glas

Glas Cymru Cyfyngedig

Report and Accounts 2014

WE WILL EARN THE TRUST OF OUR CUSTOMERS EVERY DAY

GLAS CYMRU IS A SINGLE PURPOSE COMPANY FORMED TO OWN, FINANCE AND MANAGE DŴR CYMRU WELSH WATER.

IT IS A 'COMPANY LIMITED BY GUARANTEE' AND AS IT HAS NO SHAREHOLDERS, ANY FINANCIAL SURPLUSES ARE RETAINED FOR THE BENEFIT OF WELSH WATER'S CUSTOMERS.

GLAS CYMRU IS COMMITTED TO GOOD CORPORATE GOVERNANCE AND VOLUNTARILY COMPLIES WITH THE UK CORPORATE GOVERNANCE CODE 2012.

CONTENTS

CHAIRMAN'S STATEMENT

I am pleased to report that in 2013-14, Dŵr Cymru Welsh Water delivered its best overall performance since being acquired by the holding company, Glas Cymru, in 2001. We have shown again, I believe, that the unique ownership model of Glas Cymru which involves no distribution of profits to shareholders enables us to perform as well or better than our peers in the industry.

Our objective as a company is to provide the highest quality water and wastewater services for our customers at affordable prices.

Since Glas Cymru Cyfyngedig acquired Welsh Water, the Board has been determined that our customers not only experience the highest standards possible but that our charges are as low as possible. Last year was the fourth successive year when our annual price increases have been kept below the rate of inflation, and the industry regulator Ofwat ranked Welsh Water joint second in the industry league table for customer satisfaction.

Our strong performance over the past 12 months was achieved despite extreme weather conditions; a very hot summer and exceptional storms and rain in the winter. These challenged the resilience and commitment of all our employees as well as our systems and assets. We managed to limit the impact of these weather conditions on our services to our customers and I am grateful to everyone in Welsh Water who contributed so much over these long and sometimes very difficult months.

Glas Cymru is not a co-operative nor an employee owned company. It is unique in the utilities sector in England and Wales as it is a private company providing public services but with no private interest in its profits.

Our profits are all disbursed in the customers' interests but in accordance with the decisions of the Directors and Members of the company. The performance and quality of the Directors and the Members is therefore very important and we invest a great deal of time in their selection. Members must have the skills and experience to hold the Board to account. Directors must have the necessary business skills and experience but also the personal qualities to enable the Board as a whole to function at the highest level.

Finding a successor to Nigel Annett, our former Managing Director, was therefore of particular importance and after an open and extremely competitive selection process, we appointed Chris Jones as our new Chief Executive in September. Chris had previously held the role of Finance Director at Welsh Water since founding Glas Cymru with Nigel Annett in 2000.

We also appointed Graham Edwards as a new Non-Executive Director in October 2013. Graham's experience and achievements in the utilities sector speak for themselves and he has led Wales and West Utilities as its Chief Executive since 2005. I welcome him to the Board.

As well as sustaining our high levels of performance and completing successfully the last year of our current five year Business Plan approved by Ofwat (called PR09), Chris Jones and his Executive Team have been working assiduously over the past year in the preparation of the new five year Business Plan for 2015 to 2020 (PR14). During this round of price determinations, Ofwat has been particularly concerned that customers' interests are safeguarded, that the Boards of regulated companies actively participate in the development of their Plans and that they, the Boards, are fully bound into them. Whilst this has always been the case at Welsh Water, I hope that we have been able to show to Ofwat that we regard our customers' interests as paramount. Our Business Plan as originally submitted saw charges to customers fall in real terms over the five year period, together with improving service and environmental performance and a capital investment programme of around £1.5 billion.

This Plan was not developed by the company in isolation but after an unprecedented level of customer research and engagement. We asked customers directly what they wanted but also put our proposals to a 'Customer Challenge Group' which, under the chair of Diane McCrea (chair of Consumer Council for Water Wales), represented customer interests and shaped our proposals. We were therefore very pleased that 94% of customers (polled on a representative sample) supported the final version of our new five year Plan as approved by the Board. This will mean that by 2020, customers will have benefited from ten consecutive years of annual price increases being kept below the rate of inflation. It also represents a significant step towards realising our 25 year vision as outlined in 'Our Sustainable Future' which we published in 2007.

None of last year's performance would have been possible without the contribution of each and every one of Welsh Water's employees, to whom I pay tribute and extend the thanks of the whole company. Neither would it have been possible without the leadership of the Executive Team initially under Nigel Annett and then Chris Jones to whom I also extend our gratitude. And nor finally to the commitment and contribution of the Members of the company and the Board of Directors themselves. We are all fortunate to have attracted such high calibre Members and Directors who give such skilled and professional service.

Early last year, my wife, Julia, was diagnosed with a serious illness and I wanted to look after her. John Bryant unhesitatingly stepped into the breach and took over as Chairman and the Board granted me a period of unpaid absence. I have no doubt that these generous acts helped Julia achieve what we hope is a complete recovery. And we are both exceedingly grateful.

On behalf of the Board and all the employees of Welsh Water, I would like again to thank Nigel Annett (now CBE) for his vision and commitment and for leading the company through a period of significant transformation.

Welsh Water's performance last year was achieved, to a significant extent, by our ability to adapt to new conditions and to the rapidly changing working environment.

Our performance above all reflects the efforts of all our employees who work tirelessly, through extreme conditions, 365 days a year, to ensure that services to our customers are maintained to the highest possible standard.

Their commitment, enthusiasm, and determination are key to us earning the trust of our customers and showing that our 'Glas' model, where 'all gains go to customers', is a good way to own and manage the responsibilities of Welsh Water.

Robert Ayling, Chairman
12 June 2014

STRATEGIC REVIEW

As a company, we are committed to ensuring that our corporate reporting provides a balanced and comprehensive review of our performance between 1 April 2013 and 31 March 2014.

This section is structured to provide an overview of our strategy and business model; analysis of our performance against key indicators; and a summary of the principal risks and uncertainties that we manage.

— Chief Executive's Review
— Perfomace Scorecard for 2013-14
— Who we are
— Our vision and our values
— Why we're different
— The Glas Cymru Board of Directors
— Our industry and regulators
— Listening to our customers
— Managing risk and uncertainties
— Key risks faced by the Group
— Our plan for 2014-15
— Measuring our progress
— Overview of company performance

CHIEF EXECUTIVE'S REVIEW

As a company without any shareholders, our sole focus is our customers and our vision is to earn their trust every single day by delivering the best possible service at the most affordable price.

The last 12 months was another year of significant progress as we successfully delivered our best ever year in terms of overall performance to customers and managing our impact on the environment. This was achieved during a period of significant challenge and change.

PERFORMANCE

In terms of our overall operational performance, this has been our strongest year to date with nearly £1 million a day invested in delivering major improvements in drinking water safety, environmental quality, customer service and energy efficiency.

We continue to provide some of the highest quality drinking water in England and Wales and we remain committed to improving the quality and resilience of the drinking water we supply. Between 2010 and 2015, we are investing nearly £120 million in building or upgrading 12 water treatment works processes across our operating area and this is helping us withstand challenges such as managing the changing quality of raw water at its source and meeting new regulations so that we maintain an uninterrupted supply of high quality tap water to our customers.

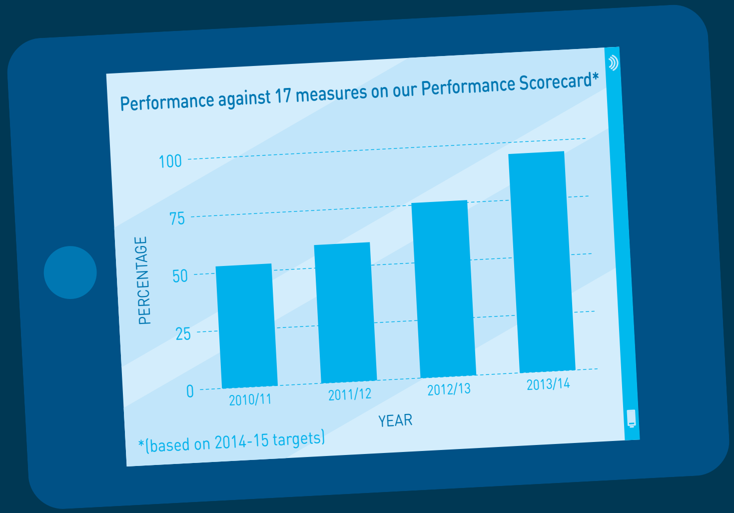
Limiting our impact on the environment is vital for the long term sustainability of our services and our environmental performance improved further in 2013. Despite the wettest winter in nearly 250 years, the impact on our customers and the environment was kept to a minimum as we achieved our lowest ever number of pollution incidents.

This is key as safeguarding our coastal water and rivers from pollution is one of our most important responsibilities. We are proud that our work contributed to Wales securing 33 Blue Flags for the 2013 summer bathing season – around a third of the UK's Blue Flags – despite managing only around 15% of the British coastline. This was followed by the Marine Conservation Society 'recommending' a record 109 beaches in Wales for their excellent water quality in 2014.

However, there are particular environmental areas that need further improvement. This includes the management of some local assets, after a number of factors – including human error – led to the failure of a local pumping station in Treorchy, South Wales, which flooded 19 properties in December 2013. We appreciate the upset and distress caused by this incident and we worked closely with the customers affected to restore their homes. We also reviewed all other pumping stations in the area as well as our own operating procedures in order to minimise the risk of such incidents occurring in the future.

Unfortunately, the stormy weather also led to additional cost pressures over the year. As one of Wales' largest energy users, we try to offset some of our operating costs by generating our own energy through anaerobic digestion at our wastewater treatment sites (by extracting methane gas from wastewater which is then used to produce electricity). However, in late 2013 and early 2014, our operations were adversely impacted by the wet weather which also resulted in us requiring more energy to pump huge amounts of rainwater around our network.

We have taken the view that the problem of overloaded sewers cannot be resolved simply by building bigger sewers, storage tanks and extending our network – this would be unaffordable for our customers and would not tackle the fundamental problem of too much surface water getting into our network. We are now at the forefront of the industry in developing and using innovative, sustainable and cost-efficient schemes at a catchment level that will redirect and slow down the speed at which surface water enters the sewer network. We have called this approach 'RainScape'.



CUSTOMERS

Despite serving around three million people, most customers rarely have reason to contact us. However, as a company without any shareholders, our customers are our primary focus and we want to provide them with the best possible service. This is why we were the first company to start proactively texting customers to forewarn them about potential service issues. We are pleased that independent research from our regulator, Ofwat, shows that we are joint second in the industry rankings with customer satisfaction rates consistently around 90%.

To maintain this, we are determined to earn the trust of our customers. We must always display the right values and behaviours and after consulting more than 1,000 colleagues, I am proud to have launched our new vision and values in 2013 which give a clear sense of purpose about what we do and what we stand for. Our colleagues are our most important asset and we are determined to provide the best possible training, whilst also building on the success of our bespoke apprentice, graduate and traineeship schemes.

All this will also allow us to build on our best ever score of 79% (2012: 76%) in the Employee Engagement Survey in 2013.

Our research shows that customers want a closer relationship with us as we try to deliver the best possible service. This is important at a time when we need our customers to help us deliver key business outcomes as shown last year by the success of our three month 'Let's Stop the Block' campaign. This involved working with domestic and business customers in Rhondda Cynon Taff and Caerphilly which helped reduce sewer blockages in their communities by 30%. The campaign has since been rolled out in Cardiff with more activity planned throughout 2014.

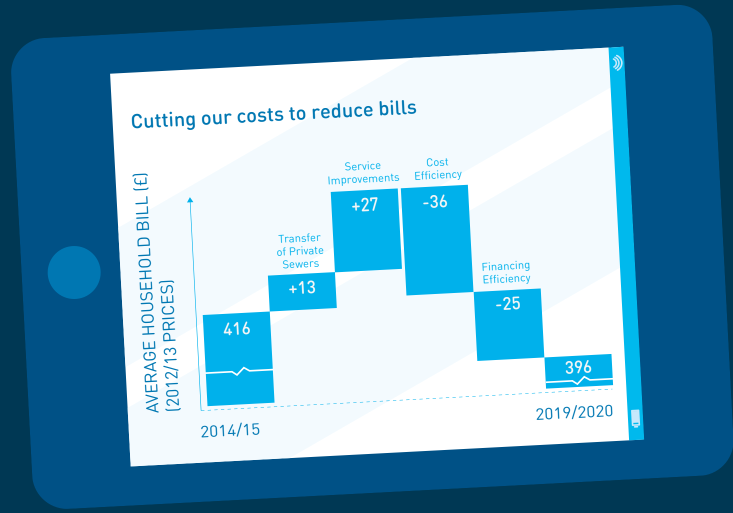
We also continued to raise customer awareness of what we do and highlight the dangers inherent at some of our operational sites. This follows the tragic death of two individuals last July in separate incidents of swimming in reservoirs in South Wales during an exceptionally hot weekend. Whilst we welcome visitors who wish to come and enjoy our recreational facilities, we will make every effort to highlight the dangers of swimming in our reservoirs.

VALUE FOR MONEY

The annual price increase in 2013-14 was below inflation for the fourth year running. However, with relatively high deprivation in parts of our region, affordability continues to be a key challenge for us. Around 60,000 customers are currently receiving help to pay their bills through our social tariffs and we plan to introduce a new tariff in 2015 that will increase the number of recipients to over 100,000 by 2020.

Despite the help we provide to those who genuinely struggle to pay their bills, we still have relatively high levels of bad debt across our operating area with water customers paying around £20 extra on annual bills to cover the cost of those who choose not to pay or who are not able to pay. We plan to reduce bad debt through improved use of customer information, and we support the Welsh Government's proposed new regulations which will encourage landlords to forward the details of their tenants to us as this should help us reduce the cost of bad debt which is a particular problem amongst tenanted properties.

STRATEGIC REVIEW



INNOVATION AND EFFICIENCY

A key element of our plan to improve value for money for our customers is setting challenging targets for ourselves in terms of reducing costs. Whilst we remain the only water and wastewater company in England and Wales to have reduced our operating costs in real terms since 2001, we want to build on this success and drive forward initiatives such as our industry-leading surface water management techniques, known as RainScape. This is also why we established our very own Ideas Lab in 2013 which is now allowing us to invest more time and resource into progressing new ideas. We are also driving innovation by benchmarking and sharing best practice with other international water companies such as Oasen Drinkwater in Holland.

SHAPING THE FUTURE

The last 12 months have seen water companies submitting their Business Plans for 2015 to 2020 to the industry regulator, Ofwat. Being uniquely placed to ensure that our Plan is driven entirely by the needs and preferences of our customers and other stakeholders, we undertook our largest ever customer research and consultation. Over 11,000 customers and stakeholders took part in 'Your Company, Your Say' which resulted in a 94% acceptance rate of our planned £1.5 billion investment. It contains a range of ambitious service and environmental improvements which reflect customer priorities, including our commitment to keep bill increases at least 1% below the rate of inflation for each year until 2020.

We have also seen much discussion in 2013 to 2014 about the direction of regulation in the water industry with the UK Government's Water Act 2014 and the Welsh Government's 'Water Strategy for Wales'. We continue to play an active part in informing these policy discussions to ensure that we remain in a position to continue delivering the best possible value for our customers.

As one of Wales' leading companies, we have continued to make good progress in 2013-14. That we have achieved this performance in challenging conditions is entirely due to the considerable efforts of the team here at Welsh Water, along with effective partnership working with our contractors and supply chain. We always aim to do the right thing for our customers and where we don't get things right, we will always be open and honest in trying to put it right.

This approach helped us to be recognised in 2013 by Business in the Community Wales as the 'Responsible Large Business of the Year'. Together, Welsh Water and our customers have contributed around £5 million to our nominated charity, WaterAid, over the past 10 years. The charity aims to transform lives by improving access to safe water, hygiene and sanitation in the world's poorest communities.

As one of the first companies to sign the Welsh Government Sustainable Development Charter in June 2011, we remain determined to play our part in improving the long-term economic, social and environmental wellbeing of people and communities in Wales.

I would like to take this opportunity to thank everyone involved in delivering our best year ever in terms of overall performance. The unwavering commitment and professionalism of our colleagues means that we can build on this success so that we are consistently ranked as leading performers in the water and wastewater industry and can realise our vision of earning the trust of customers every single day.

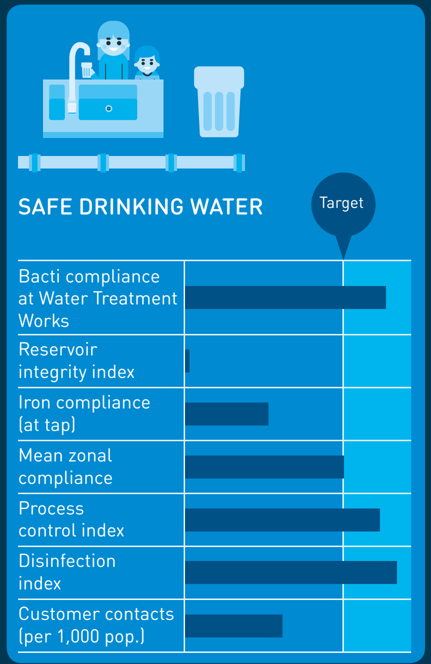
C. A. Jones

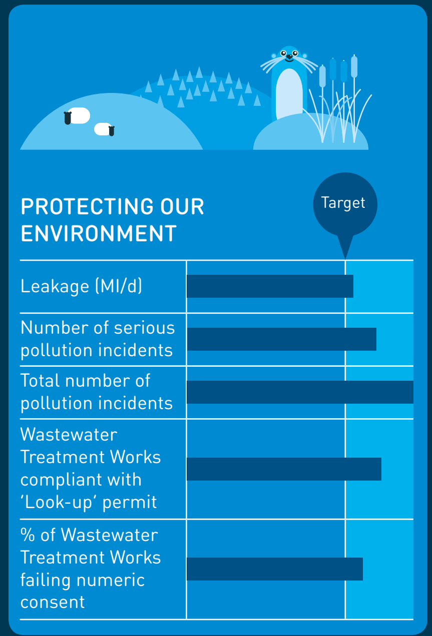
Chris Jones, Chief Executive
12 June 2014

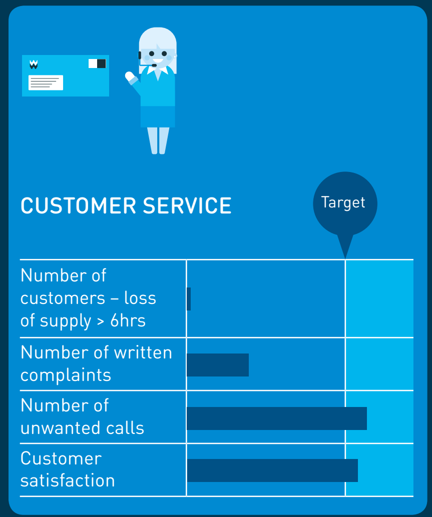
PERFORMANCE SCORECARD FOR 2013-14

On most of the measures that matter for our customers and other stakeholders, our performance now ranks us towards the top of the industry league tables.

The regulated water industry is particularly measurable, which allows the Board to set targets for the business that are based on sector benchmarks and to judge where we stand compared with the best performers in the sector. We use a number of key measures to make up our Performance Scorecard against which – alongside the achievement of cost efficiency targets – variable pay for every member of staff is calculated. Last year we achieved or beat the targets set by the Board for 13 of the 18 measures on our Performance Scorecard.







WHO WE ARE

Welsh Water is the sixth largest of the ten regulated water and wastewater companies in England and Wales.

Our primary responsibility is to deliver safe and reliable drinking water and sanitation to the 3.2 million people we serve in Wales, Herefordshire and parts of Deeside.

We provide an essential public service and, as custodians of the water industry in our area, we are responsible for protecting the environment and delivering a high quality and reliable service to our customers.

Much of what we do from day to day involves operating and maintaining an enormous network of assets that would cost some £26 billion to rebuild – the equivalent of £20,000 per household customer.

We provide our services by:

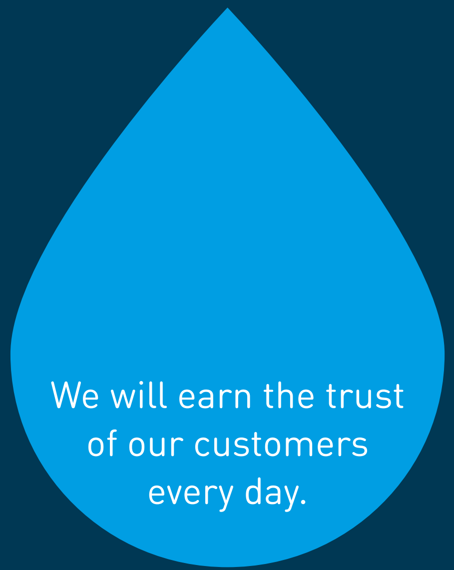
— managing 91 reservoirs and supplying over 800 million litres of safe, clean drinking water each day through more than 27,000km of pipes. We also carry out almost 400,000 tests a year on tap water at our state-of-the-art laboratories in Newport, South Wales and Bretton, North Wales
— collecting wastewater (including surface water) through more than 30,000km of sewers. We deal with over 2,000 blockages a month and manage to stop flooding or pollution in 99% of cases, helping to protect public health and the environment
— managing 40,000 hectares of land. This includes four visitor centres that between them attract around 1 million visitors each year
— employing nearly 3,000 colleagues across Wales, Herefordshire and parts of Deeside and supporting a further 3,500 jobs to help ensure that we provide a first class essential service.

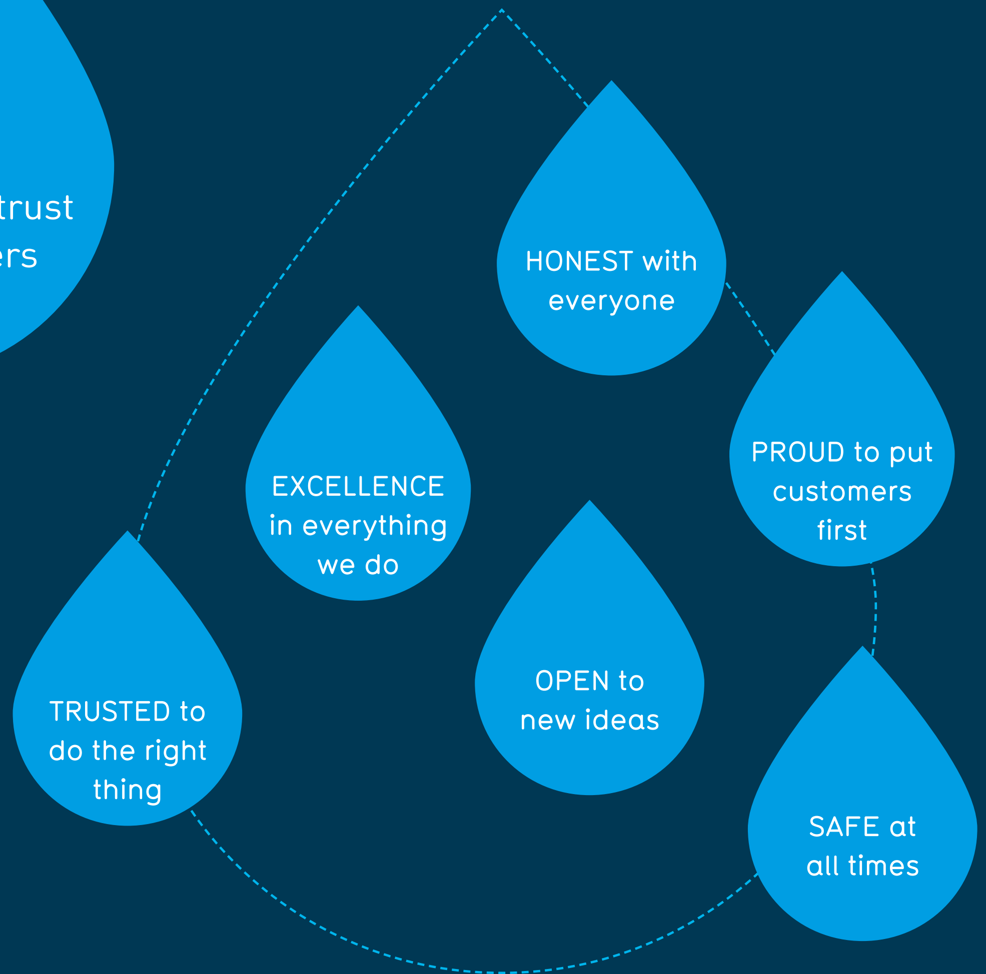
OUR VISION AND OUR VALUES

Customers must be able to trust that the essential services we deliver are safe and of the highest standard.

We know that we must be relied upon to do the right thing on their behalf. This is why we put customers first. They are at the heart of everything we do.

We will do this by delivering high quality, essential services that protect our customers' health, our communities and the environment around us.





WHY WE'RE DIFFERENT

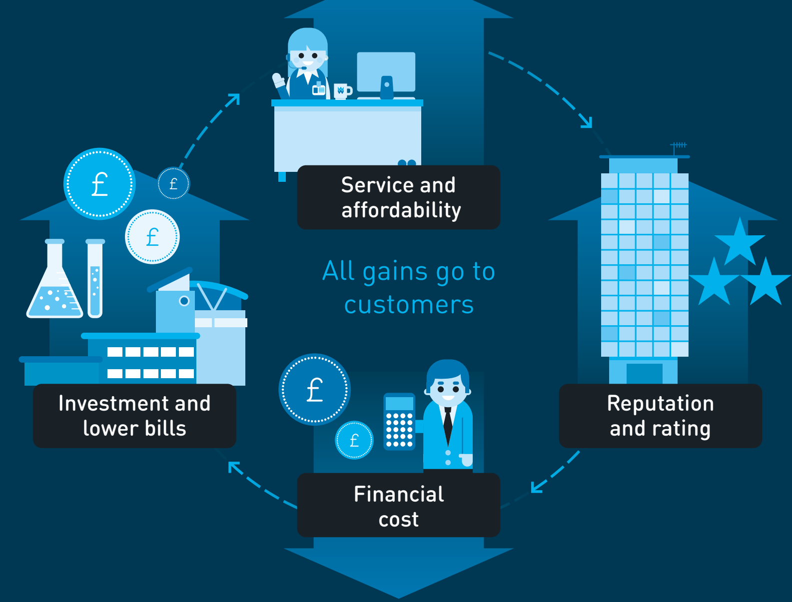
Welsh Water is owned by Glas Cymru Cyfyngedig, a single purpose company with no shareholders and run solely for the benefit of customers. Glas Cymru was specifically formed to own, finance and manage Welsh Water.

Our governance structure is supported by the role played by Glas Members, who have no financial stake in the company but who perform an essential governance function and hold the Board to account for the good governance of the Group. The Group structure is outlined in more detail on page 57.

Welsh Water's sole purpose is to deliver high quality water and wastewater services at the least possible cost to its customers now and long into the future. Without any shareholders, it does not pay dividends and this enables the company to share all its gains with customers.

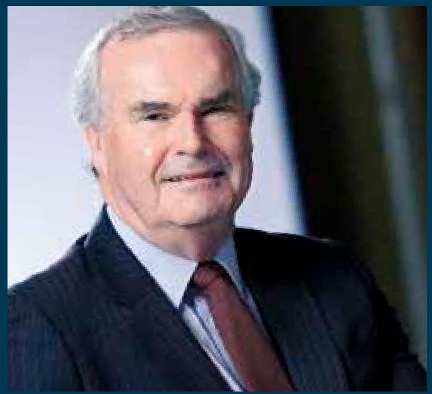
Between 2010 and 2015, we are on target to return £136 million to customers by investing:
— £87 million to finance accelerated capital projects to improve services to customers and the environment
— £22 million on supporting customers who struggle to pay their bills
— £27 million on meeting the costs of new legal obligations such as the transfer of 17,000 km of private sewers in 2011.

THE GLAS CYMRU MODEL



THE GLAS CYMRU BOARD OF DIRECTORS

ROBERT AYLING,
Chairman



JOHN BRYANT,
Senior Independent Director

CHRIS JONES,
Chief Executive

PETER PERRY,
Chief Operating Officer

GRAHAM EDWARDS,
Non-Executive Director

PROFESSOR STEPHEN PALMER,
Non-Executive Director

MENNA RICHARDS,
Non-Executive Director

JAMES STRACHAN,
Non-Executive Director

ANNA WALKER,
Non-Executive Director

JOHN WARREN,
Non-Executive Director

Biographies available on page 61

OUR INDUSTRY AND REGULATORS

Welsh Water is one of ten water and wastewater companies and there are also nine regional companies which supply water services only in certain areas.

Our regulators include the following:

— **Ofwat** (our economic regulator) exists to ensure that water companies provide a good quality service at a fair price. It sets price limits for customer bills to ensure that they are no higher than they need to be. It assesses the operating costs and investment we need to maintain our network of assets to meet required standards and deliver high quality services to customers. Ofwat promotes the interests of customers by incentivising efficiency and good service and penalising inefficiency and poor service.

— The **Consumer Council for Water** (an independent body established to represent the interests of customers) investigates complaints, champions customer concerns, and audits our more general performance on customer service, as well as influencing policy.

— The **Welsh Government** sets the framework for public policy matters for Wales, including policy and legislation on water and environmental matters.

— Drinking water quality is regulated and monitored by the **Drinking Water Inspectorate**.

— Our environmental performance, especially the way we abstract water from rivers and reservoirs and then discharge wastewater after it has been cleaned, is regulated by **Natural Resources Wales** and the **Environment Agency**. They oversee our management of designated sites for nature conservation and how we meet our obligations to conserve and improve biodiversity and our natural resources.

— The **Health and Safety Executive** is the national independent regulator for work-related health, safety and illness.

— The principal aim of the **Welsh Language Commissioner** is to promote and facilitate the use of the Welsh language. We submit an annual compliance report to the Commissioner's office detailing how we have complied with the provisions of our statutory Welsh Language Scheme which outlines how we provide bilingual services to our customers.

LISTENING TO OUR CUSTOMERS

8,800 visited roadshow

260,000 facebook impressions

3,900 website hits

200,000 tweets

As a company without any shareholders, we are uniquely placed to ensure that our plans are shaped entirely by the needs and preferences of our customers and other stakeholders.

This is why listening to our customers is so important to us and we are proud to have conducted our biggest ever customer and stakeholder consultation in 2013 to shape our Business Plan for 2015 to 2020.

This included:

— arranging six three-day roadshows visiting communities from Swansea to Llandudno
— conducting 3,000 interviews
— inviting customers and stakeholders to eight open evenings
— coordinating a stakeholder workshop with representatives of vulnerable customers
— conducting 40 focus groups with different types of customers.

Since our original Business Plan for 2015 to 2020 was submitted to Ofwat in December 2013, we revised our Plan in response to additional customer and economic research and new regulatory guidance. We received a draft determination from Ofwat on 30 May, which we are currently considering. A final determination will be issued in December 2014.

The draft determination proposes a 5% reduction before inflation in the average household water and wastewater bill by 2020 whilst maintaining record investment at £2.5 billion.

Other key changes include:

— average household bill in 2019-20 will be £21 lower than in 2014-15 before inflation
— a sliding scale of financial rewards and penalties to reflect over or under performance.

MANAGING RISKS AND UNCERTAINTIES

We know that effective risk management is central if we are to achieve our strategic priorities.

There are a number of commercial risks and uncertainties that could have a significant operational, financial and reputational impact and we invest substantial resources to identify, analyse and manage these challenges:

— each member of our leadership team maintains a detailed register of risks, reviewed monthly with their teams. The significant risks from each team are reported to and reviewed at one of the Executive meetings each month
— these risks are then 'mapped' to the current Board Strategic Risks to ensure that there are no gaps and to give a view as to the current status of each risk, taking account of the effectiveness of mitigation steps in place
— a Strategic Risk Analysis Report, showing the mapping of current issues and mitigations in place against each Strategic Risk is included in the papers for each Board meeting and consideration of the report is an agenda item. Each risk on the Strategic Risk Analysis Report is owned by an Executive Member to ensure consistency and accountability
— every six months the Board reviews whether they believe the risks listed remain the most important risks and a new list of strategic risks is agreed.
— Audit Committee has accountability for overseeing the risk management processes and procedures, and reports to the Board.

The long term success of the Group depends on identifying, assessing and managing risks effectively and all colleagues play a part in our approach to risk management. This bottom up and top down approach to risk management provides assurance that risks are being effectively managed by the business to identify those areas where further mitigation steps are needed and to assist the Board in reviewing strategic risks facing the business.

WE USE A 'THREE LINES OF DEFENCE' MODEL TO ENSURE COMPLIANCE WITH INTERNAL CONTROLS:

The Board considers that the principal risks and uncertainties affecting the business activities of the company include the following:

KEY RISKS FACED BY THE GROUP

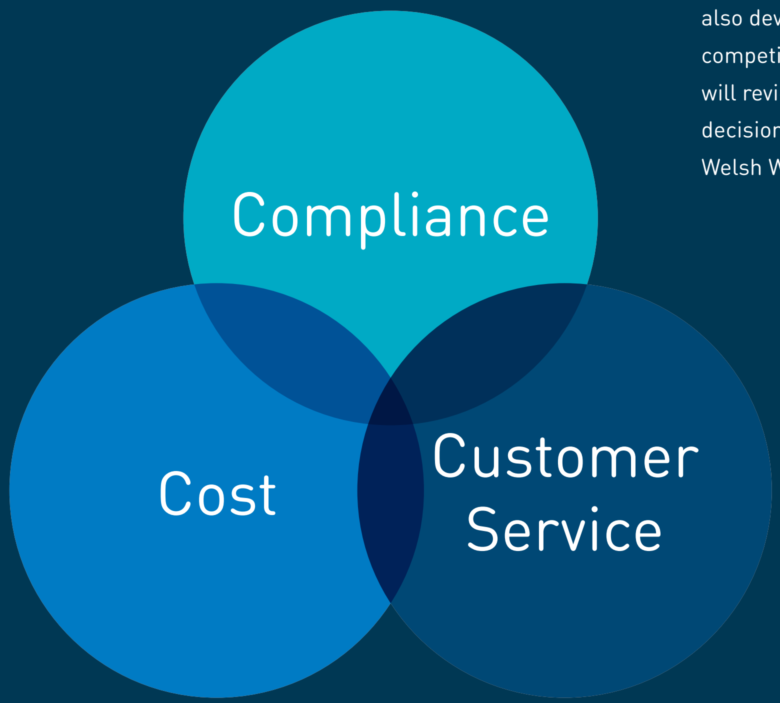
KEY RISKS	KEY MITIGATIONS
1 HEALTH AND SAFETY MAJOR INCIDENT The Health and Safety of our employees and the public in the provision of our services and on our sites is our utmost priority. The risk of a major health and safety incident would include the potential for an accident to a member of the public, on one or our sites or as a result of our actions, or to an employee in discharging their duties.	Welsh Water has a Health and Safety Strategy and Management Plan in place with operational procedures accredited by Occupational Health and Safety Advisory Services. The importance of Health and Safety is highlighted through communication and awareness plans. We run comprehensive training programmes for our colleagues. This year's focus was given to a behavioural safety training programme called 'Safety Takes Every Person'. There are also quarterly Director led Safety Days, an annual Health and Safety Conference, and Trade Union Health and Safety Consultative Forums are run at both company and operational levels. Health and Safety performance is reported to Dŵr Cymru Executive, Board and the Quality and Environment Committee.
2 RISK OF MAJOR PUBLIC HEALTH INCIDENT Any problem affecting drinking water quality (e.g. cryptosporidium or bacteriological failure) could cause our customers to become ill, and would require a widespread boil water notice in order to protect public health, causing disruption to our customers. Such an incident could also lead to a prosecution.	Welsh Water has Drinking Water Strategies in place which are signed off by the Head of Water Quality and Director of Potable Water Services and monitored by the Quality and Environment Committee. A capital investment programme called 'Go to Green' is underway to build or refurbish 12 Water Treatment Works at a cost of some £120 million. A review of data is being undertaken to seek areas of potential risk and to prioritise areas for improvement.
3 BUSINESS PLAN 2015 TO 2020 (PR14) OUTCOME This has been a year of uncertainty around future investment plans and levels of bills for all water and wastewater companies, while the outcome of the 2014 price review process (PR14) and the final determination on these issues by the economic regulator, Ofwat, is awaited. The eventual outcome could impact on the company's investment plans for 2015 to 2020, financing methods and credit rating. A very challenging determination could make it impossible to deliver our planned investment, raising long-term risks to customer service, asset reliability and operational performance.	Our Business Plan had strong customer endorsement and we will continue to engage closely with Ofwat to promote the best long-term outcomes for our customers.
4 CONSUMER DEBT Changes to the benefit system and continuing squeezed living standards put cash collection at risk.	We continue to promote our assistance scheme and range of social tariffs for those customers who are genuinely struggling to pay their bills. A new scheme is planned to be launched from April 2015, which will aim to increase the number of potential recipients from among those customers who have difficulty in paying our bills from 60,000 to 100,000. In order to keep bills to as low a level as possible, a new litigation team has been created using our recently updated Tallyman III debt management system to improve debt recovery from those who do have the means to the pay.
5 FAILURE TO ACHIEVE COST REDUCTIONS The risk that the company will be unable to achieve its cost reductions over the next year and into the next regulatory investment period to meet the stringent targets set in our PR14 Business Plan.	A cost reduction plan has been created for 2014-15 to ensure we meet the requirements of the Ofwat 2009 price review determination. Welsh Water is developing a wide range of cost reduction initiatives for the coming five years, to reduce both operating and capital costs and support the challenging goals set out in our proposed plans for this period. This will be supplemented by budget management with clear escalation controls.
6 MARKET REFORMS AND THE CONTINUED DEVELOPMENT OF THE COMPETITIVE MARKET The risk of potential changes to the market including the introduction of retail competition for business customers, which will involve significant changes to regulation as a result of the implementation of the Water Act 2014.	A Market Opening Steering Group has been established to consider implications for the business and we are closely following developments in the sector. Our business strategy is aimed at delivering high quality, high value services to our customers at a competitive price.

KEY RISKS	KEY MITIGATIONS
7 INCREASED ENVIRONMENTAL REGULATION Changed interpretations or enforcement of existing regulations, or new regulatory standards could impose significant costs on us or on the sector as a whole.	We continue to work closely with our Independent Environmental Advisory Panel to seek best value for both our customers and the environment. We sponsor research and other studies to provide evidence to policy makers to support better decision making. We maintain regular structured dialogue with key stakeholders, including direct liaison with Welsh Government, UK Government's Department for Environment, Food and Rural Affairs and our trade association, Water UK, to evaluate any such new or modified regulatory standards.
8 COMPLIANCE WITH REGULATORY REQUIREMENTS We have important obligations to provide complete and accurate information to our regulator. A failure to meet these obligations could lead to significant penalties. A review of our reporting of regulatory data has identified some areas where our procedures for ensuring accuracy of reporting and compliance with reporting requirements can be enhanced.	A new Compliance Team has been put in place during the year. This is focused on assisting the business to ensure compliance with regulatory reporting requirements and to monitor best practice developments in this area.
9 POTENTIAL DETERIORATION IN PERFORMANCE While 2013 to 2014 was probably the strongest year yet for Welsh Water in terms of overall operational performance, we are not complacent and have taken steps to guard against a deterioration in this performance. Sustained deterioration in performance over two years could lead to a 'marginal' serviceability assessment and the risk of a penalty at a following price review.	Operational strategies for Water Quality and Wastewater are regularly reviewed by the Executive Team, with capital investment targeted as appropriate to mitigate the performance risk. Operational performance is tracked through the Executive and Quality and Environment Committee.
10 STRATEGIC ASSET FAILURE A strategic asset or network failure could lead to flooding or loss of supply for thousands of customers.	We have a detailed asset strategy and asset maintenance plan to reduce the risk of unanticipated asset failure. Where incidents do occur, there are strict emergency incident response procedures to be followed by operations teams. We have a comprehensive reservoir safety strategy and surveillance programme. In addition, we have had positive feedback on external security audits this year and will continue to build on the measures taken to ensure security of our assets.
11 ORGANISATIONAL CAPABILITY, SUCCESSION ISSUES AND CULTURE CHANGE A lack of engaged or capable employees could result in poor customer service or compliance, and exacerbate other identified strategic risks.	Welsh Water undertakes an annual talent and resource review and develops employees at all levels throughout the company. There are graduate, trainee and apprenticeship programmes as well as competent operator programmes and leadership development. Where appropriate and necessary, there is also targeted external recruitment. Welsh Water undertakes an employee engagement review annually and the Board monitors and reviews the results. This year the level of employee engagement achieved was 79%. This is the highest engagement level achieved to date. A comprehensive action planning process has been developed to address issues raised.
12 ICT RISK A major loss of ICT service would put business performance at risk. In addition, several business improvement plans are reliant on new ICT systems.	A Director led Systems and Change Board (internal management committee) was created to oversee a major ICT delivery programme, and the in-house ICT team has been increased to meet these requirements. In 2013, attention has been given to improving systems, ICT security and document retention.

OUR PLAN FOR 2014-15

2014 to 2015 will be a 'year of transition' for Welsh Water. In this last year of the current investment cycle, the company aims to achieve very stretching operational and customer service performance targets, at a significantly reduced level of cost.

In the short term, our Business Plan for 2014-2015 sets 12 key priorities for the company. These include performance objectives for compliance, customer service and cost. If achieved, these targets would put our service levels amongst the best in the sector on most measures.



KEY BUSINESS PRIORITIES FOR 2014 TO 2015:

CUSTOMER

1. **Health and safety:** Focus on behavioural safety; develop new 'process safety' approach in relevant teams.
2. **Customer service improvements:** Improve customer service processes and promotion of online service channels.

COST

3. **Cost efficiency:** Significant savings will be required to hit targets for 2010 to 2015 and to cover increased power costs.
4. **Establishing a commercial arm:** A small team will be created to look at new commercial opportunities including additional renewable energy projects.
5. **Planning for 2020:** The final determination for the next regulatory investment period between 2015 and 2020 is expected from Ofwat in December 2014 and Ofwat are also developing plans for increased competition in England in 2017. We will review the consequence of these decisions and how they impact on Welsh Water.

COMPLIANCE

6. **Improved water distribution performance:** Improve operational strategies and adoption of drinking water safety plan approach.
7. **Environmental performance:** Maintain excellent performance on environmental pollutions and transfer some resource to investment to combat sewer flooding of properties.
8. **People and culture:** Continue to develop our people, strengthen our pool of strong managers and specialists and embed our vision and values.
9. **Compliance and regulatory standing:** Compliance will have a heightened profile across the business and the new Compliance Team will focus on a wider range of issues.

ENABLERS

10. **Lean operations:** Roll out Lean operating practices across water treatment works and wastewater sludge treatment centres.
11. **Developing a smart business:** Develop innovation strategies for water and wastewater to 2020; move towards real time management of the networks and better targeting of investment.
12. **ICT change programme:** Replace our billing system (Project Newid); update our IT operating systems (Project RevITalise).

At the same time, over the next 12 months we will also be driving forward a number of key business improvement strategies, which will position us to meet the even more demanding challenges in the next investment period from 2015 to 2020 – in terms of cost reduction, performance targets and value returned to customers. We have developed a detailed Business Plan for 2015 to 2020 which sets out our objectives and performance targets for the period. This plan may need to be revised in light of the Ofwat Final Determination in December 2014.

GLAS CYMRU CYFYNGEDIG
REPORT AND ACCOUNTS 2014

MEASURING OUR PROGRESS

Our business planning is structured around eight key 'outcomes' that have driven performance since the publication of 'Our Sustainable Future' in 2007 and used also in our latest Business Plan for 2015 to 2020.

With challenging but deliverable targets set for each outcome, this provides a consistent and transparent platform for allowing us to measure our operational, environmental, financial and customer performance in order to determine our progress.

THE EIGHT KEY OUTCOMES WE AIM TO ACHIEVE ARE:

1

HIGH QUALITY DRINKING WATER
You will have complete confidence that your drinking water is safe, reliable and tastes good.

2

PROTECTING THE ENVIRONMENT
We will safeguard a sustainable environment that we are proud to hand on to future generations.

3

RESPONDING TO CLIMATE CHANGE
We will adapt our activities to deal with the potential effects of climate change, while reducing our own carbon footprint.

4

EXCELLENT CUSTOMER SERVICE
Our customer service will be as good as the best utility companies in the UK.

5

AFFORDABLE BILLS
Our prices will reflect good value for money for our customers, with an effective range of help for those struggling to pay.

6

LOOKING AFTER OUR ASSETS
We will maintain our assets for future generations, at the most efficient cost.

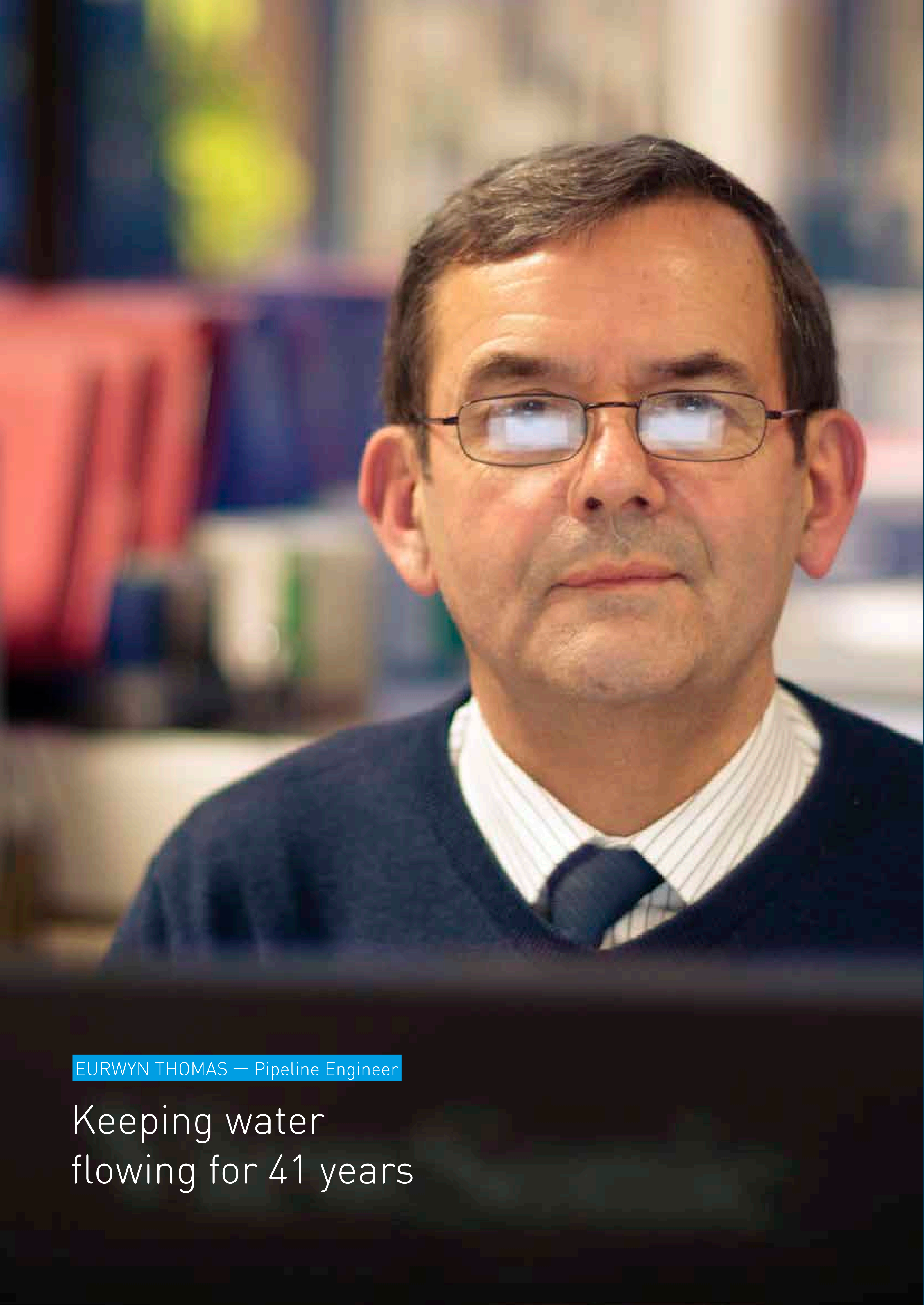
7

DEVELOPING OUR PEOPLE
We will develop a team of people who will provide a great service to our customers.

8

AN EFFICIENT BUSINESS
We will continue to be an efficient business with a strong credit quality.

By delivering these outcomes and supplementary measures, we will deliver improving value for money for customers, both now and for future generations. These underpin our long-term plans and are designed to respond to emerging issues and challenges so that we can continue to earn the trust of our customers long into the future.



EURWYN THOMAS — Pipeline Engineer

Keeping water flowing for 41 years

1 HIGH QUALITY DRINKING WATER

OUR AMBITION:
You will have complete confidence that your drinking water is safe, reliable and tastes good.

INTRODUCTION
We know that supplying safe drinking water at all times is our most important responsibility. Providing 800 million litres of high quality, clean tap water to our customers every day – the equivalent of over 320 Olympic sized swimming pools — makes a vital contribution to public health and so we know that it must be free from harmful chemicals and bacteria and have a good taste.

To help achieve this, we only abstract for public supply around 3% of 'effective rainfall' in Wales whilst carrying out more than 1,000,000 tests every year at our state of the art laboratories on samples taken from our various water sources (lakes, rivers and reservoirs). A further 400,000 tests are taken and analysed under regulations monitored by the Drinking Water Inspectorate (DWI) and assessed against a unique and extensive set of standards set by EU Directives and UK legislation.

HIGHLIGHTS
In 2013, the high quality of the water we supply improved even further with 99.97% (2012: 99.96%) of samples taken and analysed meeting drinking water quality standards at customer taps. With only a single bacteriological failure (2012: 3) at our water treatment works, we have again met our performance targets on four of the six key measures used by the DWI to measure water quality compliance at each point of the water supply system. We also achieved better than the industry average on four of these six key indices.

99.97% overall water quality compliance

Based on our Drinking Water Safety Plans, we are building on this success by identifying and addressing potential risks to tap water (from source to tap). Due to changing raw water quality, these problems have been more acute in North Wales and so we are well advanced in building brand new water treatment works at Llyn Conwy near Betws-y-coed (£15 million), Alwen on the Denbigh Moors (£10 million), Alaw (£17 million) and Cefni (£15 million) on Anglesey, Dolbenmaen near Porthmadog (£28 million) and Bont-goch in Mid Wales (£9 million). Our new £9 million service reservoir at Coed Dolwyd is also now fully operational giving 70,000 customers in the Colwyn Bay and Llandudno areas additional security of supply.

£120m

invested in building or upgrading 12 water treatment works

CHALLENGES FACED

Iron is one of the main causes of discoloured water in our customers' homes and businesses and this remains a concern as we came below this year's target of 99.70% by only achieving 99.54% compliance. Notwithstanding the water mains renewal programme of the last ten years which includes recently renewing 13km of iron water mains in Hereford and Newport at a cost of £2 million, we still have more than 6,500km of unlined iron mains which can cause discoloured water. Whilst we will continue to address this between 2015 and 2020, it remains a significant risk and will remain a major challenge for us, especially in 'hotspots' such as Herefordshire, Holywell and Mold, Cardiff and Newport.

No water restriction measures in over 25 years.

The extreme weather patterns over the past 12 months placed our network under severe pressure. A prolonged hot and dry summer saw an increased demand for water with supplies increasing to just under 1,000 million litres a day – the highest level for a number of years. However, after tankering additional supplies to many of our service reservoirs, we generally coped well despite having to manage pockets of low pressure and discolouration across the network. Whilst this was directly linked to a 30% increase in customer calls during July compared to the rest of the year, our customer contact rate of 2.02 per 1,000 customers in 2013 was lower than the previous year (2012: 2.14). Despite this challenging period where dedicated leakage resources were diverted to maintain water supplies, we still managed to achieve our challenging leakage target for the year.

This dry period was then followed by an exceptionally wet and windy winter which culminated in unprecedented power failures and flooding at some of our water treatment sites and pumping stations in February 2014. Maintaining our services during this period was challenging with generators being utilised as contingency measures at all 66 of our water treatment works at one point. Whilst ensuring that drinking water supply to our customers was maintained during this exceptional weather in 2013 to 2014 resulting in additional costs, this extra resourcing helped us avoid any further widespread disruption to services.

GLAS CYMRU CYFYNGEDIG REPORT AND ACCOUNTS 2014

Amroth, Pembrokeshire — Despite the water main being washed away by the stormy sea in January 2014, we restored water supplies to the local community within around 5 hours.

LOOKING AHEAD

As part of our plans to maintain a reliable water supply during exceptional weather events, we have now published our 25 year Water Resource Management Plan to ensure that there will be sufficient water to meet the future requirements of our customers. We have also finalised our Drought Plan because although we have not had to introduce water restriction measures in over 25 years, we still need to understand and plan how we would respond to such extreme weather conditions. This will enable us to prepare and implement the best possible solutions so that we continue to meet customer demand during exceptionally dry periods whilst also safeguarding the environment.

CASE STUDY

ALGAE IS A KEY RISK TO THE WATER QUALITY IN OUR RESERVOIRS.

When water abstracted for drinking water treatment contains algal blooms, blockages can occur in the filters and odours may develop in the treated water. We are now working with partners to develop innovative new ways to manage this risk by placing a sound buoy on the surface water of the reservoir. This monitors the water quality, identifies any algae and automatically adjusts its ultrasound wave to destroy the algae. This will help us improve water quality and reduce our overall costs.

RICHARD POOLE — Area Lands Manager

Working to protect our environment — for today's customers and for future generations

STRATEGIC REVIEW

2 PROTECTING THE ENVIRONMENT

OUR AMBITION:

We will safeguard a sustainable environment that we are proud to hand on to future generations.

INTRODUCTION

To provide our essential public service and protect public health, we rely on the environment to abstract water from it, then treat it before supplying it for customers to use. We then collect it again before screening, treating it and returning it to our rivers and seas. With over 4,600 miles of rivers and a 1,000 mile coastline, our stewardship of the environment is crucial to the long term interest of our customers.

We need to ensure that our assets operate effectively and are able to treat sewage and discharge effluents in line with the permit conditions issued by our regulators, Natural Resources Wales and the Environment Agency, so that we can protect wildlife, habitats and other users of these waters.

HIGHLIGHTS

Our sewer network has generally performed well in most parts over the past 12 months despite the extreme weather conditions. The number of reported pollution incidents at 124 was at its lowest level ever, a 40% reduction on 2012 (205). This figure is even more striking when compared to pre 2009 levels when the number of annual pollution incidents often exceeded 300.

Over the past 12 months, we have invested £62 million in improving our wastewater network and improved operational processes. This included a £7 million new stormwater storage tank at Heswall Wastewater Treatment Works – the size of three Olympic swimming pools – which has improved water quality in the Dee Estuary. A further example is the £2.5 million invested at Bynea, Llanelli, to replace 1km of sewer main to increase capacity on the network and improve its performance during storm weather conditions.

Our 834 wastewater treatment sites have performed well during the year and coped with the additional volumes of water from heavy winter rainfall. We now have the best record in the industry for pollution incidents per 100 treatment assets and whilst the number of works failing to fully comply with discharge permits has increased slightly since 2012, from 8 to 12, we remain within the target set by Ofwat.

Our investment in the sewer network and wastewater treatment works is delivering real results as demonstrated by the 33 Blue Flags awarded to bathing waters in Wales in 2013. With increasingly higher standards to meet, we know that bathing waters are important to the Welsh tourism economy – which already accounts for some 14% of GDP – and our £1 billion investment over the past decade reflects our commitment to safeguarding the environment which is a national asset.

33

Blue Flags awarded to bathing waters in Wales

164,000+

pupils have visited one of our four education centres

With over 2,000 blockages a month in our sewer network at a cost of over £7 million a year, we must also work with our customers to protect our environment. In addition to our 24-hour pollution hotline and web-based reporting application, we launched an ambitious new campaign in 2013 called 'Let's Stop the Block'. Targeted at customers in 'hotspot' areas across Rhondda Cynon Taff and Caerphilly that have a history of sewer blockages, we delivered a collaborative behavioural change campaign which encouraged them not to flush away everyday items (e.g. cotton buds and sanitary products) and fats, oil and grease. Subsequent customer research showed that 40% of customers were aware of the campaign which led to a 30% reduction in the number of sewer blockages in these communities during the campaign.

Our customer research also shows that reducing leakage remains a top priority as we balance the volume of water we take from the environment against the demand for water from our customers. Since the 1990s, we have halved leakage on our water supply system and we have made good progress this year with leakage at 183.75 megalitres a day and therefore met our target.

We have also continued to work with customers in this area and our 'Wrap Up Wales' winter campaign, in collaboration with representative organisations such as Age Cymru, was aimed at improving awareness about the need to protect household water pipes from freezing and led to more than 1,500 insulation kits being given to customers as part of the campaign.

Supporting customer education continues to be one of our main areas of community support. Our ongoing outreach programme, combining both school visits and site visits to our education centres, helps us show young people the importance of preserving water and protecting the environment. Since 1997, over 164,000 pupils have visited one of our four education centres. They offer a wealth of information which is developed with educational experts and linked to the national curriculum.

Due to the success of the centres, our outreach programme has been extended with teachers now regularly visiting schools to educate pupils on the key messages underpinning our behavioural change campaigns. In the last academic year, around 40,000 pupils have taken part in these workshops.

CHALLENGES FACED

Despite having delivered 28 investment schemes in 2013 to reduce the number of properties at risk of internal sewer flooding, we know that this remains a risk for some customers. It is the worst possible type of service failure, and although we were ahead of target for most of 2013, we were significantly impacted by the exceptionally wet weather in late 2013.

This year, we experienced serious internal sewer flooding in two separate incidents in December 2013 (Treorchy in South Wales and Holyhead in North Wales) but we managed to avoid more widespread incidents by pumping millions of additional gallons of surface water through the sewer network whilst also mobilising tankers to remove any excess flows. This placed additional cost pressures on the company with an extra £2 million being spent on electricity in January and February 2014 alone.

We continued to work hard to reduce pollution incidents, and in 2013, there were only 2 serious pollution incidents (2012: 6), the lowest number in England and Wales. Whilst one was beyond our control and caused by ground movement in Aberystwyth, Mid Wales, the other was as a result of the poor condition of our rising sewer main serving customers in Rhyl and Kinmel Bay in North Wales. Having caused a number of operational challenges over recent years, we decided to replace this sewer and the £4.5 million investment will now be completed in late 2014.

During the year, we also continued to work collectively with local stakeholders, through the Llyn Padarn Forum, to identify ways of improving water quality in the lake. In July 2013, Natural Resources Wales' (NRW) report investigating the 2009 algal bloom outbreak found that nutrient levels in the final effluent from Llanberis Wastewater Treatment Works had impacted on water quality. While these effluent levels did not breach the discharge limits set at the time by the NRW, we have invested over £2.5 million in our works to ensure we comply with the new limits. We have also been involved, during the year, in High Court proceedings brought by Fish Legal (representing anglers in the local area) against NRW, which challenged the decision-making process of the NRW in issuing a Notice to us to remediate the lake under the Environmental Damage (Protection and Remediation) (Wales) Regulations 2009.

We will continue to try to work proactively with all stakeholders to protect the ecology of the lake.

LOOKING AHEAD

We know that operating our estate of ageing wastewater treatment works – so that we continue to protect our rivers and coastal waters which are among the best in the UK – will remain one of our toughest challenges.

We will continue to work closely with Welsh Government, Natural Resources Wales and other relevant bodies to strengthen our collaborative approach to protecting and enhancing our natural environment. This will also include planning for the next cycle of the Water Framework Directive which will commence in 2015 and provide further guidance as how best to protect the water environment.

After the successful transfer of the private sewer network in 2011 which doubled the size of our sewer network, we are now managing the adoption of an estimated 800 private pumping stations by 2016. There remains a lot of uncertainty over the exact number and whereabouts of these assets but we started the transfer programme in 2013 with the adoption of around six stations per week.

Monitoring the volume and quality of water entering Alwen Reservoir befor starting work on the Denbigh Moors Flooding Alleviation Project.

STRATEGIC REVIEW

CASE STUDY

DENBIGH MOORS FLOODING ALLEVIATION PROJECT

Following the wettest winter in nearly 250 years and with experts predicting more exceptional weather patterns in the future, flooding incidents are likely to increase. We are now working with other external agencies to help address this proactively by taking measures to increase water absorption levels in upland areas so that we can prevent water run-off which contributes to flooding in lowland areas.

This is why we are working with the new Snowdonia and Hiraethog Peat Bog Restoration Project which aims to restore 450 hectares of wetlands on the Denbigh Moors. Partnering with Snowdonia National Park Authority, RSPB Cymru and others, the scheme is restoring natural bogs on the moors so that they will store more water and reduce the amount of run-off. In addition to helping provide a natural solution to flooding issues, the restored moors will also support more wildlife and release less carbon.

3 RESPONDING TO CLIMATE CHANGE

STRATEGIC REVIEW

OUR AMBITION:

We will adapt our activities to deal with the potential effects of climate change, whilst reducing our own carbon footprint

INTRODUCTION:

Climate change is one of the greatest challenges we all face today. Whilst we have started to take steps to ensure our network is able to cope with the extreme and highly variable weather conditions, we understand that we need to invest to develop innovative ways to maintain a more robust and sustainable network into the future.

HIGHLIGHTS:

In preparation for more frequent extreme weather events, we have made real progress in 2013 with the roll out of our new innovative surface water management approach called RainScape. This involves retrofitting sustainable urban drainage systems to capture, divert or slow down the rate at which rainwater enters our sewer network. This not only reduces the risk of flooding or pollution from overloaded sewers following heavy rainfall and helps us to limit the spills from consented sewage outfalls but it is more cost effective and sustainable and also improves local eco-systems by creating greener and cleaner places to live.

Our £12 million flagship RainScape project in Llanelli is now well underway and is already delivering real environmental benefits by removing more than 12,000m^3 of surface water from the local sewer network. We plan to invest over £40 million in 70 different schemes across Llanelli between 2015 and 2020 which is a much cheaper alternative than the £600 million required to build traditional storage solutions. Our industry-leading scheme won the Environmental Category in the Institute of Water Innovation Award 2013 and was more recently awarded the Sustainable Drainage and Flood Management Initiative of the Year at the Water Industry Achievement Awards 2014.

Working with customers is key in helping us repond to the challenges of climate change and this is why we invested a further £150,000 in 2013 in our Water Framework Directive Fund. This offers financial assistance to not-for-profit organisations for projects that will deliver improvements to the quality of our rivers, lakes and waterways and which will create a more vibrant and healthy environment for people and wildlife. Organisations that have benefited this year include the Healthy Rivers Project by Groundwork Caerphilly which aims to remove barriers to fish migration as well as promoting and facilitating volunteering opportunities on projects linked to rivers.

As one of the largest energy users in Wales with an annual energy bill of £44 million, a key challenge involves reducing our carbon footprint. We have continued to develop renewable energy projects to help power our sites more sustainably, and during 2013, we generated a record 43 GWh of renewable energy, saving 21,000 tonnes of carbon. One of the main schemes to be completed in 2013 was our largest ever solar scheme at Bolton Hill Water Treatment Works in Pembrokeshire. Our £2 million investment in our solar energy sites now helps us save over £230,000 every year. This complements our energy generation from anaerobic digestion and hydro sources, bringing the number of our sites generating green energy to 30.

CHALLENGES FACED

The exceptional wet weather in winter 2013 led to the wastewater business incurring around £25,000 a day more than average on electricity through January and February. However, due to our green energy generation and efficiency measures throughout the year, we only needed to buy 417 GWh of electricity over the year – 2% lower than the previous year. In addition, the amount of renewable energy produced from our anaerobic digestion plants was 40GWh, (2012: 35GWh). Electricity accounts for 85% of our carbon emissions and with the reduction in our usage, together with a reduction in the carbon content of Grid electricity, carbon emissions were 7% lower than the previous year at 241,637 tonnes.

£12m
RainScape investment in Llanelli

100
new RainScape schemes between 2015 and 2020

£2m
investment in our solar energy sites

While our water treatment works treat water to the highest standards to ensure customers receive a safe supply, we face issues at times with the quality of the raw water entering the works. While this does not affect the final quality of the drinking water, we need to understand why it occurs so that we can avoid such issues in future. On Anglesey, we are working as part of a wider group, which includes North Wales Wildlife Trust, to help restore 750 hectares of very rare peat-rich wetland. Restoring the wetland will help improve water quality upstream of our Llyn Cefni reservoir.

LOOKING AHEAD

We are proud to build on the success of our RainScape in Llanelli with the launch of a similar initiative in Cardiff in 2014. This latest scheme, called 'Greener Grangetown', will involve working directly with City of Cardiff Council and Natural Resources Wales and is part of our longer term plan to introduce around 100 RainScape schemes across our operating area by 2020.

Our recently published Water Resource Management Plan, outlining how we will maintain a sustainable balance between water supplies and demand over the next 25 years specifically reviews the impact of climate change on our water resources and this again will help us safeguard a reliable supply of drinking water to our customers.

In terms of energy generation, we will continue to invest in hydro and solar energy projects as well as erect our first wind turbine in 2014 at Nash Wastewater Treatment Works in Newport. The turbine, which will generate enough energy to power 50% of the site, will save over £500,000 per year and also 2,000 tonnes of carbon annually.

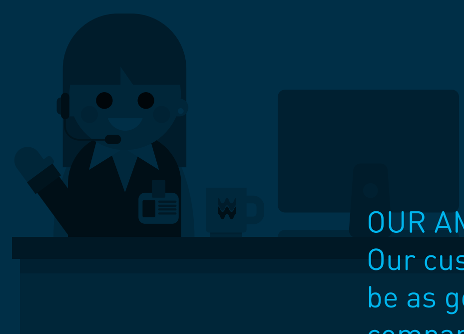
STRATEGIC REVIEW

(Left - Right) Joyce Watson AM, Nia Griffith MP, Alun Davies AM, Minister for Natural Resources and Food, Nigel Annett, Keith Davies AM, being accompanied by pupils from Stebonheath Primary School to mark the launch of our innovative Rainscape scheme in Llanelli.

CASE STUDY

IN THE SUMMER OF 2013, we invested £500,000 in a surface water removal scheme at Stebonheath Primary School in Llanelli. The scheme, which has halved the amount of surface water from the school which enters the sewer network, has also helped create a water garden classroom for the pupils, the first of its kind in the UK. Whilst it has attracted significant media attention, featuring on the BBC's News at Ten and on Radio 4's Today programme, it is also supported by our regulator Natural Resources Wales and is being praised as an exemplar by political stakeholders, including the Welsh Government's Minister for Natural Resources and Food, Alun Davies AM.

4 EXCELLENT CUSTOMER SERVICE



OUR AMBITION:
Our customer service will be as good as the best utility companies in the UK.

INTRODUCTION

As a company, our primary focus is our customers and we want to deliver the best possible service so that customers can trust us and rely on us to always do the right thing. We hope that customers rarely have reason to contact us but when they do need to get in touch, it's important that we aim to put things right, first time, every time.

HIGHLIGHTS

We have maintained our high standards of customer service in 2013 with independent research carried out each month showing that customer satisfaction has remained consistently over 90%. This has ranked Welsh Water joint second in the industry league table for this key measure. This success can be attributed to our bespoke customer services training including our Contact Centre call handler programme and our 'How2Wow' initiative which has benefited over 600 colleagues across the water and wastewater services.

Over the past 12 months, we have reduced the need for customers to contact us about issues such as discolouration or loss of water supply. This is largely due to providing more targeted information on our website as well as our proactive text messaging service which we now use to notify customers of any potential unplanned interruptions to their water supplies. Having been the first water company to do this, we sent over 850,000 text messages in the past year to customers who were at risk of being impacted by service issues.

We also improved our communication with customers in 2013 by refreshing our website and establishing an active presence on Twitter and Facebook for those customers who prefer to contact us using social media. These platforms, in addition to the 'livechat' facility we already offer, are proving successful with the number of Twitter followers increasing by over 300% in the past 12 months.

Customers who need to contact us are encouraged to share constructive feedback. We always try to act on this with customers also being able to nominate colleagues for providing good service through our new recognition scheme, the 'diolch' awards. This recognises those colleagues that 'go the extra mile' for customers and we are proud that over 500 nominations were received from customers across our operating area in the past 12 months.

CHALLENGES FACED

The number of written complaints received from customers in relation to their water, wastewater and billing services increased this year to 4,079 (2012: 3,652) and we are determined to improve on this measure. The issues experienced by customers were partly due to the warm summer weather which posed challenges in terms of water supplies in pockets of our operating area, including the Llŷn Peninsula and rural Herefordshire. These events also contributed to the number of customers who were without water for more than six hours.

In recent months, we have also been working with Citizens Advice Cymru to raise awareness of third party intermediaries who have been contacting our customers and offering — for a set fee — to recover money from Welsh Water on their behalf. This usually relates to confirming eligibility for surface water rebates – a service we already offer free of charge. We will therefore continue to promote our service with customers and stakeholders to ensure they are aware that they can contact us directly.

When operating a vast network, things inevitably can go wrong for customers. When this happens, our priority is to take any action necessary to put things right, and learn lessons to reduce the risk of the same thing happening again. The worst type of service failure is internal sewer flooding and this regrettably impacted on 19 customers in Treorchy, South Wales, in December 2013. As outlined in the case study opposite, we worked closely with those who were affected until their homes were fully restored.

300%
increase in Twitter followers

850,000
text messages to our customers

LOOKING AHEAD

In order to maintain excellent customer service, we know that we need to embrace changing customer trends and patterns. This is why we plan to further entrench social media platforms within our customer channels and have also made good progress with 'Newid', a major project to replace our 25 year old billing system and which will give Welsh Water a proven and state-of-the-art customer billing platform to enable further customer service improvements.

In terms of business customers, our plans include assistance for businesses to benchmark their water charges against similar organisations to identify opportunities to reduce consumption, along with expanding our telemetry services to enable customers to see exactly where they are using water on their sites. Combined with this, we will provide a leakage repair service and process audits to identify where businesses could be more water efficient. Our new billing system will mean that more of our businesses can receive an emailed single bill for all their premises.

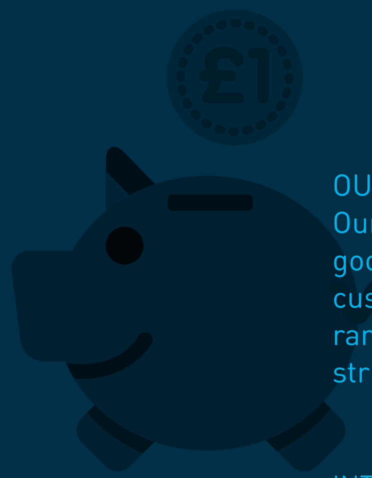
CASE STUDY

HANNAH WILSON is a member of Welsh Water's Customer Services Team and played a key role in helping residents in Treorchy affected by the flooding incident in late 2013.

"It's always terrible when something like this happens, but especially in the run up to Christmas. We worked closely with customers to ensure that we could help in any way that was needed. They appreciated that we were there on-site, addressing any queries and were willing to front-up.

"It was very difficult for customers and as they set about restoring their homes, it was important that they weren't left isolated and had clear lines of communication into the business. After all, we owed it to them to do the right thing."

5 AFFORDABLE BILLS



OUR AMBITION:

Our prices will represent good value for money for our customers, with an effective range of help for those struggling to pay.

INTRODUCTION

We aim to provide the best possible water and wastewater services to our customers and these services must remain affordable. Our customers have, in many cases, faced falling household incomes in recent years due to the unfavourable economic climate and this remains a particular challenge for our company. Wales has a relatively low level of average household income and a much higher than average concentration of areas of significant income deprivation. It is estimated that around 15% of our household customers spend more than 5% of their disposable income on their water and wastewater bills. Consequently, affordability is, and will continue to be, a key challenge for us.

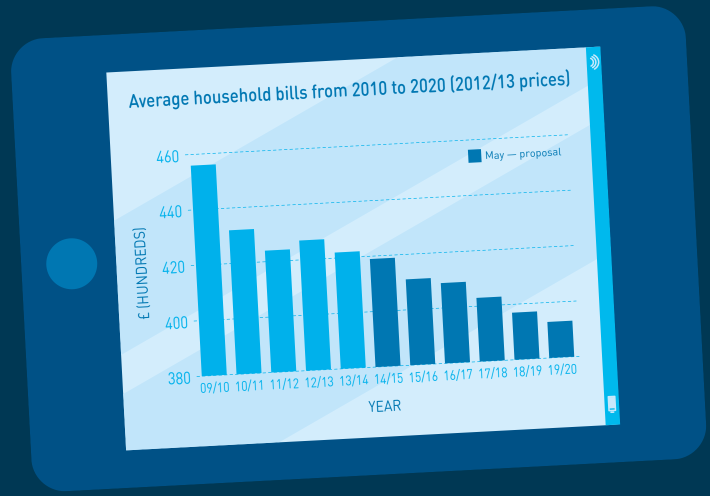
HIGHLIGHTS

Our annual price increase in 2013 to 2014 was the lowest across the industry for the third year running. It also marked the fourth year that we have kept price increases below the rate of inflation. This latest limited increase means that we are now on track to ensure that household customer bills are likely to fall by 6% on average before inflation between 2010 and 2015.

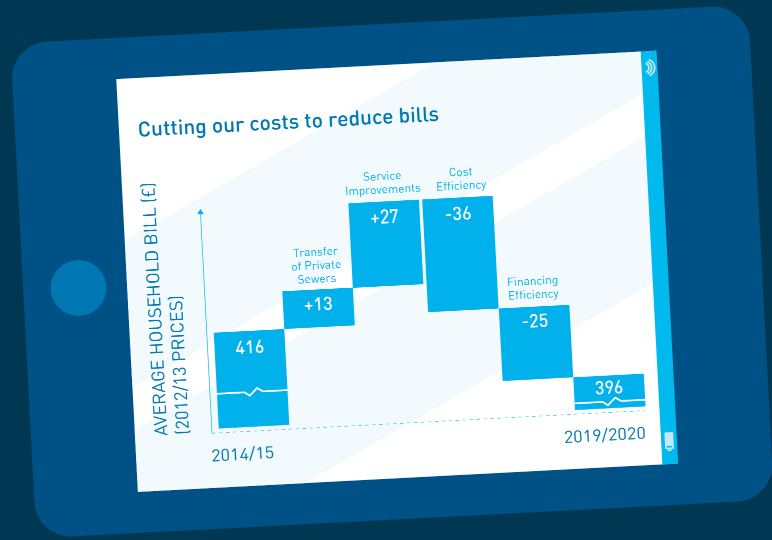
Our strong financial position has allowed us to do much more for our customers than would otherwise have been possible. This involves providing help to more customers than ever before with around 60,000 benefiting from help to pay their water bills through our tariffs for vulnerable customers.

CHALLENGES

Despite successive below-inflation bill increases, our bill remains above the industry average in England and Wales. This is partly explained by our mountainous and relatively rural operating environment which requires more assets per customer and, hence, more cost.



It is also largely due to the wastewater element of the bill as we have had to invest £1 billion in the 1990s to build new treatment works around the coast of Wales to meet increasing environmental standards – which has been financed through customer bills. However, we have successfully been reducing the gap between our average bill and the overall industry average. In 2000, our bill was 14% above the industry average but by 2015, our average household bill is projected to be only 5% above the industry average and we are determined to improve this further.



Like most other water companies, customer debt recovery remains a high priority, especially in a difficult economic environment where companies have no sanction to disconnect supplies to non-paying household customers. The bad debt charge for the year was £28 million (2013: £27 million) and represents around 4% of annual turnover.

With water customers in Wales paying around £20 extra on annual bills to cover the costs of those who choose not to, or who are not able to pay, this issue is particularly acute in the case of tenanted properties. We therefore support the Welsh Government's proposed regulations which will encourage landlords to pass on the details of their tenants to water companies.

LOOKING AHEAD

As we plan our future activity, we know that affordability remains a real concern for customers.

We will need to manage the trade-off between the financeability of the business and the affordability of bills very carefully so that we can continue to provide a high quality service at an affordable price — both for today's customers and for future generations.

This is why we plan to develop a new social tariff framework over the next 12 months that will enable us to nearly double the number of customers benefiting from help to pay their water and sewage bills. With around nearly 190,000 of our household customers spending more than 5% of their disposable income on their water and wastewater bill, we will need to continue targeting our affordability support quickly and effectively. This is why we are currently working with Community Housing Cymru, Moneyline Cymru and other stakeholders to develop a new social tariff that will substantially increase the number of customers – currently benefiting from our help to pay their water bills from 60,000 to over 100,000.

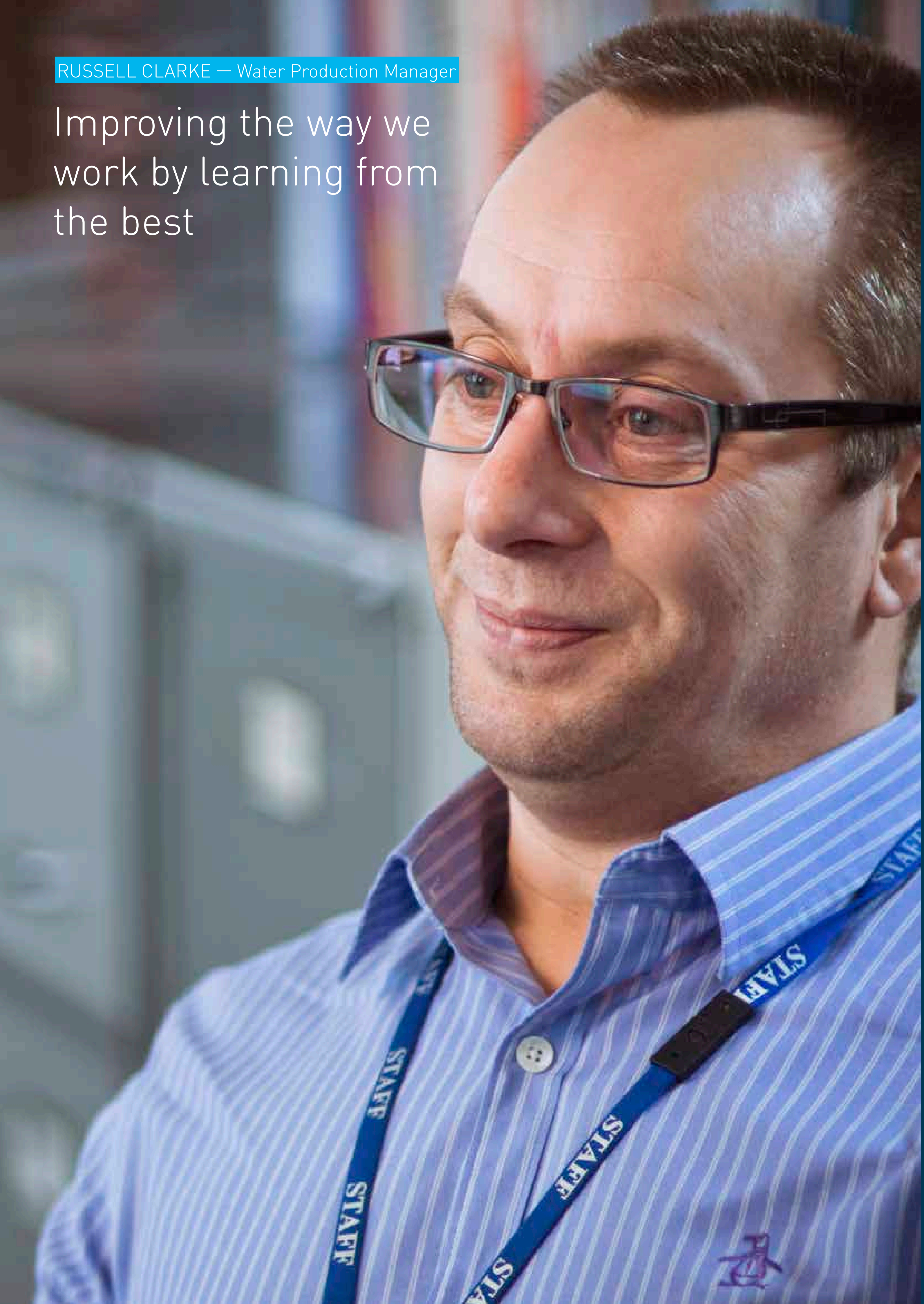
We have also been finalising our future investment for the next regulatory period (2015–2020) to ensure that any bill increases are kept below inflation every year until 2020. This will mean that our customers will have benefited from a decade of below-inflation bill increases by 2020 and that the average household bill by then will be 14% lower in real terms than in 2010.

CASE STUDY

WELSH WATER CUSTOMER, SWANSEA

"When people face financial difficulty, often they choose to ignore the mountain of debt. I did exactly that when illness prevented me from working. Falling further and further behind with my water charges, I continued to ignore the reminder letters. As they mounted up, it soon became clear that I needed some help.

"Firstly, Welsh Water placed me on their Welsh Water Assist which is available to people with certain medical conditions. They also registered me for their Customer Assistance Fund which is designed to help those in severe financial hardship. Since using the support available, I am making regular payments and also taking steps to address my other debts. It's been a big help and a relief."



RUSSELL CLARKE — Water Production Manager

Improving the way we work by learning from the best

6 LOOKING AFTER OUR ASSETS

OUR AMBITION:
We will maintain our assets for future generations, at the most efficient cost.

INTRODUCTION

Our main responsibility is to operate, maintain and upgrade our network of assets so that we can provide a safe and reliable supply of drinking water and deal effectively with wastewater. This is why we invested £354 million in our capital projects last year so that we can protect public health and the natural environment in our care.

With a network replacement value of £26 billion (or £20,000 per household customer), we operate 66 water treatment works supplying safe, clean drinking water through more than 27,000km of pipes whilst around 30,000km sewer network includes some 1,800 pumping stations and 3,500 consented sewer overflows. Our topography and geography, with many discrete areas of low population density, means that we have more assets per customer and limited opportunities to benefit from economies of scale.

Asset 'serviceability' is the key measure used by Ofwat to monitor how water companies invest in their assets to maintain service to customers at a 'stable' level. By doing that, we help maintain our service to customers now and into the future.

HIGHLIGHTS

In 2013 to 2014, our performance across above-ground and below-ground assets for water and wastewater was very strong. We are now consolidating the improvements we have made to continue to deliver excellent services both in terms of water quality (£120 million 'Go to Green' investment programme to rebuild, refurbish or upgrade 12 water treatment works) and environmental compliance (£29 million investment to replace or upgrade 40 wastewater assets). As a result, we have managed to meet most of our 'serviceability' targets.

We rely on a number of key partners to help us maintain our assets and our services and we responded swiftly to maintain service levels in May 2013 after one of our primary network engineering partners, Daniel Contracting Limited, went into administration. We managed to work with the parties involved to successfully facilitate the TUPE transfer of employees to another emergency contractor and thereby ensured a seamless continuity of service, avoiding any impact on our services to customers.

We are also continuing to improve our operational efficiency through the introduction of Lean operating principles. This is aimed at maximising the efficient use of our assets through significantly reducing our operating costs by retaining only those practices that add value and are core to good operations and asset management. In the past year, this has been embedded in some of our water treatment works and waste sludge centres, and we are now finalising plans for it to be rolled out further across our network.

We have also continued to build our IT capability over the last 12 months by investing over £26 million to support frontline operations, capital delivery and customer service. We have started to in-source IT support services that were previously contracted out and this should enable projected annual cost savings of over £700,000 from April 2015 onwards.

£26m

invested in IT to support frontline operations, capital delivery and customers services

CHALLENGES FACED

The most significant challenge to our assets over the past 12 months involved the extreme winter weather conditions in our area. This required emergency planning activity, and after mobilising our Silver Command Centres for much of November and December 2013 in order to coordinate our response to the adverse conditions, our Gold Command Centre for water and wastewater services was assembled simultaneously for the first time in February this year. This proved absolutely crucial in allowing us to address challenges such as flooding, high tides, gales and power failures and implement contingency measures to help avoid any widespread disruption to our services.

With such an extensive network, we are continuing to nurse a number of assets that need investment. This has led to service issues which are impacting on our customers including discoloured water (Herefordshire), low water pressure (Carmel, Anglesey), intermittent supplies (the Llŷn Peninsula) and odour from the operation of our wastewater treatment works (Chester and Swansea) and pumping stations (Pant-y-Wacco, near Holywell).

During the year, we also faced several prosecutions brought by Natural Resources Wales in North Wales for breaching discharge consents. We have instigated various process improvements following these cases, and will continue to work with our regulator to ensure that we minimise our impact on the environment.

LOOKING AHEAD

Even though our assets are designed to withstand extreme weather conditions and other known risks, we constantly face other threats (e.g. flooding, coastal erosion and power failures) as well as crime and terrorism. There is evidence that the frequency and severity of some of these hazards may be increasing due to the effects of factors that are beyond our control (for example, climate change) and they can adversely affect the services we provide to our customers and the impact we have on the environment. Improving the resilience of our assets to the risks associated with such extreme events will be a key part of our future investment programme.

£1.5bn

capital investment between 2015 and 2020

To prepare for the next investment cycle between 2015 and 2020, we are now planning to work differently and creating a new Alliance that will bring together the skills of colleagues and partners. This will enable us to drive value in the planning and pre-construction phase by co-locating Welsh Water, contractor and consultant resource in a single Integrated Solutions Team to help facilitate collaboration and innovation.

As part of our future work, we are also committed to realising our ambition of developing a SMART network across the water and wastewater networks to help predict problems before they impact on our customers. Having identified areas of poor performance and emerging risks, we are already piloting trials (including on the wastewater network in Gowerton, Chester, and Llai near Wrexham) which are testing the use of sophisticated monitors that will help inform the future operation of the network and the establishment of a dedicated Smart Network Hub.

CASE STUDY

RUSSELL CLARKE is Water Production Manager at Broomy Hill Water Treatment Works, Hereford.

"Having introduced Lean into Welsh Water's maintenance activity, we were one of the first sites to introduce Lean practices into our day to day operations. This has involved taking apart our day-to-day processes and evaluating what we need and what adds value to what we do. Whilst creating a safer and better working environment for the teams, it has also brought a real consistency and improved reliability in terms of our day to day work. It is delivering benefits including a reduction in the number of breakdowns, call-outs and overall costs. It's great that we've all been involved in this process which ultimately helps us deliver a better service for customers."

7 DEVELOPING OUR PEOPLE

OUR AMBITION:

We will develop a team of people who will provide a great service to our customers.

INTRODUCTION

As the fourth largest company in Wales, we have nearly 3,000 colleagues who all play a key part in delivering a vital public service. They are highly skilled, trained and motivated at all times to deliver the high standards our customers expect.

With female colleagues now representing 28% (825) of our workforce, we value and continue to promote diversity within the workforce and have procedures and policies in place to ensure that we are an equal opportunities employer. All job applications are fully and fairly considered, having regard only to the applicant's aptitudes and abilities relevant to the role. In the event of disability, every effort is made to ensure that employment continues and appropriate adjustments are made and training given. Career development and promotion of disabled people is identical to that of other colleagues.

As demonstrated during the exceptional weather patterns experienced over the past 12 months, colleagues often 'go the extra mile' and it is our responsibility as a company to ensure that they return home safely at the end of each working day. We have a duty to ensure that they are trained appropriately for their roles as well as encouraging the correct behaviours as their health, safety and wellbeing are paramount.

HIGHLIGHTS

In terms of health and safety, we have continued to make good progress towards our 'Journey to Zero' — our ultimate goal of 'no lost time injuries' to our colleagues and contractors when no time is lost from work. One indicator by which we measure performance is the number of injury reported per year to the Health and Safety Executive under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013 (RIDDOR). We have seen an overall reduction in RIDDOR incidents with 23 incidents in 2013 compared to an average of 26 incidents over the past three years. We have not and will not compromise on safety, and as part of our 'Safety Takes Every Person' (STEP) campaign, we commenced a major safety culture training programme for over 200 managers in 2013. The impact of this has been seen with the number of 'Positive Interventions' reported increasing by 50% to nearly 16,300 over the last 12 months (2012: 10,500). By increasing the number of reported 'Positive Interventions' and taking action to remove hazards and risks, research shows that this should lead to a reduction in the number of reportable injuries.

To maintain our high levels of customer service, we have continued to embed the 'customer first' culture through our 'How2Wow' bespok e customer service training programme. This has been accredited by the Institute of Customer Service and having already been delivered to 600 operational colleagues, it will now be rolled out across other functions.

We also know that recognising and celebrating colleague achievement and contribution is key and we were proud to launch the new 'diolch' awards in January 2014. This new recognition scheme rewards teams and individuals from across the company — along with our strategic partners and contractor companies — who clearly demonstrate our vision whilst placing our core values at the heart of everything we do.

Listening to our colleagues helps us improve our performance. This is why we conduct an annual Employee Engagement Survey. Whilst we are proud to achieve a record 79% engagement score in 2013 – a 10% increase since our first survey in 2011 — it is equally pleasing that the results also show that we have a strong customer ethos. 83% of colleagues believe that Welsh Water puts its customers first.

We also know that we must have an honest, two-way engagement with colleagues across our business and over the past 12 months, we have sought to ensure that every colleague is informed of key decisions affecting the business. Over 1,000 colleagues attended workshops last summer to help develop our new company vision; eight workshops were also held with colleagues to gauge their opinion on our draft Business Plan for 2015 to 2020; two rounds of employee roadshows were arranged in March and September, at over 19 locations, and attended by more than 2,000 colleagues; and two Leadership Conferences were also held for senior managers.

83%

of colleagues believe Welsh Water puts its customers first

79%

engagement score in 2013

These events are supplemented by a six-weekly internal newspaper (dŵr) and a weekly e-mail bulletin (dŵr weekly).

CHALLENGES FACED

Despite challenging economic conditions, we have remained committed to investing and developing our colleagues. We are particularly proud of our Essential Skills in the Workplace Programme, developed in partnership with the Welsh Governments and trade unions. Over 350 colleagues are currently working towards achieving around 700 qualifications in numeracy, literacy and IT skills. We remain the only large company in Wales to be recognised by the Employer Pledge Award as a result of this programme and its success.

Meanwhile, we have also continued to invest in our senior leadership community with over 220 benefiting from our internally designed management development programme which has been accredited by the Institute of Leadership and Management. This builds on the support we provide to the professional development of our scientists and engineers who are working towards Chartership status.

Our frontline colleagues are also benefiting from our City and Guilds accredited Competent Operator programme which ensures that we can provide a consistent and competent service for our customers.

Colleagues being recognised for completing the Essential Skills Programme by Welsh Water's HR Director, Linda Williams.

LOOKING AHEAD

With nearly one in 10 of our colleagues having more than 35 years service and nearly one in five due to be 65 or over in the next 10 years, achieving our business goals depends on us having a strong pipeline of talented people ready and able to step into roles as their colleagues retire. This is why we are proud to have developed bespoke programmes such as our Trainee Distribution Inspector Programme which is aimed specifically at addressing the potential shortages in this particular area. We also welcomed six graduates, five trainee inspectors and eight apprentices into the company in 2013.

Maintaining health and safety of colleagues will also be a key focus as we move forward. With the majority of accidents caused by slipping or lifting, we will continue to focus on incidents with a behavioural root cause. We have already started to focus on improving 'human factor' safety by providing targeted and bespoke training such as 'Manual Handling' and 'Safety Culture', and after being completed by over 1,500 operators, it is now being rolled out across the company.

CASE STUDY

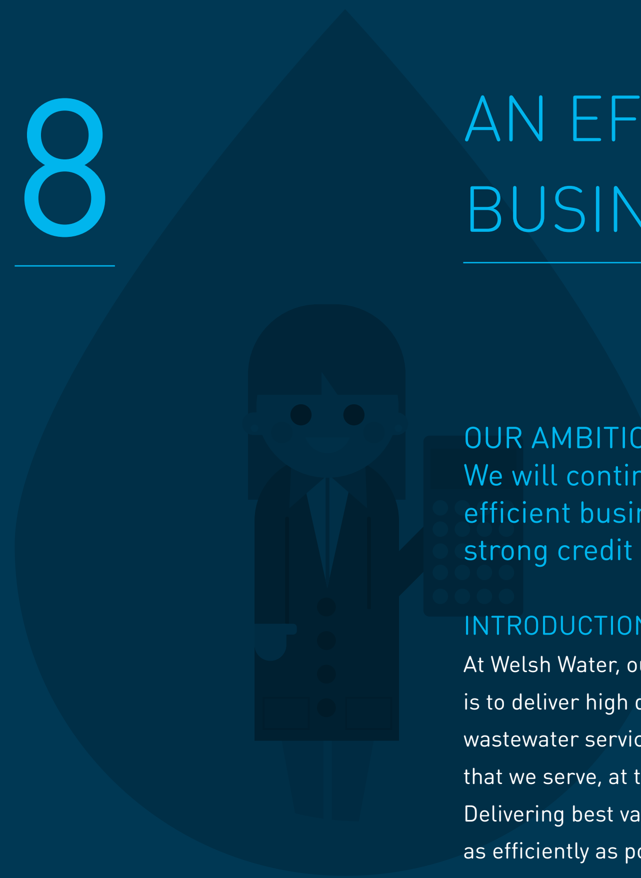
MIKE WILSON is the Essential Skills Programme Lead at Welsh Water and was awarded the Wales T.U.C. Learning Representative of the Year in 2013.

"I passionately believe in adult education and helping my colleagues at Welsh Water to learn new skills as this in turn helps them to grow in confidence. We have had many examples where learners have been able to help their children and in some cases their grandchildren with their homework for the first time after attending the essential skills sessions. This makes me so proud to be part of Welsh Water's efforts to help colleagues fulfill their potential not only in the workplace but in life more generally."

GERAINT WILLIAMS — Sewer Operator

UNLOCKING IDEAS, UNBLOCKING SEWERS

8 AN EFFICIENT BUSINESS



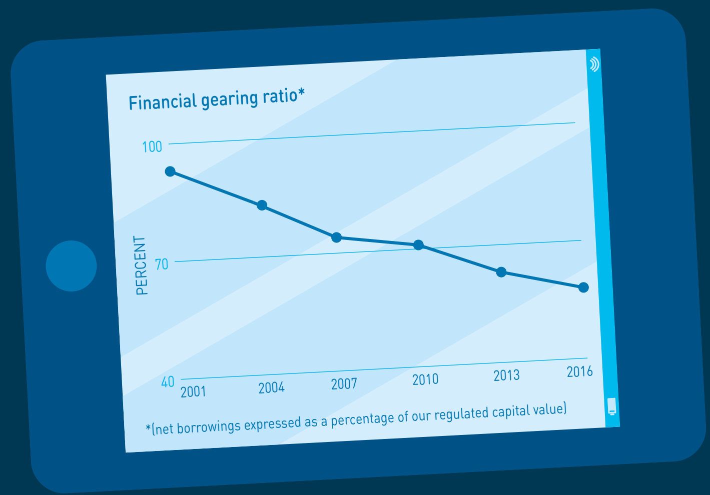
OUR AMBITION:

We will continue to be an efficient business with a strong credit quality.

INTRODUCTION

At Welsh Water, our main objective is to deliver high quality water and wastewater services to the communities that we serve, at the least possible cost. Delivering best value means spending as efficiently as possible, managing cost pressures, and recovering costs in the way that best balances the interests of today's customers and future generations.

Glas Cymru has no shareholders – it is funded solely from debt – and so no dividends are paid and all 'equity returns' generated by Welsh Water are used by Glas Cymru for the benefit of customers.



HIGHLIGHTS

Welsh Water continues to have the highest credit rating of any regulated utility company in the UK. This allows us to raise funds for investment from long term bond investors at low cost which brings substantial benefits for Welsh Water customers. The financial savings resulting from our ownership model have generated financial reserves – or customer equity — of £1.6 billion and our financial gearing has now fallen to 63% compared with 93% when Welsh Water was acquired by Glas Cymru in 2001.

Operating costs in 2013 to 2014 have reduced to £296m (2013: £298m) but cost increases include higher energy costs (£4m), a higher bad debt charge (£1m) and the additional expenditure necessary to maintain operations during the failure of the Daniel Contracting Limited business (£4m). These have been more than offset by cost reductions including an accounting credit relating to the defined benefit pension scheme (£5m) and additional savings from insourcing and other efficiency initiatives. These include generating more of our energy from renewable sources and realising £1 million in cost savings per year after successfully completing the in-sourcing of laboratory services from the previous contract provider. These measures have played an important part in us ensuring that we remain the only water and wastewater company that has reduced its operating costs in real terms since 2001.

CHALLENGES

Our long term challenges include access to funding for our investment programme as well as the tight management of costs. If we are to sustain high levels of investment and deliver new higher standards in the future, it is important that we have continued access to keenly priced funding from the private capital markets. To help reduce costs further, we are participating in a European Benchmarking Cooperation exercise involving the exchange and evaluation of key data involving some 40 utility companies from over 18 countries.

This will continue to be a useful way of comparing both cost and other data so that we can look to continuously improve and compare performance against some of the best water companies in the world.

CASE STUDY

GERAINT WILLIAMS, a sewer operator in Rhondda Cynon Taff, describes how he's developed an innovative way to help tackle blockages in our network. His work will help customers as well as the company by saving an estimated £1 million in costs by December 2015.

"My colleagues and I were spending more and more time trying to reach and remove items that were blocking the sewers. When we couldn't do this, we'd have to call specialist engineers to come along and use an expensive high pressure jetting system to clean the sewers or even sometimes cut into the pipes and disrupt our services.

"I went home, and after some late nights in the garage, I developed eight different tools which are now helping us to remove the most common items we find that cause these blockages. It's making our lives much easier and also saving the company – and more importantly customers – a lot of money."

Geraint's inventions will now be trialled amongst other teams before being rolled out across the company.

LOOKING AHEAD

Like other companies, we will face increasing costs in the future which are likely to impact on customer bills. This includes external costs such as increases in the price of power and energy as well as internal costs such those associated with the private sewer transfer and the adoption and rehabilitation of private pumping stations. Nonetheless, we are determined to continue delivering best value for money for our customers by offsetting these costs through efficiency initiatives.

We are well underway with this after establishing an internal steering group tasked with identifying £30 million of operational cost savings over the five years to 2020, which forms part of our published draft Business Plan for this period.

Chris Jones, Chief Executive
12 June 2014

CORPORATE GOVERNANCE REPORT

INTRODUCTION FROM THE CHAIRMAN

Strong and effective corporate governance and Board leadership remain key to our ability to deliver essential public services to over three million people every day. The Board and management team are entirely focused on delivering the best outcomes for our customers: supplying drinking water of the highest quality and safeguarding the environment on behalf of the communities we serve, and continuing to do so affordably.

We take decisions in the long term interests of the customers of Welsh Water, and this objective underpins our whole approach to corporate governance. We do not see governance as a compliance activity but rather as a guide to ensure that we act in the right way. We believe that good corporate governance is in the best interests of our customers and will help to ensure the success and sustainability of Welsh Water. We comply with the UK Corporate Governance Code 2012 (the 'Code') to the extent relevant to us as a company limited by guarantee, and we fully comply with Ofwat's published corporate governance principles for regulated companies (available at: http://ofwat.gov.uk/regulating/gud_pro20140131leadershipregco.pdf).

In April 2014, we published a Governance Code to explain how we comply with these governance principles. http://www.dwrcymru.co.uk/en/Company-Information/Governance.aspx

Ensuring that we conduct business in the appropriate way requires the right leadership by the Board; it should add value and do so by establishing strategy, creating accountability, monitoring and driving performance and setting the moral tone of the company. Accordingly, our Board composition includes Directors with diverse skills and experience to ensure a balanced approach, and where appropriate to challenge decision making. During 2013-14, we have seen significant change. We are grateful to Nigel Annett for his continued contribution as Managing Director until 1 September 2013. Chris Jones was appointed as our Chief Executive with effect from 1 September 2013 and Graham Edwards joined as an independent Non-Executive Director from October. I was also grateful to John Bryant for assuming the Chairmanship of the company during my six month leave of absence as Chairman, and I returned as Chairman as planned in November 2013.

Maintaining good and open relationships with Members and investors continues to be very important. We continue to enjoy a very high attendance by Members at our six monthly Members' meetings, which gives them regular opportunities to meet the Board; at these meetings we provide presentations on company performance, developments and prospects. All Directors, including the Chairmen of the key Board committees, are available to answer questions. After each meeting, all Members receive a written brief of issues discussed and the replies to questions asked. Between meetings, we keep Members up to date on key issues and developments through a combination of news bulletins and updates.

This year we had an additional Members' meetings focused on the Price Review and held our first regional Members' meeting. We undertook extensive stakeholder engagement activities in order to ensure that these views informed our business plan for the Price Review submission.

Investors receive a quarterly report and each summer we host an annual investor meeting in London. Following the announcement of interim and preliminary results for any period there are informal meetings with major bondholders and other investors, who may also request a meeting with a Board member at any time. The Board receives a report following meetings with investors and, where appropriate, takes into account the views expressed by investors on issues affecting the company.

Regular communication is also maintained with the Welsh Government and with each of the economic, water quality and environmental, and customer service regulators of Welsh Water.

In 2014, we undertook an externally facilitated review of the Board and the findings are on page 60.

This report is presented in what the Directors consider to be a fair, balanced and understandable manner.

Robert Ayling, Chairman
12 June 2014

OUR GOVERNANCE STRUCTURE

Welsh Water is different from other water companies. We don't have shareholders and we are owned and managed on behalf of all the customers we serve.

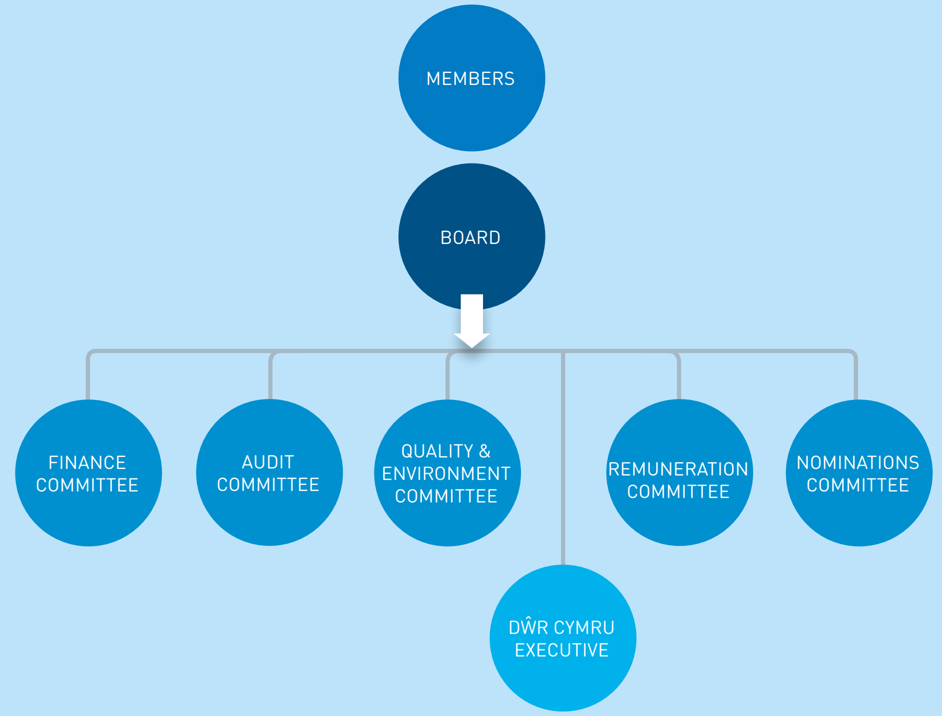
Our Company Structure

Our accounts (from page 87) provide details of the following companies in our Group structure:

— Glas Cymru Cyfyngedig was formed as a company limited by guarantee with the single purpose to acquire and manage Dŵr Cymru Cyfyngedig.
— Glas Cymru (Securities) Cyfyngedig is the holding company for Dŵr Cymru (Holdings) Limited and its subsidiaries.
— Dŵr Cymru (Holdings) Limited is the intermediate holding company of Dŵr Cymru Cyfyngedig and Dŵr Cymru (Financing) Limited.
— Dŵr Cymru Cyfyngedig is a wholly owned subsidiary of Glas Cymru and is the Group's principal trading company.

Its principal activity is the supply of water and treatment and disposal of wastewater under the Instrument of Appointment made by the Secretary of State for Wales under the Water Act 1989.
— Dŵr Cymru (Financing) Limited was formed in 2001 and is the 'issuer' company for the Group's bonds, which are listed on the Luxembourg Bourse. Dŵr Cymru (Financing) Limited, is incorporated in the Cayman Islands, but is managed, controlled and resident in the UK for tax purposes. The company on lends the proceeds of any bond issues to Dŵr Cymru Cyfyngedig.
— Dŵr Cymru Customer Services Limited provides income collection and billing services to Dŵr Cymru Cyfyngedig.

Our Membership, Board and Committees — How we are different



CORPORATE GOVERNANCE

Role of Members

As a Company Limited by Guarantee, we do not have shareholders but our Members fulfil the valuable role that shareholders would play in corporate governance. Members do not make strategic decisions but hold the Board to account for the stewardship of our assets, and our goal of providing an essential public service to more than 3 million people 24/7 in a manner which will be sustainable for future generations.

The key role of our unpaid Members is to ensure that we remain focused on our primary purpose, which is to provide efficient high quality and affordable water and sewerage services to Welsh Water's customers.

Our Members are individuals, appointed by the Board but selected by an independent Member Selection Panel, which is required to maintain a balanced and diverse membership, as far as possible broadly reflective of the range of our customer and other stakeholders' interests. However, membership is personal, and therefore Members do not represent any groups or stakeholders. They do not receive fees, nor do they have a financial stake in the business. We believe this independence enables robust governance.

There are presently 57 independent Members of Glas Cymru (not including the Directors). Under the Company's Articles of Association each Director is also a Member while they hold office as a Director.

Norma Barry

"I became a Member of Glas Cymru because I believe passionately in the company model that uses any profits for the benefit of its customers. The role has provided me with a valuable insight into the challenges of running major, regulated businesses.

"More importantly, it has given me the opportunity to input into company decision making to help ensure that the interests of Welsh consumers are protected. Board members and key staff are always willing to listen and welcome constructive challenge."

Members are asked to attend two formal Members' meetings each year. In 2013-14, we held three additional meetings to keep Members informed about the development of work towards submitting the company's Business Plan in December 2013, and in particular to seek Members' views on the proposals for the Business Plan for 2015 to 2020.

A list of the independent Members of Glas Cymru, together with our Membership Policy and the Terms of Reference of the Membership Selection Panel, is published on our website www.glascymru.com.

Role of the Board

The Group is led and controlled by a Board of Directors, which is collectively responsible for its long-term success. The Board sets the Group's strategic aims, monitors the performance of management against the strategic aims, ensures good governance, sets the risk appetite and ensures that effective controls are in place in the business.

There is a schedule of matters reserved for the Board under which the Board retains ultimate responsibility in areas such as strategy, risk and many other decisions. The schedule of matters reserved was last reviewed in March 2014 and is available on our website.

Board governance and leadership is essential to maintaining the confidence of our customers and we are as transparent as possible about our performance in order to support this.

Role of the Chairman

The role of the Chairman is to lead a unified board, facilitating meetings, and to be responsible for good governance.

Meeting Agendas are agreed in consultation with the Chief Executive and Company Secretary, although any director may request that an item be added to the agenda. At least once a year, the Chairman meets with the Non-Executive Directors without the Executive Directors present, to consider the performance of the Executive Directors and to provide feedback. Generally, the Chairman also meets individually with each Board Member to review individual performance during the year, although this did not happen in 2013-14 due to Robert Ayling's six month leave of absence. Meetings between the Chairman and individual Directors are planned to be held in calendar year 2014.

Role of the Senior Independent Director

The Senior Independent Director acts as the bridge between the Chairman and Non-Executives and liaises with our Members. John Bryant is the current Senior Independent Director, who is due to step down from the Board in July 2014. It will be recommended to our Members at our AGM on 4 July 2014 that Menna Richards be appointed as Senior Independent Director.

Role of the Non-Executives

Non-Executive Directors are appointed to the Board to contribute their expertise and provide independent challenge and rigour in the Board's deliberations. The Non-Executive Directors meet at least once per year without the Chairman present, to discuss his performance.

Role of the Chief Executive

The board has delegated responsibility beyond matters reserved for the Board to the Chief Executive in order to achieve the company's strategy and manage the day to day affairs of the company. The Chief Executive is supported by the Executive Team of Welsh Water in implementing strategy.

Role of the Company Secretary

The Company Secretary is responsible for supporting the Chairman in ensuring that the company demonstrates good governance. The Company Secretary is available to the Non-Executive Directors and ensures that there are good information flows to the board and its committees and between senior management and the Non-Executive Directors.

Appointments

The company's Articles of Association empower the Board to appoint new Directors. For a Board to add value and be effective it needs to be comprised of individuals with the right balance of skills and experience and diverse backgrounds. Directors must display independent judgement and an ability to challenge constructively. The search for Board candidates is conducted by the Nominations Committee on the basis of merit, against objective criteria set for the role, and with due regard to maintaining an appropriate balance of skills and experience and to the importance of ensuring diversity of representation on the Board. The Non-Executive Directors' letters of appointment are made available for public inspection upon request to the Company Secretary.

Victoria Provis

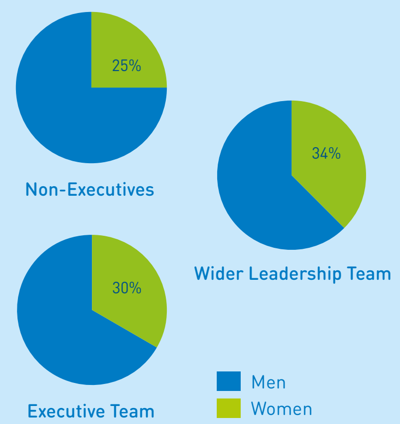
"I was interested to learn more about a complex industry of vital importance to all of us. The opportunity to participate in discussions on a broad range of issues has been interesting and challenging – in my experience it is rare to have the chance to listen to the contrasting views of so many different stakeholders and to know that the executive team are listening.

"Our recent discussions over PR14 have convinced me yet again that Members' views are valued and incorporated into submissions to the regulator. As a professional executive search consultant, I have been particularly interested to watch how the company has managed both succession planning at the senior level, and the challenging shift away from outsourcing towards direct employment of the company's skilled and dedicated workforce."

Welsh Water is committed to promoting diversity, non-discrimination, and equality of opportunity in the way we treat employees, prospective employees, visitors, clients, customers and suppliers. The Board has documented its approach to recruitment in a diversity policy which it is committed to following.

Gender diversity

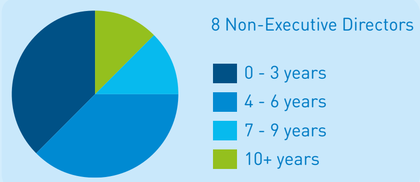
With regard to having an appropriate level of representation from women, we are making good progress toward meeting the objectives of the Davies Report. Currently, 25% of our Non-Executive Directors are women, 30% of the Executive team are women and 34% of Welsh Water's wider Leadership Team are women.



The gender diversity statistics for the whole company are available on page 49.

Length of service

The respective periods of service of our Non-Executive Directors are shown below.



Induction and development

Directors receive a personalised induction process, including an information pack, site visits and one to one meetings with senior managers. The Board and committees undertake training and briefing sessions as appropriate. In 2013-14 our Board (with the exception of Graham Edwards and Anna Walker who both hold responsibility for health and safety issues in related roles elsewhere) received health and safety training (IOSH Safety for Senior Executives). This year we have increased the number of site visits and meetings around the business for both DCE & Board. The Board has visited sites including the Rainscape project sites in Llanelli and Llyswen Water Treatment Works and has met at locations in North and South Wales.

Balance and independence

The Board believes that it and its Committees have an appropriate composition to undertake its responsibilities effectively. The Board keeps its membership and that of its Committees under review to ensure that an acceptable balance is maintained. The Board is satisfied that all Directors have adequate time to commit to their role and that there are no cross-Directorships or significant business interests in common between members of the Board.

All of our Non-Executive Directors have been determined to be independent in accordance with the code and free from any business or other relationship which could compromise their independent judgement. As an integral part of the Board's succession plan, we have made a conscious decision to balance the appointment of new Directors with maintaining sufficient stability for the Board as a whole. Graham Edwards joined the Board in 2013 and brings a vast range of operational experience to the Board and QEC, in particular as regards experience in the utilities sector. John Bryant will stand down from the Board at 2014 AGM after 13 years on the Board. John has shown extraordinary commitment and has been an asset to the Board throughout several periods of intense change. He has an in-depth knowledge of the company and has retained the independence of character and judgement required in a well performing Non-Executive Director. Robert Ayling was an Independent Non-Executive Director until his appointment as Chairman in 2010.

In order to ensure that we have an effective Board, we undertake a review once a year to provide opportunity for continuous improvement. In March 2014 we undertook an externally facilitated review undertaken by Independent Audit. The Group has no other connection with Independent Audit. The outcome of the evaluation was reviewed by the Chairman and presented to the Board by Jonathan Hayward at its May 2014 meeting. The results were generally very positive with some ideas identified for further enhancement to Board papers and risk reporting. An action plan has been put in place to address these issues. In response to last year's Board effectiveness survey, some improvements have already been made to the format and content of the papers sent to the Board, and a review of our risk management processes has been undertaken and enhancements implemented.

In order to effectively review Board performance and allow open dialogue, the Non-Executive Directors also meet without the Executive once a year and without the Chairman once a year.

Re-election of Directors

In accordance with the code, all Directors seek re-election every year by Members and any Director appointed during the year seeks election at the next AGM.

Board Meetings

In 2013-14, the Board had 9 scheduled meetings and 2 additional meetings which were called to deal with issues arising in the course of the PR14 price review process. Our scheduled meetings are held over two days to give the Board the time it needs to review progress against strategic objectives and to meet key business managers. In the past year, the strategic issues focused on by the Board have included: the price review process, innovation, risk, the company's Vision and Values and culture change.

Attendance

When a Director is unable to participate in a meeting the Chairman will seek their views on key items ahead of the meeting so that these can be added to the discussion.

Conflicts of Interest

Under UK company law conflict situations must be authorised in advance to avoid a director being in breach of the statutory duty.

All Directors must immediately disclose conflicts, or potential conflicts, of interest. In addition all Directors sign an annual declaration and disclose their external appointments.

External Appointments

Non-Executive Directors may serve on a number of other boards provided they continue to demonstrate the requisite commitment to discharge effectively their duties. The Chairman will consider this as part of his review of the effectiveness of each Director. Executive Directors have also been encouraged to gain the experience of sitting on another Board and, subject to annual approval of their appointment by the Remuneration Committee, are permitted to retain any fees earned from any such appointment.

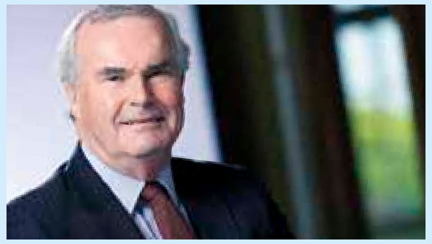
	RA	CJ	PP	JB	SP	JS	MR	AW	JW	GE	NA
Board (11)	5	11	11	11	11	11	11	11	9	5	4
Audit (4)	2	4	—	2		—	4	—	4		1
QEC (10)	3	5	10	10	10	—	—	—		3	5
RemCo (6)	3	5	—	6		6		6	5	—	2

Robert Ayling (RA); Chris Jones (CJ); Peter Perry (PP); John Bryant (JB); Stephen Palmer (SP); James Strachan (JS); Menna Richards (MR); Anna Walker (AW); John Warren (JW); Graham Edwards (GE); Nigel Annett (NA).

*Notes on attendance
— Robert Ayling took a six month leave of absence
— John Bryant began attending Audit Committee whilst Robert Ayling was on his six month leave of absence
— Nigel Annett and Graham Edwards were only on the Board for part of the year
— Chris Jones was not a member of QEC until his appointment as Chief Executive in September 2013.

THE DIRECTORS

Robert Ayling, Chairman
Appointed a Non-Executive Director in April 2008, Robert became Chairman of Glas Cymru in July 2010. He is also Independent Chairman of HM Courts & Tribunals Service. A solicitor by profession, with 20 years in the City of London and as a senior government legal adviser at the Department of Trade and Industry, he held a number of senior management positions at British Airways plc of which he was Group Managing Director and Chief Executive from 1993 to 2000. He is also a former Chairman of Dyson Ltd, The International Dispute Resolution Centre Ltd, Sanctuary Group Plc and Holidaybreak plc and a non Executive Director of Royal & Sun Alliance Insurance Group plc and QANTAS.



John Bryant, Senior Independent Director
Appointed a Non-Executive Director in March 2001, John is a former Chief Executive of British Steel and, until December 2000, was Joint Chief Executive of Corus Plc. He was a Non-Executive Director of Costain Group Plc until January 2013, and was a Non-Executive Director of Bank of Wales Plc between 1996 and 2001.

Chris Jones, Chief Executive
Chris became Chief Executive in September 2013 having previously been Finance Director of Welsh Water since May 2001 and Glas Cymru since April 2000. He has also previously served as Director of Regulation of Welsh Water and South Wales Electricity Plc. Before joining Welsh Water in 1995, he was a Director at National Economic Research Associates and, prior to that, worked for HM Treasury. He is Deputy Chairman of the Council of the Prince's Trust – Cymru. He has previously been a Non-Executive Director of the Principality Building Society, and a Trustee of the Institute of Welsh Affairs.

Peter Perry, Chief Operating Officer
Appointed Operations Director in July 2006, Peter has a civil engineering background and was formerly the Chief Operating Officer for United Utilities Operational Services (UUOS), having previously been the Operations Director for UUOS with responsibility for the operational contract with Welsh Water and UUOS's water interests in Scotland and Ireland. Prior to joining UUOS he worked for Welsh Water for over 20 years. He is also a Director (representing Wales) at The Water Regulations Advisory Service, the national body specifying standards for materials and workmanship used in potable water supply.

CORPORATE GOVERNANCE

Graham Edwards,
Non–Executive Director
Appointed a Non-Executive Director in October 2013, Graham is currently Chief Executive Officer of Wales & West Utilities (WWU). He has significant senior management experience in the utility sector running electricity distribution and water businesses with South Wales Electricity, Hyder and Thames Water. He has held senior positions in various functions across a wide range of businesses including Engineering, Production, Human Resources and Operations. He is a Fellow of the Chartered Institute of Personnel & Development and immediate past Chair of CBI Wales.

Professor Stephen Palmer,
Non–Executive Director
Appointed a Non-Executive Director in October 2009, Professor Palmer (62) is Mansel Talbot Professor of Epidemiology and Public Health at Cardiff University. From 2003 until July 2010, he was Director of the Health Protection Agency's chemical hazards division, and local and regional services division, and head of profession for epidemiology in the HPA. A fellow of the Faculty of Public Health and the Royal College of Physicians, he has been an influential figure in public health for over 25 years. He has a long CV of previous public health professional functions and has written many books and peer reviewed papers on infectious diseases and chemical hazards.

Menna Richards,
Non–Executive Director
Appointed a Non–Executive Director in November 2010, Menna Richards' executive career was in broadcasting as Director BBC Cymru Wales (2000 – 2011) and previously Managing Director, HTV Wales. She is also a Non-Executive Director of the Principality Building Society and of Welsh National Opera. She is a trustee of the ALOUD charity. She has been Chair of Governors of the Royal Welsh College of Music and Drama and is currently Vice-President. She is also Pro-Chancellor of Cardiff University. Menna was also a board member of the Cardiff Bay Development Corporation.

James Strachan,
Non–Executive Director
Appointed a Non-Executive Director in June 2007. James is a Non-Executive Director of Towergate Insurance Limited, JP Morgan Asian Investment Trust PLC and Sarasin and Partners LLP. Former roles include: Chairman of the Audit Commission, a Non-Executive Director of the Bank of England, the Financial Services Authority, Legal and General Group plc, Care UK plc and Social Finance Limited, a Board member of Ofgem (the energy regulator), Senior Visiting Fellow in risk and regulation at LSE, chairman of the charity RNID and Managing Director of Merrill Lynch.

Anna Walker,
Non–Executive Director
Appointed a Non-Executive Director in March 2011, Anna has a wealth of experience in regulation, customer service, policy making and working with governments. She is Chair of the Office of Rail Regulation and undertook an independent review for government in 2008 into household water charging. Her former roles include Chief Executive of the Healthcare Commission (2004-2009), Director General, Land Use and Rural Affairs at DEFRA, Director General - Energy Group at DTI, and Deputy Director General at Oftel, the telecoms sector regulator. Anna, who was given a CB in 2003 for public service, is Chair of the charity Young Epilepsy, a former Vice Chair of Consumer Focus, the statutory consumer champion body and a member of the Council of Which?

John Warren,
Non–Executive Director
Appointed a Non-Executive Director in May 2012, John is a qualified accountant with more than 25 years' experience in finance roles and has extensive experience in chairing Audit Committees of major UK listed companies. Until his retirement in 2005, he was Group Finance Director for WH Smith PLC and, before that, United Biscuits Plc. He is currently the Senior Independent Director and Chairman of the Audit and Risk Committee at Spectris plc, and a Non-Executive Director and Chairman of the Audit Committee for Greencore Group plc, 4imprint Group plc and Bovis Homes PLC.

GLAS CYMRU CYFYNGEDIG REPORT AND ACCOUNTS 2014

REPORTS FROM THE COMMITTEES

Committees

To fulfil its role in the time available, certain responsibilities of the Board are delegated to Committees, which play an important role in working with management to ensure our business is financially strong, well governed and risks are identified and mitigated. Each Committee has written terms of reference (which are available on request to the Company Secretary), approved by the Board, summarising the responsibilities delegated to it.

Our principal committees are:
— Nominations Committee
— Finance Committee
— Audit Committee
— Quality and Environment Committee ('QEC')
— Remuneration Committee
— Dŵr Cymru Executive Committee

Upon joining a Committee, Directors are provided with an appropriate induction and are offered ongoing training and education opportunities. After each meeting, a summary of matters discussed is reported to the Board, and committee minutes are circulated to Directors. The committees can engage the services of such advisors as it needs to fulfil its responsibilities.

In addition to chairing or being a member of a committee, each Director commits additional time and input on the following matters: public health (Stephen Palmer), operations (John Bryant and Graham Edwards), customer service and regulation (Anna Walker), finance and audit (John Warren), finance, regulation and remuneration (James Strachan), communications and Member relations (Menna Richards) and government and regulation (Robert Ayling).

A report from the Chairman of the Nominations Committee

Current Chairman: Robert Ayling[1]
Members: Each of the Non-Executive Directors and the Chief Executive Officer

The role of this Committee is to ensure that plans are in place for orderly succession for appointment to the Board. We therefore look at the size, structure, and composition of the Board (and the skills, knowledge and experience around the Board table) and, where appropriate, recommend candidates for Board appointment.

This year the Nominations Committee has been involved in identifying a successor to Nigel Annett as Managing Director, and subsequently a Finance Director to replace Chris Jones and an independent Non-Executive Director to succeed John Bryant. In order to do this, we engaged the services of Odgers Berndtson and Spencer Stuart respectively to help us.

Welsh Water is committed to promoting diversity, non-discrimination, and equality of opportunity in the way we treat employees, prospective employees, visitors, clients, customers and suppliers. The Board as a whole takes an interest in the succession planning at a senior management level. The Board has documented its approach to recruitment in a diversity policy which it is committed to following.

// Neither Odgers Berndtson nor Spencer Stuart has any other connection with the company. Following these processes, Peter Bridgewater has been appointed as Finance Director with effect from September 2014, and Graham Edwards joined as Non-Executive Director in October 2013.

1 Except between 1 May and 31 October 2013, during which period Robert Ayling took a leave of absence from the Board but remained a Director. John Bryant became Chairman during this period.

Finance Committee Report

Members: John Bryant; Robert Ayling[2]; Chris Jones; James Strachan and John Warren

The Finance Committee is authorised to approve financing and treasury-related transactions where a decision is required between meetings of the Board. In 2013 to 2014, the Finance Committee was requested and provided approval for such decisions on one occasion.

Audit Committee Report

Members: John Warren (Chairman); Robert Ayling[1]; Menna Richards and John Bryant

The Audit Committee met on four occasions during 2013-14. During the early part of the financial reporting year 2014-15, the Audit Committee has met on a further occasion to discuss in greater detail the issues of judgement around the financial statements with a view to ensuring that the Annual Report for 2013-14 presents a 'fair, balanced and understandable' picture of the company's financial status, in accordance with the 2012 revised UK Corporate Governance Code.

The Audit Committee is also supported by the external auditors, PwC, who have been reappointed for a further year ending on 31st March 2015, prior to which date we intend to initiate a formal tender process to appoint auditors for the next five year period.

2 Except between 1 May and 31 October 2013, during which period Robert Ayling took a leave of absence from the Board but remained a Director.

The judgements and issues considered by the Audit Committee to be important background against which to judge our financial results performance included the following:

For the Interim financial statements:

Daniel Contracting Limited
On 15 May 2013 Daniel Contracting Limited, which had provided a maintenance service contract for Welsh Water covering both water and sewerage networks for a number of years, went into administration. Welsh Water incurred additional costs of some £3.8 million as part of the support and subsequent termination of the Daniel contract and the initial set-up of a replacement contract, all of which was charged to the income statement. At the time of Daniel's failure, Welsh Water owed the business up to £3.9m in respect of services provided under this contract. In the event of the Daniel business failing, the contract provided for Welsh Water to be fully compensated for the full cost of contract termination and appointment of a replacement contractor. It is the Audit Committee's judgement that while the £3.8 million additional costs are unlikely to prove recoverable, these costs can be offset. £3.2m of this has therefore been released to the income statement to offset these costs; the remainder has been held on the balance sheet as at 31 March 2014 as a retention in respect of recently completed works.

Capitalisation of support costs
In preparing the financial results for the year to 31 March 2013, management performed a wholesale review of its approach to the capitalisation of support costs; this formalised the accounting treatment of all support costs that are directly attributable to the capital programme in order to provide consistency and a robust audit trail. This was approved by the Audit Committee in May 2013 and did not result in any material change to the overall level of capitalisation. In respect of the year ended 31 March 2014, all categories and rates of capitalisation have been reassessed by heads of department and the Financial Controller; the Audit Committee has reviewed and approved the resulting level of capitalisation of £53.9m (2013: £50.3m).

Infrastructure renewals expenditure (IRE)
It was agreed to carry out a project by project review of the capitalisation of IRE costs at the year end.

For the end of year financial statements:

Provision for impairment of trade receivables
Provisioning for bad and doubtful debts is a sensitive judgement; in making its recommendation to the Audit Committee management has examined cash collection performance for measured and unmeasured customers during 2013-14 and has by extrapolation concluded that, over a four-year period, Welsh Water could ultimately expect to collect some 36% of debt outstanding at 31 March 2014. Collection rates over the past five years have shown a declining trend in cash collection as a proportion of debt. If this trend were to continue the company might expect not to collect a further 1.4% of measured and unmeasured debtors. Against a backdrop of continuing economic uncertainty, ongoing deteriorations in collection rates and the reform of the state welfare system, management considers it appropriate to accommodate this trend in setting the bad debt provision. Having reviewed and considered the ageing of customer debt at 31 March 2014, historical cash collection performance and the current economic climate, the Audit Committee concurred that Welsh Water's bad debt provision be set at £66m (2013: £61m) which generates a bad and doubtful debt charge for the year ("trade receivables impairment") of £28m.

Retirement benefit obligations
Calculation of the defined benefit pension liability for inclusion in the balance sheet in accordance with IAS 19 requires the use of two key financial estimates, namely the discount rate and future inflation. IAS 19 states that the discount rate should be derived from the yields of AA-rated corporate bonds. As at 31 March 2014, the yield on the iBOXX Sterling Corporates AA 15+ index was 4.3%. However, the average term of the collection of bonds within the iBOXX index is not long enough to be equivalent to the term of the scheme's liabilities, and the yield curve at 31 March was slightly upward-sloping at longer durations. Management have therefore judged a discount rate of 4.6% to be appropriate (2013: 4.5%). The inflation assumption has been determined having regard to the difference between the yields available on fixed interest and index-linked government bonds as well as other sources of inflation forecasting. At 31 March 2014, management considers 3.4% to be an appropriate inflation assumption (2013: 3.2%). A rate of 2.3% has been used for salary inflation, reflecting RPI-J forecasts and the value of progression-in-role incremental salary increases. These judgments were reviewed by PwC who concluded that they lay within an acceptable range. The Committee closely questioned their suitability before concluding that they were acceptable, for the purposes of the accounts. It was noted that on an actuarial basis, the pension scheme was in surplus.

Infrastructure renewals expenditure
In recent years Welsh Water's level of infrastructure renewals expenditure has risen and management has undertaken a review of expenditure to identify any schemes which deliver more than the repair of an asset to maintain its operating condition for the remainder of its life. The review focused on identifying schemes which resulted in upgraded assets, extended useful lives, improved operational efficiency, improved strength and/or capacity. The Audit Committee concurred with management's judgement that, of a total of £94m of expenditure classified as IRE for regulatory purposes, £22m should appropriately be classified as capital additions in the statutory financial statements prepared under International Financial Reporting Standards (2013: £23m).

Measured income accrual
Welsh Water's billing system generates an estimate of the income due from metered customers for the period between their last meter reading and the balance sheet date. The estimate is based on consumption over the preceding twelve months and is reviewed by management as the basis for setting the measured income accrual. As at 31 March 2014, this estimate was £64.2m, a reduction of £1.7m from 31 March 2013. This is a consequence of a reduction in the average number of days' accrual, partially offset by growth in the metered customer base and a slight increase in consumption. The Audit Committee judges this level of accrual to be reasonable.

Provisions
During the year to 31 March 2014, the level of provisioning has fallen by £5.7m to £14.9m, principally following utilisation of the restructuring provision (£3.9m) and the settlement and reassessment of outstanding liabilities for uninsured losses (£2.0m). The Audit Committee has reviewed the closing provision and judges the level of provisioning to be adequate.

Derivative financial instruments
The fair values of derivative financial instruments are provided by swap counterparties and subject to review by management. The Bloomberg financial dataset platform allows management to perform an independent valuation of these contracts which is then compared to the counterparty confirmations. The Audit Committee is comfortable that no material variances were identified; the instruments have been reported in the financial statements at the values provided by the counterparties. The total balance sheet liability at 31 March 2014 amounted to £265.0m (2013: £359.2m).

Recognition of intangible fixed assets
Intangible additions of £25.6m in the year to 31 March 2014 include £14.2m relating to the replacement of Welsh Water's billing system. A further £2.5m relates to research and development expenditure. Management has reviewed the items and concluded that they have been appropriately capitalised in accordance with IAS 38. During the course of the next regulatory period Welsh Water plans to invest more heavily in research and development and management will seek to enhance existing procedures for the capitalisation and financial monitoring of intangible assets. The Audit Committee has reviewed and approved the level of capitalisation in the year as well as the planned approach in future years of greater investment in this area.

Other activities of the Audit Committee
During 2013-14, two of the four meetings focused specifically on reviewing the Group's preliminary and interim financial results and related areas of judgement and accounting policy.

The Audit Committee places considerable reliance on the active role played by the Business Assurance (Internal Audit) function within the Group. The Committee approves the Business Assurance detailed annual plan, and receives regular updates on progress in carrying out the internal audit programme. The Committee takes this opportunity to challenge management's assessment of key financial and business risks and the mitigation strategies put in place to address these. Detailed feedback on the discussions at Audit Committee meetings is provided at Board Meetings, and all Directors receive copies of the Minutes.

The Committee also receives at each meeting a detailed report on any disclosures since the previous meeting which have been made under the Board's whistleblowing policy, and monitors investigations and follow-up undertaken as a result of any whistleblowing disclosure. During 2013-14, this has focused particularly on the outcome of the whistleblowing investigation into the activities of an employee, who had been placing equipment obtained via Group procurement processes for sale via an eBay account for his own benefit. That employee has since been dismissed and has pleaded guilty to theft in associated criminal proceedings which followed. Issues in relation to the process followed by this individual on regulatory reporting issues have led to Welsh Water restating its figures for reported "Interruptions to Supply" for 2011-12 and 2012-13 and a complete overhaul of the approach to this measure of regulatory reporting across the business.

Audit Committee has received regular reports from the Compliance Manager on the investigation, which consisted of a root cause analysis of the enablers of the theft and regulatory reporting issues, and monitoring of action plans put in place to address the issues identified. The Board was also kept updated on developments in relation to the investigation at every meeting, and Members were given an overview of the position at both the AGM and December Members' meeting.

Other topics reviewed by the Committee during 2014/15 included:

— reviewing the controls and processes being put in place to address risk management across the business;
— reviewing the company's reporting processes for Ofwat's Service Incentive Mechanism;
— information security issues;
— the content of quarterly reports to Glas Cymru's investors;
— treasury policy and controls, including a detailed review of the bank rating triggers in light of worsening credit ratings for some of the company's banks which breached minimum rating thresholds for the liquidity facilities.

The Committee has also received regular updates on the implementation of the new billing system, which is due to be implemented in Autumn 2014.

External audit services are currently provided by PricewaterhouseCoopers LLP. Our policy is that the external auditors will not be used for internal audit services, and that all non-audit work above a threshold of £25,000 will generally be subject to a prior competitive tendering and approval by the Chairman of the Audit Committee. The figures for non-audit and audit fees paid to PricewaterhouseCoopers LLP during the year 2013-14 appear on page 99 of the Financial Statements section.

This year, £101,000 (approximately one third of the total fees earned by the auditors) related to non-audit work. These fees were incurred as a result of work undertaken in connection with the submission of the Company's AMP6 Business Plan to Ofwat and also to carry out a governance review of Project Newid-the development and implementation of the new billing system.

In the case of both the work to support PR14 and the review of Project Newid, the auditors were only instructed to carry out this work after a full and thorough assessment of the value case for using the auditor and of the skills and experience that the auditor would bring to each assignment in the best interests of the Company. In each case, I was consulted as Chairman of the Audit Committee prior to the instruction being given.

The role of internal audit/business assurance is to provide assurance and to advise management and the Board Committee on the extent to which systems of internal control and arrangements to manage risk are appropriate and operate effectively. The Audit Committee also receives independent advice from and assurance from Welsh Water's Reporter (Black & Veatch) in relation to regulatory reporting issues.

Audit plans for both internal and external audit are focused on those areas identified as potentially being of greatest risk to the business. The Audit Committee has approved the external and internal audit plans for 2014-15 and has met privately (without the Executive present) with both the external auditors and the Head of Business Assurance as part of an annual review of audit independence.

On the basis of this work, and regular meetings with management, we have concluded that external and internal audit continue to operate effectively.

In order to ensure that we have an effective Audit Committee, we undertake a review once a year to provide opportunity for continuous improvement. In March 2014 we undertook an internal committee review using an electronic survey resource provided by Independent Audit; the outcome of the evaluation was reviewed by the Chairman and presented to the committee at its May 2014 meeting. The results were generally very positive with some ideas identified for further enhancement to risk reporting and the role of the external auditors. An action plan has been created to address these points over the coming months.

Report from the Chairman of the Quality and Environment Committee

Members: Stephen Palmer (Chairman), Robert Ayling[3], John Bryant, Graham Edwards[4], Chris Jones, Peter Perry, Ian Christie (Director of Water Services), Steve Wilson (Director of Waste Water Services), Tony Harrington (Director of Environment), Steve Brown (Independent Advisor), Andrew Davies (Independent Advisor).

The role of the QEC is to advise the Board on any issue relating to operational policy and practice in relation to public health and compliance with drinking water and environmental regulations and standards, together with occupational health and safety issues.

3 Except between 1 May and 31 October 2013, during which period Robert Ayling took a leave of absence from the Board but remained a Director.

4 From October 2013.

At each meeting of the Committee there are also regular attendees from the wider business with a range of operational responsibilities. In addition, the Board benefits from two independent advisors. In 2013-14, these were Andrew Davies, who advised on water quality matters, and Steve Brown who advised on environmental matters.

The Committee meets at various sites across the company's supply area. In 2013-14, these sites included Cardiff, Llyn Alaw, Baglan, Deganwy, Felindre and Llanelli.

In 2014, the structure of meetings was altered. There are now 8 meetings a year and these will be equally divided between monitoring performance and strategy. The committee reviews the company's performance in detail against key water quality, environmental performance and health and safety indicators, and monitors progress against key strategies aimed at protecting public health, safeguarding the environment, ensuring the safety of our employees and contractors and delivering efficient service to our customers.

The Committee also reviews the findings of investigations into any water quality, environmental or customer service failure (and requires a specific report from the Chief Executive Officer for those deemed serious by the Committee), and maintains oversight of the programmes of risk management and of internal and external audits. A serious incident review was carried out regarding the sewer flooding incident in Treorchy. The focus of the Committee is on ensuring:

— arrangements for risk management are fit for purpose to identify key risks promptly and manage them appropriately;
— continuous improvement of systems and processes and ensuring staff receive appropriate training;
— monitoring of the ongoing function of systems and processes and appropriate management oversight; appropriate lessons are learned from performance failures; and
— appropriate strategies and procedures are in place to comply with statutory and regulatory requirements.

A marked improvement in performance over the 2013-14 period is commented upon in detail elsewhere in this Annual Report, however the topics covered by the Committee in 2013-14 included:

— water quality
— service reservoirs
— customer service
— leakage
— flooding
— health & safety issues
— pollution incidents
— progress on environmental performance and considering the impact of likely future developments
— innovation and strategy

The continuing themes pursued by the Committee in reviewing these areas of the business during the year have included an emphasis on:

— the benefits of adopting a systematic approach to identifying root causes of incidents and compliance failures;
— the importance of science and innovation to improving our processes and systems and the benefits of benchmarking initiatives and data analysis;
— building relationships of trust with the company's regulators;
— communicating the company's role and of the communications strategy as a whole;
— the value of working on predicting and identifying emerging areas of risk. Identifying where particular areas of risk are across the business will enable forward planning to deal with these areas; and
— developing strategies to ensure compliance with our statutory duties and regulatory requirements.

// Water quality and environmental quality performance data referred to in this report is for the calendar year 2013. Other performance information (such as customer service measures and performance against Ofwat's DG service standards) is given for the regulatory reporting year 1 April 2013 to 31 March 2014.

Remuneration Committee

The membership and the role and responsibilities of the Remuneration Committee are described in the 2014 Remuneration Report on page 79. This includes a summary of key issues discussed by the Committee last year and of the remuneration policy and arrangements approved by the Committee for 2014-15.

Internal control

The Board has overall responsibility for the operation and effectiveness of the group's system of internal controls and risk management. The system of controls is designed to manage the risk of failure to achieve business objectives, and comprises audited policies and procedures aimed at identifying and managing the most significant risks faced by the business.

During 2013, the Board reviewed the approach to risk to ensure that we comply with best practice. A detailed review of risk is available on page 19.

In considering the development of the system of controls, the management team reviewed the materiality and the relative cost benefit associated with each identified significant risk. The internal control systems are designed to provide reasonable assurance against misstatements or loss.

The key features of our system are typical for a business of our scale and complexity. They include:
— consideration of acceptable risk parameters set by the Board, particularly in the context of the business planning process for the purposes of the current price review;
— identification of key risks and hazards which are measured and managed to an acceptable level, together with the opportunity to review emerging and current issues at meetings of the Executive and the Quality and Environment Committee;
— clear management accountability for risk management, supported by regular risk reporting to the Board,the Quality and Environment Committee and the Audit Committee;
— controls that recognise that the nature and balance of risk changes and evolves;
— procedures that govern the approval and control of major items of capital expenditure, the acquisition and disposal of material assets, and commitment to any arrangement that gives rise to, or could give rise to, a material liability;
— financial systems and procedures for preparing consolidated accounts.

The Board receives assurance from independent work by Welsh Water's Reporter (Black & Veatch) and from the programme of internal and quality audit, the major findings from which are reviewed at the Audit Committee and the Quality and Environment Committee. A strategic risk update is considered at each meeting of the Board and a strategic review of risk is considered twice a year under a process chaired by the Chief Executive, who submits an update to the Board of the Executive's view of the key strategic risks facing the business.

The process to review the effectiveness of internal control includes discussion with management on significant risk issues and a review of plans for, and results from, internal and external audit. The Audit Committee reports the results of its review to the Board which then draws its collective conclusion on the effectiveness of the system of internal controls. In fulfilling this responsibility, the Board considers periodic reports from the Audit Committee, Quality and Environment Committee and from management, and relies on its routine monitoring of key performance indicators and monthly reports of financial and operational performance. This enables the Board to review the effectiveness of the internal control system throughout the course of the year.

As part of the work undertaken to review its internal controls on an annual basis, the Board also considers the effectiveness of its system of internal controls with regard to how these have operated in respect of the specific challenges faced by the company over the course of the previous reporting period. For 2013-14, the Board found that the internal control processes accurately identified and enabled the management of the principal risks facing the business.

REMUNERATION COMMITTEE REPORT

I am pleased to present the 2014 report from the Remuneration Committee of the Board ('the Committee') which provides details of the remuneration paid to Directors in the financial year 2013-14 and our Remuneration Policy for 2014-15.

Our Remuneration Policy aims to align executive remuneration with the implementation of the Company's strategy to deliver the best possible outcomes for our customers and to protect the environment. It shows clearly how remuneration is linked to performance both annually and over the five year regulatory period that will end in March 2015 ('the AMP5 period'). AMP5 is the most challenging since privatisation, with price increases for Welsh Water's customers being kept below the rate of inflation in each year of the period. To deliver this, Welsh Water has had to reduce controllable operating costs by around 20% while improving customer service performance, meet challenging serviceability targets and deliver a £1.5 billion capital investment programme. Overall, service performance has improved over the AMP5 period to date, in line with our objectives. The financial position of the Company has further strengthened which will enable the delivery of greater improvement to customer value in the future. The Committee believes that the performance measures for variable pay - comprising the Company's Performance Scorecard (which includes a range of key measures covering drinking water quality, sanitation, protecting the environment from pollution and customer service), operating cost reduction, Ofwat's Service Incentive Mechanism ('SIM') measure (an industry wide measure for overall customer service and satisfaction) and growth in customer equity (i.e. financial reserves being regulatory capital value less net debt) - all support the delivery of these strategic targets.

The Committee undertook a review of remuneration arrangements in 2010-11 and following the Annual General Meeting (AGM) in 2011 adopted a Policy that was designed to be appropriate for the AMP5 period. On an annual basis thereafter the Committee has considered whether the overall policy remains appropriate. The Policy approved in 2011 has materially been applied since its approval in 2011 and it will be applied for 2014-15 in a way that is essentially unchanged from the Policy we described in the 2013 Remuneration Report ('the AMP5 remuneration arrangements').

During the year, the Company has started to consider the arrangements over the five year regulatory period that will end in March 2020. While the details of the arrangements cannot be finalised until after the Final Determination the payment of any variable pay will continue to be aligned to our strategy, focusing on the three pillars of customer, cost and compliance.

Key points in relation to remuneration for the financial year ending 31 March 2015
— Executive Directors' salaries were increased by 2% in April 2014. This is the same as the 2% general pay award received by staff.
— Under the Annual Variable Pay Scheme ('AVPS') the quantum (as a percentage of salary) that can be earned in 2014-15 remains at 100% of salary. We have made some minor changes to the terminology describing the targets to align with the Business Plan categories of Customer, Cost and Compliance, for example, OPEX is now referred to as Cost.
— Under the Long-Term Variable Pay Scheme ('LTVPS') the quantum that can be earned in 2014-15 for the customer service element is unchanged at 30% of salary. The final staged payment for the customer equity element for 2014-15 is up to 50% of salary less any interim payments that may be required to be clawed back. No changes to the Scheme are proposed for this final year of the AMP5 period.

The Committee remains satisfied that whilst the remuneration arrangements include variable elements linked to performance, the Policy does not encourage undue risk taking which is inappropriate in light of the risk profile of the Company, and ensures that remuneration levels rise and fall depending on performance. The inclusion of variable elements of pay also ensures that the Policy is sufficiently competitive to attract and retain high quality staff.

Remuneration paid in respect of the financial year ended 31 March 2014
— A base salary (which had been increased by 2% in April 2013).
— Under the AVPS 2013-14 awards have been made equivalent to 23.2 percentage points ('%') of base salary for performance against the Performance Scorecard, 21.9% for operating cost performance and 4.75% to 8.5% against Strategic and Personal objectives, making a total award of 49.9% to 53.6% of base salary. This compares with a maximum of 100% of base salary and awards of 60.6 – 63.6% of salary for performance in 2012-13.

- Under the Long Term Variable Pay Scheme 2010 ('LTVPS'), staged awards may be made under the customer equity element of the scheme (see page 74). Over the life of the scheme so far, a staged award of 10% of salary was made in respect of performance in 2010-11, 20% of salary was made in respect of 2011-12, 30% of salary was made in respect of 2012-13 and, reflecting financial performance in 2013-14 a payment of 40% of salary has been made. Welsh Water's provisional ranking was 3rd in the Ofwat SIM league table for 2013-14 which would result in an award of 15% of salary being made under the Customer Service Award which is calculated on a rolling three year average. (see page 74).
- Nigel Annett stepped down from formal duties as Managing Director on 1 September 2013 and following a handover with the new Chief Executive, stood down from the Company on 31 March 2014. He commenced receipt of his defined benefit pension and payments accrued within the Employer Funded Retirement Benefit Scheme (EFBRS) arrangements from 1 April 2014.
- Nigel will receive his accrued AVP award for the full performance year 2013/2014. At the 2013 AGM a resolution was approved by Members to make a payment to him reflecting his benefits accrued under the LTVPS as at 31 March 2014. This payment reflects Nigel Annett's long term contribution to the business and is considered fair on the basis that he will have completed the pro rata performance period for this staged payment for 2014-15. He will receive no other employment related payments.
- Chris Jones was promoted from Finance Director to Chief Executive with effect from 1 September 2013.
- Peter Perry was promoted from Operations Director to Chief Operating Officer with effect from 1 September 2013.
- An announcement was made on 14 March 2014 that Peter Bridgewater will join the Boards of Dŵr Cymru and Glas Cymru Cyfyngedig as the new Finance Director. He is due to join no later than 1 September 2014 on a salary of £229,500 per annum with a remuneration package in line with our policy for new appointments as outlined on page 72.

Further details on how our Remuneration Policy functions and how it is implemented in practice can be found in the Policy and Implementation Reports that follow.

The Government Department for Business, Innovation & Skills ('BIS') introduced new regulations governing pay disclosure for UK quoted companies on 1 October 2013. We have compiled this year's Remuneration Report to comply as appropriate where relevant with the new regulations.

We were pleased that the 2012-13 Remuneration Report received a vote of approval at the 2013 Annual General Meeting ('AGM'). Two separate resolutions approving the Policy Report and the Annual Report on Remuneration will be put to the Members at the 2014 AGM.

James Strachan
Chairman of the Remuneration Committee
12 June 2014

This Remuneration Report has been prepared in accordance with the provisions of schedule 8 to the Large and Medium sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2008 (as amended) and is fully compliant with provisions of The UK Corporate Governance Code ('the Governance Code').

Policy Report

Remuneration Policy

The principles and framework of the current Remuneration Policy will be approved by Members at the AGM on 4 July 2014 and if so approved will be effective from the date of the AGM. The Policy aims to align executive remuneration with the implementation of the Company's strategy to deliver the best possible outcomes for our customers and to protect the environment. It shows clearly how remuneration is linked to performance both annually and over the five year regulatory period that will end in March 2015 ('the AMP5 period'). This is achieved by paying remuneration at levels which are sufficiently competitive to recruit and retain high quality staff whilst ensuring that the remuneration packages are structured so as to discourage inappropriate risk taking.

The Policy is delivered by:

- Setting levels of base salary and total remuneration that (when assessed periodically against market benchmarking) are considered to be fair and competitive having regard to an individual's experience and responsibility.
- Encouraging improved performance by having a significant proportion of total remuneration being delivered via variable pay - although the majority of the target package is base salary to ensure that executives are not encouraged to take inappropriate risk.
- Focusing incentives on the relative performance of Welsh Water – based on independent information published by Ofwat, the Drinking Water Inspectorate, Natural Resources Wales, the Environment Agency and the Consumer Council for Water – thereby promoting the objective of producing sector-leading performance in a transparent and accountable way.

The Committee remains satisfied that whilst the Remuneration Policy includes variable elements linked to performance, the Policy does not encourage risk taking which is inappropriate in light of the risk profile of the Company, and ensures that remuneration levels rise and fall depending on performance. The inclusion of variable elements of pay also ensures that the Policy is sufficiently competitive to attract and retain high quality staff. This in turn ensures that it is well aligned to the long term success of Welsh Water and the interest of its customers.

The Committee remains satisfied that whilst the Remuneration Policy includes variable elements linked to performance, the Policy does not encourage risk taking which is inappropriate in light of the risk profile of the Company, and ensures that remuneration levels rise and fall depending on performance. The inclusion of variable elements of pay also ensures that the Policy is sufficiently competitive to attract and retain high quality staff. This in turn ensures that it is well aligned to the long term success of Welsh Water and the interest of its customers.

When formulating the Remuneration Policy and the implementation of it, the Committee considers remuneration arrangements across the business as a whole and considers the impact of the Policy in light of broader social, environmental and governance issues. The Company consults with staff via a single table arrangement with the recognised trade unions to negotiate salaries for the wider workforce. The Committee considers the agreed increase for the wider employee base and also reviews market practice and conditions. It should also be noted that the same Performance Scorecard used in the Executive Directors' AVPS, and a similar operating cost element, is applied in variable pay arrangements across the organisation, promoting a unified business culture and consistency in our performance assessment.

The key difference in the remuneration package for senior executives relates to participation in the LTVPS. This plan is focussed on the long term strategic and financial performance of Welsh Water, and is reserved for those senior executives in a position to influence such performance.

The Committee actively engages with Members (through regular Member meetings) and other stakeholders and values their input in helping to shape Welsh Water's Remuneration Policy.

The table below provides a summary of the components constituting the Executive Directors' remuneration packages as per Welsh Water's Remuneration Policy.

	Purpose and link to strategy	Operation	Opportunity	Performance metrics
Base salary	— To help recruit, retain and motivate high calibre employees.	Normally reviewed annually with effect from 1 April. Review reflects: — Role, experience and performance — Wider economic conditions — Increases awarded throughout the rest of the broader workforce — Total organisational salary budgets — Takes periodic account of levels in other utilities and in the wider market.	— Annual increases generally linked to those of the wider workforce though the Remuneration Committee retain discretion to award increases to individuals above this level where appropriate. — Current salaries disclosed in the Annual Report on Remuneration.	None
Benefits	— To provide a market competitive benefits package to help recruit and retain employees — Healthcare benefits promote business continuity.	— Directors are entitled to private health cover, permanent health and life insurance — New Executive Directors are not eligible for permanent health insurance — Directors do not receive company cars or car allowances — Other benefits such as relocation expenses or travel/accommodation allowances may be offered as appropriate.	— Value of benefits is based on the cost to the Company and is not predetermined.	None
Pension	— To help recruit and retain high calibre employees — Discrete post-retirement planning provision.	— The Company operates a defined benefit pension scheme — Where contributions would exceed either the lifetime or annual contribution limits provision is made by way of an unfunded EFRBS. — Normal retirement age of 60 — New Executive Directors will be automatically enrolled in the DCWW Group Personal Pension Plan with the opportunity to opt out and receive a cash allowance equivalent to the prevailing Employer contribution.	— Up to 1/45th of salary accrual for each year of pensionable service subject to maximum of 2/3rds of final pensionable salary — Maximum employer contribution to the DCWW Group Personal Pension Plan of 11% providing the employee contributes 6% or more.	None
AVPS	— To incentivise the annual delivery of stretching targets and delivery of personal objectives.	— AVPS targets reviewed annually by the Committee — Targets designed to relate to areas of the business over which executive has particular control — Outturn determined by the Committee after the year end based on performance against targets — Paid as cash — Not pensionable — Clawback provisions apply.	— Maximum AVP potential of 100% of salary, for the achievement of stretching performance conditions.	— Measures will be aligned to the Business Plan themes of Customer, Compliance and Cost with additional Strategic and Personal targets — See page 74.
LTVPS	— To align the long term interests of the Executive Directors with those of Welsh Water's customers and stakeholders — To incentivise achievement of value creation over the long term — To aid retention	— LTVPS 2010 approved by Members — Cash awards based on stretching performance targets relating to: — Rolling three year relative SIM performance — Customer equity performance over the five year regulatory period to 31 March 2015 — Clawback provisions apply.	— 300% of salary over the five year regulatory period to 31 March 2015.	— 50% based on relative SIM performance — 50% based on customer equity performance — See page 75
Non Executive Directors	— Provides an appropriate level of fixed fee to recruit and retain individuals with a broad range of experience and skill to support the Board in the delivery of its duties.	— The Committee determines the fee payable to the Chairman of the Board and, separately, the Executive Directors and the Chairman approve the fee level payable to the Non Executive Directors.	— Non Executive Directors do not receive any additional fees for chairing committees	None
New appointments	— Base salary levels will be set to reflect the experience of the individual, appropriate market data and internal relativities. If it is considered appropriate to appoint a new Executive Director on a below market salary they may be subject to a series of increases to the desired salary positioning over an appropriate timeframe subject to performance in post. This approach will apply to both internal and external appointments. — The policy will be for the new Executive Director to participate in the remuneration structure detailed above. Exceptions to this could be setting different measures or implementing transitional arrangements should an Executive Director join part way through the 5 year regulatory period. — Should it be the case that the Remuneration Committee considered it necessary to buy out incentive pay which an individual would forfeit on leaving their current employer, such compensation, where possible, would be structured so that the terms of the buy out mirrored the form and structure of the remuneration being replaced.			
Policy for payments to departing executives	— The Executive Directors have service contracts that are subject to a 12 month notice period and which do not provide for compensation to be payable in the event of early termination by the Company. At the Company's discretion, an Executive Director may be paid base salary alone in lieu of notice. A significant element of mitigation is built into the contract should the Company choose to exercise its option to make a payment in lieu of notice. — When an Executive Director leaves via redundancy and is not required to work his/her notice period, he/she will be entitled to Statutory Redundancy plus 12 months' pay in lieu of notice together with pay in lieu of accrued but untaken holidays. Any accrued Annual Variable Pay or Long Term Variable Pay award payments will be made in accordance with the respective scheme rules. — Should an Executive Director resign, he/she will be expected to work their notice period unless an alternative arrangement such as garden leave or a reduced notice period is agreed. The Executive will receive any accrued Annual Variable Pay or Long Term Variable Pay awards in accordance with the respective scheme rules. — In the event that the Company terminates the Executive's employment, the Company will take legal advice and will pay to the Executive only such amount as the Executive is legally entitled to receive. The Annual Variable Pay and Long Term Variable scheme rules in relation to leavers will apply.			

For the avoidance of doubt, in approving this Directors' Remuneration policy, authority is given to the Company to honour any commitments entered into with current or former Directors that have been disclosed in previous remuneration reports. Details of any payments to former Directors will be set out in the Annual Report on Remuneration as they arise as required under the Remuneration Regulations.

Discretions retained by the Committee

The Committee operates the Annual Variable Pay Scheme and the Long Term Variable Pay scheme according to the rules of each respective Scheme and consistent with normal market practice, including flexibility in a number of regards. How the Committee will retain flexibility includes:

— When to make awards and payments
— How to determine the size of an award, a payment, or when and how much of an award should vest
— How to deal with a change of control or restructuring of the Group
— Whether a director is a good/bad leaver for incentive plan purposes and whether and what proportion of awards vest at the time of leaving or at the original vesting date(s)
— What the weighting, measures and targets should be for the Annual Variable Pay Scheme and Long Term Variable Pay Scheme from year to year.

The Committee also retains the discretion within the policy to adjust targets and/or set different measures and alter weightings for the Annual Variable Pay Scheme and to adjust targets for the Long Term Variable Pay Scheme if events happen that cause it to determine that the conditions are unable to fulfil their original intended purpose.

Service Contracts

The Chairman and the Non-Executive Directors are appointed under letters of appointment terminable by either party on three months' written notice.

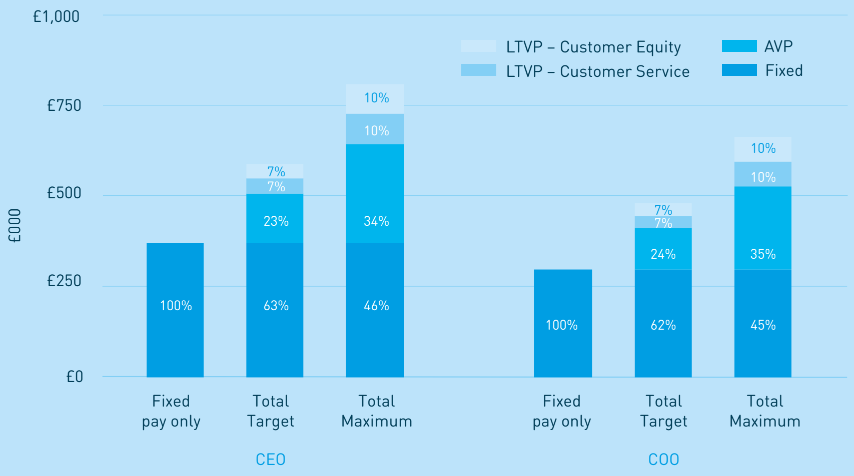
Dates of letters of appointment of the Non Executive Directors were:

Bob Ayling	3 April 2008
John Bryant	5 March 2001
James Strachan	1 June 2007
Stephen Palmer	26 October 2009
Menna Richards	22 November 2010
Anna Walker	3 May 2012
John Warren	3 May 2012
Graham Edwards	1 October 2013

Performance Scenarios

The Committee aims to provide an appropriate proportion of the Executive Directors' total remuneration through performance-related variable pay and figure 1 shows a breakdown of the value of the various elements of the remuneration package, assuming threshold, target and maximum levels of performance are achieved. The aim of the Committee is to provide, at a target level of performance, for around 60% of the total remuneration package to be fixed and around 40% to be variable:

Figure 1 – Executive Directors' Remuneration Package Components



The following assumptions have been made in preparing these charts:

1 Fixed pay only – fixed pay only with no vesting under the AVPS or LTVPS. Fixed pay comprises salary as at 1 April 2014, value of benefits and pension received in the 2013-14 financial year as disclosed in the table on page 76.

2 Total target – fixed pay plus AVPS of 50% of the maximum (i.e. 50% of salary), and LTVPS of 50% of the 5 year maximum of 300% of salary annualised over 5 years (i.e. 30% of salary on an annualised basis).

3 Total maximum – fixed pay plus maximum AVPS and maximum LTVPS of 300% of salary on an annualised basis (i.e. 60% of salary).

Policy on external appointments

The Board recognises the benefit of broadened experience that might be achieved through the involvement of Executive Directors in external activities. Any appointment is subject to annual approval by the Committee and, subject to the Committee's agreement, a Director may retain any fees.

ANNUAL REPORT ON REMUNERATION

1. Remuneration Policy for Executive Directors in more detail

Salary

Following a review in March 2014 the Committee has set the base salaries for the Executive Directors for 2014-15 (effective 1 April 2014) as below. This mirrors the average staff increase of 2%. The Company consults with staff via a single table arrangement with GMB, UNISON and UNITE trade unions. During the 2014 general pay award negotiations for staff, details of Executive Directors' salaries within Welsh Water and the Water Industry generally were reviewed (figure 2).

During the year a review of the fees payable to Non-Executive Directors resulted in fees being increased by around 1.75%. Benchmark data provided independently by New Bridge Street ('NBS') reflected the new fee as being broadly in line with mid-market levels.

The fees payable for the financial year that commenced on 1 April 2014 are:

Chairman	£212,000	(2013: £208,000)
Senior Independent Director	£68,700	(2013: £67,500)
Non-Executive Director	£58,000	(2013: £57,000)

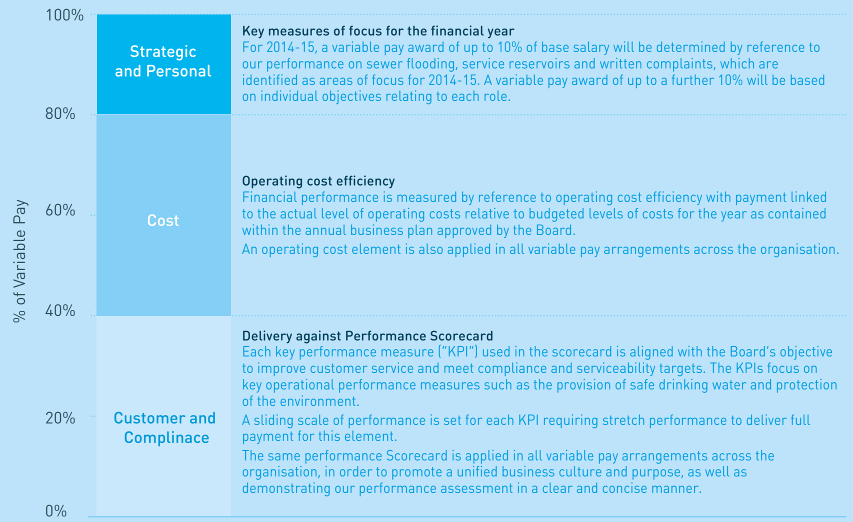
Annual Variable Pay Scheme ('AVPS') — The maximum variable pay that Executive Directors can earn under the AVPS in 2014-15 is unchanged and equates to 100% of base salary. The achievement of variable pay is assessed across three components, as illustrated in figure 3. Specific targets for 2014-15 have not been disclosed as they are considered commercially sensitive but will be disclosed next year.

Figure 2	Effective 1 April 2013	Effective 1 September 2013[1]	Effective 1 April 2014[2]
Chris Jones	£226,495	£270,000	£275,400
Peter Perry	£215,467	£225,000	£229,500
Peter Bridgewater	n/a	n/a	£229,500

1 Salaries were reviewed mid year in September 2013 after Nigel Annett stood down as a director on 1 September 2013 and the consequent promotions of Christopher Jones to Chief Executive and Peter Perry to Chief Operating Officer.

2 Peter Bridgewater is due to start on 1 September 2014.

Figure 3 – Annual Variable Pay Scheme Structure



Long Term Variable Pay Scheme 2010 ('LTVPS') — The objective of the LTVPS is to align the longer term aspects of total remuneration with Company performance over the course of the five year regulatory period ending on 31 March 2015. The awards comprise a cash payment. Under the LTVPS two types of cash award can be made:

— A Customer Equity Award, which is measured by the creation of customer equity over the regulatory period. Customer equity is the group's financial reserves, i.e. regulatory capital value less net debt (as defined for the purposes of the quarterly Investor Report); and

— A Customer Service Award, which is measured by the Company's average ranking in the Ofwat league table for SIM over the last three years. The Customer Service Award is therefore informed by and rewards, the Company's relative performance compared with other companies in the sector.

The LTVPS performance targets reflect the Board's ambition that Welsh Water should rank alongside the leading companies in the industry on key measures for customer service and long term financial efficiency for the benefit of customers. SIM is used for the Customer Service Award and comprises two measures of customer service. One is a qualitative measure reflecting the results of independent research carried out on behalf of Ofwat to capture customer satisfaction with the service they have received, and the other a quantitative measure which covers customer complaints and unwanted calls. The performance targets under each of the LTVPS awards are described more fully in figure 4.

The period over which performance is determined and the potential payment dates over the regulatory period to 31 March 2015 are illustrated in the schematic figure 5.

Details of payments made to Executive Directors under LTVPS for 2013-14 are set out in figure 6, 'Payments made to Directors', on page 76.

External appointments

Nigel Annett was appointed as a Non-Executive Director of the Principality Building Society on 21 October 2013, in respect of which he received payment of £27,943 to 31 March 2014.

Figure 4	Customer Service	Customer Equity [1,4]
Performance measure	Measured by reference to Ofwat's SIM measure.	Actual customer equity at 31 March 2015 (the end of the AMP5 period) compared to budget.
Rationale for selected measures	Ofwat's SIM measure of consumer experience which is independent, objective and measureable, and which allows relative performance to be compared against other water companies.	This is the strongest financial measure of the value of the customers' interest in the business.
Performance period	3 Financial Years immediately prior to the Financial Year in which an award is made.	1 April 2010 to 31 March 2015
Performance target [2,3]	Out of UK's 10 water and sewerage companies: — 100% of award payable for achieving first position — 75% of award payable for achieving second position — 50% of award payable for achieving third position — 25% of award payable for achieving fourth position — 0% of award payable for a ranking of fifth or below.	— 100% of award payable for achieving customer equity on 31 March 2015 of £100m in excess of the 2010 business plan target. — 0% of the award will be payable for meeting or falling short of the 2010 business plan target — Straight-line pro rata calculation between the business plan target and £100m above this target.

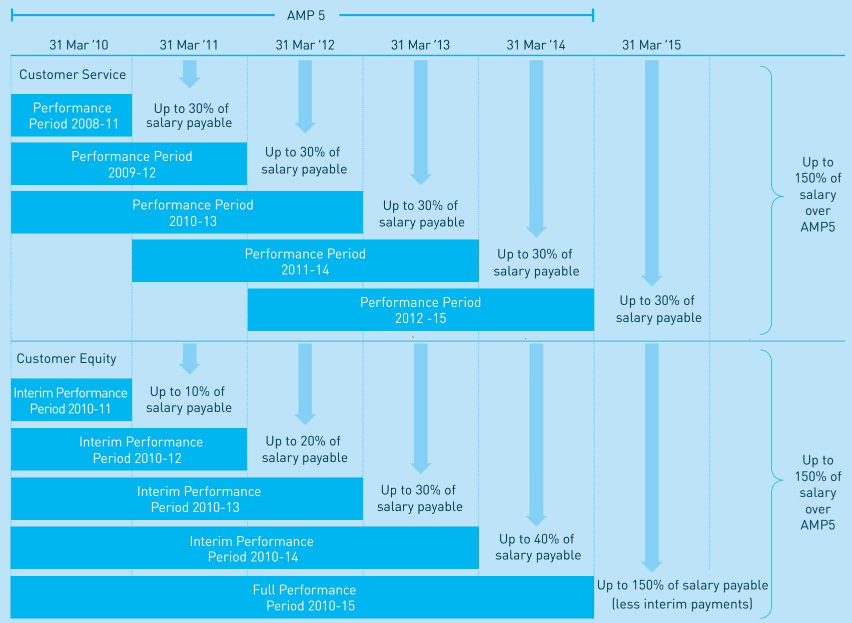
1. The customer equity target may be amended in certain circumstances at the discretion of the Committee. These circumstances include where (i) there are differences between actual inflation and the assumptions originally made; (ii) the Board had modified a relevant policy after the original forecast was made (e.g. dispersal of customer equity by way of additional investment to deliver extra benefits for customers); and (iii) there is a material influence on financial reserves that was not originally foreseen and which the Committee determines to be outside the control of the Executive Directors.

2 Payment may be deferred at the discretion of the Committee in the event that there is a significant deterioration in performance. Deferral may be for up to two years, or until the shortfall has been remedied, whichever is the earlier.

3 When determining the level of any staged or final award the Committee will have regard to the rating of the group's bonds and may at its discretion defer all or part of an award if the group's bonds have been put on credit watch or downgraded.

4 In circumstances where the Committee makes an interim or staged payment against the customer equity target but the final customer equity figure at the end of the five year performance period is less than the sum of the interim payment or payments, then such payments will be reconciled (or 'trued-up') so that any excess sums are clawed back from participants.

Figure 5



CORPORATE GOVERNANCE

2. What was paid in 2013-14 and link between pay and performance

Payments made to Directors in 2013-14

Figure 6 sets out the Directors' emoluments in respect of the year ended 31 March 2014 in comparison to year ended 31 March 2013.

Determination of 2013-14 AVPS outcome

Based on overall performance against the scorecard, 58% of maximum was awarded (23.2% of salary against a target of 24% of salary).

Financial performance in 2013-14 was based on operating cost efficiency. Based on Welsh Water's level of performance, 54.75% of maximum was awarded (21.9% of salary against a target of 25% of salary).

Based on the Committee's consideration of the performance against each of the Executive Director's strategic and personal objectives 23.75% to 42.5% of maximum was awarded (4.75% to 8.5% of salary against a target of 20% of salary). Objectives included combined sewer flooding measure from the scorecard, customer satisfaction, improving employee engagement, increasing the reporting of near miss and dangerous occurrences in the supply chain, introduction of Lean operations and maintenance processes at a number of sites, cash collection targets and successful engagement with customers on the PR14 proposals

Determination of 2013-14 LTVPS outcome

For the Customer Service element of the scheme, Welsh Water's SIM rating was provisionally ranked third relative to the SIM rating of the other water and sewerage companies over the three year performance period to 31 March 2014. As a consequence, an award of 15% would be payable. The maximum potential is 30% of salary (as per the vesting schedule as set out in figure 5 on page 75). However, the final SIM scores for 2013-14 have not yet been published and there is a possibility that Welsh Water's ranking for 2013-14 could change. The Committee will monitor this position and describe any different outcomes in next year's report.

Figure 6 – Payments and benefits made to Directors in 2013-14

Directors	Salary		Fees		BIK[3]		AVP[4]		Pension		LTVPS[5]		Total Emoluments	
(FY)	2012/13	2013/14	2012/13	2013/14	2012/13	2013/14	2012/13	2013/14	2012/13	2013/14	2012/13	2013/14	2012/13[a]	2013/14[1,2]
RA	–	–	204,000	121,331	–	–					–	–	204,000	121,331
NA	281,622	287,254	–	–	905	905	170,663	143,196	52,633	120,544	84,487	114,902	590,310	666,801
CJ	222,054	251,873	–	–	905	905	134,565	128,707	48,686	93,329	66,616	100,749	472,826	575,563
PP	211,242	221,028	–	–	905	905	134,350	118,471	10,766	66,668	63,373	88,411	420,636	495,483
JB	–	–	66,300	137,750	–	–	–	–			–	–	66,300	137,750
AH*	–	–	15,060	–	–	–	–	–			–	–	15,060	–
SP	–	–	56,000	57,000	–	–	–	–			–	–	56,000	57,000
JS	–	–	56,000	57,000	–	–	–	–			–	–	56,000	57,000
MR	–	–	56,000	62,250	–	–	–	–			–	–	56,000	62,250
AW	–	–	56,000	57,000	–	–	–	–			–	–	56,000	57,000
JW*	–	–	51,190	57,000	–	–	–	–			–	–	51,190	57,000
GE*	–	–	–	28,500	–	–	–	–			–	–	–	28,500
Total	714,918	760,155	560,550	577,831	2,715	2,715	439,578	390,374	112,085	280,541	214,476	304,062	2,044,322	2,315,678

a As presented in 2013 Remuneration Report.

The information in the table above has been audited by PwC.

1. Changes of director: Graham Edwards was appointed a Non-Executive Director on 1 October 2013. John Warren was appointed a Non-Executive Director on 4 May 2012. Tony Hobson retired following the AGM on 6 July 2012 (* denotes pro-rata fees). Nigel Annett stood down from the Board on 1 September 2013 but continued his employment until he retired on 31 March 2014 to ensure a smooth transition to Chris Jones who was promoted to Chief Executive on 1 September 2013. Full financial year figures are shown in the table for Nigel Annett. Peter Perry was promoted to Chief Operating Officer on 1 September 2013.
2. John Bryant undertook the role of Chairman for a six month period from 1 May 2013 while Robert Ayling stood down temporarily. Menna Richards undertook the Senior Independent Director role from 1 May 2013 whilst John Bryant was acting Chairman.
3. Benefits in kind compromise private health cover .
4. Please see Determination of AVP Outcome on page 76.
5. Please see Determination of LTVP Outcome on page 76.
6. The highest-paid director in 2013-14 was Nigel Annett who received emoluments of £666,801 (2013: Nigel Annett, £590,310).
7. Pension data based on real increase in the capitalised value – increased by the CPI figures at the previous September which were 5.2% and 2.2% respectively.

For the customer equity element of the scheme measured from 1 April 2010 to 31 March 2015, a staged payment at the maximum of 40% of salary has been made. This has been based on the Committee's determination that customer equity at 31 March 2014 of £1,648 million exceeds projections for meeting the required £100 million in excess of the 2010 business plan target for full vesting over the life of the plan.

This brings the sum of the staged payments to 100% for the four years of AMP5.

Pension benefits

For the period 1 April 2013 to 31 March 2014, Nigel Annett, Chris Jones and Peter Perry were all members of the DCWW Pension Scheme ('the Scheme'), which is a defined benefit arrangement. Benefits accrue at 1/45th of Final Pensionable Salary per year of Pensionable Service (except for Peter Perry who accrues 1/60th of Final Pensionable Salary for each year of Pensionable Service), subject to a maximum overall pension at normal retirement age of two-thirds of Final Pensionable Salary. The Scheme also provides life cover of four times Pensionable Salary for death in service, a pension payable in the event of retirement due to ill health and a spouse's pension payable on the death of a member. Executive Directors have the benefit of private health cover and permanent health insurance cover. The Executive Directors are Lifetime Allowance and/or Annual Allowance Capped Members of the Scheme and where their Scheme benefits exceed HMRC limits, additional benefits are provided via an Employer Financed Retirement Benefit Scheme (EFRBS). The Company's obligations under this EFRBS will not be funded, however such obligations constitute liabilities of the Company, payable when they are due.

The pension benefits earned by the Directors in the Scheme during the year are shown in the table below which has been audited:

CORPORATE GOVERNANCE

Figure 7 – The pension benefits earned by the Executive Directors in the Scheme during the year are shown in the table below:

	Normal Retirement Age	Accrued Pensions at 31 March 2012[1]	Capitalised value of accrued pension at 31 March 2012	Accrued Pensions at 31 March 2013[1]	Capitalised value of accrued pension at 31 March 2013	Member contributions paid during the year 2013	Pension Input Amount net of member contributions[2] 2013	Accrued Pensions at 31 March 2014[1]	Capitalised value of accrued pension at 31 March 2014	Member contributions paid during the year 2014	Pension Input Amount net of member contributions[2] 2014
NA	60	£129,943	£2,598,860	£140,599	£2,811,980	£25,346	£52,633	£151,012	£3,020,240	£25,853	£120,544
CJ	60	£84,663	£1,693,260	£92,499	£1,849,980	£19,985	£48,686	£100,220	£2,004,400	£20,385	£93,329
PP	60	£109,060	£2,181,200	£116,220	£2,324,400	£19,012	£10,766	£123,080	£2,461,600	£19,392	£66,668

The information in the table above has been audited by PwC.

Notes:

1. In accordance with new reporting regulations, the pension benefits are calculated on a consistent basis with HMRC's "Annual Allowance Method" for determining the taxable value of defined benefit pensions. This is a change from previous years and consequently, the values of the accrued pensions at 31 March 2012 and 31 March 2013 have been re-stated.
2. The pension input amounts net of member contributions represents the adjusted for inflation increase in the capitalised value of accrued pensions during the year less the cash contribution made by the members. The adjustment for inflation is determined by reference to CPI in the previous September; 2.2% in September 2012 and 5.2% in September 2013. The difference in CPI inflation has a significant impact on the valuation.

Comparison of overall pay and performance

Figure 8 and 9, together with the table below shows how our pay policy has compared with performance and compares the total pay of our Chief Executive to year on year growth in customer equity (i.e. financial reserves being regulatory capital value less net debt) over the previous five years.

Relative importance of spend on pay

It is important that the Committee considers the cost of remuneration in relation to other factors such as company performance, figure 10 sets out the change in total expenditure, total employee remuneration costs and customer equity in 2014 compared to 2013.

Employee remuneration costs rose by 17% due to a number of factors including a number of roles being transferred into the company and new roles being identified as more contracted services were brought in-house in 2013-14, particularly in the Business Information Services area. Other factors include pension auto enrolment costs and the 3% pay award in April 2013

Figure 8 – Customer Equity over 5 years to 31 March 2013

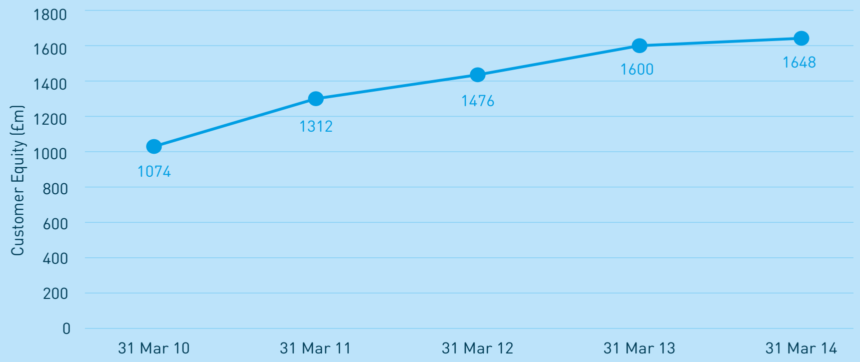


Figure 9

	2010	2011	2012	2013	2014
Total remuneration for Chief Executive (NA)	£390,320	£665,965	£677,770	£590,310	£666,801
Total remuneration for Chief Executive (CJ)	n/a	n/a	n/a	n/a	£575,563
Variable Pay (as % of maximum potential in each year)					
AVPS award (NA)	38.2%	76.3%	77.6%	60.6%	49.9%
AVPS award (CJ)	n/a	n/a	n/a	n/a	51.1%
Long Term incentives (LTVPS for AMP 5)	19.5%	25.0%	40.0%	50.0%	70.0%

Note:
1. For 2014 full financial year figures have been provided for Nigel Annett and Chris Jones and do not solely relate to the period as Chief Executive.
2. The total remuneration figures for Nigel Annett have been recalculated and restated from 2010 onwards taking into account the new reporting regulations for calculating pension benefits as described above in the Pension Benefits section on page 76. In 2010, the pension figure was negative, therefore a £0 value was included in the remuneration figure. High inflation and no salary increase were the contributing factors for the negative pension benefit. The new methodology is very sensitive to inflation.
3. The LTVPS percentages show the % of the maximum potential rather than the % of salary awarded.

Figure 10 – Relative importance of spend on pay

	2014 £m	2013 £m	£m	Change %
Total expenditure[1]	790.7	773.4	17.3	2%
Employee remuneration costs	118.9	101.5	17.4	17%
Customer equity[2]	1,648	1,600	48.0	3%
Executive Director remuneration costs	1.7	1.5	0.2	14.0%

1. Operational expenditure, capital expenditure and financing costs.
2. Regulatory capital value less net debt. Customer equity metric included to enable comparisons with shareholder owned companies.

Figure 11 – Percentage change in CEO remuneration compared with other employees

	Chief Executive % change from 2012/13	Employees % change from 2012/13
Salary	-3.5%	4.1%
Benefits	0%	0%
Annual Variable Pay	-24.6%	-1%

Note:
— Chief Executive salary is a blended rate using pro rata amounts for Nigel Annett and Chris Jones.
— Annual Variable Pay % change compares the current Chief Executive's award (Chris Jones) with the previous Chief Executive's award (Nigel Annett).
— Employees salary % change includes increases awarded for annual pay award and career progression.
— Excludes subsidiary due to separate payrolls and administration.

3. How pay is determined

Remuneration Committee

The Committee is chaired by James Strachan. In 2013-14, the other members of the Committee were Robert Ayling, John Bryant, Anna Walker and John Warren. The Board considers that all the members of the Committee are independent and, in the case of Robert Ayling, that he was considered to be independent on his appointment as Chairman of the Company. The Chief Executive and the Director of Human Resources attend meetings of the Committee by invitation (except where their own remuneration is discussed) and the Company Secretary acts as secretary to the Committee. The Committee was convened on four occasions in 2013-14.

The role of the Committee is to approve, implement and keep under review the Remuneration Policy of the Board and specifically:

— to agree the Policy and framework and service contracts for the remuneration of the Chairman and the Executive Directors and the remuneration framework for certain senior managers (the Dŵr Cymru Executive and Leadership Teams); and
— to determine variable pay arrangements that encourage and recognise good performance and that reward individuals in a fair and responsible manner for their contribution to the success of the Company.

In 2013-14, the Committee received independent advice from New Bridge Street ('NBS'), a trading name of Aon Hewitt Limited (an Aon plc company). NBS is a signatory to the Remuneration Consultants Group Code of Conduct and any advice given is governed by the Code. NBS advised on market best practice in the design of incentive performance arrangements, the benchmarking of Directors' remuneration and fees and provided general remuneration advice to the Committee. During 2013-14 NBS received fees amounting to £41,923 in relation to advice provided to the Committee and did not provide any other advice to the Company. The Committee also sought advice and information from Quantum Actuarial LLP (pension data).

The Committee has concluded that there are no conflicts of interest in relation to these organisations supporting both the Committee and the Company in the implementation of its decisions.

During 2013-14, the activities of the Committee included:

— approving the 2013 Remuneration Report;
— assessing performance achieved against the conditions attached to the 2013-14 AVPS and LTVPS and agreeing awards to be made to participants;
— reviewing salaries and AVPS for the broader executive and leadership teams;
— conducting a review of the incentive plan structure in readiness for AMP6
— consideration of remuneration and pension trends and best practice;
— determining the salary of the Executive Directors and the Chairman's fee for 2014-15; and
— determining the total remuneration for the Managing Director and Finance Director of DCCS Ltd.

At last year's AGM, Members voted in favour of the Directors' Remuneration Report.

DIRECTORS' REPORT

This Report should be read in conjunction with the Corporate Governance Report (page 55) and The Audit Committee Report, which collectively constitute the Directors' Report.

Glas Cymru Cyfyngedig (Company number 03975719) is a company limited by guarantee incorporated in England and Wales. Our registered office is Pentwyn Road, Nelson, CF46 6LY.

The Directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the company's performance, business model and strategy. In order to arrive at this position, the Board were assisted in the following ways:

— Annual Report was drafted by senior management and overall co-ordination overseen by the Company Secretary and Director of Communications to ensure consistency.
— Reviews of drafts undertaken by Members of the Executive team and a verification process involving the Reporter and the company's auditors, has been undertaken.
— The final draft was reviewed by the Audit Committee prior to review and approval by the Board, and submission to Members for approval.

The Board has prepared a Strategic Report which provides a summary of the development and performance of the company's business in the year ended 31 March 2014 and covers likely future developments.

Directors: The names and brief biographical details of the Directors are given on page 61 of this document.

All Directors served throughout the year ended 31 March 2014 except Graham Edwards who joined the Board in October 2013. At the 2014 AGM, John Bryant will stand down, Graham Edwards will formally stand for election for the first time and all other Directors will stand for re-election. This will meet the requirement under our Articles of Association for one third of Directors to retire by rotation. The Board has endorsed the effectiveness and commitment (and, in respect of the Non-Executive Directors, the independence) of the Directors and recommends each for re-election. Further details are set out in the Notice of the 2014 AGM which will take place on Friday 4th July 2014. The Non-Executive Directors' letters of appointment are made available for public inspection.

No Director has, or has had, a material financial interest, directly or indirectly, in any contract significant to the Company's business and the Board has not been requested to use, and has not used, its discretion under Article 57 of Glas Cymru's Articles of Association which allows the approval of a potential conflict of interest. Details of the remuneration of individual Directors and of the remuneration strategy approved by the Board are included in the Remuneration Report for the year ended 31 March 2014 contained in this Annual Report. A resolution will be proposed at the 2014 AGM to approve the 2014 Remuneration Report.

The Company has in place Directors' and Officers' insurance giving cover against legal action brought against the Directors and an indemnity in circumstances where a director has not acted fraudulently or dishonestly. The indemnity is a qualifying indemnity for the purpose of the Companies Act and is for the benefit of all Directors. No claims have been made against this policy since the date of the last report.

Employees: At 31 March 2014, the Group had 2,954 employees. Our success is dependent upon our having highly committed and motivated people and in other sections of this annual report we describe how we are engaging with colleagues and developing the talent and core competence of the business.

We do will not discriminate against applicants or employees on the basis of age, disability, gender reassignment, marital or civil partner status, pregnancy or maternity, race, colour, nationality, ethnic or national origin, religion or belief, sex or sexual orientation ("protected characteristics" in accordance with the Equality Act 2010) or any other personal characteristic. If an employee is disabled or becomes disabled, we consider any reasonable adjustments that would help overcome or minimise the difficulty. It is the policy of the Group that the training, career development and promotion of a disabled person should, as far as possible, be identical to that of a person who does not suffer from a disability.

Occupational Health and Safety: We are committed to high standards of occupational health and safety and over the period 2013-14 our like-for-like performance improved with fewer RIDDOR accidents. More information on our health and safety strategy and performance is provided in our 2014 Occupational Health and Safety Report which is available on our website.

Research and Development: Our Research and Development work has focused on two main areas, developing and deploying new technology, and understanding our impact on the environment and how best to mitigate this. Our Independent Environmental Advisory Panel made up of regulators, academics and environmental stakeholders continues to advise the business on research and environmental matters. The Panel has also been instrumental is assisting us with the design of our research proposals for the next investment period. The panel has also assisted us both to tap into the expertise and resources available in such bodies and build our relationships with them, so as to leverage funding and expertise into our research. More generally, we have driven elements of the national research and development agenda by participation in water industry research initiatives, most notably through membership of UK Water Industry Research Limited which manages and coordinates the research interests of UK water companies. We have also held two annual innovation workshops, involving a wide range of Universities, technology companies, suppliers and others to develop our 25-year innovation strategies for water, wastewater and customer services.

Greenhouse gases – The release of greenhouse gases (GHG) has an impact on climate change which, either directly or indirectly, presents considerable risks both to the business and the environment. The Group seeks to reduce its releases of greenhouse gases were possible. In 2007, as part of its Strategic Direction statement Welsh Water set itself the targets of reducing operational carbon emissions by 25% by 2015 and by 50% by 2025 from the 2007/08 levels. Our energy use (mainly from Grid electricity) accounts for around 85% of operational carbon emissions and is our second largest operating cost (after people). Almost all of this comes from the operational businesses. Our entire offices and transport fleet account for less than 5% of the annual total emissions between them.

During the year our carbon emissions fell by 13 ktCO_2 or 5% percent to 243 ktCO_2 (256 in 2012/13). The biggest single factor was as a result of a significant reduction in the carbon content of the electricity grid from last year (this factor is based on the proportion of electricity derived from each source – more wind and nuclear in the mix means lower carbon). Our own reductions came mainly from increased on-site renewable energy generation (up by 6 GWh (3 ktCO_2) to 43 GWh). With further projects in delivery for 2014-15 we remain on track to hit our 2015 target for CO_2.

For consistency across all our reports, we report carbon based on the Defra methodology for reporting to OfWat. Under the Defra/DECC guidelines for annual reporting, the figure is 249 ktCO_2e (equivalent not previously reported). The difference is made up mainly from the impact of chemical usage, principally granular activated carbon (GAC).

Corporate Social Responsibility: We have a firm commitment to environmental responsibility and to being a good neighbour and a trusted partner in the communities we serve. To earn this trust, we have to show that we behave fairly and responsibly in the interests of customers, that we use resources wisely, and that we make an appropriate contribution to community. Examples from 2013-14 include our education centres, Rainscape and Stop the Block campaigns, also a wide range of ecological and biodiversity related projects such as work to regenerate upland peat bogs, and protect the quality of our raw water sources.

Political Donations: It is Board policy not to make donations to political parties or to incur political expenditure and during 2013-14 no donations or payments were made which are required to be disclosed under section 366 of the Companies Act 2006.

Welsh Language Scheme: We welcome dealing with customers and other stakeholders in Welsh or English and aim to provide an effective standard of service in both languages. Our Welsh Language Scheme is an approved scheme under the provisions of the Welsh Language Act 1993 and we are working closely with the Welsh Language Commissioner's office to prepare for the implementation of the provisions of the Welsh Language Measure 2011.

Regulatory Accounts (Dŵr Cymru): Condition F of the Instrument of Appointment under which Welsh Water operates requires that we publish additional financial information as an 'appointed business'. A copy of this information is published on our website.

CORPORATE GOVERNANCE

Events after the Financial Year-End: There have been no post balance sheet events.

Annual General Meeting: The 2014 AGM will be held on Friday 4 July 2014 at the Marriott Hotel, Swansea. The business for the AGM includes the approval of the Directors' Report and Financial Statements and the Remuneration Report for the year ended 31 March 2014 and approval of the Remuneration Policy, the re-election of all Directors, a resolution to authorise the Company to make donations to EU political organisations and to incur EU political expenditure up to defined limits and resolutions to reappoint the auditors and to authorise the Audit Committee to fix their fees. These resolutions are all matters of ordinary business – there is no special business. Further information in respect of all resolutions is provided in the Notice of 2014 AGM sent to the Members of Glas Cymru with this report.

The Directors are responsible for preparing the Directors' 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 financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a fair, balanced and understandable view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing these financial statements, the Directors are required to:

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

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 statement comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Going Concern: The Directors are satisfied that the business has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2014 have been prepared on a going concern basis.

Auditors: PricewaterhouseCoopers LLP acted as the auditors to Glas Cymru for the accounts for the year ended 31 March 2014. As part of the audit process we have confirmed that as far as each Director is aware there is no relevant audit information of which the auditors are unaware and that they have taken steps to be made aware of any relevant audit information and to establish that the Company's auditors are aware of that information. A resolution to re-appoint PricewaterhouseCoopers will be put to Members at the 2014 AGM.

By order of the Board

Nicola Williams
General Counsel and Company Secretary
12 June 2014

Independent Auditors' Report to the Members of Glas Cymru Cyfyngedig

Report on the financial statements

Our opinion

In our opinion the financial statements, defined below:

- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2014 and of the Group's profit and of the Group's and Parent Company's cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The Group financial statements and Parent Company financial statements (the "financial statements"), which are prepared by Glas Cymru Cyfyngedig, comprise:

- the Group and Parent Company statements of financial position as at 31 March 2014;
- the Group income statement and statement of comprehensive income for the year then ended;
- the Group and Parent Company statements of changes in equity and statements of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company, as applied in accordance with the provisions of the Companies Act 2006.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). 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 and 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 Report and Accounts (the "Annual Report") to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Overview of our audit approach

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole. Based on our professional judgment, we determined materiality for the Group financial statements as a whole to be £9.1million, which represents 2.5% of Group EBITDA. Given that the company has no shareholders and reinvests all surpluses back into the company in the form of infrastructure improvements and improvements of the delivery of the service to customers, there is a focus on the generation of positive operating cash flows, for which EBITDA is a reasonable proxy.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.45 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

The Group financial statements are a consolidation of seven entities, comprising the group's operating businesses and centralised functions.

The Group audit team audited the complete financial information of all seven entities. This gave us the evidence we needed for our opinion on the Group financial statements as a whole.

Areas of particular audit focus

In preparing the financial statements, the Directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the Audit Committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 63.

Area of focus	How the scope of our audit addressed the area of focus
Provision for impairment of trade receivables We focused on the provision calculated for impairment because the calculation method is sensitive to changes in assumptions and an element of judgement is required in assessing the effect changes in external factors will have on future impairment losses.	We evaluated and tested the design and operating effectiveness of controls surrounding the calculation of the provision for impairment of trade receivables and compared the consistency of the approach taken by management with prior years. We also tested the underlying data upon which the calculations were based and challenged the key judgements applied in calculating the provision by applying sensitivity analysis using a number of reasonably possible scenarios.
Valuation of pension scheme We focused on this area because the pension scheme liability is material to the financial statements and sensitive to a number of subjective assumptions.	We considered the competency and qualifications of the actuary who performed the valuation and checked that the appropriate data had been used in the calculation. In addition, we formed an independent expectation of what the key pension valuation assumptions should be and compared them to those adopted by management. We checked the disclosure of the information provided by the actuary.
Allocation of capital costs Expenditure on the capital programme is either capitalised as a capital addition or expensed within the income statement. Given the complexity of the capital programme, the classification of some of the expenditure is open to judgement. We have determined the key areas of judgement to be around the costs classified as Infrastructure renewals expenditure, the capitalisation of support costs and the capitalisation of intangible additions.	We evaluated and tested the design and operating effectiveness of controls addressing the risk. We tested a sample of costs capitalised within Property, plant and equipment and intangible assets met the recognition criteria of IAS 16 and IAS 38 respectively. In relation to Infrastructure renewals expenditure which has been expensed in the Income statement we tested a sample to determine that it is appropriate that these costs have not been capitalised.
Valuation of derivative financial instruments The group has a number of complex derivative financial instruments whose valuation is both complex and sensitive to small changes in the valuation basis.	We performed independent valuations of the derivative financial instruments and compared them to those obtained by management.

Presumed areas of focus	How the scope of our audit addressed the area of focus
Fraud in revenue recognition ISAs (UK & Ireland) presume there is a risk of fraud in revenue recognition because of the pressure management may feel to achieve the planned results. Whilst we have assessed the risk and performed work across all revenue streams, the area subject to the greatest level of estimation is the measured income accrual.	We evaluated and tested the design and operating effectiveness of controls addressing the risk and the revenue recognition policy adopted by the group. We also tested the flow of revenue transactions through the use of computer aided auditing techniques and investigated unusual entries. For balances held with other water companies we directly confirmed the revenue and debtor balance. In addition, we tested manual journals affecting revenue and tested the reconciliations between the revenue systems used by the Group and its financial ledgers. Specifically in relation to the measured income accrual, we have checked that appropriate data has been used in the calculation and that the calculation is accurate.
Risk of management override of internal controls ISAs (UK & Ireland) require that we consider this.	We assessed the overall control environment of the Group, including the arrangements for staff to "whistle-blow" inappropriate actions, and interviewed senior management and the Group's internal audit function. We examined the significant accounting estimates and judgments relevant to the financial statements for evidence of bias by the Directors that may represent a risk of material misstatement due to fraud. We also tested journal entries focussing on manual journals.

Going concern

The Directors have voluntarily complied with Listing Rule 9.8.6(R)(3) of the Financial Conduct Authority and provided a statement in relation to going concern, set out on page 82, required for companies with a premium listing on the London Stock Exchange.

The Directors have requested that we review the statement on going concern as if the Parent Company were a premium listed company. We have nothing to report having performed our review. As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting.

The going concern basis presumes that the Group and Parent Company have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Parent Company's ability to continue as a going concern.

Opinion on other matter prescribed by the Companies Act 2006

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

Opinion on additional disclosures Directors' Remuneration Report

The Parent Company voluntarily prepares a Directors' Remuneration Report in accordance with the provisions of the Companies Act 2006. The Directors have requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the Parent Company were a quoted company.

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

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. We have no exceptions to report arising from this responsibility.

Corporate Governance Statement

The Directors have chosen to voluntarily comply with the UK Corporate Governance Code ("the Code") as if the parent company were a premium listed company. On page 82 of the Annual Report, as required by the Code Provision C.1.1, the Directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Parent Company's performance, business model and strategy.

On page 64, as required by C.3.8 of the Code, the Audit Committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the Directors is materially inconsistent with our knowledge of the Group and Parent Company acquired in the course of performing our audit; or
- the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

Other information in the Annual Report

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Parent Company acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Matter on which we have agreed to report by exception

Corporate Governance Statement

The Parent Company's voluntary Corporate Governance Statement includes details of the Parent Company's compliance with the UK Corporate Governance Code. The Directors have requested that we review the parts of the Corporate Governance Statement relating to the parent company's compliance with the nine provisions of the UK Corporate Governance Code specified for auditor review by the Listing Rules of the Financial Conduct Authority as if the Parent Company were a premium listed company. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & 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.

KE Finn

Katharine Finn
Senior Statutory Auditor
for and on behalf of
PricewaterhouseCoopers LLP
Chartered Accountants and
Statutory Auditors
Cardiff
12 June 2014

FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2014

			2014		As restated 2013
Continuing activities	Note	£m	£m	£m	£m
Revenue			736.5		716.4
Operating costs:					
- Operational expenditure	3		(296.4)		(297.7)
- Infrastructure renewals expenditure	3		(71.8)		(79.4)
- Depreciation and amortisation	3		(163.7)		(158.7)
			(531.9)		(535.8)
Operating profit			204.6		180.6
Financing costs:					
- Interest payable and similar charges	4a	(160.6)		(141.3)	
- Finance income receivable	4a	6.3		7.0	
- Fair value gains/(losses) on derivative financial instruments	4b	94.2		(61.2)	
			(60.1)		(195.5)
Profit/(loss) before income tax			144.5		(14.9)
Taxation	5		10.8		14.4
Profit/(loss) for the year			155.3		(0.5)

UNDERLYING PROFIT FOR THE YEAR

(Profit before taxation, fair value adjustments and accounting profit on lease termination)

	2014 £m	As restated 2013 £m
Profit/(loss) before taxation per Income Statement	144.5	(14.9)
Adjustment for:		
- Fair value (gains)/losses on derivative financial statements (see note 4b)	(94.2)	61.2
- Accounting profit on lease termination	—	(20.1)
Underlying profit for the year	50.3	26.2

The company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the parent company's income statement. The profit of the parent company for the year was nil (2013: nil).

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2014

	Note	2014 £m	As restated 2013 £m
Profit for the year		155.3	(1.1)
Items that will not be reclassified to profit or loss			
Actuarial gain recognised in the pension scheme	20	24.9	5.0
Movement on deferred tax asset relating to pension scheme	5	(5.8)	(0.9)
Total comprehensive income for the year		174.4	3.0

CONSOLIDATED STATEMENT OF CHANGES IN RESERVES FOR THE YEAR ENDED 31 MARCH 2014

	2014 £m	As restated 2012 £m
Balance as at 1 April	(74.4)	(77.4)
Total comprehensive income for the year	174.4	3.0
Reserves/(deficit) at 31 March	100.0	(74.4)

There were no changes in reserves of the parent company during the year (2013: none).

The restatement of the prior year comparative is in consequence of the revisions to IAS 19 which require a change to the calculations of the interest cost in relation to defined benefit pension schemes. Further information is provided in note 1

CONSOLIDATED BALANCE SHEET AS AT 31 MARCH 2014

	Note	2014 £m	2013 £m
Assets			
Non-current assets			
Property, plant and equipment	7	3,442.3	3,336.1
Intangible assets	8	83.9	66.1
Investments	9	—	—
		3,526.2	3,402.2
Current assets			
Trade and other receivables	10	526.7	526.1
Inventories		2.3	1.6
Financial assets:			
- derivative financial instruments	14	3.7	4.4
Cash and cash equivalents	11	94.4	157.4
		627.1	689.5
Total assets		4,153.3	4,191.7
Liabilities			
Current liabilities			
Trade and other payables	12	(535.5)	(542.6)
Financial liabilities:			
- borrowings	13	(30.6)	(79.7)
- derivative financial instruments	14	(32.3)	(37.9)
Provisions for other liabilities and charges	16	(4.6)	(10.5)
		(603.0)	(670.7)
Net current assets		24.1	18.8
Non-current liabilities			
Trade and other payables	12	(80.2)	(67.7)
Financial liabilities:			
- borrowings	13	(2,879.3)	(2,815.2)
- derivative financial instruments	14	(236.4)	(325.7)
Post employment benefits	20	(2.8)	(32.8)
Provisions for other liabilities and charges	16	(10.3)	(10.1)
		(3,209.0)	(3,251.5)
Net assets before deferred tax		341.3	169.5
Deferred tax – net	6	(241.3)	(243.9)
Net assets/(liabilities)		100.0	(74.4)
Reserves/(deficit)		100.0	(74.4)

The financial statements on pages 88 to 119 were approved by the Board of Directors on 6 June 2013 and were signed on its behalf by:

C A Jones
Chief Executive Officer

P D Perry
Chief Operating Officer

FINANCIAL STATEMENTS

PARENT COMPANY BALANCE SHEET AS AT 31 MARCH 2014

	Note	2014 £m	2013 £m
Assets			
Non-current assets			
Investment in subsidiaries	9b	—	—
Trade and other receivables	10	3.4	3.4
		—	3.4
Current assets			
Cash and cash equivalents	11	0.1	0.1
		0.1	0.1
Liabilities			
Current liabilities			
Trade and other payables	12	(3.5)	(3.5)
		(3.5)	(3.5)
Net assets		—	—
Reserves			
Retained earnings		—	—
Total reserves		—	—

The financial statements on pages 88 to 119 were approved by the Board of Directors on 6 June 2013 and were signed on its behalf by:

C A Jones
Chief Executive Officer

P D Perry
Chief Operating Officer

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2014

	Note	2014 £m	2013 £m
Cash flows from operating activities			
Cash generated from operations	17a	351.8	326.0
Interest paid	17b	(174.7)	(124.5)
Income tax received		—	4.2
Net cash generated from operating activities		177.1	205.7
Cash flows from investing activities			
Interest received		6.3	7.3
Purchase of property, plant and equipment		(227.4)	(199.2)
Purchase of intangible assets		(55.5)	(53.2)
Grants and contributions received		14.6	13.7
Net cash outflow from investing activities		(262.0)	(231.4)
Net cash outflow before financing activities		(84.9)	(25.7)
Cash flows from financing activities			
Long term loans received		75.0	—
Term loan repayments		(13.5)	(13.5)
Finance lease principal payments		(39.4)	(103.6)
Other loan repayments		(0.2)	(0.3)
Net cash inflow/(outflow) from financing activities		21.9	(117.4)
Decrease in cash and cash equivalents	18	(63.0)	(143.1)
Cash and cash equivalents at 1 April		157.4	300.5
Cash and cash equivalents at 31 March	11	94.4	157.4

The parent company had no cash flows during the year (2013: none).

1 ACCOUNTING POLICIES, FINANCING RISK MANAGEMENT AND ACCOUNTING ESTIMATES

Accounting policies for the year ended 31 March 2014
The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been applied consistently to both of the years presented.

Basis of preparation
The consolidated financial statements of Glas Cymru Cyfyngedig have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS interpretations committee (IFRS IC) as adopted by the European Union and the Companies Act 2006 applicable to companies reporting under IFRS and IFRIC interpretations. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss.

Going concern
As described in the financing risk management section the group meets its day to day working capital requirement through its bank facilities. The current economic conditions continue to create uncertainty over the level of demand for the group's services; and the availablity of bank finance for the foreseeable future. The group's forecasts and projections, taking account of reasonably possible changes in trading performance, show that it should be able to operate within its current facilities. After making enquires, the Directors have a reasonable expectation that the group has adequate resources to continue operational existence for the foreseeable future. The group therefore continues to adopt the going concern basis in preparing its financial statements.

The preparation of financial statements in conforming with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas including a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed on page 97.

Changes in accounting policies and disclosures
The following standards have been adopted by the group for the first time in the financial year beginning on 1 April 2013 and have a material impact on the group. As at 31 March 2014 there were no new standards or interpretations in issue but not yet effective which are expected to have a material impact on the company's financial statements.

IAS 19 (revised) 'Employee benefits'
IAS 19 (revised) amends the accounting for employment benefits. The group has applied the standard retrospectively in accordance with the transition provisions of the standard. The impact on the group has been in the following areas:

— The standard requires past service cost to be recognised immediately in profit or loss.
— The standard replaces the interest cost on the defined benefit obligation and the expected return on plan assets with a net interest cost based on the net defined benefit asset or liability and the discount rate, measured at the beginning of the year. There is no change to determining the discount rate; this continues to reflect the yield on high-quality corporate bonds. This has increased the income statement charge as the discount rate applied to assets is lower than the expected return on assets. This has no effect on total comprehensive income as the increased charge in profit or loss is offset by a credit in other comprehensive income.
— There is a new term 'remeasurements'. This is made up of actuarial gains and losses, the difference between actual investment returns and the return implied by the net interest cost. 'Retirement benefit obligations' as previously reported have been restated at the reporting dates to reflect the effect of the above. The effect of the change in accounting policy on the statement of cash flows was immaterial.

IFRS 10 'Consolidated financial statements'
The group has early adopted IFRS 10. Under IFRS 10 subsidiaries are all entities (including structured entities) over which the group has control. The group controls an entity where the group has power over an entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are deconsolidated from the date that control ceases. The group has applied IFRS 10 retrospectively in accordance with the transition provisions of IFRS 10.

IFRS 13 'Fair value measurement'
IFRS 13 'Fair value measurement' applies to annual periods beginning on or after 1 January 2013. It provides a single framework for measuring fair values and requires additional disclosures about fair value measurements.

New standards and interpretations not yet adopted
A number of new standards and amendments to standards and inpretations are effective for annual periods beignning after January 2013, and have not been applied in preparing these consolidated financial statement. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below ;

IFRS 9 'Financial instruments'
IFRS 19 'Financial instruments' addresses the calissification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in Novemeber 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial asstes to be classified into two measurement catergories; those measured at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The mainchange is that, in cases where the fair value option is taken for financial liabilities, the part of the fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The group is yet to assess IFRS 9's full impact. The Group will also condsider the impact of the remaining phases of IFRS 9 when completed by the Board.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

Basis of consolidation
The consolidated financial statements include the financial statements of the company and its subsidiaries. The results of companies and businesses acquired during the year are dealt with in the consolidated financial statements from the date of acquisition. Intra-group transactions and profits are eliminated on consolidation.

Revenue recognition
Revenue represents the income receivable in the ordinary course of business for services provided, excluding value added tax. Where services have been provided but for which no invoice has been raised at the year-end an estimate of the value is included in revenue (see the 'Critical accounting estimates' section for further details). Revenue recognised reflects the value of services provided to customers in the year. Where customers have made payments in advance as at the year end, this is recognised as deferred income.

Segment reporting
Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segment, has been identified as the steering committee that makes strategic decisions.

Property, plant and equipment
Property, plant and equipment are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs and borrowing costs.

Property, plant and equipment comprise:

a) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls); and
b) Other assets (including properties, overground operational structures and equipment, and fixtures and fittings).

The carrying value of assets is reviewed for impairment if circumstances dictate that the carrying value may not be recoverable. Asset lives and residual values are reviewed annually.

Infrastructure assets
Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas, reflecting the way the group operates its wastewater activities.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is treated as additions, which are included at cost. Expenditure incurred in repairing and maintaining the operating capability of individual infrastructure components, 'infrastructure renewals expenditure', is expensed in the year in which the expenditure is incurred.

The depreciation charge for infrastructure assets is determined for each component of the network and is based on each component's cost, estimated residual value and the expected remaining average useful life. The useful average economic lives of the infrastructure components range principally from 60 to 150 years.

Other assets
Other assets are depreciated on a straight line basis over their estimated useful economic lives, which are as follows:

Freehold buildings	60 years
Operational structures	5 – 80 years
Plant, equipment and computer hardware and software	3 – 40 years

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

Intangible assets
Intangible assets, which comprise principally computer software, systems developments and research and development are included at cost less accumulated amortisation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs. Research expenditure is recognised as an expense as incurred. Costs incurred on development projects are recognised as intangible assets when the relevant recognition criteria are met (as per IAS 38).

The carrying values of intangible assets are reviewed for impairment if circumstances dictate the carrying value may not be recovered. Intangible assets are amortised on a straight line basis over their estimated useful economic lives, which range between 3 and 20 years. These asset lives are reviewed annually.

Leased assets
Where assets are financed by leasing arrangements, which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are capitalised and included in 'property, plant and equipment' with the corresponding liability to the lessor included within 'financial liabilities – borrowings'. Leasing payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor with the finance charge being recognised over the period of the lease based on its implicit rate so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Grants and customer contributions
Grants and customer contributions in respect of expenditure on property, plant and equipment have been offset against these assets.

Grants in respect of revenue expenditure are credited to the Income statement over the same period as the related expenditure is incurred.

Capital expenditure programme incentive payments
The group's agreements with its construction partners involved in delivering capital expenditure programmes incorporate incentive bonuses payable after completion of the programmes. The cost of property, plant and equipment additions includes an accrual for incentive bonuses earned to date, relating to projects substantially completed at the year-end, where the likelihood of making the incentive payment is considered probable. Amounts recoverable from contract partners relating to targets not being achieved are recognised only on completed projects.

Trade receivables
Trade receivables are recognised initially at fair value and measured subsequently at amortised cost less provision for impairment. They are first assessed individually for impairment, or collectively where the receivables are not significant individually. Where there is no objective evidence of impairment for an individual receivable, it is included in a group of receivables with similar credit risk characteristics and these are assessed collectively for impairment based on their ageing.

Movements in the provision for impairment are recorded in the income statement.

Cash and cash equivalents
Cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition and typically include cash in hand and deposits with banks or other financial institutions.

Pension costs
1) Defined benefit scheme
The group operates a defined benefit scheme which is funded by both employer's and employees' contributions. Actuarial valuations of the scheme are carried out at intervals of not more than three years. Contribution rates are based on the advice of a professionally qualified actuary.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. In countries where there is no deep market in such bonds, the market rates on government bonds are used. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income.

The group's accounting treatment has been updated in accordance with revisions to IAS 19 (see basis of preparation).

2) Defined contribution scheme
The group also operates a defined contribution scheme for those employees who are not members of the defined benefit scheme. Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

The group's accounting treatment has been updated in accordance with revisions to IAS 19 (see basis of preparation)

Financial liabilities
Debt is measured initially at fair value, being net proceeds after deduction of directly attributable issue costs, with subsequent measurement at amortised cost. Debt issue costs are recognised in the income statement over the expected term of such instruments at a constant rate on the carrying amount.

Trade payables are obligations to pay for goods/services acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year, or in the normal operating cycle of the business if longer. If not, they are presented as non-current liabilities.

Derivative instruments utilised by the group are interest rate and inflation swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the group. Derivatives are recognised initially and subsequently re-measured at fair value (based on market price data from relevant counterparties). During the year to 31 March 2014, none of the group's derivatives qualified for hedge accounting under IAS 39 (2013: none).

These instruments are carried at fair value with changes in fair value being recognised immediately in the income statement.

Deferred taxation
Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax has been recognised in relation to rolled over gains except for where reinvestment has been made in certain operational assets which the company plans to use until the end of their useful economic life. The company anticipates that these assets will then be scrapped for negligible proceeds, or proceeds less than their tax base, and therefore no chargeable gain is expected to arise in the future.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Provisions
Provisions for restructuring costs, dilapidations and uninsured losses are recognised when the group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation; and the amount has been estimated reliably. Restructuring provisions comprise employee severance and pension fund top-up costs.

Where the group receives claims that are either not covered by insurance or where there is an element of the claim for which insurance cover is not available, a provision is made for the expected future liabilities. Provisions are not recognised for future operating losses.

Where there is a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligation may be small.

Borrowing costs
General and specific borrowing costs directly attributable to acquisition, constrcution and production of quantifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those until such time as the assets are substantially ready for their intended use.

Financing risk management objectives and policies
Treasury activities are managed within a formal set of treasury policies and objectives, which is reviewed regularly and approved by the Board. The policies specifically prohibit any transactions of a speculative nature and the use of complex financial instruments. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may be changed only with the consent of Dŵr Cymru Cyfyngedig's Security Trustee. The risk is mitigated further by limiting exposure to any one counterparty. The group uses financial instruments to raise finance and manage operational risk; these instruments principally include listed bonds, finance leases, bank loan facilities and derivatives.

Credit risk

The group has a prudent policy for investing cash and short term bank deposits, set by the bond documentation within the Common Terms Agreement. Deposits of up to one year can be placed with counterparties that have a minimum short-term rating of A1/P1/F1 from Standard & Poor's, Moody's and Fitch Ratings respectively. Deposits of over one year should be placed with counterparties that have a minimum rating of AA-/Aa3/AA-.

In practice, in the current economic environment the group has adopted a more prudent approach to cash management and deposits are placed for a maximum of three months with banks subject to minimum short-term rating criteria of A1/P1/F1. Bond and commercial paper purchases of up to one year can be placed with certain AAA-rated supranationals only. The maximum cash investment with a single counterparty was £25m (2013: £60m).

Interest rate risk

The group hedges at least 85% of its total outstanding financial liabilities, including finance leases, into either index-linked or fixed rate obligations. For this purpose floating rate interest liabilities are hedged through a combination of derivative instruments and cash balances. The regulatory framework under which revenues and the regulatory asset value are indexed also exposes the group to inflation risk. Therefore subject to market constraints and Board approval, the group therefore may seek to raise new debt through index-linked instruments or to enter into appropriate hedging transactions.

The group analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. Of total borrowings of £2,910m as at 31 March 2014 (2013: £2,895m) none related to floating rate debt (2013: none). The group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2014, 100% (2013: 100%) of the group's gross debt was at fixed or index-linked ('RPI') rates of interest after taking into account interest rate and RPI swaps. The 'hedges' established to manage interest rate risks are economic in nature, but do not satisfy the specific requirements of IAS 39 in order to be treated as hedges for accounting purposes. Accordingly, all movements in the fair value of derivative financial instruments are reflected in the income statement. This has resulted in a net liability of £265m in the balance sheet at 31 March 2014 (2013: £359m) but, assuming that the swaps are held to maturity, this will ultimately reduce to nil.

Power price hedges

The company enters into contracts which fix the price of a proportion of future power purchases in order to reduce the impact of power price variances. The company has forward-purchased around 70% of the estimated power requirement of the business over the remainder of the regulatory period to 31 March 2015. These contracts neither qualify as financial instruments under IAS 39 nor as onerous contracts under IAS 37 and, consequently, are not included in the financial statements until the contracts are effective.

Refinancing risk

Refinancing risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of instruments, types and maturities. The group's policy is to ensure that the maturity profile does not impose an excessive strain on its ability to repay loans. Under this policy, no more than 20% of the principal of group borrowings of £2,910m (2013: £2,895m) can fall due in any 24 month period.

Liquidity risk

The group maintains committed banking facilities in order to provide flexibility in the management of its liquidity.

Under the Common Terms Agreement which governs obligations to bond holders and other financial creditors, the group is required to have cash available to fund operations for 12 months. As at 31 March 2014, the group had committed undrawn borrowing facilities of £140m (2013: £215m) and cash and cash equivalents (excluding debt service payments account) of £73m (2013: £98m).

The group has revolving credit facilities totalling £140m with a group of six banks. £30m of these facilities will expire in May 2014, £20m is available to be drawn until May 2016 and £90m is available until May 2017. There is also a £10m overdraft facility (2013: £10m).

As at 31 March 2014 there was also a special liquidity facility of £135m (2013: £135m); this is required in order to meet certain interest and other obligations that cannot be funded through operating cash flow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants. The facility is renewable on an annual basis.

Capital risk

The group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail Prices Index and determined by Ofwat. As at 31 March 2014 gearing was 63%.

In respect of the risks detailed above, further quantitative disclosures are provided in note 15.

Critical accounting estimates

The preparation of financial statements conforming to IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

Provision for impairment of trade receivables

Individual impairment losses on customer debts are calculated based on an individual assessment of expected cash flows. Collective impairment losses on receivables with similar credit risk are calculated using a statistical model. The key assumption in the model is the probability of a failure to recover amounts when they fall into arrears.

The probability of failing to recover is determined by past experience, adjusted for changes in external factors. The accuracy of the impairment calculation would therefore be affected by unexpected changes to the economic situation, and to changes in customer behaviour. To the extent that the failure to recover debts in arrears alters by 1%, the provision for impairment would increase or decrease by £0.7 million (2013: £0.6 million).

Pension benefits

The present value of the pension obligations is dependent on the actuarial calculation, which includes a number of assumptions. These assumptions include the discount rate, which is used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the group considers market yields of high quality corporate bonds, denominated in sterling, that have times to maturity approximating the terms of the pension liability.

Were this discount rate to reduce or increase by 0.1%, the carrying value of the pension obligations as at 31 March 2014 would increase or reduce by £6.8 million (2013: £8.0 million).

Measured income accrual

Revenue includes an accrual for unbilled charges at the year-end. The accrual is estimated using a defined methodology based upon the weighted average water consumption by tariff, which is calculated using historical billing information adjusted for changes in external factors, such as weather. The total accrual as at 31 March 2014 was £64.2 million (2013: £65.9 million). A 1% change in actual consumption from that estimated would have the effect of increasing or decreasing the accrual by £0.7 million (2013: £0.7 million).

Fair value estimation

In accordance with IFRS 13 Fair Value Measurement trading and treasury derivatives of the group are categorised into different levels;

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

All of the group's trading and treasury derivatives are categorised at Level 2 and as at 31 March 2014 were valued as follows:

Assets: Trading derivatives £0.0m, Treasury derivatives £3.7m. (March 2013: Trading derivatives £0.8m, Treasury derivatives £4.4m)

Liabilities: Trading derivatives £7.7m, Treasury derivatives £268.6m. (March 2013: Trading derivatives £1.9m, Treasury derivatives £363.6m).

Trading derivatives relate to power price hedges and are not recorded on the balance sheet. Treasury derivatives relate to interest rate swap contracts and are recorded on the balance sheet at fair value. These have all been assessed as Level 2.

The power price hedging contracts have been fair valued using rates that are quoted in an active market. While interest rate swaps are fair valued using forward interest rates extracted from observable yield curves. The effects of discounting are generally insignificant for Level 2 derivatives.

Level 2 debt investments are valued using a discounted cash flow approach, which discounts the contractual cash flows using discount rates derived from observable market prices of other quoted debt instruments of the counterparties.

There were no transfers between levels 1 and 2 during the year.

2 SEGMENTAL INFORMATION

The Directors consider that there is only one operating segment, being the operation of water and sewerage business in the UK. As the group has only domestic activities there is also only one geographical segment; therefore, the disclosures for this segment have also already been given in these financial statements.

3 PROFIT/(LOSS) BEFORE TAXATION

The following items have been included in arriving at the profit/(loss) before taxation:

	Group 2014 £m	As restated 2013 £m
Operating charges		
- Power	42.6	38.8
- Chemicals	8.6	8.4
- Materials and equipment	5.1	2.8
- Vehicles and plant	7.7	9.8
- Office expenses	6.3	6.1
- Property costs	4.4	4.1
- Insurance	5.6	7.2
- Sewerage contractors	19.4	19.3
- Customer services contract	–	5.7
- Laboratories and analytical services	1.1	3.2
- Collection commissions	4.0	3.9
- IT contracts	21.8	20.4
- Bought-in services and other costs	24.7	26.7
	151.3	156.4
Employee costs (note 19)	113.7	104.2
Staff costs capitalised	(43.5)	(35.9)
	70.2	68.3
Research and development expenditure	0.4	0.5
Trade receivables impairment	28.5	27.4
Rates	29.7	29.3
Environment Agency charges	16.0	15.6
Fees payable to auditors	0.3	0.2
Total operational expenditure	296.4	297.7
Infrastructure renewals expenditure	71.8	79.4
Depreciation and amortisation		
- Owned assets	118.0	112.0
- Under finance leases	33.9	33.9
- Amortisation of intangible assets	12.5	13.0
- Profit on disposal of property, plant and equipment	(0.7)	(0.2)
	163.7	158.7
	531.9	533.1

The restatement of the prior year comparative is in consequence of the revisions to IAS 19 which require a change to the calculations of the interest cost in relation to defined benefit pension schemes. Further information is provided in note 1.

Services provided by the group's auditors

During the year, the group obtained the following services from its statutory auditors:

	2014 £000	Group 2013 £000
Audit fees		
Audit of parent company and consolidated financial statements	13	12
Audit of subsidiary companies	91	87
Total statutory audit fees	104	99
Audit-related assurance services		
Review of interim financial statements	23	23
Regulatory audit services pursuant to legislation	28	41
Regulatory price review assurance work	49	–
Investor report reviews	8	8
Total audit and audit-related assurance services	212	171
Other services		
Replacement billings system project assurance work	74	
Other	27	24
Total other services	101	24
Total cost of services provided by the group's auditors	313	195

Regulatory audit services include audit work on the Regulatory Accounts and Principal Statement.

In addition to the above services, PricewaterhouseCoopers LLP acted as auditors to the DCWW Pension Scheme. The appointment of auditors to the pension scheme and the fees paid in respect of the audit are agreed by the trustees of the scheme, who act independently from the management of the group. The fees paid in respect of audit services to the pension scheme during the year were £18,000 (2013: £13,000).

The Board has adopted a formal policy with respect to services received from external auditors. The external auditors will not be used for internal audit services and all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee.

4 FINANCING COSTS

a) Finance cost before fair value gains/(losses) on derivative financial instruments

	2014 £m	Group 2013 £m
Interest payable on bonds	(86.3)	(85.1)
Indexation on index-linked bonds	(38.5)	(38.9)
Interest payable on finance leases (including swaps to RPI)	(27.7)	(28.1)
Other loan interest	(12.3)	(12.1)
Other interest payable and finance costs	(2.4)	(2.2)
Net interest credit/(charge) on pension scheme liabilities	(1.3)	(1.5)
Accounting profit on termination of lease	–	20.1
Capitalisation of borrowing costs under IAS 23 (2014 5.7%; 2013: 4.9%)	7.9	6.5
	(160.6)	(141.3)
Finance income	6.3	7.0
Net finance income before fair value adjustments	(154.3)	(134.3)

b) Fair value gains/(losses) on derivative financial instruments

Derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IAS 39. Consequently, the group's interest rate and index-linked swaps are fair valued at each balance sheet date with the net loss or gain disclosed in the income statement. Over the life of these swaps, if held to maturity, these fair value adjustments will reverse and reduce to zero. (See note 14 in respect of derivative financial instruments held on the balance sheet.)

	2014 £m	Group 2013 £m
Fair value gains/(losses) on interest rate swaps	22.6	(12.5)
Fair value gains/(losses) on index-linked swaps	71.6	(48.7)
Total fair value losses on derivative financial instruments	94.2	(61.2)

Interest rate swap movements are caused by fluctuations in long-term swap rates, while the index-linked swap movements result from fluctuations in the value of index-linked gilts 3-month LIBOR.

5 TAXATION

Analysis of credit in the year

	2014 £m	Group 2013 £m
Current tax		
- Current tax on profits for the year	0.9	–
- Adjustment in respect of prior years	1.5	0.4
Total current tax	2.4	0.4
Deferred tax		
- Origination and reversal of timing differences	(39.9)	2.4
- Adjustment in respect of prior year	6.3	(0.6)
- Effect of tax rate change	36.2	10.7
Total deferred tax (note 6)	2.6	12.5
Taxation credit	5.0	12.9
Analysed as:		
Credit to Income Statement	10.8	13.8
Charge to Statement of Comprehensive Income	(5.8)	(0.9)
	5.0	12.9

Tax trading losses carried forward as at 31 March 2014 are circa £300m (2013: circa £400m).

The effective rate of tax for the year is lower (2013: lower) than the standard rate of corporation tax in the UK (2014: 23%, 2013: 24%). The differences are explained below:

	2014 £m	Group 2013 £m
Profit/(loss) before tax	144.5	(12.2)
Profit/(loss) before tax multiplied by the corporation tax rate in the UK of 23% (2013: 24%)	33.2	(2.9)
Effect of:		
- Adjustments in respect of prior years	(7.8)	0.2
- Other permanent differences	(0.2)	(0.2)
- Effect of tax rate change	(36.0)	(10.9)
- Movement on deferred tax asset relating to pension scheme	5.8	0.9
Total taxation credit	(5.0)	(12.9)

FINANCIAL STATEMENTS

6 DEFERRED TAX

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 20% (2013: 23%).

The movement in the deferred tax provision is as shown below:

	2014 £m	Group 2013 £m
At 1 April	243.9	256.4
Credit to Income Statement	(8.4)	(13.4)
Charge to Statement of Comprehensive Income	5.8	0.9
At 31 March	241.3	243.9

	2014 £m	Group 2013 £m
Effect of:		
- Tax allowances in excess of depreciation	353.9	441.7
- Capital gains rolled over	3.2	3.7
	357.1	445.4
- Deferred tax on tax losses carried forward	(61.2)	(109.3)
- Deferred tax on losses on derivative financial instruments	(53.1)	(82.9)
- Pensions	(0.2)	(7.4)
- Other tax differences	(1.3)	(1.9)
Net provision for deferred tax	241.3	243.9

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered. Under the current tax regime, trading tax losses carried forward will be available to offset trading profits in future periods.

In Finance Act 2014 the Government enacted reductions in the rate of corporation tax to 21% and 20% from 1 April 2014 and 1 April 2015 respectively. The reduction in the rate of corporation tax to 20% has been used to calculate the deferred tax in these financial statements.

The company has no deferred tax balance.

7 PROPERTY, PLANT AND EQUIPMENT

Group

Current year	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2013	35.7	1,680.3	3,117.4	238.8	5,072.2
Additions net of grants and contributions	1.1	55.5	189.9	14.0	260.5
At 31 March 2014	36.8	1,735.8	3,307.3	252.8	5,332.7
Accumulated depreciation					
At 1 April 2013	18.3	236.6	1,246.1	235.1	1,736.1
Charge for the year	0.4	26.0	117.3	10.6	154.3
At 31 March 2014	18.7	262.6	1,363.4	245.7	1,890.4
Net book value					
At 31 March 2014	18.1	1,473.2	1,943.9	7.1	3,442.3

The net book value of property, plant and equipment includes £126m in respect of assets in the course of construction (2013: £140.1m).

The net book value of property, plant and equipment includes £28.8m of borrowing costs capitalised in accordance with IAS 23 (2013: £20.2m), of which £7.2m were additions in the year (2013: £6.2m).

On 1 October 2011 Dŵr Cymru Cyfyngedig assumed responsibility for managing the private sewers network in its operational area. The transfer of an estimated 17,000km of private drains and sewers has increased the size of the network significantly. Little information is available to judge the condition of those sewers – and any attributable value – but they are typically expected to be poor and below the standard of assets that the industry is generally required to operate. In light of this, and the fact that they do not generate an increase in the regulatory capital value of the business, a value of nil has been attributed to these assets in the financial statements as at 31 March 2014 (2013: nil).

Prior year	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2012	35.1	1,627.1	2,920.7	237.4	4,820.3
Additions net of grants and contributions	0.6	53.2	196.7	1.4	251.9
At 31 March 2013	35.7	1,680.3	3,117.4	238.8	5,072.2
Accumulated depreciation					
At 1 April 2012	17.9	212.3	1,132.8	225.4	1,588.4
Charge for the year	0.4	24.3	113.3	9.7	147.7
At 31 March 2013	18.3	236.6	1,246.1	235.1	1,736.1
Net book value					
At 31 March 2013	17.4	1,443.7	1,871.3	3.7	3,336.1

FINANCIAL STATEMENTS

Assets held under finance leases

Included within the above are assets held under finance leases as analysed below:

Group

Current year	Infrastructure assets	Operational structures	Total
	£m	£m	£m
At 31 March 2014			
Cost	611.8	275.5	887.3
Accumulated depreciation	(90.2)	(155.2)	(245.4)
Net book value	521.6	120.3	641.9

Prior year	Infrastructure assets	Operational structures	Total
	£m	£m	£m
At 31 March 2013			
Cost	611.8	307.7	919.5
Accumulated depreciation	(82.4)	(170.0)	(252.4)
Net book value	529.4	137.7	667.1

The parent company owns no property, plant or equipment.

8 INTANGIBLE ASSETS

Group

Current year	Cost	Amortisation	Net book value
	£m	£m	£m
At 1 April 2013	**154.7**	**(88.6)**	**66.1**
Additions/(charge for the year)	**30.3**	**(12.5)**	**17.8**
At 31 March 2014	**185.0**	**(101.1)**	**83.9**

Prior year	Cost	Amortisation	Net book value
	£m	£m	£m
At 1 April 2012	142.2	(75.6)	66.6
Additions/(charge for the year)	12.5	(13.0)	(0.5)
At 31 March 2013	154.7	(88.6)	66.1

Intangible assets comprise computer software and related system developments.

The net book value of intangible assets includes £2.0m in respect of assets in the course of construction (2013: £13.0m).
The net book value of intangible assets includes £1.1m of borrowing costs capitalised in accordance with IAS 23 (2013: £1.1m), of which £0.3m were additions in the year (2013: £0.3m).

The parent company owns no intangible assets.

9 INVESTMENTS

(a) Group

	2014	2013
	£m	£m
Cost and net book value		
At 1 April and 31 March	–	–

Equity of less than 10% is held in the following unlisted company:

	Principal activities	Country of incorporation	Holding
Water Research Centre (1989) plc	Water research	England and Wales	'B' Ordinary Shares of £1

In addition, the group held 5% Convertible Unsecured Loan Stock 2014 at a cost of £23,326 in Water Research Centre (1989) plc. This was redeemed on 31 March 2014.

(b) Parent Company

The company has a £1 investment in Glas Cymru (Securities) Cyfyngedig (100% holding) and has indirect investments in the following subsidiary undertakings:

	Principal activities	Country of incorporation	Holding
Dŵr Cymru (Holdings) Limited	Holding company	England and Wales	100%
Dŵr Cymru Cyfyngedig	Water and sewerage	England and Wales	100%
Dŵr Cymru (Financing) Limited	Raising finance	Cayman Islands	100%
Welsh Water Utilities Finance plc	Dormant	England and Wales	100%
Dŵr Cymru Customer Services Limited	Income and billing services	England and Wales	100%

Further information on the group's structure is available in the Annual Report on page 57.

10 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2014	2013	2014	2013
	£m	£m	£m	£m
Current				
Trade receivables	**502.8**	498.5	**–**	–
Provision for impairment of receivables	**(65.9)**	(61.4)	**–**	–
Trade receivables – net	**436.9**	437.1	**–**	–
Prepayments and accrued income	**67.4**	72.1	**–**	–
Other receivables	**22.4**	16.9	**–**	–
	526.7	526.1	**–**	–
Non-current				
Amounts receivable from group undertakings	**–**	–	**3.4**	3.4
	–	–	**3.4**	3.4
Total trade and other receivables	**526.7**	526.1	**3.4**	3.4

All non-current receivables are due within five years from the balance sheet date.

As at 31 March 2014, based on a review of historical collection rates it was considered that £65.9m (£2013:£61.4m) of trade receivables were impaired and these have therefore been provided for (2013: £61.4m). The impaired receivables relate mainly to the supply of measured and unmeasured water. Trade receivables aged greater than one month are past due; the net column shows amounts deemed not to be impaired.

The ageing of receivables was as follows:

Current year Trade receivables	Total £m	Provided for £m	Net £m
Billed in advance	387.6	–	387.6
Under one month	11.2	(5.3)	5.9
Between one and six months	27.7	(13.5)	14.2
Between six months and one year	25.8	(12.7)	13.1
Between one and two years	27.1	(19.5)	7.6
Between two and three years	19.1	(14.1)	5.0
Over three years	4.3	(0.8)	3.5
	502.8	(65.9)	436.9

Prior year Trade receivables	Total £m	Provided for £m	Net £m
Billed in advance	389.9	–	389.9
Under one month	16.8	(4.2)	12.6
Between one and six months	31.1	(13.1)	18.0
Between six months and one year	22.6	(9.9)	12.7
Between one and two years	22.3	(18.7)	3.6
Between two and three years	14.5	(14.2)	0.3
Over three years	1.3	(1.3)	—
	498.5	(61.4)	437.1

The maximum exposure to credit risks at the reporting date is the carrying value of each class of receivable mentioned above. The group does not hold any collateral as security.

Movements in the provision for impairment of trade receivables are as follows:

	2014 £m	2013 £m
At 1 April	61.4	54.6
Charge to Income Statement	27.9	26.7
Receivables written off during the year as uncollectable	(23.4)	(19.9)
At 31 March	65.9	61.4

The creation and release of provision for impaired receivables have been included in operational expenditure.

The other classes of trade and other receivables do not contain impaired assets. All trade and other receivables are denominated in sterling.

During the year the group has written off £24.0m of debt which had been provided for in full (2013: £19.9m).

GLAS CYMRU CYFYNGEDIG REPORT AND ACCOUNTS 2014

11 CASH AND CASH EQUIVALENTS

	Group		Company	
	2014 £m	2013 £m	2014 £m	2013 £m
Cash at bank and in hand	4.8	(13.7)	0.1	0.1
Short-term deposits	89.6	171.1	–	–
	94.4	157.4	0.1	0.1

The effective interest rate on short-term deposits as at 31 March 2014 was 0.5% (2013: 0.4%) and these deposits had an average maturity of 5 days (2013: 12 days). All cash and cash equivalents are held in sterling.

12 TRADE AND OTHER PAYABLES

Current	Group		Company	
	2014 £m	2013 £m	2014 £m	2013 £m
Trade payables	47.1	49.3	–	–
Capital payables	30.2	33.9	–	–
Amounts due to group undertakings	–	–	3.5	3.5
Social security and other taxes	3.8	3.4	–	–
Accruals and deferred income	454.4	456.0	–	–
	535.5	542.6	3.5	3.5

Non-current	Group		Company	
	2014 £m	2013 £m	2014 £m	2013 £m
Deferred income	80.2	67.7	–	–

FINANCIAL STATEMENTS

13 FINANCIAL LIABILITIES – BORROWINGS

Current	2014 £m	Group 2013 £m
Interest accruals	0.9	51.3
Unamortised bond premium	0.6	0.6
Unamortised bond issue costs	(0.3)	(0.3)
European Investment Bank loans	15.9	13.5
Local authority loans	0.3	0.3
Finance lease obligations	13.2	14.3
	30.6	79.7

Non-current	2014 £m	Group 2013 £m
Interest accruals	49.2	38.5
Bonds	1,976.8	1,938.4
Unamortised bond premium	7.9	8.4
Unamortised bond issue costs	(5.1)	(5.6)
KfW Bank loan	35.0	35.0
European Investment Bank loans	256.6	197.5
Local authority loans	0.8	1.0
Finance lease obligations	558.1	602.0
	2,879.3	2,815.2

The parent company has no borrowings.
A security package was granted by Dŵr Cymru Cyfyngedig (DCC), as part of the group's bond programme for the benefit of holders of senior bonds, finance lessors and other senior financial creditors.

The obligations of DCC are guaranteed by the company, Glas Cymru (Securities) Cyfyngedig and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:
i) a first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence; and
ii) a fixed and floating security given by the guarantors referred to above which are accrued on each of these companies' assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

The group's Class A Bonds of £988.8m (2013: £969.5m) benefit from a guarantee from MBIA UK Insurance Limited ("MBIA"). MBIA's credit rating has been reduced to B3 and BBB+ by Moody's and S&P respectively, and is no longer rated by Fitch. The credit rating of the Class A bonds has therefore defaulted to the higher underlying rating of these bonds, of A3/A/A from Moody's, S&P and Fitch respectively. The underlying rating reflects the standalone credit quality of these bonds without the benefit of the MBIA guarantee, and is the same as the credit ratings of the group's Class B bonds of £988.1m (2013: £968.9m).

14 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are held for economic hedging purposes. However, they do not qualify as accounting hedges under IAS 39 and movements in their fair value are taken to the Income Statement (see note 4b). The fair values of all derivative financial instruments held by the group are the result of mark-to-market pricing by the issuing counterparties and as such fall within level 2 of the fair value hierarchy set out in IFRS 7.

Group - 2014	Fair values Assets £m	Liabilities £m
Current		
Index-linked swaps	3.7	(21.4)
Interest rate swaps	-	(10.9)
	3.7	(32.3)
Non-current		
Index-linked swaps	–	(175.0)
Interest rate swaps	–	(61.4)
	–	(236.4)
Total	3.7	(268.7)

Group - 2013	Fair values Assets £m	Liabilities £m
Current		
Index-linked swaps	4.4	(26.5)
Interest rate swaps	–	(11.4)
	4.4	(37.9)
Non-current		
Index-linked swaps	–	(240.0)
Interest rate swaps	–	(85.7)
	–	(325.7)
Total	4.4	(363.6)

In accordance with IAS 39, 'Financial instruments: Recognition and Measurement', the group has reviewed all contracts for embedded derivatives that are required to be accounted for separately if they do not meet certain requirements set out in the standard. The group has no such embedded derivatives as per IAS 39.

The parent company has no derivative financial instruments or embedded derivatives.

Interest rate swaps

At 31 March 2014 an interest rate swap fixes the interest rate on £192m (2013: £192m) of floating liabilities held by the group. The maturity date of the swap is 31 March 2031 and the quarterly LIBOR fixed interest rate is 5.67%. In addition, £50m (2013: £50m) of finance lease liabilities have been swapped from a floating to a fixed LIBOR rate of 3.57% until March 2017. The notional amount of the swap is £48m (2013: £50m).

Index-linked swaps

Finance lease swaps

The index-linked swaps have the effect of index-linking the interest rate on £436m (2013: £439m) of finance lease liabilities by reference to the Retail Prices Index ("RPI").

The notional amount of index-linked swaps allocated to finance leases as at 31 March 2014 is £440m (2013: £528m), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2014. The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases.

The principal terms are as follows:

Notional amount	£440m amortising (2013: £528m amortising)
Average swap maturity	23 years (2013: 24 years)
Average interest rate	1.63% fixed plus RPI (2013: 1.63% fixed plus RPI)

Bond swap

The index-linked swaps have the effect of index-linking the interest rate on £100m of fixed rate bonds by reference to the RPI.

The principal terms are as follows:

Indexed notional amount	£128m (2013: £124m)
Swap maturity	43 years (2013: 44 years)
Interest rate	1.35% indexed by RPI (2013: 1.35% indexed by RPI)

15 FINANCIAL RISK MANAGEMENT

The policies of the group in respect of financial risk management are included in the accounting policies note on page 95. The numerical financial instrument disclosures as required by IFRS 7 are set out below.

a) Interest rate risk

The effective interest rates at the balance sheet dates were as follows:

	2014	2013
Assets:		
Cash and cash equivalents	0.5%	0.4%
Liabilities:		
Bonds	5.2%	5.1%
European Investment Bank loans	1.1%	1.0%
KfW loan	1.2%	1.2%
Local authority loans	5.0%	6.0%
Finance lease obligations	1.0%	1.2%

Trade and other receivables and payables are non interest-bearing.
The effective interest rates ignore the effect of the interest rate and index-linked swaps set out in note 14. They also exclude the indexation charge applicable to the index-linked bonds.

b) Liquidity risk

Group - 2014	Within 1 year £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
Assets:					
Cash and cash equivalents	94.4	–	–	–	94.4
Trade and other receivables	526.7	–	–	–	526.7
	621.1	–	–	–	621.1
Liabilities:					
Bonds	0.6	0.6	0.6	1,983.5	1,985.3
KfW Bank loan	–	–	35.0	–	35.0
European Investment Bank loans	15.9	11.6	92.6	152.4	272.5
Local authority loans	0.3	0.3	0.5	–	1.1
Finance lease obligations	13.2	14.2	86.9	456.9	571.2
Trade and other payables	535.5	1.8	4.9	73.7	615.9
	565.5	28.5	220.5	2,666.5	3,481.0

Group - 2013	Within 1 year £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
Assets:					
Cash and cash equivalents	157.4	–	–	–	157.4
Trade and other receivables	454.0	–	–	–	454.0
	611.4	–	–	–	611.4
Liabilities:					
Bonds	0.6	0.7	1.8	1,944.3	1,947.4
KfW Bank loan	–	–	35.0	–	35.0
European Investment Bank loans	13.5	15.9	53.5	128.1	211.0
Local authority loans	0.3	0.3	0.5	0.2	1.3
Finance lease obligations	14.3	43.3	83.8	474.9	616.3
Trade and other payables	505.3	1.8	4.7	61.2	150.9
	571.3	59.6	173.7	2,616.7	3,420.5

The minimum lease payments under finance leases fall due as follows:

	2014 £m	2013 £m
Gross finance lease liabilities		
Within one year	18.9	21.1
Between two and five years	123.4	153.9
After five years	514.2	542.4
	656.5	717.4
Future interest	(85.3)	(101.1)
Net finance lease liabilities	571.2	616.3
Net finance lease liabilities are repayable as follows:		
Within one year (note 14)	13.2	14.3
Between two and five years	101.1	127.1
After five years	456.9	474.9
Total over one year (note 14)	558.0	602.0

FINANCIAL STATEMENTS

c) Fair values
The fair values of the group's derivative financial instruments are set out in note 14. The following table summarises the fair value and book value of the group's bonds.

	2014 Book value £m	2014 Fair value £m	2013 Book value £m	2013 Fair value £m
Bonds (note 14)	**1,985.3**	**2,168.9**	1,947.4	2,498.7

The fair values of all other financial instruments are equal to the book values.

d) Borrowing facilities
As at 31 March 2014, the group had available undrawn committed borrowing facilities of £140m expiring as set out below, in respect of which all conditions precedent had been met (2013: £215m).

	2014 £m	2013 £m
Expiring in less than 1 year:		
- term loan facility	**–**	75
- revolving credit facilities	**30**	–
Expiring in more than 1 year:		
- revolving credit facilities	**110**	140
	140	215

Dŵr Cymru Cyfyngedig also has a £10m overdraft facility renewable on an annual basis.

On 16 December 2013 the group drew the remaining £75m loan facility with European Investment Bank facility.

The group has £140 million of revolving credit facilities, of which £30 million of which will expire in May 2014.
£20 million is availaible to be drawn until May 2016 and £90m is available until May 2017.

At 31 March 2014, Dŵr Cymru (Financing) Limited also had a special liquidity facility of £135m (2013: £135m) which it is required to maintain in order to meet certain group interest and other obligations that cannot be funded through operating cash flow of the group, in the event of a standstill being declared by the Security Trustee. A standstill would occur in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. No such covenant default has arisen during the year. The facility is renewable on an annual basis.

All of the above facilities are at floating rates of interest.

e) Capital risk management
Gearing ratios

	2014 £m	2013 £m
Total borrowings	**(2,909)**	(2,895)
Less: cash and cash equivalents	**94**	157
Net debt	**(2,815)**	(2,738)
Regulatory capital value (RCV)	**4,468**	4,344
Total capital	**1,653**	1,606
Less: unamortised bond costs	**(5)**	(6)
Total capital per bond covenants	**1,648**	1,600
Gearing ratio	**63%**	63%

As set out on page 96, the group monitors its capital structure based on a regulatory gearing ratio which compares its net debt
to the Ofwat-determined RCV.

16 PROVISIONS

	Restructuring provision £m	Dilapidation provision £m	Uninsured loss provision £m	Other provisions £m	Total £m
At 1 April 2013	7.0	2.1	7.2	4.3	20.6
Charged to income statement	–	0.1	1.0	0.2	1.3
Utilised in year	(3.9)	–	(1.6)	(1.5)	(7.0)
At 31 March 2014	**3.1**	**2.2**	**6.6**	**3.0**	**14.9**
Split as:					
Amounts to be utilised within one year	3.1	–	–	1.5	4.6
Amounts to be utilised after more than one year	–	2.2	6.6	1.5	10.3
At 31 March 2014	**3.1**	**2.2**	**6.6**	**3.0**	**14.9**

The parent company has no provisions at 31 March 2014 (2013: £nil).

Restructuring provision
This provides for the costs of terminating the outsourced contracts with United Utilities Operational Services and Kelda Water Services in the year to 31 March 2011 along with the estimated restructuring costs associated with a reduction in the headcount by some 300.

Dilapidations provision
This provision relates to estimated dilapidation costs, which will be incurred over the next five years.

Uninsured loss provision
This provision is in respect of uninsured losses and instances where insurance does not cover a deductible amount.
The utilisation period of these liabilities is uncertain due to the nature of claims, but is estimated to be within five years.

Other provisions
Other provisions are made for certain other obligations which arise during the ordinary course of the group's business.

17 NET CASH INFLOW FROM OPERATING ACTIVITIES

a) Cash generated from operations
Reconciliation of operating profit to cash generated from operations:

	2014 £m	Group 2013 £m
Operating profit	**204.6**	183.3
Adjustments for:		
- Depreciation and amortisation	**163.7**	158.7
- Changes in working capital:		
Increase in trade and other receivables	**(0.5)**	(18.8)
Increase in inventory	**(0.7)**	(0.7)
(Decrease)/Increase in trade and other payables	**(3.2)**	1.7
Pension contributions (above)/below service cost	**(10.0)**	1.6
(Decrease)/increase in provisions	**(2.1)**	0.2
	(16.5)	(16.0)
Cash generated from operations	**351.8**	326.0

FINANCIAL STATEMENTS

b) Interest paid

	Group 2014 £m	Group 2013 £m
Interest payable per income statement	**160.6**	141.3
Less non-cash items:		
- Indexation on index-linked bonds	**(38.5)**	(38.9)
- Amortisation of bond issue costs	**(0.3)**	(0.3)
- Interest charge on pension scheme liabilities	**(1.3)**	(1.5)
- Amortisation of bond issue premium	**0.6**	0.6
- Effect of capitalisation under IAS 23	**7.9**	6.5
- Accounting profit on lease termination	**–**	14.4
- Decrease in accruals	**45.7**	2.4
	14.1	(16.8)
Interest paid	**174.7**	124.5

18 ANALYSIS AND RECONCILIATION OF NET DEBT

a) Net debt at the balance sheet date may be analysed as:

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Cash and cash equivalents	**94.4**	157.4	**0.1**	0.1
Debt due after one year	**(2,272.1)**	(2,174.7)	**–**	–
Debt due within one year	**(16.5)**	(14.1)	**–**	–
Finance leases	**(571.2)**	(616.3)	**–**	–
Accrued interest	**(50.1)**	(89.8)	**–**	–
	(2,909.9)	(2,894.9)	**–**	–
Net (debt)/cash	**(2,815.5)**	(2,737.5)	**0.1**	0.1

b) The movement in net debt during the year may be summarised as:

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Net (debt)/cash at start of year	**(2,737.5)**	(2,689.6)	**0.1**	0.1
Movement in net cash	**(63.0)**	(143.1)	**–**	–
Movement in debt arising from cash flows	**(21.9)**	117.4	**–**	–
Movement in net debt arising from cash flows	**(84.9)**	(25.7)	**–**	–
Movement in accrued interest	**39.7**	2.4	**–**	–
Indexation of index-linked debt	**(38.5)**	(38.9)	**–**	–
Accounting profit on lease termination	**–**	14.4		
Other non-cash movements	**5.7**	(0.1)	-	–
Movement in net debt during the year	**(78.0)**	(47.9)	**–**	–
Net (debt)/cash at end of year	**(2,815.5)**	(2,737.5)	**0.1**	0.1

19 EMPLOYEES AND DIRECTORS

Staff costs for the group during the year

	2014 £m	As restated 2013 £m
Wages and salaries	**98.0**	82.5
Social security costs	**8.1**	7.0
Other pension costs	**7.6**	14.7
	113.7	104.2

Of the above, £43.5m (2013: £35.9m) has been capitalised.

Average monthly number of people employed by the group (including Executive Directors)	2014 Number	2013 Number
Regulated water and sewerage activities	**2,871**	2,617

20 PENSION COMMITMENTS

The group operates a funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service), the DCWW Pension Scheme. The assets of the scheme are held in a separate trustee-administered fund.

The DCWW Pension Scheme was closed to new members from 31 December 2005 and a new defined contribution scheme, the Dŵr Cymru Defined Contribution Scheme, was introduced from 1 January 2006.

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2013 by Joanne Eynon of Quantum Advisory, an independent, professionally qualified actuary, using the projected unit method. This valuation has been updated as at 31 March 2014 and the principal assumptions made by the actuaries were:

	2014	2013
Discount rate	**4.4%**	4.5%
Inflation assumption	**3.4%**	3.2%
Rate of increase in pensionable salaries	**2.3%**	3.2%
Rate of increase in pensions in payment	**3.2%**	3.1%
Post retirement mortality (life expectancy):		
- Current pensioners aged 65 - males	**87.1 years**	86.9 years
- Current pensioners aged 65 - females	**89.3 years**	89.6 years
- Future pensioners aged 65 (currently aged 45) - males	**88.4 years**	89.8 years
- Future pensioners aged 65 (currently aged 45) - females	**90.8 years**	92.5 years

Post retirement mortality assumptions are based on those in published actuarial tables "PA92", relevant to members' year of birth with long cohort adjustments.

The major categories of plan assets, as a percentage of total assets and the expected long-term rates of return thereon, were as follows:

	2014		2013	
	Expected return	% of total assets	Expected return	% of total assets
Equities	**6.5%**	**54.6%**	6.5%	54.8%
Bonds	**5.0%**	**32.2%**	5.0%	28.6%
Other	**3.0%**	**2.5%**	3.0%	6.0%

	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April 2013 (Restated)	**323.3**	**(291.2)**	**32.1**
Current service cost	9.9	–	9.9
Interest expense/income	14.7	(13.4)	1.3
Past service cost	0.2	–	0.2
Expenses	0.7	0.6	1.3
	25.5	(12.8)	12.7
Remeasurements			
Gain from change in demographic assumptions	(8.7)	–	(8.7)
Gain loss from change in financial assumptions	(14.6)	–	(14.6)
Experience gains	–	(1.5)	(1.5)
	(23.3)	(1.5)	(24.8)
Contributions		(16.5)	(16.5)
Benefits paid	(5.4)	5.4	–
Bulk transfer		(2.3)	(2.3)
	(5.4)	(13.4)	(18.8)
At 31 March 2014	**320.1**	**(318.9)**	**1.2**

	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April 2012 (restated)	**272.8**	**(240.8)**	**32.0**
Current service cost	11.1	–	11.1
Interest expense/income	14.1	(12.5)	1.6
Past service cost	2.3	2.3	4.6
Expenses	–	0.4	0.4
	27.5	(9.8)	17.7
Remeasurements			
Gain from change in demographic assumptions	(5.1)	–	(5.1)
(Gain)/loss from change in financial assumptions	20.8	(20.7)	0.1
Experience (gains)/loss	–	–	–
	15.7	(20.7)	(5.0)
Contributions		(11.7)	(11.7)
Benefits paid	(6.4)	6.4	–
Bulk transfer	13.7	(14.6)	(0.9)
	7.3	(19.9)	(12.6)
At 31 March 2013 (restated)	**323.3**	**(291.2)**	**32.1**

The total amount recognised in the Balance Sheet is made up as follows:

	2014 £m	2013 £m
Present value of funded obligations	**(320.1)**	(323.3)
Fair value of plan assets	**318.9**	291.2
	(1.2)	(32.1)
EFRBS unfunded liability	**(1.6)**	(0.7)
Net liability recognised in the Balance Sheet	**(2.8)**	(32.8)

	2014	2013	2012	2011	2010
Experience adjustments arising on scheme assets:					
Amount (£m)	**(2.9)**	17.9	(9.5)	(8.2)	10.0
Percentage of scheme assets	**(3%)**	(6%)	(4%)	(4%)	21%
Experience adjustments arising on scheme liabilities:					
Amount (£m)	**(5.1)**	(15.7)	(16.4)	3.6	11.5
Percentage of the present value of scheme liabilities	**(5%)**	(5%)	(6%)	2%	21%
Present value of scheme liabilities (£m)	**320.0**	323.3	272.8	238.4	54.8
Fair value of scheme assets (£m)	**318.8**	291.1	240.7	222.9	46.8
Deficit (£m)	**(1.2)**	(32.1)	(31.9)	(15.5)	(8.0)

The contributions paid in the year to 31 March 2014 include special contributions of £1.2m (2013: £0.5m). A further £3.5m was paid into the scheme to augment the benefits in respect of scheme members who left the company via selective voluntary severance (2013: £0.9m) The special contributions expected to be paid in line with the extant schedule of contributions during the financial year ended 31 March 2015 amounts to £1.4m.

	Change in assumption	Increase in Liabilities
Discount rate	0.1%	£6.8m
Price inflation	0.1%	£6.5m
Life expectancy	1 year	£6.8m

The above sensitivity analysis is based on isolated changes in each assumption whilst holding all over assumption constant. In practice, this is unlikely to occur, and there is likely to be some level of correlation between the movements in different assumptions.

21 IMPACT OF CHANGE IN ACCOUNTING POLICY

Adoption of IAS 19 (revised 2011)

The revised employee benefit standard introduces changes to regonition measurement, presentation and disclosure of post-employment benefits. The standard also requires net interest expense/income to be calculated as the product of the net defined benefit liability/asset and the discount rate as determined at the beginning of the year. The effect of this is to remove the previous concept of recognising an expected return on plan assets.

The effects of the changes in accounting policy is shown in the following tables.

Impact of change on change in accounting policy on the consolidated income statement

	March 2014	Adopt IAS 19 (revised 2011)	March 2014 as presented	March 2013	Adopt IAS 19 (revised 2011)	March 2013 as presented
Revenue	736.5		736.5	716.4		716.4
Operating costs	(526.9)	(5.0)	(531.9)	(533.1)	(2.7)	(535.8)
Operating profit	209.6		204.6	183.3	(2.7)	180.6
Financing costs	(60.1)		(60.1)	(195.5)		(195.5)
Profit/(loss) before tax	149.5	(5.0)	144.5	(12.2)	(2.7)	(14.9)
Taxation	10.8		10.8	13.8		13.8
Profit for the year	160.3	(5.0)	155.3	1.6	(2.7)	(1.1)

Impact of change on change in accounting policy on the consolidated statement of comprehensive income

	March 2014	Adopt IAS 19 (revised 2011)	March 2014 as presented	March 2013	Adopt IAS 19 (revised 2011)	March 2013 as presented
Profit for the year	160.3	(5.0)	155.3	1.6	(2.7)	(1.1)
Actuarial gain/(loss) in pension scheme	19.9	5.0	24.9	2.3	2.7	5.0
Movement on deferred tax	(5.8)		(5.8)	(0.9)	–	(0.9)
Total comprehensive income	174.4	–	174.4	3.0	–	3.0

22 CAPITAL AND OTHER FINANCIAL COMMITMENTS

The group's business plan at 31 March 2014 shows net capital expenditure and infrastructure renewals expenditure of £330m (2013: £313m) during the next financial year. While only a portion of this amount has been formally contracted for, the group is effectively committed to the total as part of its overall capital expenditure programme approved by its regulator.

23 RELATED PARTY TRANSACTIONS

In accordance with the exemption afforded by IAS 24 there is no disclosure in the consolidated financial statements of transactions with entities that are part of the Glas Cymru Cyfyngedig group. The parent company has not entered into transactions with any other group company during the year (2013: none).

24 STATUS OF THE COMPANY

The company is limited by guarantee and does not have any share capital. In the event of the company being wound up, the liability of the members is limited to £1 each.

25 ELAN VALLEY TRUST FUND

In 1984 Welsh Water Authority entered into a conditional sale and purchase agreement with Severn Trent Water Authority for the sale of the aqueduct and associated works by which the bulk supply to Severn Trent reservoirs is conveyed.

The sum of £31.7m, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Welsh Water Authority, whilst preserving the capital value of the fund in real terms. Welsh Water Authority's interest in this fund was vested in Dŵr Cymru Cyfyngedig under the provisions of the Water Act 1989.

The assets of the fund are not included in these financial statements. As at 31 March 2014 the market value of the trust fund was £103m (2013: £112m).

Interest receivable includes £5.6m (2013 £4.6m) in respect of distributions from the Elan Valley Trust Fund.

26 CONTINGENT LIABILITIES

There were no contingent liabilities other than those arising from in ordinary course of the group's business and on these no material losses are anticipated.

GLOSSARY