154.2**
AMP adjustment	18,836.7			**18,836.7**													**18,836.7**
Reclassification adjustment					19.1	460.7		**479.8**	(19.1)	(405.3)		**(424.4)**		(55.4)		**(55.4)**	
RPI adjustment	2,598.3	73.4	0.3	**2,672.0**	0.8	184.0	0.1	**184.9**	0.1	31.1		**31.2**		3.1	0.1	**3.2**	**2,891.3**
Disposals		(19.7)	(0.6)	**(20.3)**		(105.4)		**(105.4)**		(30.4)	0.2	**(30.2)**		0.1	(0.2)	**(0.1)**	**(156.0)**
Additions	130.0	76.5		**206.5**	0.1	378.3	1.0	**379.4**		95.8	3.3	**99.1**		10.2		**10.2**	**695.2**
Gross replacement cost at 31 March	**75,510.1**	**2,186.0**	**8.9**	**77,705.0**	**22.1**	**5,614.5**	**2.8**	**5,639.4**	**2.9**	**967.2**	**4.6**	**974.7**		**100.6**	**1.7**	**102.3**	**84,421.4**
Depreciation																	
Depreciation at 1 April		1,186.6	3.0	**1,189.6**		2,777.9	0.2	**2,778.1**		628.4	(0.9)	**627.5**		52.1	1.3	**53.4**	**4,648.6**
Reclassification adjustment						233.6		**233.6**		(201.2)	0.2	**(201.0)**		(32.4)	(0.2)	**(32.6)**	**(0.0)**
RPI adjustment		42.4	0.1	**42.5**		107.5		**107.5**		15.3		**15.3**		0.7		**0.7**	**166.0**
Disposals		(19.7)	(0.5)	**(20.2)**		(105.4)		**(105.4)**		(30.4)	0.1	**(30.3)**		0.1	(0.2)	**(0.1)**	**(156.0)**
Charge for year		46.6	0.6	**47.2**		130.2	0.4	**130.6**		32.4	0.5	**32.9**		1.5	0.2	**1.7**	**212.4**
Depreciation at 31 March		**1,255.9**	**3.2**	**1,259.1**		**3,143.8**	**0.6**	**3,144.4**		**444.5**	**(0.1)**	**444.4**		**22.0**	**1.1**	**23.1**	**4,871.0**
Net book amount at 31 March 2012	**75,510.1**	**930.1**	**5.7**	**76,445.9**	**22.1**	**2,470.7**	**2.2**	**2,495.0**	**2.9**	**522.7**	**4.7**	**530.3**		**78.6**	**0.6**	**79.2**	**79,550.4**
Net book amount at 31 March 2011	53,945.1	869.2	6.2	54,820.5	2.1	1,919.0	1.5	1,922.6	21.9	647.6	2.0	671.5		90.5	0.5	91.0	57,505.6

The AMP adjustment of £18.8bn relates to the adoption of private sewers and lateral drains on 1 October 2011 and represents the current cost value of these assets as at 31 March 2011 prices. See “Adoption of private sewers and lateral drains” within note 1, page 111.

Regulatory accounts and required regulatory information (continued)

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

4 Current cost analysis of fixed assets by asset type at 31 March 2012 (continued)

4c Retail

	Household				Non-household					
£m	**Infrastructure**	**Operational**	**Other tangible**	**Total**	**Infrastructure**	**Operational**	**Other tangible**	**Total**	**Total**	**Grand Total**
Gross replacement cost										
Gross replacement cost at 1 April		255.7	18.1	**273.8**		52.4	3.7	**56.1**	**329.9**	**78,992.6**
AMP adjustment										**18,836.7**
RPI adjustment		9.2	0.6	**9.8**		1.9	0.1	**2.0**	**11.8**	**3,492.4**
Disposals		(11.0)	(0.3)	**(11.3)**		(2.2)	(0.1)	**(2.3)**	**(13.6)**	**(336.6)**
Additions		37.3		**37.3**		7.6		**7.6**	**44.9**	**916.5**
Gross replacement cost at 31 March		**291.2**	**18.4**	**309.6**		**59.7**	**3.7**	**63.4**	**373.0**	**101,901.6**
Depreciation										
Depreciation at 1 April		195.5	1.9	**197.4**		40.0	0.4	**40.4**	**237.8**	**7,217.1**
RPI adjustment		7.0	0.1	**7.1**		1.4		**1.4**	**8.5**	**257.6**
Disposals		(11.0)	(0.3)	**(11.3)**		(2.2)	(0.1)	**(2.3)**	**(13.6)**	**(283.7)**
Charge for year		15.9	0.0	**15.9**		3.3		**3.3**	**19.2**	**384.6**
Depreciation at 31 March		**207.4**	**1.7**	**209.1**		**42.5**	**0.3**	**42.8**	**251.9**	**7,575.6**
Net book amount at 31 March 2012		**83.8**	**16.7**	**100.5**		**17.2**	**3.4**	**20.6**	**121.1**	**94,326.0**
Net book amount at 31 March 2011		60.2	16.2	76.4		12.3	3.3	15.6	**92.0**	**71,775.3**

Grand total represents the total of Water Services, Sewerage Services and Retail.

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Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

5 Current cost working capital

	31 March 2012 £m	31 March 2011 £m
Stocks	**9.6**	8.2
Trade debtors:		
- Measured household	**77.0**	78.7
- Unmeasured household	**115.2**	121.1
- Measured non-household	**39.9**	46.0
- Unmeasured non-household	**1.7**	1.9
- Other	**21.0**	19.9
Measured income accrual	**146.7**	136.1
Prepayments and other debtors	**39.3**	34.1
Trade creditors	**(280.7)**	(254.4)
Deferred income – customer advance receipts	**(87.8)**	(86.4)
Capital creditors	**(243.0)**	(332.3)
Accruals and other creditors	**(178.6)**	(191.8)
Total working capital	**(339.7)**	(418.9)

6 Movement on current cost reserve

	31 March 2012 £m	31 March 2011 £m
Balance at 1 April	**63,916.5**	44,110.5
RPI adjustments:		
- Fixed assets *	**3,234.8**	3,619.1
- Working capital	**(20.1)**	(13.0)
- Financing	**(41.0)**	(119.2)
- Grant and third party contributions *	**(710.3)**	(49.2)
- Mains replacement adjustment (see note 4a)	**(48.6)**	(80.2)
- AMP adjustment **	**-**	16,448.5
- Other	**1.6**	-
Balance at 31 March	**66,332.9**	63,916.5

* RPI adjustments for fixed assets include £672.5m relating to the adoption of private sewers and lateral drains on 1 October 2011, with a similar value shown within Grants and third party contributions.

** Please see “Review of asset valuations” on page 111 for details of the AMP adjustment made in the prior period.

Notes to the regulatory current cost financial statements for the year ended 31 March (continued)

7 Net debt analysis

March 2012:

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Maturity profile				
Less than one year	(285.3)	(241.2)	-	(526.5)
Between one and two years	(17.9)	(10.2)	-	(28.1)
Between two and five years	(675.1)	(139.4)	-	(814.5)
Between five and twenty years	(2,375.2)	(157.5)	(1,190.7)	(3,723.4)
In more than twenty years	(344.4)	100.0	(3,060.7)	(3,305.1)
Total borrowings	(3,697.9)	(448.3)	(4,251.4)	(8,397.6)
Cash	2.7	-	-	2.7
Short term deposits	619.4	-	-	619.4
Net debt	**(3,075.8)**	**(448.3)**	**(4,251.4)**	**(7,775.5)**

All values in the above tables are post cross currency rate swaps, interest rate swaps and index-linked swaps.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March

Regulatory Capital Value (RCV)

	2012 £m
Opening RCV (March 2011 prices)	8,849
Indexation to year end (March 2012 prices)	316
Opening RCV at year end prices	9,165
Capital expenditure (excluding infrastructure renewals expenditure)	1,293
Infrastructure renewals expenditure	180
Grants and contributions	(27)
Depreciation	(408)
Infrastructure renewals charge	(148)
Out performance of past regulatory assumptions	(50)
Closing RCV (March 2012 prices)	**10,005**
Average RCV (2011/2012 year average prices)	**9,447**

The figures quoted reflect those used by Ofwat at the 2009 Periodic Review to set prices for 2011/2012, as confirmed by Ofwat in their RCV update on 18 April 2012. All costs have been indexed to March 2012 prices (RPI index) except for the average RCV, which is shown at year average prices (RPI index) in accordance with Ofwat's convention.

Differences between the figures shown above and actual costs/income will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation at the next price review through operation of the Capital Incentive Scheme.

RAG 5 Intra-group trade

During the year there were no contracts in excess of 0.5% (£8.4m) of the Company's turnover with any subsidiary of the Thames Water group of companies.

Dividends paid to associated undertakings

During the year, the Company paid interim dividends totalling £279.5m (2011: £271.4m) to Thames Water Utilities Holdings Limited. Full disclosure of these dividends are provided in note 9 on page 80 of the statutory section of these financial statements

Transfer of assets by of to the appointee

There was no transfer of assets or liabilities by or to the Company in excess of the materiality limit (2011: £nil).

Supplementary regulatory information for the year ended 31 March (continued)

Borrowings and sums lent

All borrowings from the Company's wholly owned subsidiaries are as follows for the year ended 31 March 2012:

Instrument	Amount borrowed	Total book value *
Thames Water Utilities Cayman Limited		
€500m 6.13% Fixed rate bond due 2013.	417.1	417.1
$156m 3 month US$ libor + 0.95% floating rate bond due 2015.	97.4	97.4
€500m 3.25% Fixed rate bond due 2016.	417.1	417.1
£400m 7.24% Fixed rate bond due 2018.	400.0	398.5
$150m USPP Fixed rate bond due 2019.	93.7	93.7
£75m 1.35% Index linked bond due 2021.		
€113m 2.30% CPI index linked bond due 2022.	94.3	94.7
$150m USPP Fixed rate bond due 2022.	93.7	93.7
$200m USPP Fixed rate bond due 2024.	124.9	124.9
£550m 5.38% Fixed rate bond due 2025.	550.0	546.2
$250m USPP Fixed rate bond due 2027.	156.1	156.1
£300m 5.75% Fixed rate bond due 2030.	300.0	296.6
20bn Yen 3.28% Fixed rate bond due 2038.	152.0	152.0
£50m 3.85% Index linked bond due 2040.	50.0	55.0
£500m 5.5% Fixed rate bond due 2041.	500.0	488.6
£50m 1.98% Index linked bond due 2042.	50.0	57.7
£55m 2.09% Index linked bond due 2042.	55.0	61.3
£40m 1.97% Index linked bond due 2045.	40.0	42.5
£100m 1.85% Index linked bond due 2047.	100.0	115.5
£200m 1.82% Index linked bond due 2049.	200.0	230.4
£200m 1.77% Index linked bond due 2057.	200.0	230.4
£350m 1.76% Index linked bond due 2062.	350.0	403.2
Total	**4,441.3**	**4,572.6**
Thames Water Finance Limited		
£200m 4.90% Fixed rate bond due 2015.	200.0	200.0
£200m 5.05% Fixed rate bond due 2020.	200.0	200.0
£175m 3.38% Index linked bond due 2021.	175.0	236.1
£225m 6.59% Fixed rate bond due 2021.	225.0	225.0
£330m 6.75% Fixed rate bond due 2028.	330.0	327.8
£200m 6.50% Fixed rate bond due 2032.	200.0	198.0
£600m 5.13% Fixed rate bond due 2037.	600.0	596.4
£300m 1.68% Index linked bond due 2053.	300.0	364.8
£300m 1.68% Index linked bond due 2055.	300.0	364.8
Total	**2,530.0**	**2,712.9**
Grand total	**6,971.3**	**7,285.5**

* Total book value includes interest accretion of index linked bonds and unamortized bond fees.

See page 84 for analysis of the above amounts owed to group undertakings within one year and after more than one year.

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

TWUCL and TWUFL lend the proceeds of the external borrowings on to the Company, net of derivatives of £71.4m. Under these arrangements the Company owes TWUCL £4,623.0m and TWUFL £2,747.2m.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March (continued)

RAG 5 Directors' interests information

Listed below are details of directorships held by Thames Water Utilities Limited directors at 31 March 2012 in associated companies that have traded with the regulated business during the year.

Directorships held in Associated Companies

The following directors held directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
L F Abraira	4 August 2011	19 January 2012
E Beckley		
R Blomfield-Smith		21 November 2011
C R Deacon		
S R Eaves	20 January 2012	
G I W Parsons		
A F C DeP Santos		4 August 2011
D J Shah OBE		
Y Shi	19 January 2012	
M S W Stanley		
R Verrion		
L Webb	21 November 2011	

The following directors have formally appointed alternate directors to represent them when they are unavailable. These alternate directors also held alternate directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
S R Eaves	20 January 2012		M C Hill	20 January 2012	
G I W Parsons			E Beckley	11 November 2011	
A F C DeP Santos		4 August 2011	M C Guerreiro		4 August 2011
D J Shah OBE			L Webb		21 November 2011
			K Roseke	31 January 2012	
Y Shi	19 January 2012		F Sheng	29 February 2012	
R Verrion			S Kolenc		
L Webb	21 November 2011		C Pham	21 November 2011	

Thames Water Utilities Limited conducts its appointed business so as to ensure arm's length trading and avoidance of cross-subsidy in the spirit of Condition F of the Instrument of Appointment.

No directorships are held by Thames Water Utilities Limited directors in circumstances, which might in practice, result in conflicts of interest in intra-group trading relationships.

Supplementary regulatory information for the year ended 31 March (continued)

Directors' Certificate under Condition F6A of the Company's Appointment

This is to certify that at their meeting on 7 June 2012 the directors of Thames Water Utilities Limited ("the Appointee") resolved as follows:

- That, in the opinion of the directors', the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment(s)).

- That, in the opinion of the directors, the Appointee will, for at least the next 12 months, have available to it:

  (a) Management resources.
  (b) Systems of planning and internal control.

  Which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1(1).

- That, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

The main factors the directors have taken into account in issuing the Directors' Certificate under condition F6A of the Company's appointment are:

- That the processes and systems of internal control operated as expected.

- That the Appointee operated as if it was substantially the Appointee's sole business and that the Appointee was a separate public limited company.

- That financial resources and facilities are adequate to enable the Appointee to meet its regulatory obligations.

- The net worth of the Company and the strength of the Company's key performance indicators as shown on page 8 of the Chief Executive Officer's Business review.

- The strong investment grade ratings as shown on page 10 of the Chief Executive Officer's Business review.

- Borrowing facilities, which include significant undrawn bank facilities.

- The outcome of the 2009 regulatory price review for the five year period to 31 March 2015 and its impact on the appointee's business plans.

S Siddall
Chief Financial Officer
7 June 2012

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited

We have audited the Regulatory Accounts of Thames Water Utilities Limited for the year ended 31 March 2012 on pages 99 to 125 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; 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 to the current cost financial statements, 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 sewerage undertaker under the Water Industry Act 1991. 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 37, 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 and the Directors of Thames Water Utilities 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 104 to 105 and 111 to 113, the state of the Company's affairs at 31 March 2012 on an historical cost and current cost basis, and its historical cost and current cost profit and its 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 of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Financial information other than that prepared on the basis of UK GAAP 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 pages 100 and 101 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 102.

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 and the Directors of Thames Water Utilities 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 WSRA'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 2012 on which we report, 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.

KPMG Audit Plc
Chartered Accountants
London
7 June 2012

Notes:

1. The maintenance and integrity of the Company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions

Thames Water Utilities Limited

Glossary of regulatory terms

AMP adjustment – The revision in the real value of fixed assets arising periodically from improved information in the five-year Asset Management Plan process.

Appointed Business – The appointed business comprises the regulated activities of the Company which are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading – Trading in which the Company treats the other party, usually an associate company on the same basis as an external party.

Asset Management Plan (AMP) – A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP4 covers the investment period April 2005 to March 2010 AMP5 covers the investment period April 2010 to March 2015.

Associate company – Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the Company and its associated companies to be disclosed subject to specified materiality considerations.

Capital Incentive Scheme ("CIS") – This will be the new capital expenditure incentive mechanism introduced by Ofwat to take effect in AMP 5. Under this mechanism Ofwat sets a baseline capital expenditure plan, which they believe companies should be able to deliver. Companies are rewarded or penalised during the AMP 5 for submitting a business plan, which is lower or higher than the baseline respectively. Companies will then be further rewarded or penalised at the start of AMP 6 for underspending or overspending against that business plan.

CIS will apply to capital expenditure only, not to operational expenditure and will not apply to large projects such as the Lee Tunnel.

Final determination – The conclusion of discussions on the scale and content of the asset management plan for the forthcoming five-year AMP period. It is accompanied by a determination of the allowable K factor for the forthcoming AMP.

Financing adjustment – The impact of RPI on the real value of net finance for the business.

K factor – The annual increase, set by Ofwat, in charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula RPI + or – 'K' + 'U'. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers and 'U' is the amount of 'K' not taken up by a company in previous years.

Licence – The Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Thames Water Utilities Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Glossary of regulatory terms (continued)

Modern Equivalent Asset (MEA) – The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing, or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up to date new asset with the same service capability allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset, and is stated gross of third-party contributions.

Non-appointed business – The non-appointed business activities of the Company are activities for which the Company as a water and sewerage undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the Company (for example, the use of underground assets for cable television).

Ofwat – The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic Regulator of the water industry.

Periodic Review (PR) – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits an Asset Management Plan covering the five-year period for which Ofwat will determine prices (the K factor – see above).

Price limit – The name given to the combination of the RPI and K.

Regulatory Accounting Guidelines (RAG) – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (RCV) – The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Retail Price Index (RPI) – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (SIM) – Ofwat's measure of customer satisfaction based on surveys of customers who have contacted the Company and the number of contacts received which express dissatisfaction.

Third-party contributions since 1989/90 – Grants and third-party contributions received in respect of infrastructure assets and any deferred income relating to grants and third-party contributions for non-infrastructure assets.

Working capital – The aggregate of stocks, trade debtors and trade creditors, if material.

Working capital adjustment – The impact of RPI on the real value of working capital to the business.

Thames Water Utilities Limited

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