Regulatory accounts 2009

southwestwater.co.uk

SOUTH WEST WATER

REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2009

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

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

REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2009

CONTENTS

Page No	
3	Directors, Registered Office and Auditors
4	Operating & Financial Review
22	Directors' Responsibility Statement
23	Directors' Certificates to the Water Services Regulation Authority
24	Independent Auditors' Report
27	Historical cost financial statements and accompanying notes
66	Reconciliation between Statutory (IFRS) Accounts and Historical Cost Regulatory Accounts
69	Current cost financial statements for the appointed business and accompanying notes
82	Additional information required under Condition F of the Company's licence

DIRECTORS, REGISTERED OFFICE AND AUDITORS

Chairman	K G Harvey
Chief Executive	C Loughlin
Operations Director	S C Bird
Finance Director	S J Davy
Customer Service Director	M S Read
Secretary	K D Woodier
Registered Office	Peninsula House Rydon Lane Exeter EX2 7HR
Auditors	PricewaterhouseCoopers LLP Chartered Accountants 31 Great George Street Bristol BS1 5QD

OPERATING AND FINANCIAL REVIEW

Against an uncertain global economic background, South West Water has had a strong performance this year, improving customer service, delivering further operational efficiency and a sound financial performance.

South West Water has made excellent progress by:

- improving service to customers, tackling affordability issues and levels of customer debt
- completing required investment in our assets and infrastructure for the benefit of our customers and the environment
- delivering further operating efficiencies
- ensuring there is efficient financing in place secured into the next 2010-2015 regulatory period.

BUSINESS AND STRATEGY

South West Water is the licensed water and sewerage service provider for Devon, Cornwall and parts of Dorset and Somerset. The company serves a region of nearly 10,300 square kilometres with 1.65 million residents and in excess of 10 million annual visitors. It distributes over 440 Megalitres (Ml) of treated water each day and disposes of around 250 Ml of waste water each day through an asset base comprising:

Distribution mains	15,041 km
Sewers	9,221 km
Impounding reservoirs	15
Water treatment works	40
Waste water treatment works	633
- including 54 works with ultra violet treatment and three with membrane filtration	
Intermittent discharges	1,686
- including 1,041 combined sewer overflows	

Since privatisation in 1989 the company has successfully delivered the largest capital programme per capita of any of the privatised water and sewerage companies with an initial focus on improving coastal waste water treatment and disposal. The region currently has 144 EU designated bathing waters, almost one third of the total in England and Wales, and 132 of these have been improved over the last 18 years from the company's marine investment programme. The emphasis has now moved to completing a 15-year programme of improving the quality of drinking water and to providing better customer service.

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

In the current regulatory period Ofwat assumed that the equity cost of capital for all companies would be 7.7% real after tax with an overall weighted average cost of capital of 5.1% real after tax.

South West Water has a clear 25 year vision 'Pure Water, Pure Service and Pure Environment', which was at the heart of our Strategic Direction Statement published in December 2007. Underpinning the vision is the strategy of striking the right balance between investing to improve our services, financeability and, importantly, customer affordability.

OPERATING AND FINANCIAL REVIEW (continued)

The vision defines the following aspirations for South West Water:

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

It is now over a year since the company's vision was launched. The vision and strategy have been used to focus delivery in what has been the penultimate year in this regulatory cycle 2005-2010 and as the basis for our detailed plans which have been developed for the next five-year cycle 2010-2015.

Significant preparation has been undertaken this financial year ahead of the Price Determination due in November 2009 by Ofwat for the 2010-2015 regulatory period:

- in August 2008 we submitted our draft business plan detailing targeted improvements to customer services, and a modest number of water and environmental quality projects.
- in April 2009, following the feedback from the public consultation on our draft plan and a comprehensive review of our proposals, we submitted our Final Business Plan to Ofwat.

Given the current economic conditions, our strategy of striking the right balance is key; our plans are mindful of the impact further investment in our assets has on the level of bills when customers are least able to afford higher charges. We have also ensured that overall funding requirements are minimised at a time when the cost of new financing is expected to be at a premium. We have targeted our plan to reflect customer priorities, whilst challenging ourselves to deliver increased efficiencies.

REGULATORY & COMPETITIVE ENVIRONMENT

COMPETITION

Customers using more than 50Ml of water per year can contract with alternative suppliers for water supply. South West Water has 45 customers in this category, whose aggregate water charges account for approximately 2.5% of its total revenue. No single customer accounts for more than 1% of revenue.

Legislation will be required for any further extension of competition in the water and sewerage markets. In May 2008 Ofwat published the second part of its review of competition which set out its recommendations for reform of the competition framework, looking beyond the assumptions of the existing Water Supply Licensing regime. Those recommendations included the establishment of water companies' retail service businesses as separate legal entities and the extension of competition to household customers.

During the year Ofwat also published two consultation documents on accounting separation, a project designed to lead to a better understanding of costs in the water sector with the aim of developing future competitive frameworks. Ofwat state that it would like to be able to introduce vertically separated price controls by the time it begins to set price limits for the period after 2015. The company has worked with Ofwat as part of a pilot group of water and sewerage companies to explore the development of these ideas.

The Government's independent review of competition and innovation in the water industry led by Professor Martin Cave published its final recommendations in April 2009. The Government welcomed the review's findings on competition and innovation and recommendations supported by the Government will be included in the Flood and Water Management Bill before Parliament. South West Water is assessing the review's recommendations, and proposed legislation to implement the recommendations supported by the Government is awaited.

OPERATING AND FINANCIAL REVIEW (continued)

The review into fairer water charges, commissioned by Defra, known as the Walker Review, is expected to be concluded later in the year. The company hosted a consultation event in Plymouth in December 2008 for the review team attended by stakeholders including MPs, business and domestic customers and representatives from Ofwat and the Consumer Council for Water. The chairman of the Walker Review took the opportunity to meet a customer who has benefited from the 'WaterCare' scheme and to see how it operates.

PRICE CAP REGULATION

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

The 'K' factors for the period 2005 to 2010 for South West Water were determined by Ofwat in its Final Determination in December 2004 and are:

Year	'K' factor %
2005/06	12.5
2006/07	9.8
2007/08	9.8
2008/09	1.7
2009/10	1.4
Average	6.9

In setting price limits for South West Water, Ofwat assumed the following annual efficiency improvements:

	Operating Costs	Capital Maintenance	Capital Enhancements
Water	2.5%	5.0%	5.0%
Sewerage	2.0%	8.7%	16.4%

The 2004 Final Determination provided for total capital expenditure of £762 million (2002/03 prices) over the five year period. Good progress has been made against the required customer service, infrastructure and financial outputs at 31 March 2009, including:

Activity	**2005-2010**	**Status at 31 March 2009**
Adequacy of water resources	Security of Supply Index to be maintained at 100	Security of Supply Index was 97. No water restrictions for 12th year
Leakage control based on three year rolling average	Maintain at 84 megalitres per day (Ml/d)	84Ml/d achieved
Asset condition above ground	Maintain stable	Stable
Asset condition below ground	Maintain stable	Stable
Meet Drinking Water Inspectorate milestones for water mains rehabilitation	Complete five milestone packages of improvements	Four milestones met, fifth progressing to plan
Continuous discharges dealt with	Complete 95 schemes by 31 March 2010	Completed 83
Improvements to intermittent sewage overflows	Complete 113 schemes by 31 March 2010	Completed 111

OPERATING AND FINANCIAL REVIEW (continued)

PERIODIC REVIEW 2009

Following submission of South West Water's Draft Business Plan in August 2008, the company's Final Business Plan was completed and provided to Ofwat on 3 April 2009. Summary information on the final plan is available on the company's website southwestwater.co.uk.

Key dates for the current Periodic Review are:

Date	Activity
April 2008	Ofwat published information requirements
April 2008 - May 2008	Companies' draft water resources plans published for consultation
August 2008	Companies submitted and published draft business plans
August 2008 - January 2009	Public consultation on draft business plans
December 2008	Ofwat published draft baseline, outputs package and 'menu'
January 2009	Ofwat issued final business plan reporting requirements
April 2009	Companies submitted and published final business plans
23 July 2009	Ofwat publish Draft Determinations for comments
July - August 2009	Companies publish final water resources plans
26 November 2009	Ofwat publish Final Determinations
January 2010	Decisions made by companies to accept Determinations or seek Competition Commission referral
1 April 2010	New price limits take effect for period 2010 to 2015

LEGISLATIVE DRIVERS

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

The Water Framework Directive was incorporated into UK law in 2003. It provides a framework for the protection of and improvement in the quality of water resources, together with the promotion of sustainable water consumption. To comply with the Water Framework Directive, EU member states will have to achieve the challenging target of 'good status' for groundwater, rivers, estuarine waters and coastal waters, in three six-year cycles, the first running from 2009 to 2015. The Draft River Basin Management Plan, published by the Environment Agency in December 2008, confirms that the plan's implications are unlikely to be significant for South West Water's assets at least until 2015, following the successful delivery of a wide range of river, estuarine and coastal water environmental improvements by the company since 1989.

Further significant legislative developments are expected for the water industry following publication of the Floods and Water Management Bill in April 2009. Many of the proposed legislative changes are to implement the recommendations of the Pitt Report which was commissioned after the severe UK flooding in summer 2007.

OPERATING AND FINANCIAL REVIEW (continued)

CLIMATE CHANGE

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

The company's final Water Resources Plan for the next 25 years is due to be published this summer following receipt of Defra's approval. It will include the latest information on rainfall and temperature alterations and allowance for demand changes associated with climate change. Predictive models are in place to address uncertainty. Infrastructure developments have been identified, the timing of which can be adjusted if the expected rate of climate change alters. Increasing efficient and careful use of water plays a major part in adapting to the expected effects.

KEY PERFORMANCE INDICATORS (KPI's)

Key Performance Indicators – Pure Water

Drinking Water Compliance

Drinking water quality overall compliance for the calendar year 2008, as monitored by the Drinking Water Inspectorate (DWI), maintained a consistently high percentage of 99.96%.

Abstraction, Supply and Leakage Control

In 2008/9, South West Water abstracted 163,792 Megalitres (Ml) of raw water from its 82 licensed abstraction locations which have a total licensed volume of 388,366 Ml. The abstraction sources are reservoirs and rivers, accounting for 93% of supplies, with 7% drawn from groundwater aquifers. The company's Security of Supply Index value was 97 at 31 March 2009 (2008 99)

Key Performance Indicators – Pure Service

Overall Performance Assessment

The Overall Performance Assessment (OPA) index is maintained by Ofwat as a comparative tool to measure companies' performance. The OPA is based on performance in areas such as customer service and complaint handling, billing, debt collection, asset serviceability, environmental compliance and quality of drinking water delivered. In 2007/08 South West Water's performance dipped to seventh place amongst the 10 water and sewerage companies (fifth in 2006/07).

Customer Satisfaction Call Handling

In April 2005, Ofwat introduced a new measure for the overall manner in which a customer call was handled. The measure is obtained by quarterly tracking surveys undertaken by an independent company engaged and managed by Ofwat. The data has been averaged for the year to assess a performance trend. For 2008/09 the satisfaction score was 4.5 (2008 4.5). The maximum score is 5.0.

OPERATING AND FINANCIAL REVIEW (continued)

Key Performance Indicators – Pure Environment

The Company recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by its activities. The Company is subject to significant regulation and must comply with the high standards set by the Environment Agency. The Pennon Group has a long established environmental policy, as set out in its annual Corporate Responsibility Report, which does not form part of this Report.

Waste Water Treatment Compliance

The percentage of population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2008 was 99.54% (99.73% in 2007). This performance contributes to South West Water's region having the highest percentage length of high quality rivers in England.

Incidents and Prosecutions

There were no Category 1 incidents for the 10th year in succession. Three Category 2 (significant pollution) events and 64 Category 3 events were recorded by the Environment Agency in 2008 which were deemed non-compliant with discharge consents. This compares with four Category 2 and 114 Category 3 incidents in 2007. The total number of pollution incidents in 2008 was 92 (2007 166).

During the year the company was convicted on four occasions for environmental offences and fined a total of £28,000 (2007/08: eight convictions and £36,100 in fines).

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

Bathing Water Performance

Compliance with the mandatory EU bathing water standard was 93.1%, a marked contrast to a decade ago when compliance was only 47.5%. Although lower than the 2007 result of 97.9%, in the summer of 2008 the South West had in excess of 150% more rainfall than normal. During May to September (the bathing water season) the region also had more rain than anywhere else in England and Wales with the wet weather washing agricultural and other surface water pollutants into the sea. The Environment Agency has confirmed that none of the bathing water failures was attributed to South West Water's operations. In 2008, all but 10 of the region's 144 bathing waters achieved the EU mandatory standard and 72.2% achieved the more stringent EU Guideline standard (78.3% in 2007).

Key Performance Indicators – Financial and Business

Growth in Regulatory Capital Value (RCV)

Regulatory Capital Value (RCV) is the financial base used by Ofwat to allow a rate of return and set prices at each Periodic Review. The RCV at 31 March 2009 amounted to £2.461 billion. This compares with £2.408 billion at 31 March 2008, an increase of 2.2%. This is a lower growth than the previous year because of the movement in year-end RPI being minus 0.4% in 2008/09 compared with positive 3.8% in 2007/08. From 31 March 2005 to 31 March 2010 the company is expecting a 25.7% growth in RCV, the highest percentage increase of any quoted UK water company. Lower values for RPI, the movement on which is one of the elements of the annual uplift in RCV, have led to lower expected growth than that reported last year. The RCV is £78m lower than the estimate made at this time last year because of the year end RPI falling to minus 0.4%

OPERATING AND FINANCIAL REVIEW (continued)

Net debt increased by £115.9m to £1,571.1m, with the gearing ratio in relation to year-end RCV of £2,461m moving to 63.8% from 60.4%.

The RCV for 2009/10 is based upon Ofwat's projections. It was set out in 'Future Water and Sewerage Charges 2005-10' published in December 2004 and has been adjusted by South West Water's estimates of outturn prices. The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by the water regulator.

Operating Profit

South West Water achieved an operating profit (on a UK GAAP regulatory basis, before restructuring costs of £5.0m) of £188.3m in 2008/9, up £7.2m from 2007/08.

Key Performance Indicators – Health and Safety Performance

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

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

The total number of accidents has remained stable during the last three years with an average of 113 per annum. An more rigorous system of accident and incident reporting was introduced in 2008. It shows an increase in incidents which it is believed reflects better reporting compared with previous years and a new arrangement whereby all potential reportable dangerous occurrences are provided to the Health and Safety Executive's Reporting Line for advice whenever there is an doubt over classifying an incident as reportable under RIDDOR. Data for 2007 and earlier years has been provided on the previous method of recording, consistent with South West Water's previous June Returns.

CORPORATE RESPONSIBILITY/RELATIONSHIPS

Governance and Internal Control

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

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

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

OPERATING AND FINANCIAL REVIEW (continued)

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

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

Customer, Community and Employees

Customers

Customers are benefiting from our focused approach to customer service. There has been an increase in first-time resolution of operational issues for customers. This has led to a reduction in the number of customer complaints received.

With the current adverse economic conditions, South West Water has further developed its range of measures to assist those customers with affordability issues:

- 'WaterCare', a ground-breaking new customer care programme, was launched early in 2007 targeted at helping those most in need to pay their bills. Customers are advised on how to manage better both their water use and household budget, including claiming all the benefits to which they are entitled. Some customers benefit from moving on to a special payment plan which enables them to make regular affordable payments, thereby reducing the company's outstanding debt. In 2008/09 the number of customers receiving tangible benefits through the programme has doubled. Since the start of the programme a total of 4,548 customers have been helped with benefit entitlement checks, tariff advice and water-saving measures

- an innovative water tariff trial was approved by Ofwat at the beginning of 2009. The tariff, being trialled with a random sample of 1,000 customers, will incentivise customers to use less water by pricing water for essential use 27% lower than the standard tariff and for non-essential at a premium rate. This will enable customers who conserve their water to make savings on their annual bills. We will review the data obtained at the end of the three-year trial period.

South West Water has consulted with customers about its priorities for 2010-2015 and has used their feedback for the development of its customer service improvement plans.

The company leads the industry in the provision of priority services to vulnerable customers and has helped thousands of customers in 2008/09 with reading their meter or by providing extra help in an emergency.

Customers are kept informed about our services through 'WaterLevel', our company newspaper, leaflets, the media and our website www.southwestwater.co.uk. Detailed research and consultation has been undertaken with customers and stakeholders in relation to the Periodic Review process.

OPERATING AND FINANCIAL REVIEW (continued)

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

South West Water's 'Customer Plus' programme is aimed at transforming its customer service and making it amongst the best in the industry. Working with Accenture (South West Water's customer service and billing partner) the company is investing £4 million in improving customer services. The company's monthly customer satisfaction survey shows rising satisfaction with South West Water's customer service.

Accenture has made significant steps in transforming billing and contact management in its first year with new systems and processes which include scanning and electronic processing of all incoming customer mail; workflow management; bill production with a specialist subcontractor; and implementing improved reporting, quality management and audit.

Against this background of significant change, service levels have been maintained making for a successful first year and delivering a sound basis for improvements in the future.

The company continues to promote the efficient use of water with advice and practical support for householders and non-domestic customers. As part of the 'WaterCare' programme and to investigate customers' high water consumption queries, 3,088 audits were completed in 2008/09.

South West Water continues to support business customers through water efficiency reviews, waste minimisation projects, providing advice for water management plans and by highlighting opportunities for reduction, re-use or alternative sources of supply.

Business customers continue to have access to a secure online system which tracks and displays consumption on their sites. South West Water's 'Business Accounts Online' also offers a water efficiency calculator with a free water audit. Since the launch of the calculator tool in November 2007, 182 businesses with over 6,200 accounts have registered to use the water efficiency element of the service.

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

Community and Sponsorship

South West Water concentrates its sponsorship on community projects and organisations within its service area which are linked to water, benefit the environment or promote youth participation.

Highlights in 2008/09 included the company's sponsorship of the Falmouth Tall Ships Regatta which included South West Water running a competition for young customers enabling five 16 to 18-year-olds win a trip of a lifetime on board one of the tall ships racing to Porto.

For the second year the company also co-sponsored South West Tourism's annual awards and funded the sustainable tourism prize to demonstrate how its 'Clean Sweep' project has helped underpin the renaissance of the region's number one industry since 1989. This proved particularly successful when the winner of the award went on to win first place at national level.

Youth participation projects included sponsoring national junior championships in Cornwall run by the Surf Life Saving Association of Great Britain and the Plymouth-based Drake Trust. The company is proud to continue to support the water industry charity, WaterAid, through sponsorship and many other fund-raising activities. In total, 45 organisations and individuals across the region were sponsored during the year.

OPERATING AND FINANCIAL REVIEW (continued)

Employees

The average number of employees during the year was 1,227 compared to 1,276 last year. Details of the related costs can be found in note 8 to the financial statements.

South West Water has developed a clear and coherent strategy concentrating on recruitment, and the development and performance of its employees. The strategy is aimed at supporting the company's 'Pure vision' values enabling the delivery of a high quality service to customers and achievement of operational outputs and cost efficiencies through its employees.

Continuity of the business is vital to its future success and the focus on management and graduate development programmes continues to provide employees with opportunities to develop their managerial and organisational skills. A range of other learning programmes support the development of customer, technical and operational skills.

We achieved the 'Investor in People' (IIP) Silver Status, which represents the achievement of a high standard in IIP evidence requirements, in March 2009 as part of our IIP reaccreditation, valid for a period of three years. Particular areas of strength include the company's approach to leadership and succession planning; the production of a new corporate values which employees understand and to which they can relate.

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

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

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

OPERATING AND FINANCIAL REVIEW (continued)

Key Relationships

Regulators and Others

Relationships with regulators, Government and its agencies, customer representative organisations and its customers are central to South West Water's operations. The Company maintains a continuing dialogue with Ofwat, the Environment Agency and the Drinking Water Inspectorate. It contributes to national policy on developing issues through its membership of Water UK, the industry trade body. The company works with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the company's activities is maintained.

Procurement and Suppliers

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

The company is also in the process of setting up a new 'Alliance' structure for delivery of its 2010 - 2015 capital programme. This will enable the company to work closely with suppliers, particularly small and medium-sized businesses across the South West, ensuring value-for-money for customers and supporting the regional economy.

No supplier (revenue) accounts for more than 4% of the turnover and South West Water sources all its purchases from competitive markets.

PRINCIPAL RISKS AND UNCERTAINTIES

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

Risk	Mitigation
Tighter price controls over the revenue of the company's regulated	South West Water has met Ofwat's efficiency expectations in the last two Periodic Review periods and is on track to meet them in the current period.
Failure to deliver the capital investment programme	The company has a track record of delivering its capital programme in accordance with regulatory requirements. The current capital programme is on track and progress is regularly monitored and reviewed.
The company may be unable to raise sufficient funds to finance its functions	Pennon Group and the company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year.
Failure to deliver operating cost savings implicit in the regulatory review	In line with its track record, the company remains confident of delivering the assumed operating cost savings. A major restructuring programme is currently being implemented.

OPERATING AND FINANCIAL REVIEW (continued)

Risk	Mitigation
Environmental regulations and quality standards could increase the company's costs	These issues are addressed through the five year regulatory review mechanism.
Climate change	The company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters which are anticipated.
Contamination to water supplies	The Company has established procedures and controls in place, as well as contingency plans and incident management procedures. It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.
Non-recovery of customer debt	In addition to existing strategies, South West Water has implemented new initiatives to improve and secure cash collection, including the use of property charging orders. Stretching debt and collection targets – with incentives – have been agreed with the customer service contractor. The accounts of major customers are kept under close review. Provision was made in the last Periodic Review for companies to make an application for an Interim Determination in the event of bad debts being significantly above the amount allowed by the water regulator.
Energy cost volatility	South West Water mitigates rising energy costs through careful system operation, by maximising renewable energy generation and by purchasing and using all forms of energy in the most efficient way.
Pension costs may increase due to factors outside the company's control	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements.
Poor investment performance may affect the defined benefit scheme assets and increases the pension scheme deficit	Employee and employer contributions are also kept under review and have been increased. Further contributions of £28.8m were made in the year. Pension trustees keep investment policy under review and use professional investment advisers.

OPERATING AND FINANCIAL REVIEW (continued)

Risk	Mitigation
Water resource adequacy	The company has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures. In particular, South West Water prepares a new Water Resources Plan every five years and reviews it annually for a range of climate change and demand scenarios. The Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.
Operational failures	The company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets.
Reduced revenue from falling customer demand for water	The reduced demand experienced in the current five year regulatory period will be taken into account by the regulator in setting a baseline turnover level for the next five year period. The water regulator is proposing a form of revenue cap regulation from 2010, which would allow water companies to recover a shortfall in income for a five year regulatory period in the next period.
Meter option take-up greater than forecast, resulting in reduced revenues	An interim Determination may be used to fully or partially recover revenue losses if they exceed the prescribed materiality threshold.
Financial loss arising from the insolvency of a major supplier or contractor	The company does not have material exposure to payment before receipt of goods and services. The company uses a third party credit monitoring service for changes to major suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.
Impact of competition in the industry	South West Water is assessing the implications of the Cave Commission report published in April 2009 in order to prepare for an extension of competition for non-household customers in the water industry. Legislation will be required for any further extension of competition in the water and sewerage markets.

The Directors have established a formal framework for the identification and monitoring of both operational and financial risks arising from the Company's activities. The effectiveness of this framework is regularly reviewed by the Board.

OPERATING AND FINANCIAL REVIEW (continued)

FINANCIAL REVIEW

Financial Results

Turnover

Appointed business turnover for the year increased by 2.7% from £413.2m to £424.7m as a result of tariff increases and new connections, offset by the effects of customers switching and lower demand. Within this, turnover from main water and sewerage charges, including large user revenues, was £411.0m (2008 £399.4m). Approved tariff increases, including the 1.7% K factor, amounted to £27.7m. 7,035 new customer connections contributed £3.6m of additional turnover.

The effect of meter option switchers was to reduce turnover by £9.5m, benefiting 23,162 customers (2008 28,528 customers) by, on average, about £372 each (2008 £350 each). 66% of South West Water's domestic customers are now metered (2008 62%).

Measured demand fell in the year by 4.2% following a 4.1% decrease in 2007/08. The impact of the 4.2% decrease in measured demand for the year was to reduce turnover by £9.8m compared to last year. Demand has been impacted by wet weather in 2008, coupled with underlying base demand reductions as seen in previous years.

Turnover continued at levels lower than that assumed in the PR04 Final Determination. In 2008/09 the shortfall was £23.4m, with the largest elements being £15.9m due to falls in measured demand for both domestic and commercial customers and £9.9m from over 16,000 additional meter optants compared to the Final Determination and an average loss per meter optant being over 50% higher than allowed. Gains against the FD were recorded on third party sales and the timing of new connections.

Operating Costs

Total Appointed business historic cost operating costs, including depreciation, rose from £236.8m to £244.1m.

Additional operating costs compared to last year consisted mainly of increased depreciation and operating costs from new and improved works (£5.7m), infrastructure renewals charge (£0.7m), and inflation (£5.6m). The company's restructuring programme continued in the year with £5.0m charged to the profit & loss account compared to £4.0m in 2007/08.

The pension cost charged to the profit & loss account continues to be lower than the Final Determination due to the adoption of FRS 17 in the regulatory accounts. The difference was £2.4m in the year. However, the economic downturn has had a detrimental impact on the performance of the pension scheme's assets and lumps sum payments to the pension scheme in the year totalled £28.8m. Losses relating to increases in the pension fund deficit are recgnised directly through reserves rather than through the profit & loss account. Over the K4 period, the company has made cash contributions to the pension scheme which have equated to more than double the amount allowed in the price limits in FD 04.

The charge for bad and doubtful debts increased in the year by £1.8m from £10.2m to £12.0m. After taking into account the impact of tariff rises, a residual increase of £0.9m for the year is considered to be the impact of the recessionary conditions and has been treated as an atypical cost. Overall the debt collection position is assessed as stable with improved collections from recent billing offsetting slower collection of older debt.

Despite the downturn in the property market, property disposals in the year contributed £1.7m to profit (2008 £0.1m loss)

OPERATING AND FINANCIAL REVIEW (continued)

Excluding the impact of the differing accounting treatment for pension costs, atypical costs for the year have been assessed at £7.1m. In addition to restructuring costs (atypical element £4.5m), the most significant factor identified has been approximately £1.7m attributable to exceptionally challenging weather conditions – both adverse winter weather causing additional leakage and burst pipe costs and another abnormally wet summer leading to increased power requirements as a result of extra pumping for the sewerage business. Despite the exceptionally cold weather the leakage target was met for the tenth consecutive year. £0.9m of bad and doubtful debt cost has also been treated as atypical, as described in the paragraph above.

The target of £13m per annum of efficiency cost savings by the end of the K4 period has been achieved ahead of schedule. We are implementing detailed plans targeting outperformance of the operating cost efficiency targets set by Ofwat for the period up to 2010. Efficiency projects are under way to create a platform to enable further improvements to operational and customer service performance. South West Water is continuing to drive and deliver efficiencies through investment in infrastructure to move the organisation towards a more centralised operational structure employing increased levels of automation and remote working. The Company has also implemented a significant programme of organisational restructuring across the business which has cost £9m to date, of which £5m was incurred in 2008/09; it is expected that a further £5m will be provided in 2009/10. To support operational and service improvements, a number of employee development programmes have been completed in the year.

There have been no changes of policy in respect of current costs depreciation and the infrastructure renewals charge. The current cost depreciation charge at £90.0m is lower by £5.7m. This profile is consistent with the PR04 Final Determination and is due to asset life assumptions for management & general capital assets.

The infrastructure renewals charge is in line with the average of the past 5 years and projections for the next 10 years, as required by the regulatory accounting guidelines.

Investment

Capital expenditure in the year was £157.8m compared to £179.7m in 2007/08.

£105.8m was invested in water supply improvements including water mains renovation and water treatment works enhancement. Continued high levels of investment in the £240m water mains renovation programme to replace or reline water mains are a key element during the current K4 period.

A further 363km of water mains were replaced or relined during the year as part of the company's ongoing 'Putting the Sparkle Back into Your Water' programme, agreed with the DWI for completion by 2010. Four key programme milestones have now been successfully achieved. Work to meet the fifth and final milestone is underway and is due to be completed before 2010 with a significant project in Exeter finishing ahead of schedule in 2008.

This has been our 12th consecutive year without water restrictions. The company has put in place a comprehensive strategy to help ensure a continued secure supply of water for the region. During 2008, the use of two new reservoirs for Cornwall was secured. The reservoirs were previously disused china clay pits, a much more cost effective solution compared with building new reservoirs. Both lakes are on Bodmin Moor and will become the fourth and fifth biggest in South West Water's service area.

There has also been investment at a number of sewage treatment works to increase capacity and deliver environmental benefits by treating previously untreated sewage.

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

OPERATING AND FINANCIAL REVIEW (continued)

Taxation

The tax charge for the appointed business for the year increased by £15.3m from £13.6m to £28.9m, with £7.7m of the increase attributable to deferred taxation.

The deferred tax charge had been reduced by £8.6m in 2007/08 due to the change of corporation tax rates from 30% to 28%. In the current year there was a benefit of £4.9m to deferred tax in respect of the abolition of Industrial Building Allowances (reducing future timing differences) but there was an adverse movement year to year of £7.7m on the amount of discount applied to the deferred tax balance because of lower discount rates.

Financing

Net interest payable increased by £5.0m to £69.9m from £64.9m. Net debt at 31 March 2009 was £1,571.1m compared to £1,455.2m at 31 March 2008, an increase of £115.9m. The main reasons for the increase in net debt were the capital programme, increased payments to the pension fund and the payment of a back-log of dividends following a share capital reduction exercise (section below on Dividends and Reserves).

The main factors leading to the increase in net interest payable were an increase of £3.5m in respect of the non-cash charge for pension liabilities and £2.8m relating to interest rate swaps. Overall movements in interest rates were beneficial to the company.

At 31 March 2009 loans and finance lease obligations were £1,806m and the company held cash and deposits of £235m.

Despite the general shortage of funds in the debt markets which has made both refinancing and the availability of new facilities more challenging, the following financing initiatives were implemented during the financial year 2008/09:

- £100m 15 year EIB funding
- £25m finance lease facility

Pennon Group and the company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year. The Treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintain reasonable headroom for contingencies and manage interest rate risk. It operates within policies approved by the Board and does not undertake any speculative trading activity.

Funding facilities are in place to cover both medium and long term requirements, including loans from the European Investment Bank. In addition, short term facilities exist with a range of financial institutions. Committed funding is in place to cover the company's requirements until 2011.

Short term facilities in place at 31 March 2009 and not utilised totalled £124.0m (2008 £135.0m). In addition the company has short-term uncommitted bank facilities of £80.0m (2008 £80.0m).

Derivatives, usually interest rate swaps, are used to manage the mix of fixed and floating rate debt. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and do not, therefore, constitute an exposure for the company.

OPERATING AND FINANCIAL REVIEW (continued)

The balance sheet value of derivatives moved from an overall asset position of £3.0m at 31 March 2008 to an overall liability position of £18.5m at 31 March 2009 due to the reduction of floating interest rates in the year. The movement is taken to reserves through the Statement of Recognised Income and Expense.

South West Water has approximately 25% of its debt index-linked to 2014-2057.

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

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

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

South West Water's debt to Regulatory Capital Value (RCV) was 63.6% at 31 March 2009 (2007/08 60.2%), within Ofwat's 'optimum range' of 55% - 65%.

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

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

Dividends and reserves

The company undertook a share capital reduction exercise in accordance with the Companies Act 2006 in 2008/09 which created sufficient reserves to pay a backlog of dividends that had built up. (The company's ability to pay dividends had previously been limited by the balance on distributable reserves as reported in its statutory accounts, which had been reduced by the requirement of International Financial Reporting Standards for deferred tax to be on an undiscounted basis).

Dividends totalling £103.8m (2008 £68.7m) were paid to the parent undertaking, comprising £48.8m relating to 2007/08, £51.4m relating to 2008/09 and £3.6m in respect of 2006/07. These dividends were calculated with reference to the projections in the Final Determination.

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

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

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

OPERATING AND FINANCIAL REVIEW (continued)

FUTURE DEVELOPMENTS

The key factor affecting the Company's performance for 2009/10 is the Periodic Review completed in December 2004 when Ofwat set water company charges for the years 2005-2010 giving 'K' price increases of 12.5%, 9.8%, 9.8%, 1.7%, 1.4% for 2005-2010 (an average of 6.9% p.a. over the five years). It also determined the investment outputs to be delivered by the Company over this period. The Company is confident that it can deliver the efficiency improvements assumed over this period and deliver the required investment programme.

For the period 2010 to 2015 (K5), the contents of the Final Determination due to be published in November 2009 will be the key factor affecting the company's future performance.

Following submission of the company's Draft Business Plan in August 2008, the company's Final Business Plan was completed and provided to Ofwat on 3 April 2009. Summary information on the final plan is available on the company's website.

DIRECTORS' RESPONSIBILITY STATEMENT FOR THE REGULATORY ACCOUNTS

Statement of directors' responsibilities for regulatory information

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

This additionally requires the directors to:

• Confirm that, in their opinion, the company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months

• Confirm that, in their opinion, the company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the company

• Confirm that, in their opinion, the company has contracts with any associate company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the company's obligations as a water and sewerage undertaker

• Report to Ofwat changes in the company's activities which may be material in relation to the company's ability to finance its regulated activities

• Undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length and

• Keep proper accounting records which comply with Condition F.

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

In the case of each of the persons who are directors at the time when the report is approved under Section 234ZA of the Companies Act the following applies:

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

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

DIRECTORS' CERTIFICATES TO THE WATER SERVICES REGULATION AUTHORITY

LICENCE OF APPOINTMENT - STATEMENT RELATING TO CONDITION K

At 31 March 2009 the Company had sufficient rights and assets to comply with the requirements of paragraph 3.1 of Condition K of the Licence from the Secretary of State for the Environment.

LICENCE OF APPOINTMENT - STATEMENT RELATING TO CONDITION F

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

(1) that in the opinion of the Directors, the Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Company's obligations under the Appointment); and

(2) that in the opinion of the Directors, the Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.

C Loughlin
Chief Executive

26 June 2009

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND THE DIRECTORS OF SOUTH WEST WATER LIMITED

We have audited the Regulatory Accounts of South West Water Limited ("the Company") on pages 27 to 86 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 reconciliation between the statutory financial statements and the 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 including the statement of accounting policies.

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

Basis of preparation

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

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

Respective responsibilities of the WSRA, the Directors and Auditors

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

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 22.

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND THE DIRECTORS OF SOUTH WEST WATER LIMITED (continued)

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

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 69 to 81 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03.

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

INDEPENDENT AUDITORS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY AND THE DIRECTORS OF SOUTH WEST WATER LIMITED (continued)

The regulatory historical cost accounting statements on pages 27 and 65 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 Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on page 67.

Opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2009 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 32, the state of the Company's affairs at 31 March 2009 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

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

a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;

b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1

c) .04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;

d) the regulatory historical cost accounting statements on pages 27 to 65 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;

e) the regulatory current cost accounting statements on pages 69 to 81 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors

26 June 2009

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2009

	Notes	**Total 2009 £m**	Total 2008 £m
Turnover	2	**432.4**	421.0
Operating costs	3	**(180.0)**	(175.9)
Depreciation	4	**(70.8)**	(67.9)
Profit / (Loss) on disposal of fixed assets		**1.7**	(0.1)
Operating Profit		**183.3**	177.1
Other income		**0.8**	0.8
Net interest payable	5	**(69.9)**	(64.9)
Profit on Ordinary Activities Before Taxation		**114.2**	113.0
Tax on profit on ordinary activities	6	**(29.3)**	(14.0)
Profit on Ordinary Activities After Taxation		**84.9**	99.0
Dividends	7	**(103.8)**	(68.7)
Retained (loss) / profit for year		**(18.9)**	30.3

HISTORICAL COST STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES for the year ended 31 March 2009

	Notes	**2009 £m**	2008 £m
Profit on Ordinary Activities After Taxation		**84.9**	99.0
Actuarial (loss) / gain recognised in the pension scheme	22	**(50.6)**	3.9
Movement on deferred tax relating to pension liability	22	**14.1**	(4.3)
Movement on hedging reserve	25	**(19.0)**	(11.6)
Total gains recognised since last annual report		**29.4**	**87.0**

The notes on pages 32 to 65 form part of these historical cost regulatory accounts.

HISTORICAL COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2009 (continued)

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

	Appointed Business £m	**Non-appointed £m**	**2009 Total £m**	Appointed Business £m	Non-appointed £m	2008 Total £m
Turnover	**424.7**	**7.7**	**432.4**	413.2	7.8	421.0
Operating costs	**(173.7)**	**(6.3)**	**(180.0)**	(169.6)	(6.3)	(175.9)
Depreciation	**(70.4)**	**(0.4)**	**(70.8)**	(67.2)	(0.7)	(67.9)
Operating income	**1.7**	**-**	**1.7**	(0.1)	-	(0.1)
Operating Profit	**182.3**	**1.0**	**183.3**	176.3	0.8	177.1
Other income	**0.3**	**0.5**	**0.8**	0.3	0.5	0.8
Net interest payable	**(69.9)**	**-**	**(69.9)**	(64.9)	-	(64.9)
Profit on Ordinary Activities Before Taxation	**112.7**	**1.5**	**114.2**	111.7	1.3	113.0
Tax on profit on ordinary Activities	**(28.9)**	**(0.4)**	**(29.3)**	(13.6)	(0.4)	(14.0)
Profit on Ordinary Activities After Taxation	**83.8**	**1.1**	**84.9**	98.1	0.9	99.0
Dividends	**(103.8)**	**-**	**(103.8)**	(68.7)	-	(68.7)
Retained (loss) / profit for year	**(20.0)**	**1.1**	**(18.9)**	29.4	0.9	30.3

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

The notes on pages 32 to 65 form part of these historical cost regulatory accounts.

HISTORICAL COST BALANCE SHEET
at 31 March 2009

	Notes	2009 £m	2008 £m Restated
Fixed Assets			
Tangible assets	11	**2,352.1**	2,302.7
Investments	12	**3.4**	3.4
		2,355.5	2,306.1
Current Assets			
Financial assets			
Derivative financial instruments	19	**0.2**	3.5
Stocks	13	**4.1**	4.1
Debtors	14	**67.6**	78.3
Investments	15	**250.6**	241.5
Cash at bank and in hand		**1.1**	0.8
Infrastructure renewals prepayment		**13.1**	11.9
		336.7	340.1
Current Liabilities			
Creditors: amount falling due within one year	16	**(148.9)**	(176.0)
Derivative financial instruments	19	**(18.7)**	(0.5)
Net Current Assets		**169.1**	163.6
Total Assets Less Current Liabilities		**2,524.6**	2,469.7
Creditors: amounts falling due after more than one year	17	**(1,767.5)**	(1,660.9)
Provisions for liabilities and charges	20	**(93.9)**	(91.6)
Deferred income	21	**(15.1)**	(16.1)
Net Assets Excluding Pension Liability		**648.1**	701.1
Pension Liability	22	**(37.1)**	(15.7)
Net Assets Including Pension Liability		**611.0**	685.4
Capital and Reserves			
Called-up share capital	23	**150.9**	450.9
Reserves	25	**460.1**	234.5
Capital and Reserves	26	**611.0**	685.4

The notes on pages 32 to 65 form part of these historical cost regulatory accounts.

The historical cost regulatory accounts on pages 27 to 65 were approved by the Board on 26 June 2009 and signed on its behalf by:-

C Loughlin
Chief Executive

S Davy
Finance Director

HISTORICAL COST BALANCE SHEET
at 31 March 2009 (continued)

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

	Appointed Business £m	**Non-appointed £m**	**2009 Total £m**	Appointed Business £m	Non-appointed £m	2008 Total £m
Fixed Assets						Restated
Tangible assets	**2,352.1**	**-**	**2,352.1**	2,302.7	-	2,302.7
Investments	**3.4**	**-**	**3.4**	3.4	-	3.4
	2,355.5	**0.0**	**2,355.5**	2,306.1	-	2,306.1
Current Assets						
Derivative financial instruments	**0.2**	**-**	**0.2**	3.5	-	3.5
Stocks	**4.1**	**-**	**4.1**	4.1	-	4.1
Debtors	**66.2**	**1.4**	**67.6**	76.9	1.4	78.3
Investments	**250.6**	**-**	**250.6**	241.5	-	241.5
Cash at bank and in hand	**-**	**4.5**	**4.5**	-	3.4	3.4
Infrastructure renewals prepayment	**13.1**	**-**	**13.1**	11.9	-	11.9
	334.2	**5.9**	**340.1**	337.9	4.8	342.7
Current Liabilities						
Creditors: amount falling due within one year	**(151.6)**	**(0.7)**	**(152.3)**	(177.9)	(0.7)	(178.6)
Derivative financial intruments	**(18.7)**	**-**	**(18.7)**	(0.5)	-	(0.5)
Net Current Assets	**163.9**	**5.2**	**169.1**	159.5	4.1	163.6
Total Assets Less Current Liabilities	**2,519.4**	**5.2**	**2,524.6**	2,465.6	4.1	2,469.7
Creditors: amount falling due after more than one year	**(1,767.5)**	**-**	**(1,767.5)**	(1,660.9)	-	(1,660.9)
Provisions for liabilities and charges	**(93.9)**	**-**	**(93.9)**	(91.6)	-	(91.6)
Deferred income	**(15.1)**	**-**	**(15.1)**	(16.1)	-	(16.1)
Net Assets Excluding Pension Liability	**642.9**	**5.2**	**648.1**	697.0	4.1	701.1
Pension Liability	**(37.1)**	**-**	**(37.1)**	(15.7)	-	(15.7)
Net Assets Including Pension Liability	**605.8**	**5.2**	**611.0**	681.3	4.1	685.4
Capital and Reserves						
Called-up share capital	**150.9**	**-**	**150.9**	450.9	-	450.9
Profit and loss account	**454.9**	**5.2**	**460.1**	230.4	4.1	234.5
Capital and Reserves	**605.8**	**5.2**	**611.0**	681.3	4.1	685.4

HISTORICAL COST CASH FLOW STATEMENT
for the year ended 31 March 2009

	Notes	**2009 £m**	2008 £m
Net Cash Inflow from Operating Activities	28a	**235.6**	261.1
Returns on Investments and Servicing of Finance	28b	**(56.1)**	(62.1)
Taxation		**(21.8)**	(7.2)
Capital Expenditure and Financial Investment	28b	**(157.8)**	(166.3)
Equity Dividends paid		**(103.8)**	(68.7)
Cash Outflow Before Use of Liquid Resources and Financing		**(103.9)**	(43.2)
Management of Liquid Resources	28b	**(80.0)**	(30.0)
Financing	28b	**111.5**	152.9
(Decrease) / Increase in Cash in Year	28c	**(72.4)**	79.7

The notes on pages 32 to 65 form part of these historical cost regulatory accounts.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1 Accounting Policies for the year ended 31 March 2009

These financial statements are "regulatory accounts" prepared in accordance with guidance issued by the Water Services Regulation Authority (Ofwat). They have been prepared under the historical cost convention, as modified by the revaluation of certain financial instruments, and in accordance with applicable accounting standards in the UK except for the dis-application of certain parts of FRS 12 and FRS 15 in relation to infrastructure renewals accounting as described below in note 1(c)(i) and, except for the treatment of grants and contributions on infrastructure assets, with the Companies Act 1985. An explanation of this departure from the requirements of the Companies Act 1985 is given in note 1(e) below. A summary of the more important accounting policies is set out below, together with an explanation of where changes have been made to previous policies on the adoption of new accounting standards in the year.

These financial statements were approved by the Board of Directors on 26 June 2009.

Changes in accounting policies

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

(a) **Consolidated financial statements**

The Company is exempt under the provisions of Section 228 of the Companies Act 1985 from the requirement to produce group financial statements (as amended by Section 5 of the Companies Act 1989) as it is a wholly-owned subsidiary undertaking of Pennon Group Plc which is registered within the European Economic Area and which itself prepares consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

(b) **Turnover**

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

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

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

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

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1 **Accounting Policies (continued)**

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

Tangible fixed assets comprise:-

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

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

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

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

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

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

Buildings	30 – 60 years
Operational properties	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

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

(d) **Leased assets**

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

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

(e) Grants and contributions

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1 **Accounting Policies (continued)**

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

Grants and contributions receivable relating to infrastructure assets are deducted from the cost of tangible fixed assets. This is not in accordance with the Companies Act 1985 which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. This departure from the requirements of the Companies Act 1985 is, in the opinion of the Directors, necessary for the financial statements to show a true and fair view as, while a provision is made for depreciation of infrastructure assets, these assets do not have determinable finite lives and therefore no basis exists on which to recognise grants and contributions as deferred income. The effect of this treatment on the value of tangible fixed assets is disclosed in note 11.

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

(f) **Investments**

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

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

(g) **Stocks**

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

(h) **Pension costs**

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

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

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

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

(i) **Share based payments**

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1 **Accounting Policies (continued)**

(i) **Share based payments (continued)**

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

(j) **Research and Development Expenditure**

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

(k) **Taxation**

Tax payable is provided on taxable profits at current rates. Tax deferred or accelerated as a result of timing differences between the treatment of certain items for taxation and for accounting purposes is provided for in full. Where the effect of the time value of money is material the current amount of the reversals of tax deferred or accelerated is discounted to its present value. The unwinding of the discount to present value is included in the tax charge. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits against which the deferred tax asset can be recovered in future periods.

(l) **Dividend distributions**

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

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

The Company classifies its financial instruments in the following categories.

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

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

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

ii) Derivative financial instruments

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

1 Accounting Policies (continued)

(m) Derivatives and other financial instruments (continued)

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

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

(iii) Trade debtors

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

(iv) Trade creditors

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

(n) Fair value estimate

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

2 Segmental analysis

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

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

3 Operating Costs

	2009 £m	2008 £m
Manpower costs (note 8)	**34.7**	37.2
Raw materials and consumables	**12.9**	13.6
Rentals under operating leases:-		
Hire of plant and machinery	**0.7**	0.6
Other operating leases	**1.3**	1.5
Research and development expenditure	**0.2**	0.2
Auditors' remuneration	**0.2**	0.1
Other external charges	**85.8**	80.7
Infrastructure renewals charge	**26.3**	25.6
Other operating charges	**17.9**	16.4
	180.0	175.9

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

	2009 £000	2008 £000
Audit services	**100**	92
Audit-related regulatory reporting	**124**	28
Other services	**24**	-
	248	120

Expenses reimbursed to the auditors in relation to the audit of the Company were £14,000 (2008: £13,000).

4 Depreciation

	2009 £m	2008 £m
On owned non-infrastructure assets	**50.9**	49.3
On non-infrastructure assets held under finance leases	**21.5**	19.8
	72.4	69.1
Deferred income released to profits	**(1.6)**	(1.2)
	70.8	67.9

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

5 Net Interest Payable

	2009 £m	2008 £m
Interest payable:-		
To subsidiary company	**(12.7)**	(11.1)
Bank loans and overdrafts	**(10.5)**	(14.6)
Interest element of finance lease rentals	**(53.8)**	(51.9)
Other finance charges – pension cost (see note 22)	**(18.8)**	(15.3)
Other finance charges	**(3.8)**	(1.3)
	(99.6)	(94.2)
Interest receivable:-		
From parent undertaking	**1.6**	0.7
From subsidiary company	**0.1**	0.1
Other finance income – pension interest (see note 22)	**17.8**	17.4
Other investments (as defined in note 15)	**10.2**	11.1
	29.7	29.3
Net interest payable	**(69.9)**	(64.9)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

6 Tax on Profit on Ordinary Activities

(a) Analysis of charge for year	**2009 £m**	2008 £m
Current tax :		
UK corporation tax at 28% (2008: 30%) :-		
Current year	**22.2**	25.4
Prior year	**(1.7)**	(3.1)
Amounts receivable from Pennon Group companies in respect of surrender of taxable losses and advance corporation tax	**-**	(3.8)
Total current tax (note 6(b))	**20.5**	18.5
Deferred tax :		
Origination and reversal of timing differences	**11.8**	9.9
Increase in discount	**1.9**	(5.8)
Total deferred tax charged to profit & loss in year (note 20)	**13.7**	4.1
Effect of change of rate of corporation tax	**-**	(8.6)
Derecognition of deferred tax liabilities related to industrial buildings (note 20)	**(4.9)**	-
Tax on profit on ordinary activities	**29.3**	14.0

(b) Factors affecting current tax charge for the year	**2009 £m**	2008 £m
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 28% (2008: 30%)		
The differences are explained below:		
Profit on ordinary activities before tax	**114.2**	113.0
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2008: 30%)	**32.0**	33.9
Tax effects of:		
Expenses not deductible for tax purposes	**0.7**	0.5
Income not charged to profits	**1.1**	1.2
Capital allowances for year in excess of depreciation	**(1.2)**	(4.2)
Other timing differences	**(10.4)**	(6.0)
Adjustments to tax charge in respect of prior year	**(1.7)**	(6.9)
Current tax charge for the year (note 6(a))	**20.5**	18.5

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

7 Dividends

	2009 £m	2008 £m
2006/07 Outperformance dividend paid 24 July 2008	**3.6**	23.0
Base dividend in respect of 2007/08 and 2008/09 paid 20 January 2009	**100.2**	45.7
	103.8	68.7

8 Employees and Employment Costs

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

	2009	2008
Regulated water and sewerage activities	**1,227**	1,276

	2009 £m	2008 £m
Employment costs comprise:-		
Wages and salaries	**33.0**	34.6
Social security costs	**2.5**	2.4
Share-based payments	**1.2**	0.8
Pension costs (note 22)	**7.9**	10.0
Total employment costs	**44.6**	47.8
Charged as follows:-		
Manpower costs (note 3)	**32.5**	34.4
Restructuring	**2.2**	2.8
	34.7	37.2
Capital schemes	**9.9**	10.6
	44.6	47.8

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

9. Directors' emoluments

	2009 £000	2008 £000
Total emoluments of the Directors of the Company :		
Salary	**602**	555
Performance related	**159**	169
Other emoluments	**133**	147
Total emoluments	**894**	871

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

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

The emoluments of the highest paid Director were £421,000 (2008: £397,000).

At 31 March 2009 retirement benefits were accruing to 3 Directors (2008: 3 Directors) under defined benefit pension schemes operated by the parent company.

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

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

Background

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

Elements of Remuneration

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

Payments related to performance against agreed standards

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

9. Directors' emoluments (continued)

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

In respect of the other Directors, for the year 2008/09, maximum performance related bonus payments achievable in respect of service as executive directors of South West Water Limited are, expressed as a percentage of salary up to a maximum of 37.5%, as follows:

i Based on an estimate of the Overall Performance Assessment (OPA) points to be awarded by Ofwat for 2008/09 0.25% up to a maximum of 2.5% for each position above 10th compared to the published scores for 2007/08 for the water and sewerage companies. This reflects the importance South West Water attaches to all round performance.

ii Up to a maximum of 5% in relation to a series of discrete individual Director's targets for performance on Ofwat DG measures, pollution and waste water measures set by the Environment Agency, drinking water compliance and level of customer debt. Performance under each of these standards reflects customer and stakeholder measures.

iii A bonus for outperformance of South West Water against its operating cost budget, the maximum bonus of 7.5% being achieved if outperformance is 3% or higher. Cost control and efficiency are key factors in South West Water's long term performance.

iv A bonus for outperformance of South West Water against its budget for profit before tax, the maximum bonus of 5.0% being achieved if outperformance is 7.5% or higher. Profit before tax is a key measure of performance.

v A 1% bonus for every 0.5% that capital expenditure is below budget, up to a maximum of 5%. Cost control and efficiency are key factors in South West Water's long term performance.

vi A bonus of up to 2.5% if net debt is 1% below budget. Cash control is a key factor in South West Water's long term performance.

vii Up to a maximum of 10% in relation to personal objectives set for each Director and focused on development and delivery of the Company's strategic objectives.

These arrangements were approved by the Remuneration Committee of Pennon Group Plc on 2 June 2008.

For 2008/09 no Director achieved the maximum bonus available of 37.5% of salary. The actual payments relating to performance against agreed standards amounted to:

	£000	% bonus achieved
S C Bird	35.9	25.4
S J Davy	27.9	24.1
M S Read	21.3	23.0

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

9. Directors' emoluments (continued)

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

10 Directors' Interests

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

The interests of the other Directors holding office at 31 March 2009 in the shares of Pennon Group Plc at 31 March 2009 and 31 March 2008 were:

(a) Shareholdings

	2009 Ordinary Shares (40.7p each)	2008 Ordinary Shares (40.7p each)
S C Bird	**13,197**	12,039
S J Davy	**3,067**	-
M S Read	**44,632**	35,578

(b) Share Incentive Plan

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

	2009 Ordinary shares (40.7p each)	2008 Ordinary shares (40.7p each)
S J Davy	**299**	19
M S Read	**786**	490

(c) Sharesave scheme

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

	Options over Ordinary Shares of 40.7p each				
	31 March 2009	Granted in Period	Exercised in Period	Lapsed In Period	31 March 2008
S C Bird	**2,053**	727	1,401	-	2,727
S J Davy	**1,818**	1,818	-	-	-
M S Read	**8,163**	-	-	-	8,163

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

10 **Directors' Interests (continued)**

(d) Restricted Share Plan

In addition to the above beneficial interests, the Directors had a contingent interest in the shares of Pennon Group Plc under the terms of the Pennon Group Long Term Incentive Plan, described in note 24, as follows :

	Contingent interest in Ordinary Shares of 40.7p each				
	31 March 2009	Granted in Period	Vested in Period	Lapsed In Period	31 March 2008
S C Bird	**15,041**	-	11,802	5,058	31,901
M S Read	**9,048**	-	7,641	3,276	19,965

The above represent the maximum number of shares to which the Directors would become entitled if all relevant criteria are met. The awards vested during the year at a price of 592p per share. It is not anticipated that the shares awarded in 2006 to Directors will vest because the performance condition has not been met.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Restricted Share Plan.

(e) Incentive Bonus Plan

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

	Contingent interest in Ordinary Shares of 40.7p each				
	31 March 2009	Granted in Period	Vested in Period	Lapsed In Period	31 March 2008
S C Bird	**15,131**	5,585	7,770	**-**	17,316
M S Read	**9,904**	3,661	5,082	**-**	11,328
S J Davy	**2,951**	2,951	-	**-**	-

The above represent the maximum number of shares to which the Directors would usually become entitled if they remain employed by the Pennon Group for a further three years from the date of the awards. The awards vested during the year at a price of 634p per share. It is anticipated that all the shares will vest under the 2006 awards as the service criteria are expected to be met.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Incentive Bonus Plan.

A further conditional award of shares will be made in 2008/09 to match the amount of the cash bonus shown in Note 9.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

10 **Directors' Interests (continued)**

(f) Performance and Co-investment Plan

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

	Conditional interest in Ordinary Shares of 40.7p each				
	31 March 2009	Granted in Period	Vested in Period	Lapsed In Period	31 March 2008
S C Bird	**37,145**	17,756	-	-	19,389
M S Read	**24,234**	11,595	-	-	12,639
S J Davy	**14,556**	14,556	-	-	-

Additional ordinary shares (40.7p each) have been acquired by the Directors since 31 March 2009 as follows as a result of participation in the Pennon Group's Dividend Re-investment plan or the Pennon Group's Share Incentive Plan:

M S Read	620	S J Davy	133

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

11 Tangible Fixed Assets

	Freehold land and buildings	Infra-structure assets	Opera-tional properties	Fixed & mobile plant, vehicles and computers	Construc-tion in progress	**Total**
	£m	£m	£m	£m	£m	**£m**
Cost:-						
At 1 April 2008	17.6	1,165.9	606.3	996.5	110.3	**2,896.6**
Additions	0.5	32.8	1.7	29.7	65.5	**130.2**
Grants and contributions	-	(6.3)	-	-	-	**(6.3)**
Transfers / reclassifications	1.1	35.0	10.5	35.0	(81.6)	**-**
Disposals	(0.3)	-	-	(1.7)	-	**(2.0)**
At 31 March 2009	**18.9**	**1,227.4**	**618.5**	**1,059.5**	**94.2**	**3,018.5**
Depreciation:-						
At 1 April 2008	4.0	-	149.0	440.9	-	**593.9**
Charge for year	0.3	-	11.3	62.4	-	**74.0**
Disposals	(0.1)	-	-	(1.4)	-	**(1.5)**
At 31 March 2009	**4.2**	**-**	**160.3**	**501.9**	**-**	**666.4**
Net Book Value:-						
At 31 March 2009	**14.7**	**1,227.4**	**458.2**	**557.6**	**94.2**	**2,352.1**
At 31 March 2008	13.6	1,165.9	457.3	555.6	110.3	2,302.7

Out of the total depreciation charge for the Company of £74.0m (2008: £70.4m), the sum of £1.6m (2008: £1.3m) has been charged to capital projects, and £72.4m (2008: £69.1m) against profits.

The cost of freehold land and buildings and operational properties includes non-depreciable land of £3.7 (2008: £3.5m) and £9.3 (2008: £9.3m) respectively.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

11 Tangible Fixed Assets (continued)

Assets held under finance leases included above:-

	Infra-structure assets	Opera-tional properties	Fixed & mobile plant, vehicles and computers	Construction in progress	**Total**
	£m	£m	£m	£m	**£m**
Cost:- At 31 March 2009	361.2	444.9	312.5	25.1	**1,143.7**
Depreciation:- Charge for year	6.4	7.3	14.2	-	**27.9**
Depreciation:- At 31 March 2009	30.3	73.8	150.5	-	**254.6**

12 Fixed Asset Investments

	Joint Venture £m	Subsidiary Undertakings £m	**Total Investments £m**
At 1 April 2008 and 31 March 2009	0.1	3.3	**3.4**

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

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

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

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

13 Stocks

	2009 £m	2008 £m
Raw materials and consumables	**4.1**	4.1

14 Debtors

	2009 £m	2008 £m Restated
Amounts falling due within one year:-		
Trade debtors	**68.0**	58.1
Less: provision for bad debts	**(44.0)**	(37.0)
	24.0	21.1
Amounts owed by subsidiary companies	**3.5**	8.0
Amounts owed by parent undertaking	**1.0**	16.5
Amounts owed by joint venture	**-**	2.1
Other debtors	**10.0**	2.8
Prepayments and accrued income	**29.1**	27.8
	67.6	78.3

15 Current Asset Investments

	2009 £m	2008 £m
Other investments:-		
Overnight deposits	**63.8**	141.1
Other short-term deposits	**170.1**	90.3
Other deposits	**16.7**	10.1
	250.6	241.5

Other deposits include £16.7m (2008: £10.1m) of restricted funds to settle long-term liabilities (note 18)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

16 Creditors: Amounts Falling Due Within One Year

	2009 £m	2008 £m Restated
Loans:- (note 18)		
European Investment Bank loans	**14.1**	14.1
Bank loans and overdrafts	**17.0**	21.6
	31.1	35.7
Obligations under finance leases (note 18)	**24.2**	17.7
Trade creditors	**13.1**	14.3
Capital creditors	**37.1**	47.1
Amounts owed to parent undertaking	**-**	-
Other amounts owed to joint venture	**-**	0.2
Amounts owed to subsidiary companies	**1.6**	3.5
Amounts owed to fellow subsidiary undertakings	**0.1**	0.2
Other creditors	**1.3**	2.7
Corporation Tax	**23.2**	26.7
Other taxation and social security	**1.0**	7.0
Accruals and deferred income	**16.2**	20.9
	148.9	176.0

17 Creditors: Amounts Falling Due After More Than One Year

	2009 £m	2008 £m Restated
Loans:- (note 18)		
European Investment Bank loans	**287.7**	201.8
Loan from subsidiary company	**318.0**	311.7
	605.7	513.5
Obligations under finance leases (note 18)	**1,161.8**	1,147.4
	1,767.5	1,660.9

Accrued finance charges arising on obligations under finance leases have been re-analysed between current and non-current amounts and comparatives have been restated accordingly.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

18 Loans and Other Borrowings

	2009 £m	2008 £m
Loans		
Repayable:-		
Over five years	**428.3**	343.2
Over two and up to five years	**63.3**	156.3
Over one and up to two years	**114.1**	14.0
Falling due after more than one year (note 17)	**605.7**	513.5
Falling due within one year (note 16)	**31.1**	35.7
	636.8	549.2

	2009 £m	2008 £m Restated
Obligations under finance leases		
Repayable:-		
Over five years	**1,010.8**	1,024.7
Over two and up to five years	**117.5**	101.2
Over one and up to two years	**33.5**	21.5
Falling due after more than one year (note 17)	**1,161.8**	1,147.4
Falling due within one year (note 16)	**24.2**	17.7
	1,186.0	1,165.1

Included above are accrued finance charges arising on obligations under finance leases totalling £136.0m (2008: £129.8m), of which £13.8m (2008: £8.1m) is repayable within one year.

Included above is £14.6m (2008; £21.7m) due to Peninsula Leasing Limited, a subsidiary company, under finance lease agreements of which £7.2m (2008: £7.6m) is repayable within one year.

Loans and obligations under finance leases

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

	2009 £m	2008 £m Restated
Loans	**519.8**	427.6
Obligations under finance leases	**1,171.4**	1,143.4
	1,691.2	1,571.0

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

18 Loans and Other Borrowings (continued)

The Company has undrawn committed borrowing facilities:

	2009 £m	2008 £m
Floating rate:		
Expiring within one year	**-**	55.0
Expiring after one year	**124.0**	80.0
	124.0	135.0

In addition, the Company has short-term uncommitted bank facilities of £80.0m (2008: £80.0m).

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0m for certain water and sewerage business tangible fixed assets that are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2011.

During 2006/07 the period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts comparative to the difference between the original and revised payments due. The accumulated deposits of £16.7m at 31 March 2009 are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

19 Derivative Financial Instruments

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

	2009 £m	2008 £m
Interest rate swaps – cash flow hedges:		
Assets	**0.2**	3.5
Liabilities	**(16.6)**	(0.5)
Derivatives deemed held for trading		
Liabilities	**(2.1)**	-

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of net borrowings is at fixed rate. At 31 March 2009 62% of net borrowings was at fixed rate (2008: 64%).

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

19 Derivative Financial Instruments (continued)

At 31 March 2009 interest rate swaps to hedge financial liabilities with a notional principal value of £540m existed, with a weighted average maturity of 2.5 years (2008 £584.0m, with 3.0 years) to swap from floating to fixed rate. The weighted average interest rate of the swaps was 4.8% (2008 4.9%).

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

In 2009 derivatives held for trading relate to interest rate swaps which no longer qualify for hedge accounting.

20 Provisions for Liabilities and Charges

	Restructuring £m	Deferred Tax £m	**Total £m**
At 1 April 2008	1.5	90.1	**91.6**
Charged against profits	5.0	3.5	**8.5**
Utilised during year	(6.2)	-	**(6.2)**
At 31 March 2009	**0.3**	**93.6**	**93.9**

Deferred Taxation

	2009 £m	2008 £m
Accelerated capital allowances	**290.2**	311.1
Other timing differences	**(0.5)**	(5.1)
Undiscounted provision for deferred tax	**289.7**	306.0
Discount	**(196.1)**	(215.9)
Discounted provision for deferred tax	**93.6**	90.1

	£m	**£m**
Provision at 1 April 2008		**90.1**
Deferred tax charge in profit and loss account for year	**13.7**	
Derecognition of deferred tax liabilities related to industrial buildings	**(4.9)**	
		8.8
Deferred tax charge relating to pension liability		**(5.8)**
Deferred tax credited to reserves for the period		**0.5**
Provision at 31 March 2009		**93.6**

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

21 Deferred Income

	Grants and contributions £m
At 1 April 2008:	
Amount to be released :	
after more than one year	**16.1**
within one year	**1.2**
	17.3
Additions	**0.7**
Released to profits	**(1.6)**
At 31 March 2009:	**16.4**
Amount to be released:	
within one year	**(1.3)**
after more than one year	**15.1**

22 Pensions

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

The principal actuarial assumptions at the balance sheet date were :

	2009 %	2008 %
Expected return on scheme assets	**7.0**	7.0
Rate of increase in pensionable pay	**3.75**	4.4
Rate of increase for present and future pensions	**2.75**	3.4
Rate used to discount schemes' liabilities	**6.5**	6.9
Inflation	**2.75**	3.4

More detailed information for the Pennon Group pension funds on assumptions regarding future mortality experience and the sensitivities regarding the principal assumptions used to measure the schemes' liabilities are given in the financial statements of Pennon Group Plc.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22 **Pensions (continued)**

The amounts recognised in the profit and loss account were :

	2009 £m	2008 £m
Current service cost	**(6.8)**	(8.7)
Past service cost	**(1.6)**	(1.2)
Total included within operating costs	**(8.4)**	(9.9)
Expected return on pension scheme's assets	**17.8**	17.4
Interest cost on retirement benefit obligations	**(18.8)**	(15.3)
Total included within net interest payable (note 5)	**(1.0)**	2.1
Total charge	**(9.4)**	(7.8)

The actual return on scheme's assets was a decrease of £27.6m (2008: decrease of £34.1m).

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

	2009 £m	2008 £m
Actuarial (losses) / gains recognised in the year	**(50.6)**	3.9

The amounts recognised in the balance sheet were :

	2009 £m	2008 £m
Fair value of scheme's assets	**209.9**	255.4
Present value of defined benefit obligations	**(261.3)**	(277.1)
Deficit in scheme	**(51.4)**	(21.7)
Related deferred tax asset	**14.3**	6.0
Net liability recognised in the balance sheet	**(37.1)**	(15.7)

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

	Expected return %	**2009 Value £m**	**Fund %**	Expected Return %	2008 Value £m	Fund %
Equities	**8.8**	**126.8**	**60**	8.0	152.1	60
Property	**7.9**	**7.7**	**4**	7.6	11.6	4
Bonds	**5.2**	**72.5**	**35**	4.6	91.6	36
Other	**8.75**	**2.9**	**1**	5.9	0.1	-
		209.9	**100**		255.4	100

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22 **Pensions (continued)**

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

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

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

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

Movements in the balance sheet liability were:-

	2009 £m	2008 £m
At 1 April 2008	**(21.7)**	(34.5)
Income statement	**(9.4)**	(7.8)
Statement of recognised income and expenditure	**(50.6)**	3.9
Regular contributions	**1.5**	1.3
Prepayment of contributions	**28.8**	15.4
At 31 March 2009	**(51.4)**	(21.7)

Movements in the fair value of schemes' assets were :

	2009 £m	2008 £m
At 1 April 2008	**255.4**	285.5
Expected return on schemes' assets	**17.8**	17.4
Actuarial losses	**(81.5)**	(53.6)
Members' contributions	**0.4**	0.3
Benefits paid	**(12.5)**	(10.9)
Company regular contributions	**1.5**	1.3
Prepayment of Company regular contributions	**28.8**	15.4
At 31 March 2009	**209.9**	255.4

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

22 **Pensions (continued)**

Movements in the present value of defined benefit obligations were :

	2009	2008
	£m	£m
At 1 April 2008	**(277.1)**	(320.0)
Service costs	**(8.4)**	(9.9)
Interest cost	**(18.8)**	(15.3)
Members' contributions	**(0.4)**	(0.3)
Benefits paid	**12.5**	10.9
Actuarial gains	**30.9**	57.5
At 31 March 2009	**(261.3)**	(277.1)

The Company adopted FRS 17 from 1 April 2004 and the following historical data has been presented from that date.

	2009	2008	2007	2006	2005
	£m	£m	£m	£m	£m
Fair value of schemes' assets	**209.9**	255.4	285.5	266.7	187.9
Present value of defined benefit obligations	**(261.3)**	(277.1)	(320.0)	(301.7)	(255.0)
Net liability recognised	**(51.4)**	(21.7)	(34.5)	(35.0)	(67.1)
Experience (losses) / gains on schemes' assets					
Amount (£m)	**(80.7)**	(53.6)	3.2	33.7	8.9
Percentage of schemes' assets	**(38.4)%**	(21.0)%	1.1%	12.6%	4.7%
Experience losses on defined benefit obligations					
Amount (£m)	**18.3**	(5.8)	(4.4)	(32.2)	(7.9)
Percentage of defined benefit obligations	**7.0%**	(2.1)%	(1.4)%	(10.7)%	(3.1)%

The Company's current service cost during the year was 16.4% of pensionable earnings (2008 21.7%). The Company's existing defined benefit schemes have been closed to new entrants from 1 April 2008.

In 2008 the Pennon Group completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2007 which resulted in higher future service and deficit recovery contributions. The Group further updated this valuation to 30 September 2008 and the company has made further prepayments of contributions in the year totalling £28.8m (2008 £15.4m).

The Pennon Group monitors funding levels on an annual basis and no further Company regular contributions are expected to be paid to the scheme during the year ended 31 March 2010.

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

23 Called-up Share Capital

	2009 £m	2008 £m
Authorised, 500,000,000 Ordinary shares of £1 each	**500.0**	500.0
Allotted, called-up and fully paid:- 150,950,000 (2008: 450,950,000) Ordinary shares of £1 each	**150.9**	450.9

The company undertook a share capital reduction exercise in accordance with the Companies Act 2006 in 2008/09 which created sufficient reserves to pay a backlog of dividends that had built up.

24 Employee share schemes

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

i) Sharesave Scheme

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

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

Date granted and subscription price fully paid		Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
			2009	2008
6 July 1999	275p	2002 - 2006	**-**	-
5 July 2000	154p	2003 - 2007	**-**	-
4 July 2001	163p	2004 - 2008	**-**	29
9 July 2002	189p	2005 - 2009	**27**	27
8 July 2003	177p	2006 - 2010	**41**	256
6 July 2004	200p	2007 - 2011	**187**	195
5 July 2005	270p	2008 - 2012	**188**	403
4 July 2006	358p	2009 - 2013	**381**	394
3 July 2007	522p	2010 - 2014	**294**	306
8 July 2008	517p	2012 - 2016	**247**	-
			1,365	1,610

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24 Employee share schemes (continued)

i) Sharesave Scheme (continued)

At 31 March 2009 there were 723 participants in the Sharesave Scheme (2008: 752).
The number and weighted average exercise price of Sharesave options:

	2009		2008	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share p**	Number of ordinary shares (thousands)	Weighted average exercise price per share p
At April 1	**1,610**	**313**	2,052	240
Granted	**262**	**517**	332	522
Exercised	**(438)**	**221**	(606)	186
Expired	**(69)**	**353**	(168)	292
At March 31	**1,365**	**379**	1,610	313

The weighted average price at the date of exercise of Sharesave options during the year was 594p (2008: 606p). The options outstanding at 31 March 2009 had a weighted average exercise price of 379p (2008: 313p) and a weighted average remaining contractual life of 1.8 years (2008: 1.9 years).

The aggregate fair value of options granted during the year was £0.4m (2008: £0.5m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model were:

	2009	2008
Weighted average share price	**646p**	652p
Weighted average exercise price	**517p**	522p
Expected volatility	**21.3%**	18.7%
Expected life	**3.8 years**	3.9 years
Risk-free rate	**4.9%**	5.3%
Expected dividend yield	**3.3%**	3.6%

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24 **Employee share schemes (continued)**

ii) Restricted Share Plan

Under this plan, Directors and senior management receive a conditional award of ordinary shares in Pennon Group Plc. The eventual number of shares, if any, which vest is dependent upon the achievement of the performance condition of the plan over the restricted period, being not less than three years.

The number and weighted average price of shares in the Restricted Share Plan are:

	2009		2008	
	Number of ordinary shares (thousands)	**Weighted average price per share p**	Number of ordinary shares (thousands)	Weighted average price per share p
At April 1	**325**	**411**	563	360
Vested	**(96)**	**392**	(176)	270
Lapsed	**(105)**	**410**	(62)	350
At March 31	**124**	**494**	325	411

The plan was succeeded in 2007 by the Performance and Co-investment Plan and only the 2006 award remains at 31 March 2009. None of the 2006 award will vest in September 2009 as the performance criterion has not been met.

The awards outstanding at 31 March 2009 had a weighted average price of 494p (2008: 411p) and a weighted average remaining contractual life of 0.5 years (2008: 1.1 years). The fair value of awards was determined using a Monte-Carlo simulation model.

iii) Performance and Co-investment Plan

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

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24 **Employee share schemes (continued)**

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

	2009		2008	
	Number of ordinary shares (thousands)	**Exercise price per share p**	Number of ordinary shares (thousands)	Exercise price per share p
At April 1	**112**	**557**	-	-
Granted	**121**	**638**	112	557
At March 31	**233**	**598**	112	557

The awards outstanding at 31 March 2009 had an exercise price of 598p (2008 557p) and a remaining contractual life of 1.9 years (2008 2.5 years). The aggregate fair value of awards granted during the year was £0.5m (2008 £0.6m), determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2009	2008
Share price	**638p**	557p
Expected volatility	**21.3%**	18.7%
Risk-free rate	**4.9%**	5.3%

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

iv) Annual Incentive Bonus Plan – Deferred Shares

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

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

	2009		2008	
	Number of ordinary shares (thousands)	**Weighted average price per share p**	Number of ordinary shares (thousands)	Weighted average price per share p
At April 1	**122**	**457**	165	349
Granted	**58**	**620**	51	600
Vested	**(62)**	**411**	(94)	345
At March 31	**118**	**578**	122	457

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

24 Employee share schemes (continued)

The awards outstanding at 31 March 2009 had a weighted average price of 578p (2008: 457p) and a weighted average remaining contractual life of 1.4 years (2008: 1.4 years). The Pennon Group Plc share price at the date of the awards ranged from 484p to 620p.

The aggregate fair value of awards granted during the year was £0.4m (2008: £0.3m), determined from market value. No option pricing issues arise as dividends declared on the shares are receivable by the participants in the scheme.

25 Reserves

	Profit and loss account £m	Hedging Reserve £m	Total £m
At 1 April 2008	231.9	2.6	234.5
Profit on ordinary activities after taxation	84.9	-	84.9
Dividends paid (note 7)	(103.8)	-	(103.8)
Actuarial (loss) recognised in the pension scheme	(50.6)	-	(50.6)
Movement on deferred tax relating to pension liability	14.1	-	14.1
Reduction in share capital	300.0	-	300.0
Deferred tax charged directly to reserves	(0.5)	-	(0.5)
Adjustment in respect of share schemes	0.5	-	0.5
Net movement on interest rate swaps	-	(19.0)	(19.0)
At 31 March 2009	**476.5**	**(16.4)**	**460.1**

The cumulative value of goodwill at 31 March 2009 resulting from acquisitions, which has been written off against reserves, is £1.4m (2008 £1.4m).

26 Statement of Movements in Shareholders' Funds

	2009 £m	2008 £m
Profit on ordinary activities after taxation	**84.9**	99.0
Dividends paid	**(103.8)**	(68.7)
Adjustment for cost of Sharesave scheme	**0.5**	-
Adjustments for share-based payments	**-**	-
Other recognised gains and losses relating to the year	**(55.5)**	(12.0)
Deferred tax recognised directly in equity	**(0.5)**	-
Net change in Shareholders' Funds	**(74.4)**	18.3
Shareholders' Funds as at 1 April	**685.4**	667.1
Shareholders' Funds as at 31 March	**611.0**	685.4

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

27 Commitments and Contingent Liabilities

	2009 £m	2008 £m
Capital commitments		
Contracted but not provided	**76.2**	74.1
Commitments under operating leases		
Rentals during the year following the balance sheet date		
Land and buildings leases expiring:-		
within one year	**-**	0.1
Between one and five year	**0.1**	-
after five years	**1.3**	1.2
	1.4	1.3

	2009 £m	2008 £m
Contingent Liabilities		
Contractors' claims on capital schemes	**1.3**	2.3
Guarantee of borrowings of subsidiary undertaking	**300.0**	300.0
	301.3	302.3

28 Notes to the Cash Flow Statement

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

	2009 £m	2008 £m
Operating profit	**183.3**	177.1
Depreciation charge	**70.8**	69.1
Adjustment for employee share schemes	**1.1**	0.8
Deferred income released to profits	**(1.6)**	(1.2)
(Decrease) / increase in retirement benefit obligations	**(22.1)**	(6.9)
(Decrease) in provisions for liabilities and charges	**(1.3)**	1.5
(Increase) in stocks	**-**	(0.1)
Decrease in debtors (amounts falling due within and over one year)	**(9.1)**	(6.3)
Increase in creditors (amounts falling due within and over one year)	**(10.9)**	0.6
Other income	**0.8**	0.8
Infrastructure renewals charge	**26.3**	25.6
Loss / (profit) on disposal of tangible fixed assets	**(1.7)**	0.1
Net cash inflow from operating activities	**235.6**	261.1

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

28 Notes to the Cash Flow Statement (continued)

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

(i) Returns on Investments and Servicing of Finance	**2009 £m**	2008 £m
Interest received	**11.6**	11.4
Interest paid	**(20.2)**	(23.4)
Interest element of finance lease rentals	**(47.5)**	(50.1)
Net cash outflow for returns on investments and servicing of finance	**(56.1)**	(62.1)

(ii) Capital Expenditure and Financial Investment	**2009 £m**	2008 £m
Purchase of tangible fixed assets	**(138.9)**	(145.2)
Grants and contributions: Infrastructure assets	**6.2**	6.6
: Non-infrastructure assets	**0.1**	0.1
Receipts from disposal of tangible fixed assets	**2.2**	0.2
Infrastructure renewals expenditure	**(27.4)**	(28.0)
Net cash outflow for capital expenditure and financial investment	**(157.8)**	(166.3)

(iii) Management of Liquid Resources	**2009 £m**	2008 £m
Purchase of current asset investments	**(804.3)**	(665.0)
Sale of current asset investments	**724.3**	635.0
Net cash outflow from management of liquid resources	**(80.0)**	(30.0)

(iv) Financing	**2009 £m**	2008 £m
(Decrease) in debt due within one year (other than bank overdrafts)	**-**	(12.7)
Increase in debt due after more than one year	**85.8**	85.2
Finance lease drawdowns	**25.4**	100.9
Capital element of finance lease rental payments	**(10.6)**	(12.6)
Transfers to restricted deposit accounts	**(5.9)**	(5.8)
Loans to parent undertaking	**16.8**	(2.1)
Net cash inflow from financing	**111.5**	152.9

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

28 Notes to the Cash Flow Statement (continued)

(c) Analysis of Net Debt

	At 1 April 2008 £m	Cash flow £m	Non-cash movements £m	**At 31 March 2009 £m**
Cash at bank and in hand	0.8	0.3	-	**1.1**
Current asset investments:-				
Overnight deposits	141.1	(77.3)	-	**63.8**
Bank overdrafts	(21.6)	4.6	-	**(17.0)**
	120.3	(72.4)	-	**47.9**
Loans to parent undertaking	16.8	(16.8)	-	**-**
Restricted deposit accounts	10.1	6.6	-	**16.7**
Debt due within one year (other than bank overdrafts)	(14.1)	14.1	(14.1)	**(14.1)**
Debt due after more than one year	(513.5)	(100.0)	7.8	**(605.7)**
Finance lease obligations	(1,165.1)	(14.8)	(6.1)	**(1,186.0)**
	(1,665.8)	(110.9)	(12.4)	**(1,789.1)**
Current asset investments:- other than overnight deposits	90.3	80.0	(0.2)	**170.1**
	(1,455.2)	(103.3)	(12.6)	**(1,571.1)**

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

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

	2009 £m	2008 £m
(Decrease) / Increase in cash in year	**(72.4)**	79.7
Cash outflow from increase in debt and finance leasing	**(111.5)**	(152.9)
Cash inflow from decrease in liquid resources	**80.0**	30.0
Increase in net debt arising from cash flows	**(103.9)**	(43.2)
Non-cash movements:-		
Increase in accrued finance charges on finance lease obligations	**(6.1)**	(3.4)
Other	**(5.9)**	(2.5)
Increase in net debt in the year	**(115.9)**	(49.1)
Net debt at 1 April	**(1,455.2)**	(1,406.1)
Net debt at 31 March	**(1,571.1)**	(1.455.2)

NOTES TO THE HISTORICAL COST REGULATORY ACCOUNTS

29 Related Party Transactions

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

During the year the Company purchased services in the ordinary course of business from Echo South West Limited, a joint venture undertaking, at a cost of £nil (2008 £10.3m) and sold services to Echo South West Limited of £nil (2008: £2.7m). The Company was owed £nil by Echo South West Limited at 31 March 2009 (2008: £2.1m), as shown in note 14 and owed £nil (2008 £0.2m), as shown in note 16.

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

30 Parent Company

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

RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND HISTORICAL COST REGULATORY ACCOUNTS

South West Water prepares its statutory accounts under International Financial Reporting Standards (IFRS). The regulatory accounts contained in this document are prepared on the basis of regulatory accounting guidelines and UK accounting standards. The principal differences between the Company's statutory accounts and its regulatory accounts are set out below.

Profit and loss account / income statement

	2009 £m	2008 £m
Turnover		
Per statutory accounts	**432.0**	421.3
IFRS: revenue not recognised under IFRS as deemed uncollectible	**5.7**	4.5
Infrastructure charges credited to fixed assets in regulatory accounts	**(4.5)**	(4.0)
Rental income classified as 'other income' in regulatory accounts	**(0.8)**	(0.8)
Per regulatory accounts	**432.4**	421.0
Operating profit		
Per statutory accounts	**186.8**	181.1
Infrastructure charges credited to fixed assets in regulatory accounts	**(4.5)**	(4.0)
Rental income classified as 'other income' in regulatory accounts	**(0.8)**	(0.8)
IFRS: difference between infrastructure renewals charge and depreciation	**(7.5)**	(8.7)
IFRS: capitalisation policy difference	**9.3**	9.5
Per regulatory accounts	**183.3**	177.1
Profit before tax		
Per statutory accounts	**116.9**	116.2
Infrastructure charges credited to fixed assets in regulatory accounts	**(4.5)**	(4.0)
IFRS: difference between infrastructure renewals charge and depreciation	**(7.5)**	(8.7)
IFRS: capitalisation policy difference	**9.3**	9.5
Per regulatory accounts	**114.2**	113.0
Taxation		
Tax charge per statutory accounts	**51.3**	10.6
IFRS: difference in deferred tax charge because provision not discounted	**1.9**	(5.8)
Difference in movement on deferred tax related to pension deficit taken to income statement		(2.5)
IFRS: deferred tax differences on industrial buildings	**(24.0)**	-
IFRS: deferred tax difference on effect of change of corporation tax rate	**-**	11.9
Rounding	**0.1**	(0.2)
Tax charge per regulatory accounts	**29.3**	14.0
Retained Profit		
Profit for year per statutory accounts	**65.6**	105.6
Profit before tax differences as above	**(2.7)**	(3.2)
Taxation differences as above	**22.0**	(3.4)
Dividends (not shown in income statement for IFRS)	**(103.8)**	(68.7)
Retained (loss) / profit per regulatory accounts	**(18.9)**	30.3

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

Balance Sheet

	2009 £m	2008 £m
Fixed assets		
Net book value per statutory accounts	**2,377.9**	2,323.8
Infrastructure charges current year (see operating profit above)	**(4.5)**	(4.0)
Infrastructure charges brought forward	**(27.6)**	(23.6)
IFRS: difference in infrastructure assets net book value as renewals accounting not used	**(8.3)**	(8.8)
IFRS: grants and contributions netted against fixed assets	**14.6**	15.3
Net book value per regulatory accounts	**2,352.1**	2,302.7
Current assets		
Per statutory accounts	**322.3**	327.4
Infrastructure prepayment in regulatory accounts	**13.1**	11.9
IFRS: derivative assets displayed as long-term assets	**0.2**	-
IFRS: receivables displayed as long-term assets	**1.1**	0.8
Per regulatory accounts	**336.7**	340.1

	2009 £m	2008 £m
Current liabilities		
Per statutory accounts	**150.3**	208.3
IFRS: current element of provisions shown in current liabilities	**(0.3)**	(1.5)
IFRS: current element of derivative financial instruments shown in current liabilities	**(2.1)**	(0.5)
IFRS: current element of grants & contributions netted against fixed assets	**1.0**	1.2
Per regulatory accounts	**148.9**	207.5
Deferred tax provision		
Per statutory accounts	**316.9**	300.0
IFRS: discounting not permitted	**(196.1)**	(215.9)
IFRS: deferred tax differences on industrial buildings	**(41.5)**	-
IFRS: deferred tax asset relating to pension fund deficit disclosed within other deferred tax balances rather than netted against deficit	**14.3**	6.0
Per regulatory accounts	**93.6**	90.1
Pension fund deficit		
Per statutory accounts	**51.4**	21.7
IFRS: deferred tax asset relating to pension fund deficit disclosed within other deferred tax balances rather than netted against deficit	**(14.3)**	(6.0)
Per regulatory accounts	**37.1**	15.7

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

	2009 £m	2008 £m
Net assets		
Per statutory accounts	**400.6**	494.1
Opening difference	**191.3**	201.0
Profit before tax difference in year per above	**(2.7)**	(3.2)
Taxation difference in year per above	**27.8**	(3.4)
Less: deferred tax on pension scheme included in above taken to reserves in regulatory accounts	**(5.9)**	(3.2)
Rounding	**(0.1)**	0.1
Net assets per regulatory accounts	**611.0**	685.4

CURRENT COST PROFIT AND LOSS ACCOUNT FOR THE APPOINTED BUSINESS for the year ended 31 March 2009

	Notes	2009 £m	2008 £m
Turnover	2	**424.7**	413.2
Current cost operating costs	3	**(263.7)**	(265.2)
Current cost profit on sale of fixed assets	2	**1.6**	(0.2)
		162.6	147.8
Working capital adjustment		**(0.1)**	0.9
Current Cost Operating Profit		**162.5**	148.7
Other income		**0.2**	0.3
Net interest payable		**(69.9)**	(64.9)
Financing adjustment		**(6.0)**	54.8
Current Cost Profit Before Taxation		**86.8**	138.9
Tax on profit on ordinary activities:			
- Current tax		**(20.1)**	(18.0)
- Deferred tax		**(8.8)**	4.5
Current Cost Profit on Ordinary Activities After Taxation		**57.9**	125.4
Dividends		**(103.8)**	(68.7)
Current Cost Surplus Transferred to Reserves		**(45.9)**	56.7

CURRENT COST BALANCE SHEET
FOR THE APPOINTED BUSINESS
at 31 March 2009

	Notes	**2009 £m**	2008 £m
Fixed Assets			
Tangible fixed assets	4 (a,b,c)	**8,143.3**	8,140.2
Third party contributions since 1989/90		**(137.2)**	(132.3)
Infrastructure Renewals Prepayment		**13.1**	11.8
Working capital	5	**(7.3)**	(24.8)
Net operating assets		**8,011.9**	7,994.9
Cash and investments		**250.8**	245.8
Non-trade debtors		**12.2**	24.2
Non-trade creditors due within one year		**(100.4)**	(124.6)
Creditors due after more than one year		**(1,769.1)**	(1,631.2)
Provisions for liabilities and charges:			
- Deferred tax		**(93.6)**	(90.1)
- Other provisions		**(0.3)**	(1.5)
Net assets excluding pension liability		**6,311.5**	6,417.5
Pension liability		**(37.1)**	(15.7)
Net assets employed including pension liability		**6,274.4**	6,401.8
Capital and Reserves			
Called-up share capital		**150.9**	450.9
Profit and loss account	6a	**366.6**	168.1
Current cost reserve	6b	**5,756.9**	5,782.8
Total Capital and Reserves		**6,274.4**	6,401.8

Approved by the Board on 26 June 2009 and signed on its behalf by:-

C Loughlin
Chief Executive

S Davy
Finance Director

CURRENT COST CASH FLOW STATEMENT
for the year ended 31 March 2009

	Notes	2009 Appointed Business £m	2009 Appointed Business £m	2008 Appointed Business £m	2008 Appointed Business £m
Net cash flow from operating activities	7		**234.3**		259.7
Returns on investment & servicing of finance:					
Interest received		**11.6**		11.4	
Interest paid		**(20.2)**		(23.4)	
Interest in finance lease rentals		**(47.5)**		(50.1)	
Net cashflow from returns on investment & servicing of finance			**(56.1)**		(62.1)
Taxation			**(21.4)**		(7.0)
Capital expenditure and financial investment:					
Gross cost of purchase of fixed assets		**(138.9)**		(145.2)	
Receipt of grants and contributions		**6.3**		6.7	
Infrastructure renewals expenditure		**(27.4)**		(28.0)	
Disposal of fixed assets		**2.2**		0.2	
Net cash outflow from investing activities			**(157.8)**		(166.3)
Acquisitions and disposals			**-**		-
Equity dividends paid			**(103.8)**		(68.7)
Management of liquid resources:					
Disposal or redemption of other liquid assets		**724.3**		635.0	
Purchase of other liquid investments		**(804.3)**		(665.0)	
Net cash flow from management of liquid resources			**(80.0)**		(30.0)
Net cash flow before financing			**(184.8)**		(74.4)
Financing:					
Capital element in finance lease rentals		**(10.6)**		(12.6)	
New bank loans		**-**		312.7	
Draw down/ (repayment) of borrowings		**122.1**		(147.2)	
Net cash inflow from financing			**111.5**		152.9
(Decrease) / Increase in cash and cash equivalents			**(73.3)**		78.5

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

1 Current Cost Accounting Policies

(a) General

These Financial Statements have been prepared for the Appointed Business of South West Water Limited in accordance with guidance issued by the Water Services Regulation Authority (Ofwat) for modified real terms financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance in the context of assets which are valued at their current cost value to the business.

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

(b) Tangible Fixed Assets

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

The Periodic Review process provides for a re-assessment of asset valuations through a refinement of asset records as part of the Company's Asset Management Plan (AMP). The current cost gross asset values and depreciation used in the current cost statement for 2006/2007 have been based on data derived from this review.

(i) Land and Buildings

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

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

(ii) Infrastructure Assets

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

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

(iii) Other Fixed Assets

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

(iv) Surplus Land

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

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

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

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

(v) **Grants and Other Third Party Contributions**
Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

(c) **Real Financial Capital Maintenance Adjustments**
These adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

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

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

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

	2009			2008		
	Water Services £m	**Sewerage Services £m**	**Appointed Business £m**	Water Services £m	Sewerage Services £m	Appointed Business £m
Turnover						
Measured	**111.1**	**125.3**	**236.4**	101.3	117.6	218.9
Unmeasured	**67.4**	**94.4**	**161.8**	68.1	98.9	167.0
Trade effluent	**-**	**4.5**	**4.5**	-	4.2	4.2
Large user revenues	**6.2**	**7.0**	**13.2**	6.6	8.2	14.8
Other sources	**-**	**-**	**-**	-	-	-
Third party services	**7.3**	**1.5**	**8.8**	7.0	1.3	8.3
	192.0	**232.7**	**424.7**	183.0	230.2	413.2
Current Cost Profit / (Loss) on Sale of Fixed Assets	**0.8**	**0.8**	**1.6**	(0.1)	(0.1)	(0.2)

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

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

3 Analysis of Operating Costs and Current Cost Fixed Asset Net Book Values by Service 2009

	WATER SUPPLY			SEWERAGE SERVICES					BUSINESS ACTIVITIES		
	Resources and Treatment £m	Distrib-ution £m	Water Supply Total £m	Sewerage £m	Sewage Treatment £m	Sludge Treatment and Disposal £m	Sewage Treatment and Disposal Sub Total £m	Sewerage Services Total £m	Customer Services £m	Scientific Services £m	Cost of Regulation £m
Direct Costs											
Employment costs	3.9	3.1	7.0	0.7	5.6	0.7	6.3	7.0			
Power	2.2	3.9	6.1	1.8	7.8	1.0	8.8	10.6			
Agencies	-	-	-	-	-	-	-	-			
Hired and contracted services	1.1	8.7	9.8	2.5	2.2	5.5	7.7	10.2			
Materials and consumables	2.7	0.1	2.8	0.1	2.2	1.7	3.9	4.0			
Service charges	4.3	0.0	4.3	0.9	3.3	0.0	3.3	4.2			
Other direct costs	0.2	1.0	1.2	0.1	0.4	0.0	0.4	0.5			
Total Direct Costs	14.4	16.8	31.2	6.1	21.5	8.9	30.4	36.5	11.9	3.4	3.1
General & support expenditure	5.5	5.0	10.5	1.9	9.4	3.3	12.7	14.6	3.1	1.1	0.2
Functional Expenditure	19.9	21.8	41.7	8.0	30.9	12.2	43.1	51.1	15.0	4.5	3.3
Business activities			13.0					9.9			
Rates			8.3					4.4			
Doubtful debts			5.3					6.7			
Exceptional Item			0.0					0.0			
Service Costs			68.3					72.1			
Third party services			6.3					0.7			
Total Operating Expenditure			74.6					72.8			
Capital Costs											
Infrastructure renewal :	1.7	11.7	13.4	12.9	0.0	0.0	0.0	12.9			
- expenditure											
- (prepayment)/accrual											
Current cost depreciation	16.2	13.5	29.7	7.4	44.1	9.0	53.1	60.5			
Business activities capital costs			0.7					0.4			
Amortisation of deferred credits			-0.5					-1.1			
Capital Maintenance excl. Third Party Services			43.3					72.7			
Third party services			0.1					0.2			
Total Capital Maintenance			43.4					72.9			
Total Operating Costs			118.0					145.7			

Total Operating Expenditure above includes Planned and Reactive Maintenance Expenditure of:								
Infrastructure	0.1	11.3	11.4	2.2	0.0	0.0	0.0	2.2
Non Infrastructure	2.6	1.7	4.3	1.4	4.3	1.3	5.6	7.0
			15.7					9.2

Current Cost Net Book Values of Fixed Assets								
Service activities	685.6	2,829.5	3,515.1	3,898.2	598.3	122.6	720.9	4,619.1
Business activities			3.6	0.4			1.6	2.0
Service Totals			3,518.7	3,898.6			722.5	4,621.1
Third party services			0.3					3.2
Total			3,519.0					4,624.3

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

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

3 Analysis of Operating Costs and Current Cost Fixed Asset Net Book Values by Service 2008

	WATER SUPPLY			SEWERAGE SERVICES					BUSINESS ACTIVITIES		
	Resources and Treatment £m	Distrib-ution £m	Water Supply Total £m	Sewerage £m	Sewage Treatment £m	Sludge Treatment and Disposal £m	Sewage Treatment and Disposal Sub Total £m	Sewerage Services Total £m	Customer Services £m	Scientific Services £m	Cost of Regulation £m
Direct Costs											
Employment costs	4.6	3.2	7.8	0.7	5.6	0.7	6.3	7.0			
Power	2.9	3.9	6.8	1.7	7.6	1.0	8.6	10.3			
Agencies	-	-	-	-	-	-	-	-			
Hired and contracted services	1.1	7.5	8.6	2.7	2.1	5.7	7.8	10.5			
Materials and consumables	2.5	0.4	2.9	0.4	2.2	1.9	4.1	4.5			
Service charges	4.0	0.0	4.0	0.9	3.0	0.0	3.0	3.9			
Other direct costs	0.2	1.0	1.2	0.2	0.6	0.1	0.7	0.9			
Total Direct Costs	15.3	16.0	31.3	6.6	21.1	9.4	30.5	37.1	7.9	3.3	1.9
General & support expenditure	6.1	5.2	11.3	2.0	10.4	3.3	13.7	15.7	3.2	0.9	0.3
Functional Expenditure	21.4	21.2	42.6	8.6	31.5	12.7	44.2	52.8	11.1	4.2	2.2
Business activities			10.5					8.0			
Rates			8.0					4.2			
Doubtful debts			4.5					5.8			
Exceptional Item			-					-			
Service Costs			65.6					70.8			
Third party services			7.0					0.6			
Total Operating Expenditure			72.6					71.4			
Capital Costs											
Infrastructure renewal :											
- expenditure	1.3	11.8	13.1	15.0				15.0			
- (prepayment)/accrual				(2.5)				(2.5)			
Current cost depreciation	17.4	14.5	31.9	7.8	45.2	9.3	54.5	62.3			
Business activities capital costs			1.5					1.1			
Amortisation of deferred credits			(0.5)					(0.7)			
Capital Maintenance excl. Third Party Services			46.0					75.2			
Third party services			-					-			
Total Capital Maintenance			46.0					75.2			
Total Operating Costs			118.6					146.6			

Total Operating Expenditure above includes Planned and Reactive Maintenance Expenditure of:								
Infrastructure	0.1	9.9	10.0	2.8				2.8
Non Infrastructure	2.6	1.7	4.3	1.4	4.9	1.3	6.2	7.6
			14.3					10.4

Current Cost Net Book Values of Fixed Assets								
Service activities	676.3	2,790.9	3,467.2	3,904.1	625.9	128.1	754.0	4,658.1
Business activities			8.1	1.3			5.1	6.4
Service Totals			3,475.3	3,905.4			759.1	4,664.5
Third party services			0.1					0.2
Total			3,475.4					4,664.7

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

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

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

Water Services	Specialised Operational Assets	Non-specialised Operational Properties	Infra-structure Assets	Other Tangible Assets	Total
	£m	£m	£m	£m	£m
Gross Replacement Cost:-					
At 1 April 2008	918.3	7.7	2,983.9	92.3	4,002.2
RPI adjustment	(3.7)	-	(11.9)	(0.4)	(16.0)
Disposals	(0.2)	-		(1.0)	(1.2)
Additions	25.7	-	53.3	10.4	89.4
At 31 March 2009	**940.1**	**7.7**	**3,025.3**	**101.3**	**4,074.4**
Depreciation:-					
At 1 April 2008	467.1	6.0		53.6	526.7
RPI adjustment	(1.9)	-		(0.2)	(2.1)
Disposals	(0.1)	-		(0.9)	(1.0)
Charge for year	25.8	0.4		5.6	31.8
At 31 March 2009	**490.9**	**6.4**		**58.1**	**555.4**
Net Book Value:-					
At 31 March 2009	**449.2**	**1.3**	**3,025.3**	**43.2**	**3,519.0**
At 1 April 2008	451.2	1.7	2,983.9	38.7	3,475.5

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

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

Sewerage Services	Specialised Operational Assets	Non-specialised Operational Properties	Infra-structure Assets	Other Tangible Assets	Total
	£m	£m	£m	£m	£m
Gross Replacement Cost:-					
At 1 April 2008	1,576.4	16.5	3,795.9	77.5	5,466.3
RPI adjustment	(6.3)	(0.1)	(15.2)	(0.3)	(21.9)
Disposals	(0.2)	-	-	(1.1)	(1.3)
Additions	26.0	-	7.9	6.9	40.8
At 31 March 2009	**1,595.9**	**16.4**	**3,788.6**	**83.0**	**5,483.9**
Depreciation:-					
At 1 April 2008	742.3	6.0		53.3	801.6
RPI adjustment	(3.0)	-		(0.2)	(3.2)
Disposals	(0.1)	-		(0.9)	(1.0)
Charge for year	56.2	0.4		5.6	62.2
At 31 March 2009	**795.4**	**6.4**		**57.8**	**859.6**
Net Book Value:-					
At 31 March 2009	**800.5**	**10.0**	**3,788.6**	**25.2**	**4,624.3**
At 1 April 2008	834.1	10.5	3,795.9	24.2	4,664.7

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

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

Total	Specialised Operational Assets £m	Non-specialised Operational Properties £m	Infra-structure Assets £m	Other Tangible Assets £m	**Total £m**
Gross Replacement Cost:-					
At 1 April 2008	2,494.7	24.2	6,779.8	169.8	**9,468.5**
RPI adjustment	(10.0)	(0.1)	(27.1)	(0.7)	**(37.9)**
Disposals	(0.4)	-	-	(2.1)	**(2.5)**
Additions	51.7	-	61.2	17.3	**130.2**
At 31 March 2009	**2,536.0**	**24.1**	**6,813.9**	**184.3**	**9,558.3**
Depreciation:-					
At 1 April 2008	1,209.4	12.0		106.9	**1,328.3**
RPI adjustment	(4.9)	-		(0.4)	**(5.3)**
Disposals	(0.2)	-		(1.8)	**(2.0)**
Charge for year	82.0	0.8		11.2	**94.0**
At 31 March 2009	**1,286.3**	**12.8**		**115.9**	**1,415.0**
Net Book Value:-					
At 31 March 2009	**1,249.7**	**11.3**	**6,813.9**	**68.4**	**8,143.3**
At 1 April 2008	1,285.3	12.2	6,779.8	62.9	8,140.2

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

5 Working Capital

	2009 £m	2008 £m
Stocks	**4.1**	4.1
Trade debtors		
- measured household	**1.5**	0.1
- unmeasured household	**13.4**	12.7
- measured non-household	**7.1**	6.5
- unmeasured non-household	**0.3**	0.2
-other	**0.3**	0.3
Measured Income Accrual	**25.1**	25.4
Prepayments and other debtors	**6.3**	7.5
Trade creditors	**(12.4)**	(13.7)
Deferred income - customer advance receipts	**(5.2)**	(5.6)
Capital creditors	**(37.1)**	(47.1)
Accruals and other creditors	**(10.7)**	(15.2)
	(7.3)	(24.8)

6 Reserves

(a) Profit and Loss Account

	£m
At 1 April 2008	**168.1**
Profit on ordinary activities after taxation	**57.9**
Dividends paid	**(103.8)**
Actuarial loss recognised in the pension scheme	**(50.6)**
Movement on deferred tax relating to pension liability	**14.1**
Adjustment in respect of share-based payments	**1.0**
Adjustment in respect of share options vesting	**(0.6)**
Reduction in share capital	**300.0**
Deferred tax transferred directly to reserves	**(0.5)**
Net movement on interest rate swaps	**(19.0)**
At 31 March 2009	**366.6**

(b) Current Cost Reserve

	2009 £m	2008 £m
At 1 April	**5,782.8**	5,547.1
RPI Adjustments:-		
Fixed assets	**(32.5)**	296.0
Working capital	**0.1**	(0.9)
Financing	**6.0**	(54.8)
Grants and third party contributions	**0.5**	(4.6)
At 31 March	**5,756.9**	5,782.8

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

7 Notes to the Cash Flow Statement

Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2009	2008
	£m	£m
Current cost operating profit	**162.5**	148.7
Working capital adjustment	**0.1**	(0.9)
Increase in working capital	**(7.4)**	(5.1)
Receipts from other income	**0.3**	0.3
Current cost depreciation	**90.0**	95.7
Current cost profit on sale of fixed assets	**(1.6)**	0.2
Intrastructure renewals charge	**26.3**	25.6
Movement in provisions	**(35.9)**	(4.8)
Net cash flow from operating activites	**234.3**	259.7

8 Analysis of Net Debt

	Interest rate risk profile			
	Fixed rate	Floating rate	Index linked	**Total**
Maturity Profile	£m	£m	£m	**£m**
Less than one year	30.3	25.0	0.0	**55.3**
Between one and two years	139.1	8.5	0.0	**147.6**
Between two and five years	175.5	4.9	0.4	**180.8**
Between five and twenty years	519.9	38.8	22.1	**580.8**
In more than twenty years	148.3	379.5	330.5	**858.3**
Borrowings (excluding preference shares)	1,013.1	456.7	353.0	**1,822.8**
Preference share capital				**0.0**
Total Borrowings (including overdraft of £17.0m)				**1,822.8**
Cash				**(1.1)**
Short term deposits				**(250.6)**
Net Debt				**1,571.1**

NOTES TO THE CURRENT COST REGULATORY ACCOUNTS

9 Regulatory Capital Value

	Note	2009 £m
Opening RCV for the year (indexed by RPI)	(a)	**2,399**
Capital Expenditure	(a)	**163**
Infrastructure renewals expenditure		**27**
Grants and contributions		**(7)**
Depreciation		**(90)**
Infrastructure renewals charge		**(23)**
Outperformance of Regulatory Assumptions (5 years in arrears)		**(8)**
Closing RCV carried forward	(a)	**2,461**
Average regulatory capital value		**2,470**

(a) The table shows the RCV used in setting the price limits for 2008/09. The differences between the assumptions for the component parts such as capital expenditure shown above and the actual amounts do not affect the price limits in the current review period. Capital efficiencies achieved in the current price setting period will be taken into account in the calculation of the RCV used to set prices for the next review period. Other adjustments to the RCV used for the next review period will be agreed with Ofwat through the process of logging up / logging down of capital expenditure. The opening RCV for the year shown above is inflated from the closing RCV for the previous year by RPI.

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

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

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

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

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

Nature of transaction	Company	Turnover of associated company £m	Terms of supply	Value £m
Group expenses	Pennon Group Plc	7.6	Recharge of appropriate costs	4.0
Dry waste and sludge transport	Viridor Waste Group	522.7	Competitive letting/ other market testing	0.5
Customer service facilities	Echo South West Ltd	0.0	Competitive letting	0.0
Property sales	Peninsula Properties (Exeter) Ltd	0.1	Other market testing	0.1
Insurance premiums	Peninsula Insurance Ltd	1.1	Other market testing	0.5
				5.1*

* £0.1m of expenditure relates to capital work conducted by the appointed business.

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

Nature of transaction	Company	Terms of supply	Value £m
Administrative services	Pennon Group Plc	Recharge of appropriate costs	0.5
Administrative services	Echo South West Ltd	Recharge of appropriate costs	0.0
Tankered waste & trade effluent charges	Viridor Waste Group	Commercial at arms length.	0.7
Other services	Various	Recharge of appropriate costs	0.3
			1.5

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

(iii) Dividends Paid to Associated Companies

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

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

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

Dividends totalling £103.8m (2008: £68.7m) were paid to the parent undertaking, comprising £3.6m balance of 2006/07 outperformance dividend and £100.2m of based dividend relating to 2007/08 and 2008/09. (£45.7m base dividend relating to 2006/07 and £23.0m in outperformance dividends). These dividends were calculated with reference to the projections in the Final Determination.

(iv) Borrowings from Associated Companies

Company	Principal Amount £m	Repayment date	Interest rate %
South West Water Finance Plc: loan notes 2050	100.0	2010/2050 (see below)	4.13% (fixed until June 2010)
South West Water Finance Plc: index-linked bond 2057	218.0	2057	RPI + 1.99%
Peninsula Leasing Limited: Finance leases in respect of motor vehicles	0.9	2008/09 to 2010/11	6.06%
Peninsula Leasing Limited: Finance leases in respect of motor vehicles	13.7	5 April 2011	12month LIBOR

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

(v) Loans to Associated Companies

Company	Principal £m	Repayment date	Interest rate %	Interest received £m
Pennon Group Plc	-	Overnight lending	Money market variable	1.6
Peninsula Leasing Ltd	1.4	2008/09 to 2010/11	Variable	0.1

(vi) Guarantees

(i) The Company has provided guarantees to third party lenders in respect of loans and finance leases extended to its subsidiaries, South West Water Finance Plc (£318.0m at 31 March 2009) and Peninsula Leasing Limited (£14.6m at 31 March 2009). The funds raised were lent to the Company on 'back to back' terms, as described in section (iv) above.

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

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

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

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

Full details are provided in the following table:

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

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

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

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

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