

**Statutory Accounts and Supplementary
Regulatory Accounting Statements**
for the year ended 31 March 2003



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Preface

for the year ended 31 March 2003

This document includes the statutory Accounts of Southern Water Services Limited to be filed with the Registrar of Companies as required under the Companies Act 1985, together with a set of supplementary regulatory accounting statements required by the Instrument of Appointment (the "Licence") issued to the company by the Secretary of State for the Environment.

The Director General of Water Services ("the Director General") has a duty under the Water Industry Act 1991 to ensure compliance with the conditions of this Licence.

A particular point of definition is worth noting. The "Appointee" is Southern Water Services Limited, appointed in the Licence to be the undertaker. Southern Water Services Limited has other functions and activities which are not regulated by the Licence. These activities are termed the "Non-Appointed Business".

Ring fencing statement

Under paragraph 3.1 of Condition K of its Licence, the company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the company.

In the opinion of the directors, the company was in compliance with that requirement as at 31 March 2003.

Protection of the core business (Licence Condition F6A)

The directors state that the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least 12 months, its regulated activities and sufficient management resources to enable it to carry out its functions.

Directors' responsibilities for the preparation of the supplementary regulatory accounting statements

In addition to their responsibilities to prepare Accounts in accordance with the Companies Act 1985, described on page 2, the directors are also responsible under Condition F of the Licence issued to the company by the Secretary of State for the Environment as a water and sewerage undertaker under the Water Industry Act 1991 for:

- (a) ensuring that proper accounting records are maintained by the Appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by the Director General to the Appointee from time to time;
- (b) preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, having regard also to the terms of guidelines notified by the Director General from time to time, which so far as is reasonably practicable have the same content as the annual Accounts of the Appointee prepared under the Companies Act 1985 and which are prepared in accordance with the formats, accounting policies and principles which apply to those accounts;
- (c) preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by the Director General from time to time;
- (d) preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by the Director General from time to time.

The directors approved the statutory Accounts on pages 4 to 16 on 15 July 2003. They approved the supplementary regulatory accounting statements on pages 20 to 33 and pages 36 to 37 on 23 July 2003.

By order of the Board



Stuart Derwent
Managing Director
23 July 2003

Report of the Directors

The directors present their report and the audited Accounts for the year ended 31 March 2003.

Results and dividend

The profit after taxation for the financial year amounted to £63.6 million (2002: £93.0 million). The directors recommend a final dividend of £nil per ordinary share (2002: £nil) which together with an interim dividend totalling £1,214 per ordinary share (2002: £nil) gives a total dividend of £1,214 per ordinary share for the year (2002: £nil). The retained loss for the year of £4.4 million (2002: Profit £93.0 million) has been transferred to reserves.

Principal activities and review of the business

The principal activities of the company are the provision of water supply and wastewater services in the south-east of England.

Turnover in 2002/03 increased by 1.8% to £436.5m (2001/02 £428.9m) resulting from an increase in charges and new growth. Operating costs, before exceptional items, increased by 17% in 2002/03 to £255.9m (2001/02 £217.7m) representing the effects of inflation together with increases in depreciation and bad debts and costs arising from newly commissioned schemes and new regulatory obligations offset by operating efficiencies.

The company is undertaking a major refinancing project which, it is anticipated, will be completed during the financial year 2003/2004.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are key aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.8 million (2002: £2.0 million).

Directors and their interests

The directors who held office at 31 March 2003 were as follows:

Anthony Nelson (Chairman - appointed 23 April 2002, resigned 7 May 2003)
Martin Baggs
Prof Christopher Chapman
Barrie Delacour
Stuart Derwent
Anthony Fegan
John Harris
Eric Hutchinson (Resigned 30 May 2003)
David Stainthorpe

None of the directors who held office at the end of the financial year had any disclosable interests in the shares of the company.

Post balance sheet events

On 7 May 2003, the ultimate parent undertaking, First Aqua Holdings Limited, sold its entire interest in the ordinary shares of Southern Water Services (Finance) Limited (formerly First Aqua (JV Co) Limited) (an intermediate parent company) to Southern Water Capital Limited.

From 7 May 2003, the directors regard Southern Water Capital Limited as the ultimate holding company. Southern Water Capital Limited is majority owned by Royal Bank of Scotland plc.

On 7 May 2003 Bob Thian was appointed as Non-Executive Chairman and Rory Cullinan, Cyril Roger-Lacan, Jean Claude Banon and François Darley were appointed as Non-Executive Directors.

Directors' responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;

- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;

- prepare the accounts on a going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. The directors are responsible for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Employees

The company has developed its communications processes with its employees to ensure greater understanding of and involvement in the business. This has been achieved through the "Waterline" staff magazine, produced to complement "Southern Water News", and by staff briefings.

The Southern Water Learning business is now firmly established with programmes for school leavers and the long-term unemployed to work alongside and learn from our employees. The Open Learning facilities at all the main company locations reinforce the commitment of the company to providing learning opportunities.

The company continues to work actively with the trade unions and meets with them at senior management level on a regular basis. Key issues for consideration include business reorganisations, consultation on employment policy and discussion of key health and safety issues.

As a result of recent changes in the business structure, the company is currently carrying out a review of the consultation arrangements. The objective of this review will be to ensure that all areas of the new organisation are adequately represented for consultation purposes.

Equal opportunity

Southern Water Services Limited policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The company is a member of the Employer's Forum on Disability, which supports the efforts to meet the needs of the disabled for employment and access to the company and its buildings.

Health and safety

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety, and there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

Southern Water Services Limited has its own internal occupational health service, including the provision of physiotherapy. These services are being developed to meet the needs of the business and our employees at work.

Creditor payment policy and practice

The company's current policy and practice concerning the payment of its trade creditors is to follow the Better Payment Practice Code to which it is a signatory. Copies of the Code may be obtained from the Department of Trade and Industry or from the website www.payontime.co.uk.

The company's policy and practice is to settle terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in

accordance with its contractual and legal obligations. The company's creditor days at 31 March 2003 were 52 days (2002 : 56 days).

Auditors

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 6 March 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company will be proposed at the annual general meeting.

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



Kevin Hall
Secretary
15 July 2003

Registered office
Southern House, Yeoman Road,
Worthing, West Sussex BN13 3NX

Profit and Loss Account

for the year ended 31 March 2003

	Notes	2003 £m	2002 £m
Turnover	1,2,3	436.5	428.9
Cost of sales	3	(230.7)	(195.9)
Gross profit		205.8	233.0
Administrative expenses – normal	3	(26.7)	(23.4)
– exceptional	4	–	(9.6)
Total administrative expenses		(26.7)	(33.0)
Other operating income	3	1.5	1.6
Operating profit and profit on ordinary activities before interest and taxation	5	180.6	201.6
Profit on disposal of fixed assets		8.8	1.6
Net interest and similar charges – normal	7	(76.3)	(71.9)
– exceptional	4,7	(14.0)	–
Total net interest and similar charges		(90.3)	(71.9)
Profit on ordinary activities before taxation	5	99.1	131.3
Tax on profit on ordinary activities	8	(35.5)	(38.3)
Profit on ordinary activities after taxation	19	63.6	93.0
Dividends	9,19	(68.0)	–
Retained (loss)/profit for the financial year	19	(4.4)	93.0

The above results relate entirely to continuing operations. There were no recognised (losses)/profits other than the retained (losses)/profits for the periods presented. The company has no recognised gains and losses other than those included in the loss above and therefore no separate statement of total recognised gains and losses has been presented.

The Notes on pages 6 to 16 form part of these Accounts.

Balance Sheet

as at 31 March 2003

	Notes	2003 £m	2002 £m
Fixed assets			
Tangible assets	10	2,631.9	2,504.8
Investments	11	–	–
		2,631.9	2,504.8
Current assets			
Stocks	12	1.8	4.1
Debtors: amounts falling due within one year	13	97.8	111.8
		99.6	115.9
Creditors: amounts falling due within one year	14	(1,516.5)	(939.5)
Net current liabilities		(1,416.9)	(823.6)
Total assets less current liabilities		1,215.0	1,681.2
Creditors: amounts falling due after more than one year	15	–	(482.1)
Provision for liabilities and charges	16	(372.2)	(355.2)
Grants and contributions	17	(40.7)	(37.4)
Net assets		802.1	806.5
Capital and reserves			
Called up share capital	18	0.1	0.1
Share premium	19	46.3	46.3
Profit and loss account	19	755.7	760.1
Total equity shareholders' funds		802.1	806.5

The Accounts on pages 4 to 16 were approved by the Board on 15 July 2003 and signed on its behalf by:



Stuart Derwent
Managing Director

Notes to the Accounts

for the year ended 31 March 2003

1 Accounting policies

Basis of accounting

The Accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 1985.

Basis of preparation

The Accounts contain information about Southern Water Services Limited as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under section 228 of the Companies Act 1985 from the requirement to prepare consolidated accounts as it and its subsidiary undertaking are included by full consolidation in the consolidated Accounts of an intermediate holding company, Southern Water Services Group Limited (formerly First Aqua Limited).

The 2002 comparative for turnover has been restated from £429.9m to £428.9m to reflect the reclassification of £1m of income arising from aerial masts into other operating income. This is to ensure consistency with current year classifications.

Statement of cash flows

The company has taken an exemption, as allowed by Financial Reporting Standard 1, not to publish a cash flow statement as an intermediate parent company, Southern Water Services Group Limited (formerly First Aqua Limited), publishes full statutory consolidated Accounts.

Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of the business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured and unmeasured income.

Measured income arises from customers who have meters fitted at their premises. Therefore amounts billed are based on actual water consumption. Unmeasured income bills are based on the rateable value of properties.

The income accrual is an estimation of the amount of main water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average tariffs and historical billing and consumption information.

Bad debts

The bad debt provision is calculated based on applying expected recovery rates to an aged debt profile.

Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred.

Tangible fixed assets

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

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs represent those costs directly related to the construction of a specific infrastructure asset and are capitalised as part of infrastructure assets on the basis of the amount of time spent by individuals on capital projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

ii) Other assets (including overground assets, plant and equipment) are stated at cost less accumulated depreciation. Other assets are depreciated on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 – 60
Operational structures	15 – 80
Fixed plant	10 – 40
Vehicles, computers and mobile plant	3 – 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

iii) Freehold land is not depreciated.

Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

Grants and contributions

Capital grants and customer contributions in respect of additions to non-infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions hence these would have been accounted for as deferred income.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the Accounts to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Leased assets

Fixed assets leased to the company under finance leases are capitalised and depreciated in line with the company's depreciation policy. The interest element of finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rentals payable under operating leases are charged to profit and loss account as incurred.

Stocks

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

Taxation

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with FRS 19 "Deferred Tax". Deferred taxation balances are not discounted.

Pensions

Southern Water Limited (formerly Southern Water plc) operates pension schemes which cover the majority of the employees of Southern Water Services Limited. A valuation of the defined benefits pension schemes is normally conducted by an independent actuary every three years. In accordance with Statement of Standard Accounting Practice (SSAP) 24, the regular cost of providing pensions and related benefits and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Any difference between the charge to the profit and loss account and the actual contributions paid to the pension schemes is included as an asset or liability in the balance sheet.

Provisions

A provision is recognised when there is a present obligation, whether legal or constructive, as a result of a past event for which it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the obligation.

Notes to the Accounts

for the year ended 31 March 2003

2 Segmental analysis

The directors believe that the whole of Southern Water Service Limited's activities constitute a single class of business. The company's turnover is generated wholly from within the UK.

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income refers mainly to rents receivable.

4 Exceptional items

During the year ended 31 March 2002, net exceptional costs of £9.6m were incurred which comprised legal and professional fees arising from the proposed refinancing of the Southern Water group in March 2002.

During the year ended 31 March 2003, a net exceptional finance cost of £14.0m was incurred with respect to the early redemption of the £100m bonds issued by Southern Water Services Finance plc and charged to Southern Water Services Limited.

5 Profit on ordinary activities before taxation

	2003 £m	2002 £m
Profit on ordinary activities before taxation is stated after charging/(crediting):		
Staff costs (note 6a)	45.5	43.8
Depreciation on		
– owned assets	92.9	75.1
– leased assets	0.4	0.4
	93.3	75.5
Rentals under other operating leases	4.9	5.3
Research and development expenditure	1.8	2.0
Release of grants and contributions (note 17)	(1.9)	(1.6)
Auditors' remuneration for audit work	0.1	0.1
Auditors' remuneration for non-audit services to the company	0.1	0.1

6 Employee information

(a) Employee costs (including directors' emoluments):	2003 £m	2002 £m
Wages and salaries	50.4	49.4
Social security costs	3.6	3.6
Pension costs	8.0	4.7
Total employee costs	62.0	57.7
Less: charged as capital expenditure	(16.5)	(13.9)
Charged to the profit and loss account	45.5	43.8

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

(b) Average number of persons employed	2003 No.	2002 No.
Operations	1,289	1,399
Project Delivery	115	119
Customer Services	294	271
Corporate Centre	317	244
	2,015	2,033

7 Net interest and similar charges

	2003 £m	2002 £m
Interest payable on bank loans and overdraft	(1.2)	(2.2)
Interest payable on other loans	(75.1)	(69.9)
Exceptional costs arising due to early redemption of £100m bond by subsidiary (note 4)	(14.0)	–
Total interest payable	(90.3)	(72.1)
Interest receivable	–	0.2
Net interest charge	(90.3)	(71.9)

For the years ended 31 March 2002 and 31 March 2003, the company paid interest of £69.9m and £75.1m respectively to group companies.

8 Tax on profit on ordinary activities

	2003 £m	2002 £m
Current tax		
UK corporation tax on profits of the year at 30% (2002: 30%)	18.5	20.2
Adjustment in respect of prior years	–	(2.3)
	18.5	17.9
Deferred tax		
Origination and reversal of timing differences	11.9	20.4
Adjustment in respect of prior years	5.1	–
Total deferred tax	17.0	20.4
Total tax on profit on ordinary activities	35.5	38.3

The rate of current tax charge on profit on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2003 £	2002 £
Profit on ordinary activities before tax	99.1	131.3
Current tax:		
UK corporation tax rate at 30% (2002: 30%) on profit for the period	29.7	39.4
Adjustment in respect of prior years	–	(2.3)
Other differences	(0.6)	–
Permanent differences	1.3	1.2
Tax charge on ordinary activities	30.4	38.3
Effect of deferred tax	(11.9)	(20.4)
Current tax charge for period	18.5	17.9

9 Dividends per ordinary share

	2003 £ per ordinary share	2002 £ per ordinary share	2003 £m	2002 £m
Interim dividend – 23 July 2002	482.14	–	27.0	–
Interim dividend – 23 Oct 2002	364.29	–	20.4	–
Interim dividend – 23 Jan 2003	367.86	–	20.6	–
Total interim dividend	1,214.29	–	68.0	–
Final dividend	–	–	–	–
Total dividend	1,214.29	–	68.0	–

Notes to the Accounts

for the year ended 31 March 2003

10 Fixed assets and capital commitments

	Freehold land and buildings £m	Plant and machinery £m	Vehicles and equipment £m	Infrastructure assets £m	Assets in the course of construction £m	Other £m	Total £m
(a) Tangible assets							
Cost:							
At 1 April 2002	689.7	710.5	0.7	1,086.9	497.2	256.3	3,241.3
Additions	46.2	83.6	–	71.3	–	29.9	231.0
Transfers	81.2	45.8	–	55.7	(186.6)	3.9	–
Grants and contributions	–	–	–	(10.6)	–	–	(10.6)
Disposals	(0.3)	(0.5)	–	(0.7)	–	(9.8)	(11.3)
At 31 March 2003	816.8	839.4	0.7	1,202.6	310.6	280.3	3,450.4
Depreciation:							
At 1 April 2002	168.8	198.1	0.7	229.4	–	139.5	736.5
Charge for the year	17.8	30.8	–	23.7	–	21.0	93.3
Disposals	(0.3)	(0.5)	–	(0.7)	–	(9.8)	(11.3)
At 31 March 2003	186.3	228.4	0.7	252.4	–	150.7	818.5
Net book value:							
At 31 March 2003	630.5	611.0	–	950.2	310.6	129.6	2,631.9
At 31 March 2002	520.9	521.4	–	857.5	497.2	116.8	2,504.8

Of the additions to infrastructure assets, the amounts spent on infrastructure renewals during the years ended 31 March 2002 and 31 March 2003 was £32.9m and £41.0m, respectively. Of the grants and contributions set against infrastructure assets during the years ended 31 March 2002 and 31 March 2003 £6.5m and £8.9m respectively, relates to infrastructure renewals.

For the years ended 31 March 2002 and 31 March 2003, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £115.1m and £125.7m, respectively.

Freehold land is stated at a cost of £39.5m and £40.8m at 31 March 2002 and 31 March 2003, respectively, and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices.

Assets held under finance leases are capitalised and included in plant and machinery.

	2003 £m	2002 £m
Cost	11.7	11.7
Aggregate depreciation	(7.1)	(6.7)
Net book amount	4.6	5.0

(b) Capital commitments

	2003 £m	2002 £m
In respect of contracts placed	151.3	179.2

11 Fixed asset investments

Southern Water Services Limited holds 49,999 of the 50,000 issued shares of Southern Water Services Finance plc, a company incorporated in the UK on 13 March 1998. The principal activity of the company is to raise debt finance. The investment is stated at cost of £49,999 (2002: £49,999).

12 Stocks

	2003 £m	2002 £m
Raw materials	1.2	1.1
Work in progress	0.6	3.0
	1.8	4.1

13 Debtors: amounts falling due within one year

	2003 £m	2002 £m
Trade debtors	56.2	60.8
Unbilled income	34.8	32.5
Amounts owed by group undertakings	–	14.2
Prepayments	0.1	0.1
Other debtors	6.7	4.2
	97.8	111.8

14 Creditors: amounts falling due within one year

	2003 £m	2002 £m
Bank overdraft	46.7	54.5
Trade creditors	21.6	20.2
Loans from group undertakings (see below)	1,210.6	666.0
Capital creditors and capital accruals	116.4	89.0
Amounts owed to group undertakings	52.6	54.4
Corporation tax	7.3	7.4
Other taxation and social security	1.4	1.2
Other accruals and deferred revenue	59.9	46.8
	1,516.5	939.5

Amounts owed to group undertakings include £8.9m in respect of payments due for group relief, together with £30.1m from cash sweeping arrangements, £5.5m of inter company creditors and £8.1m relating to interest on loans.

The loans from the parent company and group undertakings are unsecured and repayable on demand with varying interest rates between 5-7%. An analysis is shown below:

	2003 £m	2002 £m
Loan from parent company	495.6	190.2
Loan from intermediate holding company	715.0	–
Loan from Scottish Power plc	–	475.8
	1,210.6	666.0

15 Creditors: amounts falling due after more than one year

	2003 £m	2002 £m
Loans and other borrowings:		
Loans from parent company	–	382.5
Loans from subsidiary undertaking	–	99.6
	–	482.1
Repayments fall due as follows:		
Between one to two years	–	285.5
Between two and five years	–	51.8
After five years not by instalments	–	129.7
After five years by instalments	–	15.1
	–	482.1

All group debt falling due after more than one year has been repaid following the sale of the company by Scottish Power plc.

Notes to the Accounts

for the year ended 31 March 2003

16 Provision for liabilities and charges

	2003 £m	2002 £m
(a) Environmental obligations	3.1	3.1
(b) Deferred taxation		
Accelerated capital allowances	378.0	355.6
Other timing differences	(8.9)	(3.5)
Deferred taxation	369.1	352.1
Total	372.2	355.2

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. As the period over which the provision will be utilised cannot be determined the provision is not discounted.

Movement in deferred tax provision

Deferred tax provided at 1 April	352.1	331.7
Deferred tax charge in Profit and Loss Account	17.0	20.4
Deferred tax provided at 31 March	369.1	352.1

17 Grants and contributions

	£m
At 1 April 2002	37.4
Receivable in year	5.2
Released to profit and loss account	(1.9)
At 31 March 2003	40.7

Grants and contributions relate to non-infrastructure assets.

18 Share capital

	2003 £m	2002 £m
Authorised 46,050,000 ordinary shares of £1 each	46.1	46.1
Allotted, called up and fully paid 56,000 ordinary shares of £1 each	0.1	0.1

19 Reconciliation of movement in shareholders' funds

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2001	0.1	46.3	667.1	713.5
Profit retained	–	–	93.0	93.0
At 31 March 2002	0.1	46.3	760.1	806.5
At 1 April 2002	0.1	46.3	760.1	806.5
Profit before dividends retained	–	–	63.6	63.6
Dividends paid	–	–	(68.0)	(68.0)
At 31 March 2003	0.1	46.3	755.7	802.1

20 Pensions

The Company accounted for pension costs during the year under SSAP 24, but has also made the detailed disclosures required in the second year of the transitional arrangements under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £99.5 million. The deficit has arisen mainly as a result of turbulence in the stock market and low interest rates.

Pension schemes operated

The Company principally operates three schemes:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme which has been closed to new members since 31 December 1998. This scheme has eight trustee directors.
2. Southern Water Executive Pension Scheme (SWEPS), which is a funded defined benefit scheme. This scheme has five trustee directors.

Both of the above schemes are operated by Southern Water Limited (formerly Southern Water plc). The power of appointment is vested in Southern Water Limited (formerly Southern Water plc) an intermediate holding company.

The assets of the schemes are held separately from those of the company. State Street Bank and Trust Company acts as custodian for the main defined benefit scheme (SWPS) and asset management is delegated to external fund managers.

3. Scottish Power plc pension scheme, which is also a defined benefit scheme. This is actually administered by Scottish Power plc, however, the Company makes contributions on behalf of certain of its employees.

Members of all three schemes receive an annual statement of their accrued benefits.

Regular pension costs under SSAP 24

1. Pension costs for the SWPS and SWEPS during the year were £7.1m (2002 - £4.0m). The pension cost for the year was greater than the actual contribution paid of £4.1m resulting in an accrual in the balance sheet at 31 March 2003 of £3.0m (2002 - nil). The increased cost is in relation to the fund deficits.
2. Pension costs for the Scottish Power plc scheme were £0.9m (2002 - £0.7m). The actual contributions for the year were also £0.9m, resulting in no accruals or prepayments being held on the balance sheet (2002 - nil).

FRS17 - disclosures

In November 2000 the Accounting Standards Board (ASB) issued FRS 17 'Retirement Benefits', replacing SSAP 24 'Accounting for Pension Costs'. In July 2002 the ASB published for comment an Exposure Draft which would, if implemented, allow an extension to the transitional arrangements of FRS 17.

The probability of implementation is uncertain and partly dependent upon proposals from the International Accounting Standards Board (IASB). The Company will take advice to ensure that it continues to adopt best practice in respect of accounting for retirement benefits. The Company is in the second year of the transitional arrangements under FRS 17 and the required disclosures are made below.

FRS 17 - assumptions, asset, liability and reserves disclosures

Full actuarial valuations of the two principal defined benefit schemes in the UK were carried out at 1 April 2001 and updated to 31 March 2003 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below:

	2003 %pa	2002 %pa
Price inflation	2.5	2.8
Rate of increase in salaries (plus an age-related promotional scale)	4.0	4.3
Rate of increase of pensions in payment	2.5	2.8
Rate of increase for deferred pensions	2.5	2.8
Discount rate	5.6	6.0
Expected return on assets – SWPS	7.5	7.3
Expected return on assets – SWEPS	5.6	6.0

The assets and liabilities in the schemes and the expected rates of return at the 31 March 2003 and 31 March 2002 were:

	2003 Rate of return	2002 Rate of return	2003 Value £m	2002 Value £m
Equities	8.7%	8.0%	156.4	210.3
Bonds	4.7%	5.3%	78.6	84.2
Cash	4.0%	3.8%	1.9	5.1
Total market value of Plan assets			236.9	299.6
Total value of Plan liabilities			(379.1)	(338.6)
Accrued deficit in the Plan			(142.2)	(39.0)
Related deferred tax liability			42.7	11.7
Net pension liability			(99.5)	(27.3)

Notes to the Accounts

for the year ended 31 March 2003

20 Pensions *continued*

If FRS 17 had been adopted and therefore the pension liabilities as discussed above were to be recognised, the company's net assets and profit and loss account after taking account of the effect of both pension schemes would have been as follows:

Shareholder's funds	2003 £m	2002 £m
As reported (note 19)	802.1	806.5
SSAP 24 accrual in relation to SWPS and SWEPS, net of related deferred tax	2.1	–
FRS 17 net pension liability as above	(99.5)	(27.3)
As adjusted for FRS 17	704.7	779.2

Profit and loss account	2003 £m	2002 £m
As reported (note 19)	755.7	760.1
SSAP 24 accrual as above	2.1	–
FRS 17 net pension liability as above	(99.5)	(27.3)
As adjusted for FRS 17	658.3	732.8

FRS 17 – profit and loss account disclosures

The following amounts would have been recognised in the profit and loss account for the year to 31 March 2003 under the requirements of FRS 17.

Analysis of amounts charged to operating profit:	2003 £m
Employer's current service cost	6.4
Employer's past service costs	2.0
Total charged to operating profit	8.4

Analysis of the amount charged to other finance income:	2003 £m
Interest on pension scheme liabilities	20.3
Expected return on pension scheme assets	(21.4)
Net credit to other finance income	(1.1)
Total P&L charge before deduction for tax	7.3

Analysis of the amounts recognised in STRGL:	2003 £m
Actuarial loss on scheme assets	(77.6)
Experience loss arising on scheme liabilities	(3.0)
Loss on change of assumptions (financial and demographic)	(19.4)
Total loss recognised in STRGL before adjustment for tax	(100.0)

20 Pensions *continued*

Analysis of the movement in the schemes' deficits during the year:		2003 £m
Deficit in the plan at 1 April 2002		(39.0)
Employers' contributions		4.1
Employers' current service cost		(6.4)
Employers past service cost		(2.0)
Other finance income		1.1
Actuarial loss		(100.0)
Deficit in the plan at end of year		(142.2)

Details of experience gains and losses for the year to 31 March 2003 are as follows:

		2003
a. Actuarial loss on plan assets		
Amount (£m)		77.6
Percentage of the scheme assets		32.8%
b. Experience loss on plan liabilities		
Amount (£m)		3.0
Percentage of the present value of the scheme liabilities		0.8%
c. Total actuarial loss recognised in STRGL		
Amount (£m)		100.0
Percentage of the present value of the scheme liabilities		26.4%

Future profile of the pension schemes

The SWPS closed to new members with effect from 31 December 1998. This will result in the age profile of the active membership rising over time and hence, under the method required to calculate FRS 17 liabilities, the future cost in relation to this Scheme will reduce in the long-term.

Other pension arrangements

As previously discussed, there is also a third scheme operated by Scottish Power plc which is also a defined benefit scheme. Details are given below. Southern Water continues to operate a defined benefit scheme with Scottish Power plc. However, the contributions paid by the company are accounted for FRS 17 purposes as if the scheme were a defined contribution scheme, as the company is unable to identify its share of the underlying assets and liabilities in the scheme. The cost of contributions to this scheme during the year amounted to £911k (2002: £668k).

21 Contingent liabilities

	2003 £m	2002 £m
Contractors' claims	22.5	15.7

Contractors' claims consist of the contractors' estimate of the cost of undertaking works for Southern Water. The claim is reviewed by Southern Water, who assess where the liability for the costs rests and the amount that will actually be settled. This amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractors claim and Southern Water's valuation.

Notes to the Accounts

for the year ended 31 March 2003

22 Financial commitments

	2003 £m	2002 £m
At 31 March 2003, the company had annual commitments under non cancellable operating lease agreements in respect of vehicles for which the payment extends over a number of years as follows:		
Expiring within one year	1.6	0.9
Expiring between two and five years	2.0	1.9
Expiring after five years	–	0.1
	3.6	2.9

Operating leases are charged to the Profit and Loss Account over the lease term.

23 Directors' emoluments

	2003 £000	2002 £000
Aggregate emoluments (including benefits in kind)	922	611

Retirement benefits are accruing to five directors under a Southern Water defined benefit scheme.

Details of emoluments and benefits for the highest paid director:

	2003 £000	2002 £000
Aggregate highest paid director's emoluments and benefits	234	147
Defined benefit scheme: Accrued annual pension at 31 March	90	71

24 Related party transactions

The company has taken an exemption, as allowed by Financial Reporting Standard 8, not to disclose related party transactions with other group companies as an intermediate parent company, Southern Water Services Group Limited (formerly First Aqua Limited) publishes full statutory consolidated Accounts.

Prior to 24 April 2002, the ultimate parent undertaking was Scottish Power plc which publishes full statutory consolidated Accounts.

25 Ultimate holding company

The immediate parent undertaking is SWS Holdings Limited.

Up to 24 April 2002, the ultimate parent undertaking and controlling party was Scottish Power plc.

At 31 March 2003, the ultimate parent undertaking and controlling party was First Aqua Holdings Limited. First Aqua Holdings Limited is incorporated in the Cayman Islands and does not publish financial statements.

An intermediate holding company is Southern Water Services Group Limited (formerly First Aqua Limited), which prepares consolidated accounts. Copies of Southern Water Services Group Limited's (formerly First Aqua Limited) consolidated accounts may be obtained from the Company Secretary at 200 Aldersgate Street, London, EC1A 4JJ.

26 Post balance sheet event

On 7 May 2003, the ultimate parent undertaking First Aqua Holdings Limited, sold its entire interest in the ordinary shares of Southern Water Services (Finance) Limited (formerly First Aqua (JV Co) Limited) (an intermediate parent company) to Southern Water Capital Limited.

From 7 May 2003 the directors regard Southern Water Capital Limited as the ultimate holding company. Southern Water Capital Limited is majority owned by Royal Bank of Scotland plc.

On 7 May 2003 Bob Thian was appointed as Non-Executive Chairman and Rory Cullinan, Cyril Roger-Lacan, Jean Claude Banon and François Darley were appointed as Non-Executive Directors.

On 23 April 2003 dividends of £15m were paid to Southern Water Services Group Holdings Limited.

Independent Auditor's Report

for the year ended 31 March 2003

Independent auditor's report to the members of Southern Water Services Limited.

We have audited the Accounts which comprise the profit and loss account, the balance sheet, and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the accounting policy note.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the directors' report and the Accounts in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the Accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, 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.

We report to you our opinion as to whether the Accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the Accounts, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the directors' report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Accounts. The other information comprises only the directors' report.

Basis of audit opinion

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

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

Opinion

In our opinion the Accounts give a true and fair view of the state of the company's affairs at 31 March 2003 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PricewaterhouseCoopers LLP

Chartered Accountants
and Registered Auditors
London

17 July 2003

Supplementary Regulatory Accounting Statements

The following **Supplementary Accounts** are published under the terms of the Company's Instrument of Appointment as a water and sewerage undertaker under the Water Industry Act 1991 and have been prepared in accordance with the requirements of the Regulatory Accounting Guidelines issued by the Director General of Water Services.

Regulatory Historical Cost Profit and Loss Account

for the year ended 31 March 2003

	Notes	Appointed Business £m	2003 Non- Appointed Business £m	Total £m	Appointed Business £m	2002 Non- Appointed Business £m	Total £m
Turnover	(a)	431.1	5.4	436.5	423.9	5.0	428.9
Operating costs (excluding exceptional item)		(254.3)	(3.1)	(257.4)	(215.8)	(3.5)	(219.3)
Exceptional item	(b)	–	–	–	(9.6)	–	(9.6)
Operating income	(c)	8.8	–	8.8	1.6	–	1.6
Operating profit		185.6	2.3	187.9	200.1	1.5	201.6
Other income		0.4	1.1	1.5	0.6	1.0	1.6
Net interest - normal		(76.3)	–	(76.3)	(71.9)	–	(71.9)
- exceptional	(b)	(14.0)	–	(14.0)	–	–	–
Profit on ordinary activities before taxation		95.7	3.4	99.1	128.8	2.5	131.3
Taxation							
- Current tax		(18.5)	–	(18.5)	(17.9)	–	(17.9)
- Deferred tax		(17.0)	–	(17.0)	(20.4)	–	(20.4)
Profit on ordinary activities after taxation		60.2	3.4	63.6	90.5	2.5	93.0
Dividends		(68.0)	–	(68.0)	–	–	–
Retained (loss)/profit for the year		(7.8)	3.4	(4.4)	90.5	2.5	93.0

(a) The 2002 comparative for turnover for the non-appointed business has been restated from £6.0m to £5.0m to reflect the reclassification of £1.0m of income arising from aerial masts into other operating income. This is to ensure consistency with current year classifications.

(b) Refer to note 4 of the Statutory Accounts for an explanation of the exceptional items.

(c) This relates to profit on sale of fixed assets.

The appointed business comprises those activities which are necessary for the company to fulfil its function and duties as a water and sewerage undertaker.

No separate calculation or allocation of UK corporation tax or net interest charge has been performed for the non-appointed business.

Regulatory Historical Cost Balance Sheet

as at 31 March 2003

	Notes	Appointed Business £m	2003 Non- Appointed Business £m	Total £m	Appointed Business £m	2002 Non- Appointed Business £m	Total £m
Fixed assets							
Tangible assets	(a)	2,594.9	1.5	2,596.4	2,476.3	1.3	2,477.6
Investments		–	–	–	–	–	–
Current assets							
Stocks		1.4	0.4	1.8	3.9	0.2	4.1
Debtors	(a)	132.9	0.4	133.3	138.4	0.6	139.0
Total current assets		134.3	0.8	135.1	142.3	0.8	143.1
Creditors: amounts falling due within one year:							
Short-term borrowings		(1,257.3)	–	(1,257.3)	(720.5)	–	(720.5)
Other creditors		(229.0)	(2.3)	(231.3)	(188.2)	(5.5)	(193.7)
Creditors due within one year		(1,486.3)	(2.3)	(1,488.6)	(908.7)	(5.5)	(914.2)
Net current liabilities		(1,352.0)	(1.5)	(1,353.5)	(766.4)	(4.7)	(771.1)
Total assets less current liabilities		1,242.9	–	1,242.9	1,709.9	(3.4)	1,706.5
Creditors: amounts falling due after one year:							
Borrowings		–	–	–	(482.1)	–	(482.1)
Other creditors	(b)	(40.7)	–	(40.7)	(37.4)	–	(37.4)
Total creditors: amounts falling due after one year		(40.7)	–	(40.7)	(519.5)	–	(519.5)
Provisions for liabilities and charges:							
Deferred tax		(369.1)	–	(369.1)	(352.1)	–	(352.1)
Other provisions		(3.1)	–	(3.1)	(3.1)	–	(3.1)
Deferred income	(c)	(27.9)	–	(27.9)	(25.3)	–	(25.3)
Net assets employed		802.1	–	802.1	809.9	(3.4)	806.5
Capital and reserves							
Called up share capital		0.1	–	0.1	0.1	–	0.1
Share premium		46.3	–	46.3	46.3	–	46.3
Profit and loss account		755.7	–	755.7	763.5	(3.4)	760.1
Total equity shareholders' funds		802.1	–	802.1	809.9	(3.4)	806.5

(a) see page 22 for reconciliation to Statutory Accounts.

(b) this amount relates to grants and contributions.

(c) this amount is included in the "Other accruals and deferred revenue" line in note 14 to the Statutory Accounts.

Historical Cost Balance Sheet Reconciliation to Statutory Accounts

In the preparation of its Statutory Accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis set out in FRS 15. Note 1(d) to the Regulatory Accounts sets out this basis of infrastructure renewals accounting.

However, for the purposes of the Regulatory Accounts, OFWAT have requested that this FRS 15 basis is not applied, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the Statutory Accounts and the balance sheet shown above, is set out below:

	2003 £m	2002 £m
Fixed assets		
Cost per Regulatory Accounts	3,157.7	2,980.7
Adjustment to opening balance	260.6	234.2
Infrastructure renewals expenditure capitalised in the year	32.1	26.4
Cost per Statutory Accounts	3,450.4	3,241.3
Depreciation per Regulatory Accounts	561.3	503.1
Adjustment to opening balance	233.5	212.4
Depreciation charge for infrastructure renewals expenditure	23.7	21.0
Depreciation per Statutory Accounts	818.5	736.5
Net book value per Regulatory Accounts	2,596.4	2,477.6
Adjustment for infrastructure renewals accounting	35.5	27.2
Net book value per Statutory Accounts	2,631.9	2,504.8
Debtors		
Per Regulatory Accounts	133.3	139.0
Infrastructure renewals prepayments if FRS 15 is not applied	(35.5)	(27.2)
Per Statutory Accounts	97.8	111.8

Current Cost Profit and Loss Account for the Appointed Business — for the year ended 31 March 2003

	Notes	2003 £m	2002 £m
Turnover	2	431.1	423.9
Current cost operating costs	3,4	(314.6)	(300.7)
Operating income	2	8.8	1.6
		125.3	124.8
Working capital adjustment	1(c),2	2.3	2.0
Current cost operating profit		127.6	126.8
Other income		0.4	0.6
Net interest - normal		(76.3)	(71.9)
- exceptional		(14.0)	-
Financing adjustment	1(c)	48.2	18.2
Current cost profit before taxation		85.9	73.7
Taxation			
- Current tax		(18.5)	(17.9)
- Deferred tax		(17.0)	(20.4)
Current cost profit attributable to shareholders		50.4	35.4
Dividends		(68.0)	-
Current cost (loss)/profit retained		(17.6)	35.4

Current Cost Balance Sheet for the Appointed Business as at 31 March 2003

	Notes	2003 £m	2002 £m
Tangible fixed assets	5	12,919.5	12,472.8
Third party contributions since 31 March 1990		(148.0)	(138.7)
		12,771.5	12,334.1
Working capital	6	(128.0)	(73.9)
Net operating assets		12,643.5	12,260.2
Non-trade debtors		6.8	4.2
Non-trade creditors due within one year		(1,257.3)	(720.5)
Creditors due after one year		–	(482.1)
Provisions for liabilities and charges:			
Deferred tax		(369.1)	(352.1)
Other provisions		(3.1)	(3.1)
Net assets employed		11,020.8	10,706.6
Capital and reserves			
Called up share capital		0.1	0.1
Share premium		46.3	46.3
Profit and loss account		(67.3)	(49.7)
Current cost reserve	7	11,041.7	10,709.9
Total capital and reserves		11,020.8	10,706.6

Current Cost Cash Flow Statement

for the year ended 31 March 2003

	Notes	Appointed Business £m	2003 Non- Appointed Business £m	Total £m	Appointed Business £m	2002 Non- Appointed Business £m	Total £m
Net cash inflow from operating activities	8	327.0	0.2	327.2	199.4	–	199.4
Returns on investments and servicing of finance							
Interest received		–	–	–	0.2	–	0.2
Interest paid		(116.2)	–	(116.2)	(42.9)	–	(42.9)
Net cash outflow from returns on investments and servicing of finance		(116.2)	–	(116.2)	(42.7)	–	(42.7)
Taxation		(18.6)	–	(18.6)	(32.7)	–	(32.7)
Net cash outflow from taxation		(18.6)	–	(18.6)	(32.7)	–	(32.7)
Capital expenditure and financial investment							
Gross purchase of fixed assets		(171.4)	(0.2)	(171.6)	(239.6)	–	(239.6)
Receipts of grants and contributions		15.8	–	15.8	12.1	–	12.1
Infrastructure renewals expenditure		(32.1)	–	(32.1)	(26.4)	–	(26.4)
Disposal of fixed assets		8.8	–	8.8	1.6	–	1.6
Net cash outflow from capital expenditure and financial investment		(178.9)	(0.2)	(179.1)	(252.3)	–	(252.3)
Equity dividends paid		(68.0)	–	(68.0)	(47.8)	–	(47.8)
Net cash outflow before financing	9	(54.7)	–	(54.7)	(176.1)	–	(176.1)
Financing							
New loans		1,210.6	–	1,210.6	182.8	–	182.8
Repayment of loans		(1,148.1)	–	(1,148.1)	(14.4)	–	(14.4)
Net cash inflow from financing		62.5	–	62.5	168.4	–	168.4
Increase /(decrease) in cash and cash equivalents		7.8	–	7.8	(7.7)	–	(7.7)

Notes to the Current Cost Accounts

for the year ended 31 March 2003

1 Accounting Policies

(a) General

These supplementary current cost Accounts have been prepared in accordance with guidance issued by the Director General of Water Services for modified real terms Accounts for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of assets which are valued at their current cost value to the business with the exception of assets acquired prior to 31 March 1990, the effective commencement of the new regulatory regime.

These Accounts have been prepared in accordance with Regulatory Accounting Guidelines (RAGs) 1 to 4. In respect of cost allocations the company has continued to allocate costs as in previous years on the basis suggested in RAG 4 (Analysis of Operating Costs and Assets). The accounting policies used are the same as those adopted in the statutory historical cost Accounts, except as set out below.

(b) Periodic review

The Strategic Business Plan produced by the company for the Periodic Review re-assessed asset stock and valuations. The valuations used in the current cost statements have been based on data from the 1999 Strategic Business Plan.

(c) Real financial capital maintenance adjustments

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

Depreciation adjustment – this is the difference between depreciation based on the current cost value of assets in these Accounts and depreciation charged in arriving at historical cost profit. The depreciation adjustment is incorporated within operating costs in the Profit and Loss Account.

Working capital adjustment – this is calculated by applying the change in the

Retail Price Index (RPI) over the year to the opening total of trade debtors and stock less trade creditors.

Disposal of fixed assets adjustment – the difference between the values of realised assets in these current cost Accounts and in the historical cost Accounts. The disposal of fixed assets adjustment is incorporated within operating income in the Profit and Loss Account.

Financing adjustment – this is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

(d) Infrastructure renewals accounting

For the purposes of the Regulatory Accounts, infrastructure renewals accounting has been continued and the relevant sections of FRS 15 have been dis-applied. A reconciliation between the statutory and Regulatory Accounts has been provided in the Historical Cost Balance Sheet for the appointed business (page 22).

(e) Tangible fixed assets

Assets acquired prior to 31 March 1990 and in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for possible funding of future replacements of pre-31 March 1990 assets by contributions from third parties and, to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amount.

Land and buildings – non-specialised operational properties have been valued using existing current cost values at 31 March 1993 as an estimate of open market value for existing use at that date,

as the directors believe that there is no material difference between these values. These values have been adjusted for inflation using RPI since that date.

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

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

A process of continuing refinement of asset records is expected to produce adjustments to existing values when Periodic Reviews of the AMP take place. In intervening years, values are restated for inflation using the RPI.

Other operational fixed assets – all other operational fixed assets are valued periodically at depreciated replacement cost. Between Periodic Reviews, values are restated for inflation using the RPI.

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

(f) Grants and other third party contributions

Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been released to profit. The balance carried forward is restated for the change in the RPI for the year and is treated as deferred income.

2 Analysis of turnover and operating income for the appointed business

	Water Supply £m	2003 Sewerage Services £m	Total Appointed Business £m	Water Supply £m	2002 Sewerage Services £m	Total Appointed Business £m
Turnover						
Measured	41.3	86.9	128.2	39.9	81.4	121.3
Unmeasured	65.5	212.5	278.0	67.5	209.9	277.4
Trade effluent	–	7.1	7.1	–	6.7	6.7
Large user revenues	4.0	2.4	6.4	4.5	3.2	7.7
Other sources (excluding third parties)	0.6	6.6	7.2	0.6	5.6	6.2
Third party services	4.2	–	4.2	4.6	–	4.6
Total turnover	115.6	315.5	431.1	117.1	306.8	423.9

The 2002 turnover comparatives have been restated to reflect the reclassification of £0.6m of measured income from sewerage services to water supply.

Operating income

Current cost profit on disposal of fixed assets	4.6	4.2	8.8	0.8	0.8	1.6
Working capital adjustment	0.6	1.7	2.3	0.5	1.5	2.0

3 Reconciliation of Historical to Current Cost operating costs

	2003 £m	2003 £m	2002 £m	2002 £m
Historical cost operating costs (including exceptional item)		254.3		225.4
Current cost depreciation	129.8		129.8	
Historical cost depreciation	(69.5)	60.3	(54.5)	75.3
Current cost operating costs		314.6		300.7

Notes to the Current Cost Accounts

for the year ended 31 March 2003

4 Analysis of current cost operating costs by service - 2003

	Service analysis								Business services		
	Water supply			Sewerage					Customer services £m	Scientific services £m	Cost of regulation £m
	Resources and treatment £m	Distribution £m	Water supply sub total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment and disposal £m	Sewerage service sub total £m			
Direct costs											
Employment costs	0.9	2.8	3.7	3.2	4.2	3.5	7.7	10.9			
Power	1.2	3.1	4.3	2.3	6.8	1.4	8.2	10.5			
Hired & contracted services	1.0	4.7	5.7	1.4	1.1	2.0	3.1	4.5			
Materials & consumables	0.2	1.1	1.3	0.4	0.6	0.3	0.9	1.3			
Service charges, EA	3.7	–	3.7	0.8	2.2	–	2.2	3.0			
Other direct costs	1.5	0.4	1.9	0.3	0.7	11.9	12.6	12.9			
Total direct costs	8.5	12.1	20.6	8.4	15.6	19.1	34.7	43.1	10.2	3.0	1.3
General & support expenditure	7.6	9.2	16.8	6.9	14.1	10.0	24.1	31.0	3.1	1.1	0.5
Functional expenditure	16.1	21.3	37.4	15.3	29.7	29.1	58.8	74.1	13.3	4.1	1.8
Total Business Activities			8.3					10.9	(13.3)	(4.1)	(1.8)
Rates			6.4					8.8			
Doubtful debts			3.9					10.1			
Total opex less third party services			56.0					103.9			
Third party services – opex			3.0					–			
Total operating expenditure			59.0					103.9			
Capital costs											
Infrastructure renewal expenditure	2.3	15.6	17.9	13.7	0.5	–	0.5	14.2			
Movement in infrastructure renewal prepayment	–	(7.0)	(7.0)	(1.4)	–	–	–	(1.4)			
Current cost depreciation (allocated)	26.4	4.0	30.4	30.1	42.7	26.6	69.3	99.4			
Amortisation of deferred credits			(0.4)					(1.4)			
Capital maintenance			40.9					110.8			
excluding third party services											
Third party services – capital maintenance			–					–			
Total capital maintenance			40.9					110.8			
Total operating costs			99.9					214.7			
Total operating expenditure above includes											
Reactive and Planned Maintenance of:											
Infrastructure	–	7.5	7.5	4.7	–	–	–	4.7			
Non-Infrastructure	2.4	0.4	2.8	2.9	3.8	3.7	7.5	10.4			
CCA (MEA) values											
Service activities	541.0	2,632.6	3,173.6	7,971.4	1,082.2	672.6	1,754.8	9,726.2			
Business activities			–					–			
Service totals	541.0	2,632.6	3,173.6	7,971.4	1,082.2	672.6	1,754.8	9,726.2			
Services for third parties			19.7					–			
Total CCA (MEA) values			3,193.3					9,726.2			

4 Analysis of current cost operating costs by service - 2002

	Service analysis								Business services		
	Water supply			Sewerage					Customer services £m	Scientific services £m	Cost of regulation £m
	Resources and treatment £m	Distribution £m	Water supply sub total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment and disposal £m	Sewerage service sub total £m			
Direct costs											
Employment costs	1.0	3.2	4.2	2.6	3.9	3.1	7.0	9.6			
Power	3.0	2.0	5.0	3.1	5.7	1.3	7.0	10.1			
Hired & contracted services	0.3	3.1	3.4	1.6	1.2	1.4	2.6	4.2			
Materials & consumables	0.1	1.4	1.5	0.4	0.7	0.3	1.0	1.4			
Service charges, EA	3.7	–	3.7	0.6	2.1	–	2.1	2.7			
Other direct costs	1.0	0.4	1.4	0.2	0.5	10.2	10.7	10.9			
Total direct costs	9.1	10.1	19.2	8.5	14.1	16.3	30.4	38.9	11.6	2.6	1.3
General & support expenditure	6.4	7.9	14.3	5.9	10.8	7.7	18.5	24.4	4.4	1.2	0.5
Functional expenditure	15.5	18.0	33.5	14.4	24.9	24.0	48.9	63.3	16.0	3.8	1.8
Total Business Activities			9.1					12.5	(16.0)	(3.8)	(1.8)
Rates			6.5					7.7			
Doubtful debts			1.7					4.5			
Exceptional items			3.3					6.3			
Total opex less third party services			54.1					94.3			
Third party services – opex			3.1					–			
Total operating expenditure			57.2					94.3			
Capital costs											
Infrastructure renewal expenditure	0.1	14.3	14.4	12.0	–	–	–	12.0			
Movement in infrastructure renewal prepayment	–	(5.8)	(5.8)	0.4	–	–	–	0.4			
Current cost depreciation (allocated)	26.6	4.5	31.1	29.6	42.6	26.5	69.1	98.7			
Amortisation of deferred credits			(0.3)					(1.3)			
Capital maintenance			39.4					109.8			
excluding third party services											
Third party services – capital maintenance			–					–			
Total capital maintenance			39.4					109.8			
Total operating costs			96.6					204.1			
Total operating expenditure above includes											
Reactive and Planned Maintenance of:											
Infrastructure	–	7.7	7.7	4.8	–	–	–	4.8			
Non-Infrastructure	1.1	0.2	1.3	3.7	3.6	3.5	7.1	10.8			
CCA (MEA) values											
Service activities	520.9	2,548.7	3,069.6	7,727.0	1,022.0	635.2	1,657.2	9,384.2			
Business activities			–					–			
Service totals	520.9	2,548.7	3,069.6	7,727.0	1,022.0	635.2	1,657.2	9,384.2			
Services for third parties			19.0					–			
Total CCA (MEA) values			3,088.6					9,384.2			

The 2002 comparative costs for reactive and planned maintenance, non-infrastructure, have been restated from £0.3m and £1.0m to £1.1m and £0.2m respectively, in order to be consistent with the current year basis of allocation between resources and treatment and distribution. There is no change in the total of £1.3m.

Notes to the Current Cost Accounts

for the year ended 31 March 2003

5(a) Current cost analysis of fixed assets by asset type – Water Supply

	Specialised operational assets £m	Non- specialised operational assets £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
Balance at 1 April 2002	853.2	17.0	2,570.1	98.0	3,538.3
RPI adjustment	26.5	0.5	79.7	3.0	109.7
Disposals	(0.1)	–	–	(2.7)	(2.8)
Additions	23.5	0.4	5.1	10.3	39.3
Balance at 31 March 2003	903.1	17.9	2,654.9	108.6	3,684.5
Accumulated depreciation					
Balance at 1 April 2002	380.7	4.5	–	64.5	449.7
RPI adjustment	11.8	0.1	–	2.0	13.9
Disposals	(0.1)	–	–	(2.7)	(2.8)
Charge for year	23.6	0.3	–	6.5	30.4
Balance at 31 March 2003	416.0	4.9	–	70.3	491.2
Net book value at 31 March 2003	487.1	13.0	2,654.9	38.3	3,193.3
Net book value at 31 March 2002	472.5	12.5	2,570.1	33.5	3,088.6

5(b) Current cost analysis of fixed assets by service – Sewerage Services

	Specialised operational assets £m	Non- specialised operational assets £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
Balance at 1 April 2002	2,650.2	68.0	7,686.9	145.0	10,550.1
RPI adjustment	82.2	2.1	238.3	4.5	327.1
Disposals	(0.9)	–	–	(10.7)	(11.6)
Additions	108.6	1.6	25.2	15.1	150.5
Balance at 31 March 2003	2,840.1	71.7	7,950.4	153.9	11,016.1
Accumulated depreciation					
Balance at 1 April 2002	1,035.8	17.9	(0.5)	112.7	1,165.9
RPI adjustment	32.1	0.6	–	3.5	36.2
Disposals	(0.9)	–	–	(10.7)	(11.6)
Charge for year	85.8	1.2	–	12.4	99.4
Balance at 31 March 2003	1,152.8	19.7	(0.5)	117.9	1,289.9
Net book value at 31 March 2003	1,687.3	52.0	7,950.9	36.0	9,726.2
Net book value at 31 March 2002	1,614.4	50.1	7,687.4	32.3	9,384.2

5(c) Current cost analysis of fixed assets by asset type – Total

	Specialised operational assets £m	Non- specialised operational assets £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
Balance at 1 April 2002	3,503.4	85.0	10,257.0	243.0	14,088.4
RPI adjustment	108.7	2.6	318.0	7.5	436.8
Disposals	(1.0)	–	–	(13.4)	(14.4)
Additions	132.1	2.0	30.3	25.4	189.8
Balance at 31 March 2003	3,743.2	89.6	10,605.3	262.5	14,700.6
Accumulated depreciation					
Balance at 1 April 2002	1,416.5	22.4	(0.5)	177.2	1,615.6
RPI adjustment	43.9	0.7	–	5.5	50.1
Disposals	(1.0)	–	–	(13.4)	(14.4)
Charge for year	109.4	1.5	–	18.9	129.8
Balance at 31 March 2003	1,568.8	24.6	(0.5)	188.2	1,781.1
Net book value at 31 March 2003	2,174.4	65.0	10,605.8	74.3	12,919.5
Net book value at 31 March 2002	2,086.9	62.6	10,257.5	65.8	12,472.8

6 Working capital

	2003 £m	2002 £m
Stocks	1.4	3.9
Trade debtors	90.5	92.8
Trade creditors	(21.0)	(15.0)
Short-term capital creditors	(116.4)	(89.0)
Infrastructure renewals prepayment	37.0	28.6
Other accruals	(74.1)	(65.4)
Receipts in advance	(27.9)	(25.3)
Corporation tax	(7.3)	(7.3)
Payroll related tax and social security	(1.4)	(1.2)
Group trade debtors/(creditors)	–	3.9
Other short term group debtors/(creditors)	(8.9)	–
Prepayments	0.1	0.1
Total working capital	(128.0)	(73.9)

7 Movement on Current Cost Reserve

	2003 £m	2002 £m
Balance at 1 April	10,709.9	10,572.8
RPI Adjustments		
Fixed assets	386.7	159.0
Grants and third party contributions	(4.4)	(1.7)
Working capital	(2.3)	(2.0)
Financing	(48.2)	(18.2)
Balance at 31 March	11,041.7	10,709.9

Notes to the Current Cost Accounts

for the year ended 31 March 2003

8 Reconciliation of current cost operating profit to net cash flow from operating activities

	2003 £m	2002 £m
Current cost operating profit	127.6	126.8
Working capital adjustment	(2.3)	(2.0)
Increase in stocks	2.4	(0.5)
Receipt from other income	0.4	0.6
Current cost depreciation	129.8	129.8
Current cost profit on sale of assets	(8.8)	(1.6)
Decrease/(increase) in debtors and prepaid expenses	13.9	(19.8)
Increase/(decrease) in creditors and accrued expenses	42.1	(53.2)
Infrastructure renewals expenditure	32.1	26.4
Decrease in provision for infrastructure renewals	(8.4)	(5.4)
Amortisation of grants and contributions	(1.8)	(1.6)
Effect of other deferrals and accruals on operating activity cashflow	-	(0.1)
Net cash flow from operating activities	327.0	199.4

9 Analysis of net debt

	At 31 March 2002 £m	Cash flows £m	At 31 March 2003 £m
Bank Overdrafts	(54.5)	7.8	(46.7)
Loans due after one year	(482.1)	482.1	-
Loans due within one year	(666.0)	(544.6)	(1,210.6)
Total	(1,202.6)	(54.7)	(1,257.3)

10 Regulated Capital Value (RCV)

OFWAT in its letter to the Regulatory Directors of Water and Sewerage and Water only companies dated 18 March 2003 (RD 08/03) published the closing Regulated Capital Value of Southern Water at 31 March 2003 as £2,126m at 2001/02 prices.

	£m
RCV at 31 March 2002	2,039
Indexation	27
Opening RCV	2,066
Capital expenditure (excluding IRE)	223
Infrastructure renewals expenditure	22
Infrastructure renewals charge	(23)
Grants & contributions	(8)
Depreciation	(98)
Outperformance of regulatory assumptions (5 years in arrears)	(57)
RCV at 31 March 2003	2,126
Average Year RCV	2,089

Numbers are as published by OFWAT and do not add due to rounding.

The table shows the RCV used in setting the price limits for the period in 2000/01 to 2004/05; the differences from the actual capital expenditure and depreciation etc will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation for the next periodic review.

Five Year Rolling Summary

Current cost profit and loss account for appointed business

	2003 £m	2002 £m	2001 £m	2000 £m	1999 £m
Turnover	431.1	432.8	431.3	496.3	470.2
Current cost operating costs (including exceptional item)	(314.6)	(307.0)	(278.9)	(299.8)	(306.6)
Operating income	8.8	1.6	1.5	4.3	3.8
Working capital adjustment	2.3	2.0	2.9	4.4	4.7
Current cost operating profit	127.6	129.4	156.8	205.2	172.1
Other income	0.4	0.6	0.6	0.6	0.6
Net interest (including exceptional item)	(90.3)	(73.4)	(68.7)	(61.3)	(55.7)
Financing adjustment	48.2	18.6	31.2	22.2	13.6
Current cost profit before taxation	85.9	75.2	119.9	166.7	130.6
Taxation	(35.5)	(39.1)	(27.8)	(62.7)	(34.6)
Current cost profit attributable to shareholders	50.4	36.1	92.1	104.0	96.0
Dividends	(68.0)	–	(49.5)	(48.9)	(47.5)
Current cost (loss)/profit retained	(17.6)	36.1	42.6	55.1	48.5

Current cost balance sheet for appointed business

	2003 £m	2002 £m	2001 £m	2000 £m	1999 £m
Tangible fixed assets	12,919.5	12,859.5	12,775.0	12,620.3	14,405.1
Third party contributions since 31 March 1990	(148.0)	(143.0)	(139.1)	(134.6)	(129.4)
Working capital	(128.0)	(76.2)	(164.3)	(129.9)	(172.0)
Net operating assets	12,643.5	12,640.3	12,471.6	12,355.8	14,103.7
Non-trade debtors	6.8	4.3	6.3	3.8	41.9
Non-trade creditors due within one year	(1,257.3)	(742.8)	(406.0)	(780.5)	(291.6)
Creditors due after one year	–	(497.0)	(666.5)	(568.7)	(574.5)
Deferred tax	(369.1)	(363.0)	(346.5)	–	–
Other provisions for liabilities and charges	(3.1)	(3.2)	(3.2)	(3.3)	(3.5)
Dividends payable	–	–	(49.9)	(49.0)	(48.0)
Net assets employed	11,020.8	11,038.6	11,005.8	10,958.1	13,228.0
Capital and reserves					
Called up share capital	0.1	0.1	0.1	0.1	0.1
Share premium	46.3	47.8	48.4	49.5	50.7
Profit and loss account	(67.3)	(51.2)	(88.8)	(134.9)	142.8
Current cost reserve	11,041.7	11,041.9	11,046.1	11,043.4	13,034.4
Total capital and reserves	11,020.8	11,038.6	11,005.8	10,958.1	13,228.0

The prior year figures above have been adjusted for subsequent inflation using the indexation procedures prescribed by the DG in RD 17/03. Accordingly the 2002 figures are different from the comparatives on pages 21 to 28 which have not been indexed.

Independent Auditors Report to the Director General of Water Services (the Regulator) and the Directors of Southern Water Services Limited for the year ended 31 March 2003

We have audited the Regulatory Accounts of Southern Water Services Limited (referred to as the Company or the appointee) on pages 19 to 33 which comprise:

- the regulatory historical cost accounting statements comprising the historical cost profit and loss account and balance sheet; and
- the regulatory current cost accounting statements comprising the current cost profit and loss account, balance sheet, cash flow statement and the related notes.

This report is made solely to the Company and the Regulator in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewage undertaker under the Water Industry Act 1991. Our audit work has been undertaken so that we might state to the Company and the Regulator those matters we have agreed to state to them in our report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility for our audit work, for our report, or for the opinions we have formed to any other person than those to whom we have agreed in writing to accept responsibility.

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention. As such, the Regulatory Accounts are separate from the Statutory Accounts of the company and have not necessarily been prepared under the basis of Generally Accepted Accounting Principles. Financial information other than that prepared on the basis of Generally Accepted Accounting Principles does not necessarily represent a true and fair view of the financial position of a company as shown in financial statements

prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and Auditors

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

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 1.

Our responsibility is to audit the Regulatory Accounts in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, except as stated in the "Basis of audit opinion", below.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 23 to 25 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by

paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the preface, the additional accounting information, and the additional commentary on trends and comparisons.

Basis of audit opinion

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

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

Our opinion on the Regulatory Accounts is separate from our opinion on the Statutory Accounts of the Company, which are prepared for a different purpose. We do not and will not, by virtue of this report assume any responsibility, whether in contract, negligence or otherwise, in relation to our audits of the Company's statutory financial statements required by the Companies Act 1985.

The regulatory historical cost accounting statements on pages 20 and 21 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on page 22.

Opinion

In our opinion the Regulatory Accounts for the Company contain the information for the year ended 31 March 2003 to comply with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewage undertaker under the Water Industry Act 1991.

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

- (a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;
- (b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and

Regulatory Accounting Guideline 4.02 issued by the Regulator;

- (c) the regulatory historical cost accounting statements on pages 20 to 21 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;
- (d) the regulatory current cost accounting statements on pages 23 to 25 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered
Auditors
23 July 2003

1. The maintenance and integrity of the Company website is the responsibility of the Directors and the maintenance and integrity of the Regulator's website is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the websites.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions.

Additional Accounting Information

Services supplied to the appointee by associated companies

Scottish Power plc sold Southern Water Services Ltd to Southern Water Services Group Limited (formerly First Aqua Ltd) in April 2002.

There were no material transactions between Southern Water Services Limited and the Scottish Power plc Group companies during April 2002.

There were no transactions relating to services between any of the First Aqua Group companies and Southern Water Services Limited during the year to 31 March 2003.

Allocation of costs between regulated and non-regulated businesses

Each non-appointed activity is treated separately within the company's financial records. Examples of non-appointed activities include non-monopoly rechargeable works, property searches and recreation and amenity services. Revenues, costs, assets and liabilities are generally directly allocated to particular business activities. Administrative overheads have been apportioned from the appointed business to the non-appointed business on an activity cost basis.

Details of inter-company loans

Loan from parent company	£495.6m
Loan from intermediate holding company	£715.0m

Dividends paid

During the year, dividend payments of £68.0m were made to SWS Holdings Limited, an immediate parent company.

Asset transfers

There were no asset transfers during the year.

Rental income from associated companies

There was no material rental income received from associated companies during the year.

Additional Commentary on Trends and Comparisons

Five year trend

In real terms current cost operating profit fell by £44.5 million over five years mainly reflecting the decrease in turnover relating to the Final Determination P-nought adjustment. Major cost efficiencies continue to be made in the implementation of the Way Ahead Plan, through the use of new technology and new business processes. These efficiencies have offset cost increases due to inflation, additional operating costs arising from capital, new obligations and increased depreciation resulting from schemes commissioned during the year.

Movements from prior year

Turnover

	£m
Turnover 2001/02	423.9
Price limits and inflation	2.3
Other	4.9
Turnover 2002/03	431.1

Operating costs (net of capital maintenance)

	£m
Operating costs 2001/02	151.5
Exceptional cost 2001/02	(9.6)
Reductions	(7.0)
Additional cost obligations	28.0
Operating costs 2002/03	162.9

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