

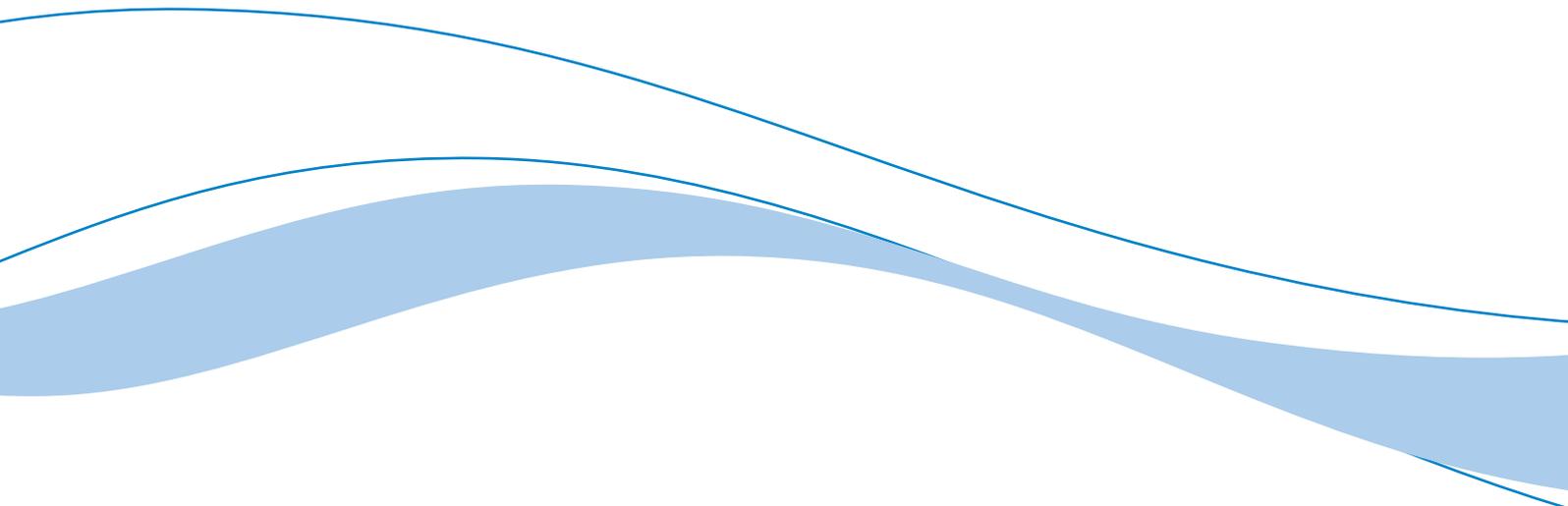


Water
Service

Annual Report and Accounts
2006-07



An Agency within the Department for
**Regional
Development**
www.drdsn.gov.uk



**Water Service Annual Report and Accounts
for the year ended 31 March 2007**

*Laid before the Northern Ireland Assembly
under section 11(3) (c) of the Government Resources
and Accounts Act (Northern Ireland) 2001 by the Department for Regional Development*

6 July 2007

NIA 46/06-07

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CHAIRMAN'S FOREWORD

This has been an extraordinary, busy year with the preparations for the setting up of Northern Ireland Water (NIW) as a Government Owned Company (GoCo) from 1 April 2007. This preparatory work has involved the appointment of a Shadow Board, the preparation of medium term plans and negotiations with Westminster Government on capital structure, efficiency targets and financing arrangements.

Consequent on the restoration of the Local Assembly in Northern Ireland it was decided to defer the introduction of new annual domestic and unmeasured non-domestic charges for 2007-08. In addition, the Regional Development Minister announced an independent review of the future financing and provision of water and sewerage services. We welcome this Review and look forward to working with the Review Panel and our stakeholders to help find a way forward which is appropriate for Northern Ireland.

The Shadow Board consisted of three executive Directors (Katharine Bryan, Ronan Larkin and Phil Barker), myself as non-executive Chair and three non-executive Directors (John Ballard, Ruth Thompson and Rose Hynes).

During 2006-07, the Shadow Board established the following sub Committees in line with good corporate governance practice: the Audit Committee; the Risk and Reputation Committee; the Nomination and Remuneration Committee and the Asset Investment Committee.

The Shadow Board and its sub Committees met regularly between June 2006 and March 2007. All members of the Shadow Board became members of the NIW Board on 1 April 2007.

The transition to NIW is a very significant step forward in the delivery of a key public service in Northern Ireland. It is a real opportunity to make major improvements in the service we provide, in terms of both quality and cost. Achievement of our objectives as set out in the Strategic Business Plan (2007-2010) will require us to continue to use the resources at our disposal intelligently, work smarter and be very responsive to our customers. Our targets for improvement in quality and efficiency are challenging.

Our opening environment has also changed radically from April 2007:-

- NIW will be subject to economic regulation by the Northern Ireland Authority for Utility Regulation;
- customers interests will be represented by the Consumer Council for Northern Ireland; and
- drinking water and environmental regulation will also change as NIW will be subject to full environmental and statutory controls, with Crown Immunity from prosecution being abolished.

Despite this challenging environment we have made further progress on efficiency and compliance and met the majority of our key performance targets for 2006-07. This is a tremendous achievement. My thanks go to everyone for all their hard work.

We look forward to working in conjunction with our Regulators and the Local Assembly to ensure our customers see further improvements in the service they receive in the coming year.

Chris Mellor
Chairman

2 July 2007



CHIEF EXECUTIVE'S FOREWORD

I am pleased to present the Water Service's 2006-07 Annual Report and Accounts. Throughout the last year we have made substantial progress in our aim to deliver water and wastewater services to our customers to the highest possible standards.

We met the majority of our challenging key performance targets. Most notably we increased the percentage of works complying with wastewater treatment work's discharge standards from 82% in 2005-06 to 84% in 2006-07. In relation to leakage we managed to reduce the amount lost by almost 10 million litres per day, a reduction of over 5%.

Water Service is engaged in a large programme of capital expenditure which will ensure it meets the demanding European Union drinking water and environmental standards as well as the increased number of wastewater standards. This year we invested £243 million on capital projects.

Every day, 619 million litres of good quality drinking water are supplied to customers through more than 26,500 km of water mains.

Every year, 133 million m³ of wastewater are collected, treated and disposed from 660,000 businesses and households connected to the sewerage system. This involves the transportation of sewage through 14,500 km of sewers to works where it is treated and disposed.

During this financial year, Water Service completed several major water related projects including Clay Lake Water Treatment Works (WTW) at a cost of £5 million, Carran Hill WTW (£9 million) and the Dunore Point to Hyde Park Pumping Main (£23 million) which supplies Belfast with 165 million litres of treated water each day.

In November 2006, the then Minister, David Cairns MP, opened the new £18 million Fofanny WTW. This new works is situated in the Mourne Mountains and is capable of supplying 52 million litres of treated water to the Newry and surrounding areas.

We are committed to continuously developing the quality of our service to meet the increasing expectations and changing demands of our customers.

During the year, activity in this area included:

- successful procurement of an outsourced partnership to provide best practice customer billing, contacts and operational work management services;
- establishment of a Corporate Communications Unit with full responsibility for managing all internal and external communication programmes, to ensure broad awareness in the community, business community and the media of the complex challenges ahead and our significant programme of infrastructure investment; and
- development of the relationship with the Consumer Council for Northern Ireland including the preparation of a formal representative framework which accompanied the transition to NIW.

Our performance has been achieved in the context of the major transformation programme which has prepared Water Service for transition to NIW on 1 April 2007 when it became a government-owned company outside the Civil Service.

NIW has committed in the Strategic Business Plan, agreed with the then Minister in March 2007, to match or exceed the performance levels of similar companies in Great Britain

against key customer, environmental and financial parameters. The scale of change is very demanding and should not be underestimated but it is a challenge which NIW looks forward to meeting. The pace of change will be shaped by both what customers and the shareholder can afford and by the organisational capacity of the company.

Following the recent Assembly elections the main political parties agreed to restore the Assembly on the 8 May 2007 and have asked the Government to defer the introduction of new annual domestic and unmeasured non-domestic water charging. The Government has agreed and these charges have not been implemented in 2007-08. The longer term position on charging is currently unclear.

The Assembly decided to conduct a comprehensive review to address the longer term approach that should be adopted in relation to the financing and provision of water and sewerage services.

On 11 June 2007 the Minister made a statement to the Assembly setting out the terms of reference for an independent review to take forward the Assembly's decision.

NIW is looking forward to working in partnership with all its stakeholders, including the Assembly, and welcomes this review.

Finally, I wish to pay tribute to the hard work and dedication of staff for their determination to succeed in these challenging times.

Katharine Bryan
Chief Executive

2 July 2007

Directors' Report



Water Service was an Executive Agency within the Department for Regional Development (the Department). The Department had statutory responsibility for the provision of water and sewerage services under the Water and Sewerage Services (Northern Ireland) Order 1973. The Water Service exercised these responsibilities on behalf of the Department.

Prior to the transition to NIW on 1 April 2007, Water Service was the sole public water and sewerage undertaker in Northern Ireland and provided water and sewerage services to domestic, agricultural, commercial, and business customers throughout Northern Ireland. The net book value of its fixed assets was £873 million as at 31 March 2007.

Water Service was a multi disciplinary organisation with over 1,900 professional, technical, scientific, administrative and industrial staff. The head office was located in Belfast with subsidiary offices in Ballymena, Belfast, Craigavon, and Londonderry.

The Minister with responsibility for Regional Development determined the policy framework within which we operated, our level of resources and the scope of activities. The Minister approved our Strategic Business Plan (2007-10) and monitored our performance. The Chief Executive was responsible to the Minister for our performance and operations. In 2006-07, an Executive Team of eight Directors supported the Chief Executive.

DIRECTORS

Directors who served in the year were:

<i>Katharine Bryan</i>	(Chief Executive)
<i>Ronan Larkin</i>	(Finance and Regulation)
<i>William Duddy</i>	(Customer Services)
<i>Pauline Shepherd</i>	(Human Resources)
<i>Peter May</i>	(Business Transformation) – transferred back to the Northern Ireland Civil Service on 31 March 2007
<i>Phil Barker</i>	(Operations)
<i>Trevor Haslett</i>	(Engineering and Procurement)
<i>George Butler</i>	(Asset Management)
<i>Sue Holmes</i>	(Public Private Partnerships)



STATEMENT OF RESPONSIBILITIES

Under section 11 of the Government Resources and Accounts Act (Northern Ireland) 2001, the Department of Finance and Personnel has directed the Water Service to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the Agency's state of affairs at the year end and of its income and expenditure, recognised gains and losses and cash flows for the financial year.

In preparing accounts, the Accounting Officer is required to comply with the requirements of the Government Financial Reporting manual and in particular to:

- observe the Accounts Direction issued by the Department of Finance and Personnel, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;

- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Government Financial Reporting manual have been followed, and disclose and explain any material departures in the financial statements; and
- prepare the financial statements on the going concern basis.

The Accounting Officer for the Department for Regional Development has designated the Chief Executive of the Water Service as the Accounting Officer for the Agency. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the Agency's assets, are set out in the Accounting Officer's Memorandum issued by the Department of Finance and Personnel and published in Government Accounting Northern Ireland.

Katharine Bryan
CHIEF EXECUTIVE

The Chief Executive was responsible for all aspects of the Agency's planning and performance together with policy formulation and liaison with the DRD Permanent Secretary and Minister.

Ronan Larkin
FINANCE & REGULATION

All financial matters, financial systems and the Agency's performance reporting. Direction of strategic and business planning process and the establishment of economic regulatory capability.

William Duddy
CUSTOMER SERVICES

Revenue and billing, customer relations management, internal and external communications strategies.

Pauline Shepherd
HUMAN RESOURCES

HR Strategy and delivery of all personnel services.

Peter May
BUSINESS TRANSFORMATION

Transformation programme, efficiency, Strategy 2010, impact of reform legislation, preparation for standalone status, legislative matters and Secretariat.

Trevor Haslett
ENGINEERING & PROCUREMENT

Procurement of capital investment programme, supplies and services.

Phil Barker
OPERATIONS

Procurement, treatment and distribution of water to customers. Recovery, treatment and disposal of wastewater to the environment in a sustainable manner. Mechanical and electrical engineering policy and activity.

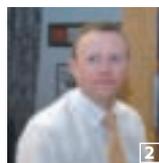
George Butler
ASSET MANAGEMENT

Environmental regulatory compliance and water quality management. Standards and technology development, telecommunications, information systems and asset management planning.

Sue Holmes
PPP PROGRAMME

PPP Programme, Alpha and Omega Projects. Kinnegar contract management.

- 1 Katharine Bryan
- 2 Ronan Larkin
- 3 William Duddy
- 4 Pauline Shepherd
- 5 Peter May
- 6 Trevor Haslett
- 7 Phil Barker
- 8 George Butler
- 9 Sue Holmes



Directors' Interests

Water Service was required to maintain a register of any company directorships or other significant interests. This register can be accessed by contacting the Company Secretary at Northland House, 3-5 Frederick Street, Belfast, BT1 2NR. There were no conflicts of interests with the Directors' management responsibilities in Water Service.

Disclosure to the Auditor

The financial statements are audited by the Comptroller and Auditor General for Northern Ireland (C&AG) in accordance with the Government Resource and Accounts Act (Northern Ireland) 2001. He is head of the Northern Ireland Audit Office and he and his staff are wholly independent of the Agency and he reports his findings to Parliament.

The audit of the financial statements for 2006-07 resulted in a notional audit fee of £35,000, which is included in the administration costs in the Operating Cost Statement.

So far as the Accounting Officer is aware, there is no relevant audit information of which the Water Service's auditors are aware and the Accounting Officer has taken all the steps that she ought to have taken to make herself aware of any relevant audit information and to establish that the Water Service's auditors are aware of that information.

Employees

Employee numbers in 2006-07 are shown in note 4 to the Accounts.

Water Service gave full consideration to applications for employment from disabled persons where the requirements of the job can be adequately fulfilled by a handicapped or disabled person. Where existing employees became disabled, it was the Agency's policy wherever practical to provide continuing employment under normal terms and conditions and to provide training, career development and promotion to disabled employees where appropriate.

Payments to suppliers

The Water Service was committed to the prompt payment of bills for goods and services received in accordance with the Better Payment Practice Code. Unless otherwise stated in the contract, payment was due within 30 days of the receipt of the goods or services, or presentation of a valid invoice or similar demand, whichever is later. During the year 89.1% of bills were paid within this standard.

Pension Liabilities

Staff pension liabilities are borne by the Principal Civil Service Pension Scheme (NI) and are therefore not reflected in these Accounts (see Notes 1 and 4 to the Accounts).

Charitable Donations

Water Service made no charitable donations during the year. However, Water Service staff have taken part in a number of charitable activities throughout the year.

Fixed Assets

Details of the movements in fixed assets are set out in note 7 to the Accounts.

Transfer of assets to NIW

As set out in note 23 to the accounts, Water Service transformed into a Government Owned Company, Northern Ireland Water (NIW) on 1 April 2007. The value of the assets of Water Service were written down to a value of £822m as part of the process of establishing NIW.

Governance Structure

The governance structure in place during 2006-07 is detailed on page 4. The new governance structure for 2007-08 is detailed below.



NIW Governance Structure

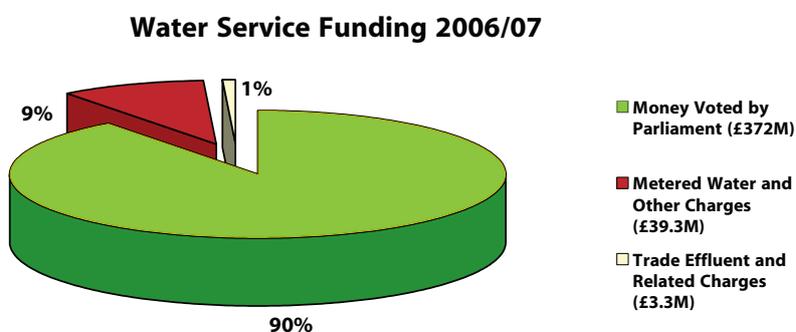
KEY FINANCIAL HIGHLIGHTS

Funding

We received funding from two main sources:

- direct charges to customers; and
- money voted for from Parliament.

The chart (right) shows our funding for the last financial year.



Financial results– Year ended 31 March 2007

As the Summary Operating Cost Statement (right) reflects income from charges only, it shows a substantial deficit representing the amount by which expenditure and capital charges exceed income. This deficit is met by monies voted by Parliament which are credited to reserves when received. The cost of capital charge on the Water Service asset base is also credited to reserves. The level at which the Parliamentary Vote is set takes into account Water Service's approved capital expenditure requirements.

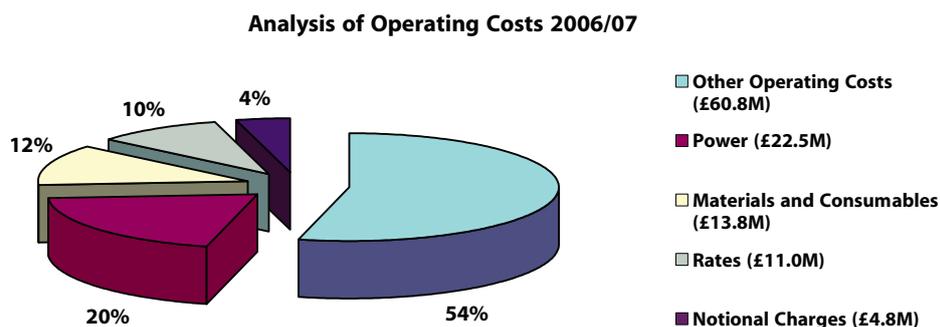
	2006-07 (£m)	2005-06 (£m)
Income	42.6	41.3
Staff Costs	50.0	55.0
Operating Costs	112.9	97.6
Depreciation	112.4	124.3
Net Deficit before Interest and Capital Charges	(232.7)	(235.6)
Extraordinary Item	3,225.5	-
Net Deficit before Interest and Capital Charges after Extraordinary Item	(3,458.2)	(235.6)
Capital Charges and Interest	212.6	198.1
Net Deficit after Interest, Capital Charges and Extraordinary Item	(3,670.8)	(433.7)

Features arising from this year's performance are:

- a charge of £3,225.5m has been made to the Operating Cost Statement in respect of the impairment of assets prior to the change of status of Water Service to NIW on 1 April 2007;
- staff costs, compared to 2005-06, have reduced as a result of decreasing staff numbers;
- operating costs have increased due to additional costs associated with new treatment processes and increased power costs; and
- increased capital charges reflecting the increase in the net assets as a result of the investment in the capital programme.

Other notable financial performance measures were:

- we spent £243 million on fixed assets in the year largely to meet our compliance targets;
- the impairment exercise reduced the current cost value of Net Assets from £6 billion in 2005-06 to £822 million in 2006-07; and
- Water Service achieved 89.1% of payments made within 30 days of receipt of invoice in line with the Government prompt payment policy.



MANAGEMENT COMMENTARY

Facts & Figures about Water Service for 2006-07

Water Supply

- Water Service provided clean safe drinking water to some 795,000 households and businesses throughout Northern Ireland;
- 619 million litres of good quality drinking water were supplied each day to customers through more than 26,500 km of water mains;
- 46 impounding reservoirs (including 7 natural loughs);
- 490 service reservoirs;
- 44 major treatment works;
- 270 water pumping stations;
- as a result of significant investment in recent years, compliance with EU drinking water standards has risen from 98.63% in 2004 to 99.33% in 2006; and
- drinking water mean zonal compliance is targeted to reach 99.77% in 2009.

Wastewater

- Water Service collected, treated and disposed of 133 million m³ of wastewater from 660,000 businesses and households connected to the sewerage system;
- it transported sewage through 14,500 km of sewers to works where it was treated and disposed;
- 1,060 wastewater treatment works;
- 1,093 wastewater pumping stations;
- investment in recent years has meant an increase in compliance with EU wastewater treatment standards from 56.50% of people served by compliant works in 2004 to 76.88% in 2006; and
- 94% of people should be served by compliant wastewater treatment works in 2009.

KEY PERFORMANCE INDICATORS

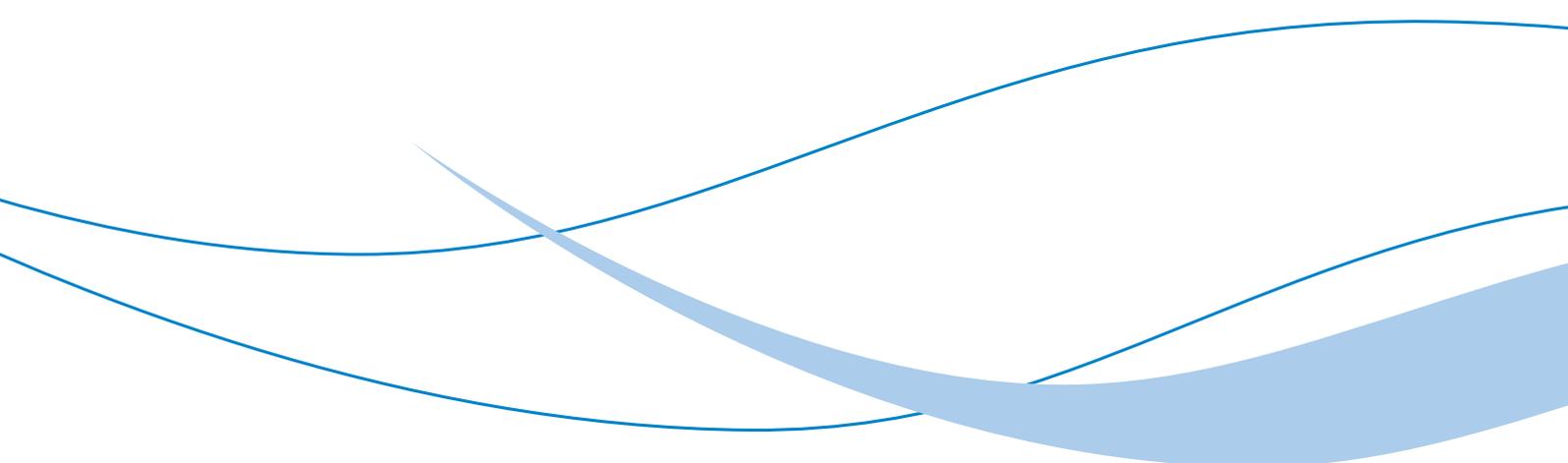
The key performance indicators are derived from the Public Service Agreement (PSA) targets. PSA targets are high level targets agreed with the Department as part of the business planning cycle. Guidance on performance measurement was first issued by the Department for the 2002-03 key targets to ensure performance data was comprehensive, consistent and capable of withstanding audit scrutiny. For 2006-07 the Water Service Executive Team monitored performance against 17 Key Performance Indicators (KPIs) on a monthly basis, as shown in the table below. Further information on the calculation of KPIs is included in Annex B to the Annual Report. The Department's Internal Auditor carried out an exercise to independently validate performance against 12 targets. These included targets 1 to 7, 10 and 11 listed in the table below. In addition, the following 2006-07 Operating Plan targets were subject to validation:

“ **...compliance with EU drinking water standards has risen from 98.63% in 2004 to 99.33% in 2006.** ”

- by 31 March 2007 achieve operating cost efficiency savings of £25 million;
- by 31 March 2007 implement the new pension scheme for staff transferring to NIW; and
- by 31 March 2007 confirm transitional licensing regime for all scheduled Water Service abstractions.

Year to 31 March 2007	Achieved 2006-07	Target 2006-07	Previous outturn 2005-06	At or ahead of target	At or better than previous year	Target for 2007-08
CUSTOMERS						
1 Supply interruptions – number of properties experiencing unplanned and unwarned interruptions (expressed as a percentage of households) in excess of 12 hours (%)	0.13	0.30	0.87	✓	✓	0.25
2 Customer correspondence - percentage of customer written correspondence answered within 10 working days (%)	59.09	90	90.34	✗	✗	n/a
3 Response to written complaints – number of written complaints answered within 10 working days expressed as a percentage of total written complaints (%)	91.4	90	92	✓	✓	96
4 Ease of telephone contact – percentage of customer calls answered during business hours (8am to 8pm Monday to Friday, 8am to 6pm Saturday and 10am to 6pm Sunday) within 30 seconds (%)	83.1	93	89.0	✗	✗	93
5 Freedom of information – percentage of FOI and EIR requests responded to within 20 working days (%)	83	100	100	✗	✗	n/a
CASH						
6 Leakage - reduction in overall leakage (million litres per day)	168.06	169	177.77	✓	✓	157
7 Unit costs - unit cost of water delivered (pence per m ³)	84	94	87	✓	✓	85
8 Units costs - unit cost of wastewater treated (pence per m ³)	79	87	85	✓	✓	84
PEOPLE						
9 Health and safety - reduce by 5% the number of 'days lost' due to accidents based on the previous three year average (equates to a target of 935 days lost)	650	935	n/a	✓	n/a	620

Year to 31 March 2007	Achieved 2006-07	Target 2006-07	Previous outturn 2005-06	At or ahead of target	At or better than previous year	Target for 2007-08
10 Health and safety - reduce by 5% the number of 'lost day' accidents based on the previous three year average (equates to a target of 19 lost day accidents)	19	19	n/a	✓	n/a	18
11 Manpower numbers – number of posts	1,744	1,911	n/a	✓	n/a	1,881
12 Staff attendance (%)	94.20	95.42	95.1	✗	n/a	96.5
COMPLIANCE						
13a Drinking water quality – percentage compliance with the Water Supply (Water Quality) Regulations (NI) 2002 – taking into account Authorised Departures (%)	99.66	99.70	99.73	✗	✗	99.72
13b Drinking water quality – percentage compliance with the Water Supply (Water Quality) Regulations (NI) 2002 – not taking into account Authorised Departures (%)	99.42	99.45	99.19	✗	✓	99.60
14 Mean zonal compliance - water quality at the tap (%)	99.33	99.33	n/a	✓	n/a	99.44
15 Operational Performance Indicator – Turbidity, Iron and Manganese (%)	99.33	98.87	n/a	✓	n/a	98.90
16a Wastewater quality – number of wastewater treatment works (WWTW) serving greater than 250 population equivalent achieving compliance with WWTW's discharge standards expressed as a percentage of works (%)	84	84	82	✓	✓	84
16b Wastewater quality – number of wastewater treatment works (WWTW) serving greater than 250 population equivalent achieving compliance with WWTW's discharge standards expressed as a percentage of population equivalent (%)	77	76	67	✓	✓	82.5
17 Capital Works Programme – percentage of schemes costing over £250k scheduled to complete in the Capital Works Programme (%)	93	90	93	✓	✓	90



The Department's Internal Auditor was able to validate achievement of 10 of the 12 targets. Explanatory notes for the 2 targets which were validated as not being achieved are listed below.

Target 2 – customer written correspondence

Outturn up to the end of October 2006 was 93.31%. However, following significant organisational changes associated with the establishment of the new Customer Relations Centre in October 2006, there was a lead in period in relation to the implementation of new systems and processes which resulted in an end of year outturn of 59.09%. Intensive work is continuing to consolidate the new systems and processes during 2007-08.

Targets 13a and 13b – compliance with drinking water standards

The drinking water quality targets 13a and 13b above were not met in 2006. This was largely as a result of higher than usual Trihalomethane levels in zones fed from non-compliant Slow Sand Filter works. These treatment works are currently being upgraded with new treatment facilities under construction. The new works will be in operation in late 2008. In the interim we have carried out remedial

work where possible, to ensure that Trihalomethane levels in drinking water supplied from these plants are restored to lower levels.

Some drinking water samples had higher than usual Bromate levels. This was an industry wide problem. During 2006 difficulty was experienced in sourcing a disinfection product which did not contain ultra-low Bromate levels. The problem has been addressed and Bromate levels in drinking water have returned to acceptable levels.

On completion of our new Drumaroad water treatment works, the Authorised Departure for the area was removed. Unfortunately the provision of additional trunk mains was delayed due to land acquisition difficulties and this resulted in water being supplied to the Downpatrick area with higher than usual Aluminium levels which resulted in a small number of sample exceedances.

Although we failed to meet our targets 13a and 13b, the exceedances above did not have an implication on Public Health. It is recognised that Trihalomethanes in drinking water continue to be the

major issue. We have in place Authorised Departures which have been agreed with the Drinking Water Inspectorate and include a full programme of work. The completion of the major water treatment works through the PPP project will give a long term solution to the Trihalomethane problem.

Three further targets were not achieved. These were not subject to validation by the Department's Internal Auditor. Explanatory notes for these three targets are listed below.

Target 4 – customer calls

As a result of the Public Awareness Charges Campaign, Water Service experienced a significant increase in call volumes resulting in an end of year outturn of 83.10%.

Target 5 – FOI and EIR requests

Internal process failures resulted in an end of year outturn of 83%. Processes and procedures have been reviewed to ensure an improved performance during 2007-08.

Target 12 – Staff attendance

This transition year has been demanding and challenging for both the organisation and our staff. The Human Resources Directorate will be looking at refining the Absence Policy and integrating it with the Health and Well Being Strategy to encourage and incentivise attendance.

WATER

Water Resources

Approximately 795,000 domestic, agricultural, commercial and business properties in Northern Ireland are connected to the public water supply and each day we supplied some 619 million litres of high quality drinking water to customers. Water Service operated approximately 46 sources which

comprised upland impounding reservoirs, boreholes, rivers and loughs.

Water Service, through its Water Resource Strategy, has planned to ensure that demand for drinking water is met for the period up to 2030. The strategy emphasises the need to rationalise existing uneconomic water sources and concentrate on the sources that can meet our needs cost-effectively and reliably.

Leakage

We currently have a Water Efficiency Plan with an associated Leakline number. The plan aims to implement and promote a range of water conservation measures that can be employed by both Water Service and its customers.

**Report leaks on roads and
footpaths to LEAKLINE**

(Freephone) 08000 282 011

**“ ...each day we supplied some 619 million litres
of high quality drinking water to customers. ”**

The Leakline number allows customers to report leaks on roads and footpaths at no cost to themselves and we are committed to the prompt investigation and repair of any leaks.

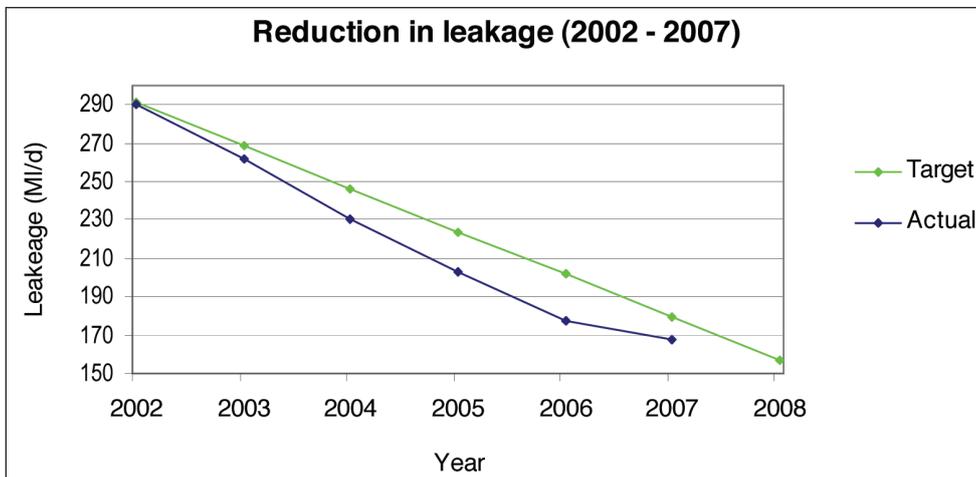
Leakage is a major element in the Water Efficiency Plan and for the fifth consecutive year, leakage reduction targets have been achieved – on a cumulative basis leakage has reduced during that period by 123 million litres per day (ml/d). We remain on course to achieve the target leakage level of 157 ml/d by 31 March 2008.

Water Quality

In 2004 the Water Supply (Water Quality) Regulations (NI) 2002 came into force. These regulations implement the EC Drinking Water Directive (Council Directive 98/83/EC on the quality of water intended for human consumption). They fully incorporate, and go beyond, the requirement of the Directive and introduce tighter quality standards, particularly for lead and other health related parameters. They allow a time limited, authorised departure from the regulatory limit for certain parameters, provided that there

is a planned programme of work at the water treatment works to improve the water quality, and provided that there are no adverse health implications arising from the departure.

Compliance against these standards is monitored during the year through an extensive water sampling and testing programme. During 2006 this involved over 112,000 tests. Levels of compliance for Schedule 1 parameters (including Zonal Total Coliforms) are shown overleaf.



“...for the fifth consecutive year, leakage reduction targets have been achieved.”

Overall Water Quality		
	Number of Analytical Tests	Percentage Compliance with Regulatory standards including Authorised Departures
Water leaving treatment works	20,157	99.90%
Water in service reservoirs	35,828	99.79%
Water at customer taps including authorised supply point	56,059	99.66%
Overall Water Quality	112,044	99.75%

Major projects

During the year we completed work on the new WTW at Clay Lake. This modern works in South Armagh is capable of producing up to 5 million litres of high quality treated water per day. This will be sufficient to meet anticipated future demand within its supply area.

Also completed during 2006-07 and located in South Armagh, Carran Hill WTW is capable of producing 6.8 million litres of high quality treated water per day to meet the anticipated future demand in its supply area west of Newry and to the south of Armagh.

The Dunore Point to Hyde Park Pumping Main is capable of delivering 165 million litres of high quality treated water to Belfast. It is the first portion of a programme of work designed to meet the future anticipated demand in greater Belfast to be completed.

As part of our continued commitment to improving the water main network we invested

Water Service continued to meet the obligations placed upon it to comply with regulatory standards and heightened demands due to increased customer expectation. Investing in the extension and upgrading of water treatment works remains a top priority and this is reflected in 2006, where the completion of several major capital works projects has improved the quality of water delivered to our customers.

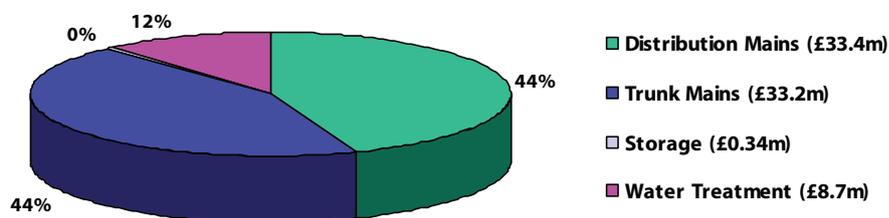
Further details about the quality of drinking water are available in our Drinking Water Quality Report, which is published annually. This can be viewed or obtained on our website at www.niwater.com or by calling the **WATERLINE 08457 440088**.

District Councils are also provided with details of the quality of drinking water supplied in their local areas. A Drinking Water Quality Register, which provides results for each water supply zone, is available for inspection at any one of our four main offices at Belfast, Ballymena, Craigavon and Londonderry, during normal office hours.

Water Investment

The provision of safe and wholesome drinking water is vital to the maintenance of public health, and requires substantial investment in the water infrastructure and assets to assist in meeting our statutory drinking water quality obligations. During the year we invested over £75 million to maintain and improve our high quality water supplies.

The expenditure during the year can be broken down as shown in the chart below:



“ During the year we invested over £75 million to maintain and improve our high quality water supplies. ”

some £45 million on the trunk and distribution system throughout Northern Ireland. Expenditure included the provision of the Dunore Point to Hyde Park Pumping Main and new or replacement water mains in areas such as North Down, Belfast, Armagh and Ballymena. We also continued with our detailed studies of the water main network system. As a result, we commenced improvements to the water main network system in the Ballinrees area, Armagh City, Ards North, Lough Cowey and a new trunk main at Moira.

Direct service to Customers

During the year we continued to provide services to meet customer demand and to ensure a reliable and secure service:

- made approximately 12,000 new connections to existing water mains;
- dealt with 2,486 unplanned interruptions to water supply;
- dealt with 3,440 water distribution network repairs; and
- treated and distributed 619 megalitres of drinking water per day.

WASTEWATER

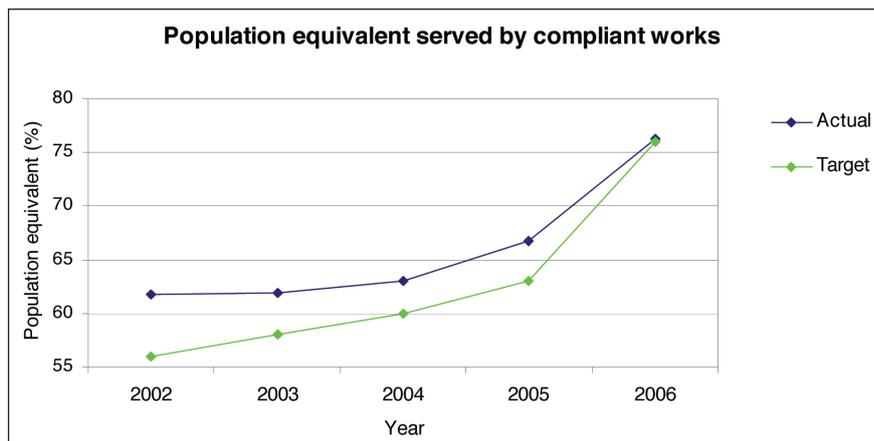
Wastewater treatment and collection

Investment levels in wastewater treatment in Northern Ireland have lagged far behind those in the rest of the United Kingdom for many years and this has resulted in compliance with European Union Directives also being significantly lower. We have recently embarked on a major capital investment programme to improve wastewater treatment facilities and increase levels of compliance. Although this will take a number of years to implement, we are already seeing improvement in compliance with the wastewater treatment works Registered Discharge Standards as set by the Environment and Heritage Service. The chart below

illustrates the improvement in compliance levels over the course of the past 5 years.

The ongoing improvement in compliance levels last year is due not only to the commissioning of new and upgraded treatment facilities at sites such as Culmore and Omagh but also to the implementation of interim solutions at a number of other wastewater treatment works.

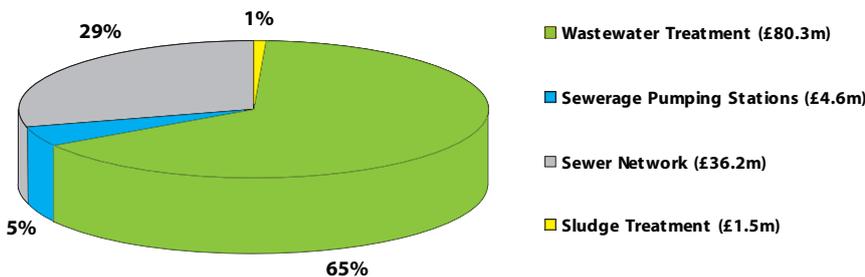
The public register containing the standards and the results of tests is available for inspection at the Environment and Heritage Service.



“ During the year we invested almost £123 million to improve the wastewater treatment and sewerage infrastructure. ”

Wastewater Investment

During the year we invested almost £123 million to improve the wastewater treatment and sewerage infrastructure. Expenditure during the year is broken down as shown in the chart below.



Major projects

During the year we completed major improvements to a number of wastewater treatment works including those located at Culmore, Omagh, Strabane, Dundrum, Tandragee, Carrickfergus and Whitehouse as well as a number of smaller works such as Lislea, Mayobridge and Kinallen.

Major improvements to the existing treatment facilities at North Coast wastewater treatment works, a £42 million project which will serve the Coleraine, Portrush and Portstewart areas. When completed, these works will provide the necessary treatment to ensure compliance with the standards set out in the Urban Wastewater Treatment Works Regulations. In total, £80 million was spent on improvements to our wastewater treatment facilities during the year.

In addition, approximately £36 million was invested on improvements to the sewerage network in areas such as Londonderry and Newry. We also continued with our drainage area studies, which has led to the

commencement of an extensive sewerage network rehabilitation programme. As a result of such studies, work continued on the upgrade of sewers as part of the Belfast Sewers Project. The Project is estimated to cost in excess of £100 million and aims to provide Belfast with a modern sewerage system to meet its existing and future development needs.

The European Court of Justice recently ruled against the UK Government in respect of discharges of sewage into the sea at 13 locations of which 9 are in Northern Ireland. These amounts will not be levied on Water Service or NIW, but on the UK Government.

Direct Service to Customers

During the year we continued to provide services to meet customer demand and to ensure a reliable and secure service:

- dealt with 1,227 sewerage network repairs;
- cleared 15,900 sewer blockages; and
- collected 133 million m³ of wastewater.

PUBLIC PRIVATE PARTNERSHIP (PPP)

Water Service requires capital investment of more than £3 billion over the next 20 years to upgrade both water and wastewater assets and infrastructure in Northern Ireland. This investment will enable Water Service to meet the required drinking water and wastewater quality standards, and improve levels of service to meet the current and future demands of its customers.

Given the extent of the water assets and infrastructure upgrades required to improve standards, ensure environmental compliance and increase capacity in the timeframe needed, it was recognised that the necessary resources cannot be met from traditional public sector funding alone.

The major Public Private Partnership (PPP) Programme was launched in 2004. Water Service is using the PPP approach to upgrade water and wastewater facilities, and sludge disposal, through Design, Build, Finance and Operate (DBFO) contracts, where affordable value for money can be obtained to meet its compliance timeframe.

The Programme is split into Water and Wastewater PPP Projects known as the Alpha and Omega Projects.

The PPP Directorate also manages the existing Private Finance Initiative (PFI) contract at Kinnegar.

Alpha Project

The Project will provide a bulk potable Water Supply to Water Service in excess of 396 ml/d. The water treatment facilities included in the Alpha Project are located at

Ballinrees, Castor Bay, Dunore Point, Forked Bridge and Moyola as well as associated link mains. These five major works will be consolidated to four sites as part of the improvement process.

Summary of progress

- the Dalriada Water consortium was awarded the Contract in May 2006. It is estimated that this appointment will provide savings in excess of 25% from the preliminary Water Service capital cost estimate, with 15% savings in annual operating costs. Dalriada Water comprises a number of organisations, namely: Kelda Group Plc; Farrans Ltd and Tyco International Ltd; and
- Dalriada Water will be responsible for operating and maintaining the water treatment facilities for 25 years (including upgrading/ construction). The PPP Contractor will recover its investment in the Alpha Project through a monthly unitary charge over the period of the contract.

The project is on track for latest service commencement no later than October 2008.

Omega Project

The wastewater treatment works included in the Omega Project are Craigavon Area Rationalisation (including Ballynacor, Bullays Hill and Seagoe), Armagh, Richhill, Ballyrickard, North Down / Ards and the Sludge Disposal Solution.

The treatment capacity for these Omega Works is between a population equivalent of 300,000 and 303,000 excluding sludge disposal. The Omega Project represents approximately 20% of Northern Ireland's current

wastewater treatment capacity, and 100% of its sludge disposal capacity.

Summary of progress

- the Glen Water consortium was appointed as the Preferred Bidder in January 2006 and entered into an Advance Works Contract with Water Service to construct the North Down / Ards Wastewater Treatment Works in February 2006;
- Glen Water comprises a number of organisations, namely: Thames Water, Laing O'Rourke, Dawson WAM, BSG Civil Engineering, Williams Industrial Services Ltd and Hyder Consulting Ltd;
- during the reporting year construction of the North Down / Ards Wastewater Treatment Works (under the Advance Works

Contract) progressed rapidly and is on target to comply by December 2007;

- the Omega Contract award took place on 6 March 2007 at which time the Advance Works Contract was subsumed into the main contract; and
- Glen Water will be responsible for operating and maintaining the wastewater treatment facilities for 25 years (including upgrading/construction). The PPP Contractor will recover its investment in the Omega Project through a monthly unitary charge over the period of the contract.

The project is on track for service commencement no later than June 2009.



THE ENVIRONMENT

The activities in which we are engaged have a strong influence on the quality of the natural environment and the quality of life of our customers. We aim to maintain the diversity and quality of the natural environment while enhancing the service that we give to our customers.

Environmental management

The Water Service maintained operational activities at over 2,300 sites, some in environmentally sensitive locations. Our impact on the environment is assessed and controlled through an Environmental Management System, which encompasses all our activities, including the core businesses of water supply and distribution, and the collection and treatment of waste water. Our staff have been trained in the use of our Environmental Management System, which promotes continuous environmental improvement and pollution prevention. The system is externally certified as compliant to the international standard ISO 14001.

Environmentally sensitive construction

We have significantly increased the scale of our programme of capital investment in line with our strategies to meet growth in demand, compliance with higher standards and to renew ageing infrastructure. In 2006-07 capital investment was focused mainly on compliance with European Directives relating to the quality of drinking water and wastewater.

Such an investment programme could have a major impact on the natural environment, and could cause disruption to local

communities. At an early stage in major projects an environmental impact assessment is made to determine the effect the work is likely to have on the environment and on the local community. Measures to mitigate the significant impacts are established in project plans and a dialogue maintained with local representatives during the construction phase.

Greening the supply chain

We continue to consider environmental credentials of suppliers and contractors when evaluating tenders for the supply of goods and services. Approved suppliers and contractors are required to comply with Water Service's environmental policy statement and management systems and are encouraged to develop and progress their own environmental management systems towards ISO 14001 accreditation. Approved contractors are also required to carry out construction in a sustainable manner on major capital projects and comply with Water Service's environmental management system.

Sustainability

We participate with Water UK in the ongoing development of sustainability indicators, for the UK Water Industry. The indicators measure performance on the social, environmental and economic aspects of the Water Industry and show the breadth of its sustainable development agenda. Our progress towards sustainability is included in the composite Water UK annual report. We will continue to introduce further sustainability targets to our contracts.

Biodiversity

Water Service will strive to maintain and where possible enhance the biodiversity of its landholdings. Tests of Likely Significance have been carried out on all water abstraction points, and all wastewater treatment works discharges within Natura 2000 sites.

Use of resources

Water Service has set targets within the environmental management system to conserve its use of natural resources, minimise the generation of waste and to promote recycling. We have sought to reduce the amount of spoil generated and aggregate used through the increased application of trenchless technology. In October 2006 we were on target to surpass the 2006-07 target of 65% for laying water mains using trenchless technologies (72% was the running figure at that time). However, as a result of the re-profiling of the Capital Works Programme and the resultant alteration to the priority of certain watermain rehabilitation projects, our compliance figure for 2006-07 fell to 55% for watermains. (From October onwards, Engineering and Procurement Directorate were limited mainly to large diameter watermains that afford very little scope for the use of trenchless technology). On the Sewerage side of the Capital Works Programme we had a target of 15% for 2006-07. 21% was achieved, with a corresponding reduction in construction spoil to landfill and in aggregate required for trench backfill / reinstatement.

Water Conservation

In January 2004 the Minister for Regional Development launched the updated Water Efficiency Plan. This includes objectives for leakage reduction, the promotion of water conservation to our customers and the promotion of water efficient appliances.

In 2006 additional resources were allocated to leakage activities and we were successful in reducing overall leakage by a further 9.71 ml/d this year.

Energy Use

The attainment of higher standards in the quality of the water we deliver and the treated waste water we return to the environment has inevitably increased our use of energy. We strive to minimise our energy use and to ensure that, as the energy markets and investment in technology allow, an increasing proportion is supplied from renewable sources. In 2006-07, in excess of 8% of energy consumed was derived from renewable sources through self-generation and procurement.

EC Bathing Waters

During the year the Environment and Heritage Service monitored 16 identified bathing waters (under the EC Bathing Water Directive) throughout the bathing season. The sites were those at which bathing is traditionally practised by large numbers of bathers and each site was sampled on 20 occasions during the season, which runs from June to early September.

The Directive contains two standards on the quality of bathing water: a mandatory standard; and a more stringent guideline standard. In 2006, all 16 of the identified

bathing waters in Northern Ireland met the mandatory standard, and 14 met the higher guideline standards. One bathing water area (Newcastle) failed the bathing water directive. A further 11 less well used bathing locations all passed the Directive's mandatory standard and 9 passed the guideline standard.

CUSTOMER SERVICES

We are committed to continuously developing the quality of our service to meet the increasing expectations and changing demands of our customers.

Following on from major internal restructuring in 2004-05, we have concentrated on the development of Customer Services Directorate through increasing the focus on:

- efficient handling of customer contacts;
- development of more challenging customer service targets in line with industry standards;
- preparation for formal customer representation and consumer regulation to be introduced in

the Water Reform process; and

- communications with customers and stakeholders.

During the year, activity in this area included:

- successful procurement of an outsourced partnership to provide best practice customer billing, contacts and operational work management services;
- establishment of a Corporate Communications Unit with full responsibility for managing all internal and external communication programmes, to ensure broad awareness in the community, business community and the media of the complex challenges ahead and our significant programme of infrastructure investment; and
- development of the relationship with the Consumer Council for Northern Ireland including the preparation of a formal customer representative framework which accompanied the transition to NIW.

“ In 2006, all 16 of the identified bathing waters in Northern Ireland met the mandatory standard and 14 met the higher guideline standard. ”

“ We handled over 221,000 calls on our dedicated customer lines (Waterline and Leakline)... ”

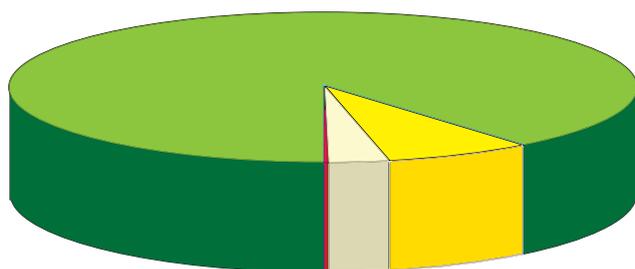
Customer Contact

We are contacted by customers by letter, telephone, email and in person, about a range of water, sewerage and billing enquiries or complaints. In all cases we aim to give a prompt, courteous and professional response.

During 2006-07:

- we handled over 221,000 calls on our dedicated customer lines (Waterline and Leakline) answering over 83% within 30 seconds;
- over 18,000 calls were received on the Metered Water line (028 90321500) relating to various revenue and billing enquiries; and
- we processed 12,647 items of correspondence and 1,220 written complaints, replying to 59% and 92% respectively within the 10 day target response time.

The volume of customer contacts is shown below.



- Waterline
- Metered Line
- Correspondence
- Written Complaints

Meter Reading, Billing and Cash Collection

There are over 77,000 meters installed on non domestic premises and we issued over 140,000 bills during 2006-07 to metered water and trade effluent customers. 96.9% of customers were billed based on actual meter readings. We provided a range of payment options to these customers including:

- direct debit via the budget payment plan;
- in person at our main Revenue Branch office in Belfast or any of the local offices across Northern Ireland;
- bank or Post Office Giro; and
- BACS.

Corporate Communications Unit

Water Service is committed to managing our relationships with customers and stakeholders and of course our own staff. We are also committed to promoting the services we provide and work we undertake. To maximise the effectiveness and professionalism of the Water Service communications, a Corporate Communications Unit was recently established to manage all internal and external communications.

External Communications

In January 2007 a new Press Office was set up to take over from the DRD Press Office. The new Press Office is committed to managing all interactions with the media and to raising a positive profile of the Water Service.

A new Education Programme has been developed which targets both Schools and the General Public. The Schools Programme is aimed at Key Stage 1, 2 and 3 and is presently being implemented. The wider Education Programme covers key themes including Water for Health, Water Efficiency, The Water Cycle and Environmental Responsibility.

In 2006-07 a Brand Project Board was established to guide the development and implementation of an effective brand for NIW. The Brand Project Board was responsible for ensuring optimum integration of the brand project and its key elements with the organisation's transformation programme. The outcome has been the successful implementation of the new brand throughout the organisation.

Internal Communications

A series of regular communication channels have been established to keep staff informed about the rapid changes ongoing within the Water Service, as well as about day to day business. These communication channels include 'In Brief' - a weekly bulletin, 'Waterline' - a bi-monthly staff magazine and 'Team Talk' - a monthly team briefing process. The Internet and Intranet sites will be re-launched to prepare for the launch of the new organisation.

The Corporate Communications Unit is also committed to organising one off events, to keep our staff informed, motivated and effective. Six Road Shows were held across the Province in March 2007 prior to the launch of NIW. The Road Shows were used to brief staff about the transition to NIW.

Stakeholder Communications

An intensive programme of stakeholder engagement was organised prior to the launch of NIW. The purpose of this programme was to build strong working relations and communication channels with our stakeholders, to support business transformation and to provide focus on the Customer Readiness Campaign.

As the debate on water charging continues, engagement with key stakeholders is crucial. Opportunities exist in communicating the NIW Strategic Business Plan, forging strong working relations with our incumbent regulators, communicating improved performance standards, managing stakeholder expectations, influencing key stakeholders with regard to charging policy and communicating key messages.

Planning for Improvement

Water Service is planning for improvements across a range of customer service activity to meet the challenges of the future. We have continued to promote the efficient use of water at public exhibitions across Northern Ireland and through our "Waterbus". The Waterbus continues to provide an interactive educational experience in relation to the activities undertaken by Water Service. The Waterbus visited approximately 150 schools during 2006-07.

In addition to continuing development of our systems for customer relations management, metering and billing we are planning to:

- upgrade and expand our Internet web-site facilities;
- continuously review our standards of customer service and performance targets to aim for UK Water Industry benchmarks; and
- provide all of our staff with the training, systems and equipment to support them in continuous improvement of customer services.

For all Emergencies, Services and General Enquiries telephone the WATERLINE 08457 440088

**Text phone for people with hearing difficulties:
0800 0515 446
(All Calls charged at local rates)**

**Or e-mail your query to
waterline@niwater.com**

PEOPLE

2006-07 was a challenging year for Water Service and our staff.

In this transitional year we set the foundations to build the new Government Company, NIW including what this new organisation will stand for. This process started in April 2006 with a focus on embedding a performance improvement culture. Guidance was issued to all line managers stating we must start the process of effectively utilising our performance management system by setting challenging targets for our staff. We built upon this process by linking our Corporate Balanced Scorecard themes, Cash, Compliance, Customer and People, into the Performance Management System for level 2, 3 and 4 managers. This was supplemented with a supporting framework of the behaviours we want our staff to display.

We developed the Transformation Toolkit to support our management development. The toolkit is a portfolio of courses to support our staff in delivering the business objectives. We provided the Transformation Toolkit through a calendar system which encouraged staff to take ownership for their own development.

In recognition of the importance of communication during a transitional period, the Road Shows were used to inform staff of the Corporate Balanced Scorecard Business Planning process. Building upon this communication drive, the HR team reenergised the Whitley process with the trade unions ensuring more effective communications and consultations took place. The organisation also

ran over 80 Change and Personal Transition Workshops to support all staff in managing change.

During the year Water Service supported over 200 staff who did not wish to transfer to NIW but instead wished to retain Civil Service status. This was facilitated through transfers back to the Northern Ireland Civil Service. These transfer arrangements resulted in a major resourcing programme and the appointment of a resourcing partner.

The resourcing challenge also highlighted an issue of attracting and retaining staff. To ensure Water Service attracts and retains staff, the organisation committed to a full pay and grading review. Work started on the pay and grading review in the Autumn of 2006 with the completion due in the Autumn of 2007.

In the last quarter of this year the organisation developed a two day Corporate Induction Programme. This Programme was used to communicate our policies and our values and also provided the opportunity for staff to visit water and wastewater treatment works.

In March 2007, the Executive Team organised staff briefings across the whole organisation to communicate a wide range of issues about the transition to NIW.

WATER REFORM

Over the past year Water Service has undergone a significant reform programme to deliver the transition to NIW, a wholly owned, fully regulated and self-financing government company sitting outside the Northern Ireland Civil Service. The major projects in the programme are listed below.

Customer Billing

The Customer Billing project is a critical element of the Water Reform process, central to the establishment of NIW and the introduction of universal water and sewerage charges. In addition to handling domestic and non-domestic billing, the customer billing systems will ensure efficient response to customer complaints and assist compliance with future Consumer Regulatory requirements. The systems will also ensure the delivery of an effective and efficient customer service in the field. Following the recent Assembly elections the main political parties agreed to restore the Assembly on the 8 May 2007 and have asked the Government to defer water charging in relation to domestic and unmeasured non-domestic charges. The Government has agreed and these charges have not been implemented in 2007-08. The longer term position on charging is unclear.

Due Diligence

The due diligence project involved the identification of the current role of Water Service and its property, rights and liabilities analysed in the context of the proposed role of NIW. The due diligence process was used to inform the decisions to be made as to the assets and rights to be transferred to, or created for the benefit of, NIW and those which will remain with DRD and/or other governmental bodies.

Environmental and Quality Regulation

Work was undertaken to review the current Water Service arrangements for interfacing with and responding to the requirements of the Environment and Quality Regulators. Proposals were made

for future interface arrangements taking into account the loss of Crown Immunity.

Legislative Readiness

The legislative readiness project established the necessary functions and procedures to comply with the legal requirements placed on NIW under the Water and Sewerage Services (Northern Ireland) Order 2006, the Companies (Northern Ireland) Order 1986 and associated legislation. This included the following:

- insurance;
- legal services;
- shareholder services;
- corporate management;
- Board support;
- data protection; and
- freedom of information.

Phase II Metering

The Phase II metering project implemented Water Service's metering policy across all classes of non-domestic customers.

Other objectives included:

- establishing a clear and concise metering policy;
- identifying, through programmes of site surveys and assessments, those non-domestic properties to be metered, and implementing and completing a meter installation programme covering all identified properties; and
- ensuring consistency of approach to metering across all property classes and all areas.

Shared Services

The Shared Services project identified the shared services currently provided for and by Water Service. The project confirmed the shared services that NIW will require or should offer and determined how these services should be sourced and formalised. The scope of the

Project also included the impact and handling of the public expenditure implications on the remaining core services and resources.

Accommodation

The Accommodation Project was used to review Water Service's accommodation including offices, depots, stores and laboratories. The

water and wastewater treatment plants were not included within the scope of this project. The project aimed to improve the Water Service estate in line with best practice, targeting efficiency and addressing the pressing accommodation issues to contribute towards improving working practices and creation of a better working environment for staff.

Mobile Work Management

The Mobile Work Management project involves the introduction of new ways of working in line with best practice in GB water companies. The project will be a major contributor to the delivery of our efficiency targets and will include the following:





- using technology to improve the schedule of repairs and maintenance;
- improved customer contact handling resulting in better standards of service; and
- better information on the condition of the assets of NIW.

Finance

The Finance project has provided the foundation for a fit for purpose Finance and Regulation function to support NIW as a regulated water company post 1 April 2007. This project has involved the development of a financial model which supported negotiations with DRD in setting efficiency targets for NIW to 2010. The project has also supported the ongoing development of water charging policies to ensure appropriate procedures are implemented.

HR Strategy

The HR Strategy project has included the following:

- a migration plan to assist those staff who wished to remain within Northern Ireland Civil Service (NICS);
- an exit strategy designed to ensure that the staffing efficiency requirements post 1 April 2007 can be delivered at an affordable cost,

in terms of our cash and people imperatives;

- a recruitment and retention strategy; and
- an ongoing skills development programme designed to equip NIW staff with the necessary skills to operate within the changed environment.

HR Information Technology

The HR Information and Technology project has involved the scoping and evaluation of any solution capable of meeting the requirements of NIW. The HR solution will be able to link to the mobile work management solution to provide automated input of timesheet information. The project has also involved the scoping and evaluation of a payroll system.

NIW Pensions

As NIW will no longer be part of the NICS, the company has implemented a 'carbon copy' of the PCSPS (NI) scheme.

Strategic Business Plan (SBP)

Since the summer of 2006 Water Service has been working to produce a SBP for NIW which describes how the Company will improve standards to match those enjoyed by customers of water

companies in Great Britain.

Investment in water and sewerage services has been significantly lower in Northern Ireland in relation to mainland levels over a number of decades. The disparity was most acute during the 1990s when investment levels in England and Wales were high and significant improvements to quality standards were achieved. Investment in our assets has been substantially increased in recent years and the positive impact of that can now be seen. The proportion of the population served by compliant sewage works has risen from 63% in 2004 to 77% in 2006 (compared to 99% in England and Wales). Water quality in Northern Ireland has also improved from 98.63% in 2004 to 99.33% in 2006 (mean zonal compliance). This compares to England and Wales levels of 99.96%. Those figures both demonstrate the improvements already made and the scale of further improvement required. This improvement is an urgent priority to avoid EU infraction proceedings.

The delivery of good quality water and wastewater services is vital to secure public health and protect the environment. The creation of NIW and accompanying changes



constitute a major opportunity to transform the delivery of these services in Northern Ireland. The SBP sets out the vision and strategy for the period 2007-2010 and provides supporting detail about how that strategy will be put into effect. It describes in outline terms the key benefits to be realised to 2015 as:

- improved services to customers as a result of over £1.6 billion of investment in the period 2007-14 combined with better working practices. Over time customers will experience fewer supply interruptions and less 'out of sewer flooding';
- improved water quality and reduced environmental pollution with the investment primarily focused on the legacy of compliance issues at treatment works. Under this plan, by 2010, non compliance will be almost halved in terms of wastewater with a projected compliance level of 91%. In the same time period non compliance will be reduced by two thirds in terms of drinking water quality with a projected compliance level of 99.77% (mean zonal compliance);
- by building on operating

- expenditure efficiencies already achieved and delivery of further expenditure efficiencies by 2010;
- improved organisational capability to deliver outcomes and meet stakeholder needs through investment in both systems and staff to ensure the skills needed are developed; and
- financial sustainability - NIW aims to become fully self financing and will have the ability to plan in a medium to long term way for the future investment and customer improvements needed to achieve parity with similar companies in Great Britain. The development of improved asset management approaches will significantly improve the use of existing assets and deliver better capital solutions in the future.

Efficiency targets

The need for efficiency, to ensure that customers' bills are kept as low as possible, is a vital element of the Water Reform Programme. Evidence from the water industry in Great Britain has demonstrated that there is considerable scope for cost reductions in Water Service.

Significant progress has been made towards the longer term aim of

ensuring that prices remain as low as possible for Water Service customers, by the achievement of £25 million of efficiency savings in operating costs to 2006-07. Moving forward, NIW will be focused on delivery of substantial operational efficiencies at the same time as driving service and quality upwards. NIW will achieve its 28.7% (£55m) of controllable operating expenditure efficiency targets by 2010 through a series of major projects which will target the key areas of cost within the business. The operating expenditure efficiencies envisage overall workforce reductions of 36% from 2003-04 including approximately 500 post reductions in the 2007-10 period. The capital expenditure programme includes 17% efficiencies to be achieved in the period to 2009-10.

K. Bryan

Katharine Bryan
Chief Executive

2 July 2007

The image shows a river scene. In the foreground, there is a weir with several steps where water is cascading down, creating white foam. In the middle ground, a fountain sprays water upwards from a central point. In the background, a bridge with arches spans across the river. A white van is visible on the bridge. The sky is overcast. A blue graphic, consisting of a thin line and a larger curved shape, is overlaid on the image. The text 'Remuneration Report' is written in white, bold, sans-serif font across the blue graphic.

Remuneration Report

The Shadow Board of the new Government Owned Company, Northern Ireland Water (NIW) consists of a non-executive Chair (Chris Mellor) and three non-executive Directors (John Ballard, Ruth Thompson and Rose Hynes). The Shadow Board also consists of three executive Directors (Katharine Bryan, Ronan Larkin and Phil Barker). The Shadow Board was responsible for governing the organisation and in shaping the future company.

The Chief Executive of Water Service, Katharine Bryan, has been responsible for leading Water Service through the transition from an Executive Agency to NIW. The salary level and bonus terms for the post were set at the minimum considered necessary to attract and retain a person of the necessary calibre and will be uplifted annually in line with the revalorisation of Senior Civil Service pay-bands until NIW is established in April 2007. All members of the Executive Team, with the exception of Sue Holmes, were members of the Northern Ireland Senior Civil Service.

Sue Holmes was employed via an agreement with the Strategic Investment Board (SIB), and the contract of employment was issued by SIB. The PPP Director was a member of the Water Service Executive Team at the request of the Chief Executive.

The Shadow Board and all Directors in post on creation of NIW transferred to the new organisation.

Remuneration Policy

The remuneration of senior civil servants is set by the Prime Minister following independent advice from the Review Body on Senior Salaries. In reaching its recommendations,

the Review Body has regard to the following considerations:

- the need to recruit, retain and motivate suitably able and qualified people to exercise their different responsibilities;
- regional / local variations in labour markets and their effects on the recruitment and retention of staff;
- Government policies for improving the public services including the requirement on departments to meet the output targets for the delivery of departmental services; and
- the funds available to departments as set out in the Government's departmental expenditure limits; and the Government's inflation target.

The Review Body takes account of the evidence it receives about wider economic considerations and the affordability of its recommendations.

The remuneration of all senior civil servants is entirely performance based. Permanent Secretaries pay awards are determined by the Northern Ireland Civil Service (NICS) Permanent Secretary Remuneration Committee.

Further information about the work of the Review Body can be found at www.ome.uk.com

The remuneration for the post of PPP Director is paid by SIB, but recouped from Water Service by SIB.

Service Contracts

Civil Service appointments are made in accordance with the Civil Service Commissioners for Northern Ireland's Recruitment Code, which requires appointment to be on merit on the basis of fair and open competition but also includes the

circumstances when appointments may otherwise be made.

Unless otherwise stated below, the officials covered by this report hold appointments, which are open-ended until they reach the normal retiring age of 60. Policy relating to notice periods and termination payments is contained in the Northern Ireland Civil Service (NICS) Staff Handbook.

Further information about the work of the Civil Service Commissioners can be found at www.nicscommissioners.org

The Chief Executive was appointed on the basis that she would transfer to NIW on its formation.

Salary and pension entitlements

The following sections provide details of the remuneration and pension interests of the Shadow Board and the Directors of Water Service. They have been audited by the Northern Ireland Audit Office.

Non-executive Chairman and non-executive Directors:

	2006-07	
	Salary and Allowances £'000	Benefits in kind (to nearest £100)
Chris Mellor Non-executive Chairman (appointed February 2006)	35 - 40	Nil
Rose Hynes# Non-executive Director (appointed April 2006)	20 – 25	Nil
Ruth Thompson# Non-executive Director (appointed April 2006)	25 – 30	Nil
John Ballard# Non-executive Director (appointed April 2006)	20 – 25	Nil

#The three non-executive Directors are paid at the same rate per day.

Executive Directors:

	2006-07		2005-06	
	Salary and Allowances including performance pay £'000	Benefits in kind (to nearest £100)	Salary £'000	Benefits in kind (to nearest £100)
Katharine Bryan Chief Executive	175 – 180	Nil	160 – 165	Nil
Ronan Larkin Director of Finance and Regulation	100 – 105	Nil	50 – 55 (100 – 105 Full Year Equivalent)	Nil
Pauline Shepherd Director of Human Resources	65 – 70	Nil	55 – 60 (60 – 65 Full Year Equivalent)	Nil
William Duddy Director of Customer Services	65 – 70	Nil	60 – 65	Nil
Peter May Director of Business Transformation	70 – 75	Nil	65 – 70	Nil
Trevor Haslett Director of Engineering and Procurement	70 – 75	Nil	65 – 70	Nil
Phil Barker Director of Operations	110 – 115	Nil	60 – 65 (110 – 115 Full Year Equivalent)	69,000#
George Butler Director of Asset Management	100 – 105	Nil	90 – 95 (95 – 100 Full Year Equivalent)	Nil

This includes cost of relocation including professional fees and removal costs.

Further detail on Directors' remuneration is shown in Note 4 to the accounts.

'Salary' includes gross salary, performance pay or bonuses, and any allowance, such as London Weighting Allowances, to the extent

that it is subject to UK taxation. This report is based on payments made by the Department and thus recorded in these accounts.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided

by the employer and treated by HM Revenue and Customs as a taxable emolument.

Executive Directors (cont'd):

	Accrued pension at age 60 as at 31 March 2007 £'000	Related lump sum as at 31 March 2007 £'000	Real increase in pension at age 60 £'000	Real increase in lump sum at age 60 £'000
Katharine Bryan Chief Executive	7.5 – 10	0 – 5	0 – 2.5	0 – 2.5
Ronan Larkin Director of Finance and Regulation	2.5 – 5	0 – 5	0 – 2.5	0 – 2.5
Pauline Shepherd Director of Human Resources	20 – 25	60 – 65	20 – 22.5	60 – 62.5
William Duddy Director of Customer Services	25 – 30	75 – 80	0 – 2.5	0 – 2.5
Peter May Director of Business Transformation	15 – 20	35 – 40	0 – 2.5	0 – 2.5
Trevor Haslett Director of Engineering and Procurement	20 – 25	70 – 75	17.5 – 20	52.5 – 55
Phil Barker Director of Operations	0 – 5	0 – 5	0 – 2.5	0 – 2.5
George Butler Director of Asset Management	0 – 5	0 – 5	0 – 2.5	0 – 2.5

Executive Directors (cont'd):

	CETV at 31 March 2007 £'000	CETV at 31 March 2006 £'000	Real increase in CETV £'000
Katharine Bryan Chief Executive	153	87	30
Ronan Larkin Director of Finance and Regulation	30	8	16
Pauline Shepherd Director of Human Resources	315	8	299
William Duddy Director of Customer Services	564	426	8
Peter May Director of Business Transformation	217	169	9
Trevor Haslett Director of Engineering and Procurement	527	110	371
Phil Barker Director of Operations	34	9	18
George Butler Director of Asset Management	45	17	19



Pension benefits are provided through the Civil Service pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium, and classic plus). The schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is

payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly in the same way as in classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee from a selection of approved products. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also

contribute a further 0.8% of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

Further details about the Civil Service pension arrangements can be found at the website www.civilservicepensions-ni.gov.uk

Cash Equivalent Transfer Values

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme.



The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements and for which the CS Vote has received a transfer payment commensurate with the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

K. Bryan

Katharine Bryan
Chief Executive

2 July 2007

Statement of Internal Control



1. Scope of Responsibility

I have been Accounting Officer for the period to which these accounts relate. The Department for Regional Development has therefore extended this particular responsibility until the accounts are signed off. I have had responsibility for maintaining a sound system of internal control that supports the achievement of the Department for Regional Development's policies, aims and objectives, whilst safeguarding the public funds and Agency's assets for which I have been personally responsible, in accordance with the responsibilities assigned to me in Government Accounting Northern Ireland.

2. The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control was based on an ongoing process designed to identify and prioritise the risks to the achievement of Agency policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control was in place in the Agency for the year ended 31 March 2007 and up to the date of approval of the Annual Report and Accounts, and accords with DFP guidance.

3. Capacity to handle risk

Appropriate procedures were developed to ensure that we identified the Agency's key business performance themes and risks and determined a control strategy for each of the significant risks. The procedures include the allocation of responsibilities to the appropriate staff.

The risk management cycle adopted a "top-down" and "bottom-up" approach. This approach allowed risks to be identified and managed at all levels and to be escalated as appropriate.

In addition, the Agency had its own policy on risk management to provide clarity and direction on risk management.

4. The risk control framework

The system of internal control within the Agency was based on an ongoing risk management process. This identified the key risks associated with the achievement of the Agency's strategic aims and business performance themes, along with the controls in place to manage those risks at three key levels:

- Corporate – key risks for the Agency managed by the Executive Team;
- Directorate – key risks identified and managed by Directors and their management teams; and
- Business Unit – key risks at this level were managed by the Head of Branch and fed into the Directorate/Corporate level risks as appropriate.

The Agency managed risks by the:-

- consistent and methodical identification, assessment and prioritisation of risk, with clear assignment of accountability for management;
- identification and evaluation of existing risk control measures and determination of additional control measures; and
- continual assessment of risks to ensure that existing risks were being managed as intended and that emerging risks were identified and managed.

The Corporate Risk Register identified the key risks that could impact upon the achievement of the Agency's objectives. It evaluated the likelihood and impact of occurrence and also assessed the controls in place to manage those risks. The "Risk Appetite" was considered and further action to improve control was agreed where appropriate. The ownership of each risk was allocated to appropriate staff.

In 2006-07 the Executive Team, supported by the Internal Controls Committee, regularly reviewed the Corporate Risk Register. The key Agency risks requiring management at corporate level included:-

- failure to meet compliance targets and statutory requirements through inadequate investment in, and operation of, capital assets;
- failure to minimise the impact of a major incident and thereby fail to protect human health and the environment;

- failure to meet customer standards;
- failure to develop and deliver effective strategic plans to keep Water Service transformation on time and within budget;
- failure to make Water Service fully self-financing by not delivering charging / billing on time and within budget;
- failure to stay within budget by non-delivery of business efficiencies and quality improvements;
- failure to comply with financial management processes;
- inadequate information leading to the undermining of credibility and decision-making;
- staffing – loss of skilled / key staff, low morale, unable to recruit and retain skilled staff;
- public opposition to water charges;

- failure to develop and implement adequate corporate governance arrangements; and
- efficiency targets set at a level which makes the organisation unsustainable.

5. Review of effectiveness

As Accounting Officer, I had responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control has been informed by the work of the internal auditors and the executive managers within the Agency responsible for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letters and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Executive Team and the Internal Controls Committee and a plan to address weaknesses and ensure continuous

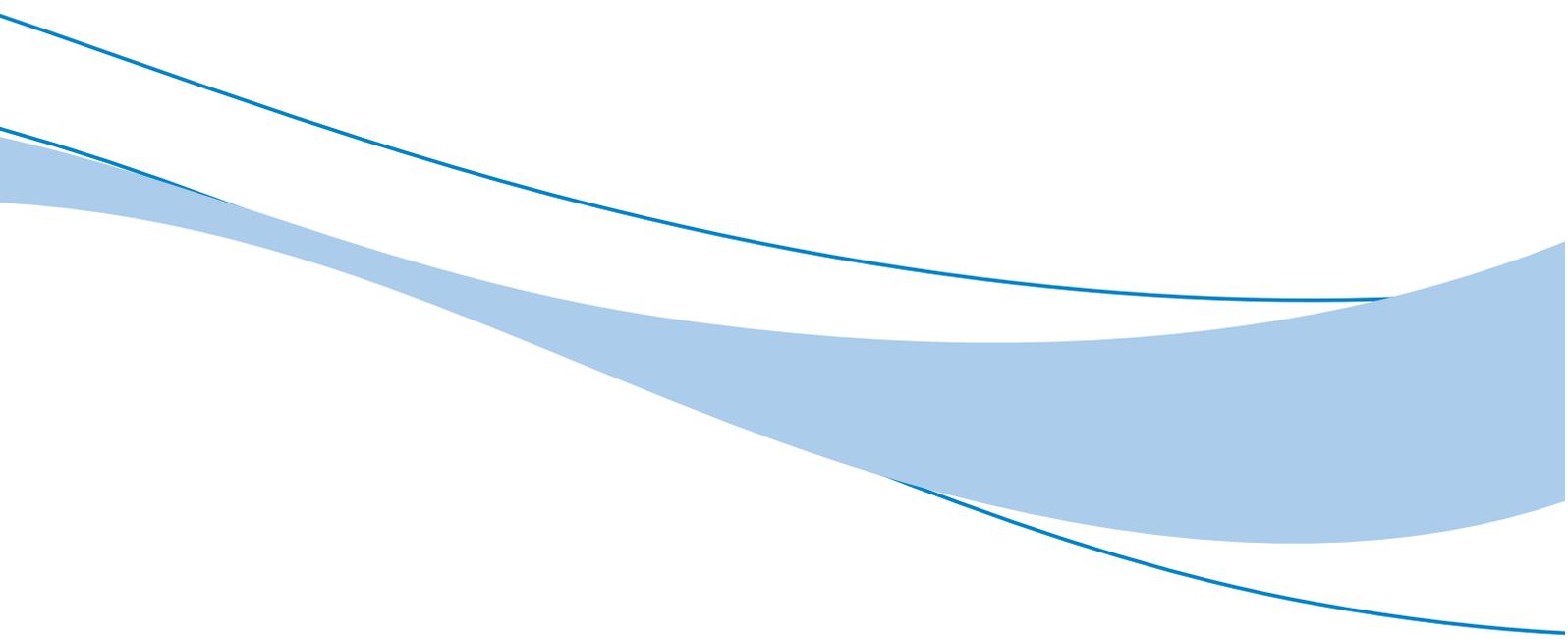
improvement of the system is in place for NIW.

The Agency Audit Committee, which met bi-annually and was attended by representatives of Internal Audit and the Northern Ireland Audit Office as well as the Executive Team, provided support and guidance on corporate governance issues.

6. Significant internal control problems

For 2006-07 Internal Audit has provided me with reasonable assurance, in overall terms, regarding the adequacy and effectiveness of the risk management, control and governance processes for the Agency. Substantial or reasonable assurance ratings were provided in six (6) of the eight (8) reports conducted during 2006-07.

Internal Audit has highlighted control issues during the recent reviews of Financial Management and Sick Absence, where overall



'Limited Assurance' ratings have been attributed. As follow-up reviews on Unipay and New Connections did not proceed as originally intended, and the follow-up review undertaken on Freedom of Information indicated that some recommendations had not been implemented, the limited assurances attributed to those areas during 2005-06 remain applicable.

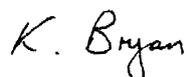
The Unipay system would require a fundamental review which is not feasible given that it will be replaced by the new HR Payroll System currently under development.

A planned follow-up review on New Connections was deferred taking account of the introduction of new legislation and the planned introduction of new systems and centralised processes for management of the new connections from 1 April 2007.

The significant internal reorganisation within Customer

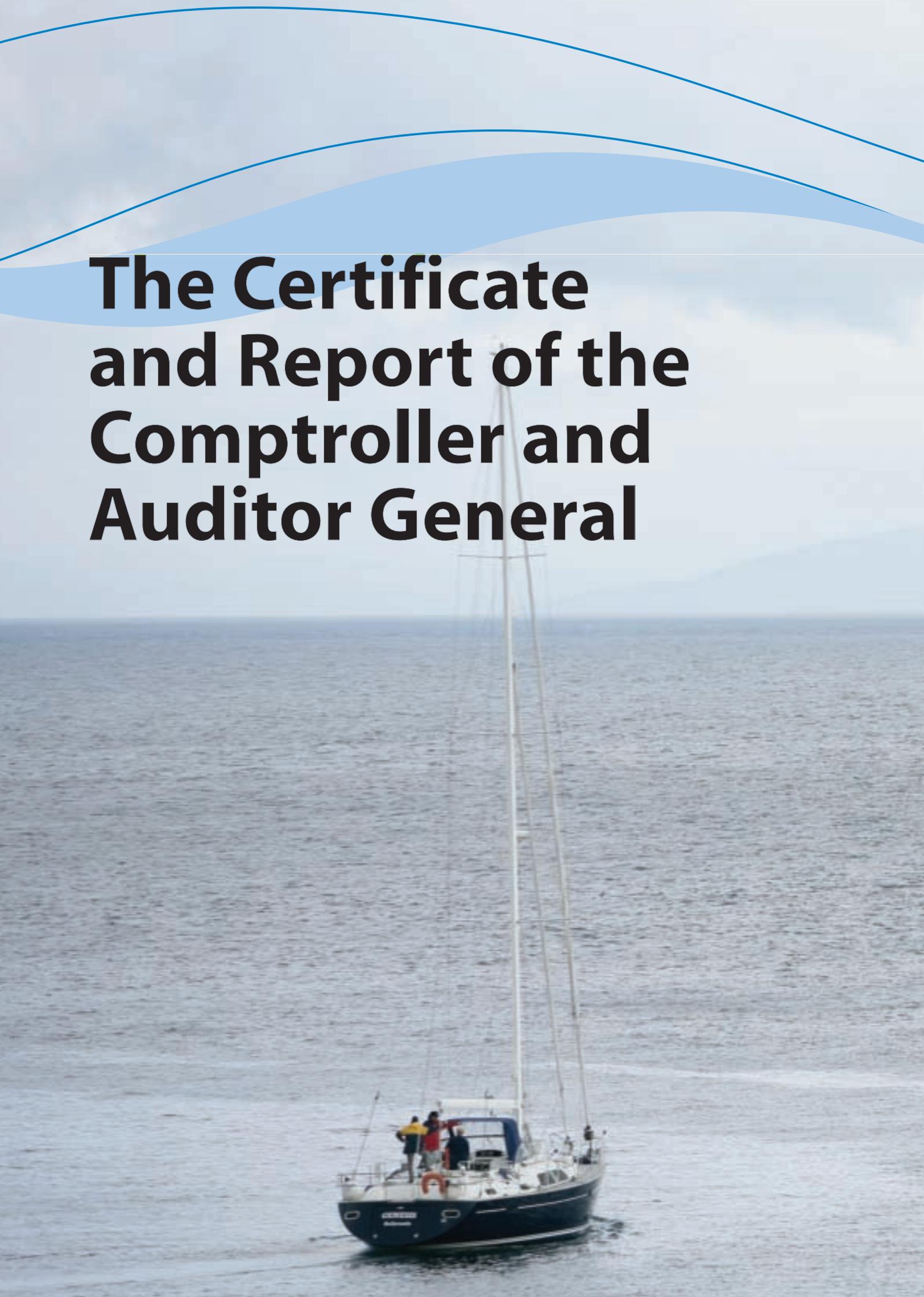
Services Directorate during 2006-07 has delayed the implementation of the recommendations in relation to Freedom of Information.

It is my intention to have follow-up reviews carried out in due course by NIW's Internal Auditors to assure me that the shortcomings, which relate primarily to non-compliance with established procedures, have been addressed.



Katharine Bryan
Chief Executive

2 July 2007

The image features a blue and white sailboat on a vast, greyish-blue ocean. The boat is positioned in the lower third of the frame, moving towards the left. Several people are visible on the deck. The background shows a hazy horizon and distant landmasses. At the top of the image, there are decorative blue wave-like graphics. The text is overlaid on the upper left portion of the image.

The Certificate and Report of the Comptroller and Auditor General

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE NORTHERN IRELAND ASSEMBLY

I certify that I have audited the financial statements of the Water Service Agency for the year ended 31 March 2007 under the Government Resources and Accounts Act (Northern Ireland) 2001. These comprise the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cash flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Agency, the Chief Executive and auditor

The Agency and Chief Executive, as Accounting Officer, are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Government Resources and Accounts Act (Northern Ireland) 2001 and the Department of Finance and Personnel directions made there under and for ensuring the

regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements and the part of the Remuneration Report to be audited in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Department of Finance and Personnel directions issued under the Government Resources and Accounts Act (Northern Ireland) 2001. I report to you whether, in my opinion, certain information given in the Annual Report, which comprises the Chairman's Foreword, Chief Executive's Foreword, Directors' Report, Key Financial Highlights, Management Commentary, and the information in the Remuneration Report that is not described in that Report as audited, is consistent with the financial statements. I also report whether in all material respects the

expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I report to you if the Agency has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by the Department of Finance and Personnel regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Agency's compliance with the Department of Finance and Personnel's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the Agency's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent

misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Agency's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material

misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act (Northern Ireland) 2001 and directions made thereunder by the Department of Finance and Personnel, of the state of the Agency's affairs as at 31 March 2007, and of the net deficit on operations, recognised gains and losses and cash flows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Department of Finance and Personnel directions issued under the Government Resources and Accounts Act (Northern Ireland)

2001; and

- the information given within the Annual Report, which comprises the Chairman's Foreword, Chief Executive's Foreword, Directors' Report, Key Financial Highlights, Management Commentary, and the information in the Remuneration Report that is not described in that Report as audited, is consistent with the financial statements.

Audit Opinion on Regularity

In my opinion, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Report

See also my report on pages 67 to 68.



*JM Dowdall CB
Comptroller and Auditor General
Northern Ireland Audit Office
106 University Street
Belfast
BT7 1EU*

3 July 2007

Accounts for the year ended 31 March 2007

Operating Cost Statement for the year ended 31 March 2007

	Notes	2007 £'000	2006 £'000
Income from activities	2	42,608	41,298
Expenditure			
Staff Costs	4	50,014	54,971
Operating Costs	5	112,941	97,620
Depreciation	7	112,427	124,267
Total Expenditure		275,382	276,858
Net deficit on operations before interest and cost of capital charges		(232,774)	(235,560)
Extraordinary Item	23	(3,225,457)	-
Net deficit on operations before interest and cost of capital charges and after extraordinary item	22(i)	(3,458,231)	(235,560)
Interest payable on Loans		-	46
Cost of Capital Charge	6	212,627	198,118
Net deficit on operations after cost of capital and interest charges and after extraordinary item		(3,670,858)	(433,724)

All amounts derive from continuing operations.

The notes on pages 49 to 66 form part of these accounts.

Statement of Recognised Gains and Losses

	2007 £'000	2006 £'000
Net (loss)/gain on revaluation of Fixed Assets (note 15)	(2,110,774)	290,362
Net gain on the revaluation of fixed asset investments	45	3
Receipt of adopted assets	32,147	15,739
Recognised gains and losses relating to the year	(2,078,582)	306,104

**Balance Sheet
at 31 March 2007**

	Notes	2007 £'000	2006 £'000
Fixed Assets			
Tangible Assets	7	873,278	6,046,100
Investments	9	107	62
		<u>873,385</u>	<u>6,046,162</u>
Current Assets			
Stocks and work in progress	10	2,409	1,685
Debtors due within one year	11	33,399	32,093
Cash at bank and in hand		46	23
		<u>35,854</u>	<u>33,801</u>
Creditors: amounts falling due within one year	12	72,037	88,113
Net Current (Liabilities)		<u>(36,183)</u>	<u>(54,312)</u>
Total Assets less Current Liabilities		<u>837,202</u>	<u>5,991,850</u>
Creditors: amounts falling due after one year	13	4,597	4,781
Provisions for Liabilities and Charges	14	10,915	4,251
Net Assets		<u>821,690</u>	<u>5,982,818</u>
Taxpayer's Equity			
General Fund	15	755,519	3,784,317
Revaluation Reserve	15	51,645	2,089,227
Government Grant Reserve	15	14,526	109,274
		<u>821,690</u>	<u>5,982,818</u>

The notes on pages 49 to 66 form part of these accounts.

K. Bryan

**Katharine Bryan
Chief Executive**

2 July 2007

**Cash Flow Statement for the
year ended 31 March 2007**

	Notes	2007 £'000	2006 £'000
Net cash outflow from continuing operating activities	22(i)	(128,423)	(66,305)
Servicing of finance			
Interest paid on Government Loans			(56)
Capital Expenditure			
Purchase of tangible fixed assets		(242,688)	(265,655)
Proceeds from disposal of assets		308	476
		<u>(242,380)</u>	<u>(265,179)</u>
Cash outflow before financing		<u>(370,803)</u>	<u>(331,540)</u>
Financing			
Payments of amounts due to consolidated fund		(130)	(49)
Repayment of loans		-	(1,412)
Amount received from DRD	15	<u>372,000</u>	<u>344,050</u>
		<u>371,870</u>	<u>342,589</u>
Increase/(Decrease) in cash in the period	22(ii)	<u><u>1,067</u></u>	<u><u>11,049</u></u>

The notes on pages 49 to 66 form part of these accounts

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2007

Note 1 Principal Accounting Policies Statement of Accounting Policies

The financial statements have been prepared in accordance with the 2006-07 Government Financial Reporting Manual (FRoM) issued by HM Treasury. The accounting policies contained in the FRoM follow UK generally accepted accounting practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector. Where FRoM permits a choice of accounting policy, the accounting policy which has been judged to be most appropriate to the particular circumstances of the Agency for the purpose of giving a true and fair view has been selected. The Agency's accounting policies have been applied consistently in dealing with items considered material in relation to the accounts.

1.1 Accounting Convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of fixed assets, and stocks where material, at their value to the business by reference to their current costs.

1.2 Tangible Fixed Assets

Tangible fixed assets are stated at the lower of replacement cost and recoverable amount. Expenditure on tangible fixed assets of over £3,000 is capitalised except for land for which there is no threshold. On initial recognition they are measured at cost including any costs such as installation directly attributable to bringing them into working condition.

All tangible fixed assets are restated to current value each year except for assets in the course of construction and computers and IT equipment.

Land and buildings with an open market value are restated to current value using professional valuations which were provided by the Valuation and Lands Agency at 1 April 2002 in accordance with FRS15 and in the intervening years by the use of published indices appropriate to the type of land or building. Other operational assets, where an open market value is not obtainable, are valued on the basis of depreciated replacement cost using information from the last Asset Management Plan which reported at 1 September 2001. Published indices appropriate to the category of asset are normally used to estimate value. The value is restated to reflect subsequent expenditure.

The value of infrastructure assets, (being mains and sewers, impounding and pumped raw water storage reservoirs and sludge pipelines) is based on the last Asset Management Plan and updated to include subsequent expenditure. Expenditure on infrastructure assets relating to increases in capacity, enhancement or upgrading of the network in accordance with defined standards of service is treated as an addition, thus increasing the value of the asset.

Properties managed and controlled by the Water Service for its specific purposes (specialised buildings) are incorporated in the accounts as if owned by the Water Service. The remaining buildings used by the Water Service (some of which have shared occupancy) are part of the Government Estate. As rents are not paid for these properties an assessment of the rent that would be payable on an open market basis has been charged in order to reflect the full economic cost.

Residual interests in off-balance sheet PFI properties are included in the tangible fixed assets at the amount of unitary charge allocated for the acquisition of the residual to the balance sheet date plus an adjustment based on the net present value of the change in the fair value of the residual as estimated at the start of the contract and its estimated fair value at the balance sheet date.

1.3 Depreciation

Tangible fixed assets are depreciated at rates calculated to write them down to estimated residual value on a straight-line basis over their estimated useful lives. Assets in the course of construction and residual interests in off-balance sheet PFI contract assets are not depreciated until the asset is brought into use or reverts to the Agency respectively. No depreciation is provided on freehold land as it has an infinite useful life.

Asset lives are normally in the following ranges:

- Buildings
 - Operational structures
40-80 years
 - Other buildings
30-60 years
 - Fixed and mobile plant
3-40 years
 - Vehicles, fixtures and fittings
4-10 years
 - Office Equipment
3-10 years
- Infrastructure assets represent a network of systems, which are required to be maintained in perpetuity and therefore have no finite economic life. The depreciation charge for infrastructure assets is the estimated level of annual

expenditure required to maintain the operating capability of the network. The calculation of this charge has been revised in 2006-07 and is based on the yearly average of the 5 year historic and 5 year forecast renewals expenditure with the latter identified by the certified interim Asset Management Plan to maintain the assets to defined standards of service and indexed each year to reflect inflation.

- IT equipment and computers are depreciated using the accelerated depreciation method to write off assets over three years.

1.4 Adopted Assets

Adopted assets are capitalized at their current value on receipt, and this value is credited to the general fund. They are subject to cost of capital charges at the standard rate of 3.5%.

1.5 Government Grants

Government grants received in respect of capital assets are treated as deferred credits and are transferred to the Operating Cost Statement in accordance with the asset lives of those assets.

1.6 Investments

Fixed asset investments (all of which are unlisted) consist of loan stock and ordinary shares. The loan stock is valued at cost, which is considered to be a close approximation to market value. The shares are stated at market value which has been determined by an independent stockbroker.

1.7 Stocks and Work in Progress

Stocks and work in progress are valued as follows:

- a) finished goods and goods for resale are valued at cost or, where

materially different current replacement cost, and at net realisable value only when they either cannot or will not be used; and

- b) work in progress is valued at the lower of cost, including appropriate overheads, and net realisable value.

1.8 Administrative and Programmed Expenditure

Note 8 analyses costs between Administration and Programme. Administration costs reflect the costs of running the Water Service. These include both administrative costs and associated operating income. Programme costs reflect non-administration costs.

1.9 Capital Charge

A charge, reflecting the cost of capital utilised by the Water Service, is included in the Operating Cost Statement. The charge is calculated at the real rate set by government (currently 3.5 per cent) on the average carrying amount of all assets less liabilities, except for:

- a) fixed assets where the cost of capital charge is based on the opening values, adjusted pro rata for in-year:
 - additions at cost
 - disposals as valued in the opening balance sheet (plus any subsequent capital expenditure prior to disposal)
 - impairments at the amount of the reduction of the opening balance sheet value (plus any subsequent capital expenditure)
 - depreciation of tangible fixed assets;
- b) amounts to be surrendered to the Consolidated Fund; and
- c) cash balances.

In previous years assets that had been funded through supply monies which had been made available through the Strategic Investment Programme (part of the Reinvestment and Reform Initiative) were excluded from the cost of capital calculation and notional interest was charged on these assets as if the supply monies had been made available by a loan. This is no longer the case and these assets are included in the cost of capital calculation.

1.10 Pensions

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (NI) (PCSPS) which is a defined benefit scheme and is unfunded and non-contributory. The Agency recognises the expected cost of providing pensions on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS (NI) of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS (NI).

Employees of the Water Service are Northern Ireland Civil Servants to whom the conditions of the Superannuation (NI) Order 1972 and subsequent amendments apply. Most Water Service staff are members of the Principal Civil Servant Pension Scheme (NI), which is a non-contributory scheme.

1.11 Leases

Operating leases and the rentals are charged to the Operating Cost Statement on a straight-line basis over the term of the lease.

1.12 Private Finance Initiative (PFI) transactions

PFI transactions have been accounted for in accordance with Technical Note No.1 (Revised) entitled *How to account for PFI Transactions* as required by FReM. Where the balance and the risks and rewards of ownership of the PFI property are borne by the PFI operator, the PFI payments are recorded as an operating cost. Where the Water Service has contributed assets, a prepayment for their fair value is recognised and amortised over the life of the PFI contract. Where at the end of the PFI contract a property reverts to the Water Service, the difference between the expected fair value of the residual on reversion and any agreed payment on reversion is built up over the life of the contract by capitalising part of the unitary charge each year.

Where the balance of risk and rewards of ownership of the PFI property is borne by the Water Service the property is recognised as a fixed asset and the liability to pay for it is accounted for as a finance lease. Contract payments are apportioned between an imputed finance lease charge and a service charge.

1.13 Provisions

The Agency provides for the legal or constructive obligations which are of uncertain timing or amount at the balance sheet date on the basis of the best estimate of the expenditure required to settle the obligation.

1.14 Contingent Liabilities

In addition to contingent liabilities disclosed in accordance with FRS12, the Agency discloses certain contingent liabilities where the likelihood of a transfer of economic benefit is remote.

These comprise:

- items over £100,000 that do not arise in the normal course of business and which are reported to Parliament/the Northern Ireland Assembly by Minute prior to the Agency entering into the arrangement; and
- all items (whether or not they arise in the normal course of business) over £100,000 which are required by FReM to be noted in the resource accounts.

Where the time value of money is material, contingent liabilities which are required to be disclosed under FRS 12 are stated at discounted amounts and the amount reported to Parliament/the Northern Ireland Assembly separately noted. Contingent liabilities that are not required to be disclosed by FRS 12 are stated at the amounts reported to Parliament/the Northern Ireland Assembly.

1.15 Value Added Tax

VAT is recovered centrally by the Department for Regional Development. Both trade debtors and trade creditors are stated gross of VAT and the VAT account balance is adjusted accordingly. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

1.16 Notional Costs

Some of the costs directly related to the running of the Water Service are borne by other Government bodies. These have been included on the basis of the estimated cost incurred by the providing Department.

Note 2 Income

	2007	2006
	£'000	£'000
Direct Charges	40,200	38,840
Other Operating Income	2,408	2,458
Income from Activities	<u>42,608</u>	<u>41,298</u>

CFER income has been included within Other Operating Income (2007:£132k, 2006:£53k).

Note 3 Business Activities Attracting Fees and Charges

	Income	2007	(Deficit)	Income	2006	(Deficit)
	£000	Cost	£000	£000	Cost	£000
		£000			£000	
Water	39,256	268,632	(229,376)	36,914	282,696	(245,782)
Sewerage	3,352	219,377	(216,025)	4,384	192,326	(187,942)
Total	<u>42,608</u>	<u>488,009</u>	<u>(445,401)</u>	<u>41,298</u>	<u>475,022</u>	<u>(433,724)</u>

Costs in 2007 exclude £3,225,457k that relates to the charge for impairment.

Income consists of that directly billed to customers plus miscellaneous income.

The above information relates to Fees & Charges Requirements and is not disclosed for the purposes of SSAP 25.

CFER income has been included within Other Operating Income. See note 2 above.

Note 4 Staff Costs

(i) Analysis of Staff Costs

	2007	2006
	£'000	£'000
Salaries and Wages	42,773	46,007
Social Security Costs	3,289	3,491
Superannuation	6,618	7,101
Total direct employee staff costs	<u>52,680</u>	<u>56,599</u>
Amounts payable in respect of agency/temporary staff and contract staff	<u>2,572</u>	<u>1,715</u>
Subtotal	<u>55,252</u>	<u>58,314</u>
Other staff costs	463	2,145
Less Staff costs capitalised	(5,701)	(5,488)
Total	<u><u>50,014</u></u>	<u><u>54,971</u></u>

Other staff costs in 2006-07 relate to costs incurred to fund the early retirement scheme, lump sum compensations and equal opportunity payments.

(ii) Average Numbers of Persons Employed

The average number of persons employed during the year was:

	2007	2006
Senior Management	8	9
Industrials	892	913
Non industrials	829	1,067
Agency temporary and contract	177	122
Total	<u><u>1,906</u></u>	<u><u>2,111</u></u>

There were approximately 142 staff employed on capital projects in 2006-07.

The Principal Civil Service Pension Scheme (PCSPS) (NI) of which most of the Agency's employees are members is an unfunded multi-employer defined benefit scheme which produces its own resource accounts but the Water Service is unable to identify its share of the underlying assets and liabilities. The most up to date actuarial valuation was carried out as at 31 March 2003 and details of this valuation are available in the PCSPS (NI) Resource Accounts.

For 2006-07, normal employer's contributions of £6,616,796 were payable to the PCSPS (NI) (2005-06 £7,097,068) at one of four rates in the range 16.5% to 23.5% of pensionable pay, (2005-06 16.5% to 23.5%) based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. The salary bands and contribution rates were revised for 2005-06 and will remain unchanged until 2008-09. The contribution rates reflect the benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Employees joining after 1 October 2002 could opt to open a partnership account, a stakeholder pension with an employer contribution. Employer's contributions of £1,265 (2005-06 £4,427) were payable to one or more of a panel of four appointed stake holder pension providers. Employer contributions are age related and range from 3% to 12.5% (2005-06 3% to 12.5%) of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition employer contributions of £697, 0.8% (2005-06 £646, 0.8%) of pensionable pay, were payable to the PCSPS (NI) to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees. Contributions due to the partnership pension providers at the balance sheet date were £nil (2005-06 £nil). Contributions prepaid at that date were £nil (2005-06 £nil).

11 people (2005-06 25 people) retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £12,668 (2005-06 £24,548).

(iii) Board Members and Senior Managers

See Remuneration Report for details of Shadow Board Members and Senior Managers salaries and pension disclosures.

Note 5 Operating Costs

Analysis of operating costs by type of expense:

	2007 £'000	2006 £'000
Power	22,518	17,615
Rates	11,048	10,583
Materials and Consumables	13,793	14,813
Other Operating Costs	61,079	49,889
Notional Charges *	4,815	5,330
Loss/(Profit) on Disposal of Assets	(206)	(129)
Other Costs of Employment	1,925	1,537
Release from Government Grant Reserve	(2,031)	(2,018)
	<u>112,941</u>	<u>97,620</u>

* Analysis of Notional Charges

	2007 £'000	2006 £'000
Construction Service	2,844	2,987
DRD Personnel Costs	538	566
NIAO (Audit fee)	35	25
Other	1,398	1,752
	<u>4,815</u>	<u>5,330</u>

See note 19 detailing the losses incurred and special payments made during the year.

Note 6 Cost of Capital

The Operating Cost Statement bears a non cash charge for interest relating to the use of capital by the Agency.

	Notes	2007 £'000	2006 £'000
Capital employed 1 April 2006		5,988,261	5,511,417
Total assets less liabilities		821,690	5,982,818
Less: Indexed Fixed Assets		(873,278)	(6,046,100)
Plus: Unindexed Fixed Assets		6,210,100	5,755,737
Less: RRI Funded Assets		-	(142,421)
EU grant creditor		1,482	3,592
Amounts to be surrendered to the Consolidated Fund	12	6	4
Bank Balances		803	1,847
Capital employed 31 March 2007		<u>6,160,803</u>	<u>5,555,477</u>
Average Capital Employed for capital charging		6,074,532	5,533,447
Capital charge @ 3.5%		<u>212,627</u>	<u>193,671</u>
Add interest on Reinvestment & Reform Initiative (RRI) loan *		-	4,447
Total Capital Charge		<u><u>212,627</u></u>	<u><u>198,118</u></u>

* Prior to 1 April 2006 assets specifically financed by RRI borrowing were excluded when calculating the Average Capital Employed for capital charging and an amount equivalent to the interest that would have been charged on the additional supply for RRI borrowing separately charged.

Note 7 Tangible Fixed Assets

	Assets in the course of construction	Freehold Land	Freehold Buildings	Civil Structures	Fixed Plant	Infra- structure Assets	Mobile Plant & Vehicles	Information Technology	TOTAL
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cost/Valuation									
At 1 April 2006	586,583	109,458	200,137	1,297,439	618,155	5,709,288	20,927	8,931	8,550,918
Opening Adjustments *	1,000	-	-	-	-	-	-	-	1,000
Additions	231,083	1	17	1,099	1,415	8,937	-	350	242,902
Adopted Assets	-	23	-	106	58	31,959	-	-	32,146
Transfers	(379,140)	323	12,532	68,838	81,516	209,731	3,245	2,955	-
Disposals	(112)	(35)	(3,501)	(30,676)	(15,259)	-	(3,616)	(2,761)	(55,960)
At 31 Mar 2007	439,414	109,770	209,185	1,336,806	685,885	5,959,915	20,556	9,475	8,771,006
Accumulated Depreciation									
At 1 April 2006	-	-	(69,021)	(636,348)	(384,057)	(1,393,284)	(14,861)	(7,247)	(2,504,818)
Disposals	-	-	3,487	30,663	15,259	-	3,589	2,749	55,747
Charge	-	-	(5,873)	(36,223)	(27,511)	(38,923)	(1,843)	(2,054)	(112,427)
At 31 March 2007	-	-	(71,407)	(641,908)	(396,309)	(1,432,207)	(13,115)	(6,552)	(2,561,498)
Net Replacement Value At									
31 March 2007	439,414	109,770	137,778	694,898	289,576	4,527,708	7,441	2,923	6,209,508
Adjustment to fair value:									
Revaluation	92	20,681	6,862	2,973	22,931	-	1,454	903	55,896
Indexation	-	-	-	-	-	-	428	4	432
Impairment	(378,844)	(92,527)	(115,512)	(611,602)	(274,963)	(3,919,091)	(5)	(14)	(5,392,558)
Adjusted Net Replacement Value									
At 31 March 2007	60,662	37,924	29,128	86,269	37,544	608,617	9,318	3,816	873,278
At 31 March 2006	586,583	109,458	131,116	661,091	234,098	4,316,004	6,066	1,684	6,046,100

* Opening adjustments £1,000k relating to the creation of the residual asset PFI Scheme (Note 16). This had no cash impact.

Note 8 Analysis of Administration and Programme Costs

	2007		2006	
	£'000	£'000	£'000	£'000
Administration costs				
Staff costs	52,680		56,599	
Other administration costs	29,001		16,561	
Notionals	4,637		5,330	
Movement in provisions	(263)		1,269	
Cost of capital charge	4,910		2,703	
Own work capitalised	(5,701)		(5,488)	
Net Administration Costs		85,264		76,974
Programme Costs				
Request for Resources B				
Expenditure	3,422,339		204,651	
Notionals	178		-	
Cost of capital charge	207,717		195,415	
Less EU income - department	(2,031)		(2,018)	
Consolidated Fund Extra Receipts	(132)		(53)	
Other	(42,477)		(41,245)	
Net Programme Costs		3,585,594		356,750
Operating Deficit per Operating Cost Statement		<u>3,670,858</u>		<u>433,724</u>

Depreciation

Depreciation in respect of Administration and Programme costs has been included as follows:

	2007		2006
	£'000		£'000
Administration costs (included within 'Other administration costs')	2,593		1,695
Programme costs (included within 'Expenditure')	109,834		122,572
Total depreciation	<u>112,427</u>		<u>124,267</u>

Note 9 Investments

	2007	2006
	£'000	£'000
Investments	<u>107</u>	<u>62</u>

Shares have been revalued to market value at 31 March 2007.

Note 10 Stocks and work in progress

	2007	2006
	£'000	£'000
Raw materials and consumables	2,141	1,614
Work in progress	<u>268</u>	<u>71</u>
	<u>2,409</u>	<u>1,685</u>

Note 11 Debtors due within one year

	2007	2006
	£'000	£'000
Trade debtors	6,974	4,196
Prepayments and accrued income	10,478	8,384
EU grant receivable-capital	1,482	3,592
VAT	<u>14,465</u>	<u>15,921</u>
	<u>33,399</u>	<u>32,093</u>

The EU grants receivable are to be surrendered to the Consolidated Fund when received.

Details of EU grants receivable

	£'000	£'000
At 1 April 2006	3,592	11,867
Amounts claimable 2006-07	-	3,771
Received in year	(2,077)	(5,853)
Amounts unrecoverable	<u>(33)</u>	<u>(6,193)</u>
At 31 March 2007	<u>1,482</u>	<u>3,592</u>

The amount of £33k in 2007 relates to an exchange loss on their receipt during the year.

Note 12 Creditors: Amounts falling due within one year

	2007	2006
	£'000	£'000
Bank overdraft	803	1,847
Trade creditors	58,325	69,407
Taxation and social security	181	182
Other creditors and accruals	11,246	13,085
EU grants payable to Consolidated Fund on receipt	1,482	3,592
	<u>72,037</u>	<u>88,113</u>

Other creditors and accruals include £6k payable to the Consolidated Fund, (2006: £4k)

Note 13 Creditors: Amounts falling due after more than one year

	2007	2006
	£'000	£'000
Capital Retentions	4,597	4,781
	<u>4,597</u>	<u>4,781</u>

Note 14 Provisions for liabilities and charges

	2007	2006
	£'000	£'000
Balance at 1 April 2006	4,251	2,246
Payments made	(2,302)	(1,699)
Increase in provision	8,966	3,704
Balance at 31 March 2007	<u>10,915</u>	<u>4,251</u>

The provision at 31 March 2007 includes £6.7m in relation to the potential costs associated with environmental works.

The remaining provision relates primarily to unsettled public/employer liability claims at the year end, as indicated by DRD Central Claims Unit.

Note 15 Movements on Reserves

	General Fund	Revaluation Reserve	Government Grant Reserve	Total
	2007 £'000	2007 £'000	2007 £'000	2007 £'000
Balance as at 1 April 2006	3,784,317	2,089,227	109,274	5,982,818
Adjustment to Opening Balance *	1,000	-	-	1,000
Adjusted Opening Balance	<u>3,785,317</u>	<u>2,089,227</u>	<u>109,274</u>	<u>5,983,818</u>
Adopted assets	32,147	-	-	32,147
Net deficit	(3,670,858)	-	-	(3,670,858)
Net Vote Funding in Year	372,000	-	-	372,000
Notional Charges	4,815	-	-	4,815
Cost of capital charge	212,627	-	-	212,627
Realised element transfer	19,570	(19,570)	-	-
CFERs	(132)	-	-	(132)
Release to Income and Expenditure	-	-	(2,031)	(2,031)
Revaluation of investments	-	45	-	45
Surplus on indexation	-	(2,018,057)	(92,717)	(2,110,774)
Exchange difference	33	-	-	33
At 31 March 2007	<u>755,519</u>	<u>51,645</u>	<u>14,526</u>	<u>821,690</u>

* refers to PPP Residual Interest (see note 16).

Note 16 Private Finance Initiative

Water Service has accounted for Private Finance Initiative (PFI) transactions in line with Accounting Policies Note 1.12.

Off-Balance Sheet

Kinnegar

A contract with Coastal Clearwater Ltd. was signed on 30 April 1999 for the provision of sewerage treatment which covered the upgrading of the Kinnegar Waste Treatment Works with a capital cost in the region of £11 million. The contract is for 25 years with an end date of 30 April 2024.

The PFI property involved is not an asset of Water Service but the assets will revert to Water Service at the end of the contract. FReM indicates that where at the end of a PFI contract a property reverts in this way, the difference between the expected fair value of the residual on reversion and any agreed payment on reversion is built up over the life of the contract by capitalising part of the unitary charge each year.

Kinnegar has not been accounted for in this way prior to 2006-07. In 2006-07 an amount of £1,000k was credited to General Fund as an opening balance adjustment (see Note 15) to account for the prior years capitalisation for the residual interest asset. In 2006-07 an amount of £215k was credited to the Operating Cost Statement for this year. These transactions gave a residual interest asset of £1,307k in Kinnegar at year end. This asset has been included in Fixed Assets (see Note 7).

Omega

A contract with Glen Water Ltd. was signed on 6 March 2007 for the provision of sewerage treatment and sludge disposal at five sites with a capital cost in the region of £122 million. The contract is for 25 years with an end date of 5 March 2032. The PFI property involved is not an asset of Water Service but since the assets will revert to Water Service at the end of the contract a residual interest asset will be established whenever unitary payments commence.

Silent Valley / Ben Crom

A smaller PFI contract was signed on 29 June 1999 with Highland, Light and Power Northern Ireland Limited to facilitate the generation of hydro electricity at Silent Valley/Ben Crom Reservoirs. The contract period is for nine years and the estimated capital value is £840,000. There are no annual payments under this contract.

Charge to the Operating Cost Statement and Future Commitments.

In 2006-07 the only charge to the Operating Cost Statement in respect of off-balance sheet PFI transactions related to Kinnegar. This was for £1,546,388 (2005-06: £2,168,033). The unitary payment was £1,761,604 (2005-06: £2,378,000) with £215,216 (2005-06: £209,967) capitalised in relation to the residual interest asset. The future estimated annual amount payable under the Kinnegar off-balance PFI agreement is £2,234k.

The Omega unitary payments do not commence until late 2007-08 (£1,125k). The future estimated first full year (2009-10) annual amount payable under the Omega off-balance PFI agreement is £20,229k.

The future estimated total annual amount payable under off- balance PFI agreements is £22,463k.

These payments are subject to performance , volume and quality targets being met, which lead to fluctuations in the amount payable. Payments to which Water Service is committed during 2007-08, analysed by the period during which the commitment expires is as follows

	2007	2006
	£'000	£'000
Expiry within 1 year	-	-
Expiry within 2 to 5 years	-	-
Expiry within 6 to 10 years	-	-
Expiry within 11 to 15 years	-	-
Expiry within 16 to 20 years	2,234	2,400
Expiry within 21 to 25 years	1,125	-

On-Balance Sheet

Alpha

A contract with Dalriada Water Ltd. was signed on 30 May 2006 for the provision of bulk drinking water supplies. This has a capital cost in the region of £110 million. The service provision will roll-out from April to October 2008. The contract is for 25 years with an end date of 29 May 2031.

Charge to the Operating Cost Statement and Future Commitments

There are no amounts charged to the Operating Cost Statement in respect of the service element of on-balance sheet PPP transactions in 2006-07 (2005-06 : nil).

The Alpha unitary payments do not commence until mid 2008-09 and therefore no commitment to make payments under on-balance sheet PFI agreements exists for 2007-08.

The future estimated first full year (2009-10) annual amount payable under the Alpha on-balance PFI agreement is £17,926k. These payments are subject to performance , volume and quality targets being met, which lead to fluctuations in the amount payable.

Note 17 Capital Commitments and Contingent Liabilities

Capital commitments at 31 March 2007 for which no provision has been made in the accounts were as follows:

	2007 £'000	2006 £'000
Contracted	225,605	205,607
Authorised but not contracted	1,214,189	882,616

The Department is disputing liability in 279 Public liability and 16 Employer's liability cases amounting to £1,809k. It has been estimated that there is a less than 50% chance of these cases leading to a loss.

Note 18 Commitments under leases

Operating leases

Commitments under operating leases to pay rentals during the year following the year of these accounts are given in the table below, analysed according to the period in which the lease expires.

	2007 £'000	2006 £'000
Obligations under operating leases comprise:		
Office Equipment		
Expiry within 1 year	-	55
Expiry within 2 to 5 years	99	115
	<u>99</u>	<u>170</u>

Note 19 Losses and Special Payments

	2007 No of cases	2007 £'000	2006 No of cases	2006 £'000
Losses:				
Stores and plant losses	5	10	7	7
Other Cash Losses	5	69	377	434
Foreign exchange loss	1	33	1	142
Constructive loss	-	-	1	1,417
Total Losses	<u>11</u>	<u>112</u>	<u>386</u>	<u>2,000</u>
Special Payments	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

Note 20 Related Party Transactions

During 2006-07 Water Service was an Executive Agency within the Department for Regional Development ('the Department'). (See Note 23 for status from 1 April 2007).

The Department is regarded as a related party. During the year the Water Service has had various transactions with the Department and with other entities for which the Department is regarded as the parent, primarily Roads Service.

In addition the Water Service has had a small number of transactions with other Government Departments and other central government bodies.

None of the Shadow Board members, members of the key management staff or other related parties has undertaken any material transactions with the Water Service during the year.

Note 21 Inter Government Balances

	Debtors: Amounts falling due within one year £000	Debtors: Amounts falling due after more than one year £000	Creditors: Amounts falling due within one year £000	Creditors: Amounts falling due after more than one year £000
Balances with other central government bodies	14,727	-	1,668	-
Balances with local authorities	248	-	2	-
Balances with NHS Trusts	73	-	-	-
Balances with public corporations and trading funds	1	-	7	-
Balances with bodies external to government	18,350	-	70,360	4,597
At 31 March 2007	<u>33,399</u>	<u>-</u>	<u>72,037</u>	<u>4,597</u>
Balances with other central government bodies	10,757	-	4,611	-
Balances with local authorities	92	-	17	-
Balances with NHS Trusts	71	-	-	-
Balances with public corporations and trading funds	7	-	-	-
Balances with bodies external to government	21,166	-	83,485	4,781
At 31 March 2006	<u>32,093</u>	<u>-</u>	<u>88,113</u>	<u>4,781</u>

Note 22 Notes to the cash flow statement

(i) Reconciliation of Net Deficit to Operating Cash Flows

	Note	2007 £'000	2006 £'000
Operating deficit before interest and capital charge		(3,458,231)	(235,560)
Adjustments for non-cash transactions			
EU Grant income released from reserves		(2,031)	(2,018)
Impairment	23	3,225,457	1,417
Exchange loss	11	33	142
Unrecoverable government grant		-	1,178
Loss/(Profit) on disposal of assets and assets decapitalised		(94)	(129)
PPP Residual Asset Credit	16	(215)	-
		<u>(235,081)</u>	<u>(234,970)</u>
Depreciation on tangible fixed assets	7	112,427	124,267
Notional charges	5	4,815	5,330
Adjustments for movements in working capital			
Decrease/(Increase) in stocks	10	(724)	551
Decrease/(Increase) in debtors	11	(3,416)	(428)
Increase/(Decrease) in creditors	12 & 13	(13,108)	36,940
Increase/(Decrease) in provisions	15	6,664	2,005
Net cash outflow from operating activities		<u>(128,423)</u>	<u>(66,305)</u>

The movement in debtors and creditors excludes EU grants receivable & payable. In addition the movement in creditors excludes loans repayable & associated interest (£nil 2007: £nil 2006) and the bank overdraft.

(ii) Reconciliation of Net Cash Flow to Movement in Net Debt

	2007 £'000	2006 £'000
(Decrease)/Increase in cash in the period	1,067	11,049
Cash used to repay debt	-	1,412
Change in net debt	<u>1,067</u>	<u>12,461</u>
Net debt at 1 April 2006	(1,824)	(14,285)
Net debt at 31 March 2007	<u>(757)</u>	<u>(1,824)</u>

(iii) Analysis of Changes in Net Debt

	At 1 April 2006	Cash flows	Other changes	At 31 March 2007
	£'000	£'000	£'000	£'000
Cash at hand, at bank	23	23	-	46
Overdraft	(1,847)	1,044	-	(803)
TOTAL	<u>(1,824)</u>	<u>1,067</u>	<u>-</u>	<u>(757)</u>

Note 23 Extraordinary Item and Events after the Balance Sheet date

Discontinuing Operations

The Department for Regional Development's Executive Agency, Water Service, has transformed into a self financing Government Owned Company (GoCo), Northern Ireland Water Limited (NIW), from the 1st April 2007. As a result, responsibility for the provision of water and wastewater services has transferred from Water Service to NIW. The GoCo is owned by the Department, and raises finance through income from customers and loan finance. It is also subject to economic regulation. The financial accounts will no longer be subject to the Financial Reporting Manual (FRM) but will be required to fully comply with company legislation and UK GAAP.

Extraordinary Item - Impairment

The value of the assets of Water Service have been written down as part of the process of establishing the GoCo, and the write down reduced them to a value of £822m at 31 March 2007. This write down is required to reflect the value placed on the assets of the GoCo which operates outside central government, but is subject to a new economic regulatory regime and will be required to be self-financing. The GoCo was established through the enactment of legislation on 14th December 2006. An appropriate valuation for the GoCo at 1 April 2007 has been determined in accordance with relevant valuation methodologies applicable in this context, and the value has been set at approximately £822m.

The Operating Cost Statement on page 46 shows an extraordinary item of £3,225,457k which represents the impairment of fixed assets described above.

Further information on the impairment is included in Annex A.

ANNEX A REPORT OF THE COMPTROLLER AND AUDITOR GENERAL

TRANSFER OF NI WATER SERVICE TO NI WATER LTD, AND THE ASSOCIATED WRITE DOWN OF ASSET VALUES

As recorded at Note 23 to the accounts, the assets and liabilities of Northern Ireland Water Service (WS) were transferred on 1 April 2007 from an executive agency within the Department for Regional Development (DRD) to a self-financing Government Owned Company (GoCo) known as Northern Ireland Water Limited (NIW). The transfer took place in accordance with the provisions in the Water and Sewerage Services (Northern Ireland) Order 2006.

Whereas WS was required to prepare its accounts in accordance with UK Generally Accepted Accounting Practice (UK GAAP) subject to such adaptations as are necessary in the public sector and set out in relevant government guidance, NIW's accounts will be prepared on commercial principles and fully under UK GAAP, in line with the water companies in Great Britain. Under government accounting guidance, infrastructure assets are valued on the basis of depreciated replacement cost. Depreciated replacement cost is the value of the asset for existing use from which appropriate deductions may be made to allow for relevant factors such as the age and condition of the asset, which might result in the existing asset being worth less to WS than would be a new replacement. At 31 March 2006 WS reported fixed assets in excess of £6bn on this basis. NIW however will value its assets at fair value. At 31 March 2007, immediately

before the transfer to GoCo status, WS was required to write down the value of its assets in order that its net assets reflected the fair value of the assets and liabilities to be transferred to NIW.

WS and DRD carried out extensive work to establish fair value. The best estimate of fair value was considered to be based on the projected discounted cash flows of NIW. This means that the forecast income and forecast expenditure over a period of seven years were estimated, and the net income discounted to allow for the time value of money. On that basis, it was concluded that the opening fair value should be £800m. The model on which these calculations were based was independently reviewed and the independent consultants concluded that the model was sound. The net assets of £822m shown on the balance sheet include £22m surplus assets, which are excluded from the fair value assessment on the grounds that they will not be used to generate a return.

Note 7 to the accounts shows a net downward adjustment to the value of tangible fixed assets of £5.3bn. Part of this amount has been recognised as a loss in the Statement of Recognised Gains and Losses (£2.1bn), on the grounds that it is the reversal of previous revaluation gains. The remainder (£3.2bn) of the adjustment is shown as a charge to the Operating Cost

Statement. The adjustment is an impairment in accounting terminology, but does not imply that there is any operational impairment of the assets.

I examined the assessment of fair value in order to form an opinion on whether the valuation of WS at 31 March 2007 is reasonable and fairly stated in the financial statements.

The assessment of fair value through projected discounted cash flows necessarily depends on prediction of future events. It is an accounting estimate, not measurable with the same degree of precision as other figures in financial statements. There are a number of key assumptions underpinning the model, such as

- RPI is assumed to be 2.5% per annum on operating costs;
- NIW will achieve £44m of operating cost efficiencies (at 2006-07 prices) by 2010;
- 36,000 pensioner households will opt for meters in the first 2 years;
- levels of bad debts estimated as five per cent for domestic customers and two and a half percent for non-domestic customers each year (£11.6m in the first year of full charging); and
- levels of capital expenditure, estimated at £1.6bn over a seven year period.

The actual fair value of the net assets on the basis of discounted

cash flows may be higher or lower depending on the outcome of the assumptions made. For example, although it is assumed that the efficiency targets are challenging, there is potential for NIW to increase its value by outperforming its regulatory targets. The additional efficiency savings in expenditure, compared to the forecast savings, would lead to an increase in net inward cash flow and therefore to an increase in the value of the company as estimated by discounted cash flows. On the other hand if the forecast savings were not achieved this would lead to a decrease in net inward cash flow, and therefore to a decrease in the value of the company.

The Regulator (the Northern Ireland Authority for Utility Regulation), whose duties include the protection of the interest of customers, ensuring proper service provision, and ensuring that NIW can finance its functions, has stated in a Statement of Regulatory Policy and Intent that it is likely to adopt the Government-determined Regulatory Capital Value (RCV) as the starting point for determining the RCV for price controls. However,

it has not yet adopted NIW's model for the purposes of regulation, and will continue to keep it under review over the rest of 2007. Within the regulatory framework there are a series of notifiable items which can allow NIW the opportunity to recover excess expenditure through increased tariffs. That is, in certain narrowly defined circumstances, and having regard to whether any such expenditures are a consequence of management action, the Regulator would be likely to revise price limits in NIW's favour. For as long as NIW can seek relief for notifiable events it has some limited potential protection against the impact of notifiable events that are beyond management's control.

As a result of the above, in my opinion, £800m represents a fair value of the net assets of WS (excluding surplus assets and associated liabilities) as at 31 March 2007.



JM Dowdall CB

3 July 2007

ANNEX B

EXPLANATION OF KEY PERFORMANCE INDICATORS

Target 1 – supply interruptions

Parameters of target

- the percentage of overall properties connected to the water distribution system that are affected by unplanned interruptions in water supply lasting greater than 12 hours duration; and
- does not differentiate between interruptions caused by third parties and those for which Water Service is solely responsible.

Measurement of target

- Networks staff, based on their knowledge of the infrastructure and the area affected, estimate the number of properties affected by interruptions. Where practicable property counts are carried out.

Target 2 – customer correspondence

Parameters of target

- date of receipt is counted as zero and the next working day as day one;
- the target relates to the percentage number of written correspondence for which substantive responses have been issued within 10 working days;
- for the purposes of the target written correspondence covers letters, e-mails and faxes from members of the public. It excludes complaints; and
- responses may be by letter, e-mail, telephone or any other appropriate means and should aim to reply in full; and where it is not possible to issue a substantive reply within the 10 working days, a

full holding reply should issue.

A full holding reply will advise that the Water Service needs to undertake additional research and should include details of when a substantive response will issue.

Measurement of target

- performance is monitored across Water Service; and
- each Directorate has established procedures for recording the date of receipt of incoming written correspondence (excluding complaints which are dealt with separately) and the date of response.

Target 3 – written complaints

Parameters of target

- date of receipt is counted as zero and the next working day as day one;
- target relates to the percentage of written complaints for which substantive responses have issued within 10 working days; and
- responses can be made by letter, e-mail, telephone or any other appropriate means and should aim to reply in full. Where it is not possible to issue a substantive reply within the 10 working days limit then a full holding reply should issue.

Measurement of target

- performance against this target is monitored across Water Service; and
- each Directorate has established procedures for recording the date of receipt of all incoming written complaints and the date of response.

Target 4 – telephone contact

Parameters of target

- target relates to the percentage of telephone calls on the Waterline customer service number (08457 440088) and to the Metered Water Branch number (9032 1500) that are answered within 30 seconds.

Measurement of target

- the target is measured by a call monitoring system which automatically records the number of calls and the number answered within the 30 seconds target. Calls were managed by four regional Water Service Customer Service Units and Revenue Branch up to November 2006 when the new Customer Relations Centre was established in Belfast with upgraded telephoning and reporting systems; and
- the percentage of calls answered in 30 seconds is established by using the following formula: total Calls answered in 30 seconds / (total calls received less total abandoned within 30 seconds)

Target 5 – FOI/EIR requests

Parameters of Target

- target relates to the percentage number of Freedom of Information (FOI) and Environmental Information Regulations (EIR) requests which are responded to within 20 days of receipt.

Measurement of target

- performance monitored across Water Service; and
- each Directorate has established procedures for recording the date of receipt of all incoming request and the date of response.

Target 6 – leakage

Parameters of target

- this target relates to the reduction in the level of leakage from the water distribution system. The overall leakage level at 31 March 2006 was 177.77 million litres per day, and a reduction of 8.77 million litres per day is required to achieve the target for 31 March 2007.

Measurement of target

- the monthly estimate is based on the 2006-07 Water Balance, changes in metered consumption and water produced into distribution.

Target 7 – unit costs of water delivered

Parameters of Target

- this target relates to the unit cost of water delivered.

Measurement of target

- calculated by dividing the water proportion of total operating costs:- which is made up of:
 - relevant staff costs;
 - other costs of operations e.g. power, plant, chemicals;
 - the cost of depreciating assets; and
 - a proportion of the total cost of capital.
- by the total volume of water delivered.

Target 8 - unit costs of wastewater treated

Parameters of Target

- target relates to the unit cost of wastewater treated.

Measurement of target

- calculated by dividing the waste water proportion of total operating costs:- which is made up of:
 - the relevant staff costs;
 - other costs of operations e.g. power, plant, chemicals;

- the cost of depreciating assets; and
- a proportion of the total cost of capital.

- by the total volume of wastewater collected.

Target 9 – health and safety – ‘days lost’

Parameters of target

- target includes all ‘days lost’ due to accidents in the workplace.

Measurement of target

- average of previous three years outcome less a 5% reduction.

Target 10 – health and safety – ‘lost day accidents’

Parameters of target

- target includes accidents which result in at least one full days absence immediately following the date of the accident.

Measurement of target

- average of previous three years total ‘lost days accidents’ less a 5% reduction.

Target 11 – manpower

Parameters of target

- number of full and part time staff.

Measurement of target

- based on information supplied by the NICS’ Human Resource Management System (HRMS).

Target 12 – staff attendance

Parameters of target

- based on number of full and part time staff.

Measurement of target

- staff attendance information supplied by NI Statistics and Research Agency.

Targets 13a and 13b - drinking water compliance

Parameters of target

- targets relates to quality of water supplied at the customers’ taps; and assessed on a calendar year basis.

Measurement of target

- Water Supply (Water Quality) Regulations (NI) 2002 specify the number of parameters to be analysed from samples taken at: Customer Tap; Water Treatment Works; and Service Reservoirs; based on either the population supplied, or the volume of potable water produced;
- Water Service assesses its percentage compliance against Mandatory determinations taken either at the customer tap, or else an authorised supply point during the calendar year reported on; and
- there is a provision to have time banded authorised departures of results above the regulatory Prescribed Concentration or Value (PCV) limit for certain parameters where existing water treatment is ineffective. These time banded authorised departures are granted by the DWI, provided a planned programme of work is in place to address the water treatment effectiveness.

Target 14 – mean zonal compliance (water quality at the tap)

Parameters of target

- Mean Zonal Compliance (MZC) is a measure of compliance with Drinking Water Standards as used by the Drinking Water Inspectorate (DWI).

Measurement of target

- for any one zone, the zonal compliance for any one parameter is the percentage of samples meeting the PCV. For any parameter, mean zonal compliance is the mean of the zonal compliance values for all zones in Northern Ireland. Overall mean zonal compliance is the mean or average of the mean zonal compliance values for all parameters as defined by the DWI.

Target 15 – operational performance indicator – Turbidity, Iron and Manganese

Parameters of target

- OPITIM is the mean or average of the mean zonal compliance values for Turbidity, Iron and Manganese and is the Operational Performance Index used by the DWI.

Measurement of target

- as per Target 14 but only for Turbidity, Iron and Manganese parameters.

Target 16a and 16b – wastewater quality

Parameters of target

- target 16(a) relates to the percentage of the 287 wastewater treatment works (WWTW) whose effluent quality complies with the registered discharge standards set by EHS;
- target 16(b) relates to performance of the same WWTWs but measurement is against the population equivalent served by compliant works; and
- performance is assessed on a calendar year basis.

Measurement of target

- the Water Service Manual specifies the number of samples taken at each wastewater treatment works relating to the population equivalent served by the works. Laboratories analyse samples for those parameters included in the Registered Discharge Standard;
- compliance for each wastewater treatment works is assessed on a parameter basis using the Urban Waste Water Treatment Regulations (NI) 1995 Look-up Table. This statistically derived methodology permits a certain number of exceedances, based on the number of samples taken, for each parameter included in the Registered Discharge Standard. When this number of exceedances is surpassed a works is deemed to fail; and
- a number of wastewater treatment works have upper tier limits on the parameters included in the registered discharge standard and one exceedance of these values will result in the failure of a works. For 16(a), at the end of the calendar year the number of works which have passed is calculated as a percentage of the total number of works to determine if target met. For target 16(b), the population equivalent served by compliant works as a percentage of the total population equivalent served is calculated. The population equivalent is based on Asset management Plan figures.

Target 17 – capital works programme

Parameters of Target

- target relates to the achievement of completion dates for projects costing more than £250,000 included in the Capital Works Programme.

Measurement of target

- the target relates to schemes completed during 2006-07.

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