

*Registered Number: 08066326*

**KELDA FINANCE (No. 1) LIMITED**

**ANNUAL REPORT AND FINANCIAL STATEMENTS**

***FOR THE PERIOD ENDED 31 MARCH 2013***

**KELDA FINANCE (No. 1) LIMITED**  
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# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report***

*for the period ended 31 March 2013*

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The directors present their report and the audited consolidated financial statements for the Group for the 325 day period ended 31 March 2013.

### **Financial results for the period**

The loss for the period was £104.2m. Kelda Finance (No. 1) Limited (The Company) paid £236.7m of cash dividends and £260.0m of other dividends to its parent company, Kelda Group Limited.

### **Incorporation**

Kelda Finance (No. 1) Limited was incorporated on 11 May 2012 in England and Wales. On 24 June 2012, Kelda Finance (No. 2) Limited, a wholly owned subsidiary of Kelda Finance (No. 1) Limited, acquired the Yorkshire Water Services Holdings Limited group of companies in exchange for shares issued to Kelda Group Limited.

### **Principal activities**

The principal activities of the Group are the supply of clean water and the treatment and disposal of waste water. Yorkshire Water Services Limited (Yorkshire Water or YW), the Group's regulated utility business in the UK, is responsible for both water and waste water services.

The principal activity of The Company is to be a holding company within the Kelda Holdings Limited group, and is expected to continue to be so for the foreseeable future

None of the risks discussed below are considered likely to have a significant impact on the short or long-term value of the Group in the immediate future.

### **Principal risks and uncertainties**

Principal risks are classified in five categories:

- Statutory responsibilities;
- Business development;
- Environmental;
- Financial; and
- Operational.

### **Statutory responsibilities**

#### ***Risk and Compliance Statement***

In Yorkshire Water's annual Risk and Compliance Statement to Ofwat, the following material or potentially material risks were identified:

- Sewer flooding;
- Water quality;
- Pollution incidents;
- Discharge permit compliance; and
- Disposal of sludge.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

***for the period ended 31 March 2013***

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The Risk and Compliance Statement 2013 covers the reporting year 1 April 2012 to 31 March 2013 for all obligations, with the exception of environmental compliance and water quality parameters, which rely on a calendar year report, for which the statement covers obligations during the year 1 January 2012 to 31 December 2012.

Mitigation plans have now been put in place to tackle all the areas of potential risk, details of which can be obtained from <http://www.yorkshirewater.com/about-us/our-performance/reports-and-accounts/company-compliance-certificate.aspx>.

### ***Failure to deliver the capital investment programme***

YW requires significant capital expenditure for additions to, or replacement of, plant and equipment. The price limits set by Ofwat every five years take into account the level of capital expenditure expected to be incurred during the relevant price review period and the associated funding costs and operating costs.

If YW was unable to deliver its capital investment programme at expected expenditure levels, was unable to secure the expected level of efficiency savings, or the programme fell behind schedule, profitability may suffer because of a need for increased capital expenditure. Ofwat may also factor such failure into future Periodic Reviews by seeking to recover amounts equivalent to the "allowed costs" of any parts of the programme that are not delivered. YW's ability to meet regulatory output targets and environmental performance standards could also be adversely affected by such failure, which may result in penalties imposed by Ofwat of an amount up to ten per cent of turnover or other sanctions.

A Board Capital Investment Committee (BCIC) with delegated power from the board monitors the capital programme delivery and provides strategic direction.

### **Business Development**

#### ***Draft Water Bill***

On 8 May 2013, it was announced in the Queen's Speech that the Coalition Government would be consulting on a new Water Bill during 2013/14.

The Bill allows for greater freedom for businesses to choose their water supplier and is designed to make companies more responsive to the needs of customers. This could impact on future revenues, either in a positive or negative way.

Reforms will mainly apply to England and Wales but will also allow for a joint water and sewerage retail market with Scotland.

YW welcomes the introduction of greater retail competition and is currently providing pro bono communications support to the High Level Group and Programme Delivery Board that have been established to facilitate the changes.

YW is also developing a strategy to ensure it remains the supplier of choice in the region.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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### ***The PR14 Price Review***

Ofwat's PR14 Price Review is of strategic importance to YW as it will determine prices and levels of investment for the period 2015 to 2020.

This year YW will be carrying out its biggest ever customer and stakeholder engagement campaign to help inform its business plan submission.

This campaign will complement the work already carried out in 2012/13, which saw the creation of an independent Customer Forum and in-depth research into customers' willingness to pay for particular improvements and investment.

When the business plan has been finalised, Ofwat will ask the Customer Forum to look at how YW has consulted with its customers and check that they have been happy with the process. The Customer Forum is an independent group of invited experts who represent the needs of customers and of the environment.

Water companies' business plans must be submitted in December 2013, with Ofwat determining future prices and levels of investment in 2014 or early 2015.

### **Environmental**

#### ***Climate change***

YW recognises the need to enhance the resilience of its assets and services to today's weather and to tomorrow's climate. This goes to the heart of the Group's vision: **taking responsibility for the water environment for good.**

YW has seen how drought, floods and cold winters have impacted utility providers in recent years. These extreme weather events have highlighted current levels of resilience to weather and areas of vulnerability.

In the future, assets and services are likely to be challenged by more frequent and more severe extreme weather events because the climate is changing. YW needs to consider both past events and future projections to ensure robust, long-term decision-making.

This is important now because assets built today will be in operation for many decades to come.

There is overwhelming scientific evidence that the climate is changing. Latest assessments confirm that climate change and extreme weather pose strategic risks to the YW, potentially impacting on every part of the business in both the short and long-term.

In the long-term, the cost of managing these risks in order to maintain services in a changing climate could be large. To avoid significant price shocks for customers and investors, YW has developed a long-term climate change adaptation and mitigation strategy. It is also developing a comprehensive statement of needs for extreme weather resilience and climate change in YW's PR14 price review submission.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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### **Financial**

#### ***Commodity prices***

National and international economic uncertainties may put pressure on YW's input costs. In particular, YW has significant and growing energy demands, thus meaning the business model is exposed to energy price fluctuations.

Energy and other commodity costs may rise at rates above RPI between now and 2020.

To mitigate this, YW is looking to reduce its reliance on grid electricity and use renewable energy where appropriate and economically viable. YW continues to seek long-term supply relationships where appropriate.

#### ***Changes in the rate of inflation***

YW's turnover is linked to the underlying rate of inflation (measured by the Retail Prices Index – "RPI") and as such is subject to fluctuations in line with changes in this rate of inflation. In addition, changes in the rate of inflation are likely to impact on the operating costs and capital expenditure of YW and on customers' ability to pay any increased charges.

To mitigate this risk the YW maintains levels of index linked debt and swaps; therefore as RPI reduces and income reduces, the interest charge will also reduce.

#### ***Construction Output Prices Index***

Under the 2009 Final Determination the allowed annual capital expenditure was indexed using the Construction Output Prices Index ("COPI"). There is a risk that the actual costs of capital investment in the AMP5 Period will be higher than the ex-post COPI-adjusted allowed capital expenditure, resulting in a revenue penalty applied in the Periodic Review process for the next AMP Period. This may arise where contract conditions do not allow for index tracking (e.g. fixed cost contracts or contracts which are linked to RPI).

To mitigate this risk, where possible construction contracts have been linked to COPI. Additionally YW's target level of gearing is adjusted to reflect any movements in COPI compared to RPI to eliminate any impact on RCV in the subsequent price control period.

#### ***Non-recovery of customer debt***

Non-recovery of customer debt is a risk to YW and may cause profitability to suffer. This risk is exacerbated by the fact that water companies are prohibited from disconnecting domestic customers who do not pay. Nor can water companies limit domestic customers' supplies with the intention of enforcing payment. Allowance is however made by Ofwat in the price limits at each Periodic Review for a proportion of debt deemed to be irrecoverable.

To mitigate this risk YW operates a range of schemes designed to help customers who genuinely cannot pay their bills while having strong processes in place for overall debt collection.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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### **Operational**

#### ***Asset serviceability***

Every year Ofwat publishes an assessment of YW's water and sewerage infrastructure and non-infrastructure serviceability. Failure to deliver "stable" serviceability could lead to an adverse adjustment in future price determinations, which could have a material adverse impact on the business, financial condition or operational performance of YW. Failure may result in fines of up to 50% of the relevant capital maintenance budget, or other sanctions, and further increases in capital expenditure and operating expenditure.

#### ***Sewer flooding***

YW's combined sewerage systems can, during prolonged heavy rainfall, reach their hydraulic capacity resulting in flooding. As it is not possible to forecast accurately the occurrence and effects of sewer flooding, forward planning and the making of full and reliable provision for the effects, or the alleviation of the risk, of sewer flooding is difficult. The financial costs of measures required to deal with sewer flooding, or measures designed to alleviate the risk of sewer flooding to properties which become at risk, may therefore not be taken into account fully in a Periodic Review, which could have a material adverse impact on the financial condition or operational performance of YW.

#### ***Water shortages***

In the event of water shortages, additional costs may be incurred by YW in order to provide emergency reinforcement to supplies in areas of shortage which may adversely affect its business, results of operations, profitability or financial condition.

In addition, restrictions on the use or supply of water (including hosepipe bans and Drought Orders or Drought Permits) may adversely affect YW's turnover and may, in very extreme circumstances, lead to significant compensation becoming due to customers because of interruptions to supply, both of which could have a material adverse impact on the financial condition or operational performance of YW.

Potential water shortages may be exacerbated by reductions in the volume of water licensed to be abstracted imposed by the EA to mitigate environmental damage or to achieve sustainable levels of abstraction. Costs may be incurred by YW in implementing replacement sources and abstraction charges could be increased by the EA to cover compensation payments made to other abstractors whose licences are revoked or varied to alleviate environmental impact, each of which could have a material adverse impact on the financial condition or operational performance of the YW.

To mitigate these risks YW has a 25-year water resources plan which is regularly consulted on with customers and stakeholders.

#### ***Service interruptions due to key site or installation disruption***

Unexpected failure or disruption (including criminal acts or major health and safety incident) at a key site or installation (including a reservoir or treatment works) could cause a significant interruption to the supply of services (in terms of duration or number of customers affected), materially affecting the way that YW operates, prejudicing its reputation and resulting in additional costs including liability to customers or loss of

**Kelda Finance (No. 1) Limited**  
**Directors' Report** (continued)  
for the period ended 31 March 2013

revenue, each of which could have a material adverse impact on the financial condition or operational performance of YW.

**Catastrophic risk**

Catastrophic events such as dam bursts, fires, earthquakes, floods, flu pandemic, droughts, terrorist attacks, diseases, plant failure or other similar events could result in personal injury, loss of life, pollution or environmental damage, severe damage to or destruction of YW's operational assets. Subject to a possible application for an interim determination of prices under the terms of the YW's Instrument of Appointment as a water and sewerage undertaker, any costs resulting from suspension of operations of YW could have a material adverse effect on its ability to meet future financing obligations.

YW also has security and risk escalation processes in place and maintains an element of contingency within its financial planning.

**Key financial performance indicators**

	Period ended 31 March 2013
	£m
Operating profit from continuing operations	241.7
EBITDA	412.7

Operating profit is disclosed in the income statement on page 15.

**Operating results for the period**

The result for the period shows an operating profit from continuing operations of £241.7m, which is principally generated by Yorkshire Water's regulated water business.

**Exceptional finance costs for the period**

Exceptional finance costs comprise the following:

	Period ended 31 March 2013
	£m
<b>Included in finance costs:</b>	
Movement on fair value of index linked swaps	(292.3)
Movement on fair value of finance lease interest rate swaps	(0.8)
Movement of fair value of combined cross currency interest rate swaps and associated bonds	(1.8)
Movement of fair value of fixed to floating interest rate swaps and associated bonds	(2.2)
	(297.1)

The movement of fair value of index linked swaps is a result of swaps which were taken out during 2007/08 by Yorkshire Water Services Limited, a subsidiary of the Group at 31 March 2013. These swaps hedge against movements in RPI by receiving interest based on LIBOR and accruing interest payable based on RPI. The swaps have been valued at the reporting date at fair value, which at 31 March 2013 resulted in a £1,729.0m provision



# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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(On acquisition of subsidiary: £1,418.7m). Of the movement in the period of £310.3m, a charge of £18.0m relating to RPI accretion has been recognised within finance costs and a charge of £292.3m has been recognised as an exceptional finance cost. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves have not been met.

The movement of fair value of finance lease swaps is a result of floating to fixed interest rate swaps taken out by Yorkshire Water Services Limited to hedge against movements in 12 month LIBOR interest rates on floating rate finance leases. The swaps hedge the movement in interest rates by receiving interest based on 12 month LIBOR and accruing interest payable at a fixed rate. The swaps have been valued at the reporting date at fair value, which at 31 March 2013 resulted in a £21.6m loss (On acquisition of subsidiary: £20.8m). The movement during the period of £0.8m has been recognised as an exceptional finance cost. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves were not met. The interest charged or credited to the income statement in relation to these swaps is shown in note 6 of the financial statements.

Exceptional finance costs include the fair value movement of various combined cross currency interest rate swaps which were nominated as fair value through profit and loss on inception. The combined cross currency interest rate swaps were taken out during 2011/12 by Yorkshire Water Services Limited, a subsidiary acquired by the Group during the period, and have been valued at the reporting date at fair value as the criteria for hedge accounting have been met. In line with IAS39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2013. The net impact of the fair value movement of the cross currency swaps and the associated bonds has resulted in a £1.8m charge to the income statement.

Exceptional finance costs also include the fair value movement of fixed to floating interest rate swaps that were nominated as fair value through profit and loss on inception. The fixed to floating interest rate swaps were taken out by the Group during the period and have been valued at the reporting date at fair value as the criteria for hedge accounting have been met. In line with IAS39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2013. The net impact of the fair value movement of the cross currency swaps and the associated bonds has resulted in a £2.2m charge to the income statement.

### **Capital structure**

In June 2012 Kelda Finance (No. 2) Limited entered into a new £260m bank facility; £150m with a term of three years and £110m with a term of five years. The proceeds from this new facility were lent to Kelda Holdco Limited (a fellow subsidiary of Kelda Eurobond Co Limited) to enable it to repay the remaining balance on its external loan facility.

In August 2012, Yorkshire Water Services Bradford Finance Limited raised a £250m Class A bond with a maturity of seventeen years, with the proceeds being lent to Yorkshire Water Services Limited. In addition, in October 2012, Yorkshire Water extended the term of its £490m working capital and revolving credit facilities by a year to October 2017.

In February 2013, Kelda Finance (No.3) PLC raised a £200m high yield bond with a maturity of seven years. The proceeds were lent to Kelda Finance (No.2) Limited to enable

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## **Directors' Report** *(continued)*

*for the period ended 31 March 2013*

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it to repay all of the three year bank facility referred to above and a part of the five year facility.

### **Accounting policies**

The Group financial statements have been prepared in accordance with the accounting policies described in note 2 to the financial statements.

### **Treasury policy**

The Group's treasury operations are controlled centrally by a treasury department which operates on behalf of all companies controlled by the ultimate parent. Activities are carried out in accordance with approved board policies, guidelines and procedures. Treasury strategy is designed to manage exposure to fluctuations in interest rates, preclude speculation and to source and structure the Group's borrowing requirements.

The Group uses a combination of fixed capital, retained profits, long-term loans, finance leases and bank facilities to finance its operations. Any funding required is raised by the Group treasury department in the name of the appropriate company, operating within the covenants contained within the Common Terms Agreement and other facilities agreements. Funds raised may be lent to or from each Group subsidiary at commercial rates of interest. Cash surplus to operating requirements is invested in short-term instruments with institutions having a long-term rating of at least A- or A3 and a short-term rating of at least A1 or P1 issued by Standard & Poors and Moody's respectively.

### **Directors**

The directors, who served during the period and up to the date of signing of these financial statements, including any changes, are shown below:

Paul Newcombe	(appointed 11 May 2012, resigned 25 June 2012)
Elizabeth Barber	(appointed 25 June 2012)
Richard Flint	(appointed 25 June 2012)
Stuart McFarlane	(appointed 25 June 2012)

The Group had directors' and officers' liability insurance in place throughout the financial period and up to the date of approval of the financial statements. By virtue of the articles of association, the company had also provided indemnity for its directors and the secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

### **Research and development**

The Group undertakes a programme of research in pursuit of improvements in service and operating efficiency. During the period, £3.4m was committed to research and development including £2.8m on non-current assets.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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### **Valuation of assets**

The Group has adopted an accounting policy of valuation in respect of certain categories of fixed assets (infrastructure assets, residential properties, non-specialised properties and rural estates) which are held in the balance sheet at valuation (less accumulated depreciation), based on their existing use value.

Further details are provided in note 10 to the financial statements.

The policy of holding these assets at valuation rather than historic cost has no impact on bank covenants or on distributable reserves. The policy is intended to better reflect the value of those asset classes in the financial statements. These assets will be revalued on a periodic basis, to coincide with valuations required for future Ofwat Periodic Reviews.

### **Payment of suppliers**

The Group'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 period end bears to the amounts invoiced by suppliers during the period) is 25 days.

### **Employees and employment policies**

The Group strives to create a positive working environment for all colleagues and places great emphasis on open two-way communications. It values involvement and engagement at all levels, recognising that everyone in the business is valued for their contribution and is a potential source of innovation and change. Internal consultation and communication processes provide the key to this involvement.

The Group communications strategy is based on a 'face to face first' approach and all messages are delivered through 'two-way' channels, including regular 'Team Talks' and 'Talk Back' sessions with line managers and the Directors.

Regular employee satisfaction surveys are undertaken throughout the Group, using a variety of engagement tools including telephone-based and online surveys. We also supplement the surveys with a variety of employee focus groups.

These surveys and focus groups highlight what is going well and provide the company with valuable information about where to place more emphasis to really make a difference to how people feel at work.

To promote successful employee relations, the Group demonstrates its commitment to effective and two way communication through its information and consultation framework. In addition to collective bargaining arrangements with its recognised trade union, communication and consultative forums take place across the Group, comprising elected (union and non-union) employees who meet regularly with Directors and senior managers.

# **Kelda Finance (No. 1) Limited**

## **Directors' Report** *(continued)*

*for the period ended 31 March 2013*

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The Group promotes freedom of association, principally through its diversity and inclusion strategy. The Group's equality and diversity, 'open to all', policy covers gender, marital status, parental status, sexual orientation, race, colour, ethnic or national origin, disability, age, religion or belief and trade union membership. Yorkshire Water has previously been recognised by winning the Personnel Today award for Diversity in the Workplace and has also featured as a case study on a website created by the London Development Agency for businesses in their region. We have an active approach to keeping employees who become disabled in employment and our commitment to equal opportunities for less able job applicants has been recognised with the 'double tick' accreditation from the UK Employment Service.

Key to achieving operational excellence and delivering out-performance is ensuring that every individual understands their role and how they can make a difference whilst feeling valued for their contribution. We are committed to rewarding the right performance and we adopt a 'total reward' approach to salary and benefits which are designed to be competitive. Performance related pay gives colleagues at all levels the opportunity to share in the success of the business, through quarterly or annual bonus payments linked to the achievement of individual and business plan targets.

The Group continually strives to attract, select and retain the best people. Looking to the future, there is a strong commitment and focus on proactively resourcing the business by understanding future roles and skills requirements and ensuring that plans are in place to meet our needs. Our approach includes understanding people's career aspirations, meeting development needs and actively mitigating resourcing challenges to ensure that we retain our best talent. In 2012/13 a further 16 apprentices joined what is already a successful programme.

The Group places great emphasis on enhancing business performance by maximising individual, team and organisational potential through skills development. We are focused on developing safety, technical, behavioural and leadership capability. It is our belief that everyone can demonstrate leadership skills. This commitment is demonstrated through our focus on leadership development for managers and senior managers across the business and the company's commitment to embedding a coaching culture. This enables people to learn and grow by identifying and focusing on their own development areas. The Group provides a wide range of development opportunities, including in-house and accredited programmes to help all employees (including disabled employees) develop the necessary skills, knowledge, values and experience to realise their performance potential.

### **Health and safety**

The Group is committed to achieving high health and safety standards throughout its businesses. The management of health and safety issues operates in the context of the health and safety policy adopted by the board and the system of internal control.

The Group operates within a framework of policy procedural requirements and must have in place appropriate health and safety policies and procedures and provide necessary information, instruction, training and supervision. In addition, the Group provides occupational health, safety and welfare advisory services for employees.

Specific health and safety goals are also set within the business. These goals include a combination of reductions of accidents, near miss reporting, hazard identification,

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

***for the period ended 31 March 2013***

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behavioural safety conversation, training delivery, internal safety audits and health promotion and surveillance programmes.

Senior management awareness and active employee involvement in health and safety is fundamental to company success. A Think Safety First programme was launched successfully in Yorkshire Water in 2006 and is now being reviewed to further improve its currency and its impact in communicating and engagement with colleagues across the business around their health and safety risks.

Consultation with all employees via area and functional health and safety forum groups and safety committees is actively encouraged. Where possible, the intent is for local health and safety issues to be discussed and resolved with line management. In Yorkshire Water there are health and safety champions who work alongside the Trade Union safety representatives and line management. This ensures that health and safety issues are regularly discussed within each team in all business units.

Our goal is to achieve zero accidents and the measures taken by the company are intended to place emphasis on the proactive identification and control of our health and safety risks.

### **Environment**

The environmental policy of the Group 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 Group's website which can be viewed at <http://csr.keldagroup.com>.

### **Community**

The Group contributes actively to the communities which it serves. It encourages and supports colleagues in volunteering, charitable giving and community involvement. One in three employees is active in a wide range of supported community activities. These include 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.

### **Charitable and political donations**

Charitable donations totalling £61,000 were made during the period. No political donations were made. Cash donations during the period included:

- £50,000 to 31 community projects in Hull to thank local residents and businesses for their patience whilst odour issues at the Hull waste water treatment works were resolved;
- £6,000 to support the work of Wateraid, a charity whose mission is to transform lives by improving access to safe water, improve hygiene and sanitation in the world's poorest communities; and
- £5,000 was given to Waterwheelers as part of a "cashmatching" scheme. Waterwheelers is a charity run by Yorkshire Water employees which organises

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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fund-raising events in support of worthy local, regional and national causes. Good causes include Children in Need, Comic Relief, Children's Heart Foundation, Marie Curie Cancer Care, Genes for Jeans and Sports Relief. As an incentive to colleagues, the company match fund-raising efforts, pound for pound, up to a value of £5,000 per annum.

### **Independent auditors**

The independence and objectivity of the external auditors is considered on a regular basis, with particular regard to the level of non-audit fees.

The Group has adopted an auditor independence policy which establishes procedures and guidance under which the Group's relationship with its external auditors is governed so that the audit committee is able to satisfy itself that there are no factors which may, or may be seen to, impinge upon the independence and objectivity of the audit process.

### **Financial instruments**

Details are provided in the financial statements section under note 19.

### **Likely future developments**

The next 18 months are of significant strategic importance to the water industry, in which the Group operates.

Later this year the Coalition Government in the UK is expected to publish further details of its Water Bill which aims to improve competition and customer choice in the water sector. The legislation is designed to stimulate new investment and innovation in the UK's water infrastructure and to make the sector more resilient in the face of natural hazards such as floods and drought. Yorkshire Water will continue to play its role in helping to shape the final Bill to ensure it delivers maximum benefit for the company's domestic and business customers and the environment.

At the same time, the Group will strive to ensure it submits the best and most appropriate business plan for Ofwat's PR14 price review, as part of which Yorkshire Water Services Limited will be rolling out its biggest ever consultation exercise to date.

The Group must ensure that it is spending money in the right way, on the right things. Affordability is a major issue and as such, the Group will be challenging itself to become even more efficient and innovative.

There will be significant challenges too on the way to achieving the Group's long-term vision – population growth, climate change and affordability to name but three.

### **Annual general meeting**

Kelda Finance (No. 1) Limited has dispensed with the requirement to hold an annual general meeting.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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### **Going concern**

After making enquiries, the directors have a reasonable expectation, given the nature of the regulated water services business, that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group has £657.3m of undrawn committed borrowing facilities (note 13) and has a robust business model with positive cash flows projected for the next 25 years. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.

### **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 Group's auditors are 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 Group's auditors are aware of that information.

### **Independent auditors**

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office.

# ***Kelda Finance (No. 1) Limited***

## ***Directors' Report (continued)***

*for the period ended 31 March 2013*

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### **Statement of directors' responsibilities**

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 prepared the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). 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 Group and the company and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent; and
- state whether IFRSs as adopted by the European Union and applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the group and parent company financial statements respectively.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

On behalf of the Board



Stuart McFarlane  
Director  
11 July 2013

Company secretary:      Stuart McFarlane

Registered address:  
Western House  
Halifax Road  
Bradford  
West Yorkshire  
BD6 2SZ



# Independent auditors' report to the members of Kelda Finance (No. 1) Limited

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We have audited the Group financial statements of Kelda Finance (No. 1) Limited for the period ended 31 March 2013 which comprise the Group income statement, the Group statement of comprehensive loss, the Group balance sheet, the Group statement of changes in equity, the Group cash flow statement and the related notes. 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.

## **Respective responsibilities of directors and auditors**

As explained more fully in the statement of directors' responsibilities set out on page 12, 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.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## **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 Group'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 and financial statements to identify material inconsistencies with the audited financial statements. 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 Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 March 2013 and of its loss and cash flows for the period 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 and Article 4 of the IAS Regulation.

# Independent auditors' report to the members of Kelda Finance (No. 1) Limited (continued)

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## **Opinion on other matter prescribed by the Companies Act 2006**

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

## **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where under the Companies Act 2006 we are required to report to you if, in our opinion:

- 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.

## **Other matter**

We have reported separately on the parent company financial statements of Kelda Finance (No. 1) Limited for the period ended 31 March 2013.



Richard Bunter (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds  
11 July 2013

**Kelda Finance (No. 1) Limited**  
**Group income statement**  
*for the period ended 31 March 2013*

	Note	Period ended 31 March 2013 £m
<b>Group revenue</b>		<b>716.7</b>
<b>Total operating costs</b>	3	<b>(475.0)</b>
<b>Group operating profit from continuing operations</b>		<b>241.7</b>
Finance income	6	63.1
Finance costs	6	(194.3)
Exceptional finance costs	4	(297.1)
<b>Total finance costs</b>		<b>(491.4)</b>
<b>Loss from continuing operations before taxation</b>		<b>(186.6)</b>
Tax credit	7	82.4
<b>Loss for the period attributable to owners of the parent</b>		<b>(104.2)</b>

All material activities in the current period relate to continuing operations. Group revenue is derived principally from UK regulated water services.

**Group statement of comprehensive loss**  
*for the period ended 31 March 2013*

	Note	Period ended 31 March 2013 £m
<b>Loss for the period</b>		<b>(104.2)</b>
<b>Other comprehensive income:</b>		
Tax on items taken directly to comprehensive income	7	17.3
<b>Other comprehensive income for the period</b>		<b>17.3</b>
<b>Total comprehensive loss for the period</b>		<b>(86.9)</b>

# Kelda Finance (No. 1) Limited

## Group balance sheet

as at 31 March 2013

	Note	2013 £m
<b>Non-current assets</b>		
Intangible assets	9	14.2
Property, plant and equipment	10	6,322.4
Financial assets	19	19.0
Trade and other receivables	12	1,273.3
		<b>7,628.9</b>
<b>Current assets</b>		
Inventories	11	1.1
Trade and other receivables	12	179.1
Cash and cash equivalents	13	38.9
		<b>219.1</b>
<b>Total assets</b>		<b>7,848.0</b>
<b>Current liabilities</b>		
Trade and other payables	14	(469.5)
Tax liabilities		(13.1)
Short-term borrowings	13	(273.8)
		<b>(756.4)</b>
<b>Non-current liabilities</b>		
Long-term borrowings	13	(4,433.4)
Long-term payables	14	(50.9)
Financial liabilities	19	(1,665.8)
Deferred grants and contributions on depreciated assets	14	(53.1)
Provisions	15	(0.6)
Deferred tax liabilities	16	(537.8)
		<b>(6,741.6)</b>
<b>Total liabilities</b>		<b>(7,498.0)</b>
<b>Net assets</b>		<b>350.0</b>
<b>Capital and reserves attributable to owners of the Group</b>		
Ordinary shares	18	-
Hedging reserve		(13.2)
Revaluation reserve		1,013.7
Accumulated losses		(650.5)
<b>Total equity attributable to equity holders of the parent</b>		<b>350.0</b>

The financial statements on pages 17 to 58 were approved by the board of directors on 11 July 2013 and signed on their behalf by:



**Elizabeth Barber**  
Director

**Kelda Finance (No. 1) Limited**  
**Group statement of changes in equity**  
for the period ended 31 March 2013

	Note	Ordinary shares £m	Share premium £m	Hedging reserve £m	Revaluation reserve £m	Accumulated losses £m	Total equity £m
On incorporation		-	-	-	-	-	-
Shares issued		-	778.4	-	-	-	778.4
Reduction in capital		-	(778.4)	-	-	778.4	-
On acquisition of subsidiaries		-	-	(13.2)	1,014.4	(845.5)	155.7
Loss for the period		-	-	-	-	(104.2)	(104.2)
Dividends paid	8	-	-	-	-	(496.7)	(496.7)
Credit to income statement for surplus depreciation		-	-	-	(18.0)	18.0	-
Other movements		-	-	-	-	(0.5)	(0.5)
Total included in the Group statement of comprehensive income		-	-	-	17.3	-	17.3
<b>At 31 March 2013</b>		-	-	<b>(13.2)</b>	<b>1,013.7</b>	<b>(650.5)</b>	<b>350.0</b>

**Kelda Finance (No. 1) Limited**  
**Group cash flow statement**  
for the period ended 31 March 2013

	Note	2013 £m
<b>Cash flows from operating activities</b>	21	405.1
Income taxes received		4.0
Interest paid		(169.0)
<b>Net cash generated from operating activities</b>		<b>240.1</b>
<b>Cash flows from investing activities</b>		
Interest received		88.0
Proceeds on disposals of property, plant and equipment		0.5
Purchases of property, plant and equipment		(285.1)
Capital grants and contributions		9.8
<b>Net cash used in investing activities</b>		<b>(186.8)</b>
<b>Cash flows from financing activities</b>		
Dividends paid	8	(236.7)
Borrowings raised (net of fees)		449.1
Repayments of borrowings		(259.1)
Repayment of obligations under finance leases and hire purchase agreements		(20.2)
<b>Net cash used in financing activities</b>		<b>(66.9)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(13.6)</b>
<b>Cash and cash equivalents at the beginning of the period</b>		<b>-</b>
<b>Cash and cash equivalents in subsidiary on acquisition</b>		<b>52.5</b>
<b>Cash and cash equivalents at the end of the period</b>	13	<b>38.9</b>

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the Group financial statements***

*for the period ended 31 March 2013*

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### **1. Authorisation of financial statements**

The Group's financial statements for the period ended 31 March 2013 were authorised for issue by the board of directors on 11 July 2013 and the balance sheet was signed on the board's behalf by Elizabeth Barber, Director of Finance and Regulation. Kelda Finance (No. 1) Limited is a limited company incorporated and domiciled in England and Wales.

### **2. Accounting policies**

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

#### **Basis of accounting**

The consolidated financial statements of Kelda Finance (No. 1) Limited have been prepared on the going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, IFRIC interpretations and the Companies Act 2006 applicable to companies reporting under IFRS as they apply to the financial statements of the Group for the period ended 31 March 2013.

The consolidated financial statements have been prepared under the historical cost convention except for certain categories of property, plant and equipment which are held at valuation, all derivative financial instruments and financial assets which have been measured at fair value.

#### **Basis of consolidation**

The Group financial statements consolidate the financial statements of Kelda Finance (No. 1) Limited and its subsidiaries. The results of undertakings acquired or sold are consolidated for the periods from the date of acquisition or up to the date of disposal. Acquisitions of subsidiaries are accounted for under predecessor accounting principles. Intra-group balances, and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

On 24 June 2012 the Group acquired the Yorkshire Water Services Holdings Limited group of companies in exchange for shares issued to Kelda Group Limited. The Group has applied predecessor accounting principles to the initial consolidation of its results to 31 March 2013, incorporating assets and liabilities upon acquisition at their existing book values in the financial statements of the entities under common control. Business combinations under common control are accounted for in the consolidated financial statements prospectively from the date the Group obtained the ownership interest. The Group has maintained the reserves structure of the companies acquired.

#### **Foreign currencies**

On an individual company basis, individual transactions denominated in foreign currencies are translated into functional currency at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into functional currency at the rates ruling at the balance sheet date. Profits and losses on both individual foreign currency transactions during the period and monetary assets and liabilities are dealt with in the income statement.

***Kelda Finance (No. 1) Limited***  
***Notes to the Group financial statements (continued)***  
*for the period ended 31 March 2013*

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**Revenue**

Revenue comprises charges to customers for water, waste water and environmental services, excluding value added tax. Revenue excludes inter-company sales.

Revenue is not recognised until the service has been provided to the customer. Revenue relates to charges due in the period, excluding any amounts paid in advance. Revenue for measured water charges includes amounts billed plus an estimation of the amounts unbilled at the period end. The accrual is estimated using a defined methodology based upon daily average water consumption, which is calculated based upon historical billing information.

**Net operating costs**

Net operating costs include the following:

*Rental income*

Rental income arising on investment properties is accounted for on a straight line basis over the lease term on ongoing leases.

*Other operating income*

Profit relating to the sale of commercial and residential properties to third parties is included within other operating income, which is part of operating costs.

*Dividends receivable*

Dividends receivable are recognised when the owners' right to receive the revenue is established.

**Finance income**

Interest receivable is recognised as the interest accrues using the effective interest method that is the rate that exactly discounts estimated future cash receipts and payments through the expected life of the financial instrument to the net carrying amount of the financial assets.

**Dividends payable**

Interim and final dividends payable are recognised on payment of the dividend.

**Research and development expenditure**

Research expenditure is written off in the income statement in the period in which it is incurred.

Development expenditure is charged to the income statement except where the expenditure meets the criteria for recognition as an internally generated intangible asset as outlined in IAS 38 "Intangible assets". Where the recognition criteria are met, intangible assets are capitalised and amortised over their useful economic lives from the date of commissioning.

**Taxation**

*Current tax*

Current tax for the current period is, to the extent unpaid, recognised as a liability. If the amount already paid in respect of the current period exceeds the amount payable, the excess is recognised as an asset.



# ***Kelda Finance (No. 1) Limited***

## ***Notes to the Group financial statements (continued)***

***for the period ended 31 March 2013***

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### *Deferred tax*

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes with the following exceptions:

- where the deferred income tax liability arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised, except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Current and deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly in equity in which case the current or deferred tax is reflected in equity.

### **Goodwill and intangible assets**

Goodwill represents the excess of the fair value of the consideration paid for a business over the fair value of the identifiable assets and liabilities acquired after costs incurred directly in relation to the transaction. Goodwill is capitalised and subject to an impairment review, both annually and when there are indications that the carrying value may not be recoverable.

### **Property, plant and equipment**

Residential properties, non-specialised properties and rural estates held within Land and Buildings are held at valuation. Infrastructure assets are held at valuation (see note 10). Other property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

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Freehold land is not depreciated. Depreciation is charged on property, plant and equipment on a straight line basis over their estimated useful economic lives, or the estimated useful economic lives of their individual major components, from the date of commissioning.

Useful economic lives are principally as follows:

Buildings	25 - 60 years
<i>Plant and equipment</i>	
Fixed plant	5 - 40 years
Vehicles, mobile plant and computers	3 - 10 years
<i>Infrastructure assets</i>	
Water mains and sewers	40 -125 years
Earth banked dams and reservoirs	200 years

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

In the UK regulated water services business, infrastructure assets comprise a network of systems being mains and sewers, impounding and pumped raw water storage, reservoirs, dams and sea outfalls. The opening balance for infrastructure assets in Yorkshire Water Services Limited on transition to IFRS was calculated with reference to the estimated fair value of the infrastructure network as a whole at 1 April 2004. Subsequent expenditure is classified as operating expenditure or capital and accounted for appropriately.

Infrastructure assets, residential properties, non-specialised properties and rural estates are held at valuation with external valuations being undertaken on a periodic basis. An interim valuation is booked in the intervening years if there has been a material change. Residual values and depreciation rates are reviewed on revaluation. On sale of a revalued asset, the revaluation reserve is recycled to the income statement.

In respect of borrowing costs relating to qualifying assets for which the capitalisation date is on or after 1 January 2009, the Group capitalises borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Prior to this date the Group recognised all borrowing costs as an expense immediately. This change in accounting policy was due to the adoption of IAS 23 'Borrowing costs'.

***Impairment of property, plant and equipment and goodwill***

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable. Useful lives and residual values are reviewed annually. Where adjustments are required, these are made prospectively.

Impairment on goodwill is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount is less than the carrying amount, an impairment loss is recognised. When an entity is disposed of, any goodwill associated with it is included in the carrying amount of the operation when determining the gain or loss on disposal.

***Accounting for leases***

***Finance leases***

Assets which are financed by leasing agreements that transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised, at the lower of the fair value of the leased property and the present value of future lease payments, in property, plant and equipment and the corresponding capital cost is shown as an obligation to the lessor in

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the Group financial statements (continued)***

*for the period ended 31 March 2013*

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borrowings. Depreciation is generally charged to the income statement 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 income statement over the term of the lease in proportion to the capital amount outstanding. Any arrangement fees or other direct costs incurred on a finance lease are capitalised and amortised over the length of the lease.

### *Operating leases*

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Lease payments are charged to the income statement on a straight line basis over the term of the lease.

### **Government grants and contributions**

Government grants and contributions in respect of property, plant and equipment are deferred and credited to the income statement by instalments over the expected economic lives of the related assets. Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

Government grants and contributions received in respect of an item of expense during the period are recognised in the income statement on a systematic basis in line with the cost that it is intended to compensate.

Government grants which can be allocated against an individual asset are included as part of the carrying value of the asset. Government grants which cannot be allocated to individual assets are held as deferred income and released to the income statement over the life of the grant.

### **Inventories**

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

### **Provisions**

Provision is made for self insured claims incurred but not reported and other known liabilities which exist at the period end as a result of a past event.

### **Financial instruments**

#### *Financial assets*

Financial assets are recognised in relation to public to private concession arrangements to the extent that the Group has a contractual right to receive cash of a specified and determinable amount independent of when and how much the service is used and the only risk of non-recovery is credit deterioration of the counterparty. They are measured at fair value through profit and loss.

#### *Cash and cash equivalents*

Cash equivalents include short term deposits with original maturity within 3 months. For the purposes of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents net of outstanding bank overdrafts held with the same bank where there is a legal right and intention to offset.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
*for the period ended 31 March 2013*

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**Trade and other receivables**

Trade and other receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. There is no intention to trade the receivables.

Invoices for unmeasured water charges are due on predetermined dates, irrespective of date of receipt. Other trade receivables generally have 7-30 day payment terms. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

**Trade and other payables**

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

**Interest bearing loans and borrowings**

All loans and borrowings are initially recognised at fair value less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses arising on repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in investment income and finance costs.

**Derivative financial instruments**

The Group uses derivative financial instruments such as foreign currency contracts and interest rate swaps to hedge its risks associated with interest rate and foreign currency fluctuations. Such derivative financial instruments are stated at fair value.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swap contracts is determined by reference to market values for similar instruments.

For the purposes of hedge accounting, hedges are classified as either fair value hedges where they hedge the exposure to changes in the fair value of a recognised asset or liability and unrecognised firm commitments; or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

In relation to cash flow hedges, which hedge highly probable forecasted transactions and which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in net profit or loss.

When the hedged highly probably forecasted transaction results in the recognition of a non-monetary asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same period in which the hedged firm commitment affects the net profit or loss, for example when the future sale actually occurs.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement for the period. These are classified as exceptional items within operating costs.

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the Group financial statements (continued)***

***for the period ended 31 March 2013***

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Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the period.

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the effective portion of the hedge is recognised in equity and any gain or loss on the ineffective portion is recognised in the income statement. On disposal of the foreign operation the cumulative value of any gains or losses recognised directly in equity is transferred to the income statement.

### **Employee benefits**

#### **(a) Pension plans**

The Group accounts for its pensions in accordance with IAS 19 'Employee Benefits'.

##### **(i) Defined contribution scheme**

The Group operates two defined contribution schemes for those members of staff who are not members of its defined benefit scheme. Two pension plans exist under which the Group pays a fixed contribution into a separate entity which operates the schemes. The other provides the employees with a lump sum on retirement, with which they then invest in an annuity. Other than this contribution, the Group has no further legal or constructive obligation to make further contributions to the scheme.

Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

##### **(ii) Defined benefit scheme**

A majority of the Group's employees participate in the Kelda Group Pension Plan (KGPP), a group defined benefit pension scheme as described in note 17 of the financial statements. The KGPP is a group defined benefit plan such that the risks are shared between various entities under the control of the Kelda Holdings Group of companies. As there is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with IAS 19 to individual group entities, the Kelda Finance (No. 1) Limited Group recognises a cost equal to its contribution payable for each accounting period.

#### **(b) Equity settled share based payments**

Previously, Kelda Group plc operated a savings related share option scheme under which options were granted to employees of Yorkshire Water Services Limited, a subsidiary acquired by the Group during the period. The fair value of options granted in exchange for employee services rendered was recognised as an expense in the income statement with a corresponding credit to equity.

The total amount expensed over the vesting period was determined by the fair value of the option at the date of the grant. The fair value of the option calculated was determined by use of mathematical modelling including the Black Scholes option pricing model.

The Group re-assesses 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 income statement. No expense is recognised for awards that did not ultimately vest, except for awards where vesting was conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition was satisfied, provided that all other performance conditions are satisfied.

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the Group financial statements (continued)***

*for the period ended 31 March 2013*

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The scheme was closed following the acquisition of Kelda Group plc by Saltaire Water Limited. Certain schemes have been allowed to continue until the planned maturity with members choosing whether to continue contributing. For any member who has taken that option, charges to the income statement will continue until the maturity of the scheme. For any other member who has opted to close their scheme, charges to the income statement ceased in the month that they chose to leave the scheme.

### **Share capital**

Ordinary shares are classified as equity.

### **Segmental reporting**

The Group's primary reporting format is by business segment and its secondary format is by geographical segment. A segment is a component of the Group which can be distinguished separately as providing a product or service within a particular environment which is subject to risks and rewards that are different from those of other segments. The Group has identified a single business segment, being that of UK Regulated Water Services (Yorkshire Water Services Limited).

The Group's geographical segments are determined by the location of the Group's assets and operations.

### **Exceptional items**

Exceptional items are items which derive from events or transactions that fall within the ordinary activities of the reporting entity and which individually or, if of a similar type, in aggregate need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

### **Principal areas of judgement**

The directors consider the principal areas of judgement in the financial statements to be:

- Property, plant and equipment

The Group's accounting policy for property, plant and equipment (PPE) is detailed on page 21 and 22 of the financial statements. Estimated useful economic lives of PPE are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Group, variations between actual and estimated useful lives could impact operating results both positively and negatively. Historically, only minor changes to estimated useful lives have been required. The Group is required to evaluate the carrying value of PPE for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review requires management to make subjective judgements concerning the cash flows, growth rates and discount rates of the cash generating units under review.

- Provision for doubtful debts

At each balance sheet date, the Group evaluates the collectability of trade receivables and records provisions for impairment of receivables based on experience including, for example, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of debt collected may differ for the estimated levels of recovery, which could impact operating results positively or negatively. As at 31 March 2013 current trade receivables were £107.5m, before provision for impairments.

***Kelda Finance (No. 1) Limited***  
***Notes to the Group financial statements (continued)***  
***for the period ended 31 March 2013***

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- Taxation

The corporation tax provision of £13.1m reflects management's estimation of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed by Her Majesty's Revenue and Customs.

**New standards and interpretations**

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial period beginning 11 May 2012 and do not have a material impact on the Group:

- Amendment to IFRS 7 'Financial instruments: Disclosures' on transfers of assets (effective 1 July 2012)

The following standards, interpretations and amendments to existing standards are not yet effective and have not been early adopted by the Group:

- Amendment to IFRS 7 'Financial instruments disclosures – offsetting financial assets and liabilities'
- Amendment to IFRS 1 'First time adoption on fixed dates and hyperinflation'
- Amendment to IAS 12 'Income taxes – deferred tax'
- Amendment to IAS 1 'Financial statement presentation – other comprehensive income'
- Amendment to IAS 32 'Financial instruments presentation - offsetting financial assets and liabilities'
- Amendment to IFRS 1 'First time adoption – government loans'
- IFRS 9 'Financial instruments – classification and measurement'
- IFRS 10 'Consolidated financial statements'
- IFRS 11 'Joint arrangements'
- IFRS 12 'Disclosures of interests in other entities'
- Amendments to IFRS 10, 11 and 12 on transition guidance
- IAS 27 (revised) 'Separate financial statements'
- IAS 28 (revised) 'Associates and joint ventures'
- IFRIC 20 'Stripping costs in the production phase of a surface mine'
- Amendment to IAS 19 'Employee benefits'
- IFRS 13 'Fair value measurement' annual improvements 2011

The Group is still considering the implications of applying these standards and interpretations to the Group's financial statements.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**3. Total operating costs**

	2013 £m
Own work capitalised	(30.2)
Raw materials and consumables	22.8
Other external charges	214.9
Staff costs (note 5)	86.1
Depreciation of property, plant and equipment (note 10)	
On owned assets	
- UK infrastructure	41.3
- other assets	130.5
On assets held under finance lease	
- other assets	2.1
Operating lease rentals - minimum lease payments	
- plant and equipment	1.3
- other	1.4
Amortisation of grants and contributions	(2.9)
Research and development	0.5
Impairment of trade receivables	11.9
Other operating income	(4.7)
	<b>475.0</b>

Earnings before interest, tax, depreciation and amortisation (EBITDA) excluding exceptional items, as quoted in the key financial performance indicators of the Group on page 6, is calculated as follows:

	2013 £m
Group operating profit from continuing operations	241.7
Add back depreciation and amortisation of capital grants (included above)	171.0
<b>EBITDA</b>	<b>412.7</b>

**Auditors' remuneration**

Services provided by the Group's auditors are analysed as follows:

	2013 £m
Fees payable to the Group's auditors for the audit of the parent company and consolidated financial statements	-
Fees payable to the Group's auditors for other services:	
- The audit of company's subsidiaries pursuant to legislation	0.2
- Fees for other services	0.1
	<b>0.3</b>



**Kelda Finance (No. 1) Limited**  
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**4. Exceptional finance costs**

Exceptional items comprise:

	2013 £m
<b>Included in finance costs</b>	
Movement of fair value of index linked swaps	(292.3)
Movement of fair value of finance lease interest rate swaps	(0.8)
Movement of fair value of combined cross currency interest rate swaps and associated bonds	(1.8)
Movement of fair value of fixed to floating interest rate swaps and associated bonds	(2.2)
Movement on fair value of swaps	(297.1)

The movement of fair value of index linked swaps is a result of swaps which were taken out during 2007/08 by Yorkshire Water Services Limited, a subsidiary acquired by the Group during the period. These swaps hedge against movements in RPI by receiving interest based on LIBOR and accruing interest payable based on RPI. The swaps have been valued at the reporting date at fair value, which at 31 March 2013 resulted in a £1,729.0m provision (On acquisition of subsidiary: £1,418.7m). Of the movement in the period of £310.3m, a charge of £18.0m relating to RPI accretion has been recognised within finance costs and a charge of £292.3m has been recognised as an exceptional finance cost. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves have not been met.

The movement of fair value of finance lease swaps is a result of floating to fixed interest rate swaps taken out by Yorkshire Water Services Limited to hedge against movements in 12 month LIBOR interest rates on floating rate finance leases. The swaps hedge the movement in interest rates by receiving interest based on 12 month LIBOR and accruing interest payable at a fixed rate. The swaps have been valued at the reporting date at fair value, which at 31 March 2013 resulted in a £21.6m loss (On acquisition of subsidiary: £20.8m). The movement during the period of £0.8m has been recognised as an exceptional finance cost. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves were not met. The interest charged or credited to the income statement in relation to these swaps is shown in note 6.

Exceptional finance costs include the fair value movement of various combined cross currency interest rate swaps which were nominated as fair value through profit and loss on inception. The combined cross currency interest rate swaps were taken out during 2011/12 by Yorkshire Water Services Bradford Finance Limited, a subsidiary acquired by the Group during the period, and have been valued at the reporting date at fair value as the criteria for hedge accounting have been met. In line with IAS39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2013. The net impact of the fair value movement of the cross currency swaps and the associated bonds has resulted in a £1.8m charge to the income statement.

Exceptional finance costs also include the fair value movement of fixed to floating interest rate swaps that were nominated as fair value through profit and loss on inception. The fixed to floating interest rate swaps were taken out by the Group during the period and have been valued at the reporting date at fair value as the criteria for hedge accounting have been met. In line with IAS39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2013. The net impact of the fair value movement of the cross currency swaps and the associated bonds has resulted in a £2.2m charge to the income statement.

**Kelda Finance (No. 1) Limited**  
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for the period ended 31 March 2013

**5. Directors and employees**

	2013
Average monthly number of people employed by the Group	Number
<b>Continuing operations:</b>	
UK regulated water services	2,496
	<b>2,496</b>
	<b>2013</b>
	<b>£m</b>
<b>Total employment costs:</b>	
Wages and salaries	59.2
Social security costs	5.6
Other pension costs	21.3
	<b>86.1</b>

The total share-based payment expense in the period was £nil.

**Directors' emoluments**

	2013
	£m
Wages and salaries	1.4
Social security costs	0.2
Other pension costs	0.1
	<b>1.7</b>

The amounts in respect of the highest paid director are as follows:

	2013
	£m
Wages and salaries	0.7
Social security contributions	0.1
	<b>0.8</b>

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

During the period, two directors except one were contributory members of the Kelda Group Pension Plan, a defined benefit scheme. The accrued pension benefit of the highest paid director in 2012/13 was £nil. No directors exercised any share options during the period.

The Group contributed £0.1m to a defined contribution scheme on behalf of one director.

No directors were compensated for loss of office during the period.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**6. Finance income and finance costs**

	2013 £m
<b>Finance income</b>	
Interest on bank deposits	0.1
Interest receivable from index linked swaps	9.6
Interest receivable from cross currency interest rate swaps	2.8
Interest receivable on loans to group companies	50.6
<b>Total finance income</b>	<b>63.1</b>
<b>Finance costs</b>	
Interest payable on guaranteed bonds	121.6
Interest payable on US Dollar bonds	8.5
Amortisation of issue costs in respect of bonds	0.4
<b>Total finance costs for bonds</b>	<b>130.5</b>
Bank loans and overdrafts	13.9
Bank loans under Kelda Finance facility	7.6
Interest payable on index linked swaps	52.7
Finance leases	6.7
Commitment fees and miscellaneous interest	1.4
<b>Total finance costs before capitalisation of interest</b>	<b>212.8</b>
Interest capitalised	(18.5)
<b>Total finance costs net of interest capitalised</b>	<b>194.3</b>

For more information on guaranteed and US Dollar bonds refer to note 13.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

7. Tax credit

	2013 £m
<b>Current tax</b>	
UK corporation tax at 24%	0.6
Adjustments in respect of prior periods	(3.6)
<b>Total current tax from continuing operations</b>	<b>(3.0)</b>
<b>Deferred tax</b>	
UK charge for temporary differences arising and reversing in the period	(64.3)
Effect of change in tax rates	(6.5)
Adjustments in respect of prior periods	(8.6)
<b>Total deferred tax on continuing activities (note 16)</b>	<b>(79.4)</b>
<b>Total tax credit on loss from ordinary activities</b>	<b>(82.4)</b>
<b>Tax relating to items credited to equity</b>	
<b>Deferred tax:</b>	
Effect of change in rate of deferred tax on revaluation reserve	(17.3)
<b>Tax credit in the Group statement of comprehensive loss</b>	<b>(17.3)</b>

The differences between the total current and deferred tax charge shown and the amount calculated by applying the rate of corporation tax of 24% to the loss on ordinary activities before tax is as follows:

	2013 £m
Loss from continuing operations before taxation	(186.6)
Current and deferred tax on Group loss on ordinary activities at the standard UK tax rate	(44.8)
Effects of:	
Expenses not deductible for tax purposes	12.5
Change in deferred tax rate	(6.5)
Adjustments in respect of prior periods	(12.2)
Group relief received free of charge	(31.2)
<b>Group current and deferred tax credit for the period</b>	<b>(82.4)</b>

The Finance Act 2012 introduced a reduction in the rate of corporation tax from 26% to 24% from 1 April 2012 and from 24% to 23% from 1 April 2013. These rates were substantively on 26 March 2012 and 3 July 2012 respectively and, therefore, are included in these financial statements.

Further reductions to the UK's corporation tax rate were announced in the March 2013 UK Budget Statement. Legislation to reduce the main rate of corporation tax from 23% to 21% from 1 April 2014 is expected to be included in the Finance Act 2013. A further reduction to the main rate to reduce the rate to 20% from 1 April 2015 will also be included in Finance Act 2013. These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements.

**Kelda Finance (No. 1) Limited**  
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The effect of the changes expected to be enacted in Finance Act 2013 would be to reduce the deferred tax liability provided at the balance sheet date by £70.2m. This £70.2m decrease in the deferred tax liability would increase profit by £57.6m, increase other comprehensive income by £12.6m and increase the revaluation reserve by £39.6m.

The deferred tax credit for the period relates to the following:

	2013 £m
Accelerated depreciation for tax purposes	(29.4)
Fair value adjustment of infrastructure assets	3.5
Financial instruments	(53.5)
<b>Deferred tax credit</b>	<b>(79.4)</b>

**8. Dividends**

	2013 £m
Cash dividends	236.7
Non-cash dividends	260.0
<b>Total dividends</b>	<b>496.7</b>

Non-cash dividends of £260m (£2.6m per ordinary share) were settled by way of a set off agreement which eliminated outstanding intercompany balances of the same value between Kelda Finance (No. 1) Limited and its immediate parent company, Kelda Group Limited.

During the period, dividends of £236.7m (£2.37m per ordinary share) were declared and cash settled.

**9. Intangible assets**

	Goodwill £m	Total £m
<b>Cost</b>		
On incorporation	-	-
On acquisition of subsidiaries	17.9	17.9
<b>At 31 March 2013</b>	<b>17.9</b>	<b>17.9</b>
<b>Accumulated amortisation</b>		
On incorporation	-	-
On acquisition of subsidiary	3.7	3.7
Amortisation	-	-
<b>At 31 March 2013</b>	<b>3.7</b>	<b>3.7</b>
<b>Net book value carried forward</b>	<b>14.2</b>	<b>14.2</b>

Goodwill arose on the transfer into Yorkshire Water Services Limited of the trade and net assets of The York WaterWorks Limited on 1 April 2000. The directors do not believe this should be impaired as it relates to assets which are still in continuing use within the business.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**10. Property, plant and equipment**

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Under construction £m	Group total £m
<b>Cost or valuation</b>					
On incorporation	-	-	-	-	-
On acquisition of subsidiary	1,689.0	3,290.2	2,570.7	498.0	8,047.9
Additions at cost	6.3	30.0	71.5	226.5	334.3
Grants and contributions	-	-	-	(21.9)	(21.9)
Transfers on commissioning	(37.7)	98.4	172.5	(233.2)	-
Disposals	(22.5)	-	(27.9)	(0.3)	(50.7)
<b>At 31 March 2013</b>	<b>1,635.1</b>	<b>3,418.6</b>	<b>2,786.8</b>	<b>469.1</b>	<b>8,309.6</b>
<b>Accumulated depreciation</b>					
On incorporation	-	-	-	-	-
On acquisition of subsidiary	408.2	21.9	1,433.4	-	1,863.5
Charge for the period	35.1	41.3	97.5	-	173.9
Disposals	(22.2)	-	(28.0)	-	(50.2)
<b>At 31 March 2013</b>	<b>421.1</b>	<b>63.2</b>	<b>1,502.9</b>	<b>-</b>	<b>1,987.2</b>
<b>Net book amount at 31 March 2013</b>	<b>1,214.0</b>	<b>3,355.4</b>	<b>1,283.9</b>	<b>469.1</b>	<b>6,322.4</b>

During the period the Group capitalised borrowing costs amounting to £18.5m on qualifying assets. Borrowing costs were capitalised at the weighted average rate of its general borrowings of 4.09%.

Assets included above held under finance leases amount to:

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Group total £m
Cost	108.6	71.5	186.3	<b>366.4</b>
Depreciation	(33.6)	(24.4)	(132.1)	<b>(190.1)</b>
<b>Net book amount at 31 March 2013</b>	<b>75.0</b>	<b>47.1</b>	<b>54.2</b>	<b>176.3</b>

The Group's infrastructure assets are held at valuation. The most recent valuation was carried out at 31 March 2012 and was performed in accordance with IAS 16 which requires that assets subject to a policy of revaluation should be carried at their fair value less any subsequent accumulated depreciation and accumulated impairment losses.

IAS 16 allows, where market based evidence of fair value is not available due to the specialised nature of the items of property plant and equipment, an entity to estimate fair value using an income approach. Having considered the requirement of IAS 16, Management concluded that the most reliable valuation method to determine the current value for the tangible fixed assets of a UK water company is a two-step approach:

- Estimating the business value in use ('VIU'), using a discounted cash flow ('DCF') model excluding outperformance against Ofwat's targets to determine the business enterprise value. Excluding forecast outperformance against the regulatory allowance

**Kelda Finance (No. 1) Limited**  
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is a proxy for excluding any goodwill that a purchaser would pay for the business. The enterprise value was then cross-checked against the Regulatory Capital Value ('RCV'). This step was followed by:

- Allocating the VIU of the business (less relevant working capital balances) to individual classes of tangible fixed assets.

Such valuations have been incorporated into the financial statements and the resulting revaluation adjustments taken to the revaluation reserve.

If the revalued assets were stated on a historical cost basis, the historic cost before depreciation would be £3,400.6m.

Certain other categories of the Group's land and buildings are also held at valuation, on the basis of existing use, valued by independent qualified valuers in March 2009. The valuations were undertaken in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors in the United Kingdom by the following surveyors:

Non-specialist properties	DTZ Debenham Tie Leung Limited
Rural estates	Carter Jonas LLP
Residential properties	Savills (L&P) Limited

The revaluations were based on values as at 31 March 2009.

These external valuations will be re-performed on a periodic basis. An interim valuation is booked in intervening years based on directors' valuations. No changes in values have been booked during the period. The Manager of Land, Property and Planning, a member of the Royal Institution of Chartered Surveyors, has reviewed the carrying value at 31 March 2013 of Yorkshire Water's non specialised land and buildings and considers that no impairment or uplift would be required to the accounts, and the current book values are not materially different to current market values.

These valuations have been incorporated into the financial statements and the resulting revaluation adjustments have been taken to the revaluation reserve. The revaluation surplus as at 31 March 2013 is £1,317.3m offset by a provision for deferred tax on the revalued amount of £303.6m.

Categories of assets revalued are as follows:

	Revalued amount £m	Historical cost basis £m
Non-specialist properties	7.5	2.4
Infrastructure assets	3,355.4	2,308.7
Rural estates	43.9	0.8
Residential properties	4.7	0.1
<b>Net book amount of asset revalued</b>	<b>3,411.5</b>	<b>2,312.0</b>

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Analysis of the net book value of revalued land and building is as follows:

	Revalued amount	Historical cost basis
	£m	£m
Net book amount on acquisition of subsidiary	54.4	3.3
Disposal of revalued assets	(0.5)	-
Transfer to profit and loss for additional depreciation incurred	(0.3)	-
<b>Net book amount at 31 March 2013</b>	<b>53.6</b>	<b>3.3</b>

Analysis of the net book value of revalued infrastructure assets is as follows:

	Revalued amount	Historical cost basis
	£m	£m
At cost	3,418.6	3,400.6
Aggregate depreciation	(63.2)	(1,091.9)
<b>31 March 2013</b>	<b>3,355.4</b>	<b>2,308.7</b>



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**11. Inventories**

	2013 £m
Raw materials and consumables	1.1

**12. Trade and other receivables**

	2013 £m
<b>Amounts falling due within one year:</b>	
Trade receivables	107.5
Provision for impairment of trade receivables	(25.5)
Prepayments and accrued income	61.5
Amounts owed by group companies	19.4
Other tax and social security	14.2
Other receivables	2.0
	<b>179.1</b>
<b>Amounts falling due after more than one year:</b>	
Amounts owed by group companies	<b>1,273.3</b>

All receivables are reviewed regularly to assess any associated credit risk. There are no significant concentrations of credit risk. Any impairment considered necessary has been made to the amounts included above. See note 19 for further details of credit risks associated with financial instruments.

Amounts owed by group companies within one year and after more than one year include £272.3m in respect of the fair value of index linked swaps at the date of novation from Saltaire Water Limited to Yorkshire Water Services Limited in August 2008 and £1,009.0m of upstream loans to Kelda Holdco Limited.

Trade receivables can be analysed as follows:

	2013 £m
<b>Main charges trade receivables:</b>	
Past due but not impaired	72.9
Past due and impaired	24.2
<b>Other trade receivables:</b>	
Past due but not impaired	9.1
Past due and impaired	1.3
	<b>107.5</b>

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The ageing of trade receivables classed as past due but not impaired is as follows:

	2013 £m
<b>Main charges trade receivables:</b>	
Less than one year overdue	49.9
Between one and two years overdue	12.7
Between two and three years overdue	5.5
Between three and four years overdue	2.7
More than four years overdue	2.1
<b>Other trade receivables:</b>	
Less than one year overdue	8.9
Between one and two years overdue	0.1
Between two and three years overdue	0.1
	<b>82.0</b>

The ageing of trade receivables classed as past due and impaired is as follows:

	2013 £m
<b>Main charges trade receivables:</b>	
Less than one year overdue	9.8
Between one and two years overdue	5.0
Between two and three years overdue	3.5
Between three and four years overdue	3.2
More than four years overdue	2.7
<b>Other trade receivables:</b>	
Less than one year overdue	1.3
	<b>25.5</b>

The movement in the provision for impairment of trade receivables is as follows:

	2013 £m
On acquisition of subsidiary	25.0
Provision for impairment	11.9
Amounts written off	(11.4)
<b>Provision at 31 March 2013</b>	<b>25.5</b>

In all cases, the fair value of trade and other receivables is considered to be the carrying value as stated above.

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**13. Financing**

**(i) Cash and cash equivalents**

	2013 £m
Short-term deposits	38.9

At 31 March 2013, the Group had available £657.3m of undrawn committed borrowing facilities.

**(ii) Borrowings**

	2013 £m
<b>Short-term borrowings:</b>	<b>£m</b>
Bank loans	200.5
Bank loans under Kelda Finance facility	65.0
Finance leases	8.3
	<b>273.8</b>

	2013 £m
<b>Long-term borrowings:</b>	<b>£m</b>
Bank loans	334.7
Fixed rate guaranteed bonds due in less than 5 years	447.3
Fixed rate guaranteed bonds due in more than 5 years	1,825.8
Index linked guaranteed bonds due in more than 5 years	1,161.5
Fixed rate US Dollar bonds due in more than 5 years	309.1
RPI uplift on index linked bonds	92.1
Finance leases	262.9
	<b>4,433.4</b>

**Fixed rate guaranteed bonds due in less than 5 years are made up of:**

*6% guaranteed bonds 2017 £447.3m*

These bonds are repayable in one sum on 19 August 2017. The interest is charged at 6%.

**Fixed rate guaranteed bonds due in more than 5 years are made up of:**

*6% guaranteed bonds 2019 £273.3m*

These bonds are repayable in one sum on 21 August 2019. Interest is charged at 6%.

*6.5876% guaranteed bonds 2023 (Exchange bonds) £218.1m*

These bonds are repayable in one sum on 21 February 2023. Interest is charged at 6.5876%.

*5.375% guaranteed bonds 2023 (Stranded bonds) £4.1m*

These bonds are repayable in one instalment on 21 February 2023. Interest is charged at 5.375%.

*5.5% guaranteed bonds 2027 (Stranded bonds) £6.3m*

These bonds are repayable in one instalment on 28 May 2027. Interest is charged at 5.5%.

*6.454% guaranteed bonds 2027 (Exchange bonds) £140.4m*

These bonds are repayable in one sum on 28 May 2027. Interest is charged at 6.454%.

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**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

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*6.6011% guaranteed bonds 2031 (Exchange bonds) £244.3m*

These bonds are repayable in one sum on 17 April 2031. Interest is charged at 6.6011%.

*6.625% guaranteed bonds 2031 (Stranded bonds) £0.7m*

These bonds are repayable in one sum on 17 April 2031. Interest is charged at 6.625%.

*5.5% guaranteed bonds 2037 £195.0m*

These bonds are repayable in one instalment on 28 May 2037. Interest is charged at 5.5%.

*6.375% guaranteed bonds 2039 £305.7m*

These bonds are repayable in one sum on 19 August 2039. The interest is charged at 6.375%.

*5.75% guaranteed bonds 2020 £196.2m*

This bond was taken out on 6 February 2013 and is repayable in one sum on 17 February 2020. The interest is charged at 5.75%.

*3.625% index linked guaranteed bonds 2029 £241.7m*

These bonds were issued on 1 August 2012 and are repayable in one instalment on 1 August 2029. The interest is charged at 3.625% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

**Index linked guaranteed bonds due in more than 5 years are made up of:**

*3.3066% index linked guaranteed bonds 2033 (Exchange bonds) £139.4m*

These bonds are repayable in one instalment on 29 July 2033. The interest is charged at 3.3066% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

*2.718% index linked guaranteed bonds 2039 £314.5m*

These bonds are repayable in one instalment on 30 December 2039. The interest is charged at 2.718% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

*2.16% % index linked guaranteed bonds 2041 £51.4m*

These bonds are repayable in one instalment on 30 December 2041. The interest is charged at 2.16% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

*1.8225% index linked guaranteed bonds 2050 £77.7m*

These bonds are repayable in one instalment on 1 February 2050. The interest is charged at 1.8225% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

*1.462% index linked guaranteed bonds 2051 £153.8m*

These bonds are repayable in one instalment on 1 August 2051. The interest is paid at 1.462% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

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## **Notes to the Group financial statements (continued)**

*for the period ended 31 March 2013*

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### *1.758% index linked guaranteed bonds 2054 £101.7m*

These bonds are repayable in one instalment on 1 February 2054. The interest is charged at 1.758% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

### *1.46% index linked guaranteed bonds 2056 £153.7m*

These bonds are repayable in one instalment on 1 August 2056. The interest is paid at 1.46% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

### *1.709% index linked guaranteed bonds 2058 £119.5m*

These bonds are repayable in one instalment on 1 February 2058. The interest is charged at 1.709% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

### *1.083% index linked guaranteed bonds 2042 £51.0m*

These bonds were issued on 22 May 2012 are repayable in one instalment on 22 May 2042. The interest is charged at 1.083% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

The Group has an early repayment option on all of the above bonds, subject to the agreement of the issuer.

### **Fixed rate US Dollar bonds due in more than 5 years**

During the financial year ended 31 March 2012 the Yorkshire Water Services group of companies raised \$455m of US bonds in tranches with durations of 7, 10, 12 and 15 years, incurring fixed rate interest charges at rates from 3.18% to 5.07%, as follows:

- \$30m fixed rate bonds expiring in 2018 carrying fixed rate interest at 3.18%; and
- \$115m fixed rate bonds expiring in 2021 carrying fixed rate interest at 3.77%.

The above bonds were issued on 13 December 2011.

- \$15m fixed rate bonds expiring in 2019 carrying fixed rate interest at 3.18%;
- \$40m fixed rate bonds expiring in 2022 carrying fixed rate interest at 3.77%;
- \$75m fixed rate bonds expiring in 2022 carrying fixed rate interest at 5.07%;
- \$150m fixed rate bonds expiring in 2023 carrying fixed rate interest at 3.87%; and
- \$30m fixed rate bonds expiring in 2024 carrying fixed rate interest at 3.87%.

The above bonds were issued on 5 January 2012.

The Group hedges the fair value of the Dollar bonds using a series of combined interest rate and foreign currency swaps that in combination form cross currency interest rate swaps, swapping dollar principal repayments into sterling and fixed rate dollar interest payments into sterling floating rate interest payments (see note 19 for more details).

### *Bank loans*

Bank loans within long term borrowings relates to facilities held with European Investment Bank, repayable as £28.6m (1 - 2 years), £103.5m (2 – 5 years) and £202.6m (more than 5 years).

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**Notes to the Group financial statements (continued)**  
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Short and long term bank loans are held in sterling and bear interest at normal commercial rates. The weighted average interest rates associated with the bank loans were 4.013%.

**(iii) Finance leases**

	Minimum lease payments 2013 £m
Amounts payable under finance leases:	
No later than 1 year	11.0
Later than 1 year and no later than 5 years	228.7
Later than 5 years	145.5
	<b>385.2</b>
Less: future finance charges	(114.0)
Present value of lease obligations	<b>271.2</b>
Amount due for settlement within 12 months	8.3
Amount due for settlement after 12 months	262.9
	<b>271.2</b>

All lease obligations are denominated in sterling.

The weighted average lease term is 13.0 years. For the period ended 31 March 2013 the average effective borrowing rate was 2.6%. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

**14. Trade and other payables**

	2013 £m
<b>Amounts falling due within one year:</b>	
Trade payables	57.5
Capital payables	99.7
Deferred grants and contributions on depreciated assets	2.9
Social security and payroll deductions	2.0
Receipts in advance	50.6
Amounts owed to group companies	7.3
Interest payable	90.9
Deferred income	150.4
Other payables	8.2
	<b>469.5</b>
<b>Amounts falling due after more than one year:</b>	
Deferred grants and contributions on depreciated assets	53.1
Interest payable	50.8
Other payables	0.1
	<b>104.0</b>

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs. The directors consider that the carrying amount of trade and other payables approximate to their fair value.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**15. Provisions**

	£m
On incorporation	-
On acquisition of subsidiaries	0.6
<b>At 31 March 2013</b>	<b>0.6</b>

Certain subsidiaries of the Group operate a self-insurance policy. Provisions relate to estimated liabilities relating to self-insured claims, including an estimate for claims incurred but not reported.

**16. Deferred tax liabilities**

	Accelerated capital allowances	Fair value adjustment of infrastructure assets	Revaluation reserve	Roll-over relief	Financial instruments	Total
	£m	£m	£m	£m	£m	£m
On incorporation	-	-	-	-	-	-
On acquisition of subsidiaries	589.7	41.8	320.9	0.8	(318.7)	634.5
(Credit)/charge to income statement	(29.4)	3.5	-	-	(53.5)	(79.4)
Credit to revaluation reserve	-	-	(17.3)	-	-	(17.3)
<b>At 31 March 2013</b>	<b>560.3</b>	<b>45.3</b>	<b>303.6</b>	<b>0.8</b>	<b>(372.2)</b>	<b>537.8</b>

**17. Pensions**

**(i) Defined benefit scheme**

The parent group sponsors a UK pension scheme, called the Kelda Group Pension Plan (KGPP). This scheme was previously sponsored by Kelda Group plc. before its acquisition by Saltaire Water Limited. The KGPP has a number of benefit categories providing benefits on a defined benefit basis and a defined contribution basis.

Contributions over the year ended 31 March 2013 were paid by members at 3%, 4%, 4.5%, 5% or 6% of pensionable pay (depending on benefit category). The majority of members now pay contributions through a salary sacrifice arrangement with effect from 1 October 2008. Following the actuarial valuation in March 2010 the Group contributed 23.6% of pensionable pay in respect of the majority of members. The Group also paid lump sum deficit contributions of £1.0m per month in the period to 31 March 2013.

An accrual for unfunded benefits of £3.1m has been included in the Group's financial statements at 31 March 2013.

The sponsoring employer of the KGPP is Kelda Group Limited, a subsidiary of Kelda Holdings Limited. As there is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole as measured in accordance with IAS19 to individual Group entities, Kelda Finance (No. 1) Group recognises a cost equal to the contributions made by its subsidiaries.

Details of the major assumptions and scheme assets and liabilities of the KGPP can be found below.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**(ii) Major assumptions**

Pension contributions are determined with the advice of independent qualified actuaries, Mercer Limited, on the basis of annual valuations using the projected unit credit method.

	2013 %
Inflation	3.4
Rate of increase in salaries	4.4
Rate of increase to pensions in payment and deferred pensions	3.4
Discount rate for scheme liabilities	4.4
Life expectancy for a male pensioner aged 60 (in years)	26.7
Projected life expectancy at age 60 for male aged 40 (in years)	28.7

**(iii) Scheme assets and liabilities**

Scheme assets are stated at their bid values at the respective balance sheet dates.

To develop the expected long-term rate of return on assets assumption, the Company considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class.

	2013 Market value £m	Expected long term rate of return %
<b>Fair value of scheme assets</b>		
Equities	438.5	6.25
Bonds	400.0	4.25
Property	76.3	6.25
Other	106.1	3.50
Total value of assets	1,020.9	
Present value of scheme liabilities	(1,179.3)	
Pension liability	(158.4)	

**(iv) Defined contribution scheme**

The Group ran two defined contribution schemes for its employees. These were closed to new members on 30 September 2007 and replaced by one defined contribution scheme on 1 October 2007. The total charged to the income statement for the defined contribution schemes for the period ended 31 March 2013 was £0.9m.



**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**18. Ordinary shares**

	2013 £
<b>Issued and fully paid</b>	
100 Ordinary shares of £1.00 each	100

**19. Financial instruments**

The disclosures below exclude short term receivables and payables which are primarily of a trading nature and expected to be settled within normal commercial terms.

Net debt and financial liabilities comprise the following:

	2013 Less than one year £m	2013 More than one year £m	2013 Total £m
Financial assets:			
Combined cross currency interest rate swaps	-	19.0	19.0
	-	19.0	19.0
Financial liabilities:			
Interest rate swaps	-	(21.6)	(21.6)
Fixed to floating interest rate swaps	-	(7.3)	(7.3)
Index linked swaps	-	(1,636.9)	(1,636.9)
	-	(1,665.8)	(1,665.8)
Net debt:			
Cash and cash equivalents	38.9	-	38.9
Loans receivable from group companies	-	1,009.0	1,009.0
Borrowings	(273.8)	(4,433.4)	(4,707.2)
	(234.9)	(3,424.4)	(3,659.3)

Cash and short term deposits were invested with a range of counterparties; either AAA rated sterling liquidity funds or banks with a rating of at least long term A, short term A1/P1, in accordance with approved investment guidelines.

The Group holds index linked swaps with a mark to market loss of £1,729.0m. £1,636.9m is shown as index linked swaps in the table above; the remaining £92.1m is shown within borrowings in note 13.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**(a) Interest rate risk profile of financial assets and liabilities**

The interest rate risk profile of the Group's financial assets and liabilities at 31 March 2013 is below. This includes interest payable or receivable in the period as well as the principal repayments. It is assumed that LIBOR and indexation remain constant at the period end position.

**Period ended 31 March 2013**

	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	Total £m
<b>Financial liabilities and borrowings</b>							
<b>Fixed rate</b>							
Bank loans	45.0	37.9	36.8	35.7	34.6	53.8	243.8
Guaranteed bonds	134.6	134.6	134.6	134.6	134.6	3,490.1	4,163.1
US Dollar bonds	11.4	11.4	11.4	11.4	11.4	336.1	393.1
Finance lease swaps	2.1	2.3	2.3	2.3	2.3	29.7	41.0
	<b>193.1</b>	<b>186.2</b>	<b>185.1</b>	<b>184.0</b>	<b>182.9</b>	<b>3,909.7</b>	<b>4,841.0</b>
<b>Floating rate</b>							
Index linked guaranteed bonds	22.1	22.1	22.1	22.1	22.1	1,636.1	1,746.6
US Dollar bonds	1.1	1.1	1.1	1.1	1.1	76.9	82.4
Bank loans	3.3	3.3	3.6	4.0	20.1	157.0	191.3
Bank loans under Kelda Finance facility	65.7	-	-	-	-	-	65.7
Combined cross currency interest rate swaps	6.6	6.6	6.6	6.6	6.6	28.2	61.2
Fair value interest rate swaps	4.8	4.8	4.8	4.8	4.8	52.4	76.4
Index linked swaps	31.9	31.9	31.9	31.9	31.9	690.9	850.4
Finance leases	10.9	52.6	49.5	57.8	68.8	145.5	385.1
	<b>146.4</b>	<b>122.4</b>	<b>119.6</b>	<b>128.3</b>	<b>155.4</b>	<b>2,787.0</b>	<b>3,459.1</b>
<b>Non-interest bearing financial liabilities</b>							
Trade payables	57.5	-	-	-	-	-	57.5
Other payables	208.1	-	-	-	-	-	208.1
	<b>265.6</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>265.6</b>
<b>Financial assets</b>							
<b>Floating rate</b>							
Cash and cash equivalents	(38.9)	-	-	-	-	-	(38.9)
	<b>(38.9)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(38.9)</b>
<b>Non-interest bearing financial assets</b>							
Trade receivables	(82.0)	-	-	-	-	-	(82.0)
Other tax and social security	(14.2)	-	-	-	-	-	(14.2)
	<b>(96.2)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(96.2)</b>

***Kelda Finance (No. 1) Limited***  
***Notes to the Group financial statements (continued)***  
***for the period ended 31 March 2013***

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**(b) Financial risks**

***Capital risk management***

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide benefits to stakeholders, returns to owners and to maintain an optimal capital structure. In order to do this, the Group will consider the amount of debt and assets held and their liquidity.

When monitoring capital risk, the Group considers its gearing and the ratio of net debt to RCV.

Centrally managed funds are invested entirely with counterparties whose credit rating is 'A-' or better.

Maximum exposure relating to financial assets is represented by carrying value as at the balance sheet date.

***Credit risk***

The Group has some exposure to credit risk through the holding of receivables on the period end balance sheet. These can be split into main charges receivables and other trade receivables.

Risks associated with main charges receivables include limits on the Group's ability to restrict supply. However, this does not apply to all receivables. The credit risk is mitigated by introducing payment plans, providing advice and support to customers where this is viable and where it is considered necessary, using legal procedures to reclaim outstanding debts.

Risks associated with other trade receivables are mitigated by credit checks performed on customers before they are supplied, the cessation of supply to customers who are a high credit risk and payment in advance where this is deemed necessary.

The directors consider that the carrying amount of trade and other receivables approximates to their fair value. The amounts presented in the balance sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment.

The Group's objective is to minimise the risk by minimising the amount of overdue debt at any time. The Group manages the risk by timely review of the ageing profile and employing specific staff to monitor and collect these debts. The risk is measured by monitoring of overdue receivables.

In respect of credit risk arising from the other financial assets of the Group, which comprise cash, investments in the equity of other companies such as joint ventures and other receivables and financial assets in relation to concession arrangements, the Group's exposure to credit risk arising from default of the counterparty, with a maximum exposure equal to the carrying value of these instruments.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

At 31 March, the maximum exposure to credit risk for the Group and company is represented by the carrying amount of each financial asset in the statement of financial position:

	Group 2013 £m	Company 2013 £m
Cash and short term deposits (see note 13)	38.9	-
Trade and other receivables (see note 12)	1,452.4	-
Financial assets	19.0	-
Investments	-	778.4

**Liquidity risk**

Liquidity risk is the risk that the Group will not have the level of liquid funding available to meet its requirements. Maintaining an inadequate amount of liquidity and being unable to access the debt markets when required exposes the Group to the risk of being unable to finance its functions, whilst maintaining excess liquidity potentially exposes the Group to the risk of inefficient funding costs.

The Group looks to manage its liquidity by ensuring debt is held with a range of durations and the maturity profile is actively managed by the Group's treasury function. Existing bank covenants require the Group to keep a combination of available cash and banking facilities sufficient to cover anticipated capital expenditure, operating costs and interest costs for the succeeding 12 months. This is a rolling requirement. The Group extend the requirement to cover all other future outgoings. Further facilities are not expected to be required within the next year to comply with the above policy.

At 31 March 2013 the Group had £696.2m of available liquidity which comprised £38.9m available cash and short term deposits, and £657.3m of undrawn committed borrowing facilities.

The maturity profile on page 48 represents the forecast future contractual principal and interest cashflows in relation to the group's financial liabilities and derivatives on an undiscounted basis. There is no material risk to the timing or value of payment of the amounts disclosed with the exception of changes to the RPI and LIBOR forecasts.

**Market risk**

Market risk is the risk that movements in market conditions, including inflation and interest rates will impact materially on the Group financial performance. The Group's exposure to market risks primarily results from its financial arrangements and the economic return which it is allowed on the regulatory capital value (RCV).

The Group uses a variety of financial instruments, including derivatives, in order to manage the exposure to these risks.

The Group's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The Group's floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Group uses interest rate swap contracts to hedge these exposures where appropriate.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

The sensitivity of the Group's interest and borrowings to the above risks can be summarised as follows:

	2013 £m
<b>Impact on profit before tax</b>	
1% increase in RPI leading to a decrease in profit	(27.3)
1% decrease in RPI leading to an increase in profit	27.3
1% increase in LIBOR leading to an increase in profit	0.3
1% decrease in LIBOR leading to a decrease in profit	(0.3)

**(c) Fair values of financial assets and financial liabilities**

The following table provides a comparison by category of the book values and the fair values of the Group's financial assets and liabilities at 31 March 2013.

	2013 Book value £m	2013 Fair value £m
<b>Primary financial instruments financing the Group's operations</b>		
<b>Financial assets</b>		
<b>Designated as Fair Value Through Profit and Loss</b>		
Combined cross currency interest rate fair value swaps	(19.0)	(19.0)
<b>Financial assets held at amortised cost</b>		
Cash and cash equivalents	(38.9)	(38.9)
<b>Financial liabilities</b>		
<b>Designated as Fair Value Through Profit and Loss</b>		
Fixed rate interest rate swaps in respect of finance leases	21.6	21.6
Fixed to floating interest rate swaps	7.3	7.3
Fixed rate US Dollar bonds	309.1	309.1
Index linked swaps	1,729.0	1,729.0
<b>Financial liabilities held at amortised cost</b>		
Fixed rate bank loans	600.3	653.9
Fixed rate sterling bonds	2,272.9	2,722.9
Index linked sterling bonds	1,161.5	1,172.5
Finance leases	271.2	271.2

The fair values for all financial instruments have been calculated either by discounting the expected future cash flows at interest rates prevailing for a comparable maturity period for each instrument or by reference to market values for similar instruments.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
*for the period ended 31 March 2013*

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All fair value measurements are therefore categorised as classified as level 1 under IFRS7 'Financial Instruments - Disclosures' as they are based upon quoted prices in active markets for similar instruments. There have been no transfers between levels within the fair value hierarchy within the period.

Movements in the fair value of index linked swaps in respect of borrowings of £310.3m were recognised in the income statement. Of this movement a charge of £292.3m is recognised in exceptional finance costs and a charge of £18.0m is recognised in finance costs to accrue for the RPI bullet payment on the swaps. Movements in the fair value of fixed rate swaps in respect of borrowings and finance leases of £0.8m were recognised in the income statement. Movement in fair value of combined cross currency interest rate swaps of £3.8m were recognised in the income statement. All interest rate swaps have maturity dates in excess of five years.

Some interest rate swaps in respect of borrowings have break dates at which time both parties have an option to repay the swap. All break dates are in excess of five years.

**(d) Hedges**

The Group's policy is to hedge interest rate risk within approved board policies and guidelines.

Interest rate swaps are used to manage interest rate exposure under a policy that requires at least 85% of Yorkshire Water and Kelda Holdco Limited (a fellow subsidiary of Kelda Eurobond Co Limited, the ultimate parent company in the UK) net debt to be fixed or index linked. At the financial period end the proportions were 110% and 105% respectively.

***Hedging of floating rate interest due on borrowings***

The Group has a number of borrowing facilities with a number of counterparties on which interest is linked to LIBOR. It is therefore exposed to changes in LIBOR which could have a material effect on interest costs from year to year and over time.

In order to manage its exposure to movements in LIBOR, the Group has entered into a number of floating rate to index linked swaps and also a floating interest rate to fixed interest rate swap.

The nominal value of index linked swaps total £1,289.0m and have an average life of 37 years. The nominal value of the floating interest rate to fixed interest rate swap is £45.0m with a remaining life of 18 years.

The hedging instruments are not a perfect cash flow hedge against changes in LIBOR as the dates and amounts of the swaps vary in some cases to the borrowings which they hedge.

The fair value of the indexed linked hedging instruments at 31 March 2013 was a loss of £1,729.0m (on acquisition of subsidiaries: £1,418.7m loss). The fair value movement in the period has been recognised in the income statement as an exceptional item because the criteria for hedge accounting were not met.

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the Group financial statements (continued)***

***for the period ended 31 March 2013***

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### ***Hedging of interest due under finance leases***

Yorkshire Water has a number of finance leases with a number of counterparties lasting from inception for periods up to 35 years. In most cases interest payable under the lease is set once a year in late March or early April based on 12 month LIBOR. Yorkshire Water is therefore exposed to changes in 12 month LIBOR which could have a material effect on interest costs from year to year and over time. £59.2m of leases are reset semi-annually based on 6 month LIBOR.

In order to fix the interest cost on a proportion of its net debt, Yorkshire Water has entered into a number of floating to fixed interest rate swaps.

The hedging instrument does not meet the criteria to classify for hedge accounting. The fair value of the hedging instrument at 31 March 2013 was a £21.6m loss (on acquisition of subsidiaries: £20.8m loss).

The cash flow hedge was assessed to be ineffective at 31 March 2013 and a charge of £0.8m relating to the hedging instrument was included in the income statement (net of deferred tax).

### ***Fair value hedges***

Combined cross currency interest rate swap contracts exchanging fixed rate interest for floating rate interest on the Group's US Dollar bonds are designated and effective as fair value hedges in respect of interest rates and foreign currency risk. The fair value of the combined cross currency interest rate swap instruments was a gain of £19.0m (on acquisition of subsidiary: £15.2m). The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the period and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate movements and foreign currency exposure, the carrying amount of the bonds was adjusted for a fair value loss of £5.6m which was included in the income statement at the same time that the fair value of the combined cross currency interest rate swap was included in the income statement.

During 2012/13 the Group entered into a £250m nominal fixed to floating interest rate swap which is designated as a fair value hedge of fixed rate bonds of the same value. During the year, the hedge was at least 95% effective in hedging the fair value exposure to interest rate movements. The fair value of the fixed to floating interest rate swaps was a loss of £7.3m. The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the year and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate, the carrying amount of the bonds was adjusted for a fair value gain of £5.1m which was included in the income statement at the same time that the fair value of the fixed to floating interest rate swap was included in the income statement.

### ***Foreign currency risk management***

The Group has a number of long term interest bearing liabilities denominated in foreign currencies; consequently exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising combined cross currency interest rate swaps.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**20. Share based payments**

**Share options**

Prior to its acquisition by the Group, Yorkshire Water Services Limited was part of a group of companies that operated a savings related share option scheme under which options were granted to employees. The scheme was closed following the acquisition of Kelda Group plc by Saltaire Water Limited in the 2008/9 financial year. Certain schemes have been allowed to continue until the planned maturity with members having the option to continue contributing. For any member who has taken that option, charges to the income statement will continue until the maturity of the scheme. For any other member who has opted to close their scheme, charges to the income statement ceased in the month that they chose to leave the scheme.

The employee share option plans were open to all qualifying employees and provided for an exercise price equal to the daily average market price on the date of grant less 20%. The options previously vested if the employee remains in service for the full duration of the option scheme (either three or five years), but the choice to vest on takeover was available to all option holders.

	2013	Weighted average exercise price £
	Options	
On acquisition of subsidiaries	2,384	7.41
Exercised during the period	(2,384)	7.41
<hr/>		
Outstanding at the end of the period	-	-
<hr/>		
Of which exercisable at the end of the period	-	-

The weighted average share price at the date of exercise for share options exercised during the period was £10.90. There were no options outstanding at 31 March 2013.

The fair value of the share options granted is estimated as at the date of grant using the Black Scholes statistical model. There were no shares granted in the period ending 31 March 2013. The inputs into the Black Scholes model for 2007 were as follows:

	2007
Share price at date of grant	926p
Exercise price	741p
Expected volatility	25%
Expected life	3 and 5 years
Risk free rate	5.08%
Expected dividends	31p

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



**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

**21. Additional cash flow information**

Analysis of movement in net debt

	On incorporation £m	On acquisition of subsidiaries £m	Non-cash movements £m	Cash movements £m	At 31 March 2013 £m
Cash and cash equivalents	-	52.5	-	(13.6)	38.9
Debt due within one year	-	(232.5)	(260.0)	226.9	(265.6)
Finance leases due within one year	-	(23.3)	-	15.1	(8.2)
Debt due after one year	-	(255.8)	(260.0)	242.0	(273.8)
Finance leases due after one year	-	(3,716.3)	(39.6)	(414.6)	(4,170.5)
	-	(268.1)	-	5.2	(262.9)
	-	(3,984.4)	(39.6)	(409.4)	(4,433.4)
<b>Total net debt</b>	-	<b>(4,187.7)</b>	<b>(299.6)</b>	<b>(181.0)</b>	<b>(4,668.3)</b>

Net debt does not include financial liabilities which are not considered to be part of the Group's borrowings.

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
for the period ended 31 March 2013

Cash generated by continuing operations as noted in the Group cashflow statement can be derived as follows:

	2013 £m
Loss from continuing operations before taxation	(186.6)
Finance income	(63.1)
Finance costs	194.3
Exceptional finance costs (non-cash)	297.1
Depreciation and amortisation of capital grants	171.0
Decrease in inventories	0.1
Decrease in trade and other receivables	12.0
Decrease in trade and other payables	(20.1)
Other movements	0.4
<b>Cash generated from continuing operations</b>	<b>405.1</b>

**22. Commitments**

	2013 £m
<b>Contracts placed at 31 March</b>	<b>326.2</b>

The long term investment programme for the UK regulated water services business, which identified substantial future capital expenditure commitments in the period 1 April 2010 to 31 March 2015, was agreed as part of the Periodic Review process which was finalised in November 2009.

At 31 March, Group companies were committed to making the following payments under non-cancellable operating leases as set out below.

The Group has entered into commercial leases on certain property, motor vehicles and items of machinery. These leases have an average duration of between 3 and 10 years. There are no restrictions placed on the Group by entering into the leases.

Future minimum rentals payable under non-cancellable operating leases are as follows:

	2013 Land and buildings £m	2013 Other £m
No later than 1 year	0.1	0.2
Later than 1 year and no later than 5 years	1.0	1.9
Later than 5 years	1.2	-
	<b>2.3</b>	<b>2.1</b>

**Kelda Finance (No. 1) Limited**  
**Notes to the Group financial statements (continued)**  
*for the period ended 31 March 2013*

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**23. Related parties**

Compensation of key management personnel (including directors)

	2013 £m
Short-term benefits	3.0
Post-employment benefits	0.2
Termination payments	0.1
	<b>3.3</b>

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**24. Post balance sheet events**

During April 2013, the Group raised AU\$50m of Australian dollar fixed rate bonds repayable in one lump sum on 15 August 2023. These bonds incur interest at 5.875%. During May 2013 the Group raised £90m of sterling fixed rate class B bonds repayable in one lump sum on 12 December 2033. These bonds incur interest at 4.965%.

**25. Ultimate controlling party**

The company's immediate parent company is Kelda Group Limited. The ultimate parent company and controlling party is Kelda Holdings Limited, a company registered in Jersey and resident for tax in the UK.

Kelda Eurobond Co Limited, a company registered in England and Wales, is the largest UK Group to consolidate these financial statements.

Copies of the consolidated financial statements may be obtained from the Company Secretary, Kelda Eurobond Co Limited, Western House, Halifax Road, Bradford BD6 2SZ.

# ***Kelda Finance (No. 1) Limited***

## ***Group companies***

*as at 31 March 2013*

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<b>Principal subsidiary companies</b>	<b>Country of incorporation</b>	<b>Country of tax residence</b>	<b>Class of shares in issue</b>	<b>Proportion of class of share held</b>
<b>Water services</b>				
Yorkshire Water Services Limited	England & Wales	UK	Ordinary	100%
<b>Holding and finance companies</b>				
Kelda Finance (No. 2) Limited	England & Wales	UK	Ordinary	100%
Kelda Finance (No. 3) PLC.	England & Wales	UK	Ordinary	100%
Yorkshire Water Services Holdings Limited	England & Wales	UK	Ordinary	100%
Yorkshire Water Services Finance Limited	England & Wales	UK	Ordinary	100%
Yorkshire Water Services Odsal Finance Limited	Cayman Islands	UK	Ordinary	100%
Yorkshire Water Services Bradford Finance Limited	Cayman Islands	UK	Ordinary	100%

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**Kelda Finance (No. 1) Limited**  
**Company balance sheet**  
*as at 31 March 2013*

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	Notes	2013 £m
<b>Fixed assets</b>		
Investments	3	778.4
<b>Total assets</b>		<b>778.4</b>
<b>Net assets</b>		<b>778.4</b>
<b>Capital and reserves</b>		
Profit and loss account	4	778.4
<b>Total shareholder's funds</b>		<b>778.4</b>

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The financial statements on pages 59 to 62 were approved by the board of directors on 11 July 2013 and signed on their behalf by:



**Elizabeth Barber**  
Director  
Kelda Finance (No. 1) Limited

Registered Number: 08066326

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the company financial statements***

*for the period ended 31 March 2013*

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### **1. Company accounting policies**

#### **Basis of accounting**

The company's financial statements are prepared on a going concern basis, under the historical cost convention in compliance with all applicable United Kingdom accounting standards and, except where otherwise stated in the notes to the financial statements, with the Companies Act 2006.

The going concern basis has been applied in these financial statements. The accounting policies shown below have been applied consistently throughout the current period.

#### **Taxation**

##### *Current tax*

Current tax for the current and prior periods is, to the extent unpaid, recognised as a liability. If the amount already paid in respect of the current and prior periods exceeds the amount payable, the excess is recognised as an asset. The benefits relating to a tax loss that can be carried back to recover current tax of a previous period are held as an asset.

##### *Deferred tax*

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 disposals 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.

#### **Investments in subsidiaries**

Investments in subsidiaries are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

#### **Financial instruments**

##### **Trade debtors and creditors**

Trade debtors do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. There is no intention to trade the debtors. Trade creditors are not interest bearing and are stated at their nominal value.

##### **Interest bearing loans and borrowings**

All loans and borrowings are initially recognised at fair value less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses arising on repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance income and finance costs.

# ***Kelda Finance (No. 1) Limited***

## ***Notes to the company financial statements (continued)***

***for the period ended 31 March 2013***

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### **Cash flow statement**

The Company is a wholly owned subsidiary company of a group headed by Kelda Holdings Limited, and is included in the consolidated financial statements of that company, which are publicly available. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996) 'Cash flow statements'.

### **Dividends receivable**

Dividends receivable are recognised when the shareholders' right to receive the revenue is established.

### **Dividends payable**

Interim dividends payable are recognised on payment of the dividend. Final dividends payable are recognised on approval by shareholders in the annual general meeting.

### **Share capital**

Ordinary shares are classified as equity.

## **2. Profit attributable to the parent company**

The result of the parent company was a profit of £496.7m. Advantage has been taken of the exemption available under section 408 of the Companies' Act 2006 not to present a profit and loss account for the Company alone. The parent company profit and loss account was approved by the board on 11 July 2013.

## **3. Fixed asset investments**

	<b>Shares in Group undertakings £m</b>
<b>Cost</b>	
On incorporation	-
On acquisition of subsidiaries	778.4
<b>At 31 March 2013</b>	<b>778.4</b>

On 25 June 2012, Kelda Finance (No. 1) Limited issued 99 ordinary shares of £1.00 each, in addition to the single share already in issue, at a premium of £778.4m to Kelda Group Limited in a share for share exchange in return for the entire share capital of Kelda Finance (No.2) Limited.

A list of the major subsidiaries of the Company can be found on page 58. The directors believe that the carrying value of the investments is supported by their underlying net assets.

**Kelda Finance (No. 1) Limited**  
**Notes to the company financial statements (continued)**  
for the period ended 31 March 2013

**4. Reconciliation of movements in shareholder's funds**

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total Shareholder's funds £m
On incorporation	-	-	-	-
Issue of shares	-	778.4	-	778.4
Reduction in capital	-	(778.4)	778.4	-
Profit for the period	-	-	496.7	496.7
Dividends paid	-	-	(496.7)	(496.7)
<b>Shareholder's funds at 31 March 2013</b>	<b>-</b>	<b>-</b>	<b>778.4</b>	<b>778.4</b>

During the period 99 ordinary shares of £1.00 each were issued to Kelda Group Limited at a premium of £778.4m in exchange for the entire shareholding of Kelda Finance (No.2) Limited. See note 3 for more details.

On 25 June 2012, the board passed a special resolution to reduce the share premium account from £778.4m to £nil.

**5. Other information**

The company had no employees at 31 March 2013.

Details of directors' emoluments are set out in the directors' emoluments note on page 30. No elements related specifically to their work in the company.

Disclosure notes relating to share capital, auditors' remuneration and financial instruments are included within the financial statements of the Group.

The company has taken advantage of the exemption granted by paragraph 3c of FRS8 "Related party disclosures", not to disclose transactions with other wholly-owned Group companies.

Auditors' remuneration has been borne by Kelda Group Limited.

**6. Ultimate controlling party**

The company's immediate parent company is Kelda Group Limited. The company's ultimate parent company is Kelda Holdings Limited, a company registered in Jersey and resident for tax in the UK.

Kelda Eurobond Co Limited, a company registered in England and Wales, is the largest UK Group to consolidate these financial statements. Kelda Finance (No. 1) Limited is the smallest UK group to consolidate these financial statements.

Copies of the consolidated financial statements may be obtained from the Company Secretary, Kelda Eurobond Co Limited, Western House, Halifax Road, Bradford BD6 2SZ.



# ***Independent Auditors' Report to the members of Kelda Finance (No. 1) Limited for the company financial statements***

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We have audited the parent company financial statements of Kelda Finance (No. 1) Limited for the period ended 31 March 2013 which comprise the company balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

## **Respective responsibilities of directors and auditors**

As explained more fully in the statement of directors' responsibilities set out on page 12, the directors are responsible for the preparation of the parent company 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 parent company 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.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## **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 parent 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. 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 parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2013;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; 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 Directors' Report for the financial period for which the parent company financial statements are prepared is consistent with the parent company financial statements.

***Independent Auditors' Report to the members of  
Kelda Finance (No. 1) Limited for the company financial statements  
(continued)***

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**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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

**Other matter**

We have reported separately on the Group financial statements of Kelda Finance (No. 1) Limited for the period ended 31 March 2013.



Richard Bunter (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds  
11 July 2013