

Notes to the group financial statements

1 General information

The Severn Trent group has two segments which have a number of operations. These are described in the segmental analysis in note 5.

Severn Trent Plc is a company incorporated and domiciled in the United Kingdom. The address of its registered office is shown on the back of the cover of the annual report and accounts.

Severn Trent Plc is listed on the London Stock Exchange.

2 Accounting policies

a) Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2010 and those parts of the Companies Act 2006 applicable to companies reporting under IFRS as adopted by the European Union.

The financial statements have been prepared on the going concern basis (see Directors' report on page 28) and under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

The preparation of financial statements in conformity with 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 amount of revenues and expenses for the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

b) Basis of consolidation

The financial statements include the results of Severn Trent Plc and its subsidiaries, joint ventures and associated undertakings. The results of subsidiaries, joint ventures and associated undertakings are included from the date of acquisition or incorporation, and excluded from the date of disposal.

The results of subsidiaries are consolidated where the group has the power to control a subsidiary.

The results of joint venture undertakings are accounted for on an equity basis where the company exercised joint control under a contractual arrangement.

The results of associates are accounted for on an equity basis. Associates are entities where the group has the power to exercise significant influence.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since that date. Losses attributable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

c) Revenue recognition

Revenue represents the fair value of consideration receivable, excluding value added tax, trade discounts and inter company sales, in the ordinary course of business for goods and services provided.

Revenue is not recognised until the service has been provided to the customer, or the goods to which the sale relates have either been despatched to the customer or, where they are held on the customer's behalf, title has passed to the customer.

Turnover includes an estimate of the amount of mains water and waste water charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

In respect of long term contracts, revenue is recognised based on the value of work carried out during the year with reference to the total sales value and the stage of completion of these contracts.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable. Dividend income from investments is recognised when the group's rights to receive payment have been established. Interest and dividend income are included in finance income.

d) Exceptional items

Exceptional items are income or expenditure, which individually or, if of a similar type, in aggregate should, in the opinion of the directors, be disclosed by virtue of their size or nature if the financial statements are to give a true and fair view. In this context, materiality is assessed at the segment level.

e) Taxation

Current tax payable is based on the taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expenses that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full, using the liability method, on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future to utilise it. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have then 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 tax liability is settled.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the group intends to settle its current tax assets and liabilities on a net basis.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

2 Accounting policies (continued)

f) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Goodwill arising on acquisition of subsidiaries is included in intangible assets, whilst goodwill arising on acquisition of associates is included in investments in associates. If an acquisition gives rise to negative goodwill this is credited directly to the income statement. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill arising on all acquisitions prior to 1 April 1998 was written off to reserves under UK GAAP and remains eliminated against reserves. Purchased goodwill arising on acquisitions after 31 March 1998 is treated as an intangible fixed asset.

Goodwill is tested for impairment in accordance with the policy set out above and carried at cost less accumulated impairment losses. Goodwill is allocated to the cash generating unit that derives benefit from the goodwill for impairment testing purposes.

Where goodwill forms part of a cash generating unit and all or part of that unit is disposed of, the associated goodwill is included in the carrying amount of that operation when determining the gain or loss on disposal of the operation.

g) Intangible non-current assets

Intangible assets acquired separately are capitalised at cost and when acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, the historical cost model is applied to intangible assets. Amortisation charged on assets with finite lives is taken to the income statement through operating expenses.

Finite life intangible assets are amortised on a straight line basis over their estimated useful economic lives as follows:

	Years
Software	3-10
Other assets	2-20

Intangible assets are reviewed for impairment where indicators of impairment exist.

h) Research and development

Research expenditure is expensed when it is incurred. Development expenditure is capitalised and written off over its expected useful economic life where the following criteria are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost can be measured reliably.

Expenditure on property, plant and equipment relating to research and development projects is capitalised and written off over the expected useful life of those assets.

i) Pre-contract costs

Pre-contract costs are expensed as incurred except where it is probable that the contract will be awarded, in which case they are recognised as a prepayment which is written off to the income statement over the life of the contract.

j) Property, plant and equipment

Property, plant and equipment comprises:

i) Infrastructure assets

Infrastructure assets are included at cost (or deemed cost on transition to IFRS) less accumulated depreciation. The costs of like for like replacement of infrastructure components are recognised in the income statement as they arise. Where it is probable that the money spent will cause future economic benefits to flow to the group, then costs are capitalised. Infrastructure assets are depreciated over their useful economic lives, which are as follows:

	Years
Impounding reservoirs	250
Raw water aqueducts	250
Mains	80-150
Sewers	150-200

ii) Other assets

Other assets are included at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated over their estimated economic lives to their residual value, which are principally as follows:

	Years
Buildings	30-80
Fixed plant and equipment	20-40
Vehicles and mobile plant	2-15

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

Interest costs of debt raised to finance new property, plant and equipment where construction commenced after 1 April 2010 are included within the cost of those fixed assets.

k) Leased assets

Where the group obtains assets under leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the group as lessee (finance leases), the lower of the fair value of the leased asset or the present value of the minimum lease payments is capitalised as an asset with a corresponding liability representing the obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor and the finance charge being written off to the income statement at a constant rate over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period.

Where the group obtains assets under leasing arrangements where substantially all the risks and rewards of ownership remain with the lessor, these are classified as operating leases. Rental costs arising under operating leases are expensed on a straight line basis over the term of the lease. Leases of land are normally treated as operating leases, unless ownership is transferred to the group at the end of the lease.

l) Grants and contributions

Grants and contributions received in respect of non-current assets, including charges made for new connections to the water and sewerage networks, are treated as deferred income and released to the income statement over the useful economic life of those non-current assets.

2 Accounting policies (continued)

l) Grants and contributions (continued)

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in operating costs in the income statement in the period that they become receivable.

m) Impairment of non-current assets

If the recoverable amount of goodwill, an item of property, plant and equipment, or any other non-current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the assets in an arm's length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash generating unit or asset.

The discount rate used is based on the group's cost of capital adjusted for the risk profiles of individual businesses.

Goodwill is tested for impairment annually. Impairment reviews are also carried out if there is an indication that an impairment may have occurred, or, where otherwise required, to ensure that non-current assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the income statement.

n) Investments

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as available for sale are measured at fair value, with gains or losses recognised in equity. When an available for sale investment is disposed of, or impaired, the gain or loss previously recognised in equity is taken to the income statement. Where there is no active market in the investments and the fair value cannot be measured reliably, the investments are held at cost.

Other investments are classified as held to maturity when the group has the positive intention and ability to hold to maturity. Investments held for an undefined period are excluded from this classification. Such investments (and those held to maturity) are measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the income statement.

o) Financial instruments

i) Debt instruments

All loans and borrowings are initially recognised at cost, being the net fair value of the consideration received. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Where a loan or borrowing is in a fair value hedging relationship it is remeasured for changes in fair value of the hedged risk at the balance sheet date, with gains or losses being recognised in gains/losses on financial instruments in the income statement (see below).

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

ii) Derivative financial instruments and hedging activities

The group uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative instruments are initially recorded at cost and subsequently remeasured at fair value at the balance sheet date. The fair value of cross currency swaps, interest rate swaps and forward currency contracts is calculated by reference to market exchange rates and interest rates at the period end. Net interest receivable or payable in respect of derivative financial instruments is included in finance income or finance costs.

In relation to fair value hedges which meet the conditions for hedge accounting, the gain or loss on the hedging instrument is taken to gains/losses on financial instruments in the income statement where the effective portion of the hedge will offset the gain or loss on the hedged item (see above).

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion in gains/losses on financial instruments in the income statement. The gains or losses deferred in equity in this way are recycled through gains/losses on financial instruments in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

Where forward currency contracts and foreign currency borrowings are used to hedge net investments in foreign currency denominated operations, to the extent that they are designated and effective as net investment hedges, they are matched in equity against changes in value of the related assets. Any ineffectiveness is taken to gains/losses on financial instruments in the income statement.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that date any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs, or transferred to gains/losses on financial instruments in the income statement if the forecast transaction is no longer expected to occur.

For derivatives that do not qualify for hedge accounting, gains or losses are taken directly to gains/losses on financial instruments in the income statement in the period.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value, with gains and losses reported in gains/losses on financial instruments in the income statement.

p) Inventory

Inventory and work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, transport and attributable overheads.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

2 Accounting policies (continued)

q) Trade receivables

Trade receivables are measured at fair value on initial recognition and are subsequently measured at amortised cost using the effective interest rate method unless there is objective evidence that the asset is impaired, where it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense.

Trade receivables that are assessed not to be impaired individually are assessed collectively for impairment by reference to the group's historical collection experience for receivables of similar age.

r) Service concession arrangements

Where the group has a right to receive cash from a government body in return for constructing or upgrading a public sector asset it recognises a financial asset in prepayments and accrued income where it has incurred costs that will be recovered from amounts receivable from the concession in future periods. Costs of construction or upgrading the public sector assets are recognised as a straight line basis, before adjusting for expected inflation, over the life of the contract.

s) Trade payables

Trade payables are initially measured at fair value and are subsequently measured at amortised cost, using the effective interest rate method.

t) Retirement benefits

The group operates both defined benefit and defined contribution pension schemes.

The difference between the value of defined benefit pension scheme assets and defined benefit pension scheme liabilities is recorded on the balance sheet as a retirement benefit asset or obligation.

Defined benefit pension scheme assets are measured using bid price. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability. Service cost, which is the increase in the present value of the liabilities of the group's defined benefit pension schemes expected to arise from employee service in the period, is included in operating costs. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, are included in other finance income or cost.

Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to equity and recorded in the statement of recognised income and expense.

Contributions to defined contribution pension schemes are charged to the income statement in the period in which they fall due.

u) Provisions

Provisions are recognised where:

- there is a present obligation as a result of a past event;
- it is probable that there will be an outflow of economic benefits to settle this obligation; and
- a reliable estimate of this amount can be made.

Self-insurance provisions are recognised for claims notified and for claims incurred but which have not yet been notified, based on advice from the group's independent insurance advisers.

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability where the effect is material.

v) Purchase of own shares

The group balance sheet includes the shares held by the Severn Trent Employee Share Ownership Trust (the Trust) and which have not vested unconditionally by the balance sheet date. These are shown as a deduction from shareholders' funds until such time as they vest.

w) Share based payments

The group operates a number of equity settled, share based compensation plans for employees. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant.

The fair value of employee services is determined by reference to the fair value of the awards granted calculated using an appropriate pricing model, excluding the impact of any non-market vesting conditions. The number of awards that are expected to vest takes into account non-market vesting conditions including, where appropriate, continuing employment by the group. The charge is adjusted to reflect shares that do not vest as a result of failing to meet a non-market condition.

x) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to 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 include cash and bank balances and investments in liquid funds. Cash and cash equivalents also include overdrafts repayable on demand.

y) Foreign currency

The results of overseas subsidiary and associated undertakings are translated into sterling, the presentational currency of the group, using average rates of exchange ruling during the year.

The net investments in overseas subsidiary and associated undertakings are translated into sterling at the rates of exchange ruling at the year end. Exchange differences thus arising are treated as movements in equity. On disposal of a foreign currency denominated subsidiary, the deferred cumulative amount recognised in equity since 1 April 2004 relating to that entity is recognised in the income statement under the transitional rule of IFRS 1.

Exchange differences arising in respect of foreign exchange instruments taken out as hedges of overseas investments are also treated as movements in equity to the extent that the hedge is effective (see note 2 o).

All other foreign currency denominated assets and liabilities of the company and its subsidiary undertakings are translated into the relevant functional currency at the rates of exchange ruling at the year end. Any exchange differences so arising are dealt with through the income statement. Foreign currency transactions arising during the year are translated into sterling at the rate of exchange ruling on the date of the transaction. All profits and losses on exchange arising during the year are dealt with through the income statement.

2 Accounting policies (continued)

z) Discontinued operations and assets held for sale

Where an asset or group of assets (a disposal group) is available for immediate sale and the sale is highly probable and expected to occur within one year then the disposal group is deemed as held for sale. The disposal group is measured at the lower of the carrying amount and fair value less costs to sell.

Where a group of assets which comprises operations that can be clearly distinguished operationally and for financial reporting purposes from the rest of the group (a component) has been disposed of or classified as held for sale, and it:

- represents a separate major line of business or geographical area of operations; or
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to resale

then the component is classified as a discontinued operation.

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Depreciation is not charged on such assets.

3 New accounting policies and future requirements

International Financial Reporting Standard 8 'Operating Segments' (IFRS 8) was issued in November 2006 and was required to be implemented by the group from 1 April 2009. The standard requires identification of operating segments based on internal reports that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and assess its performance. The impact of the standard on the group's financial statements is not significant since the group's segmental reporting already closely reflected reports regularly reviewed by the Severn Trent Executive Committee.

IAS 23 (revised) was issued in March 2007 and was required to be implemented by the group from 1 April 2009. The revision to the standard removed the option of immediately recognising as an expense borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial period of time to get ready for use or sale. Such costs are therefore required to be capitalised as part of the cost of the asset. The revised standard required the group to change its previous policy and resulted in borrowing costs that would previously have been expensed being capitalised in property, plant and equipment (£2.6 million) or intangible assets (£nil). The costs will be amortised over the expected useful lives of the relevant assets.

IAS 1 (revised) was issued in September 2007 and was required to be implemented by the group from 1 April 2009. The revision is aimed at improving users' ability to analyse and compare the information given in financial statements. The changes made are to require information in financial statements to be aggregated on the basis of shared characteristics and to introduce a statement of comprehensive income. Since the group already presented a statement of recognised income and expense, the changes had no significant impact on the group financial statements.

The following statements have been issued by the International Accounting Standards Board and are likely to affect future financial statements.

IAS 27 (revised) was issued in January 2008 and is required to be implemented by the group from 1 April 2010. The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control. The standard also specifies the accounting when control is lost. The group has had no transactions in the current or prior year that would have been impacted by the revised standard.

IFRS 3 (revised) was issued in January 2008 and is required to be implemented by the group from 1 April 2010. The standard continues to apply the acquisition method to business combinations, with some significant changes. The group has had no transactions in the current or prior year that would have been impacted by the revised standard.

IFRIC 18 "Transfer of assets from customers" was issued in January 2009 and is required to be applied retrospectively from 1 April 2010 to transfer of assets occurring after 1 July 2009. The interpretation requires that if the group receives an asset from a customer it should recognise that asset at fair value. If the group has no further obligation as a result of the transfer then the fair value of the asset is recognised as revenue. If the group has ongoing obligations then the fair value of the asset is recognised as deferred income and released to revenue over the period of the obligation.

The directors assess that the other standards and interpretations issued but not yet effective are not applicable to the group.

4 Significant accounting judgments and key sources of estimation uncertainty

In the process of applying the group's accounting policies, the group is required to make certain judgments, estimates and assumptions that it believes are reasonable based on the information available.

The more significant judgments were:

a) Tax provisions

Assessing the outcome of uncertain tax positions requires judgments to be made regarding the result of negotiations with and enquiries from tax authorities in a number of jurisdictions. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

b) Provisions for other liabilities and charges

Assessing the financial outcome of uncertain commercial and legal positions requires judgments to be made regarding the relative merits of each party's case and the extent to which any claim against the group is likely to be successful. The assessments made are based on advice from the group's internal counsel and, where appropriate, independent legal advice.

c) Service concession arrangements

Assessing the extent to which costs of constructing or upgrading the MoD assets should be recognised in the period requires judgments to be made about the expected level of costs for the whole contract. Estimates are based on engineering data and adjusted for inflation expectations.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

4 Significant accounting judgments and key sources of estimation uncertainty (continued)

The key accounting estimates were:

a) Goodwill impairment

Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units (CGU) to which goodwill has been allocated. The value in use calculation requires the group to estimate the future cash flows expected to arise from the CGU and a suitable discount rate to calculate present value. Details of the assumptions used are set out in note 16 to the financial statements.

b) Depreciation and carrying amounts of property, plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 2 j).

c) Retirement benefit obligations

Determining the amount of the group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation, salary and pension increases, investment returns and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The group makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made are set out in note 28 to the financial statements.

d) Unbilled revenue

Severn Trent Water raises bills and recognises revenue in accordance with its right to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and waste water customers with water meters, the amount recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter read and the year end. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based on estimated usage from the last billing to the end of the financial year. The estimated usage is based on historical data, judgment and assumptions.

e) Provision for impairment of trade receivables

Provisions are made against Severn Trent Water's trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. The actual amounts collected could differ from the estimated level of recovery which could impact operating results.

5 Segmental analysis

The group has two reportable segments: Severn Trent Water and Severn Trent Services. The key factor determining the identification of reportable segments is the regulatory environment in which the businesses operate. Severn Trent Water is subject to economic regulation by Ofwat and operates under a licence to provide water and sewerage services within a defined geographical region in England and Wales. Severn Trent Services is not subject to economic regulation and operates in markets in the USA, Europe and Asia.

The Severn Trent Executive Committee (STEC) is considered to be the group's chief operating decision maker. The reports provided to STEC include segmental information prepared on the basis described above. Details of Severn Trent Water's operations are described on pages 12 to 17 of the Business Review and those of Severn Trent Services on pages 19 to 21.

The group has a large and diverse customer base and there is no significant reliance on any single customer.

The measure of profit or loss that is reported to STEC for the segments is profit before interest, tax and exceptional items (underlying PBIT). A segmental analysis of sales and underlying PBIT is presented below.

2010	Severn Trent Water £m	Severn Trent Services £m
External sales	1,383.6	320.3
Inter-segment sales	1.7	16.2
Total sales	1,385.3	336.5
Profit before interest, tax and exceptional items	541.3	28.7
Exceptional items	(42.1)	(7.6)
Profit before interest and tax	499.2	21.1
Profit before interest, tax and exceptional items is stated after:		
Amortisation of intangible assets	23.4	1.6
Depreciation of property, plant and equipment	232.5	6.1
Profit on disposal of fixed assets	(4.3)	(0.2)

5 Segmental analysis (continued)

	Severn Trent Water £m	Severn Trent Services £m
2009		
External sales	1,323.5	318.7
Inter-segment sales	1.4	20.6
Total sales	1,324.9	339.3
Profit before interest, tax and exceptional items	456.0	30.5
Exceptional items	(19.4)	(0.7)
Profit before interest and tax	436.6	29.8
Profit before interest, tax and exceptional items is stated after:		
Amortisation of intangible assets	22.9	1.3
Depreciation of property plant and equipment	220.0	6.1
Profit on disposal of fixed assets	(4.0)	–

The group's treasury and tax affairs are managed centrally by the Group Treasury and Tax departments. Finance costs are managed on a group basis and hence interest income and costs are not reported at the segmental level. Tax is not reported to STEC on a segmental basis.

Interests in joint ventures and associates are not material and are not included in the segmental reports reviewed by STEC.

Separate segmental analyses of assets and liabilities are not reviewed by STEC. The balance sheet measure reviewed by STEC on a segmental basis is capital employed which includes the following components:

	Severn Trent Water £m	Severn Trent Services £m
2010		
Operating assets	6,689.9	215.3
Goodwill	–	70.6
Interests in joint ventures and associates	0.2	4.7
Segment assets	6,690.1	290.6
Segment operating liabilities	(985.3)	(92.0)
Capital employed	5,704.8	198.6

	Severn Trent Water £m	Severn Trent Services £m
2009		
Operating assets	6,379.2	213.9
Goodwill	–	63.3
Interests in joint ventures and associates	0.2	4.9
Segment assets	6,379.4	282.1
Segment operating liabilities	(801.3)	(97.6)
Capital employed	5,578.1	184.5

Operating assets comprise other intangible assets, property plant and equipment, inventory and trade and other receivables. Operating liabilities comprise trade and other payables, retirement benefit obligations and provisions.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

5 Segmental analysis (continued)

Additions to other intangible assets and property, plant and equipment were as follows:

2010	Severn Trent Water £m	Severn Trent Services £m
Other intangible assets	44.4	3.2
Property, plant and equipment	497.3	13.0

2009	Severn Trent Water £m	Severn Trent Services £m
Other intangible assets	31.6	2.0
Property, plant and equipment	470.1	6.0

The reportable segments' revenue is reconciled to group turnover as follows:

	2010 £m	2009 £m
Severn Trent Water revenue	1,385.3	1,324.9
Severn Trent Services revenue	336.5	339.3
Inter-segment sales	(17.9)	(22.0)
Group turnover	1,703.9	1,642.2

Segmental underlying PBIT is reconciled to the group's profit before tax and discontinued operations as follows:

	2010 £m	2009 £m
Underlying PBIT:		
Severn Trent Water	541.3	456.0
Severn Trent Services	28.7	30.5
Corporate and other costs	(14.2)	(16.4)
Consolidation adjustments	1.3	(0.2)
Group underlying PBIT	557.1	469.9
Exceptional items:		
Severn Trent Water	(42.1)	(19.4)
Severn Trent Services	(7.6)	(0.7)
Corporate	–	1.2
Share of results of associates and joint ventures	0.1	–
Net finance costs	(218.8)	(196.4)
Gains/(losses) on financial instruments	45.7	(87.0)
Profit before tax and discontinued operations	334.4	167.6

The reportable segments' assets are reconciled to the group's total assets as follows:

	2010 £m	2009 £m
Segment assets		
Severn Trent Water	6,690.1	6,379.4
Severn Trent Services	290.6	282.1
Corporate assets	21.7	13.5
Derivative financial assets	206.7	255.2
Cash and cash equivalents	227.8	648.1
Assets held for sale	–	4.6
Available for sale financial assets	0.1	0.1
Consolidation adjustments	(28.6)	(27.5)
Total assets	7,408.4	7,555.5

The consolidation adjustments include intra-group debtors and unrealised profits on fixed assets.

5 Segmental analysis (continued)

The reportable segments' liabilities are reconciled to the group's total liabilities as follows:

	2010 £m	2009 £m
Segment liabilities		
Severn Trent Water	(985.3)	(801.3)
Severn Trent Services	(92.0)	(97.6)
Corporate and other	(49.7)	(66.4)
Borrowings	(4,176.5)	(4,445.1)
Financial liabilities	(144.7)	(172.0)
Current tax	(67.2)	(81.1)
Deferred tax	(956.4)	(948.4)
Liabilities associated with assets held for sale	–	(0.4)
Consolidation adjustments	10.4	8.9
Total liabilities	(6,461.4)	(6,603.4)

The consolidation adjustments include intra-group creditors.

Geographical areas

The group's sales were derived from the following countries:

	2010 £m	2009 £m
UK	1,459.2	1,406.6
USA	145.1	142.6
Other	99.6	93.0
	1,703.9	1,642.2

The group's non-current assets (excluding financial instruments) were located in the following countries:

	2010 £m	2009 £m
UK	6,386.7	6,098.0
USA	61.3	62.4
Other	26.6	9.5
	6,474.6	6,169.9

6 Revenue

	2010 £m	2009 £m
Water and sewerage services	1,377.0	1,316.1
Other services	226.4	214.7
Sale of goods	47.8	63.4
Revenue from long term contracts	52.7	48.0
Total turnover	1,703.9	1,642.2
Interest receivable (note 10)	9.8	36.4
Total revenue	1,713.7	1,678.6

Notes to the group financial statements (continued)

For the year ended 31 March 2010

7 Operating costs

	2010			2009		
	Before exceptional costs £m	Exceptional costs £m	Total £m	Before exceptional costs £m	Exceptional costs £m	Total £m
Wages and salaries	276.8	14.6	291.4	265.1	1.4	266.5
Social security costs	18.5	0.5	19.0	19.8	0.1	19.9
Pension costs	19.1	7.5	26.6	28.9	–	28.9
Share based payments	5.1	–	5.1	5.3	–	5.3
Total employee costs	319.5	22.6	342.1	314.1	1.5	320.6
Power	56.0	–	56.0	56.3	–	56.3
Raw materials and consumables	116.9	0.4	117.3	128.7	0.9	129.6
Rates	61.0	0.8	61.8	59.2	–	59.2
Charge for bad and doubtful debts	35.1	0.1	35.2	31.8	0.1	31.9
Service charges	31.1	–	31.1	30.0	–	30.0
Depreciation of property, plant and equipment	236.1	0.8	236.9	223.7	–	223.7
Amortisation of intangible fixed assets	25.2	5.8	31.0	24.2	–	24.2
Hired and contracted services	145.9	4.9	150.8	143.7	2.6	146.3
Operating lease rentals						
– land and buildings	4.2	5.4	9.6	4.0	–	4.0
– other	1.1	0.1	1.2	1.6	–	1.6
Hire of plant and machinery	8.2	0.1	8.3	7.1	–	7.1
Research and development expenditure	5.6	–	5.6	5.6	–	5.6
Profit on disposal of property, plant and equipment	(4.5)	–	(4.5)	(4.0)	–	(4.0)
Foreign exchange gains	–	–	–	(0.2)	–	(0.2)
Water and sewerage infrastructure maintenance expenditure	104.5	–	104.5	130.1	–	130.1
Other operating costs	89.5	7.0	96.5	92.1	13.8	105.9
	1,235.4	48.0	1,283.4	1,253.0	18.9	1,271.9
Release from deferred income	(7.5)	–	(7.5)	(5.3)	–	(5.3)
Own work capitalised	(81.1)	–	(81.1)	(75.4)	–	(75.4)
Total operating costs	1,146.8	48.0	1,194.8	1,172.3	18.9	1,191.2

The classification of certain prior year costs has been amended to conform with the current year presentation.

Further details of exceptional costs are given in note 8. The pension costs shown above include current and past service costs. Other pension costs (interest costs, expected returns on assets and actuarial gains and losses) are included in finance costs and other comprehensive income.

During the year the following fees were charged by the auditors:

	2010 £m	2009 £m
Fees payable to the company's auditors for:		
The audit of the company's annual accounts	0.1	0.1
The audit of the company's subsidiaries pursuant to legislation	0.4	0.4
Audit fees payable to associates of the company's auditors	0.1	0.1
Total audit fees	0.6	0.6
Fees payable to the company's auditors and their associates for other services to the group		
– Other services pursuant to legislation	0.2	0.3
– Services relating to corporate finance	0.1	0.1
Total non-audit fees	0.3	0.4

Details of directors' remuneration are set out in the Directors' remuneration report on pages 45 to 57.

8 Exceptional items

	2010 £m	2009 £m
Restructuring programmes:		
Severn Trent Water	42.1	13.7
Severn Trent Services	5.9	2.1
Corporate and Other release of disposal provisions made in previous periods	–	(1.2)
Exceptional restructuring costs	48.0	14.6
Flood costs	–	13.1
Insurance recoverable	–	(14.6)
Severn Trent Water exceptional flood income	–	(1.5)
Fine and costs relating to leakage reporting	–	2.2
Contribution to charitable trust	–	5.0
Severn Trent Water exceptional charge relating to regulatory matters	–	7.2
Severn Trent Services release of provision for third party legal costs	–	(1.4)
Total exceptional operating costs	48.0	18.9
Exceptional loss on disposal of business	1.7	–
Total exceptional items	49.7	18.9

9 Employee numbers

Average number of employees (including executive directors) during the year:

	2010 Number	2009 Number
By type of business:		
Severn Trent Water	5,686	5,624
Severn Trent Services	3,090	3,120
Corporate and Other	12	24
	8,788	8,768

10 Finance income

	2010 £m	2009 £m
Interest revenue earned on:		
Bank deposits	7.0	32.0
Other financial income	2.8	4.4
Total interest revenue	9.8	36.4
Expected return on defined benefit scheme assets	71.1	89.8
Total finance income	80.9	126.2

All interest revenue relates to loans and receivables.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

11 Finance costs

	2010 £m	2009 £m
Interest on bank loans and overdrafts	7.6	13.0
Interest on other loans	195.0	191.7
Interest on finance leases	10.1	16.3
Total borrowing costs	212.7	221.0
Other financial expenses	0.9	9.7
Interest cost on defined benefit scheme obligations	86.1	91.9
Total finance costs	299.7	322.6

In accordance with IAS 23 borrowing costs of £2.6 million (2009: £nil) that were incurred funding eligible capital projects have been capitalised at an interest rate of 5.65%.

12 Gains/(losses) on financial instruments

	2010 £m	2009 £m
(Loss)/gain on cross currency swaps used as hedging instruments in fair value hedges	(10.9)	221.1
Gain/(loss) arising on adjustments for foreign currency debt in fair value hedges	22.3	(222.7)
Fair value loss on cash flow hedges transferred from equity	(7.6)	(4.9)
Gain/(loss) arising on interest rate swaps where hedge accounting is not applied	41.9	(80.5)
	45.7	(87.0)

The group's hedge accounting arrangements are described in note 21 g).

13 Taxation

a) Analysis of tax charge in the year

	2010 £m	2009 £m
Current tax		
Current year at 28%	71.3	65.0
Prior year at 28%	(30.6)	(12.9)
Total current tax	40.7	52.1
Deferred tax		
Origination and reversal of temporary differences – current year	25.9	(23.3)
Origination and reversal of temporary differences – prior year	16.3	9.2
Exceptional deferred tax	–	185.6
Total deferred tax	42.2	171.5
Total tax charge	82.9	223.6

The Finance Act 2008 included legislation which will prevent the group claiming industrial building allowances on affected assets after 2011. This change is being introduced by reducing the rate of allowance that may be claimed from 1 April 2009 to 31 March 2011 at which point the allowances will be removed. The removal of these allowances resulted in an exceptional deferred tax charge of £185.6 million in the year ended 31 March 2009.

13 Taxation (continued)

b) Factors affecting the tax charge in the year

The tax expense for the current year is lower (2009: higher) than the standard rate of corporation tax in the UK 28%. The differences are explained below:

	2010 £m	2009 £m
Profit on ordinary activities before tax:	334.4	167.6
Tax at the standard rate of corporation tax in the UK 28% (2009: 28%)	93.6	46.9
Tax effect of expenditure not deductible/(income not taxable) in determining taxable profit	2.7	(5.9)
Effect of different rates of tax in overseas jurisdictions	0.9	0.7
Adjustments in respect of prior years	(14.3)	(3.7)
Exceptional deferred tax	–	185.6
Total tax charge	82.9	223.6

c) Tax credited directly to equity

In addition to the amount charged to the income statement, the following amounts of tax have been credited directly to equity.

	2010 £m	2009 £m
Current tax		
Tax on share based payments	(0.3)	(1.3)
Tax on pension contributions in excess of profit and loss charge	(0.7)	(3.8)
Tax on exchange differences on foreign currency hedging	0.4	(2.5)
Total current tax credited directly to equity	(0.6)	(7.6)
Deferred tax		
Tax on actuarial losses	(34.1)	(30.0)
Tax on cash flow hedges	(1.6)	(0.9)
Tax on share based payments	–	3.3
Total deferred tax credited directly to equity	(35.7)	(27.6)

14 Dividends

Amounts recognised as distributions to equity holders in the period:

	2010		2009	
	Pence per share	£m	Pence per share	£m
Final dividend for the year ended 31 March 2009 (2008)	41.05	96.5	41.29	97.0
Interim dividend for the year ended 31 March 2010 (2009)	26.71	63.2	26.29	61.8
	67.76	159.7	67.58	158.8
Proposed final dividend for the year ended 31 March 2010	45.61			

The proposed final dividend is subject to approval by shareholders at the AGM and has not been included as a liability in these financial statements.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

15 Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding those held in the Severn Trent Employee Share Ownership Trust, which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. These represent share options granted to employees where the exercise price is less than the average market price of the company's shares during the year.

Basic and diluted earnings per share from continuing operations are calculated on the basis of profit from combining operations attributable to the equity holders of the company.

The calculation of basic and diluted earnings per share is based on the following data:

Earnings

	2010 £m	2009 £m
Earnings for the purpose of basic and diluted earnings per share being:		
Profit/(loss) for the period attributable to the equity holders of the company	249.2	(57.8)

Number of shares

	2010 m	2009 m
Weighted average number of ordinary shares for the purpose of basic earnings per share	236.0	234.9
Effect of dilutive potential ordinary shares:		
Share options and LTIPs	0.3	0.7
Weighted average number of ordinary shares for the purpose of diluted earnings per share	236.3	235.6

Adjusted earnings per share

	2010 Pence	2009 Pence
Adjusted basic earnings per share	122.8	92.7
Adjusted diluted earnings per share	122.6	92.4

Adjusted earnings per share figures are presented for combining operations. These exclude the effects of deferred tax, gains/(losses) on financial instruments and exceptional items in both 2010 and 2009. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used in the calculations of adjusted basic and diluted earnings per share are the same as those used in the unadjusted figures set out above.

The adjustments to earnings are as follows:

Adjustments to earnings

	2010 £m	2009 £m
Earnings for the purpose of basic and diluted earnings per share	249.2	(57.8)
Adjustments for:		
Exceptional items	49.7	18.9
Current tax related to exceptional items at 28%	(5.6)	(1.8)
(Gains)/losses on financial instruments	(45.7)	87.0
Deferred tax	42.2	171.5
Earnings for the purpose of adjusted basic and diluted earnings per share	289.8	217.8

16 Goodwill

	2010 £m	2009 £m
Cost and net book value		
At 1 April	63.3	50.2
Additions	10.3	–
Amounts written off	(0.2)	–
Exchange adjustments	(2.8)	13.1
At 31 March	70.6	63.3

Goodwill impairment tests

Goodwill is allocated to the group's cash generating units (CGUs) identified according to country of operation and business segment.

A summary of the goodwill allocation by CGU is presented below:

	2010 £m	2009 £m
Severn Trent Services		
Water Purification US	27.8	29.4
Contract Operations US	12.5	13.1
UK Services	–	0.2
UK Laboratories	12.0	12.0
Services Italy	8.0	8.6
Apliclor	10.3	–
	70.6	63.3

The recoverable amount of a CGU is determined using value in use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five year period. The key assumption underlying these budgets is the revenue growth. Assumptions are determined by management of each CGU based on past experience, current market trends and expectations of future developments.

Cash flows beyond the five year period are extrapolated using an estimated nominal growth rate stated below. The growth rate does not exceed the long term average growth rate for the economy in which the CGU operates. The assumptions used in relation to growth rates beyond the five year period and discount rates were:

	Nominal growth rate		Discount rate	
	2010 %	2009 %	2010 %	2009 %
Water Purification US	3.0	3.0	7.8	8.7
Contract Operations US	3.0	3.0	8.9	9.2
UK Laboratories	3.0	3.0	8.9	9.5
Services Italy	3.0	3.0	10.1	11.7
Apliclor	3.0	–	10.0	–

The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the CGU.

Changes in the growth rate outside the five year period or in the discount rate applied to the cash flows could cause the CGUs' carrying amounts to exceed their recoverable amounts. The amount by which the recoverable amount of each CGU exceeded its carrying value and the amount by which the growth rate or discount rate would have to change in order to reduce the recoverable amount of the CGU to its carrying value is set out below.

	Surplus of recoverable amount over carrying amount £m	Change required for recoverable amount to equal carrying amount	
		Growth rate Percentage points	Discount rate Percentage points
Severn Trent Services			
Water Purification US	250.5	(31.9)	13.4
Contract Operations US	25.6	(5.4)	3.7
UK Laboratories	5.0	(0.8)	0.9
Services Italy	17.3	(5.3)	3.6
Apliclor	12.5	(6.3)	3.7

Notes to the group financial statements (continued)

For the year ended 31 March 2010

17 Intangible assets

	Computer software		Other	Total £m
	Internally generated £m	Purchased £m	Internally generated £m	
Cost				
At 1 April 2008	99.6	145.3	19.8	264.7
Additions	12.6	20.8	0.7	34.1
Disposals	(8.0)	(14.9)	–	(22.9)
Transfers	–	2.9	(2.9)	–
Transfers to assets held for sale	–	–	(0.5)	(0.5)
Exchange adjustments	0.1	0.8	1.6	2.5
At 1 April 2009	104.3	154.9	18.7	277.9
Additions	13.1	31.5	3.1	47.7
Acquisitions of businesses	–	0.3	–	0.3
Disposals	–	(1.2)	–	(1.2)
Disposal of businesses	–	(0.1)	(0.1)	(0.2)
Transfers	–	0.1	0.4	0.5
Exchange adjustments	–	(0.2)	(0.3)	(0.5)
At 31 March 2010	117.4	185.3	21.8	324.5
Amortisation				
At 1 April 2008	(61.9)	(84.4)	(11.2)	(157.5)
Amortisation for year	(8.4)	(14.6)	(1.2)	(24.2)
Disposals	8.0	16.3	1.0	25.3
Transfers	–	(1.3)	1.3	–
Transfers to assets held for sale	–	–	0.3	0.3
Exchange adjustments	0.3	(0.1)	(0.7)	(0.5)
At 1 April 2009	(62.0)	(84.1)	(10.5)	(156.6)
Amortisations for the year	(9.1)	(14.7)	(1.4)	(25.2)
Exceptional impairment	(2.3)	(3.5)	–	(5.8)
Disposals	–	1.1	–	1.1
Disposal of businesses	–	0.1	0.1	0.2
Exchange adjustments	–	0.2	0.1	0.3
At 31 March 2010	(73.4)	(100.9)	(11.7)	(186.0)
Net book value				
At 31 March 2010	44.0	84.4	10.1	138.5
At 31 March 2009	42.3	70.8	8.2	121.3

Other assets primarily comprise capitalised development costs and patents.

18 Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Movable plant £m	Total £m
Cost					
At 1 April 2008	2,188.0	3,880.7	2,685.5	57.0	8,811.2
Additions	146.1	61.5	257.0	9.3	473.9
Disposals	(5.4)	–	(45.3)	(9.5)	(60.2)
Transfers to assets held for sale	(0.3)	–	(3.3)	–	(3.6)
Exchange adjustments	1.6	–	8.2	3.6	13.4
At 1 April 2009	2,330.0	3,942.2	2,902.1	60.4	9,234.7
Additions	162.2	78.7	269.6	10.4	520.9
Acquisition of businesses	0.3	–	0.9	–	1.2
Disposals	(7.4)	–	(22.0)	(10.0)	(39.4)
Disposal of businesses	–	–	(0.3)	–	(0.3)
Transfers	(1.4)	–	1.0	(0.1)	(0.5)
Exchange adjustments	(0.4)	–	(1.7)	(0.7)	(2.8)
At 31 March 2010	2,483.3	4,020.9	3,149.6	60.0	9,713.8
Depreciation					
At 1 April 2008	(682.1)	(1,020.3)	(1,349.0)	(28.6)	(3,080.0)
Charge for year	(48.6)	(19.9)	(147.7)	(7.5)	(223.7)
Disposals	5.5	–	42.0	7.4	54.9
Transfers to assets held for sale	0.3	–	2.5	–	2.8
Exchange adjustments	(0.9)	–	(5.3)	(2.4)	(8.6)
At 1 April 2009	(725.8)	(1,040.2)	(1,457.5)	(31.1)	(3,254.6)
Charge for year	(51.7)	(25.7)	(150.3)	(8.4)	(236.1)
Exceptional impairment	–	–	(0.8)	–	(0.8)
Acquisition of businesses	–	–	(0.7)	–	(0.7)
Disposals	7.3	–	21.7	8.0	37.0
Transfers	0.9	–	(1.0)	0.1	–
Exchange adjustments	0.2	–	1.2	0.5	1.9
At 31 March 2010	(769.1)	(1,065.9)	(1,587.4)	(30.9)	(3,453.3)
Net book value					
At 31 March 2010	1,714.2	2,955.0	1,562.2	29.1	6,260.5
At 31 March 2009	1,604.2	2,902.0	1,444.6	29.3	5,980.1

The carrying amount of property, plant and equipment includes the following amounts in respect of assets held under finance leases:

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Movable plant £m	Total £m
Net book value					
At 31 March 2010	–	121.1	116.4	–	237.5
At 31 March 2009	–	122.1	140.9	–	263.0

Property, plant and equipment includes £459.6 million (2009: £571.8 million) in respect of assets in the course of construction for which no depreciation is charged.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

19 Interests in joint ventures

	2010 £m	2009 £m
Group's share of:		
Long term assets	–	–
Current assets	1.8	2.0
Current liabilities	(1.5)	(1.7)
Amounts due from joint ventures	–	–
	0.3	0.3
Group's share of:		
Turnover	4.7	1.6
Operating costs	(4.7)	(1.6)
Profit before tax	–	–
Tax	–	–
Profit after tax	–	–

The joint ventures have no significant contingent liabilities to which the group is exposed and the group does not have any significant contingent liabilities in relation to its interests in the joint ventures. The group has no capital commitments in relation to its interests in the joint ventures.

Particulars of the group's principal joint venture undertakings at 31 March 2010 are:

Name	Country of incorporation	Proportion of ownership	Proportion of voting power
Cognica Limited	Great Britain	50%	50%
Jackson Water Partnership	USA	70%	See below

The partnership agreement for the Jackson Water Partnership requires that certain key decisions require the unanimous consent of the partners and consequently the partnership has been accounted for as a joint venture.

20 Interests in associates

	2010 £m	2009 £m
At 1 April	4.8	4.1
Share of profits	0.1	–
Other movements	(0.3)	0.7
At 31 March	4.6	4.8
Group's share of:		
Total assets	25.6	26.4
Total liabilities	(21.0)	(21.6)
	4.6	4.8
Turnover	8.0	7.0
Profit before tax	0.1	–

The associate company has no significant contingent liabilities to which the group is exposed. The group has given guarantees in respect of the associate's borrowings. The guarantees are limited to €11.2 million and the group does not expect any liabilities to arise from these arrangements. The group has no capital commitments in relation to its interests in the associate.

The principal associate at 31 March 2010 was:

Name	Equity interest	Percentage of share capital held	Nature of business
S.I.I. Societa Consortile per Azioni	16,279,127 of €1	30%	Water and sewerage

The country of incorporation and main operation is Italy.

21 Financial instruments

a) Capital management

It is the group's policy to access a broad range of sources of finance to obtain both the quantum required and the lowest cost compatible with the need for continued availability. The group is funded using a mixture of equity and debt (including fixed rate, index linked and floating rate).

At 31 March the group's equity and debt capital comprised the following:

	2010 £m	2009 £m
Cash and short term deposits	227.8	648.1
Bank loans	(689.8)	(789.8)
Other loans	(3,185.9)	(3,310.9)
Obligations under finance leases	(300.8)	(344.4)
Cross currency swaps	187.3	237.1
Net debt	(3,761.4)	(3,559.9)
Equity attributable to the company's equity shareholders	(940.7)	(946.1)
Total capital	(4,702.1)	(4,506.0)

b) Categories of financial assets

	2010 £m	2009 £m
Fair value through profit and loss		
Derivatives that do not qualify for hedge accounting		
Interest rate swaps	19.4	18.1
Derivatives that are designated and effective as hedging instruments carried at fair value		
Cross currency swaps	187.3	237.1
Available for sale investments carried at fair value		
Unquoted shares	0.1	0.1
Loans and receivables (including cash and cash equivalents)		
Trade receivables	196.6	201.1
Short term deposits	183.7	586.5
Cash at bank and in hand	44.1	61.6
	424.4	849.2
Total financial assets	631.2	1,104.5
Disclosed in the balance sheet as:		
Non-current assets		
Derivative financial instruments	203.8	225.4
Available for sale financial assets	0.1	0.1
	203.9	225.5
Current assets		
Derivative financial instruments	2.9	29.8
Cash and cash equivalents	227.8	648.1
Trade and other receivables (note 23)	196.6	201.1
	427.3	879.0
	631.2	1,104.5

Notes to the group financial statements (continued)

For the year ended 31 March 2010

21 Financial instruments (continued)

c) Categories of financial liabilities

	2010 £m	2009 £m
Fair value through profit and loss		
Derivatives that do not qualify for hedge accounting		
Interest rate swaps	(125.4)	(162.0)
Foreign exchange forward contracts	–	(0.4)
	(125.4)	(162.4)
Derivatives that are designated and effective as hedging instruments carried at fair value		
Interest rate swaps	(9.5)	(9.6)
Energy swaps	(9.8)	–
	(19.3)	(9.6)
Other financial liabilities		
Bank loans	(689.8)	(789.8)
Other loans	(3,185.9)	(3,310.9)
Obligations under finance leases	(300.8)	(344.4)
Trade payables	(28.4)	(46.3)
	(4,204.9)	(4,491.4)
Total financial liabilities	(4,349.6)	(4,663.4)
Disclosed in the balance sheet as:		
Non-current liabilities		
Derivative financial instruments	(140.3)	(171.6)
Borrowings	(3,915.6)	(4,188.9)
	(4,055.9)	(4,360.5)
Current liabilities		
Derivative financial instruments	(4.4)	(0.4)
Borrowings	(260.9)	(256.2)
Trade payables (note 26)	(28.4)	(46.3)
	(293.7)	(302.9)
	(4,349.6)	(4,663.4)

d) Derivative contracts

	2010		2009	
	Asset £m	Liability £m	Asset £m	Liability £m
Cross currency swaps – fair value hedges	187.3	–	237.1	–
Interest rate swaps – cash flow hedges	–	(9.5)	–	(9.6)
Energy swaps – cash flow hedges	–	(9.8)	–	–
Interest rate swaps – derivatives not in a formal hedge relationship	19.4	(125.4)	18.1	(162.0)
Foreign exchange forward contracts	–	–	–	(0.4)
Total	206.7	(144.7)	255.2	(172.0)
Less non-current portion:				
Cross currency swaps – fair value hedges	184.5	–	207.3	–
Interest rate swaps – cash flow hedges	–	(9.5)	–	(9.6)
Energy swaps – cash flow hedges	–	(9.7)	–	–
Interest rate swaps – derivatives not in a formal hedge relationship	19.3	(121.1)	18.1	(162.0)
Total non-current	203.8	(140.3)	225.4	(171.6)
Current portion	2.9	(4.4)	29.8	(0.4)

21 Financial instruments (continued)

e) Fair values of financial instruments

Except as disclosed below, the directors consider that the carrying amount of financial assets and liabilities recorded in the financial statements approximate their fair values.

	31 March 2010		31 March 2009 (restated)	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Borrowings falling due within one year:				
Bank loans – amortised cost	(201.2)	(201.2)	(100.0)	(102.0)
Other loans – amortised cost	(1.8)	(1.8)	(1.4)	–
Other loans – fair value	(10.6)	(10.6)	(111.4)	(111.4)
Obligations under finance leases – amortised cost	(47.3)	(48.9)	(43.4)	(63.0)
	(260.9)	(262.5)	(256.2)	(276.4)
Borrowings falling due after more than one year:				
Bank loans – amortised cost	(488.6)	(477.9)	(689.8)	(652.8)
Other loans – amortised cost	(2,016.6)	(2,159.2)	(2,004.0)	(1,814.3)
Other loans – fair value	(1,156.9)	(1,156.9)	(1,194.1)	(1,194.1)
Obligations under finance leases – amortised cost	(253.5)	(211.4)	(301.0)	(308.7)
	(3,915.6)	(4,005.4)	(4,188.9)	(3,969.9)
	(4,176.5)	(4,267.9)	(4,445.1)	(4,246.3)

Discounted future cash flows are used to determine fair values for debt. Discount rates are derived from yield curves based on quoted interest rates and are adjusted for credit risk.

The fair value of group borrowings disclosed at 31 March 2009 has been restated to reflect a change in methodology of estimating the fair value to include an adjustment for the pricing of the group's credit risk. The impact of the change was to reduce the estimated fair value of borrowings at 31 March 2009 by £1,004.4 million.

Fair value measurements recognised in the balance sheet

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets and liabilities;

Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

Cross currency swaps are valued by reference to quoted forward exchange rates at the balance sheet date and yield curves derived from quoted interest rates matching the maturities of the contracts.

Energy swaps are valued by reference to quoted forward electricity prices at the balance sheet date and yield curves derived from quoted interest rates matching the maturities of the contracts.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

21 Financial instruments (continued)

e) Fair values of financial instruments (continued)

2010	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative financial assets				
Cross currency swaps – fair value hedges	–	187.3	–	187.3
Interest rate swaps – derivatives not in designated hedging relationships	–	19.4	–	19.4
	–	206.7	–	206.7
Derivative financial liabilities				
Interest rate swaps – cash flow hedges	–	(9.5)	–	(9.5)
Interest rate swaps – derivatives not in designated hedging relationships	–	(125.4)	–	(129.4)
Energy swaps – cash flow hedges	–	(9.8)	–	(9.8)
	–	(144.7)	–	(144.7)
	–	62.0	–	62.0

f) Financial risk factors

The group's activities expose it to a variety of financial risks: market risk (including currency and interest rate risk), mainly credit risk, liquidity risk and inflation risk. The group's overall risk management programme addresses the unpredictability of financial markets and seeks to reduce potential adverse effects on the group's financial performance or position.

Financial risks are managed by a central treasury department (Group Treasury) under policies approved by the board of directors. Group Treasury identifies, evaluates and hedges financial risks in close co-operation with the group's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas such as exchange rate risk, interest rate risk, credit risk, the use of derivative and non-derivative financial instruments. Derivative financial instruments are used to hedge exposures to changes in exchange rates and interest rates. The group's policy is that derivative financial instruments are not held for trading.

i) Market risk

The principal market risk that the group is exposed to is fluctuations in interest rates. Since substantially all of the group's profits and net assets arise from Severn Trent Water, which has very limited and indirect exposure to changes in exchange rates, the sensitivity of the group's results to changes in exchange rates is not material.

Interest rate risk

The group's income and operating cash flows are substantially independent of changes in market interest rates.

The group's interest rate risk arises from long term borrowings. Borrowings issued at variable rates expose the group to cash flow interest rate risk. Borrowings issued at fixed rates expose the group to fair value interest rate risk. Group policy is to maintain 45–90% of its net debt in fixed rate instruments. At 31 March 2010 some 82.4%, of the group's net debt was fixed (2009: 87.6%).

The group manages its cash flow interest rate risk by using floating to fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Under the terms of the interest rate swaps, the group agrees with other parties to exchange, biannually, the difference between fixed contract and floating rate interest rates calculated by reference to the agreed notional principal amounts. The group has entered into a series of long dated interest rate swaps to hedge future debt. Economically these act to fix debt within the group which is denominated as floating rate, but do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a £41.9 million credit (2009: charge of £80.5 million) in the income statement.

Some of the group's debt is index-linked, that is its cost is linked to changes in the Retail Price Index (RPI). This debt provides an economic hedge for Severn Trent Water's revenues and regulatory asset values that are also RPI linked under its regulatory regime.

21 Financial instruments (continued)

f) Financial risk factors (continued)

Financial liabilities analysed by interest rate after taking account of various interest rate swaps entered into by the group

	Non-interest bearing £m	Floating interest rate £m	Fixed interest rate £m	Index linked £m	Total £m
2010					
Bank loans and overdrafts	–	(544.2)	–	(145.6)	(689.8)
Other loans	–	(247.5)	(2,029.9)	(908.5)	(3,185.9)
Finance leases	–	(141.8)	(159.0)	–	(300.8)
Other financial liabilities	(28.5)	–	–	–	(28.5)
	(28.5)	(933.5)	(2,188.9)	(1,054.1)	(4,205.0)
Impact of interest rate swaps not matched against specific debt instruments	–	835.0	(835.0)	–	–
	(28.5)	(98.5)	(3,023.9)	(1,054.1)	(4,205.0)
Weighted average interest rate			5.88%		
Weighted average period for which interest is fixed (years)			10.9		

	Non-interest bearing £m	Floating interest rate £m	Fixed interest rate £m	Index linked £m	Total £m
2009					
Bank loans and overdrafts	–	(501.5)	(140.5)	(147.8)	(789.8)
Other loans	–	(328.6)	(2,089.4)	(892.9)	(3,310.9)
Finance leases	–	(175.6)	(168.8)	–	(344.4)
Other financial liabilities	(46.3)	–	–	–	(46.3)
	(46.3)	(1,005.7)	(2,398.7)	(1,040.7)	(4,491.4)
Impact of interest rate swaps not matched against specific debt instruments	–	720.7	(720.7)	–	–
	(46.3)	(285.0)	(3,119.4)	(1,040.7)	(4,491.4)
Weighted average interest rate			5.90%		
Weighted average period for which interest is fixed (years)			12.1		

Financial assets analysed by interest rates

	Non-interest bearing assets £m	Floating interest rate £m	Fixed interest rate £m	Index linked £m	Total £m
2010					
Available for sale financial assets	0.1	–	–	–	0.1
Loans and receivables	196.6	–	–	–	196.6
Cash and cash equivalents	–	227.8	–	–	227.8
	196.7	227.8	–	–	424.5
2009					
Available for sale financial assets	0.1	–	–	–	0.1
Loans and receivables	201.1	–	–	–	201.1
Cash and cash equivalents	–	648.1	–	–	648.1
	201.1	648.1	–	–	849.3

Notes to the group financial statements (continued)

For the year ended 31 March 2010

21 Financial instruments (continued)

f) Financial risk factors (continued)

Interest rate sensitivity analysis

The sensitivity after tax of the group's profits, cash flow and equity, including the impact on derivative financial instruments, to changes in interest rates at 31 March is as follows:

	2010		2009	
	£m	£m	£m	£m
	+1.0%	-1.0%	+1.0%	-1.0%
Profit or loss	(39.2)	48.4	(65.8)	78.8
Cash flow	18.7	(14.9)	(15.1)	14.0
Equity	(34.3)	44.0	(67.2)	80.3

Inflation rate sensitivity analysis

The sensitivity after tax of the group's profits and equity to changes in inflation at 31 March is set out in the following table. This analysis excludes any impact on Severn Trent Water's revenues and Regulated Capital Value.

	2010		2009	
	£m	£m	£m	£m
	+1.0%	-1.0%	+1.0%	-1.0%
Profit or loss	(7.6)	7.6	(7.5)	7.5
Equity	(7.6)	7.6	(7.5)	7.5

Exchange rate risk

The group operates internationally and is exposed to foreign exchange risk arising from net investments in foreign operations, primarily with respect to the US dollar and the euro. However, since substantially all of the group's profits and net assets arise from Severn Trent Water, which has very limited and indirect exposure to changes in exchange rates, the sensitivity of the group's results to changes in exchange rates is not material.

The group has a significant value of foreign currency debt, primarily in yen and euros. To manage the foreign exchange risk arising from foreign currency debt the group enters into cross currency swaps with external parties.

The group's risk management policy is to hedge 100% of all foreign currency denominated debt. At 31 March 2010 all foreign currency denominated debt was hedged (2009: 100%).

Monetary assets and liabilities by currency, excluding functional currency

Certain of the group's subsidiaries operate in markets where the local currency is different from the functional currency of the operation. Exchange risks relating to such operations are managed centrally by Group Treasury through forward exchange contracts to buy or sell currency. External foreign exchange contracts are designated at group level as hedges of foreign exchange risk on specific assets, liabilities or future transactions on a gross basis. The net amount of foreign currency assets and liabilities and the forward contracts that have been taken out to hedge the exchange risks on these assets and liabilities and on future committed transactions are summarised below.

2010	US dollar £m	Euro £m	Other £m	Total £m
Functional currency of operation				
Sterling	0.6	0.1	0.1	0.8
Total	0.6	(0.1)	0.1	0.8
2009	US Dollar £m	Euro £m	Other £m	Total £m
Functional currency of operation				
Sterling	–	(0.6)	–	(0.6)
Euro	28.4	–	–	28.4
Total	28.4	(0.6)	–	27.8

21 Financial instruments (continued)

f) Financial risk factors (continued)

The group's borrowings are denominated in the following currencies after taking account of cross currency swaps

	2010 £m	2009 £m
Sterling	(4,175.3)	(4,442.7)
Euro	(1.2)	(2.4)
	(4,176.5)	(4,445.1)

The euro denominated borrowings relate to operations in which the euro is the functional currency.

ii) Credit risk

Operationally the group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history, other than in Severn Trent Water Limited, whose operating licence obliges it to supply domestic customers even in cases where bills are not paid. Amounts provided against accounts receivable and movements on the provision during the year are disclosed in note 23.

For financing purposes, derivative counterparties and cash transactions are limited to high credit quality financial institutions. The group has policies that limit the amount of credit exposure to any one financial institution.

Credit risk analysis

At 31 March the credit limits and amounts deposited analysed by credit ratings of counterparties were as follows:

Rating	Credit limit		Amount deposited	
	2010 £m	2009 £m	2010 £m	2009 £m
AAA	300.0	400.0	35.5	219.8
Double A range	450.0	525.0	89.6	112.9
Single A range	525.0	375.0	58.6	253.8
	1,275.0	1,300.0	183.7	586.5

The amounts of derivative assets analysed by credit ratings of counterparties were as follows:

Rating	Cross currency swaps		Interest rate swaps not qualifying for hedge accounting	
	2010 £m	2009 £m	2010 £m	2009 £m
AAA	—	—	—	—
Double A range	71.4	55.0	19.4	18.1
Single A range	115.9	182.1	—	—
	187.3	237.1	19.4	18.1

iii) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash balances and the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. Group Treasury manages liquidity and flexibility in funding by monitoring forecast and actual cash flows and the maturity profile of financial assets and liabilities and by keeping committed credit lines available.

At the balance sheet date the group had committed undrawn borrowing facilities of £191.7 million expiring between one and two years (2009: £ nil) and £458.3 million (2009: £500 million) expiring between two and five years.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

21 Financial instruments (continued)

f) Financial risk factors (continued)

Financial liabilities analysed by maturity date

The following tables detail the group's remaining contractual maturity for its non-derivative net financial liabilities. The information presented is based on the earliest date on which the group can be required to pay and represents the undiscounted cash flow including principal and interest.

	within one year £m	between one and two years £m	between two and five years £m	between five and ten years £m	between ten and twenty years £m	after more than twenty years £m	Total £m
2010							
Financial liabilities							
Bank loans	(206.0)	(10.4)	(212.7)	(341.9)	(43.1)	(43.1)	(857.2)
Other loans	(142.4)	(142.2)	(743.7)	(1,444.8)	(1,680.0)	(5,320.7)	(9,473.8)
Finance leases	(56.2)	(21.2)	(78.8)	(101.5)	(95.8)	(32.0)	(385.5)
Other financial liabilities	(28.4)	–	–	–	–	–	(28.4)
	(433.0)	(173.8)	(1,035.2)	(1,888.2)	(1,818.9)	(5,395.8)	(10,744.9)
Financial assets							
Trade receivables	196.6	–	–	–	–	–	196.6
Cash and short term deposits	227.8	–	–	–	–	–	227.8
Net	(8.6)	(173.8)	(1,035.2)	(1,888.2)	(1,818.9)	(5,395.8)	(10,320.5)
2009							
Financial liabilities							
Bank loans	(122.9)	(17.2)	(432.1)	(350.9)	(46.8)	–	(969.9)
Other loans	(220.9)	(144.3)	(488.2)	(2,200.3)	(1,232.7)	(4,804.7)	(9,091.1)
Finance leases	(56.0)	(58.6)	(77.3)	(132.9)	(106.1)	–	(478.2)
Other financial liabilities	(46.3)	–	–	–	–	–	(46.3)
Total	(446.1)	(220.1)	(997.6)	(2,684.1)	(1,385.6)	(4,852.0)	(10,585.5)
Financial assets							
Trade and receivables	201.1	–	–	–	–	–	201.1
Cash and short term deposits	648.1	–	–	–	–	–	648.1
Net	403.1	(220.1)	(997.6)	(2,684.1)	(1,385.6)	(4,852.0)	(9,736.3)

Other loans includes index linked debt with maturities of up to 57 years. The principal is revalued at fixed intervals and is linked to movements in the retail price index. Interest payments are made biannually based on the revalued principal. The principal repayment equals the revalued amount at maturity. The calculations above are based on forward inflation rates at the balance sheet date.

When the group entered into a £200 million facility it gave certain representations which have subsequently been discovered to be inaccurate. As a result, at 31 March 2010 there was an event of default on this facility and the outstanding amount of £200 million has been classified as current liabilities. This technical default was in the process of being remedied on 27 May 2010.

The following tables detail the group's liquidity analysis for its derivative financial instruments. The tables are based on the undiscounted net cash inflows/(outflows) on the derivative financial instruments that settle on a net basis and the undiscounted gross inflows and (outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the projected interest and foreign currency rates as illustrated by the forward curves existing at the balance sheet date.

21 Financial instruments (continued)

f) Financial risk factors (continued)

2010	Financial assets falling due						Total £m
	within one year £m	between one and two years £m	between two and five years £m	between five and ten years £m	between ten and twenty years £m	after more than twenty years £m	
Instruments settled net							
Interest rate swaps	8.0	6.0	5.5	0.3	–	–	19.8
Instruments settled gross							
Cross currency swaps							
Cash receipts	51.9	48.2	303.7	753.7	56.7	128.9	1,343.1
Cash payments	(33.0)	(43.3)	(244.2)	(630.9)	(38.7)	(60.7)	(1,050.8)
Net cash flow	18.9	4.9	59.5	122.8	18.0	68.2	292.3
Total	26.9	10.9	65.0	123.1	18.0	68.2	312.1

2010	Financial liabilities falling due						Total £m
	within one year £m	between one and two years £m	between two and five years £m	between five and ten years £m	between ten and twenty years £m	after more than twenty years £m	
Instruments settled net							
Interest rate swaps	(44.5)	(30.4)	(45.4)	(26.1)	(33.4)	(15.8)	(195.6)
Energy swaps	(0.1)	(0.6)	(8.7)	(1.0)	–	–	(10.4)
Instruments settled gross							
Cross currency swaps							
Cash receipts	–	–	–	–	–	–	–
Cash payments	–	–	–	–	–	–	–
Net cash flow	–	–	–	–	–	–	–
Total	(44.6)	(31.0)	(54.1)	(27.1)	(33.4)	(15.8)	(206.0)

2009	Financial assets falling due						Total £m
	within one year £m	between one and two years £m	between two and five years £m	between five and ten years £m	between ten and twenty years £m	after more than twenty years £m	
Instruments settled net							
Interest rate swaps	6.3	5.4	6.1	1.8	–	–	19.6
Instruments settled gross							
Cross currency swaps							
Cash receipts	156.7	54.3	221.0	914.6	55.9	159.1	1,561.6
Cash payments	(121.5)	(47.3)	(194.8)	(733.3)	(43.7)	(69.4)	(1,210.0)
Net cash flow	35.2	7.0	26.2	181.3	12.2	89.7	351.6
Total	41.5	12.4	32.3	183.1	12.2	89.7	371.2

Notes to the group financial statements (continued)

For the year ended 31 March 2010

21 Financial instruments (continued)

f) Financial risk factors (continued)

2009	Financial liabilities falling due						Total £m
	within one year £m	between one and two years £m	between two and five years £m	between five and ten years £m	between ten and twenty years £m	after more than twenty years £m	
Instruments settled net							
Interest rate swaps	(33.7)	(31.7)	(39.0)	(3.6)	(66.8)	(42.5)	(217.3)
Instruments settled gross							
Cross currency swaps							
Cash receipts	–	–	–	–	–	–	–
Cash payments	–	–	–	–	–	–	–
	–	–	–	–	–	–	–
Total	(33.7)	(31.7)	(39.0)	(3.6)	(66.8)	(42.5)	(217.3)

g) Hedge accounting

The group uses derivative financial instruments to hedge exposures to changes in exchange rates and interest rates. Hedge accounting is adopted for such instruments where the criteria set out in IAS 39 are met.

i) Fair value hedges

The group raises debt denominated in currencies other than sterling – principally Japanese yen and euro. Cross currency swaps are entered into at the time that the debt is drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR in order to mitigate the group's exposure to exchange rate fluctuations. The terms of the receivable leg of the swap closely match the terms of the underlying debt hence the swaps are expected to be effective hedges. At the year end the amounts of cross currency swaps designated as fair value hedges was as follows:

	Notional principal amount		Fair value	
	2010 £m	2009 £m	2010 £m	2009 £m
US dollar	27.0	27.0	7.7	9.9
Euro	548.0	550.0	90.2	108.9
Yen	161.0	205.9	66.9	85.7
Czech krona	47.2	65.7	22.5	25.6
Other	–	11.4	–	7.0
	783.2	860.0	187.3	237.1

21 Financial instruments (continued)

g) Hedge accounting (continued)

ii) Cash flow hedges

The group has entered into interest rate swap contracts under which it has agreed to exchange the difference between fixed and floating interest rate amounts calculated on agreed notional principal amounts. Such contracts enable the group to mitigate the risk of changing interest rates on the future cash flow exposures arising from issued variable rate debt. The group also entered into a number of interest rate swap contracts with start dates set at annual intervals throughout the regulatory period. Such contracts enable the group to mitigate the risk of changing interest rates on debt which is highly probable to be issued over the AMP5 period to fund Severn Trent Water's capital programme and have been accounted for as cash flow hedges.

The interest rate swaps settle net on a biannual basis. The floating rate on the interest rate swaps is six months LIBOR.

Details of interest rate swaps that have been accounted for as cash flow hedges are summarised below:

Period to maturity	Average contract fixed interest rate		Notional principal amount		Fair value	
	2010 %	2009 %	2010 £m	2009 £m	2010 £m	2009 £m
Less than 1 year	—	—	—	—	—	—
1 to 2 years	—	4.74	—	106.0	—	(3.3)
2 to 5 years	—	—	—	—	—	—
5 to 10 years	—	—	—	—	—	—
10 to 20 years	5.07	5.18	493.0	40.5	(9.5)	(6.3)
More than 20 years	—	—	—	—	—	—
			493.0	146.5	(9.5)	(9.6)

The group has entered into a series of energy swaps under which it has agreed to exchange the difference between fixed and market prices of electricity at six-monthly intervals between 2013 and 2024.

Details of energy swaps that have been accounted for as cash flow hedges are summarised below:

Period to maturity	Average contract price		Notional contracted amount		Fair value	
	2010 £/MWh	2009 £/MWh	2010 MWh	2009 MWh	2010 £m	2009 £m
Less than 1 year	35.6	—	65,520	—	(0.1)	—
1 to 2 years	43.9	—	196,560	—	(1.0)	—
2 to 5 years	52.4	—	1,275,456	—	(8.7)	—
			1,537,536	—	(9.8)	—

Changes in the amounts deferred in equity during the period relating to cash flow hedges were as follows:

	2010 £m	2009 £m
Fair value gains deferred in equity at start of the period	3.5	6.4
Fair value losses recognised in equity in the period	(13.2)	(7.8)
Fair value losses transferred to finance costs in the period	7.6	4.9
Fair value (losses)/gains deferred in equity at end of the period	(2.1)	3.5

During the period the group has ceased to account for certain forward start swaps as cash flow hedges because the group was not able to identify specific debt instruments that would enable the strict hedge accounting criteria of IAS 39 to be met when the swaps started. Fair value losses amounting to £3.5 million relating to these swaps that had been taken directly to equity will be transferred to the income statement on a straight line basis over the remaining lives of the swaps. Any future changes in the fair values of the swaps will be recorded in the income statement.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

21 Financial instruments (continued)

g) Hedge accounting (continued)

Details of interest rate swaps that have not been accounted for as cash flow hedges, including those where hedge accounting has been discontinued in the period, are summarised below:

Period to maturity	Average contract fixed interest rate		Notional principal amount		Fair value	
	2010 %	2009 %	2010 £m	2009 £m	2010 £m	2009 £m
Less than 1 year	5.11%	—	355.0	—	(4.2)	—
1 to 2 years	—	5.66%	—	249.0	—	(18.6)
2 to 5 years	—	—	—	—	—	—
5 to 10 years	6.32%	6.32%	225.0	225.0	(38.6)	(33.3)
10 to 20 years	—	—	—	—	—	—
20 to 30 years	5.32%	5.65%	455.0	446.7	(82.6)	(110.1)
			1,035.0	920.7	(125.4)	(162.0)

Contracts where the group receives fixed interest are summarised below:

Period to maturity	Average contract fixed interest rate		Notional principal amount		Fair value	
	2010 %	2009 %	2010 £m	2009 £m	2010 £m	2009 £m
5 to 10 years	5.18	5.18	200.0	200.0	19.4	18.1

22 Inventory

	2010 £m	2009 £m
Inventory and work in progress	26.5	30.6

23 Trade and other receivables

	2010 £m	2009 £m
Trade receivables	288.4	294.1
Less provision for impairment of receivables	(91.8)	(93.0)
Trade receivables net	196.6	201.1
Receivables from related parties	0.2	0.2
Other amounts receivable	42.4	18.4
Prepayments and accrued income	233.6	227.4
	472.8	447.1

The carrying values of trade and other receivables are reasonable approximations of their fair values.

Prepayments and accrued income include £26.2 million (2009: £24.2 million) in respect of amounts due from customers for contract work and £43.0 million (2009: £44.2 million) which is recoverable after more than one year.

Credit control policies and procedures are determined at the individual business unit level. By far the most significant business unit of the group is Severn Trent Water Limited, which represents 81% of group turnover and 62% of trade receivables. Severn Trent Water has a statutory obligation to provide water and sewerage services to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables and the credit quality of its customer base reflects the wealth and prosperity of all of the commercial businesses and domestic households within its region. None of the other business units are individually significant to the group.

23 Trade and other receivables (continued)

Movements on the doubtful debts provision were as follows:

	2010 £m	2009 £m
At 1 April	93.0	83.4
Amounts written off during the year	(36.3)	(22.9)
Charge for bad and doubtful debts	35.2	31.9
Exchange adjustments	(0.1)	0.6
At 31 March	91.8	93.0

Included in trade receivables are balances with a carrying amount of £154.5 million (2009: £165.4 million) which were past due at the reporting date but for which no specific provision has been made as the collective impairment recorded against such assets is considered to be sufficient allowance for the risk of non-collection of such balances.

The aged analysis of past due receivables that were not individually impaired is as follows:

	2010 £m	2009 £m
0 – 90 days	54.1	60.2
91 – 365 days	74.3	67.4
1 – 2 years	19.3	22.2
2 – 3 years	5.9	7.8
More than 3 years	0.9	7.8
Total	154.5	165.4

Included in the allowance for doubtful debts are provisions against specific trade receivables amounting to £6.2 million (2009: £12.8 million). The age of the impaired receivables was as follows:

	2010 £m	2009 £m
0 – 90 days	0.2	0.1
91 – 365 days	1.7	2.6
1 – 2 years	1.2	1.5
2 – 3 years	0.4	0.8
More than 3 years	3.1	8.7
Total	6.6	13.7

24 Cash and cash equivalents

	2010 £m	2009 £m
Cash at bank and in hand	44.1	61.6
Short term bank deposits	183.7	586.5
	227.8	648.1

Of the £183.7 million (2009: £586.5 million) of short term bank deposits, £27.4 million (2009: £31.1 million) is held as security deposits for self-insurance obligations and is not available for use by the group.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

25 Finance leases

Obligations under finance leases are as follows:

	2010 £m	2009 £m
Gross obligations under finance leases	385.5	478.2
Less future finance charges	(84.7)	(133.8)
Present value of lease obligations	300.8	344.4

A maturity analysis of gross obligations under finance leases is presented in note 21.

Net obligations under finance leases fall due as follows:

	2010 £m	2009 £m
Within one year	47.3	43.4
In the second year	12.9	46.9
In the third to fifth year inclusive	57.3	47.7
After more than five years	183.3	206.4
Included in non-current liabilities	253.5	301.0
	300.8	344.4

The remaining terms of finance leases ranged from 1 to 22 years at 31 March 2010. Interest terms are set at the inception of the lease. Leases with capital outstanding of £154.0 million (2009: £168.4 million) bear fixed interest at a weighted average rate of 5.4% (2009: 5.4%). The lease obligations are secured against the related assets.

There were no contingent rents, escalation clauses or material renewal or purchase options. The terms of the finance leases do not impose restrictions on dividend payments, additional debt or further leasing.

26 Trade and other payables

	2010 £m	2009 £m
Current liabilities		
Trade payables	28.4	46.3
Social security and other taxes	6.0	6.1
Other payables	34.9	34.9
Accruals and deferred income	394.9	355.4
	464.2	442.7
Non-current liabilities		
Other payables	0.3	0.2
Deferred income	239.3	233.5
Accrued expenses	4.0	7.4
	243.6	241.1

The directors consider that the carrying value of trade payables is not materially different from their fair values. Accruals and deferred income includes £nil (2009: £6.8 million) in respect of amounts due to customers for contract work.

27 Deferred tax

An analysis of the movements in the major deferred tax liabilities and assets recognised by the group is set out below:

	Accelerated tax depreciation £m	Retirement benefit obligation £m	Tax losses £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2008	862.6	(35.3)	(8.7)	(19.5)	9.2	808.3
Charge to income	202.8	–	1.4	(23.8)	(8.9)	171.5
Charge to equity	–	(30.0)	–	(0.9)	3.3	(27.6)
Exchange differences	0.6	–	(3.2)	–	(1.2)	(3.8)
At 1 April 2009	1,066.0	(65.3)	(10.5)	(44.2)	2.4	948.4
Charge to income	44.2	–	2.7	12.3	(17.0)	42.2
Charge to equity	–	(34.1)	–	(1.6)	–	(35.7)
Transfers	51.0	–	–	–	(51.0)	–
Acquisitions/disposals	0.4	–	–	–	–	0.4
Exchange differences	0.2	–	0.7	–	0.2	1.1
At 31 March 2010	1,161.8	(99.4)	(7.1)	(33.5)	(65.4)	956.4

Certain deferred tax assets and liabilities have been offset. The offset amounts are as follows:

	2010 £m	2009 £m
Deferred tax asset to be recovered after more than 12 months	(13.6)	(26.2)
Deferred tax asset to be recovered within 12 months	(4.0)	(3.6)
	(17.6)	(29.8)
Deferred tax liability to be recovered after more than 12 months	974.0	959.4
Deferred tax liability to be recovered within 12 months	–	18.8
	974.0	978.2
	956.4	948.4

28 Retirement benefit schemes

Defined benefit schemes

a) Amount included in the balance sheet arising from the group's obligations under defined benefit schemes

	2010 £m	2009 £m
Fair value of scheme assets:		
Equities	745.7	542.8
Gilts	270.8	236.0
Corporate bonds	307.0	230.1
Property	61.1	52.1
Cash	8.4	14.0
Total fair value of assets	1,393.0	1,075.0
Present value of defined benefit obligations – funded schemes	(1,740.3)	(1,301.8)
	(347.3)	(226.8)
Present value of defined benefit obligations – unfunded schemes	(7.6)	(6.2)
Liability recognised in the balance sheet	(354.9)	(233.0)

Notes to the group financial statements (continued)

For the year ended 31 March 2010

28 Retirement benefit schemes (continued)

a) Amount included in the balance sheet arising from the group's obligations under defined benefit schemes

Movements in the fair value of the scheme assets were as follows:

	2010 £m	2009 £m
Fair value at 1 April	1,075.0	1,332.3
Expected return on scheme assets	71.1	89.8
Contributions from the sponsoring companies	39.6	42.0
Contributions from scheme members	6.8	8.0
Actuarial gains/(losses) recognised in the statement of comprehensive income	270.4	(329.8)
Benefits paid	(69.9)	(67.3)
Fair value at 31 March	1,393.0	1,075.0

Movements in the present value of the defined benefit obligations were as follows:

	2010 £m	2009 £m
Present value at 1 April	1,308.0	1,458.3
Service cost	14.7	23.8
Interest cost	86.1	91.9
Curtailed costs/settlement costs	7.4	–
Contributions from scheme members	6.8	8.0
Actuarial losses/(gains) recognised in the statement of comprehensive income	394.8	(206.7)
Benefits paid	(69.9)	(67.3)
Present value at 31 March	1,747.9	1,308.0

Of which:

	2010 £m	2009 £m
Amounts relating to funded schemes	1,740.3	1,301.8
Amounts relating to the unfunded scheme	7.6	6.2
Present value at 31 March	1,747.9	1,308.0

b) Amounts recognised in the income statement in respect of these defined benefit schemes

	2010 £m	2009 £m
Amounts charged to operating costs:		
Current service cost	(14.7)	(23.3)
Curtailed charge	(7.4)	–
Past service cost	–	(0.5)
	(22.1)	(23.8)
Amounts charged to finance costs:		
Interest cost	(86.1)	(91.9)
Amounts credited to finance income:		
Expected return on scheme assets	71.1	89.8
Total amount charged to the income statement	(37.1)	(25.9)

The actual return on scheme assets was a gain of £341.5 million (2009: loss of £240.0 million).

Actuarial gains and losses have been reported in the statement of comprehensive income. The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expense since the adoption of IFRSs is a net loss of £220.1 million (2009: net loss of £95.7 million).

28 Retirement benefit schemes (continued)

c) Background

The group operates a number of defined benefit pension schemes in the UK, covering the majority of UK employees. The defined benefit schemes are funded to cover future salary and pension increases and their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit schemes, members are entitled to retirement benefits calculated as a proportion (varying between $\frac{1}{30}$ and $\frac{1}{80}$ for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years' salary in the last ten years of employment. The final salary sections of all of the pension schemes listed below are closed to new entrants and the age profile of scheme participants is expected to rise and hence service costs are also expected to rise in the future.

The UK defined benefit schemes and the date of their last formal actuarial valuation are as follows:

UK defined benefit scheme	Date of last formal actuarial valuation
Severn Trent Pension Scheme (STPS)*	31 March 2007
Severn Trent Water Mirror Image Pension Scheme	31 March 2009

* The STPS is by far the largest of the group's UK defined benefit schemes. The Severn Trent Senior Staff Pension Scheme was merged with the STPS on 31 March 2009.

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £7.6 million (2009: £6.2 million) is included in an unfunded scheme within the retirement benefit obligation.

d) Actuarial assumptions

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows:

	2010 %	2009 %
Price inflation	3.60	2.90
Salary increases	4.10	3.90
Pension decreases in payment	3.60	3.00
Pension increases in deferment	3.60	2.90
Discount rate	5.70	6.70
Long term rate of return on:		
Equities	8.00	8.00
Gilts	4.50	4.20
Corporate bonds	5.70	6.70
Property	7.00	6.10
Cash	4.50	0.50

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index linked gilts. The discount rate is based on the annualised yield from the iBoxx over 15 year AA rated sterling corporate bond index.

The expected rate of return on scheme assets is based on market expectations at the beginning of the period for returns over the life of the benefit obligation. For gilts and corporate bonds the expected rates of return are based on market yields. For equities, an equity risk premium has been added to the gilt rate.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

28 Retirement benefit schemes (continued)

d) Actuarial assumptions (continued)

The mortality assumptions adopted are based on mortality tables applicable to the sex and year of birth of individual members, with the 'medium cohort' allowance for future improvements in longevity. For men the assumptions are based on the '00' series tables and for women the '92' series, both projected to calendar year 2005 with medium cohort improvements to 2005 and a two year age rating applied. These have been based on a mortality investigation carried out in conjunction with the valuation of the STPS, carried out on behalf of the trustees, as at 31 March 2007.

The life expectancies implied by the mortality assumptions adopted at each year end are as follows

	2010	2009
Age to which current pensioners aged 65 are expected to live		
– men (years)	85.3	85.1
– women (years)	88.6	88.2
Age to which future pensioners aged 45 at the balance sheet date are expected to live		
– men (years)	86.5	85.9
– women (years)	89.6	88.9

The calculation of the scheme liabilities is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation and mortality. The following table summarises the estimated impact on scheme liabilities and service cost resulting from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £34 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £34 million
Mortality	Increase life expectancy by 1 year	Increase by £40 million

e) Contributions to the schemes

Contribution rates are set in consultation with the trustees for each scheme and each participating employer. It is anticipated that normal contributions to the scheme in the year ending 31 March 2011 will be in the order of £30 million and lump sum deficit reduction contributions of £10 million are planned subject to the outcome of the ongoing actuarial valuation.

f) History of actual and expected performance of pension scheme assets and liabilities

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Present value of defined benefit obligations	(1,747.9)	(1,308.0)	(1,458.3)	(1,499.7)	(1,624.8)
Fair value of scheme assets	1,393.0	1,075.0	1,332.3	1,364.6	1,402.9
Deficit in the schemes	(354.9)	(233.0)	(126.0)	(135.1)	(221.9)
Difference between actual and expected return on scheme assets	270.4	(329.8)	(125.7)	(10.6)	179.1
Experience adjustments on scheme liabilities	19.8	(7.9)	(64.3)	(3.7)	(152.8)

Defined contribution schemes

The group also operates defined contribution arrangements for certain of its UK and overseas employees. In September 2001, the Severn Trent Group Pension Scheme (an occupational defined contribution scheme) was established to ensure compliance with stakeholder legislation and to provide the group with an alternative pension arrangement. This was closed to new entrants on 1 April 2005 and replaced by the Severn Trent Stakeholder Pension Scheme.

The total cost charged to operating costs of £4.5 million (2009: £5.1 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2010, all contributions (2009: 100%) due in respect of the current reporting period had been paid over to the schemes.

29 Provisions

	Restructuring £m	Self insurance £m	Onerous contracts £m	Terminated operations and disposals £m	Other £m	Total £m
At 1 April 2009	1.5	23.2	4.5	5.9	4.5	39.6
Charged to income statement	9.7	5.7	7.5	(0.2)	1.6	24.3
Utilisation of provision	(0.4)	(6.8)	–	(0.2)	(3.2)	(10.6)
Other movements	–	–	0.4	–	–	0.4
Exchange differences	0.1	–	–	0.1	–	0.2
At 31 March 2010	10.9	22.1	12.4	5.6	2.9	53.9
					2010 £m	2009 £m
Included in						
Current liabilities					25.5	9.2
Non-current liabilities					28.4	30.4
					53.9	39.6

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes.

Derwent Insurance Limited, a captive insurance company, is a wholly owned subsidiary of the group. Provisions for claims are made as set out in note 2 u). The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

The onerous or loss making contract provision relates to specific contractual liabilities, either assumed with businesses acquired or arising in existing group businesses, where estimated future costs are not expected to be recovered in revenues. The associated outflows are estimated to occur over a period of ten years from the balance sheet date.

Provisions relating to terminated operations and disposals include amounts that it is probable will be paid in respect of claims arising from services performed by these businesses; and the indemnities described in note 37 b).

In 2009 other provisions include £1.8 million relating to third party legal costs incurred in the conclusion of a Severn Trent Services arbitration to settle an interpretation on a long term operating service contract.

30 Share capital

	2010 £m	2009 £m
Total authorised share capital:		
434,139,785 ordinary shares of 97 ¹⁷ / ₁₉ p (2009: 346,783,834)	425.0	339.5
Total issued and fully paid share capital:		
236,585,205 ordinary shares of 97 ¹⁷ / ₁₉ p (2009: 235,938,946)	231.6	231.0

Changes in share capital were as follows:

	Number	£m
Ordinary shares of 97¹⁷/₁₉p		
At 1 April 2009	235,938,946	231.0
Shares issued at 536p, 548p, 592p, 759p, 823p, 862p, 1172p or 1221p under the group's Employee Sharesave Scheme	639,121	0.6
Shares issued at 720p or 738p under the group's Share Option Scheme	7,138	–
At 31 March 2010	236,585,205	231.6

Notes to the group financial statements (continued)

For the year ended 31 March 2010

31 Share premium

	2010 £m	2009 £m
At 1 April	71.9	64.3
Share premium arising on issue of shares for Employee Share Option Scheme	4.0	7.6
At 31 March	75.9	71.9

32 Other reserves

	Capital redemption reserve £m	Infrastructure reserve £m	Translation exchange reserve £m	Hedging reserve £m	Total other reserves £m
At 1 April 2008	156.1	314.2	(2.5)	(40.4)	427.4
Total comprehensive income/(loss) for the period	–	–	43.3	(2.0)	41.3
At 1 April 2009	156.1	314.2	40.8	(42.4)	468.7
Total comprehensive loss for the period	–	–	(9.1)	(4.0)	(13.1)
At 31 March 2010	156.1	314.2	31.7	(46.4)	455.6

The capital redemption reserve arose on the redemption of B shares.

The infrastructure reserve arose on restating infrastructure assets to fair value as deemed cost on transition to IFRS.

The translation reserve arises from exchange differences on translation of the results and financial position of foreign subsidiaries as well as foreign exchange differences arising from hedges of net investment.

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

33 Share based payments

The group operates a number of share based remuneration schemes for employees. During the period, the group recognised total expenses of £5.1 million (2009: £5.3 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £10.50 (2009: £12.70).

At 31 March the number of shares that were exercisable under each of the share based remuneration schemes was as follows:

	2010		2009	
	Number of exercisable options/ awards	Weighted average exercise price	Number of exercisable options/ awards	Weighted average exercise price
Long Term Incentive Plan	–	–	–	–
Employee Sharesave Scheme	525,098	870p	626,053	715p
Approved Share Option Scheme	3,125	720p	4,759	724p
Unapproved Share Option Scheme	35,259	728p	40,763	728p
	563,482		671,575	

i) Long Term Incentive Plan (LTIP)

Under the LTIP annual conditional awards of shares may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period. Awards have been made on different bases to Severn Trent Plc and Severn Trent Water employees (the LTIP) and to Severn Trent Services employees (the Services LTIP). During the year awards over 163,421 shares (2009: 123,743 shares) with a fair value each of £5.41 (2009: £7.49) were made to 21 employees (2009: 23 employees) under the LTIP.

The Services LTIP awards vest in three equal tranches and are subject to achievement of turnover and profit targets in the years ending 31 March 2011, 2012 and 2013. No awards have been made to employees under the Services LTIP during the year (2009: awards over 118,489 shares to 13 employees).

The LTIP awards are subject to total shareholder return over three years measured relative to the companies ranked 51–150 by market capitalisation in the FTSE Index (excluding investment trusts).

Details of changes in the number of awards outstanding during the year are set out below.

33 Share based payments (continued)

	Number of awards	
	LTIP	Services LTIP
Outstanding at 1 April 2008	894,529	–
Granted during the year	123,743	118,489
Vested during the year	(227,490)	–
Cancelled during the year	(4,799)	–
Lapsed during the year	(203,801)	–
Outstanding at 1 April 2009	582,182	118,489
Granted during the year	163,421	–
Cancelled during the year	(17,131)	(8,049)
Lapsed during the year	(334,989)	–
Outstanding at 31 March 2010	393,483	110,440

Details of LTIP awards outstanding at 31 March were as follows.

Date of grant	Normal date of vesting	Number of shares	
		2010	2009
June 2006	2009	–	334,990
July 2007	2010	121,223	123,449
July 2008	2011	153,528	163,240
July 2008	2012	36,813	39,496
July 2008	2013	36,813	39,496
July 2009	2012	155,546	–
		503,923	700,671

The fair value of the LTIP awards made during the year was calculated using the Monte Carlo method using the principal assumptions set out below:

Assumptions	2010	2009
Expected volatility		
Severn Trent Plc	25%	17%
– comparator group	45%	30%
Correlation between Severn Trent Plc and comparator group	30%	30%
Proportion of employees expected to cease employment before vesting	0%	0%

Severn Trent share price volatility is based on observations of historical weekly volatility over a three year period. Weekly volatility in the observed data varied between 10% and 40%.

For the 2009/10 LTIP award and the 2008/09 award the comparator group is the companies ranked 51–150 in the FTSE index. Comparator group volatility was therefore based on observed volatility for the FTSE 250 index. Correlation between Severn Trent and the comparator group was based on the average pairwise correlation for companies in the FTSE 250.

The share price at the grant date was £11.34 (2009: £12.80). The vesting period commences before the grant date. Performance in the vesting period prior to the grant date is taken into account in determining the fair value of the award.

Dividends 'paid' on shares during the vesting period are accumulated during the vesting period and released subject to achievement of the performance condition, in the same manner as the underlying shares. As a result a dividend yield assumption is not required.

The 2009 Services LTIP is based entirely on non-market conditions and hence market assumptions are not required to determine the fair value of the award. For 2010 it has been assumed that performance against the Services LTIP non-market vesting conditions will be 78%.

Details of the basis of the LTIP schemes are set out in the remuneration report on page 50.

ii) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board may grant the right to purchase ordinary shares in the company to those employees who have entered into an HMRC approved Save As You Earn contract for a period of three or five years.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

33 Share based payments (continued)

Details of changes in the number of options outstanding during the year are set out below:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2008	4,033,637	843p
Granted during the year	1,671,207	862p
Forfeited during the year	(59,628)	937p
Cancelled during the year	(568,290)	1,093p
Exercised during the year	(1,321,735)	660p
Expired during the year	(30,379)	735p
Outstanding at 1 April 2009	3,724,812	887p
Granted during the year	922,888	806p
Forfeited during the year	(95,659)	1,007p
Cancelled during the year	(320,240)	981p
Exercised during the year	(639,121)	715p
Expired during the year	(25,612)	953p
Outstanding at 31 March 2010	3,637,068	899p

Sharesave options outstanding at 31 March were as follows:

Date of grant	Normal date of exercise	Option price	Number of share options	
			2010	2009
January 2002	2009	548p	–	69,236
January 2003	2008 or 2010	536p	73,017	77,253
January 2004	2009 or 2011	592p	53,862	266,288
January 2005	2008, 2010 or 2012	759p	332,581	346,747
January 2006	2009, 2011 or 2013	823p	239,385	597,749
January 2007	2010, 2012 or 2014	1,172p	286,787	351,518
January 2008	2011 or 2013	1,221p	252,683	347,912
January 2009	2012 or 2014	862p	1,411,857	1,668,109
January 2010	2013 or 2015	808p	987,096	–
			3,637,068	3,724,812

The fair value of the Sharesave options granted during the year was calculated using the Black-Scholes model. The principal assumptions were as follows:

Assumptions	2010		2009	
	3 year	5 year	3 year	5 year
Expected volatility	25%	25%	17%	17%
Risk free rate	1.80%	2.78%	2.24%	2.74%
Expected dividend yield	4.0%	4.0%	4.0%	4.0%
Proportion of employees expected to cease employment before vesting	15.0%	17.0%	15.0%	17.0%
Fair value per share	264p	280p	272p	268p

Expected volatility is based on observations of historical weekly volatility over a three year period. Weekly volatility in the observed data was between 10–40%.

The risk free rate is derived from yields at the grant date of gilts of similar duration to the Sharesave contracts.

The proportion of employees expected to cease employment before vesting is based on historically observed data.

The following data was used in the calculation of the fair value of the sharesave options.

	2010		2009	
	3 year scheme	5 year scheme	3 year scheme	5 year scheme
Share price at grant date	1,080p	1,080p	1,189p	1,189p
Vesting period (years)	3	3	3	5
Option life (years)	3.5	3.5	3.5	5.5

33 Share based payments (continued)

The number of employees entering into Sharesave contracts and the number of options granted during the year were as follows:

	2010		2009	
	3 year scheme	5 year scheme	3 year scheme	5 year scheme
Number of employees	1,602	563	2,007	869
Number of options granted	586,381	405,652	931,272	739,935

iii) Share Incentive Plan (SIP)

Under the SIP the board may grant share awards to employees of group companies. During the year the board has announced that it will make awards under the SIP based on performance against Severn Trent Water's targets for its Key Performance Indicators. Eligible employees will be entitled to shares to a maximum value of £750. It is expected that these awards will be made in August 2010. SIP shares vest with the employees on the date of grant.

iv) Approved Share Option Scheme

Under the terms of the Share Option Scheme (formerly Executive Share Option Scheme), the board has granted directors and other executives options to purchase ordinary shares in the company. No awards have been made under this scheme since July 2003.

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2008	12,012	770p
Forfeited during the year	(3,415)	638p
Exercised during the year	(3,838)	899p
Outstanding at 1 April 2009	4,759	724p
Exercised during the year	(1,634)	731p
Outstanding at 31 March 2010	3,125	720p

Options outstanding under this scheme at 31 March were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares	
			2010	2009
June 2001	2004 – 2011	738p	–	1,016
July 2002	2005 – 2012	720p	3,125	3,743
			3,125	4,759

v) Unapproved Share Option Scheme

The board has granted executives options to purchase ordinary shares in the company under an unapproved share option scheme. No awards have been made under this scheme since July 2003.

Details of the movements in the share awards outstanding during the year are as follows:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2008	49,304	724p
Exercised during the year	(8,541)	670p
Outstanding at 1 April 2009	40,763	728p
Exercised during the year	(5,504)	728p
Outstanding at 31 March 2010	35,259	728p

Options outstanding under this scheme at 31 March were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares	
			2010	2009
July 2001	2004 – 2011	738p	16,274	18,848
June 2002	2005 – 2012	720p	18,985	21,915
			35,259	40,763

Notes to the group financial statements (continued)

For the year ended 31 March 2010

34 Acquisitions

On 13 May 2009 the group acquired 100 per cent of the issued share capital of PS Apliclor SA for cash consideration of £13.2 million. This transaction has been accounted for by the purchase method of accounting.

	Book value £m	Fair value £m
Net assets acquired:		
Intangible assets	0.2	0.2
Tangible assets	0.4	0.5
Financial assets	–	–
Inventory	1.4	1.4
Accounts receivable	3.7	4.1
Borrowings: amounts falling due within one year	(1.5)	(1.6)
Accounts payable	(1.5)	(1.6)
Borrowings: amounts falling due after more than one year	(0.1)	(0.1)
	2.6	2.9
Goodwill	–	10.3
Total consideration		13.2
Satisfied by:		
Cash		13.2

The goodwill arising on the acquisition of PS Apliclor is attributable to the anticipated profitability of the company.

PS Apliclor contributed £6.7 million to revenue and £0.2 million to profit before tax for the period between the date of acquisition and the balance sheet date.

35 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	2010 £m	2009 £m
Profit before interest and tax	507.4	451.0
Depreciation of property, plant and equipment	236.1	223.7
Amortisation of intangible assets	25.2	24.2
Exceptional impairment and depreciation	6.6	–
Pension service cost	14.7	23.8
Pension curtailment cost	7.4	–
Pension contributions	(39.6)	(42.0)
Share based payments charge	5.1	5.3
Profit on sale of property, plant and equipment	(4.5)	(4.0)
Loss on disposal of businesses	1.7	–
Deferred income released	(7.4)	(5.3)
Provisions charged to income statement	24.2	10.8
Utilisation of provisions for liabilities and charges	(10.5)	(48.9)
Decrease/(increase) in stocks	3.9	(2.7)
Increase in debtors	(26.4)	(9.2)
(Decrease)/increase in creditors	(35.9)	16.8
Cash generated from operations	708.0	643.5
Tax (paid)/received	(53.8)	1.1
Net cash inflow from operating activities	654.2	644.6

b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2009: £nil).

35 Cash flow statement (continued)

c) Exceptional cash flows

The following cash flows arose from items classified as exceptional in the income statement:

	2010 £m	2009 £m
Restructuring costs	(15.9)	(16.2)
Fines and penalties	(2.0)	(40.0)
Third party legal costs	–	(1.4)
Loss on disposal of business	(0.9)	–
	(18.8)	(57.6)

d) Reconciliation of movement in cash and cash equivalents to movement in net debt

	As at 1 April 2009 £m	Cash flow £m	Fair value adjustments £m	RPI uplift on index linked debt £m	Foreign exchange £m	Other non-cash movements £m	As at 31 March 2010 £m
Cash and cash equivalents	648.1	(419.9)	–	–	(0.4)	–	227.8
Bank loans	(789.8)	100.2	–	2.1	–	(2.3)	(689.8)
Other loans	(3,310.9)	78.8	22.3	(15.7)	0.1	39.5	(3,185.9)
Finance leases	(344.4)	43.2	–	–	–	0.4	(300.8)
Net debt as previously stated	(3,797.0)	(197.7)	22.3	(13.6)	(0.3)	37.6	(3,948.7)
Cross currency swaps hedging debt	237.1	–	(10.9)	–	–	(38.9)	187.3
Net debt	(3,559.9)	(197.7)	11.4	(13.6)	(0.3)	(1.3)	(3,761.4)

36 Contingent liabilities

a) Bonds and guarantees

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees.

b) Disposal of subsidiaries

The group has given certain guarantees and indemnities in relation to disposals of businesses.

On 5 March 2007 the group received notice of a claim for €23.4 million from Veolia Proprete SA (Veolia) alleging breach of warranty in relation to the disposal of Biffa Belgium. The group has subsequently received notice from Veolia of a further claim for €5 million relating to the same matter. The group considers that there is no basis for this claim and hence no provision has been recorded in the financial statements in relation to this matter. Following a hearing in the Commercial Court in Belgium in February 2010, the Court rendered judgment in favour of the group on 1 April 2010 and declared all of Veolia's claims to be unfounded.

The group is not aware of any other liability that is likely to result from these guarantees and indemnities that has not been provided for in these financial statements.

Notes to the group financial statements (continued)

For the year ended 31 March 2010

37 Financial and other commitments

a) Investment expenditure commitments

	2010 £m	2009 £m
Contracted for but not provided in the financial statements	321.0	181.7

In addition to these contractual commitments, Severn Trent Water Limited has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services (Ofwat) and to provide for growth in demand for water and sewerage services.

b) Leasing commitments

At the balance sheet date the group had outstanding commitments for future minimum operating lease payments under non-cancellable operating leases, which fall due as follows:

	2010 £m	2009 £m
Within one year	4.9	6.8
In the second to fifth years inclusive	9.0	13.4
After more than five years	4.9	8.2
	18.8	28.4

Operating lease payments represent rentals payable by the group for certain of its office properties, plant and equipment.

38 Post balance sheet events

Following the year end the board of directors has proposed a final dividend of 45.61 pence per share. Further details of this are shown in note 14.

39 Related party transactions

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Transactions between the group and its associates and joint ventures are disclosed below.

Trading transactions

	Sale of goods		Purchase of goods		Amounts due from related parties		Amounts due to related parties	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Cognica	–	–	0.1	0.1	–	–	–	–
SII	10.5	9.4	–	–	15.5	13.8	–	–
Jackson Water Partnership	5.0	1.4	–	–	1.5	1.7	–	–
	15.5	10.8	0.1	0.1	17.0	15.5	–	–

The related parties are associates and joint ventures in which the group has a participating interest.

Remuneration of key management personnel

Key management personnel comprise the members of STEC.

The remuneration of the directors is included within the amounts disclosed below. Further information about the remuneration of individual directors is provided in the audited part of the Directors' remuneration report on pages 54 to 57.

	2010 £m	2009 £m
Short term employee benefits	5.5	6.2
Post employment benefits	0.6	0.7
Termination benefits	0.3	–
Share based payments	0.5	0.8
	6.9	7.7

40 Principal subsidiary undertakings and their directors

Details of the principal operating subsidiaries are given below. A complete list of subsidiary undertakings is available on request to the company and will be filed with the next Annual Return.

Severn Trent Water

Severn Trent Water Limited

2297 Coventry Road,
Birmingham B26 3PU
Telephone 0121 722 4000

Directors

Sir John Egan	M J Lamb
A J Ballance	M J Kane
B Bulkin	M J E McKeon
R H Davey	Baroness Noakes
A J Duff	A P Smith
G Fryett	A P Wray

Severn Trent Services

Severn Trent Services Inc.

Suite 300, 580 Virginia Drive,
Fort Washington, Pennsylvania 19034 2707, USA
Telephone 001 215 646 9201
(Incorporated and operational in the United States of America)

Directors

D L Chester	L F Graziano
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Severn Trent Environmental Services Inc.

Park 10, 16337 Park Row,
Houston, Texas 77084, USA
Telephone 001 281 578 4200
(Incorporated and operational in the United States of America)

Directors

D L Chester	K J Kelly
L F Graziano	

Severn Trent Services Limited

Arley Drive, Birch Coppice Business Park,
Dorden, Tamworth, B78 1SA
Telephone 01827 266000

Directors

L F Graziano	K A A Porritt
R C McPheely	P M Senior

Severn Trent Water Purification Inc.

3000 Advance Lane,
Colmar, Pennsylvania 18915, USA
Telephone 001 215 997 4000
(Incorporated and operational in the United States of America)

Directors

D L Chester	K J Kelly
L F Graziano	

Severn Trent Services International Limited

2308 Coventry Road,
Birmingham B26 3JZ
Telephone 0121 722 6000

Directors

L F Graziano	K A A Porritt
R C McPheely	P M Senior

C2C Services Limited (80% owned)

2308 Coventry Road,
Birmingham B26 3JZ
Telephone 0121 722 6000

Directors

D Godfrey	R J Phillips
A J Handford	W G Weatherdon
B M Horner	E A Wilson

Severn Trent Laboratories Limited

STL Business Centre, Torrington Avenue,
Coventry CV4 9GU
Telephone 0247 642 1213

Directors

L F Graziano	K A A Porritt
R C McPheely	P M Senior

Other businesses

Derwent Insurance Limited

6A Queensway, PO Box 64,
Gibraltar
Telephone 00 350 200 47529
(Insurance company, incorporated and operational in Gibraltar)

Directors

J Davies	F B Smith
N Feetham	F White

Severn Trent Luxembourg Overseas Holdings SA

1A rue Thomas Edison L-1445 Strassen,
Luxembourg
(Finance company, registered and operational in Luxembourg)

Directors

D L Chester	X Pauwels
L F Graziano	D Robyns
M J E McKeon	F B Smith

Country of incorporation, and main operation is Great Britain and registration is England and Wales unless otherwise stated. All subsidiary undertakings are wholly owned unless otherwise indicated. All shareholdings are in ordinary shares.

All subsidiary undertakings have been included in the consolidation.

As at 27 May 2010