

ARTESIAN FINANCE II PLC

Annual Report and Financial Statements

Year ended 31 March 2014

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ARTESIAN FINANCE II PLC

ANNUAL REPORT AND FINANCIAL STATEMENTS 2014

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ARTESIAN FINANCE II PLC

ANNUAL REPORT AND FINANCIAL STATEMENTS 2014

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS

Colin Benford (resigned 22 May 2014, reappointed 11 July 2014)
Paul Glendenning (appointed 12 June 2014, resigned 11 July 2014)
Capita Trust Corporate Limited
Capita Trust Corporate Services Limited

SECRETARY

Capita Trust Secretaries Limited (resigned 17 January 2014)
Capita Trust Corporate Limited (appointed 17 January 2014)
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

REGISTERED OFFICE

4th Floor
40 Dukes Place
London
EC3A 7NH

BANKERS

The Royal Bank of Scotland plc
Corporate Banking

AUDITOR

Deloitte LLP
Chartered Accountants
London

STRATEGIC REPORT

The directors present their strategic report of Artesian Finance II plc ("the Company") for the year ended 31 March 2014.

ACTIVITIES

The Company was incorporated in the United Kingdom and commenced operations on 25 February 2003. It is registered as a public limited company under the Companies Act 2006.

The principal activity of the Company is to hold loans advanced to water companies.

PRINCIPAL ACTIVITY, BUSINESS REVIEW AND FUTURE DEVELOPMENTS

The Company is authorised to issue loans and bonds up to £500,000,000 (2013: £500,000,000) ("the Bonds"). The Company has no intention to change the business activities. The Bonds are unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest under the terms of a guarantee issued by Assured Guaranty (Europe) Limited (formerly Financial Security Assurance (U.K.) Limited).

The directors do not anticipate any changes to the present level of activity or the nature of the Company's business in the near future.

BUSINESS REVIEW

The loan portfolio of the Company consists of one fixed rate and three UK Retail Price Index ("RPI") linked loans which were funded through the issuance of the fixed rate bonds. Total return swaps were entered into by the Company to exchange RPI linked cash flows it receives on the loans for the fixed coupon amount payable on the Bonds. Net interest income is a key performance indicator for the Company. The net interest income for 2014 is £41,000 (2013: £41,000) which is in line with expectations.

PRINCIPAL RISKS AND UNCERTAINTIES

The Directors acknowledge that the global macro-economic indicators and general business environment have remained challenging. Market liquidity constraints, limited availability of credit and difficult trading conditions continue to pose significant challenges to all underlying businesses and borrowers to whom the Company has exposure. Conditions may deteriorate further due to the continued global financial and economic uncertainty.

The principal risks facing the Company are liquidity risk, interest rate risk and credit risk. These risks have been monitored on an ongoing basis during the period and the Company has policies in place to mitigate these risks to enable it to continue as a going concern. Refer to Notes 1 and 11 to the Financial Statements for details.

Notwithstanding the risks and uncertainties above, the financial statements have been prepared on the going concern basis as discussed in note 1.

PAYMENT TO SUPPLIERS

Given the nature of the business, there are no trade creditors and therefore no policy or trade creditor days have been disclosed.

Approved by the Board of Directors and signed on behalf of the Board

Director



Capita Trust Corporate Services Limited

Date: 29/7/2014

DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements for the Company for the year ended 31 March 2014.

RESULTS AND DIVIDENDS

The results for the year and the state of the Company's affairs as at 31 March 2014 are set out in the accompanying financial statements. The Directors do not recommend the payment of a dividend (2013: £nil).

DIRECTORS

The Directors who served throughout the year are as follows:

Colin Benford
Capita Trust Corporate Limited
Capita Trust Corporate Services Limited

EVENTS SINCE YEAR END

On 22 May 2014, Colin Benford resigned as a director of the Company and, on 11 July 2014, was reappointed. On 12 June 2014, Paul Glendenning was appointed as a director of the Company and, on 11 July, resigned.

EMPLOYEES

The Company had no employees in the current year or prior year.

AUDITOR

Deloitte LLP have expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

DISCLOSURE OF INFORMATION TO THE AUDITOR


Each of the persons who is a director at the date of approval of this report confirms that:

- (1) so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- (2) the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Approved by the Board of Directors and signed on behalf of the Board

Director



Capita Trust Corporate Services Limited

Date: 29/7/2014

DIRECTORS' RESPONSIBILITIES STATEMENT

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 2006. 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 ARTESIAN FINANCE II PLC

We have audited the financial statements of Artesian Finance II plc for the year ended 31 March 2014, which comprise the statement of comprehensive income, the statement of financial position, the statement of changes in equity, the statement of cash flow and the related notes numbered 1 to 13. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

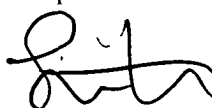
Matters on which we are required to report by exception

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

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Simon Stephens FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom

29 July 2014



STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 March 2014

	Notes	2014 £'000	2013 £'000
Interest income	3	20,798	20,798
Interest expense		(20,757)	(20,757)
Net interest income		41	41
Operating expenses	4	(60)	(66)
Other operating income		63	62
Change in fair value of loans	11	(9,455)	77,799
Change in fair value of bonds	11	3,287	(31,745)
Change in fair value of swaps	11	6,198	(46,036)
OPERATING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	5	74	55
Tax charge on profit on ordinary activities	6	(8)	(8)
PROFIT FOR THE YEAR AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		66	47

The accompanying notes form an integral part of these financial statements.

The results above arose wholly from continuing operations in the current and prior year.

ARTESIAN FINANCE II PLC

STATEMENT OF FINANCIAL POSITION At 31 March 2014

	Notes	2014 £'000	2013 £'000
NON-CURRENT ASSETS			
Loans to customers	7	568,627	578,382
CURRENT ASSETS			
Loans to customers	7	16,471	16,171
Cash and cash equivalents		447	410
Derivatives at fair value	11	3,627	2,188
		<u>20,545</u>	<u>18,769</u>
TOTAL ASSETS		<u>589,172</u>	<u>597,151</u>
CURRENT LIABILITIES			
Other payables	8	25	24
Current tax liabilities		8	8
Bonds issued	9	19,377	19,178
		<u>19,410</u>	<u>19,210</u>
NON-CURRENT LIABILITIES			
Bonds issued	9	387,609	391,095
Derivatives at fair value	11	181,057	185,816
		<u>568,666</u>	<u>576,911</u>
TOTAL LIABILITIES		<u>588,076</u>	<u>596,121</u>
EQUITY			
Share capital	10	13	13
Retained earnings		1,083	1,017
TOTAL EQUITY		<u>1,096</u>	<u>1,030</u>
TOTAL EQUITY AND LIABILITIES		<u>589,172</u>	<u>597,151</u>

These financial statements of Artesian Finance II plc, registration number 4677985, were approved and authorised for issue by the Board of Directors on 29 July 2014.

Signed on behalf of the Board of Directors

Director



Capita Trust Corporate Services Limited

The accompanying notes form an integral part of these financial statements.

ARTESIAN FINANCE II PLC

STATEMENT OF CHANGES IN EQUITY For the year ended 31 March 2014

	Share capital £'000	Retained earnings £'000	Total £'000
Balance at 1 April 2012	13	970	983
Total comprehensive income for the financial year	-	47	47
Balance at 1 April 2013	13	1,017	1,030
Total comprehensive income for the financial year	-	66	66
Balance at 31 March 2014	13	1,083	1,096

STATEMENT OF CASH FLOW
For the year ended 31 March 2014

	Notes	2014 £'000	2013 £'000
Operating profit before taxation		74	55
Adjustments for:			
Fair value of swaps	11	(6,198)	46,036
Fair value of loans	11	9,455	(77,799)
Fair value of bonds	11	(3,287)	31,745
Changes in other payables		1	1
Net cash flows from operating activities before tax		45	38
Tax paid		(8)	(8)
Net cash flows from operating activities after tax		37	30
Net increase in cash and cash equivalents		37	30
Cash and cash equivalents at the beginning of the year		410	380
Cash and cash equivalents at the end of the year		447	410
Supplemental information			
Interest received		20,799	20,798
Interest paid		(20,757)	(20,757)

The accompanying notes form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2014

1. ACCOUNTING POLICIES

General information

Artesian Finance II plc ("the Company") is a company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 1. The nature of the Company's operations and its principal activities are set out in the Directors' Report.

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") adopted by the International Accounting Standards Board ("IASB"), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together "IFRS") as endorsed by the European Union ("EU") and under the historical cost convention as modified by International Accounting Standard 39 "Financial Instruments: Recognition and Measurement" ("IAS 39").

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases have not yet been adopted by the EU):

Name of new Standards/amendments	Effective date
IFRS 9 – Financial Instruments	Accounting periods beginning on or after 1 January 2018
IFRS 10 – Consolidation	Accounting periods beginning on or after 1 January 2013
IFRS 11 – Joint Arrangements	Accounting periods beginning on or after 1 January 2013
IFRS 12 – Disclosure of Interests in Other Entities	Accounting periods beginning on or after 1 January 2013
IFRS 13 – Fair Value Measurement	Accounting periods beginning on or after 1 January 2013

The Directors are currently considering the potential impact of the adoption of IFRS 9 on the financial statements of the Company, but the Company does not believe that the adoption at any time in the future of the remaining Standards above will have any material impact on the amounts reported in these financial statements.

Due to the fact that the nature of the business is to provide finance, the Directors are of the opinion that it is more appropriate to use interest income and interest expense rather than turnover and cost of sales in preparing the statement of comprehensive income.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Going concern

The Company's business activities, performance and position, as well as principal risks and uncertainties are set out on page 2. In addition, note 11 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

The Company has met its level of expected profits for the financial period, and determined that its assets are not impaired as at the balance sheet date and therefore does not expect a shortfall in cash receipts from the borrowers. As at the balance sheet date, the Company has net assets of £1,096,000 (2013: £1,030,000). Currently the long-term assets are funded by long-term fixed rate bonds.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2014

1. ACCOUNTING POLICIES (CONTINUED)

Going Concern (Continued)

Total return swaps were entered into by the Company to exchange index-linked cash flows it receives on its loan assets for the fixed coupon amount payable on the bonds. The swap counterparties continue to have high credit ratings; therefore no significant credit issues are noted. In order to protect the Company and the bond holders in the event of a shortfall of funds available to pay amounts to on the bonds, the Company has purchased a guarantee over the principal and the interest due on the bonds from Assured Guaranty (Europe) Limited (formerly Financial Security Assurance (U.K.) Limited), who are currently rated by S&P at AA.

After making enquiries, and considering the uncertainties set out on page 2, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing the Annual Report and accounts.

Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expense, in particular over recoverability of assets and fair value of financial instruments. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements on carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from the estimates used in the financial statements.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both the current and future periods.

Loans to customers, Bonds and Derivatives

The Company does not enter into speculative derivative contracts. Loans to customers, Bonds and Derivative financial instruments are recorded at fair value, with any gain or loss on re-measurement being recognised in the statement of comprehensive income.

Revenue recognition

Financial assets and financial liabilities are recorded at fair value. Changes in fair value are recognised in profit or loss separately from interest income and expense.

Segmental analysis

All investment income arises in the United Kingdom.

Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate.

Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

2. DIRECTORS AND EMPLOYEES

None of the directors received any emoluments for their services to the Company during the year (2013: £nil).

None of the directors have any interests in the Company as at the yearend (2013: £nil).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2014

None of the directors had any material interest in any contract of significance in relation to the business of the Company (2013: £nil).

The Company does not have any employees (2013: none).

3. INTEREST INCOME

	2014 £'000	2013 £'000
Interest income on loans	16,710	16,299
Interest received on swaps	4,088	4,499
	<u>20,798</u>	<u>20,798</u>

4. OPERATING EXPENSES

	2014 £'000	2013 £'000
Administrative expenses incurred	<u>60</u>	<u>66</u>

5. OPERATING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2014 £'000	2013 £'000
The profit on ordinary activities before taxation is stated after charging:		
Auditor's fees for the audit of the Company's accounts	<u>26</u>	<u>25</u>

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 March 2014

6. TAXATION

a) Tax on profits/losses on ordinary activities

	2014 £'000	2013 £'000
Current taxation:		
UK Corporation tax at 20% (2013: 20%)	8	8
Current tax charge for the year	8	8
Total tax charge to the statement of comprehensive income	8	8

b) Reconciliation of the total tax charge

The actual tax charge differs from the expected tax charge computed by applying the applicable rate of UK corporation tax rate of 20% (2013: 20%) as follows:

	2014 £'000	2013 £'000
Profit before tax	74	55
Profit before tax multiplied by the applicable rate of corporation tax at 20% (2013: 20%)	15	11
Effects of:		
Adjustment under s14(4) SI 2006/3296	(15)	(11)
Adjustment under s14(1)(a)(ii) SI 2006/3296	8	8
Total tax charge for the year	8	8

For UK corporation tax purposes, the Company has been considered as a securitisation company under the 'Taxation of Securitisation Companies Regulations 2006' (SI 2006/3296). Therefore, the Company is not required to pay corporation tax on its accounting profit or loss. Instead, the Company is required to pay tax on its retained profits as specified in the documentation governing the securitisation transaction into which the Company has entered.

NOTES TO THE FINANCIAL STATEMENTS**For the year ended 31 March 2014****7. LOANS TO CUSTOMERS**

	2014 £'000	2013 £'000
Loans to customers – fixed rate	67,725	68,264
Loans to customers – RPI indexed	517,373	526,289
	<u>585,098</u>	<u>594,553</u>
Loans falling due within one year	16,471	16,171
Loans falling due after more than one year	<u>568,627</u>	<u>578,382</u>

The loan portfolio at year end has nominal values amounting to £321,500,000 (2013: £321,500,000) and comprises loans to four water companies. Three of them have RPI index-linked principal and interest rate characteristics while the remaining one has a fixed rate of interest (see Note 11). The loans are due to mature on 30 September 2033, but the borrowers have the right to make voluntary prepayments if they give no less than 45 days' of written notice in accordance with the loan agreement.

8. OTHER PAYABLES

	2014 £'000	2013 £'000
Other payables	<u>25</u>	<u>24</u>

9. BONDS ISSUED

	2014 £'000	2013 £'000
Fixed rate bonds	<u>(406,986)</u>	<u>(410,273)</u>
Amounts falling due within one year	(19,377)	(19,178)
Amounts falling due after more than one year	<u>(387,609)</u>	<u>(391,095)</u>

The Company has issued fixed rate bonds with a nominal value £345,950,000 under the Company's £500,000,000 bond issuance programme. The bonds bear interest of 6% with a legal maturity date of 30 September 2033. The bonds can be redeemed early under certain conditions described in the Offering Circular.

In order to protect the Company and the bond holders in the event of a shortfall of funds available to pay amounts to on the bonds, the Company has purchased a guarantee. The guarantee is provided by Assured Guaranty (Europe) Limited (formerly known as Financial Security Assurance (UK) Limited), who are currently rated by S&P at AA, which unconditionally and irrevocably guarantees all scheduled payments of principal and interest throughout the life of all related bonds issued.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2014

10. SHARE CAPITAL

	2014 £'000	2013 £'000
Authorised		
50,000 (2013: 50,000) ordinary shares of £1 each	50	50
Called up, allotted and partly paid		
50,000 (2013: 50,000) ordinary shares partly paid up at 25p each	13	13

49,999 shares of the Company are held by Capita Trust Nominees No. 1 Limited on behalf of a Charitable Trust and one share by Capita Trust Company Limited on behalf of a Charitable Trust. These shares were issued on 1 March 2003 for cash consideration of 25p each.

11. FINANCIAL INSTRUMENTS

The Company's financial instruments principally comprise loans advanced to water companies, bonds issued, total return swap contracts, cash and other items arising directly from the Company's operations.

It is, and has been throughout the year, the Company's policy that no trading in financial instruments shall be undertaken.

Capital risk management

The Company manages its capital to enable it to continue as a going concern.

The capital structure of the Company primarily comprises issued bonds. Other sources of funding consist of equity attributable to equity holders of the parent, comprising issued share capital and retained earnings.

The Company is not subject to any externally imposed capital requirements.

Credit risk

The main risk arising from the Company's financial instruments is credit risk. The Company faces the credit risk that customers might not be able to meet their obligations as they fall due. While the loans are secured by a fixed and floating charge over customers' assets and their immediate holding companies, the Company considered the customers' ability to service the loans to be the principal factor in assessing the credit risk and the decision to lend. With respect to the four loans lent to UK water board companies, the Directors conclude that there are no past due or impaired receivable balances at year-end (2013: £nil).

In addition the Company faces credit risk on the swap counterparties' obligations under the agreement. The swap counterparties Royal Bank of Scotland Plc and Belfius Bank SA (formerly known as Dexia Bank SA) continue to have high credit ratings of "A-2" by S&P, and the Directors and management will continue to monitor this exposure.

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date and prior year end is the balance sheet amount.

The fixed and floating charge over the customers' assets, and their immediate holding companies, make up the primary collateral for the loans.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2014

11. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk

Funding for purchase of the loan portfolio was obtained through issuance of fixed rate bonds to the market. The Company has entered into total return swaps to hedge the difference between amounts received on the loans to customers and amounts payable on the bonds. In order to ensure that the Company has sufficient cash at maturity to redeem the bonds, the swaps pay any difference between the principal repayment from the borrower and the total amount due to the bondholders.

The Company has in place a guarantee to ensure that sufficient liquidity is maintained to meet its obligations on the bonds. As such if the Company faces a shortfall in cash resources to pay interest or principal on the notes, the bondholders would receive the required amount from the guarantor.

The table below reflects the undiscounted contractual cash flows of financial liabilities at the balance sheet date.

As at 31 March 2014	Carrying amount £'000	Contractual cash flows £'000	<1 month £'000	1-3 months £'000	3 months -1 year £'000	1-5 years £'000	5 years and over £'000
<u>Non-derivative financial liabilities</u>							
Bonds issued	(406,986)	(750,712)	-	-	(20,757)	(83,028)	(646,927)
Other creditors	(25)	(25)	(25)	-	-	-	-
Current tax liabilities	(8)	(8)	(8)	-	-	-	-
	<u>(407,019)</u>	<u>(750,745)</u>	<u>(33)</u>	<u>-</u>	<u>(20,757)</u>	<u>(83,028)</u>	<u>(646,927)</u>
<u>Derivative financial liabilities</u>							
Total return swaps	(177,430)	(444,311)	-	-	3,752	10,895	(458,958)
Total	<u>(584,449)</u>	<u>(1,195,056)</u>	<u>(33)</u>	<u>-</u>	<u>(17,005)</u>	<u>(72,133)</u>	<u>(1,105,885)</u>
As at 31 March 2013	Carrying amount £'000	Contractual cash flows £'000	<1 month £'000	1-3 months £'000	3 months -1 year £'000	1-5 years £'000	5 years and over £'000
<u>Non-derivative financial liabilities</u>							
Bonds issued	(410,273)	(771,469)	-	-	(20,757)	(83,028)	(667,684)
Other creditors	(24)	(24)	(24)	-	-	-	-
Current tax liabilities	(8)	(8)	(8)	-	-	-	-
	<u>(410,305)</u>	<u>(771,501)</u>	<u>(32)</u>	<u>-</u>	<u>(20,757)</u>	<u>(83,028)</u>	<u>(667,684)</u>
<u>Derivative financial liabilities</u>							
Total return swaps	(183,628)	(478,248)	-	-	4,064	11,513	(493,825)
Total	<u>(593,933)</u>	<u>(1,249,749)</u>	<u>(32)</u>	<u>-</u>	<u>(16,693)</u>	<u>(71,515)</u>	<u>(1,161,509)</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2014

11. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

The table below reflects the discounted contractual cash flows of financial derivatives at the balance sheet date.

	2014 £'000	2013 £'000
Total return swaps	(177,430)	(183,628)
Amounts falling due within one year	3,627	2,188
Amounts falling due after more than one year	(181,057)	(185,816)

Interest rate risk

The Company finances its operations through the issue of bonds at a fixed rate of 6.00% per annum (p.a.). The loan to Bristol Water plc carries a fixed rate of interest of 6.01% p.a. The loans to Southern Water Services Limited, Bournemouth and West Hampshire Water plc and South East Water Limited (formerly known as Mid Kent Water Limited) carry a fixed rate of interest of 4.076% p.a., 3.083% p.a. and 2.801% p.a. respectively, adjusted for the UK RPI indexation on a semi-annual basis. However the Company has entered into total return swaps in which the Company exchanges the indexation-linked interest it receives on the loans for the fixed coupon amount payable on the bond; hence no net interest rate risk exists. As such, no sensitivity analysis has been presented. The loans and bonds mature on 30 September 2033.

Foreign exchange risk

All transactions and financial instruments are denominated in sterling and consequently no currency exposure arises.

Fair values of financial assets and financial liabilities

The fair values of all the Company's financial instruments equate to their carrying amount. For the fixed rate bonds issued, market values have been used to determine fair values. However, the bonds are not actively traded due to the limited liquidity that exists in the market. For other financial instruments where no market values are available, fair values have been calculated by discounting cash flows at prevailing interest rates. In the calculation of discount factors for the fixed rate and RPI linked loans and total return swaps, a spread consistent with that on the fixed rate bonds issued has been applied. RPI linked cash flows have been forecast using rates derived from Sterling Index Linked Gilts.

	Opening fair value £'000	Movement at cost £'000	Movement in fair value £'000	Closing fair value £'000
Cash and cash equivalents	410	37	-	447
Loans to customers – fixed rate	68,264	-	(539)	67,725
Loans to customers – RPI indexed	526,289	-	(8,916)	517,373
Fixed rate bonds	(410,273)	-	3,287	(406,986)
Total return swaps	(183,628)	-	6,198	(177,430)
	1,062	37	30	1,129

NOTES TO THE FINANCIAL STATEMENTS**For the year ended 31 March 2014****11. FINANCIAL INSTRUMENTS (CONTINUED)****Fair values of financial assets and financial liabilities (continued)**

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and
- c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

There have been no transfers between Level 1 and 2 during the year.

	Total £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000
Financial assets				
Loans to customers - fixed rate	67,725	-	67,725	-
Loans to customers – RPI indexed	517,373	-	517,373	-
Total return swaps	3,627	-	3,627	-
	<u>588,725</u>	<u>-</u>	<u>588,725</u>	<u>-</u>
Financial liabilities				
Fixed rate bonds	406,986	-	406,986	-
Total return swaps	181,057	-	181,057	-
	<u>588,043</u>	<u>-</u>	<u>588,043</u>	<u>-</u>

12. RELATED PARTY TRANSACTIONS

Capita Trust Company Limited is the corporate service provider for the Company. During the year, fees incurred for these services were £13,276 (2013: £20,785).

13. ULTIMATE PARENT AND CONTROLLING PARTY

Previously, the immediate and ultimate parent company and controlling party was Capita IRG Trustees Limited which holds a majority shareholding under the terms of a declaration of a Charitable Trust.

On 3 August 2009, Capita IRG Trustees Limited transferred 49,999 ordinary shares to Capita Trust Nominees No. 1 Limited. Consequently, the immediate and ultimate parent company and controlling party is Capita Trust Nominees No. 1 Limited under the terms of a declaration of a Charitable Trust.