YORKSHIRE WATER SERVICES LIMITED

ANNUAL REPORT AND ACCOUNTS

For the year ended
31 March 2006

Registered Number: 2366682

ANNUAL REPORT AND ACCOUNTS 2006

Contents

FINANCIAL PERFORMANCE

Key financial performance indicators

	2006	2005
Interest cover	**3.7**	3.6
Gearing	**48.8%**	43.2%
Net debt to Regulatory Capital Value (RCV)	**42.5%**	39.0%

Explanation of measures provided in Appendix to Business Review on page 5

Turnover increased by 8.5% to £704.7m (2005: £649.4m) and operating profit (before exceptionals) increased by 6.0% to £299.8m (2005: £282.8m). This year on year improved performance reflects tariff increases and keen cost control. Yorkshire Water made a good start in delivering efficiencies for PR04 by out-performing regulatory targets by £10m. This level of efficiency will provide a useful buffer against significant increases in electricity costs which will be incurred in 2006/07. The increase in operating profits also continues to fund the ongoing capital programme and taxation increases.

Yorkshire Water is a major user of electricity. Electricity for 2006/07 has now been purchased at a cost significantly higher than that allowed in the determination. Around 25% of 2007/08 electricity has also been purchased. The company is implementing initiatives to reduce the impact of the cost increase.

Regulated capital investment for the year was £330.3m (2005: £349.2m). The investment continues to be directed at the upgrading of the region's clean and waste water infrastructure. Yorkshire Water's focus on developing industry leading partnerships has resulted in a strong start to the delivery of AMP 4 targets for expenditure, outputs and efficiency.

Net debt of £1,553.8m at year end (2005: £1,328.0m) increased by £225.8m in the year, mainly attributable to payments of £254.4m relating to the ongoing capital expenditure programme. Dividend payments in the year were £268.3m (2005: £100.4m). This includes a £161.0m efficiency dividend which was paid to reflect efficiencies delivered in the previous 5 years, beyond those assumed in the determination of price limits for 2000-2005.

OPERATIONAL PERFORMANCE

Key performance indicators

	Target	**Current year**	Previous year
Overall customer satisfaction	100%	96%	95%
Overall drinking water quality	100%	99.97%	99.93%
Waste water treatment works compliance	100%	99.6%	99.97%
Accidents			
- major and over 3 day accidents	17	31	26
- all accidents	85	179	153

Explanation of measures provided in Appendix to Business Review on page 5

For the second consecutive year, Ofwat confirmed Yorkshire Water as the most efficient water and sewerage company in the UK. The company was awarded three 'A' ratings for the efficient way it runs its water and waste water operations.

Customer service

Yorkshire Water continued to improve levels of operational and customer service and was ranked number one in Ofwat's Overall Performance Assessment (OPA). The report confirmed that the company continues to achieve above average performance in a number of areas, such as reducing the number of properties suffering from poor water pressure and cutting the number of interruptions to customers' supplies.

Good progress continues to be made to reduce the number of incidents of sewer flooding and this remains one of the company's highest priorities.

Yorkshire Water's ongoing improvements to its overall levels of service contributed towards the company again being named Utility Company of the Year at the Utility Industry Achievement Awards 2005. This was the second consecutive year the company was awarded the top accolade, an unprecedented feat for any UK utility.

Two major initiatives were rolled out in 2005/2006 with far-reaching implications for the future of operational and customer service in the business and employees. The Clear Water and Waste Water 2020 initiatives will deliver a step change in the levels of service provided by the business and are designed to help the company achieve its goal of being clearly the best water company in the UK. Clear Water aims to eliminate the need to interrupt customers' water supplies while carrying out maintenance or repair work, while Waste Water 2020 will improve customer service, the way the company manages its assets and disposes of sewage sludge. Good progress has been made on both initiatives, with significant operating cost reductions also being identified.

Environmental performance

During 2005, Business in the Community held up the company as a "National Example of Excellence" for its proactive approach to environmental management and performance. The Shields Environment Award was given for a range of environmental initiatives, including staff training on environmental issues and the way the company works with its service partners and suppliers. All suppliers working with Yorkshire Water are now assessed using the company's own Environmental Vendor Evaluation System, which contributed towards the company achieving ISO14001 accreditation for every aspect of its operations.

The company staged a series of events in partnership with the Ramblers' Association to celebrate the final stages of implementation of the Countryside and Rights of Way Act 2000.

Good progress was also made towards improving the condition of Sites of Special Scientific Interest (SSSIs) on Yorkshire Water land.

Waste water treatment works compliance continues to be a concern with several works at risk of failure, however a lot of work is being carried out to minimise this risk and improve performance.

A proactive pollution prevention campaign saw the number of Category 1 and 2 pollution incidents cut from 19 to 13 during the year.

Social impact

Yorkshire Water was ranked 24th in Business in the Community's "100 Companies That Count" report, a rise of 19 places on the previous year. The report benchmarks companies' performance against a range of social, ethical and environmental issues. The company, which achieved its highest ever points score, was said to have delivered outstanding performance in the areas of community, environmental and customer management.

During the year Yorkshire Water achieved its target of 25% of its people being involved in community volunteering. Our volunteers were involved in a range of activities including 'Cares' initiatives, Right to Read and Numbers Partners. In many instances our service partners were involved, further building relationships as well as contributing to the community.

A significant milestone was reached by the company's Cool Schools campaign. More than 1,000 coolers have now been donated free of charge to local primary schools to increase the availability of fresh drinking water to pupils.

Employees

The first year of the new performance management system introduced in 2004/05 has gone well. The system which was linked to a five year pay deal involves quarterly performance reviews with the potential for additional payments based upon individual and company performance.

Yorkshire Water also has a focus on developing leadership for every individual within the organisation and sees a direct link between individual leadership and achievement of the strategic goals of the company.

The continuing high level of performance of the company is directly attributable to the talent, commitment and enthusiasm of our employees.

The increase in accidents at work in the year is disappointing and the company will continue to focus in this area.

PRINCIPAL RISKS AND UNCERTAINTIES

Strategic, financial, commercial, operational, social, environmental and ethical risks are all considered as part of the company's controls, which are designed to manage rather than eliminate the risk of failure to achieve business objectives. Therefore they can only provide reasonable, not absolute, assurance against material misstatement or loss.

Although at present there are no immediate risks considered likely to have a significant impact on the short or long term value of the company, the principal risks identified fall into 5 categories:

Changes to the regulatory environment
The company currently is allowed returns and price limits in a relatively stable environment, with investment and price limits determined by Ofwat on a 5 year cycle.

On 1 April 2006, there were some changes at Ofwat. Although it will continue to be known as Ofwat, the statutory name changed to the Water Services Regulation Authority. A new Board has replaced the Director General and will now take responsibility for the economic regulation of the water and sewerage industry in England and Wales. The appointment of Philip Fletcher as Chairman, following his 5 years as Director General of Ofwat, helps to promote certainty and reduce regulatory risk during this transition period.

Changes in legislation
The company continually monitors and attempts to influence proposed new European and UK legislation which has potential to impact on the business.

The Water Framework Directive is the most substantial piece of European water legislation to date. It requires all inland and coastal waters to reach "good status" by 2015. It will do this by establishing a river basin district structure within which demanding environmental objectives will be set, including ecological targets for surface waters. The Directive therefore sets a framework which aims to provide substantial benefits for the long term sustainable management of water.

This new Directive has the potential to drive major additional capital investment and increases in customers' charges.

Changes to weather patterns
The company's core activities, the provision of high quality water and sewerage services, are inextricably linked with the weather and therefore any climate changes have the potential to impact on business.

As the group's resources are a mixture of water captured in reservoirs or abstracted from rivers or underground aquifers, climate change could alter many of the variables in this complex equation.

Social influences
The company is subject to social influences and can be forced to change its business practices in light of consumer and stakeholder pressure.

For example, following the passing of the Water Act 2003, in future if we receive formal requests to fluoridate from strategic health authorities that have followed all the proper consultation procedures and can demonstrate public support, we are obliged, where practicable, to carry out their wishes. The company maintains a neutral position on whether fluoridation is effective or appropriate. If required to fluoridate the water supply by certain strategic Health Authorities, the company would have to introduce operational procedures to enable this.

Supplier markets
As the recent fluctuation in energy prices has clearly illustrated, the company is also subject to external market forces, where input prices can rise beyond the regulatory allowance.

In order to minimise the impact of energy price fluctuations, the company follows a clear energy purchasing policy. The company has also continued to develop new ways of reducing consumption and renewable energy sources such as wind turbines at its treatment works.

FINANCIAL KEY PERFORMANCE INDICATORS

Interest cover
This measure provides an indication of whether the company's profit is sufficient to cover its interest obligations and is calculated as operating profit divided by net interest payable. These figures are disclosed in the audited accounts in the profit and loss account.

Gearing
This ratio measures the proportion of assets invested in the business that are financed by borrowing and is calculated as net debt as a proportion of net debt plus net assets. These figures are disclosed in the audited accounts in the balance sheet and note 16 on aggregate borrowings and cash.

Net debt to Regulatory Capital Value (RCV)
The RCV is determined by Ofwat and is the value of the capital base on which a return is allowed for price setting purposes. The values are calculated and published annually by Ofwat. This ratio expresses YW's regulated net debt as a proportion of the RCV, both of which are published in YW's audited regulatory accounts.

NON FINANCIAL KEY PERFORMANCE INDICATORS

Overall customer satisfaction
The company recognises the value of listening to customers in order to deliver improvements that not only meet but surpass expectations.

Customer satisfaction is monitored on a regular basis using a combination of random telephone surveys and event-based questionnaires.

Tracker research is an ongoing telephone survey involving 220 customers chosen at random each month. This monitors customers' general perceptions and the experience that customers receive when they come into contact with the company. The survey covers a range of issues including satisfaction with the service received and whether the customer agrees that Yorkshire Water is trustworthy, listens to its customers, considers the customer's point of view, deals with complaints quickly and satisfactorily, is enjoyable to deal with, is sensitive to the customers' needs and plays key roles in protecting the environment and helping people within the community.

Ongoing event-based surveys cover 9 specific areas of customer contacts, namely clean water and waste water repair and maintenance work, customer visits by water and waste water field technicians, meter installations, supply pipe repairs, new supply applications, mains rehabilitation works and the contact centre.

Water quality
The Drinking Water Inspectorate (DWI) regulates public water supplies in England and Wales. It is responsible for assessing the quality of drinking water, taking enforcement action if standards are not being met and appropriate action when water is unfit for human consumption.

The Government has set legal standards for drinking water in the Water Quality Regulations. Most of these standards come directly from European law and are based on World Health Organisation guidelines. The UK has additional standards to safeguard the already high quality of water in England and Wales. The standards are strict and generally include wide safety margins. They cover:

- Bacteria
- Chemicals such as nitrate and pesticides
- Metals such as lead
- The way the water looks and how it tastes

Professor Jeni Colbourne, the current Chief Inspector of Drinking Water, is due to publish her report for 2005 in July 2006.

According to the DWI's last report published in July 2005, of the 447,822 tests carried out in the previous calendar year, 99.97% complied fully with the UK's stringent, health-related quality standards (2003: 99.93%).

Waste Water Treatment Works compliance

The Environment Agency issues consents to allow the discharge of treated water from waste water treatment works. The 3 principal consented limits are for suspended solids, biochemical oxygen demand and ammonia. A range of other substances may be limited depending on the type of discharge. This indicator shows loads for the following determinands:

- suspended solids, which can clog fish gills and blanket the river bed, thereby destroying fish habitat;
- biochemical oxygen demand (BOD), which is a measure of the amount of oxygen consumed in water - usually by organic pollution - and therefore reflects the quality of the water ;
- ammonia, which is toxic to fish;
- phosphate, which can lead to eutrophication in fresh waters.

All sewage treatment works are monitored for compliance with their discharge consents and the receiving waters are monitored to assess their compliance with water quality targets. The frequency of monitoring depends on the size of the treatment works; small works are monitored on a quarterly basis and large works are monitored every week.

Reportable and notifiable accidents

The Health and Safety Commission is responsible for health and safety regulation in Great Britain. The Health and Safety Executive and local government are the enforcing authorities who work in support of the Commission.

The Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR) place a legal duty on employers to notify and report some work-related accidents, diseases and dangerous occurrences.

These include, for example:

- deaths;
- major injuries;
- over-3-day injuries – where an employee or self-employed person is away from work or unable to work normally for more than 3 consecutive days;
- injuries to members of the public or people not at work where they are taken from the scene of an accident to hospital;
- some work-related diseases;
- dangerous occurrences – where something happens that does not result in an injury, but could have done.

Directors' Report

for the Year Ended 31 March 2006

The Directors present their report for the year to 31 March 2006.

Financial results for the year

Profit on ordinary activities was £151.9m (2005 restated: £164.4m).

Share capital

There has been no change during the year to the company's issued share capital of £775 million in shares of £1 each fully paid, all of which is held by Kelda Group plc.

Business review

A review of the development and performance of the business of the company, including the financial performance during the year, key performance indicators and a description of the principal risks and uncertainties facing the company are set out in the business review on pages 1 to 6. The purpose of this annual report is to provide information to members of the company and contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this report should be construed as a profit forecast.

Principal activities

The directors' report should be read in conjunction with the business review. The principal activities of the company are the supply of clean water and the treatment and disposal of waste water in Yorkshire, for which the company is the water and sewerage undertaker.

Directors

The directors who served during the year, including any changes, are shown below.

John Napier	Chairman
Kevin Whiteman	Managing Director
Richard Ackroyd	
Allison Bainbridge	
Richard Flint	
Graham Dixon	
Alan Harrison	
Michael Smith	

<u>Non executive Directors</u>

Elizabeth Kerry
Christopher Fisher
Roger Hyde

Roger Hyde was appointed as a non executive director on 21 June 2005. All other directors held office at 1 April 2005 and throughout the year. Additional information relating to directors who served during the year, including interests in shares, is disclosed in Note 5 of the accounts.

Dividends

The total dividend for the year payable to the parent company, Kelda Group plc, of £268.3m comprises the following:

	£m
Interim dividend	32.5
Efficiency dividend	161.0
Prior year final dividend	74.8
Total dividend for the year	268.3

A final dividend for the year of £78.0m has been proposed and authorised after the year end and accordingly has not been included as a liability in these financial statements.

The company's dividend policy is to deliver real growth in dividends recognising the management of economic risks, the continuing need for investment of profits in the business and to pay additional dividends which reflect efficiency improvement, and particularly improvements beyond those assumed in the determination of price limits.

The directors believe that the dividends payable for the year are in accordance with these principles.

Reserves

An amount of £151.9m has been transferred from reserves, bringing the balance held in reserve to £854.2m (after dividends in the year of £268.3m).

Research & Development

The company undertakes a major programme of research in pursuit of improvements in service and operating efficiency. In 2005/06, £4.0m was committed to research and development including £3.1m on fixed assets.

Fixed assets

The directors are aware that the value of certain land and buildings in the balance sheet may not be representative of their market value. However, a substantial proportion of land and buildings comprises specialised operational properties and structures for which there is no ready market and it is not, therefore, practicable to provide a full valuation.

Movements in fixed assets are shown in Note 11 to the accounts and include transfers to KeyLand Developments Limited, which have all been made on the basis of independent external valuations obtained specifically for the purpose and approved by the Office of Water Services. With effect from 1 April 1996, only those transfers with a value of over £500,000 have been subject to approval by the Office of Water Services.

Capital and infrastructure renewals expenditure

Total expenditure on regulated activities during the year amounted to £330.3m.

Payment of suppliers

The company's policy on the payment of suppliers is to ensure that all payments are made in accordance with the terms and conditions agreed with suppliers. For construction contracts, payment terms are covered by the appropriate Conditions of Contract, such as NEC Form of Contract, ICE 6th Edition and Model Form of Conditions of Contract for Process Plants (IChemEng).

The payment day ratio (the figure, expressed in days, which bears the same proportion to the number of days in the year as the amount owed to trade creditors at the year end bears to the amounts invoiced by suppliers during the year) is 35 days.

Instrument of Appointment

Condition F of the company's Instrument of Appointment as a water and sewerage undertaker requires the company to publish regulatory accounting information in a prescribed format in addition to that required for the statutory accounts. This additional information is included on pages 37 to 63. Further copies of these statements can be obtained, free of charge, by writing to Kelda Group plc, Company Secretary's Department, Western House, Halifax Road, Bradford, BD6 2SZ.

Employees and employment policies

The company strives to create a positive working environment for its employees. The company is committed to increasing employee involvement and places great emphasis on open two way communications. There is an extensive consultation and communication process with employees and trade unions to keep employees informed and involved. Employees have opportunities to express their views including regular face to face sessions with senior management and are kept informed via regular briefings and in-house publications.

The company's employment policies go well beyond current legal requirements. The company recognises that work/life balance is a key factor and offers a range of part time working opportunities, flexible working for some jobs, and a formal jobshare policy. Employees also have the opportunity to acquire a direct stake in the success of business through a sharesave scheme which has been operating since 1989.

The company is committed to treating job applicants and employees in the same way, regardless of their ethnic origin, gender, disability, race, colour, religion, sexual orientation or age. An active approach to keeping employees who become disabled in employment, and a commitment to equal opportunities for less able job applicants has been recognised with the 'double tick' accreditation from the UK employment service.

The company's approach to equal opportunities and diversity applies to advertisements for jobs, recruitment and selection, training, conditions of work, pay and to any other aspect of employment.

The company continues to build links with ethnic minority groups and monitors the composition of the workforce to track the effectiveness of actions in relation to issues of diversity.

The company continues to be committed to high levels of training and employee development through a wide range of in-house and accredited programmes. Employees are encouraged to seek out the information, development and training needed to carry out their role to its full potential and to share learning, expertise and information with colleagues. The company recognises team and individual achievements via 'Business Excellence' events and presentations.

Environment and community

The environmental policy of the company recognises that a sustainable water and waste water business is dependent on environmentally sustainable operations. It is therefore committed to integrating environmental best practice and continuous improvement in environmental performance through the efficient, effective and proper conduct of its business.

Environmental performance is reported through the company's web based environment and community report which is regularly updated and independently verified. This can be viewed at **www.keldagroup.com/environment**

The company contributes actively to the communities which it serves. One in five employees has volunteered to take part in a wide range of community activities. These include a Community Ambassadors scheme, a Speakers Panel, and support to local education ranging from Right to Read in junior schools through to coaching at senior schools, and mentoring university students from diverse ethnic backgrounds.

Going concern

After making enquiries, the directors have a reasonable expectation, given the nature of the regulated water services business, that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Directors' statement as to disclosure of information to auditors

As at the date of this report, as far as each director is aware there is no relevant audit information of which the company's auditor is unaware and each director has taken steps as he or she should have taken as a director in order to make him or herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Auditor

A resolution to reappoint Ernst & Young LLP as the Company's auditor will be put to the forthcoming Annual General Meeting.

BY ORDER OF THE BOARD PHILIP HUDSON, COMPANY SECRETARY, 27 JUNE 2006
REGISTERED OFFICE: Western House, Halifax Road, Bradford BD6 2SZ
REGISTERED IN ENGLAND NO 2366682

Profit and Loss Account
for the Year Ended 31 March 2006

	Notes	**2006** **£m**	*2005(restated)* £m
Turnover		**704.7**	649.4
Operating costs	*2*	**(404.9)**	(366.6)
Operating profit before exceptional costs		**299.8**	282.8
Exceptional restructuring costs	*2*	-	(5.8)
Operating profit		**299.8**	277.0
Net interest payable	*7*	**(81.8)**	(76.9)
Profit before taxation		**218.0**	200.1
Taxation	*8*	**(66.1)**	(35.7)
Profit for the year	*19*	**151.9**	164.4

Statement of Recognised Gains and Losses
for the Year Ended 31 March 2006

	2006 **£m**	*2005* £m
Profit for the financial year	**151.9**	164.4
Prior year adjustment – FRS 20	**(0.3)**	-
Total gains and losses since last annual report	**151.6**	164.4

Balance Sheet

as at 31 March 2006

	Notes	**2006**	*2005(restated)*
		£m	£m
Fixed assets			
Intangible assets	*10*	**12.3**	13.2
Tangible assets	*11*	**3,691.8**	3,542.4
Investments	*12*	**16.7**	16.7
		3,720.8	3,572.3
Current assets			
Stocks	*13*	**0.4**	0.6
Debtors	*14*	**137.4**	222.2
Cash and short term deposits		**0.1**	-
		137.9	222.8
Creditors: amounts falling due within one year			
Short term borrowings	*16*	**(22.2)**	(25.6)
Other creditors	*15*	**(341.2)**	(244.8)
		(363.4)	(270.4)
Net current liabilities		**(225.5)**	(47.6)
Total assets less current liabilities		**3,495.3**	3,524.7
Creditors: amounts falling due after more than one year			
Long term borrowings	*16*	**(743.2)**	(667.9)
Other creditors	*15*	**(904.0)**	(906.9)
Provisions for liabilities and charges	*17*	**(217.0)**	(203.0)
		1,631.1	1,746.9
Capital and reserves			
Called up equity share capital	*18*	**775.0**	775.0
Profit and loss account	*19*	**854.2**	970.6
Share-based payment reserve	*19*	**1.9**	1.3
Total equity shareholder's funds		**1,631.1**	1,746.9

Approved by the board of directors on 27 June 2006 and signed on their behalf by:

K. Whiteman

Kevin Whiteman
Managing Director

Notes to the Accounts

1. ACCOUNTING POLICIES

The following paragraphs summarise the more important accounting policies applied in the preparation of the accounts.

Basis of accounting
The accounts of the company are prepared under the historical cost convention in compliance with all applicable United Kingdom accounting standards (Financial Reporting Standards 'FRS', Statements of Standard Accounting Practice 'SSAP' and Urgent Issues Task Force abstracts 'UITF') and, except where otherwise stated in the notes to the accounts, with the Companies Act 1985. Explanations of the departures from the requirements of the Act in respect of grants and contributions and the divisionalisation of subsidiary undertakings are given in the related policies below.

The accounting policies have been reviewed in accordance with the requirements of FRS18. The directors consider that the accounting policies set out below remain most appropriate to the company's circumstances, have been consistently applied and are supported by reasonable and prudent estimates and judgements.

The financial statements are prepared on the going concern basis as the immediate holding company has agreed that that it will continue to provide financial support to this company to enable it to meet its liabilities as they fall due.

New accounting standards
The Company has adopted the following accounting standards in the year:-

- FRS17 'Retirement Benefits'. FRS17 is fully in effect for the current year. As set out below, the company is unable to identify its share of the underlying assets and liabilities in the group schemes and therefore continues to account for pensions on a contributions basis. As a result, adoption of FRS17 has no effect on the company's results or net assets.

- FRS20 'Share-based Payments'. Under FRS20 the company is required to reflect share-based payments in the profit and loss account. The ultimate parent undertaking, Kelda Group plc, operates a savings related share option scheme under which the options have been granted to employees of the company. The fair value of employee services rendered in exchange for the grant of options is recognised as an expense in the profit and loss account with a corresponding credit to equity.

- The total amount which is expensed over the specified period until the options can be exercised (the vesting period) is determined by the fair value of the option at the date of grant. The fair value of the option calculated is determined by use of mathematical modelling including the Black Scholes option pricing model.

- The company reassesses its estimate of the number of options that are expected to become exercisable at each balance sheet date. Any adjustments to the original estimates are recognised in the profit and loss account (and equity). No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

- Awards under the Long Term Incentive Plan (LTIPs) have 2 separate vesting conditions, both of which are dependent on market-based conditions (Kelda shareholder return against a comparator group and against the market). The market-based conditions of the award are taken into account in valuing the award at the grant date. Details of the valuation method adopted for the shares granted under the plan are set out in note 27 of the financial statements. At each subsequent balance sheet date the company revises its estimate of the number of employees who will receive awards. It recognises the impact of the revision of original estimates, if any, in the profit and loss account, and a corresponding adjustment to equity over the remaining vesting period.

- For both share options and LTIPs the corresponding entries to equity represent capital contributions from the parent company. When the amounts are recharged by the parent, a corresponding entry to reserves is recorded.

- The provisions of FRS20 have been applied to options granted after 7 November 2002 and that had not vested before 1 January 2005. Share-based payments comprise share options (through the company's save-as-you-earn scheme) and a long term incentive plan. The adoption of FRS20 increased net assets by £0.7m and reduced profit by £0.2m.

- FRS21 'Events after the Balance Sheet Date'. FRS21 changes the approach to dividends declared after the balance sheet date in respect of the year for which the accounts are prepared such that these dividends are no longer accrued for in the balance sheet. As a result of adopting FRS21 the Company's net assets increased by £69.3m.

Comparatives have been restated as required following the adoption of the standards above.

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

Pensions
The company's employees participate in the Kelda Group Pension Plan (KGPP), a group defined benefit scheme as described in note 22 of the financial statements. The company is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis and therefore accounts for the scheme as if they were defined contribution schemes.

Research and development expenditure
Research and development expenditure is written off in the profit and loss account in the financial year in which it is incurred. Expenditure on fixed assets relating to research and development projects is written off over the expected useful life of those assets.

Taxation
The taxation charge in the profit and loss account is based on the profit for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date, subject to the following:

- provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets.

- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is calculated at the rates at which it is estimated that tax will arise based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is discounted using the post tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred tax assets and liabilities.

Investments
Other fixed asset investments are stated at cost less provision for impairment in value.

Intangible assets
Goodwill is the excess of the fair value of the consideration paid for a business or an associate over the fair value of the identifiable assets and liabilities acquired. Goodwill is capitalised and amortised on a straight line basis over its economic useful life, which normally will not exceed 20 years. Impairment tests on the carrying value of goodwill are undertaken at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

Goodwill arising on the transfer of the trade and net assets of The York Waterworks Ltd is being amortised over a 19 year period. The net book amount of £12.3m is shown under intangible assets in the balance sheet at 31 March 2006.

Tangible fixed assets and depreciation
Tangible fixed assets comprised the following:-

Infrastructure assets
Infrastructure assets comprise a network of systems being mains and sewers, impounding and pumped raw water storage reservoirs, dams and sea outfalls.

Expenditure on infrastructure assets to increase capacity or enhance the network and to maintain the operating capability of the network in accordance with defined standards of service is treated as a fixed asset addition and included at cost after deducting grants and contributions.

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

Other tangible fixed assets
Other tangible fixed assets are included at cost less accumulated depreciation. Finance costs incurred in respect of the construction of other tangible fixed assets are not capitalised.

Freehold land is not depreciated. Depreciation is charged on other tangible fixed assets on a straight-line basis over their estimated economic lives, or the estimated useful economic lives of their individual major components, from the month following commissioning.

Useful economic lives are principally as follows:-

Buildings	25 - 60 years
Fixed plant	5 - 40 years
Vehicles, mobile plant and computers	3 - 10 years

Assets in the course of construction are not depreciated until commissioned. The carrying values of tangible fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable.

Leased assets
Assets which are financed by leasing agreements that transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised in tangible fixed assets and the corresponding capital cost is shown as an obligation to the lessor in borrowings. Depreciation is generally charged to the profit and loss account over the shorter of the estimated useful life and the term of the lease. If the operational life of an asset is longer than the lease term, and the agreement allows an extension to that term, the asset may be depreciated over its operational life. The capital element of lease payments reduces the obligation to the lessor and the interest element is charged to the profit and loss account over the term of the lease in proportion to the capital amount outstanding.

All other leases are operating leases and the rentals are charged to the profit and loss account on a straight-line basis over the term of the lease.

Grants and contributions
Grants and contributions in respect of tangible assets, other than infrastructure assets as described below, are deferred and credited to the profit and loss account by instalments over the expected economic useful lives of the related assets.

Grants and contributions in respect of expenditure enhancing the infrastructure network are applied in reducing that expenditure. This is not in accordance with Schedule 4 to the Companies Act 1985, which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. The presentation is adopted because infrastructure assets do not have determinable finite lives and therefore such grants and contributions would remain as liabilities in perpetuity. The directors consider that the company's presentation shows a true and fair view of the investment in infrastructure assets. The effect on the company's balance sheet of this departure is to decrease the net book value of tangible fixed assets by £303.2m (2005: £280.1m).

Grants and contributions received in respect of expenditure charged to the profit and loss account during the year are included in the profit and loss account.

Stocks
Stocks are stated at cost less any provision necessary to recognise damage and obsolescence. Work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, and an appropriate proportion of overheads.

Foreign currencies
Individual transactions denominated in foreign currencies are translated into sterling at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currency are translated at the exchange rates prevailing at the balance sheet date. Profits and losses on both individual currency transactions settled during the year and unsettled monetary assets and liabilities are dealt with in the profit and loss account.

Provisions
Provision is made in accordance with FRS 12 for self insured claims, including an estimate for claims incurred but not reported.

Financial instruments
Interest rate swaps are used to hedge the company's exposure to fluctuations in interest rates on its borrowings. The amounts payable or receivable in respect of interest rate swaps are accounted for on an accruals basis through adjustments to the interest expense of the corresponding liability.

Divisionalisation of subsidiary undertakings
As the Instrument of Appointment of The York Waterworks Ltd was merged with that of Yorkshire Water Services Ltd on 1 April 2000, its trade and net assets were transferred to the company at their net book value, which was less than their fair value. As a result of the transfer, the value of the company's investment in that subsidiary undertaking fell below the amount at which it was stated in the company's accounting records. Schedule 4 to the Companies Act 1985 requires that the investment be written down accordingly and that the amount be charged as a loss in the company's profit and loss account. However, the directors consider that, as there has been no overall loss to the Group, this would fail to give a true and fair view. The difference should instead be reallocated to goodwill at the time of the asset transfer, so as to recognise in the company's individual balance sheet the effective cost to the company of those net assets and goodwill. The effect on the company's balance sheet of this departure is to recognise goodwill of £12.3m (2005: £13.2m), net of amortisation of £5.6m (2005: £4.7m). The Group accounts are not affected by this transfer.

2. *OPERATING COSTS*

		2006	*2005*
		£m	£m
Own work capitalised		**(23.0)**	(23.6)
Raw materials and consumables		**13.1**	11.9
Other external charges		**180.4**	162.0
Wages and salaries		**61.5**	59.7
Social security costs		**5.3**	5.3
Other pension costs		**13.9**	5.8
Depreciation of fixed tangible assets:			
On owned assets	- infrastructure	**45.6**	39.2
	- other assets	**95.2**	95.3
On assets held under finance leases	- infrastructure	**2.0**	1.2
	- on other assets	**14.9**	13.0
Operating lease rentals	- plant and equipment	**1.8**	1.7
	- other	**0.3**	0.3
Amortisation of grants & contributions		**(3.2)**	(3.3)
Amortisation of goodwill on subsidiary undertakings		**0.9**	1.0
Restructuring costs		**1.1**	3.0
Research and development		**0.9**	0.9
Other operating income		**(5.8)**	(6.8)
		404.9	366.6
Staff costs- exceptional restructuring costs		**0.0**	5.8

Exceptional operating costs
In 2004/05, the Company incurred exceptional restructuring costs of £5.8m. These exceptional restructuring costs related primarily to the additional reductions in manpower required to achieve the Company's efficiency targets implicit in the Final Determination on price limits for the five year period 1 from April 2005 announced by OFWAT in December 2004.

Auditor's remuneration

Statutory audit fees and expenses	**0.1**	0.1
Non-audit work	**-**	-
	0.1	0.1

Employees

The average number of persons employed by the company during the year was:	**2,129**	2,158

3. DIRECTORS

	2006	*2005*
	£000	£000
Aggregate emoluments	**959.0**	1,008.0
The amounts in respect of the highest paid director are as follows:		
Emoluments	**175.0**	164.0

The Chairman, J. A. Napier, the Managing Director, K. I. Whiteman and C. C. Fisher were directors of the holding company, Kelda Group plc, and their emoluments are shown in the accounts of that company.

All the executive directors have service agreements which are terminable by the company on 12 months' notice.

The executive directors participated in a profit related pay scheme which is open to all UK employees who have been employed by the group for a minimum period of permanent employment. In 2005/06 this scheme paid £255 (2005: £415) to each qualified participant and this is included in the emoluments table above.

During 2005/06, all executive directors were contributory members of the Kelda Group Pension Plan, a defined benefit scheme. The accrued pension benefit of the highest paid director in 2005/06 was £62,976.

4. DIRECTORS' SHARE OPTIONS

In common with all eligible employees of the group, executive directors are entitled to participate in the company's Inland Revenue approved save-as-you-earn share option scheme. The interests of directors in particular issues under the scheme are:

	Balance at 1 April 2005	*Granted during year*	*Exercised/ lapsed during year*	*Balance at 31 March 2006*	*Exercise price (pence)*	*Market price at date of exercise (pence)*	*Date options exercisable*	*Date options expire*
R. K. Ackroyd								
Sharesave	1,008	-	-	**1,008**	366.0	-	1.3.07	31.8.07
Sharesave	1,233	-	-	**1,233**	461.0	-	1.3.08	31.8.08
A. M. Bainbridge								
Sharesave	2,407	-	-	**2,407**	275.0	-	1.3.07	31.8.07
Sharesave	1,771	-	-	**1,771**	320.0	-	1.3.06	31.8.06
G. Dixon								
Sharesave	1,771	-	1,771	-	320.0	-	1.3.06	31.8.06
Sharesave	822	-	-	**822**	461.0	-	1.3.08	31.8.08
Sharesave	-	954	-	**954**	588.0	-	1.3.09	31.8.09
R. D. Flint								
Sharesave	4,330	-	-	**4,330**	366.0	-	1.3.09	31.8.09
A. Harrison								
Sharesave	6,018	-	-	**6,018**	275.0	-	1.3.07	31.8.07
M. C. Smith								
Sharesave	2,055	-	-	**2,055**	461.0	-	1.3.08	31.8.08

The Chairman, J. A. Napier, and the Managing Director, K. I. Whiteman, were directors of the holding company, Kelda Group plc, and their share options are shown in the accounts of that company.

The market price of the shares subject to these options at 31 March 2006 was 788.5p (2005: 598.0p) and has ranged from 598.5p to 821.0p during the year. The aggregate gain on the exercise of share options during the year was £nil (2005: £6,641).

The Sharesave Scheme refers to shares in the holding company, Kelda Group plc and is described in the accounts of that company.

5. *DIRECTORS' SHARE INTERESTS*

The interests of the directors who held office at the end of the year, and their immediate families, in the ordinary shares of the holding company, Kelda Group plc, as at 31 March 2006 and at the beginning of the year (or date of appointment if later) are set out below:

	Ordinary shares of 15 5/9p each at 1 April 2005	*Ordinary shares of 15 5/9p each sold in year*	*LTIPs vested in year*	*Options exercised in year*	*Ordinary shares of 15 5/9p each at 31 Mar 2006*
R. K. Ackroyd	10,547	(4,000)	2,722	-	**9,269**
A. M. Bainbridge	-	-	1,272	-	**1,272**
G. Dixon	3,845	(980)	2,319	1,771	**6,955**
R. D. Flint	-	(891)	891	-	-
A. Harrison	4,132	-	2,661	-	**6,793**
M. C. Smith	12,099	(1,500)	1,224	-	**11,823**

The Chairman, J. A. Napier, the Managing Director, K. I. Whiteman and C.C. Fisher were directors of the holding company, Kelda Group plc, and their interests in the ordinary shares of Kelda Group plc are shown in the accounts of that company.

At no time during the year has any director had a material interest in a contract with any company in the group, being a contract which was significant in relation to the business of that company.

6. *LONG TERM INCENTIVES*

The company operates a long-term incentive plan for executive directors of the company which is described in detail in Note 27. Under this scheme, conditional awards of shares have been made to directors in the year and are shown overleaf. The awards relating to K. I. Whiteman are disclosed in the accounts of the holding company. Some or all of the shares may be vested after 3 years dependent on company performance during that period.

The market price of the shares on 26 June 2006 was 755.5p. The aggregate value of shares vested during the year was £108,651 (2005: £147,435).

	At 1 April 2005	*Granted during year*	*Dividend shares*	*Vested during year*	*Lapsed during year*	*At 31 March 2006*	*Earliest vesting date*
R. K. Ackroyd	5,741	-	-	(4,133)	(1,608)	**-**	11.6.05
	12,887	-	-	-		**12,887**	2.9.06
	9,960	-	-	-		**9,960**	27.5.07
	-	8,560	-	-		**8,560**	1.6.08
A. M. Bainbridge	2,683	-	-	(1,931)	(752)	**-**	11.6.05
	10,915	-	-	-	-	**10,915**	2.9.06
	8,599	-	-	-		**8,599**	27.5.07
	-	8,300	-	-	-	**8,300**	1.6.08
G. Dixon	4,890	-	-	(3,520)	(1,370)	**-**	11.6.05
	11,187	-	-	-		**11,187**	2.9.06
	8,730	-	-	-	-	**8,730**	27.5.07
	-	7,114	-	-	-	**7,114**	1.6.08
R. D. Flint	1,878	-	-	-		**1,878**	11.6.05
	7,226	-	-	-		**7,226**	2.9.06
	7,366	-	-	-		**7,366**	27.5.07
	-	7,905	-	-	-	**7,905**	1.6.08
A. Harrison	5,611	-	-	(4,039)	(1,572)	**-**	11.6.05
	12,594	-	-	-		**12,594**	2.9.06
	9,734	-	-	-		**9,734**	27.5.07
	-	9,090	-	-	-	**9,090**	1.6.08
M. C. Smith	2,580	-	-	(1,857)	(723)	**-**	11.6.05
	10,655	-	-	-		**10,655**	2.9.06
	7,321	-	-	-		**7,321**	27.5.07
	-	6,370	-	-	-	**6,370**	1.6.08

7. *INTEREST*

	2006	*2005*
Interest payable on:	**£m**	£m
Bank loans and overdrafts	**15.1**	16.4
Finance leases	**23.0**	21.5
Inter-company loans	**46.9**	46.9
	85.0	84.8
Interest receivable:		
Inter-company loans	**(2.3)**	(7.4)
Other	**(0.9)**	(0.5)
	81.8	76.9

8. *TAXATION*

	2006	*2005*
Current tax	**£m**	£m
Corporation tax at 30% (2005: 30%)	**43.9**	19.5
Group relief payments	**5.2**	1.5
Adjustments in respect of prior years	**3.2**	-
Total current tax	**52.3**	21.0
Deferred tax		
Charge for timing differences arising and reversing in the year	**15.9**	39.2
Adjustments in respect of prior years	**(3.4)**	(6.8)
	12.5	32.4
Decrease/(increase) in discount	**1.3**	(17.7)
Total deferred tax (see Note 17)	**13.8**	14.7
Total tax on profit on ordinary activities	**66.1**	35.7

The differences between the total current tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax are shown overleaf:

	2006	*2005*
	£m	£m
Profit on ordinary activities before tax	218.0	200.1
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2005: 30%)	65.4	60.0
Effects of:		
Expenses not deductible for tax purposes	0.3	0.2
Share-based payments	(0.7)	-
Capital allowances in excess of depreciation & other timing differences	(15.9)	(39.2)
Adjustment to tax charge in respect of previous periods	3.2	-
Current tax charge for period	**52.3**	**21.0**

The tax charge in future periods may be affected by the following factors:

- capital investment is expected to remain at similar levels. The company expects to be able to continue to claim capital allowances in excess of depreciation in future years .
- changes in the medium and long-term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account.

9. DIVIDENDS

	2006	*2005 (restated)*
	£m	£m
Prior year final dividend paid	**74.8**	69.3
Interim paid	**32.5**	30.9
Efficiency dividend paid	**161.0**	-
	268.3	100.2

A final dividend for the year of £78.0m (2005: £74.8m) has been proposed and authorised but not included as a liability in these financial statements.

10. INTANGIBLE ASSETS

	Goodwill
Cost	£m
Balance at 1 April 2005 and 31 March 2006	17.9
Amortisation	
Balance at 1 April 2005	(4.7)
Charge for the year	(0.9)
Balance at 31 March 2006	(5.6)
Net book amount as at 31 March 2006	**12.3**
Net book amount as at 31 March 2005	13.2

11. TANGIBLE ASSETS

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Under construction £m	Total £m
Cost					
At 1 April 2005	1,348.0	2,096.3	1,722.8	268.3	5,435.4
Transfers from other Group companies	-	-	-	0.6	0.6
Additions	19.5	68.0	61.0	181.5	330.0
Transfers on commissioning	28.1	142.4	61.0	(231.5)	-
Disposals	(0.3)	-	(7.1)	(1.0)	(8.4)
Grants and contributions	-	-	-	(23.1)	(23.1)
At 31 March 2006	**1,395.3**	**2,306.7**	**1,837.7**	**194.8**	**5,734.5**
Depreciation					
At 1 April 2005	409.9	762.9	720.2	-	1,893.0
Disposals	(0.3)	-	(6.7)	(1.0)	(8.0)
Depreciation for the year	23.8	47.6	85.3	1.0	157.7
At 31 March 2006	**433.4**	**810.5**	**798.8**	-	**2,042.7**
Net book amount at 31 March 2006	**961.9**	**1,496.2**	**1,038.9**	**194.8**	**3,691.8**
Net book amount at 31 March 2005	938.1	1,333.4	1,002.6	268.3	3,542.4
At 31 March 2006 assets included above held under finance leases amounted to:					
Cost	150.9	86.5	279.9	-	517.3
Depreciation	27.2	11.7	122.2	-	161.1
Net book amount at 31 March 2006	**123.7**	**74.8**	**157.7**	-	**356.2**
Net book amount at 31 March 2005	126.2	49.7	166.7	32.4	375.0

The net book amount of land and buildings comprised:	**Cost at 31 March 2006 £m**	**Depreciation at 31 March 2006 £m**	**Net book value at 31 March 2006 £m**	Net book value at 31 March 2005 £m
Freehold properties	**1,393.7**	**433.0**	**960.7**	936.9
Properties held on long lease	**0.5**	-	**0.5**	0.5
Properties held on short lease	**1.1**	**0.4**	**0.7**	0.7
	1,395.3	**433.4**	**961.9**	938.1

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets. The company's accounting policy in respect of grants and contributions is a departure from the Companies Act 1985 requirements and is adopted, as explained in the accounting policy note on page 18, in order to show a true and fair view of the investment in infrastructure assets. As a consequence, the net book amount of fixed assets is £303.2m (2005: £280.1m) lower than it would have been had this treatment not been adopted.

12. *INVESTMENTS*

	Shares in group undertakings £m	Other unlisted investments £m	Total £m
Cost and net book value as at 1 April 2005 and 31 March 2006	**16.6**	**0.1**	**16.7**

Shares in group undertakings

The balance at 1 April 2005 and 31 March 2006 relates to the 100% holding in The York Waterworks Ltd which was written down to the value of the underlying net assets in 2001 and the 99.9% holding in Yorkshire Water Services Finance Plc, whose principal activity is the raising of finance.

Other unlisted investments

The company holds £27,119 of 8% Unsecured Loan Stock in Water Research Centre (1989) Plc, which conducts research on behalf of the water industry. There was a small investment disposal in the year, namely WRC, where a profit of £27k was realised.

The company has taken advantage of the exemption from preparing group accounts under section 228 of The Companies Act 1985. Consolidated accounts have been prepared by Kelda Group plc, the company's immediate parent undertaking. Copies are available from its registered office: Kelda Group plc, Western House, Halifax Road, Bradford, BD6 2SZ.

13. *STOCKS*

	2006 **£m**	*2005* £m
Raw materials and consumables	**0.4**	0.4
Work in progress	**-**	0.2
	0.4	0.6

14. *DEBTORS*

	2006 **£m**	*2005* £m
Trade debtors	**48.7**	43.4
Amounts owed by group undertakings	**2.2**	104.4
Amounts owed by associated undertakings	**0.2**	0.2
Prepayments and accrued income	**68.4**	54.8
Other debtors:		
Receivable within one year	**17.8**	19.3
Receivable after more than one year	**0.1**	0.1
	137.4	222.2

15. OTHER CREDITORS

	2006	*2005 (restated)*
	£m	£m
Amounts falling due within one year:		
Trade creditors	**37.0**	33.1
Capital creditors	**71.6**	55.8
Deferred grants and contributions on depreciating fixed assets	**3.2**	3.2
Amounts owed to group undertakings	**87.8**	30.3
Amounts owed to subsidiary undertakings	**19.1**	19.2
Social security and other taxes	**2.3**	2.3
Taxation	**43.9**	19.5
Receipts in advance	**51.1**	47.1
Other creditors	**25.2**	34.3
	341.2	244.8
Amounts falling due after more than one year:		
Amounts owed to parent company	**440.0**	440.0
Amounts owed to subsidiary undertakings	**304.2**	301.0
Deferred grants and contributions on depreciating fixed assets	**82.2**	85.2
Other creditors	**77.6**	80.7
	904.0	906.9

16. AGGREGATE BORROWINGS AND CASH

		2006		
	Bank loans and overdrafts	*Other loans*	*Finance leases*	*Total*
	£m	£m	£m	£m
Repayments				
Within one year or on demand	14.3	-	7.9	22.2
Between one and two years	14.5	-	6.2	20.7
Between two and five years	76.8	2.7	28.8	108.3
After five years	202.7	-	411.5	614.2
	308.3	**2.7**	**454.4**	765.4
Cash at bank				(0.1)
Amounts owed to parent company				494.0
Amounts owed to subsidiary company				294.5
Net debt as at 31 March 2006				**1,553.8**

	2005			
	Bank loans and overdrafts	*Other loans*	*Finance leases*	*Total*
	£m	£m	£m	£m
Repayments				
Within one year or on demand	18.4	-	7.2	25.6
Between one and two years	14.3	-	7.7	22.0
Between two and five years	64.3	3.1	26.9	94.3
After five years	129.8	-	421.8	551.6
	226.8	**3.1**	**463.6**	693.5

Amounts owed by parent company	(100.0)
Amounts owed to parent company	440.0
Amounts owed to subsidiary company	294.5
Net debt as at 31 March 2005	**1,328.0**

Borrowings repayable in instalments after more than five years include £411.5m (2005: £421.8m) in respect of finance leases which have expiry dates ranging from 2018 to 2033 and carry interest rates based on 12 month LIBOR (London Inter-Bank Offered Rate).

17. PROVISION FOR LIABILITIES AND CHARGES

	Deferred tax	*Self insurance*	*Total*
	£m	£m	£m
At 1 April 2005	201.0	2.0	203.0
Additions during the year	13.8	0.8	14.6
Utilised in year	-	0.6	0.6
At 31 March 2006	**214.8**	**2.2**	**217.0**

Deferred tax

	2006	2005
	£m	£m
At 1 April 2005	**201.0**	186.3
Deferred tax charged to the profit and loss account	**13.8**	14.7
At 31 March 2006	**214.8**	201.0

Deferred tax is provided as follows:

	At 31 March 2006	At 31 March 2005
	£m	£m
Accelerated capital allowances	**582.8**	574.1
Short term timing differences	**2.8**	(1.0)
Undiscounted provision for deferred tax	**585.6**	573.1
Discount	**(370.8)**	(372.1)
Discounted provision for deferred tax	**214.8**	201.0

The current rate of corporation tax of 30% (2005: 30%) has been used to calculate the amount of deferred tax. Provision has been made for all deferred tax assets and liabilities in respect of accelerated capital allowances and other material timing differences. These deferred tax assets and liabilities have been discounted to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse.

18. CALLED UP SHARE CAPITAL

	Authorised	*Allotted and fully paid*
Ordinary shares of £1 each at 31 March 2005 and 2006	**775,000,000**	**775,000,000**

19. MOVEMENT IN SHAREHOLDER'S FUNDS

	P & L reserve	*Share-based payment reserve*	*Share capital*	*Total funds*
	£m	£m	£m	£m
At 1 April 2004 (as previously stated)	837.4	-	775.0	1,612.4
Prior year adjustment - FRS 20/21	69.1	0.9	-	70.0
At 1 April 2004 (restated)	**906.5**	**0.9**	**775.0**	**1,682.4**
Profit for the year	164.4	-	-	164.4
Dividends	(100.2)	-	-	(100.2)
Share-based payments amount due to parent	(0.1)	0.7	-	0.6
Other	-	(0.3)	-	(0.3)
At 31 March 2005	**970.6**	**1.3**	**775.0**	**1,746.9**
Profit for the year	151.9	-	-	151.9
Dividends	(268.3)	-	-	(268.3)
Share-based payments amount due to parent	-	1.0	-	1.0
Other	-	(0.4)	-	(0.4)
At 31 March 2006	**854.2**	**1.9**	**775.0**	**1,631.1**

20. COMMITMENTS

	2006	*2005*
Capital and infrastructure renewals expenditure	**£m**	£m
commitments for contracts placed at 31 March were:	**273.5**	148.4

The long term investment programme for the company, which identified substantial future capital expenditure commitments in the period 1 April 2005 to 31 March 2010, was agreed as part of the Periodic Review process which was finalised in December 2004.

At 31 March 2006 the company was committed to making the following payments during the next financial year under non-cancellable operating leases expiring as set out below:

	Land and buildings 2006	***Other 2006***	*Land and buildings 2005*	*Other 2005*
Leases which expire:	**£m**	**£m**	£m	£m
Within one year	**0.3**	**0.9**	-	0.7
Between one and five years	**-**	**0.1**	0.3	0.1
	0.3	**1.0**	0.3	0.8

21. CONTINGENT LIABILITIES

The banking arrangements of the company operate on a pooled basis with other group companies and the bank balances of each subsidiary can be offset against each other.

The company has guaranteed bonds at 6 7/8% due 2010 and 6.625% due 2031 issued by the parent company. The liabilities under these guarantees amounted to £200m and £240m respectively at 31 March 2006.

The company has guaranteed bonds at 5.375% due 2023 and 3.048% due 2033 issued by the subsidiary company Yorkshire Water Services Finance Plc. The liabilities under these guarantees amounted to £200 million and £100 million respectively at 31 March 2006.

22. PENSIONS

The group sponsors a UK pension scheme called the Kelda Group Pension Plan (KGPP). The KGPP has a number of benefit categories providing benefits on a defined benefit basis and one category providing benefits on a defined contribution basis.

Contributions over the year ended 31 March 2006 were paid by members at 3%, 4%, 4.5% or 6% of pensionable pay (depending on benefit category). The company contributed at 475% of members contributions during the accounting year in respect of the majority of members. Contributions in the forthcoming year will be at the same level.

The most recent actuarial valuation of the KGPP was carried out as at 31 March 2004 when the market value of assets was £500.0m.

Yorkshire Water Services Ltd is unable to identify its share of the underlying assets and liabilities of the KGPP and therefore accounts for pension costs on a contribution basis. The company's total pension charge for the year was £13.9m (2005: £5.8m). At 31 March the company had outstanding contributions of £1.3m (2005: £0.7m).

An accrual for unfunded benefits of £1.5m (2005: £1.0m) has been included in the company's accounts.

The financial position of the scheme at 31 March is shown overleaf, along with the principal assumptions:

Scheme assets and liabilities

	Market value (£m)			
	2006	2005	2004	2003
Market value of assets				
Equities	**517.4**	379.5	426.0	324.7
Bonds	**142.5**	156.9	60.3	69.8
Property	**49.9**	-	-	-
Other	**21.9**	12.0	14.0	22.6
	731.7	548.4	500.3	407.1
Present value of scheme liabilities	**(793.8)**	(626.8)	(587.0)	(566.9)
Pension deficit before deferred tax	**(62.1)**	(78.4)	(86.7)	(159.8)
Deferred tax	**18.6**	23.5	26.0	47.9
Net pension deficit	**(43.5)**	**(54.9)**	**(60.7)**	**(111.9)**

	Expected long term rate of return (%)			
	2006	2005	2004	2003
Equities	**6.85**	7.30	7.35	7.25
Bonds	**4.43**	4.80	5.00	4.90
Property	**6.85**	-	-	-
Other	**4.10**	4.55	4.60	4.50

Major assumptions

	2006	2005
Inflation	**2.7%**	2.7%
Rate of increase in salaries	**3.9%**	3.9%
Rate of increase to pensions in payment and deferred pensions	**2.7%**	2.7%
Discount rate for scheme liabilities	**4.9%**	5.4%
Life expectancy of male pensioner aged 60 (years)	**23.0**	21.2
Projected life expectancy at age 60 for male aged 40 (years)	**25.9**	23.9

23. ULTIMATE PARENT COMPANY

Kelda Group plc, which is registered in England and Wales, is the company's ultimate parent company and controlling party and is the parent undertaking of the smallest and largest group to consolidate these accounts. Copies of the group accounts may be obtained from the Company Secretary, Kelda Group plc, Western House, Halifax Road, Bradford BD6 2SZ.

24. CASHFLOW STATEMENT

The accounts do not include a cashflow statement because the cashflows of the company are consolidated in the cashflow statement of the holding company in accordance with Financial Reporting Standard 1 (Revised).

25. RELATED PARTY TRANSACTIONS

As a wholly owned subsidiary of Kelda Group plc, where consolidated statutory accounts are publicly available the company has taken advantage of the exemption provided by Financial Reporting Standard 8 not to report on related party transactions pertaining to companies within the group or investees of the group qualifying as related parties.

During the year the group entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into, and trading balances outstanding at 31 March, are as follows:

Related party	*Sales to related party* £000	*Amounts owed from related party* £000
Brey Services Ltd		
2006	265	152
2005	490	234

Kelda Water Services Ltd, a wholly owned subsidiary of Kelda Group plc, has a 45% interest in Brey Services Ltd.

26. SEGMENTAL INFORMATION

The Regulatory Accounting Information, commencing at page 39 of this document, shows a split of the company's activities between the Appointed Business (provision of water and sewerage services) and Non-Appointed Business.

For statutory purposes, the directors consider there to be only one business segment, being the provision of water and sewerage services.

27. SHARE-BASED PAYMENTS

Share options

The employee share option plans are open to all qualifying employees and provide for an exercise price equal to the daily average market price on the date of grant less 20%. The options will vest if the employee remains in service for the full duration of the options scheme (either 3 or 5 years). There are no cash settlement alternatives.

	Options	2006 Weighted average exercise price £	Options	2005 Weighted average exercise price £
Outstanding at the beginning of the year	**2,788,547**	**3.65**	3,299,158	3.14
Granted during the year	**651,201**	**5.88**	696,079	4.61
Lapsed during the year	**(62,493)**	**3.81**	(160,016)	3.64
Exercised during the year	**(807,292)**	**3.15**	(1,046,674)	2.66
Outstanding at the end of the year	**2,569,963**	**4.50**	2,788,547	3.65
Of which exercisable at the end of the year	**46,382**	**3.14**	74,027	2.50

The weighted average share price at the date of exercise for share options exercised during the year was £7.98 (2005: £5.95).

The options outstanding at 31 March 2006 had a weighted average exercise price of £4.50 and a weighted average remaining contractual price of 2.5 years.

The fair value of the share options granted is estimated as at the date of grant using the Black Scholes statistical model. The inputs to the Black Scholes model are as follows:

	2006	2005
Share price at date of grant	**735p**	629p
Exercise price	**588p**	461p
Expected volatility	**25%**	25%
Expected life	**3 and 5 years**	3 and 5 years
Risk free rate	**4.56%**	4.81%
Expected dividends	**30p**	29p

Expected volatility was determined by calculating the historical volatility of the group's share price over the previous 6 years.

Long term incentive plan (LTIP)

Awards under the LTIP have 2 separate vesting conditions, both of which are dependent on market-based conditions. The market-based conditions of the award are taken into account in valuing the award at the grant date by applying the probability that the LTIPs will vest to the current market price of the group's shares. At each subsequent balance sheet date the group revises its estimate of the number of employees who will receive awards. It recognises the impact of the revision of original estimates, if any, in the profit and loss account and a corresponding adjustment to equity over the remaining vesting period.

70% of the full value of the LTIPs will vest based on the company's total shareholder return (TSR) performance over the performance period (3 years). The group's share performance will be compared with reference to the 6 listed water companies. At the end of the performance period the TSR of all 7 companies will be calculated, and the results ranked. Full vesting will require top ranking and, if Kelda is ranked between median and top position, between 30% and 100% of the shares will vest depending on how close Kelda's TSR is to the first and fourth companies.

For the remaining 30%, the group's TSR will be compared to the constituents of the FTSE 350 index. No shares will vest unless Kelda is ranked at least median. 30% vest at median and 100%

will vest if Kelda is in the top 20% of companies, with pro-rata vestings based on ranking position for intermediate performance.

	2006		2005	
		Weighted average fair		*Weighted average fair*
	LTIPs	***value***	*LTIPs*	*value*
		£		£
Outstanding at the beginning of the year	**515,787**	**2.86**	400,186	3.45
Granted during the year	**148,344**	**2.43**	191,345	1.82
Lapsed during the year	**(122,392)**	**3.04**	(1,519)	3.09
Vested during the year	**(52,239)**	**3.45**	(74,225)	3.45
Outstanding at the end of the year	**489,500**	**2.64**	515,787	2.86

DIRECTORS' RESPONSIBILITIES

In relation to the accounts

Company law requires directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit and loss account for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF YORKSHIRE WATER SERVICES LIMITED

We have audited the company's financial statements for the year ended 31 March 2006 which comprise the Profit and Loss Account, Statement of Recognised Gains and Losses, Balance Sheet and the related notes 1 to 27. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for the preparation of the Annual Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, are properly prepared in accordance with the Companies Act 1985 and that the information given in the directors' report is consistent with the financial statements. The information given in the directors' report includes that specific information presented in the business review that is cross-referred from the business review section of the directors' report.

We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the business review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
Leeds

29 June 2006

Regulatory Accounting Information 2006

Contents

Explanatory note

Pages 40 to 67 include the regulatory accounting information which the company is required to publish under the company's Instrument of Appointment as a water and sewerage undertaker. The information has been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Director General of Water Services.

Historical Cost Profit and Loss Account

for the year ended 31 March 2006

		2006			2005 (restated)		
			Non-			Non-	
		Appointed	appointed	Total	Appointed	appointed	Total
		£m	£m	£m	£m	£m	£m
Turnover		**693.9**	**10.8**	**704.7**	640.1	9.3	649.4
Operating costs		**(401.4)**	**(9.3)**	**(410.7)**	(369.7)	(9.5)	(379.2)
Operating income		**3.7**	**-**	**3.7**	4.8	-	4.8
Operating profit		**296.2**	**1.5**	**297.7**	275.2	(0.2)	275.0
Other income		**2.1**	**-**	**2.1**	2.0	-	2.0
Interest receivable		**3.2**	**-**	**3.2**	7.9	-	7.9
Interest payable		**(84.9)**	**(0.1)**	**(85.0)**	(84.7)	(0.1)	(84.8)
Profit/(loss) on ordinary activities before taxation		**216.6**	**1.4**	**218.0**	200.4	(0.3)	200.1
Taxation	- current tax	**(52.3)**	**-**	**(52.3)**	(21.0)	-	(21.0)
	- deferred tax	**(13.8)**	**-**	**(13.8)**	(14.7)	-	(14.7)
Profit on ordinary activities after taxation		**150.5**	**1.4**	**151.9**	164.7	(0.3)	164.4
Dividends	- interim	**(32.5)**	**-**	**(32.5)**	(30.9)	-	(30.9)
	- efficiency	**(161.0)**	**-**	**(161.0)**	-	-	-
	- prior year final	**(74.8)**	**-**	**(74.8)**	(69.3)	-	(69.3)
Retained (loss)/profit for the year		**(117.8)**	**1.4**	**(116.4)**	64.5	(0.3)	64.2

The accounting policies set out on pages 15 to 18 apply to the historical cost regulatory accounting information, with the exception of the accounting for infrastructure assets (explained in Note 15 on page 60) and the investment in The York Waterworks Ltd (explained in Note 1 on page 46).

Historical Cost Balance Sheet

as at 31 March 2006

	2006			2005(restated)		
		Non-			Non-	
	Appointed	appointed	Total	Appointed	appointed	Total
	£m	£m	£m	£m	£m	£m
Fixed assets						
Tangible assets	3,688.4	5.2	3,693.6	3,545.3	5.2	3,550.5
Investments	12.4	-	12.4	13.3	-	13.3
	3,700.8	5.2	3,706.0	3,558.6	5.2	3,563.8
Current assets						
Stocks	0.4	-	0.4	0.6	-	0.6
Debtors	134.7	2.7	137.4	120.0	2.2	122.2
Cash at bank and in hand	0.1	-	0.1	-	-	-
Short term investments	-	-	-	100.0	-	100.0
	135.2	2.7	137.9	220.6	2.2	222.8
Creditors: amounts falling due within one year						
Borrowings	(73.6)	(2.6)	(76.2)	(22.8)	(2.8)	(25.6)
Other creditors	(266.8)	(0.6)	(267.4)	(223.9)	(1.1)	(225.0)
	(340.4)	(3.2)	(343.6)	(246.7)	(3.9)	(250.6)
Net current liabilities	(205.2)	(0.5)	(205.7)	(26.1)	(1.7)	(27.8)
Total assets less current liabilities	3,495.6	4.7	3,500.3	3,532.5	3.5	3,536.0
Creditors: amounts falling due after more than 1 year						
Borrowings	(1,477.7)	-	(1,477.7)	(1,402.4)	-	(1,402.4)
Other creditors	(87.3)	-	(87.3)	(87.2)	-	(87.2)
	(1,565.0)	-	(1,565.0)	(1,489.6)	-	(1,489.6)
Provisions for liabilities and charges						
Deferred tax	(214.8)	-	(214.8)	(201.0)	-	(201.0)
Other	(4.0)	-	(4.0)	(10.1)	-	(10.1)
Deferred income	(80.5)	(4.9)	(85.4)	(83.3)	(5.1)	(88.4)
	1,631.3	(0.2)	1,631.1	1,748.5	(1.6)	1,746.9
Capital and reserves						
Called up share capital	775.0	-	775.0	775.0	-	775.0
Profit and loss account	854.4	(0.2)	854.2	972.2	(1.6)	970.6
Other reserves	1.9	-	1.9	1.3	-	1.3
	1,631.3	(0.2)	1,631.1	1,748.5	(1.6)	1,746.9

Current Cost Profit and Loss Account for the Appointed Business

for the year ended 31 March 2006

	Notes	2006 £m	2005 (restated) £m
Turnover	5	**693.9**	640.1
Current cost operating costs	6	**(459.0)**	(423.0)
Operating income	5	**0.4**	4.8
		235.3	221.9
Working capital adjustment	5	**(1.1)**	(6.0)
Current cost operating profit		**234.2**	215.9
Other income		**2.1**	2.0
Interest receivable		**3.2**	7.9
Interest payable		**(84.9)**	(84.7)
Financing adjustment		**37.5**	53.0
Current cost profit on ordinary activities before taxation		**192.1**	194.1
Taxation - current tax		**(52.3)**	(21.0)
- deferred tax		**(13.8)**	(14.7)
Current cost profit on ordinary activities after taxation		**126.0**	158.4
Dividends		**(268.3)**	(100.2)
Current cost (loss)/profit retained		**(142.3)**	58.2

Current Cost Balance Sheet for the Appointed Business

for the year ended 31 March 2006

	Notes	2006 £m	2005 (restated) £m
Fixed assets			
Tangible assets	*8*	**21,556.5**	20,954.5
Third party contributions since 1989/90		**(342.6)**	(320.9)
Working capital	*9*	**(107.2)**	44.5
Net operating assets		**21,106.7**	20,678.1
Cash and investments		**12.4**	13.3
Non-trade debtors		**17.9**	19.4
Non-trade creditors due within one year		**(116.8)**	(97.3)
Creditors due after one year		**(1,565.0)**	(1,489.5)
Provisions for liabilities and charges:			
- deferred tax		**(214.8)**	(201.0)
- other		**(2.2)**	(2.0)
Net assets employed		**19,238.2**	18,921.0
Capital and reserves			
Called up share capital		**775.0**	775.0
Profit and loss account		**277.1**	419.4
Current cost reserve	*10*	**18,184.2**	17,725.3
Other reserves		**1.9**	1.3
		19,238.2	18,921.0

Current Cost Cash Flow Statement

for the year ended 31 March 2006

	Notes	2006 Appointed £m	2006 Non-appointed £m	2006 Total £m	2005 Appointed £m	2005 Non-appointed £m	2005 Total £m
Net cash flow from operating activities	*11*	**434.2**	**0.5**	**434.7**	429.8	(1.3)	428.5
Returns on investments and servicing of finance							
Interest received		**3.7**	-	**3.7**	8.2	-	8.2
Interest paid		**(57.8)**	**(0.1)**	**(57.9)**	(62.8)	(0.1)	(62.9)
Interest in finance lease rentals		**(31.5)**	-	**(31.5)**	(15.7)	-	(15.7)
Net cash flow from returns on Investments and servicing of finance		**(85.6)**	**(0.1)**	**(85.7)**	(70.3)	(0.1)	(70.4)
Taxation							
Tax paid		**(19.2)**	-	**(19.2)**	(18.9)	-	(18.9)
Capital expenditure and financing of investment							
Gross cost of purchase of fixed assets		**(254.2)**	**(0.2)**	**(254.4)**	(279.7)	-	(279.7)
Receipt of grants and contributions		**15.6**	-	**15.6**	11.1	-	11.1
Infrastructure renewals expenditure		**(53.9)**	-	**(53.9)**	(52.1)	-	(52.1)
Disposal of fixed assets		**5.4**	-	**5.4**	4.6	-	4.6
Net cash outflow from investing activities		**(287.1)**	**(0.2)**	**(287.3)**	(316.1)	-	(316.1)
Equity dividends paid		**(268.3)**	-	**(268.3)**	(100.4)	-	(100.4)
Net cash outflow before financing		**(226.0)**	**0.2**	**(225.8)**	(75.9)	(1.4)	(77.3)
Financing							
Capital element in finance lease rentals		**(9.3)**	-	**(9.3)**	(6.9)	-	(6.9)
New bank loans		**100.0**	-	**100.0**	-	-	-
Movement in inter-company loans		**154.0**	-	**154.0**	113.0	-	113.0
Repayment of bank loans		**(16.7)**	-	**(16.7)**	(22.9)	-	(22.9)
Net cash inflow from financing		**228.0**	-	**228.0**	83.2	-	83.2
Increase/(decrease) in cash		**2.0**	**0.2**	**2.2**	7.3	(1.4)	5.9

1. ACCOUNTING POLICIES - CURRENT COST INFORMATION

The current cost information has been prepared for the Appointed Business of Yorkshire Water Services Ltd in accordance with guidance issued by the Director General of Water Services for modified real terms financial statements suitable for regulation in the water industry. Profitability is measured on the basis of real financial capital maintenance in the context of assets which are valued at their modern equivalent asset value to the business.

Where applicable, prior year comparatives have been restated as a result of the implementation of FRS 20 and 21, described on pages 15 and 16.

The accounting policies used are the same as those adopted in the statutory historical cost accounts, except as set out below.

Infrastructure assets
As noted on page 40, FRS 12 has not been implemented in the regulatory accounts and the difference between planned and actual expenditure on infrastructure renewals is shown as a provision within working capital in the current cost balance sheet.

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 on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amount.

The modern equivalent asset values arising from the last Periodic Review are incorporated in the 2005/06 Regulatory Accounting Information.

- **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 indexing using the Retail Price Index (RPI).

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

- **Infrastructure assets**
  Mains, 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 AMP.

  Values now reflect the AMP carried out at the last Periodic Review. A process of continuing refinement of asset records is expected to produce adjustments to existing values when periodic reviews of the AMP take place. In the intervening years, values are restated to take account of changes in the general level of inflation, as measured by changes in the RPI over the year.

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

- **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 Instrument of Appointment.

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 for deferred income.

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

- **Working capital adjustment**
  This is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors and the provision for liabilities and charges.
- **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.

Investment in York Waterworks
The intangible assets and investments accounting policy on pages 16 and 17 of the accounts outlines the treatment of the transfer of the trade and net assets of The York Waterworks Ltd to Yorkshire Water Services Ltd. In the regulatory accounts, the investment figure and compensating inter-company creditor of £16.6m have been netted to provide suitable comparisons with the previous year and consistency with the approach agreed with OFWAT.

2. *APPOINTED AND NON-APPOINTED BUSINESS*

The historical cost accounting information shows separate figures for Appointed and Non-appointed Business.

The Appointed Business is defined to be the regulated activities of the Appointee, i.e. those necessary to fulfil the functions and duties of a water and sewerage undertaker. The Non-appointed Business encompasses those activities for which Yorkshire Water Services Ltd is not a monopoly supplier or the activity involves the optional use of an asset owned by the Appointed Business.

3. DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

Allocation of costs

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

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

Borrowings or sums lent

During the year, there was an amount borrowed from the parent company which represented the deficit in funds at 3 month LIBOR rates. At 31 March 2006, the amount borrowed was £54.0m. On 31 March 2000, £200m was lent by the parent company, at a fixed rate of 6.875%, repayable in 2010, on 17 April 2000 £150m was lent at a fixed rate of 6.625% repayable in 2031, and on November 2001 a further £90m was lent at a fixed rate of 6.625% repayable in 2031. £195.8m has been lent by Yorkshire Water Services Finance Plc, a subsidiary of the company, at a fixed rate of 5.375%, repayable in 2023 and £98.7m, at a floating rate, repayable in 2033. No other material sums were lent to or borrowed from other associated companies.

Dividends paid to associated undertakings

Amounts paid to the parent company, Kelda Group plc, and the underlying dividend policy are disclosed in the Directors' Report on page 8 of these accounts.

Guarantees/securities

The bankers for Kelda Group current accounts provide an arrangement whereby debit and credit balances are pooled with interest charged on the net group balance. This facility is subject to provision of cross guarantees by each company within the pooling arrangement, guaranteeing each of the other companies' current account liabilities with the bank. This is provided the net amount of aggregate cleared debit less credit balances must not exceed £20m nor must the aggregate cleared debit balances exceed £25m.

Transfer of assets and liabilities

During the course of the year land and buildings were sold to group companies at market value. Total sale proceeds were £2.7m (2005: £4.6m).

Supply of service

Details of services supplied to the Appointee by associates during the year are disclosed overleaf where these exceed a materiality level of £1m (in line with RAG 5.04 requirements). No services of a material value were provided by the Appointee to associates.

Service	Associate Company	Turnover of Associate £m	Terms of Supply	Value £m
Corporate charges	Kelda Group plc	4.6	Cost allocation	3.1
Customer Services	Loop Customer Management	18.4	Cost allocation	16.3

The Directors declare that, to the best of their knowledge, all appropriate transactions with associated companies have been disclosed.

4. *LINK BETWEEN DIRECTORS' PAY AND STANDARDS OF PERFORMANCE*

During 2005/06 remuneration has not been paid or become due to directors as a result of any arrangements which directly link the remuneration of the directors to standards of performance in connection with the carrying out by the company of the functions of a relevant undertaker and no such arrangements were in place.

The remuneration policy of the company, which is set within the context of the group's remuneration policy, is to enable directors to receive remuneration which is positioned in the upper quartile of the market for upper quartile performance, taking into account individual performance, responsibilities and experience. Accordingly, a significant proportion of directors' remuneration is performance related through annual and long term incentive plan awards which may be paid in addition to a base salary.

Under the annual incentive plan, each director has the opportunity to earn an annual incentive award up to a specified percentage of their salary. Awards are entirely performance related. At the start of the financial year the board sets challenging financial and operational performance targets. When determining the actual annual incentive award for each director, the group remuneration committee considers overall business and individual performance taking account of a range of factors including financial performance and standards of performance against regulatory measures. The amount of any annual incentive award is determined by and at the discretion of the group remuneration committee taking account of and making a judgement in the context of the balance of all matters relevant to overall performance. The group remuneration committee believes that this is the most appropriate means of aligning directors' remuneration to performance.

Awards under the long term incentive plan are based on the total shareholder return over a three year performance period of the group, compared to that of a comparator group of companies including other water and sewerage undertakers whose shares are listed on the London Stock Exchange.

Information on the remuneration of directors is set out on page 20 of the statutory financial statements.

5. ANALYSIS OF TURNOVER & OPERATING INCOME FOR THE APPOINTED BUSINESS
for the year ended 31 March 2006

	2006			2005 (Restated)		
	Water services £m	**Sewerage services £m**	**Total appointed business £m**	Water services £m	Sewerage services £m	Total appointed business £m
Turnover						
Measured	**127.2**	**114.2**	**241.4**	120.2	102.3	222.5
Unmeasured	**180.8**	**201.7**	**382.5**	168.6	187.7	356.3
Trade effluent	**-**	**7.1**	**7.1**	-	11.3	11.3
Large user revenues and special agreements	**24.9**	**26.4**	**51.3**	19.5	19.0	38.5
Other sources	**0.9**	**3.1**	**4.0**	0.8	4.0	4.8
Third party services	**7.2**	**0.4**	**7.6**	6.5	0.2	6.7
Total turnover	**341.0**	**352.9**	**693.9**	315.6	324.5	640.1
Operating income						
Current cost profit on fixed assets Net of expenses	**0.2**	**0.2**	**0.4**	3.9	0.9	4.8
Total operating income	**0.2**	**0.2**	**0.4**	3.9	0.9	4.8
Working capital adjustment	**(0.5)**	**(0.6)**	**(1.1)**	(3.0)	(3.0)	(6.0)

6. ANALYSIS OF OPERATING COSTS AND ASSETS

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

6. ANALYSIS OF OPERATING COSTS AND ASSETS
for the year ended 31 March 2006

	Resources and treatment	Distribution	**Water supply sub total**
Direct costs	£m	£m	£m
Employment costs	4.9	6.7	**11.6**
Power	9.3	3.7	**13.0**
Agencies	-	-	-
Hired and contracted services	4.9	13.9	**18.8**
Associated companies	-	-	-
Materials and consumables	5.7	0.1	**5.8**
Service charges EA	5.5	-	**5.5**
Bulk supply imports	2.8	-	**2.8**
Other direct costs	1.4	2.6	**4.0**
Total direct costs	34.5	27.0	**61.5**
General and support expenditure	10.7	13.9	**24.6**
Functional expenditure	45.2	40.9	**86.1**
Total business activities			**16.9**
Local authority rates			**20.5**
Doubtful debts			**3.5**
Exceptional items			-
Total opex less third party services			**127.0**
Third party services - opex			**7.5**
Total operating expenditure			**134.5**
Capital costs			
Infrastructure renewals expenditure	-	31.2	**31.2**
Movement in infrastructure renewals accrual/prepayment	0.3	1.4	**1.7**
Current cost depreciation (allocated)	49.5	19.1	**68.6**
Amortisation of deferred credits			**(1.5)**
Amortisation of intangible assets			**0.9**
Business activities current cost depreciation (non-allocated)			**0.6**
Total capital maintenance			**101.5**
TOTAL OPERATING COSTS			**236.0**
CCA GROSS MEA VALUES			
Service activities	4,726.0	4,866.4	**9,592.4**
Business activities			**11.1**
Service totals			**9,603.5**
Services for third parties			-
TOTAL			**9,603.5**

Notes to the Regulatory Accounting Information

Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment and disposal £m	**Sewerage services sub total £m**	Customer services £m	Scientific services £m	Cost of regulation £m
2.5	5.0	3.5	8.5	**11.0**			
1.8	10.1	3.0	13.1	**14.9**			
-	-	-	-	-			
5.9	9.1	7.5	16.6	**22.5**			
-	-	-	-	-			
0.1	1.0	3.3	4.3	**4.4**			
1.0	3.7	-	3.7	**4.7**			
-	-	-	-	-			
1.3	1.3	0.8	2.1	**3.4**			
12.6	30.2	18.1	48.3	**60.9**	17.9	6.5	3.1
5.8	11.3	5.5	16.8	**22.6**	1.2	1.5	0.5
18.4	41.5	23.6	65.1	**83.5**	19.1	8.0	3.6
				13.9			
				10.7			
				3.0			
				-			
				111.1			
				0.4			
				111.5			
22.7	-	-	-	**22.7**			
(8.0)	-	-	-	**(8.0)**			
8.8	71.2	17.6	88.8	**97.6**			
				(1.4)			
				-			
				0.6			
				111.5			
				223.0			
11,582.7	2,833.0	412.5	3,245.5	**14,828.2**			
				11.1			
				14,839.3			
				-			
				14,839.3			

7. ANALYSIS OF OPERATING COSTS AND ASSETS
for the year ended 31 March 2005

	Resources and treatment	Distribution	**Water supply sub total**
Direct costs	£m	£m	£m
Employment costs	4.4	4.6	**9.0**
Power	6.4	2.9	**9.3**
Agencies	-	-	-
Hired and contracted services	5.0	11.0	**16.0**
Associated companies	-	-	-
Materials and consumables	5.1	0.1	**5.2**
Service charges EA	5.2	-	**5.2**
Bulk supply imports	2.4	-	**2.4**
Other direct costs	1.3	1.8	**3.1**
Total direct costs	29.8	20.4	**50.2**
General and support expenditure	9.1	12.3	**21.4**
Functional expenditure	38.9	32.7	**71.6**
Total business activities			**15.6**
Local authority rates			**18.0**
Doubtful debts			**3.3**
Exceptional items			**2.2**
Total opex less third party services			**110.7**
Third party services - opex			**6.4**
Total operating expenditure			**117.1**
Capital costs			
Infrastructure renewals expenditure	4.2	23.0	**27.2**
Movement in infrastructure renewals accrual/prepayment	0.2	0.9	**1.1**
Current cost depreciation (allocated)	48.6	18.6	**67.2**
Amortisation of deferred credits			**(1.6)**
Amortisation of intangible assets			**1.0**
Business activities current cost depreciation (non-allocated)			**0.5**
Total capital maintenance			**95.4**
TOTAL OPERATING COSTS			**212.5**
CCA GROSS MEA VALUES			
Service activities	4,578.9	4,654.5	**9,233.4**
Business activities			**10.8**
Service totals			**9,244.2**
Services for third parties			**-**
TOTAL			**9,244.2**

Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment and disposal £m	**Sewerage services sub total £m**	Customer services £m	Scientific services £m	Cost of regulation £m
2.9	5.1	2.7	7.8	**10.7**			
1.7	7.1	2.6	9.7	**11.4**			
-	-	-	-	-			
6.2	8.6	6.5	15.1	**21.3**			
-	-	-	-	-			
0.1	0.9	2.7	3.6	**3.7**			
1.0	3.3	-	3.3	**4.3**			
-	-	-	-	-			
1.2	1.2	0.6	1.8	**3.0**			
13.1	26.2	15.1	41.3	**54.4**	15.7	6.9	2.8
5.6	10.0	4.7	14.7	**20.3**	0.7	1.6	0.7
18.7	36.2	19.8	56.0	**74.7**	16.4	8.5	3.5
				12.7			
				12.0			
				3.1			
				3.6			
				106.1			
				0.2			
				106.3			
24.9	-	-	-	**24.9**			
(12.8)	-	-	-	**(12.8)**			
7.8	69.2	16.0	85.2	**93.0**			
				(1.5)			
				-			
				0.6			
				104.2			
				210.5			
11,262.0	2,702.1	378.0	3,080.1	**14,342.1**			
				10.8			
				14,352.9			
				-			
				14,352.9			

8. CURRENT COST ANALYSIS OF FIXED ASSETS BY ASSET TYPE
as at 31 March 2006

	Specialised operational assets £m	Non-specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
WATER SERVICES					
Gross replacement cost					
At 1 April 2005	1,844.5	18.6	7,158.7	247.7	9,269.5
RPI adjustment	44.3	0.5	171.8	5.9	222.5
Disposals	(7.8)	-	-	(1.3)	(9.1)
Additions	55.8	0.5	49.1	15.2	120.6
At 31 March 2006	**1,936.8**	**19.6**	**7,379.6**	**267.5**	**9,603.5**
Depreciation					
At 1 April 2005	858.2	6.1	-	123.0	987.3
RPI adjustment	20.6	0.2	-	2.9	23.7
Disposals	(4.4)	-	-	(1.2)	(5.6)
Charge for year	44.3	0.7	-	24.2	69.2
At 31 March 2006	**918.7**	**7.0**	**-**	**148.9**	**1,074.6**
Net book amount at 31 March 2006	**1,018.1**	**12.6**	**7,379.6**	**118.6**	**8,528.9**
Net book amount at 1 April 2005	986.3	12.5	7,158.7	124.7	8,282.2
SEWERAGE SERVICES					
Gross replacement cost					
At 1 April 2005	3,132.8	44.9	10,934.6	240.6	14,352.9
RPI adjustment	75.2	1.0	262.5	5.8	344.5
Disposals	(6.1)	-	-	(1.4)	(7.5)
Additions	97.4	1.4	35.5	15.1	149.4
At 31 March 2006	**3,299.3**	**47.3**	**11,232.6**	**260.1**	**14,839.3**
Depreciation					
At 1 April 2005	1,554.7	19.1	-	106.8	1,680.6
RPI adjustment	37.3	0.4	-	2.6	40.3
Disposals	(6.1)	-	-	(1.3)	(7.4)
Charge for year	73.0	1.1	-	24.1	98.2
At 31 March 2006	**1,658.9**	**20.6**	**-**	**132.2**	**1,811.7**
Net book amount at 31 March 2006	**1,640.4**	**26.7**	**11,232.6**	**127.9**	**13,027.6**
Net book amount at 1 April 2005	1,578.1	25.8	10,934.6	133.8	12,672.3

8. CURRENT COST ANALYSIS OF FIXED ASSETS BY ASSET TYPE (continued)
as at 31 March 2006

	Specialised operational assets £m	Non-specialised operational properties £m	Infrastructure assets £m	Other tangible assets £m	Total £m
TOTAL					
Gross replacement cost					
At 1 April 2005	4,977.3	63.5	18,093.3	488.3	23,622.4
RPI adjustment	119.5	1.5	434.3	11.7	567.0
Disposals	(13.9)	-	-	(2.7)	(16.6)
Additions	153.2	1.9	84.6	30.3	270.0
At 31 March 2006	**5,236.1**	**66.9**	**18,612.2**	**527.6**	**24,442.8**
Depreciation					
At 1 April 2005	2,412.9	25.2	-	229.8	2,667.9
RPI adjustment	57.9	0.6	-	5.5	64.0
Disposals	(10.5)	-	-	(2.5)	(13.0)
Charge for year	117.3	1.8	-	48.3	167.4
At 31 March 2006	**2,577.6**	**27.6**	**-**	**281.1**	**2,886.3**
Net book amount at 31 March 2006	**2,658.5**	**39.3**	**18,612.2**	**246.5**	**21,556.5**
Net book amount at 1 April 2005	2,564.4	38.3	18,093.3	258.5	20,954.5

9. WORKING CAPITAL

	2006 £m	2005 (restated) £m
Stocks	**0.4**	0.6
Trade debtors	**48.0**	43.0
Trade creditors	**(42.4)**	(42.4)
Short term capital creditors	**(71.6)**	(55.8)
Infrastructure renewals accrual	**(1.8)**	(8.1)
Trade payments in advance	**(51.0)**	(47.1)
Payroll related taxes & social security contributions	**(2.3)**	(2.3)
Group trade (creditors)/debtors	**(0.2)**	2.2
Other short term group (creditors)/debtors	**(54.0)**	100.0
Prepayments	**67.7**	54.4
	(107.2)	44.5

10. MOVEMENT ON CURRENT COST RESERVE

	2006 £m	2005 £m
Balance at 1 April	**17,725.3**	16,912.1
AMP adjustment	-	224.8
RPI adjustments		
Fixed assets	**503.0**	645.0
Working capital	**1.1**	6.0
Financing	**(37.5)**	(53.0)
Grants & third party contributions	**(7.7)**	(9.6)
Balance at 31 March	**18,184.2**	17,725.3

11. RECONCILIATION OF APPOINTED BUSINESS OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2006	2005
	£m	£m
Current cost operating profit	**234.2**	215.9
Working capital adjustment	**1.1**	6.0
Change in stocks	**0.2**	0.1
Receipts from other income	**2.1**	2.0
Current cost depreciation	**165.4**	159.2
Current cost profit on sale of assets	**(0.4)**	(4.8)
Increase in debtors and prepaid expenses	**(20.4)**	(7.1)
Increase in creditors and accrued expenses	**4.1**	17.7
Infrastructure renewals expenditure	**53.9**	52.1
Decrease in provisions	**(6.0)**	(11.3)
Net cash flow from operating activities	**434.2**	429.8

12. ANALYSIS OF NET DEBT

	At 31 Mar 2005	**Cash flow**	**At 31 Mar 2006**
	£m	**£m**	**£m**
Cash in hand and bank	-	(0.1)	**(0.1)**
Overdrafts	2.1	(2.1)	**-**
Loans due within one year	16.2	(1.9)	**14.3**
Loans due after one year	211.5	85.2	**296.7**
Finance leases	463.7	(9.3)	**454.4**
Inter-company loan	634.5	154.0	**788.5**
Total net debt	1,328.0	225.8	**1,553.8**
Appointed Business	1,325.2	226.0	**1,551.2**
Non – Appointed Business	2.8	(0.2)	**2.6**
Total net debt	1,328.0	225.8	**1,553.8**

13. CURRENT COST PROFIT AND LOSS ACCOUNT FOR THE APPOINTED BUSINESS - ROLLING SUMMARY

	2006	*2005 (restated)	*2004	*2003	*2002
	£m	£m	£m	£m	£m
Turnover	**693.9**	656.7	640.4	617.7	622.3
Current cost operating costs	**(459.0)**	(434.0)	(441.2)	(429.7)	(437.4)
Operating income	**0.4**	4.9	3.7	6.5	1.9
	235.3	227.6	202.9	194.5	186.8
Working capital adjustment	**(1.1)**	(6.2)	(7.8)	0.3	(0.1)
Current cost operating profit	**234.2**	221.4	195.1	194.8	186.7
Other income	**2.1**	2.1	2.0	1.6	1.7
Net interest	**(81.7)**	(78.8)	(79.4)	(77.3)	(71.2)
Financing adjustment	**37.5**	54.4	46.0	42.9	17.3
Current cost profit before taxation	**192.1**	199.1	163.7	162.0	134.5
Taxation – current tax	**(52.3)**	(21.5)	(20.1)	(12.3)	1.8
- deferred tax	**(13.8)**	(15.1)	(12.9)	(36.4)	(17.3)
Current cost profit on ordinary activities	**126.0**	162.5	130.7	113.3	119.0
Dividends	**(268.3)**	(102.8)	(106.1)	(109.7)	(109.2)
Current cost (loss)/profit retained	**(142.3)**	59.7	24.6	3.6	9.8

* Figures for prior years shown in the table have been restated to 2005/06 prices using RPI indexation.

14. CURRENT COST BALANCE SHEET FOR THE APPOINTED BUSINESS - ROLLING SUMMARY

	2006	*2005 (restated)	*2004	*2003	*2002
	£m	£m	£m	£m	£m
Fixed assets					
Tangible assets	**21,556.5**	21,457.4	21,080.8	20,966.2	20,839.6
Third party contributions since 1989/90	**(342.6)**	(328.6)	(318.3)	(309.1)	(296.8)
Working capital	**(107.2)**	45.6	173.5	305.3	(11.1)
Net operating assets	**21,106.7**	21,174.4	20,936.0	20,962.4	20,531.7
Cash and investments	**12.4**	13.6	15.1	16.5	18.3
Non-trade debtors	**17.9**	19.9	20.8	17.9	27.5
Non-trade creditors due within one year	**(116.8)**	(99.6)	(114.0)	(100.8)	(78.0)
Creditors due after one year	**(1,565.0)**	(1,525.2)	(1,594.8)	(1,663.9)	(1,307.0)
Provisions for liabilities and charges:					
- deferred tax	**(214.8)**	(205.8)	(196.8)	(188.7)	(157.1)
- other	**(2.2)**	(2.0)	(1.6)	(2.4)	(2.2)
Dividends payable	**-**	-	(73.2)	(76.3)	(76.7)
Net assets employed	**19,238.2**	19,375.3	18,991.5	18,964.7	18,956.5
Capital and reserves					
Called up share capital	**775.0**	793.6	818.6	840.0	866.1
Profit and loss account	**277.1**	429.5	308.6	291.6	296.9
Current cost reserve	**18,184.2**	18,150.8	17,864.3	17,833.1	17,793.5
Other reserves	**1.9**	1.4	-	-	-
	19,238.2	19,375.3	18,991.5	18,964.7	18,956.5

* Figures for prior years shown in the table have been restated to 2005/06 prices using RPI indexation.

15. RECONCILIATION OF BALANCE SHEETS IN STATUTORY AND REGULATORY ACCOUNTS

In the preparation of its statutory accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS 15 "Tangible Fixed Assets". However, for the purposes of Regulatory Accounts, OFWAT has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the statutory accounts is set out below:-

	Infrastructure Assets £m
Cost	
At 31 March 2006 per Regulatory Accounts	**1,498.4**
Adjustment to opening balance	754.4
Infrastructure renewals capitalised in the year	53.9
At 31 March 2006 per Statutory Accounts	**2,306.7**
Depreciation	
At 31 March 2006 per Regulatory Accounts	**(0.4)**
Adjustment to opening balance	(762.5)
Depreciation charge for infrastructure renewals expenditure	(47.6)
At 31 March 2006 per Statutory Accounts	**(810.5)**
Net Book Value	
At 31 March 2006 per Regulatory Accounts	**1,498.0**
Adjustment for infrastructure renewals accounting	(1.8)
At 31 March 2006 per Statutory Accounts	**1,496.2**
Provisions and Liabilities	
At 31 March 2006 per Regulatory Accounts	**(1.8)**
Less infrastructure renewals accrual	1.8
At 31 March 2006 per Statutory Accounts	-

16. *REGULATORY CAPITAL VALUES AT 2005/06 PRICES*

		2006 £m
Opening regulatory capital value for the year	*	3,515
Capital expenditure	*	354
Infrastructure renewals expenditure		44
Grants and contributions		(13)
Depreciation		(159)
Infrastructure renewals charge		(39)
Outperformance of regulatory assumptions (5 years in arrears)		(27)
Closing regulatory capital value	*	**3,675**
Average regulatory capital value		**3,560**

* The table shows the regulatory capital value used in setting the price limits for the period 2005/06 to 2009/10 as published by Ofwat in April 2005, inflated to March 2006 prices, with the exception of the average RCV, which is shown at average prices. The differences from the actual capital expenditure, depreciation, etc will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation for the next periodic review.

The Business Review on page 1 contains a review of financial and operational performance in the year, together with key performance indicators, based on the statutory accounts. It also sets out, on page 3, the principal risks and uncertainties facing the business. This review contains additional information and disclosures on regulatory financial information and 5 year trends.

FINANCIAL PERFORMANCE

Key financial performance indicators

	2006	2005
Interest cover	**3.7**	3.6
Gearing	**48.7%**	43.1%
Net debt to Regulatory Capital Value (RCV)	**42.5%**	39.0%

Historical cost profit before tax has increased by £16.2m (8.1%) to £216.6m and operating profit has increased by £21.0m (7.6%) to £296.2m since 2004/05.

Total regulated turnover for 2005/06 amounted to £693.9m, an increase of £53.8m (8.4%) over the 2004/05 total of £640.1m. Main charges increased by 8.5% (£53.6m) over the previous year, primarily as a result of the weighted average charges increase of 8.9%, which included the Ofwat set K factor of 5.5% in addition to RPI of 3.4%. This was offset by the continuing impact of meter options and economic decline affecting measured consumption.

Operating costs have increased by £31.7m to £401.4m, which comprises increases in regulated operating costs (£22.6m), depreciation (£1.9m) and the infrastructure renewals charge (£7.2m). Significant additional cost pressures allowed for in the Final Determination, including power, pensions and rates, account for the large year on year increase in operating costs. The continuing delivery of efficiencies has enabled us to mitigate the impact of these, inflation and the operating cost effects of capital schemes. The increase of £7.2m in the infrastructure renewals charge reflects the anticipated capital expenditure over the period to 2010.

The interest charge of £81.7m is £4.9m higher than 2004/05 reflecting increased net debt of £1,551.2m (2005: £1,325.2m) as a result of the company's continuing significant capital investment programme. The tax charge of £52.3m is £31.3m higher than 2004/05 due to the change in the treatment of capital allowances outlined in Tax Bulletin 53.

Atypical costs
2004/05 costs included £8.8m of atypical restructuring costs (£5.8m of which was classed as exceptional) required in order to achieve the company's efficiency targets, compared with £1.1m in 2005/06. Other atypical costs in 2005/06 include £1.4m in respect of 2 mesothelioma claims, where the insurance underwriter is declining to accept liability, £0.7m of additional electricity costs incurred to pump water due to dry weather conditions and £0.2m relating flooding incidents caused by excessive rainfall (2005: £0.6m). Refunds of Local Authority rates, following successful rating appeals, and related accruals amounted to £2.2m in the year (2005: £1.3m).

Donations to charitable trusts
Donations of £0.034m were made by the company to the Community Trust which assists customers with payment difficulties. A further £0.376m was donated by the parent company, Kelda Group plc.

Dividends
The dividend for the year of £268.3m includes an efficiency dividend of £161m, an interim dividend of £32.5m and the final 2004/05 dividend of £74.8m. The proposed final dividend for 2005/06 of £78.0m will appear in the 2006/07 accounts as a result of the implementation of FRS 21 (see page 16).

The total dividend for 2005/06 (excluding efficiency dividend) of £110.5m represents a 4.6% increase on 2004/05.

5 YEAR TRENDS

Profit and loss account
Turnover over the 5 year period has increased as a result of price increases allowed by Ofwat. The dip in turnover in 2003 reflects a K factor of zero in that year, combined with a November RPI (used in price setting) lower than the average for the year. This has been offset by the impact of customers switching to domestic meters and economic decline, affecting measured and trade effluent consumption, throughout the 5 year period.

Significant additional cost pressures allowed for in the Final Determination, including power, pensions and rates, have caused a large year on year increase in operating costs in 2006. The continuing delivery of efficiencies during the 5 year period has reduced base operating costs but these have been offset by increasing capital maintenance costs arising from the large capital programme which has affected overall operating costs, particularly in 2003/04.

Net interest payable has increased each year reflecting the company's increasing net debt level.

The current tax charge has increased significantly in 2006 following the change in the treatment of capital allowances outlined in Tax Bulletin 53. Movements in the deferred tax charge over the period are mainly due to fluctuations in the rate used for discounting the provision.

Details of the dividend paid in the year and the underlying dividend policy are disclosed in the Directors' Report on page 8 of the statutory accounts. The 2006 figure includes an efficiency dividend of £161.0m. The dividends reported have been restated to comply with FRS 21 (see page 16) which was adopted in 2005/06. Comparative figures prior to this have not been restated as this is not a requirement for statutory accounts.

Balance sheet
The value of tangible fixed assets and related third party contributions has increased significantly over the 5 year period reflecting the substantial capital investment programme.

Working capital increased significantly in 2003 due to an increase of £243.0m in loans to the parent company (offset by a corresponding increase in net debt, within creditors due over one year). The internal loans have gradually been repaid over the period and in 2006 £54.0m has now been loaned from the parent company (as shown in note 9 on page 54), which accounts for the large movement between 2005 and 2006. Fluctuations in the level of capital creditors have also affected working capital, particularly in 2002, when figures were high. The level of the infrastructure renewals provision has also decreased from £20.4m in 2002 to £1.8m in 2006.

The change in creditors due over one year mainly reflects the increase in net debt over the five year period. Fluctuations in non-trade creditors due within one year are also mainly attributable to short term borrowings.

In accordance with FRS 21, no final dividend has been accrued for 2005 and 2006 under dividends payable. Comparative figures prior to this have not been restated as this is not a requirement for statutory accounts.

The other reserves, shown in 2005 and 2006, relates to the adoption of FRS 20 'Share-based Payments' described on page 15. Comparative figures prior to this have not been restated as this is not a requirement for statutory accounts.

Directors' Responsibilities and Declarations

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible under Condition F of the Instrument of Appointment by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Act 1991 for:

a) ensuring that proper accounting records are kept by the Appointee as required by paragraph 3 of Condition F of the Instrument and having regard to the terms of any guidelines notified from time to time by the Director to the Appointee;

b) preparing on a consistent basis in respect of each financial year accounting statements in agreement with the Appointee's accounting records and in accordance with the requirements of Condition F and any guidelines notified from time to time by the Director to the Appointee. So far as reasonably practicable these should have the same content as the annual accounts of the Appointee prepared under the Companies Act 1985 Act and be prepared in accordance with the formats and the accounting policies and principles which apply to those accounts;

c) preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued to the Appointee from time to time.

RING FENCING

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

DIRECTORS' CERTIFICATE – CONDITION F

The Directors declare that the company will have available, for at least the next 12 months, sufficient financial resources and facilities to enable it to carry out its regulated activities and sufficient management resources to enable it to carry out its functions. This assessment is based on the net worth of the company as shown in the accounts and on its Business Plan for the forthcoming year.

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

Auditor's Report on the Regulatory Accounting Information

To the Water Services Regulation Authority and Directors of Yorkshire Water Services Limited

We have audited the Regulatory Accounts of Yorkshire Water Services Limited on pages 39 to 64 which comprise:

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet; 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 cashflow statement and the related notes to the current cost financial statements including the statement of accounting policies.

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

Basis of preparation

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

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

Respective responsibilities of the WSRA, the directors and auditors

The nature, form and content of the 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 64.

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

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the content of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 42 to 44 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointees' accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05, and Regulatory Accounting Guideline 4.02.

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

Basis of audit opinion

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

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

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

The regulatory historical cost accounting statements on pages 40 and 41 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be 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 60.

Opinion

In our opinion, the Regulatory Accounts of the company for the year ended 31 March 2006 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 45 to 46, the state of the company's affairs at 31 March 2006 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

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

d) proper accounting records have been kept by the Appointee as required by paragraph 3 of Condition F of the Instrument;

e) the information is in agreement with the Appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA;

f) the regulatory historical cost accounting statements on pages 40 to 41 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA;

g) the regulatory current cost accounting statements on pages 42 to 44 have been properly prepared in accordance with Regulatory Accounting Guidelines 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor, Leeds

29 June 2006