NIAUR

ANNUAL INFORMATION RETURN REPORTING REQUIREMENTS

AUDITORS' GUIDANCE

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CONTENTS

INTRODUCTION

The auditors' guidance to NIW has been extensively modelled on the OFWAT guidance to the auditors of water and sewage companies. The procedures are grouped by policy areas with a cross-reference to the relevant table in the Annual Information Return.

The procedures include a 'level of significance' for certain areas. This indicates the level of importance that we apply to those balances with respect to price setting.

The deadline for submitting your report to us is 31 July 2008.

PART A – GENERAL PROCEDURES

The auditor will:

1. From discussions with management and sight of underlying documentation, describe the Company's sign off procedures. Describe the nature of the underlying documentation observed.

2. For each Regulatory Table, check that the Company has complied with Definitions Manual or has included a commentary as to why the guidance has not been followed.

3. Check that management has included a commentary including an explanation for reporting requirements that do not apply to a particular company.

4. Read the Company's explanation of reporting requirements that do not apply and check details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

5. Check that the figures reported in the regulatory accounts tables 18 to 31 and 39 in the Annual Information Return agree to the underlying accounting records and the [draft/final] Regulatory Accounts.

6. Where there are subsequent changes to the regulatory accounts, compared to the submitted Regulatory Tables, the Company should write to NIAUR setting out any differences between the submitted Regulatory Tables and the finalised Regulatory Accounts and the reasons for the changes. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

7. Read the Company's response to the Regulator's queries and check that the Company's commentary is consistent with the Regulatory Accounts and the underlying accounting records.

8. The full wording of the opinion NIAUR require for the regulatory accounts for 2007 is set out in annex A. Where the company submits a set of regulatory accounts that does not contain this wording, NIAUR will not consider it to be compliant with licence condition F. The wording of the opinion NIAUR require for the Annual Information Return is set out in annex B.

9. NIAUR expect, given the timescales of submission for the Annual Information Return 2008, that information in the Annual Information Return submission and the regulatory accounts will be consistent and that auditors will be able to agree the Annual Information Return figures to the regulatory accounts. Where this is the case, we would expect auditors to issue an opinion confirming consistency of the information in the Annual Information Return and the regulatory accounts as set out in Annex B.

   If there are any material differences between the Annual Information Return submission and the regulatory accounts, these should be detailed and explained in a covering letter by the auditors.

PART B – ACTIVITY COST ANALYSIS

1. Annual Information Return tables

Information on activity costing is recorded in tables 21 and 22.

2. Background and key risks

Activity costing analysis information is used for operating cost trends analysis and for the compilation of unit costs which are published in the 'Water and sewerage unit costs and relative efficiency' report. It is also used to inform our efficiency analysis (which is reported annually in the same report) and for setting price limits. The base years are critical for price setting but we seek to understand the movements in costs on an annual basis.

Key concerns for NIAUR are:

- Financial information may have been wrongly translated into the activity types.
- Any apportionments used may not correctly reflect the relevant cost drivers.
- That we are unaware of any changes in allocation policy.
- 'Atypicals' may have been incorrectly identified.
- That we are unaware of any changes in capitalisation policy.
- Movements in provisions (both increases and decreases) may have been unexplained.
- Non-appointed costs may have been incorrectly included.

3. Procedures

The auditor will:

1. Read the Company's explanation of the procedures used to allocate costs, starting from the point where such data is extracted from the general ledger. Check that this explanation is consistent with the preparation basis of the Regulatory Table and the underlying accounting records.

2. For any judgements, apportionments or adjustments identified by management in (1), agree that these are consistent with the basis of preparation of the Regulatory Table and, where relevant, the underlying accounting records.

3. Obtain management's commentary for changes in judgements, apportionments or adjustments when compared with the prior year. Read the Company's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

4. Obtain management's commentary on all items noted as being 'exceptional' or 'atypical'. Read the Company's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. For atypical item, compare the costs in the report year with historic actual costs for that item. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

5. Obtain management's capitalisation policy which should also highlight any changes from the prior year. Read the Company's commentary and check that it is consistent with the policies applied in the Regulatory Accounts and the underlying accounting records.

6. Trace the costs relating to 'movements in provisions' (including legal provisions) to the Regulatory Accounts and the underlying accounting records.

7. Obtain management's commentary in relation to reorganisation costs which should include a brief description of what costs have been included (split between redundancy costs and pension strain etc.) along with details of when the expenditure is expected to be incurred. Read the company's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

8. To the extent not covered by Ofwat's RAG 5.04 work on transfer pricing, check if any adjustment has been made to exclude non-appointed business costs from the Regulatory Accounts Table. Agree the adjustment to the underlying accounting records and/or the Regulatory Accounts.

4. Level of significance

For the purpose of your work on these procedures, we consider the following to be significant. Auditors should bear this in mind when working on this area:

<u>All items excluding bad debt charge and atypicals</u>

The higher of:

- 1% of total opex,
- £100,000

<u>bad debt charge</u>

- 10% of the bad debt charge.

atypicals

- all costs identified by the company as atypical should be reviewed by the auditor.

5. Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Cost allocation.
- Atypicals and exceptionals.
- Provisions.
- Re-organisation costs and provisions.

PART C – PENSIONS

1. Annual Information Return tables

Information on pensions is included in tables 18, 18d, 19, 21, 22 and 24.

2. Background and key risks

Our key issues are:

1. Industry now reporting under FRS17, how are costs reported in the accounts i.e. the split between opex and interest costs in the profit and loss account and splits within tables 21 and 22.

- FRS17 charges are identified within the activity cost analysis.
- Where costs are apportioned between more than one line in tables 21 and 22, that the apportionment reflects the appropriate cost driver.
- Changes in the rates of contribution can be matched to the most up-to-date actuarial advice/valuations and trustee agreements.
- That the appointed business is picking up only its appropriate share of costs.
- That any lump sum contributions are identified.

3. Procedures

The auditor will:

1. Obtain an explanation of the procedures used to allocate costs, starting from the point where such data is extracted from the general ledger. Check that the company's explanations and, in particular the apportionments of the FRS17 charge across several lines in tables 21 and 22, is consistent with the Regulatory Accounts and the underlying accounting records.

2. Check that an adjustment has been made for employees who are outside of the appointed business.

3. Check that the amounts included for the interest cost in table 18d and the balance sheet position in tables 19 and 24 can be agreed to the Regulatory Accounts, and where relevant the pension disclosure notes provided by the company's actuary.

4. Where any apportionments are identified in (1 and 3), obtain from management a commentary identifying any changes in apportionment policy from the prior year. Agree the new basis to the basis of preparation of the Regulatory Accounts.

5. Obtain the company's commentary on the comparison of actual contributions to those set out in the final determination. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

6. Through discussions with management, comment on any changes to future contribution levels that have been agreed with the pension scheme trustees which will commence after the year-end. If changes are noted, provide details and the details of supporting documentation that was made available.

7. For defined benefit schemes, trace the level of cash contributions stated by the company to the underlying accounting records.

8. Where the company contributes to both a defined benefit and a defined contribution scheme, check the split to the underlying accounting records.

9. Trace any lump sum contribution to the underlying accounting records and the company’s commentary.

10. Obtain from the company, detail of changes in the actuarial assumptions underpinning the FRS17 valuation that have occurred since the previous year-end. Agree these assumptions to the FRS 17 report provided by the Company’s actuary.

11. Where there has been a change in the level of contributions within the year, check that management has included a commentary on the difference in the relative amount of contributions being used to fund any deficit. If changes are noted, provide details and the details of supporting documentation that was made available.

3 Level of significance

For the purpose of your work on these procedures, we consider 5% of the FRS17 operating profit charge to be significant. Auditors should bear this in mind when working on this area.

4. Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Cost allocation.
- Level of contributions.
- Comparison with amounts allowed in price limits.
- Actuarial assumptions.
- Deficit funding.

PART D – INCOME

1. Annual Information Return tables

Information on income is recorded in tables 23 (income) and 26 (for the measured income accrual).

2. Background and key risks

Understanding the difference between the business plan forecast revenues underlying the price limits and the actual income is essential to our annual monitoring process. It is critical in establishing the base position for periodic reviews. Key concerns for NIAUR are:

- That the revenue figures contain inappropriate adjustments.
- That the revenue accrual is incorrect.
- The company does not adequately or correctly explain any variances between the revenue forecasted in the Strategic Business Plan (SBP) and the actual revenue.

3. Procedures

The auditor will:

1. Read management's reconciliation and commentary of the amounts billed to the reported turnover. Where there are adjustments, (other than for the measured income accrual) management's commentary should set out whether these are one-offs for the current year or repeated. Where the adjustments occur annually, management should comment on the size of the adjustment compared to the previous year. Read the Company's commentary and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

2. Based on discussion with management and sight of underlying documentation, describe the company's procedures for monitoring revenue, including who reviews the revenues against the SBP and forecasts, the process for identification of variances and whether any sensitivity analysis takes place. Describe the nature of the underlying

documentation observed.

3. Obtain the commentary given by the Company on both revenue reported and to explain variances between the actual and forecasted revenue in the SBP. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

4. Obtain management's commentary on the basis of the measured income accrual. Read the Company's commentary and agree the accrual and supporting details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

5. Where management has calculated a retrospective review of the previous year's accrual compared to the amounts actually billed, agree the amounts reported to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation. Where management are not able to complete a retrospective review of the previous year's accrual, ensure that the company has included an explanation of the reasons for this in their commentary.

4 Level of significance

For the purpose of your work on these procedures, we consider the higher of 0.1% of turnover, or £20,000, to be significant. Auditors should bear this in mind when working on this area.

5 Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Billed vs reported turnover.
- Revenue compared to forecast.
- Measured income accrual.

PART E – BAD DEBT

1. Annual Information Return tables

Information on bad debt is recorded in tables 6a, 21 and 22 .

2. Background and key risks

The information provided is used:

- to assess the company's claims for an allowance to cover the costs associated with increased bad debt at Periodic Reviews;
- in the event of an interim determination (IDoK) involving the notified item on bad debt, to provide comparative data on which to assess the company's IDoK applications

NIAUR's key concerns are:

- In compiling table 6A data judgement may have been used inconsistently or in such a way to manipulate the data to gain advantage at an IDoK or periodic review. This will lead to an increase in bills for all customers.
- Detailed analysis per table 6A is not consistent with the regulatory accounts tables and the company's billing/financial systems.
- Levels of write-off are inconsistent with the stated write-off policy.
- Understanding the link between outstanding revenue, write-offs and charges to the P&L account.

3. Procedures

The auditor will:

General procedures

1. Obtain the Company's commentary on whether the data has been extracted directly from their billing systems or whether numbers have been manually calculated or adjusted in some way, for example to allocate data between households and non-households. Read the Company's explanation and agree details of any assumptions or apportionment stated in the basis of preparation to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

2. Trace the data to the company's accounting records/billing systems. Describe the source of the underlying accounting records or billing systems that data has been agreed to.

3. Obtain the company's commentary on any changes in reporting methodologies (for example, apportionments used in calculating outstanding revenue collection operating expenditure) from year to year and the effect this will have on the data reported in the current, past and/or future years. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

4. For any changes in methodology check that the previous years' data has been adjusted. If previous years' data has not been adjusted, discuss with management and state the company's reasons for this.

Specific procedures – revenue outstanding

5. Describe the nature of the revenue outstanding reported in lines 1 to 29 (i.e. confirm that the definition of 'revenue outstanding' as set out in the company reporting requirements has been adhered to) of the Regulatory Table 6a and state where this information has been extracted from.

6. Check that the revenue outstanding shown in these lines has been aged into the relevant time bands correctly, through agreement to underlying accounting records. Specify the details of the underlying aged debt report or other accounting records that the revenue

outstanding has been agreed to and details of sample tested.

7. Check that the company has provided explanations for any material changes (+/-20% between the report year and the previous year) in the "revenue outstanding" lines. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

8. Check that the sum of the total revenue outstanding lines (lines 1, 13, 15, 27 and 29) reconciles to the debt reported on the Company's General Ledger. If numbers do not reconcile, test the reason for the difference in management's commentary can be agreed to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

9. Check that the reasons for any adjustments made to revenue outstanding between data extracted from billing or accounting systems and that reported in the Regulatory Table can be supported by the underlying records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

10. Check that 'non-household revenue outstanding' has been correctly extracted from the Company's underlying accounting records or other supporting documentation. Describe the nature of costs that have been reported.

Specific procedures - Customer services operating expenditure

11. Obtain the Company's commentary on the basis of allocating customer services operating expenditure (between lines 32 to 36). Check that this consistent with the underlying accounting records and other supporting documentation.

12. Check that the company has provided an explanation for any material changes (+/-30% between report year and previous year) in data reported in the 'customer service operating expenditure' lines. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

13. Describe the basis of allocating outstanding revenue collection operating expenditure in line 33.

14. Check that reported numbers for household costs for outstanding revenue collection operating expenditure in line 33 can be agreed to the underlying accounting records or other supporting documentation. Obtain the Company's commentary and check that the Company has provided reasons for any material differences (+/-30% between the report year and the previous year) in each element. Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

15. Where a company has commented on a change to the methodology used to compile line 33 auditors should agree this to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

16. Trace any amount reported in line 34 (Donations to charitable trusts assisting customers in debt) to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

17. Trace line 36 to the sum of table 21 line 13 and table 22 line 12. If not, check that reasons for any difference can be agreed to the underlying accounting records or other supporting documentation. Where

applicable, describe the nature of the underlying accounting records or other supporting documentation.

18. Where the company has included an explanation of any significant exceptional capital costs associated directly with outstanding revenue collection or provision for vulnerable customers, agree these to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

Specific procedures – Interaction between charge, provision and outstanding revenue

19. Obtain a commentary from management on the bad debt provisioning policy, particularly where this has changed from the prior year. Where a change has been reported to have taken place, check that this is consistent with the Regulatory Accounts and the underlying accounting records.

20. Provide in a table the level of consistency over time between the bad debt charge (from Tables 21 and 22) and revenue outstanding (Lines, 1, 13, 15, 27 and 29 of table 6a). Through discussions with management, explain any large movements.

21. For the effect of changes in the provisioning policy (set out in management's commentary), obtain an assessment of the impact of the change and agree to supporting documentation. Describe the nature of the supporting documentation.

4 Level of significance

For the purpose of your work on these procedures, we consider the following to be significant. Auditors should bear this in mind when working on this area:

bad debt charge

- movement in the bad debt charge of +/- 10%

Write-offs

- movement in write-offs by +/- 0.1% of turnover

Revenue outstanding

- movement in revenue outstanding by +/- 1% of turnover

5 Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Revenue outstanding.
- Write-offs.
- Customer service operating expenditure.
- Interaction between charge, provision and outstanding revenue.

PART F – TAXATION

1. Annual Information Return tables

Information on tax is recorded in Tables 18a & 18b.

2. Background and key risks

Tax information is used to enable a greater understanding of company's individual tax position and the effects of recent changes to tax rules. This in turn will provide information towards policy development at the next periodic review. It will also be used to review assumptions made at the last periodic review. In the event of an interim determination (IDoK) involving the notified item on tax, this information will provide comparative data on which to assess company's IDoK applications.

NIAUR's key concerns are:

- Detailed analysis in tables 18a & 18b is not consistent with the regulatory accounts tables and the company's submissions to HMRC.
- The tax charge has not been correctly apportioned between the appointed and non-appointed business.
- The basis on which appointed business surrenders tax losses, capital allowances and other relevant tax items to group companies (if applicable) and vice versa.

3. Procedures

Both tables 18a and 18b

1. Obtain the Company's explanation of any significant variations from the estimates that underpinned the tax charges reported in the previous year. Detailed explanations and reconciliations are required to be provided by the Company in situations where:

- the difference between the current tax charge arising from the submitted computations and that reported in the relevant years' accounts is more than 10%; or
- the difference in any individual item collected in table 18a and 18b is more than 20%.

Read the Company's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

Table 18a

Complete the following procedures in relation to Table 18a (Reconciliation of Operating Profit to Taxation Charge) for the year ended 31 March 2006:

3. Check that the Company's tax information has been accurately extracted from the underlying accounting records and is consistent with the amounts included in the tax computation submitted to HMRC.

4. Read any commentary provided by management for the difference between lines 17 (Trading profit for tax) and line 18 (Adjusted trading profit for tax) and check that it is consistent with the table and, where relevant, the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

5. Check that lines 12 (Other deductions) and 15 (Other additions) correctly reflect other deductions and additions made in calculating taxable profits. Read any commentary and check that it is consistent with the Regulatory Table and, where relevant, the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

6. For deductions where management have commented on agreements with the HMRC, agree the nature of these agreements to supporting documentary evidence. Describe the nature of the supporting documentary evidence.

7. Read any commentary on the position agreements with HMRC and check that any disclosed can be agreed to supporting documentary evidence. Describe the nature of the supporting documentary evidence.

8. Check that any deduction or additions calculated are included within table 18b (Allocation of capital expenditure for tax purposes).

9. Check that the Company's reconciliation of table 18b line 6 (capitalised revenue expenditure deducted in the year of spend) to table 18a line 4 (deduction for capitalised revenue expenditure) is consistent with the

Regulatory Accounts Tables and, where relevant, the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

Table 18b

Complete the following procedures in relation to Table 18b (Allocation of Capital Expenditure for tax purposes) for the year ended 31 March 2008 when relevant:

10. Where agreements with the HRMC are disclosed by the Company for the treatment of expenditure for tax purposes, agree the nature of these agreements to supporting documentation. Describe the nature of the other supporting documentation.

11. Check that the allocations included in the table are consistent with the computations submitted to the HMRC.

12. Check that lines 1 to 11 accurately reflect the total capital programme (including IRE and net of grants) and that the types of expenditure included in each line are consistent with the company's detailed workings.

13. Check that the average asset lives reported in lines 13 and 14 are consistent with those used for depreciation purposes.

14. Check that lines 15 to 18 accurately reflect the Company's opening tax position as per the tax computation.

15. Check that total capital expenditure in line 12 is consistent with that reported elsewhere in the Regulatory Accounts Tables.

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4. Level of significance

For the purpose of your work on these procedures, we consider the following to be significant. Auditors should bear this in mind when working on this area:

The higher of:

- 10% of the current tax charge, or
- £50,000

5. Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Variations.
- Tax computations.
- Capital allowances.

PART G – ACCOUNTING CHARGES

1. Annual Information Return tables

   Information on current cost depreciation and infrastructure renewals charge is recorded in tables 33 and 34.

2. Background and key risks

   The CCD charge should reflect the long-term maintenance needs of the above-ground assets.

   Ofwat's RAG1 stipulates that IRC should be calculated so that it reflects the company's medium to long-term view of maintenance of the infrastructure assets.

   NIAUR's key concerns are:

   - That the CCD charged in the accounts may not be reflective of the long-term view, particularly where a low confidence grade has been assigned.
   - That the IRC is not compliant with RAG1.04.

3 Procedures

Current Cost Depreciation (CCD) - Table 34

1. Check that any amounts reported by the Company for assets fully depreciated still in use and assets written off or replaced in the year which were not fully depreciated can be agreed to the underlying accounting records.

2. NB. Include any specific procedures required by the Reporter in addition to 1 above.

Infrastructure Renewals Charge (IRC) - Table 33

3. Check that the Infrastructure Renewals Charge is based on an operational assessment of activity needed to maintain the serviceability of the underground infrastructure over a reasonably long period using the definitions within RAG 1.04.

4. Check that the Company's explanation for the difference between the IRC reported in the Regulatory Accounts and the Statutory Accounts can be agreed to underlying accounting records.

4 Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Infrastructure renewals charge.
- Current cost depreciation.

PART H – LAND SALES

1. Annual Information Return tables

Information on land sales is recorded in table 39.

2. Background and key risks

The table covers all proceeds from the disposals of protected land, including those already subject to regulation through Condition K of the Licence. The net amounts, after the deduction of all offsetting costs, are in an application for an interim determination, as defined in Condition B. In addition, it records HCA book values to achieve consistency with the regulatory accounts.

NIAUR's key concerns are:

- that all relevant disposals are recorded so that the correct adjustment to the Regulatory Capital Value takes place (either at an IDOK or periodic review), and
- that proceeds equal or exceed the professional valuation.

3. Procedures

1. Agree land disposals in Table 39 (Financial Measures Proceeds from the Disposals of Protected Land) to the Regulatory Accounts and that the net proceeds are internally consistent with Table 28 (disposal of fixed assets in the cash flow statement) and Table 23 (the profit/loss on disposal).

2. For each transaction above £50,000 ˜(for any transfer to an associated company) or £100k (for disposals to a third party) agree the gross proceeds on land disposals as shown in Table 39 (Financial Measures Proceeds from the Disposals of Protected Land) to valuers' certificates.

4. Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Consistency with regulatory accounts.
- Compliance with licence condition K.

PART I – ANALYSIS OF BORROWINGS

1. Annual Information Return tables

The analysis of borrowings due after more than one year is recorded in table 19a.

2. Background and key risks

Table 19a is used to gather information on the company's cost of debt which we use to cross check the cost of debt assessment made in setting price limits.

Table 19a expands upon the borrowings due after more than one year shown in the balance sheet and reported in table 19. It requires an analysis of borrowings between its component parts. The information is required as at 31 March 2008.

Borrowings falling due after one year comprises obligations under finance leases due after one year, loans due to other group companies repayable after one year (if applicable), redeemable debentures repayable after one year, bonds redeemable after one year, commercial paper due after one year, bills of exchange maturing after one year and any other form of borrowing repayable after one year. Accrued interest on borrowings should not be included.

Each instrument included within borrowings should be reported on a separate line within the table. The reporting categories are:

- Category A – Borrowings in hedging relationships;
- Category B – Borrowings designated at fair value through profit and loss; and,
- Category C – Other borrowings.

Table 19a uses definitions of borrowings in hedging relationships and those designated at fair value through profit and loss that are consistent with the FRS 26 definitions. Other borrowings includes all borrowings measured at amortised cost and all borrowings that are not designated as either fair value through profit and loss or borrowings designated within hedging relationships.

Within each category borrowings should be split between those taken out on fixed rate terms, floating rate terms and those which are index linked.

NIAUR’s key concerns are:

- that all borrowings that are due after one year are captured within the table, and

3. Procedures

The auditor will:

1. Confirm that the total carrying value of all instruments reconciles back to the appropriate line in table 19 as required by the reporting requirements of table 19a.

2. Confirm that that each instrument has been included within the correct category (A,B,C) in accordance with the definitions of FRS 26.

3. Agree the interest rates recorded in table 19a back to loan documents and other supporting documentation.

4. Agree the hedging strategy (if applicable) to supporting documentation. Describe the nature of the supporting documentation.

5. Review the company's commentary on any significant borrowings that mature in less than one year and agree the details back to supporting documentation.

4. Reporting

The auditor will provide a long form report setting the findings and commentary arising from the above procedures. This will cover at least the following areas:

- Consistency with borrowings reported as greater than 1 year in the regulatory accounts and table 19.
- Accuracy of the interest rates reported.

Wording of the regulatory accounts audit opinion

Independent auditors' report to the Northern Ireland Authority for Utility Regulation and Directors of Northern Ireland Water Limited

We have audited the Regulatory Accounts of Northern Ireland Water Limited ("the company") on pages [x] to [x] which comprise:

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet; and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements including the statement of accounting policies.

This report is made, on terms that have been agreed, solely to the company and the Northern Ireland Authority for Utility Regulation (the "Regulator") in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Department for Regional Development to Northern Ireland Water Limited as a water and sewerage undertaker under the Water and Sewerage Services (Northern Ireland) Order 2006 (the "Regulatory Licence"). Our audit work has been undertaken so that we might state to the company and the NIAUR those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation under the company's Instrument of Appointment to procure such a report and (b) to facilitate the carrying out by the NIAUR of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the NIAUR, for our audit work, for this report, or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the company. There are differences between United Kingdom Generally Accepted Accounting Principles (UK GAAP) and the basis of preparation of information provided in the regulatory accounts because the Regulatory

Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies (Northern Ireland) Order1986.

Respective responsibilities of the NIAUR, the directors and auditors

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

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

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on auditing (UK and Ireland) except as stated in the "Basis of audit opinion", below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for the classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages [X] to [X] have been properly prepared in accordance with Regulatory Accounting Guidelines. We also report to you if, in our opinion, the company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointees' accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guidelines.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the performance review, the notes on regulatory information, and the additional information required by the licence.

Basis of audit opinion

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

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

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the company (our "Statutory" audit) was made solely to the company, in accordance with the terms of our engagement letter in respect of that audit. Our Statutory audit work was undertaken so that we might state to the company those matters we are required to state to it in a Statutory auditors' report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the company as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages [X] and [X] have been drawn up in accordance with Regulatory Accounting Guidelines in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation to the balance sheet drawn up on this basis with that drawn up under Companies (Northern Ireland) Order 1986 is given on page [X].

Opinion

In our opinion the Regulatory Accounts of the company for the year ended 31 March [XX] fairly present in accordance with Condition F of the Instrument of

Appointment granted by the Department for Regional Development to Northern Ireland Water Limited as a water and sewerage undertaker under the Water and Sewerage Services (Northern Ireland) Order 2006, the Regulatory Accounting Guidelines issued by the NIAUR and the accounting policies set out on page [X], the state of the company's affairs at 31 March [XX] on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

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

(a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the Instrument;

(b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guidelines issued by the NIAUR;

(c) the regulatory historical cost accounting statements on pages [X] to [X] present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guidelines issued by the NIAUR;

(d) the regulatory current cost accounting statements on pages [X] to [X] have been properly prepared in accordance with Regulatory Accounting Guidelines issued by the NIAUR.

KPMG
Chartered Accountants
Belfast
[Date]

Wording of the Annual Information Return audit opinion

Report of the Independent Auditors to Northern Ireland Water Limited and the Northern Ireland Authority for Utility Regulation

We have audited the Regulatory Accounts tables [6a, 18 to 31, 32a, 33, 34, and 39] set out in the Annual Information Return in respect of Northern Ireland Water Limited ("the Company").

This report is made to the Company in accordance with the terms of our engagement (the "Contract"). This report is made also to the Northern Ireland Authority for Utility Regulation (the "Regulator") in order to meet the requirements of the Instrument of Appointment by the Department for Regional Development of Northern Ireland Water Limited as a water and sewerage undertaker under the Water and Sewerage Services (Northern Ireland) Order 2006 (the "Regulatory Licence") and to enable the NIAUR to verify that a report from independent auditors has been issued in connection with the Regulatory Accounts tables [6a, 18 to 31, 32a, 33, 34, and 39]. Our work has been undertaken so that we might state to the Company and to the NIAUR those matters we have been engaged by the Company to state in this report and for no other reason.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our work, for this report, or for the opinions we have formed. We will accept such responsibility to the NIAUR on condition that the NIAUR agrees in writing to the Contract by signing the notice appended to the Contract.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of the Regulatory Accounts tables. Our responsibilities, as independent auditors, are established in the United Kingdom by relevant legal and regulatory requirements and the Contract and the Accounting Guidelines and other relevant material issued by the NIAUR. It is our responsibility to form an independent opinion based on our audit, on those tables and to report our opinion to the Company and (on the basis set out above) to the NIAUR.

Basis of opinion

We conducted our audit in accordance with the Regulatory Accounting Guidelines, the Annual Information Return reporting requirements dated [ ] and other relevant material issued by the NIAUR and the Contract.

In our opinion the Regulatory Accounts tables [6a, 18 to 31, 32a, 33, 34, and 39] set out in the Annual Information Return of the company for the year ended 31 March [XX] fairly present, in accordance with Condition F of the Instrument of Appointment granted by the Department for Regional Development to Northern Ireland Water Limited as a water and sewerage undertaker under the Water and Sewerage Services (Northern Ireland) Order 2006 and the Regulatory Accounting Guidelines issued by the NIAUR, the state of the company's affairs at 31 March [XX] on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with the relevant conditions, guidelines and accounting policies.

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

(a) the information in the Regulatory Accounts tables is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guidelines issued by the NIAUR;

(b) the information in the Regulatory Accounts tables is not materially different from, and is consistent with, the regulatory financial statements.

KPMG
Chartered Accountants
Belfast
[Date]