

# **United Utilities PLC**

## **Report and Financial Statements**

31 March 2012

## Contents

Directors, advisers and other information	2
Chief Executive Officer's statement	3
Business review	6
Directors' report	34
Statement of directors' responsibilities in respect of the financial statements	37
Independent auditor's report	38
Consolidated income statement	40
Consolidated statement of comprehensive income	41
Consolidated and company statements of financial position	42
Consolidated statement of changes in equity	43
Company statement of changes in equity	44
Consolidated and company statements of cash flows	45
Accounting policies	46
Notes to the financial statements	57

## Directors, advisers and other information

### Directors

PA Aspin  
JR Houlden  
SL Mogford

### Secretary

SR Gardiner

### Auditor

KPMG Audit Plc  
St James' Square  
Manchester  
M2 6DS

### Registered office

Haweswater House  
Lingley Mere Business Park  
Lingley Green Avenue  
Great Sankey  
Warrington  
WA5 3LP

### Terms used in this report

United Utilities PLC 'UU PLC' is the intermediate holding company of the UK's largest listed water business. The 'company' means United Utilities PLC, the 'group' means United Utilities PLC and its subsidiary undertakings, 'UUG' means United Utilities Group PLC and 'UUG group' or 'United Utilities' means United Utilities Group PLC (see note 30) and its subsidiary undertakings. The 'regulated business', 'regulated activities' or 'UW' means the licensed water and wastewater activities undertaken by United Utilities Water PLC in the North West of England (see note 13).

### Cautionary statement

The Report and Financial Statements (the Report) contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this Report and the company undertakes no obligation to update these forward-looking statements. Nothing in this Report should be construed as a profit forecast. Certain regulatory performance data contained in this Report is subject to regulatory audit.

## Chief Executive Officer's statement

We are confident that our strategy and renewed focus on operational performance will enable United Utilities to create value and deliver our commitments to our customers, shareholder and the environment.

### Strategy

Following the completion of the UUG group's non-regulated disposal programme, we set out our vision of becoming a leading North West service provider and one of the best UK water and wastewater companies. We said that our enhanced focus on the regulated business will enable us to deliver further customer service and operational efficiency improvements. We aim to outperform the regulatory contract and deliver long-term shareholder value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

During the last 12 months we have continued on our journey towards achieving our vision and we are pleased to report a good set of results in what is a tough economic climate. We have delivered improved customer satisfaction in our service and we remain on course to meet our regulatory outperformance targets, with significant financing outperformance already secured.

We have continued to make high levels of capital investment in our water and wastewater assets providing further benefits for our customers, shareholder and the environment.

### Dividend

No final dividend has been recommended for the year ended 31 March 2012 (2011: £nil pence per ordinary share).

### Operational performance

Commensurate with our focus on customer service and operational performance we have continued to implement a wide range of business improvement initiatives. Our revised customer handling arrangements have led to a marked improvement in customer satisfaction, resulting in significant progress on Ofwat's service incentive mechanism. We have built on our progress last year, reducing customer complaints by over a quarter in the last 12 months and achieving our lowest ever level of referrals to the Consumer Council for Water. We are pleased with the recent progress we have made and believe there is plenty of opportunity to deliver further improvements.

We have in place key performance indicators (KPIs) to provide visibility of our operational performance in the areas of best service to customers, lowest sustainable cost and responsible manner. These measures are used across the UUG group to focus our people on targets for improvement and to demonstrate the progress being made.

### Delivering our regulatory contract

We have continued to make good progress throughout the first two years of this regulatory period and investment in our assets has remained at high levels, helping the business meet strict environmental standards and deliver an improved service for our customers. Capital expenditure in our water and wastewater business amounted to £680 million during the year, consistent with our planned investment programme over the 2010–15 period.

### Customers

During 2011/12 our household customers have benefited from an average real reduction in their water bills of 0.2 per cent, following on from a 4.3 per cent real decrease in 2010/11. Despite this reduction in average customer bills, we have continued to invest heavily in our assets in order to ensure that we can continue to provide our customers with high quality drinking water to meet all their daily needs and environmentally responsible wastewater collection and treatment.

Our water and wastewater service currently costs households just over £1 per day on average. We believe this continues to represent excellent value for money for our customers. We recognise that we need to maintain the affordability of customer bills, in what continues to be a tough economic environment, and we continue to fund our Charitable Trust, providing £5 million per year to help customers who are struggling to pay their water bills.

## Chief Executive Officer's statement (continued)

### Regulatory developments

The government published a Water White Paper 'Water for Life' in December 2011 which reaffirmed the success of the privatisation of the water industry, with companies having invested over £90 billion to maintain and improve assets, customer service and the environment. The paper highlights that the water industry needs to evolve in order to meet the challenges arising from factors such as climate change and a growing population to help ensure that high quality water is supplied reliably while remaining affordable.

We are pleased that the government recognised the need for evolutionary, rather than revolutionary, changes to the successful existing water model. We agree that a step-by-step approach to increasing competition for non-domestic customers, as outlined in the paper, is sensible provided sufficient time and effort goes into its preparation in what will represent a significant change for the industry.

We are in agreement with many of the long-term aims set out in the Water White Paper such as tackling over abstraction, water pollution, affordability and water efficiency as well as protecting water resources and the natural environment. We have been closely engaged in the dialogue with the government and its regulators on these matters and will continue to take an active part in shaping the response the sector can make to address the issues raised in the Water White Paper.

### Responsible business

The board of directors of UUG (the board) are responsible to their shareholders, customers and other stakeholders for the performance and long-term success of the UUG group. The way in which the board operates, we believe, already reflects the highest standards of corporate governance. The board continues to monitor closely new developments and requirements in this area and have updated our statement of responsible business practice, called our Business Principles, this year to ensure these standards underpin our business strategy.

The board continues to listen to the views of all stakeholders and endeavour to develop, manage and operate in an environmentally sustainable, economically beneficial and socially responsible manner. In recognition of UUG's continued focus on responsible business, UUG retained its 'World Class' rating, as measured by the Dow Jones Sustainability Index. UUG also retained its 'Platinum Plus' ranking in the Business in the Community Corporate Responsibility Index and are proud that it is one of only six FTSE 100 companies to hold both.

The communities in which we operate are of great importance to our business and we have continued our investment in these communities of the North West both financially and in terms of employee time through volunteering.

### Our employees

The people in United Utilities are key to the delivery of the highest levels of service to our customers and we would like again to thank them for their dedication and continued hard work during the year. We believe that a committed, capable and motivated workforce is central to delivering our vision and we remain fully focused on maintaining high levels of employee development and engagement.

The safety and well-being of our employees is paramount and we believe that everybody in United Utilities, collectively and individually, has a part to play in maintaining a safe working environment. Although we have seen a reduction in employee accident rates in 2011/12, there is more to do and we will continue to give this area significant focus.

On behalf of the group board, we say thank you and farewell to David Jones, who will stand down at this year's UUG annual general meeting after over seven years as a non-executive director for UUG. We wish David all the best for the future.

We are pleased to welcome Sara Weller to the group board as a non-executive director following her appointment in March. Her understanding of customer facing businesses, together with her knowledge of operating within a regulated environment, will be major assets to the board. On David's departure, Sara will take over his position as chair of the group's Remuneration Committee.

## **Chief Executive Officer's statement (continued)**

### **Outlook**

We believe that our sharp focus on customer service and operational efficiency is delivering results. The action plans being implemented are delivering efficiencies and we remain on track to meet our regulatory targets, with substantial financing outperformance already secured. The board is encouraged with our continuing progress over the first two years of the 2010–15 regulatory period and we are confident we can continue to build on this progress throughout the remainder of the period. The UUG group's capital structure remains robust and we have a sustainable dividend policy that targets real growth through to at least 2015. In the area of regulatory and political developments, we will continue to work with politicians, regulators and all key parties to represent the best interests of our stakeholders.

Steve Mogford  
Chief Executive Officer, United Utilities PLC  
1 June 2012

## Business review

### KEY PERFORMANCE INDICATORS

The group monitors a range of financial and operational key performance indicators (KPIs) to enhance the visibility of our performance and to help drive improvements.

	2011/12	2010/11
<b>Financial KPIs</b>		
Revenue	£1,564.9m	£1,513.3m
Underlying <sup>(1)</sup> operating profit	£594.1m	£596.4m
Underlying <sup>(1)</sup> profit after taxation	£266.7m	£260.4m
Regulatory capital expenditure	£680m	£608m
Gearing: net debt to regulatory capital value	59%	59%
<b>Operational KPIs</b>		
<b>Best service to customers</b>		
Serviceability <sup>(2)</sup>	1 x improving, 2 x stable, 1 x marginal	1 x marginal 3 x stable
Service incentive mechanism – qualitative (relative) <sup>(3)</sup>	16	21
Service incentive mechanism – quantitative (absolute) <sup>(4)</sup>	273	539
<b>Lowest sustainable cost</b>		
Opex outperformance (2010-15 target of at least £50m)	On track	On track
Financing outperformance (2010-15 target of at least £300m)	On track	On track
Capex outperformance (2010-15 target to meet regulatory allowance)	On track	On track
<b>Responsible manner</b>		
Leakage – rolling average annual leakage	453MI/d – Met target	464MI/d – Met target
Environment Agency performance assessment <sup>(5)</sup>	7th	6th
Dow Jones Sustainability Index rating	‘World Class’	‘World Class’

#### Notes:

(1) See pages 27 and 28 for explanation.

(2) 2011/12 ratings subject to regulatory assessment. 2010/11 ratings have been restated from ‘4 x stable’ following regulatory assessment.

(3) Performance relative to 21 water companies.

(4) Low number indicates good performance. 2011/12 number subject to regulatory audit.

(5) Performance relative to 10 water and wastewater companies and relating to 2010/11 and 2009/10, being the latest available assessments from the Environment Agency.

## Business review (continued)

### BUSINESS MODEL AND STRATEGY

#### Our industry

Water and wastewater services are provided by 21 companies to more than 50 million customers across England and Wales. There are currently 10 licensed companies which provide both water and wastewater services to customers in their respective regions. Additionally, there are licensed regional companies which provide water only services and tend to be smaller in size. As each company in the water sector operates as a regional monopoly for its services, they are subject to regulation in terms of both price and performance.

The privatisation of the industry over two decades ago has been widely perceived as a success. It has led to improvements in the quality of services provided to customers, higher environmental standards and superior quality drinking water at lower estimated costs to customers than if the water sector was still in public ownership. The water sector economic regulator, Ofwat, estimates that water bills are on average more than £100 lower per annum than they otherwise would have been. The water industry currently invests around £80 million a week in maintaining and improving assets and services.

#### The UUG group

United Utilities Group PLC is the UK's largest listed water company. The UUG group owns and manages the regulated water and wastewater network in the North West of England, through its subsidiary United Utilities Water PLC (UUG), which constitutes the vast majority of the UUG group's assets and profit. In light of this, the UU PLC group now has a single segment for financial reporting purposes.

#### Where we operate

UUG holds licences to provide water and wastewater services to a population of approximately seven million people in the North West of England. The area we cover includes the major cities of Manchester and Liverpool but also extends as far north as the Cumbrian–Scottish border and south beyond Crewe.

From Crewe to Carlisle, the company keeps the North West flowing through:

- 56,000 hectares of catchment land
- 180 reservoirs
- 94 water treatment works
- 569 wastewater treatment works
- 42,000 km of water pipes
- 76,000 km of sewer pipes
- 5,096 employees

#### Water and wastewater operations

Almost 2,000 million litres of water is supplied every day to approximately 3.2 million homes and businesses. Water is collected from catchment land and other sources and stored in reservoirs before being treated and then delivered via a network of pipes to homes and industry. A large proportion of the water supplied flows freely by gravity and does not need to be pumped, reducing energy consumption and the carbon impact on the environment.

Wastewater is collected using a network of sewers and treated before being returned safely to the environment. A by-product of the treatment of wastewater is sewage sludge, which is treated further to produce an end product suitable for safe disposal whilst providing renewable energy generation.

Our water and wastewater service currently costs households just over £1 per day on average. Over the 2010–15 regulatory period, the average annual bill will fall by £9 in real terms. We believe this represents excellent value for money, providing our customers with high quality drinking water to meet all their daily needs and for environmentally responsible wastewater collection and treatment.



## Business review (continued)

### BUSINESS MODEL AND STRATEGY (continued)

#### Our vision

Our vision is to become:

- A leading North West service provider
- One of the best water and wastewater companies

#### Our values

To achieve our vision we will operate under the following key core values:

- Customer focus - Providing services that our customers can rely on
- Integrity - Applying the highest standards of responsible business practice
- Innovation - Encouraging new ideas to make our services better, faster or cheaper

#### Our objectives

Our aim is to deliver long-term shareholder value:

- The best service to customers - Delivering excellent services to our customers by anticipating and responding to their needs
- At the lowest sustainable cost - Providing our services as effectively as possible at the lowest cost that can be sustained over the long-term
- In a responsible manner - Managing responsibly our relationship with the environment, society, local communities and our employees

We expect continued growth in our business through our extensive capital investment programme, investing to improve our networks and service.

We are confident of delivering significant efficiencies across the current 2010–15 period in order to meet and outperform the regulatory contract.

We expect to provide sustainable real growth in the UUG dividend whilst retaining a robust capital structure.

#### Our approach to doing business

The group is committed to delivering our services in a responsible way and our approach to responsible business practice is set out in our Business Principles document. This states that for the group, being a responsible business means: providing a great service to our customers; working to protect and enhance our environment; actively supporting our local communities; supporting our employees to achieve their full potential in a safe workplace; and delivering good value to our other stakeholders whilst managing our supply chain fairly.

**Customers:** Our aim is to protect public health and provide excellent services to our customers. This means removing the need for customers to contact us unnecessarily to taking ownership of queries, satisfactorily resolving them as quickly as possible and keeping our customers informed along the way. We aim to provide bills that represent good value for money.

**Environment:** Whether it's treating and delivering drinking water for our customers, or returning treated wastewater to rivers and the sea, we're acutely aware of our responsibility to the environment. We continue to invest to protect and, where appropriate, enhance the natural environment of the North West. We continue to consider the impacts of climate change on the services we deliver and adapt accordingly.

**Communities:** The communities in which we operate are of great importance to our business – it is where our customers and employees live and work. We continue to invest in our local communities both financially and through employee volunteering. We recognise the effect that our operations can have upon the community and invest in programmes that support affected areas or help tackle current social issues.

## Business review (continued)

### BUSINESS MODEL AND STRATEGY (continued)

**Employees:** Health and safety is paramount and we strongly focus on our health and safety performance. High employee engagement is a key contributor to our performance and we place significant emphasis on maintaining and strengthening levels of engagement. Our policies on maternity, paternity, adoption, personal and special leave go beyond the minimum required by law. For disabled applicants and existing employees, we are committed to fulfilling our obligations in accordance with the relevant legislation. Applicants with disabilities are given equal consideration in the application process. Disabled colleagues have equipment and working practices modified for them as far as possible and wherever it is safe and practical to do so.

**Other stakeholders:** We are committed to honouring our responsibility to UUG's shareholders, credit investors and those who provide us with goods and services. We aim to operate as effectively as possible at the lowest sustainable cost and to retain a robust and sustainable financial profile to provide enduring shareholder value. We work with suppliers whose business principles, conduct, and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, supporting us in the delivery of wider social, economic and environmental benefits. More detail on the regulatory environment in which we operate is provided on pages 9 -12.

Given the long life of our infrastructure, we take a long-term view of our operations and key to the group's strategic objectives is the goal to operate in a more sustainable manner. Sustainability is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility (CR) factors as a strategic consideration in its decision making. The UUG board-level CR committee develops and oversees our CR strategy and this continuing focus helped the UUG group retain its Dow Jones Sustainability Index 'World Class' rating and its 'Platinum Plus' ranking in the Business in the Community CR Index. Details of our responsible business performance for the year can be found on pages 17 - 28

### Competitive environment and regulation

As services in England and Wales are not provided in competitive markets, with only large business customers able to choose their supplier, the industry is heavily regulated.

### Economic regulation

Economic regulation is the responsibility of an independent body, Ofwat, whose primary duties are to protect the interests of consumers, to ensure that companies properly carry out their functions and to ensure that companies can finance their functions. As part of its periodic review, Ofwat sets limits on the average annual increase in charges that a water company can impose across each price control period (usually five years).

The regulatory capital value (RCV) of a water company is a measure of its capital base which is used when Ofwat sets price limits. Capital expenditure to enhance and maintain the network as well as inflation is added to the RCV, while depreciation is deducted.

An allowed return on the RCV is set by Ofwat to ensure water companies can secure a reasonable return on their capital in order to finance their functions. Operating costs (subject to an efficiency target), as well as depreciation and tax are added to this allowed return. In addition, adjustments depending on each company's relative performance are added or deducted to derive the allowed revenue for each water company.

Based on each company's calculated allowed revenue across the regulatory period, Ofwat publishes annual price limits in its final price determination. The price limits for each company are set by reference to inflation as measured by the retail prices index (RPI), plus an adjustment factor known as 'K'. A company's annual 'K' factor, therefore, shows the amount above or below inflation that it is allowed by Ofwat to change its price by for that financial year.

## Business review (continued)

### BUSINESS MODEL AND STRATEGY (continued)

Price cap regulation in the UK is performance-based and companies are incentivised to be efficient in terms of their operating costs, capital programmes and financing. The benefit of any efficiency savings achieved through effective management is retained by the companies for a period of five years, after which time the benefit is passed to the customers via the subsequent price setting process. The cost of any under-performance or failure to deliver specified output requirements, due to poor management is borne by the group. Companies are also incentivised to provide high standards of service and can be penalised if these standards are not achieved, primarily by means of an adjustment to the 'K' factor at the subsequent price review.

#### Our current price limits (published in November 2009)

UUW's profile of price limits for the five-year period 1 April 2010 to 31 March 2015 is set out below:

Year	2010/11	2011/12	2012/13	2013/14	2014/15
K factor	-4.3%	-0.2%	+0.6%	+1.0%	+1.2%

Ofwat's final determination of price limits for UUW was based on:

- a capital investment programme of approximately £3.5 billion;
- 12 per cent, or approximately £900 million, real growth in the RCV over the five years;
- an average annual underlying operating efficiency improvement of 1.2 per cent for the water service and 2.4 per cent for the wastewater service; and
- a return on capital of 4.5 per cent (post-tax, real).

Every year, all water companies are required to publish details of their annual financial and operational performance. Ofwat uses this information and other data to monitor and compare companies' performance both individually and relative to the other water companies across a wide range of measures. This includes key performance indicators such as Service Incentive Mechanism (SIM), Serviceability and Leakage (see page 6).

#### Environmental and quality regulation

The water and wastewater industry in the UK is subject to substantial domestic and EC regulation, placing significant statutory obligations on water and wastewater companies with regard to, amongst other factors, the quality of treated water supplied, wastewater treatment and the effects of their activities on the natural environment.

All water and wastewater companies have a general duty to exercise their powers to protect and, where appropriate, enhance the natural environment and to promote the efficient use of water. Environmental regulation is the responsibility of the Secretary of State for Environment, Food and Rural Affairs together with:

- the Environment Agency (EA), which is responsible for conserving and redistributing water resources and securing their proper use, including the licensing of water abstraction. The EA also regulates discharges to controlled waters. The EA produces a composite index, measuring the relative annual environmental performance of the 10 water and wastewater companies. This is included as one of our key performance indicators, see page 6;
- the Drinking Water Inspectorate, which enforces drinking water quality standards; and
- Natural England, which is responsible for the protection of designated sites for nature conservation, e.g. Sites of Special Scientific Interest. There is a statutory requirement to manage these sites to protect and enhance biodiversity.

Further developments in the regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive and the revised Drinking Water Directive). The impacts of the Natural Environment and Water White Papers, published in 2011, will also affect the regulatory environment in which we operate.

## **Business review (continued)**

### **BUSINESS MODEL AND STRATEGY (continued)**

#### **Competitors**

One of the UUG group's fundamental medium to long-term goals is to become the one of the best UK water and wastewater (or sewerage) companies (WaSC). The group's main competitors are the other nine WaSCs which operate across England and Wales. The group is the second largest WaSC based on regulatory capital value and it, along with the other nine companies, comprises the vast majority of the total water and wastewater sector.

Although their relative sizes are generally far smaller than the water and wastewater companies, the remaining water only companies are also important competitors as their relative performances are included in Ofwat's published comparative information.

In line with our aspiration to be a leading North West service provider, other large service providers in the region are also important companies against which to benchmark performance. In addition, as UUG is a publicly listed FTSE 100 company, the other UK and European listed utilities are competitors from an investment perspective.

#### **Direct competition**

Aside from comparative competition, there are two main forms of direct competition in the water and wastewater industry: inset appointments and water supply licensing.

An inset appointment is made when an existing undertaker is replaced by another as the supplier of water and/or wastewater services for one or more customers within its licensed area. In the last 22 years since privatisation, less than 20 inset appointments have been granted across the industry.

From 1 December 2005, water supply licensees have been able to provide both retail supply (i.e. the supply by a licensee of water purchased from a water undertaker's supply system to an eligible customer) and combined supply (i.e. the introduction of water into an incumbent water company's existing network for retail by the licensee to an eligible customer) to non-household users with an annual consumption of not less than 50 megalitres. This threshold was lowered to five megalitres a year in December 2011 following the publication of the UK Government's Water White Paper 'Water for life'. A water undertaker is obliged to allow a licensed water supplier to use its network for this purpose, subject to payment of charges and certain conditions and rights of refusal. Only one customer has changed supplier in the six years since this was implemented.

#### **Political and regulatory developments**

The Water White Paper reaffirmed the success of the privatisation of the water industry, with companies having invested over £90 billion to maintain and improve assets, customer service and the environment. The paper highlights that the water industry needs to evolve in order to meet the challenges arising from factors such as climate change and a growing population to help ensure that high quality water is supplied reliably while remaining affordable. In line with expectations, a draft Water Bill was announced in the Queen's Speech on 9 May 2012 and is due to be published before Parliament's summer recess, which commences on 18 July 2012. In addition, Ofwat published its statement of principles for the 2014 price review on 15 May 2012.

We are pleased that the government recognised the need for evolutionary, rather than revolutionary, changes to the successful existing water model. We are in agreement with many of the aims set out in this paper, such as tackling water pollution, over abstraction, affordability and water efficiency, as well as protecting water and the natural environment. Indeed, much of what we already do supports many of the government's aspirations.

## **Business review (continued)**

### **BUSINESS MODEL AND STRATEGY (continued)**

Our sustainable catchment management programme (SCAMP) is perhaps the most high profile example of how we address sustainable abstraction. This model has been adopted as best practice in the sector. We do benefit from having robust water resources in our region and continue to enhance our regional network to provide resilience to local water stress.

We have been undertaking water trading for many years, albeit on a fairly small scale, but certainly have the potential to do more within the right industry framework. In addition to our existing water trading arrangements, we are looking at further options to help other parts of the country deal with drought conditions and we have a number of connections which can be used for short periods when required. Looking ahead, there is potential to develop more cross-border export options and we are in a strong position to contribute in such a future market scenario, although we envisage the financial quantum of this to be fairly small relative to the size of the industry. However, water trading is not the sole answer to addressing drought conditions. The longer-term answer must be comprehensive and include more large capacity pipelines, enhanced storage capacity, flexible abstraction and water efficiency measures.

We believe that water companies are in a unique position to help facilitate the use of scarce water resources by customers. In the area of water efficiency, this is something we continue to focus on and United Utilities has one of the lowest per capita consumption levels in the industry. Recent measures adopted by the group include distributing shower regulators and devices to reduce flush volumes in toilets and rolling out education programmes. We believe that more can be done to promote water efficiency and the company supports the refinement of the regulatory framework to provide companies with incentives to encourage the wise use of water.

Underpinning all of this, and the plans to increase competition for non-domestic customers, is the need to retain investor confidence in the sector. This is of paramount importance and we are pleased that the strength of the current industry structure will be retained and that the historical regulatory capital value will be protected. Key issues that are currently undergoing industry consultation include possible modifications to water companies' licences and the replacement of the 'costs principle', which governs access pricing, along with Ofwat's proposed average cost to serve methodology for the retail price control. On the matter of licence modifications, we are supportive of the simple changes necessary to implement the government's decision for expanded non-domestic competition and those necessary to facilitate the 2014 review. With regard to the 'costs principle', it is important that, in order to ensure fair network access, that any parliamentary bill or act encourages only efficient entry and protects customers not eligible for competition from cross-subsidy. In respect of retail price controls, we believe it is essential that the regulator continues to take account of regional socio-economic conditions, addresses reporting inconsistencies between companies, retains the RPI inflation link and makes adjustments to reflect the number of customers that receive only water or wastewater services. We will continue with our active involvement on these issues.

### **Economic environment**

Following on from a period of recovery since the 2008/09 global financial crisis, it has been a difficult year for the UK and the wider European economy, with economic news dominated by the ongoing European debt crisis. UK gross domestic product has stagnated during 2011/12 and the equity markets experienced a highly volatile year.

In the UK, RPI inflation has been relatively high over the last couple of years, reaching as high as 5.6 per cent in September 2011. Our revenues and asset base are linked to inflation, so the high recent levels of inflation have increased our reported revenue and RCV. We also have a large quantity of index-linked debt which means our finance costs increase as inflation rises, providing a partial economic offset to revenue, although it should be noted that both revenues and financing costs are based on differing lagged measures of inflation and so do not provide a perfect hedge.

## **Business review (continued)**

### **BUSINESS MODEL AND STRATEGY (continued)**

In the North West, the unemployment rate remained above the national average, reaching 9.6 per cent for the quarter ending March 2012, compared to 8.2 per cent nationally. A report 'Department for Communities and Local Government, Indices of Deprivation 2010', published in March 2011, highlighted that the North West had more of the most deprived areas in England than any other region. As such, particularly in the current difficult economic conditions, bad debt remains a risk to which we are exposed, although Ofwat recognises this through a special factor allowance, and this continues to be a significant area of focus for us.

#### **Value drivers**

Our business continues to grow through our extensive capital investment programme, investing to improve our networks and service. Capital expenditure helps to increase our RCV, thus generating growth in the asset base of the business, upon which Ofwat allows us an appropriate return.

Operating in the North West region, the number of customers we serve is relatively stable. Whilst there will be some impact on our revenue due to changes in consumption from our metered customers, the main driver will be from the allowed change in price we charge our customers, which is determined by Ofwat's price control model (as explained in the economic regulation section on page 9).

As the price control mechanism restricts revenues, not profits, this encourages us to control or reduce our costs to the lowest possible sustainable levels with the aim of outperforming efficiency targets set by Ofwat.

Operating costs are the largest expense to the group and minimising our costs across areas such as employee costs, power, materials, property rates and service costs is important in order to add value to our group. However, minimising costs needs to be done on a sustainable basis and not to the detriment of customer service or long-term value.

In terms of financing costs, Ofwat allows all water companies an industry wide fixed return on debt over the regulatory period in order to efficiently finance their businesses. For the 2010–15 period, this was set at 3.6 per cent plus inflation (pre tax). We can generate financing outperformance by locking-in a lower cost of borrowing than this assumed rate.

It is also important for our business to perform well operationally. Ofwat can apply financial incentives or penalties depending on our performance, both absolute and relative to our peers, such as on customer service through its SIM measures. The regulator can also require us to incur additional unfunded expenditure if, for example, we are not adequately sustaining our assets or fail to meet environmental standards or targets, such as leakage.

#### **Our key performance indicators (KPIs)**

We focus on a range of financial and operational KPIs to help assess our performance. We believe that the KPIs defined below provide a rounded view as to how we are performing against our primary objectives, helping us on our path to reaching our long-term vision. These KPIs encompass the important areas of customer service and environmental performance, as well as financial indicators, taking consideration of the interests of all our stakeholders.

## Business review (continued)

### BUSINESS MODEL AND STRATEGY (continued)

#### Financial KPIs

In respect of our financial KPIs, we use underlying profit measures as these enable more meaningful comparisons of the year-on-year performance of our business.

Company objective	KPI	Definition
Growth	Revenue	A definition of revenue is included in accounting policies note c
	Regulatory capital expenditure	Total regulatory capital expenditure during the year (including infrastructure renewals expenditure)
Delivering significant efficiencies	Underlying operating profit	A definition of operating profit is included in accounting policies note a. This underlying measure excludes from the reported operating profit any restructuring costs and other significant non-recurring items. Reconciliation is shown on page 27
	Underlying profit after taxation	This measure deducts underlying net finance expense and underlying taxation from underlying operating profit. Underlying net finance expense makes adjustments to the reported net finance expense, including the stripping out of fair value movements. Underlying taxation strips out any prior year adjustments, exceptional tax or any deferred tax credits or debits arising from changes in the tax rate from reported taxation. A reconciliation between profit after taxation and underlying profit after taxation is shown on page 27
Robust capital structure	Gearing: net debt to regulatory capital value	Group net debt (including derivatives) divided by UUK's regulatory capital value (Ofwat's published RCV in outturn prices adjusted for actual capital expenditure to date)

## Business review (continued)

### BUSINESS MODEL AND STRATEGY (continued)

#### Operational KPIs

Company objective	KPI	Definition	Target
Best service to customers	Serviceability	Ofwat rates each company's assets as 'improving', 'stable', 'marginal' or 'deteriorating' across four categories covering water and wastewater infrastructure and non-infrastructure	To hold at least a stable rating for all four asset classes, which is consistent with Ofwat's target
	Service incentive mechanism – qualitative	Ofwat derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 21 water companies. Each company receives a score in the range of zero to five, with five being the highest attainable score	To move to the first quartile in the medium-term
	Service incentive mechanism – quantitative	Ofwat derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 21 water companies. Each company receives a SIM point total, where the lowest score represents the best performance	To move to the first quartile in the medium-term
Lowest sustainable cost	Opex outperformance	Progress to date on cumulative operating expenditure outperformance versus Ofwat's allowed operating costs over the 2010–15 period	Total opex outperformance over the 2010–15 period of at least £50m
	Financing outperformance	Progress to date on financing expenditure outperformance secured versus Ofwat's allowed cost of debt of 3.6% real over the 2010–15 period	Total financing outperformance over the 2010–15 period of at least £300m
	Capex outperformance	Capital expenditure progress to date against Ofwat's capital expenditure allowance for the 2010–15 period, after adjusting, through the regulatory methodology, for the impact of construction output prices	To meet Ofwat's revised capital expenditure allowance for the 2010–15 period



## Business review (continued)

### BUSINESS MODEL AND STRATEGY (continued)

#### Operational KPIs (continued)

Company objective	KPI	Definition	Target
Responsible manner	Leakage – rolling average annual leakage	Average annual water leakage from network quantified in megalitres per day	To meet our regulatory leakage target, as set by Ofwat, each year
	Environment Agency performance assessment	Composite index produced by the Environment Agency, measuring the absolute and relative performance, across a broad range of areas including pollution, of the 10 water and wastewater companies	To move to the first quartile in the medium-term
	Dow Jones Sustainability Index rating	Rating awarded to company by Dow Jones using sustainability metrics covering economic, environmental, social and governance performance	To retain UUG's 'World Class' rating each year

A table showing our KPIs for the current year and their prior year comparators can be found on page 6. Our performance and the progress we have made against our objectives and their associated KPIs are included within the performance section on pages 17 to 28.

### PERFORMANCE SUMMARY

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
<b>Continuing operations</b>		
Underlying operating profit <sup>(1)</sup>	594.1	596.4
Underlying profit before taxation <sup>(1)</sup>	361.9	358.7
Underlying profit after taxation <sup>(1)</sup>	266.7	260.4
Revenue	1,564.9	1,513.3
Operating profit	591.5	580.2
Profit before taxation	315.3	356.6
Profit after taxation	330.9	375.3

(1) Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables on pages 27 and 28.

- Further customer service improvements delivered: significantly improved Ofwat SIM scores
- Met regulatory leakage target for sixth consecutive year
- On track to meet regulatory outperformance targets
- Continued progress on capex programme: invested £680 million, an increase of 12 per cent on prior year
- Underlying operating profit of £594 million down £2 million reflecting higher infrastructure renewals expenditure
- Robust financial position: substantially repaid all term debt due in 2010-15 period

## Business review (continued)

### OPERATIONAL PERFORMANCE

United Utilities aims to deliver long-term shareholder value by providing:

- the best service to customers;
- at the lowest sustainable cost;
- in a responsible manner.

Operational performance and customer service are top priorities for United Utilities and the group aims to deliver significant improvements in these areas and outperform its regulatory contract. The business has a range of key performance indicators (KPIs) to enhance the visibility of its performance and help drive improvements.

Supporting our drive to improve operational performance, a revised management structure was put in place earlier in the year with a strong focus on accountability and delivery. The group has moved, from its previous functional structure, to an organisational structure and managers are now responsible for end to end delivery of capital projects and operational performance within their respective regions, providing a more integrated approach. This revised management structure is now well embedded in the business and is helping to deliver performance improvements. A 'whole company' scorecard has also been introduced and short-term incentives are now more directly aligned with operational performance. Long-term incentives are aligned with our shareholder's and customers' interests, being linked to the UUG group's total shareholder return and regulatory outperformance.

#### Best service to customers

##### Actions:

**Customer initiatives** – We established a customer experience programme last year to help understand better the needs and issues of our customers and this is already delivering improvements in the levels of customer service we are providing. We offer additional contact options for customers, such as an online account management facility, to provide more choices as to when and how they can contact us. Staff availability has been extended, coupled with an online call back facility. A priority is to improve customer data management to ensure this provides a single view of the customer to help improve the efficiency and quality of service. We have focused on root cause analysis to help us understand better the reasons for customers contacting us. Supporting this customer experience programme, we increased staff training, better aligned staff incentive mechanisms, put new service level arrangements in place and we proactively contact customers to keep them informed of progress in respect of their enquiries. We have extended our focus to identifying potential customer queries in advance, through, for example, more proactive exception billing reporting and contacting the customer before the bill is sent to discuss the matter. Operationally, we are aiming for prompt completion of jobs and, where practicable, via a single visit, to improve the customer experience and reduce the need for unnecessary calls. We are also making ongoing improvements to our processes based on customer feedback.

We have made a significant improvement in our performance on Ofwat's service incentive mechanism (SIM), reflecting our increased focus on dealing with customer enquiries. The number of customer complaints made to the Consumer Council for Water (CCW) has reduced by 27 per cent in 2011/12, compared with last year, following a similar improvement in the previous year. This represents a reduction of close to a half in the number of complaints to the CCW over the last two years. We have also substantially reduced the number of escalated complaints assessed by the CCW in 2011/12, with zero assessments in several months of the year. This has helped United Utilities improve its quantitative SIM performance by 49 per cent in 2011/12, compared with 2010/11. This follows a similar significant improvement of more than 40 per cent in 2010/11, versus the indicative score for 2009/10. United Utilities has also moved up five places into the third quartile on qualitative SIM for 2011/12, representing the joint best improvement of the 21 water companies in the year. Encouragingly, we delivered continued improvement in the second half of the year on both SIM measures providing a strong platform from which to build in the forthcoming year. Improving customer service remains a significant area of continued management focus and we see plenty of opportunity to deliver further improvements.

## Business review (continued)

### OPERATIONAL PERFORMANCE (continued)

**Safe, clean drinking water** – We have an action plan to maintain safe, clean drinking water through improving the robustness of our water treatment processes, refurbishing service reservoir assets, ongoing mains cleaning and optimising water treatment to reduce discoloured water events. United Utilities continues to supply a high quality of drinking water, with a mean zonal compliance water quality performance of 99.95 per cent.

**Water supply and demand balance** – To help ensure a continuous water supply to our customers, our action plan includes innovation and investment in remote monitoring to better manage and control the group's water supply system. We also have investment projects to optimise water pressures and improve network resilience. In addition, we are improving our response to burst mains to help keep the water flowing, supported by 'wet' repairs to water mains where the supply remains on through the repair process. United Utilities completed the West East Link in 2011/12, a significant capital project designed to improve further the water supply and demand balance in its region and enhance network resilience to climate change. In addition, our reservoir levels are robust and in line with typical levels for this time of year.

**Wastewater** – United Utilities has a range of actions to help support the serviceability of its wastewater assets. To help reduce sewer flooding, these actions include incident based targeting to focus on areas more likely to experience flooding, effective intervention in cleaning and rehabilitation or refurbishment of sewers and advising customers about items not suitable for sewer disposal. The plan also includes an improved approach to risk assessment to identify and reduce the risk profile of the group's wastewater treatment works.

#### Key performance indicators:

**Serviceability** – Long-term stewardship of assets is critical and Ofwat measures this through its serviceability assessment (Ofwat defines serviceability as the capability of a system of assets to deliver a reference level of service to customers and to the environment now and in the future). Ofwat currently assesses one asset class (wastewater non-infrastructure) as 'improving' and two asset classes (water infrastructure and water non-infrastructure) continue to be rated 'stable'. United Utilities is currently assessed by the regulator as 'marginal' in respect of wastewater infrastructure and the company is implementing an action plan to return this asset class back to a 'stable' rating. The aim is to hold at least a 'stable' rating for all four asset classes, which is aligned with Ofwat's target.

**Service incentive mechanism (SIM)** – United Utilities improved its quantitative score for 2011/12 by 49 per cent, compared with 2010/11, to 273 points. This follows an improvement of over 40 per cent in the previous year. On the qualitative measure, United Utilities has improved its 2011/12 score by 0.39 points to 4.18 points and has moved up five places into 16th position (out of 21 water companies). This represents sixth position when compared with the 10 water and sewerage companies. This early progress is encouraging and the aim is to move to the first quartile in the medium-term.

#### Lowest sustainable cost

##### Actions:

**Asset optimisation** – Our asset optimisation programme continues to progress well, providing the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power (CHP) assets to improve energy efficiency. The implementation phase is well underway at over half of the 30 sites covered by the programme and a large number of schemes came on line in 2011, with further projects being scoped. The optimisation programme is targeting approximately £9 million of annual savings by 2013/14.

## Business review (continued)

### OPERATIONAL PERFORMANCE (continued)

**Proactive asset management** – We are continuing to introduce a more proactive approach to asset and network management, with the aim of improving our modelling and forecasting to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving efficiency and customer service.

**Power costs** – United Utilities has substantially locked in the cost of its power requirements through to 2014/15, via hedging, securing outperformance. Power unit costs for 2011/12 were similar to the prior year and approximately 20 per cent lower compared with 2009/10. Although power unit costs beyond 2011/12 have been secured at higher levels than those for 2011/12, this still delivers additional outperformance versus the regulatory contract.

**Debt collection** – We are adopting a more proactive approach to debt collection and have delivered another good performance in the year. We are implementing a detailed action plan, which includes enhancing systems to improve customer segmentation analysis and to obtain better data on customers who have changed address, coupled with a more proactive debt follow up strategy. To support this, a proportion of our debt collection function which was previously off-shored has been brought back in-house and this has helped improve our debt collection performance. Bad debts as a proportion of regulated revenue improved from 2.5 per cent in 2009/10 to 2.1 per cent in 2010/11. The North West faces a particularly tough economic environment with unemployment having increased at a faster rate than any other UK region in 2011/12, particularly in the second half of the year. Despite this, we have again delivered a good performance with bad debts standing at 2.2 per cent of regulated revenue for 2011/12. Debt collection will remain a significant area of focus for the business.

**Lean principles** – Supporting the group's efficiency drive is its lean principles approach to doing business. Systems and processes continue to be streamlined and the business is rationalising its infrastructure and has in-sourced its IT provision to provide greater control of its IT assets and applications.

**Pensions** – The group placed its pension provision on a more sustainable footing in 2010 and has subsequently taken additional steps to de-risk the pension schemes further. An inflation funding mechanism has been introduced, which has facilitated a move to a lower risk investment strategy with the proportion of pension assets invested in equities or other high risk assets now reduced to around 25 per cent. More prudent longevity assumptions have also been recently introduced. Further details on the group's pension provision are provided in the pensions section on page 26.

**Capital delivery** – The business is strongly focused on delivering its commitments efficiently and on time. We utilised previous experience to improve the terms and conditions of our supplier contracts and have a robust commercial capital delivery framework in place for the 2010–15 period. Contractor performance is aligned with the group's business plan through appropriate incentive arrangements. In addition, the business has introduced a more disciplined approach to spend and outputs through a Time: Cost: Quality index (TCQi). This enhances the capital investment governance process and provides a sharper focus on the delivery of commitments, with a direct link to the executive remuneration scheme. The TCQi performance score has improved from around 50 per cent last year to over 80 per cent for 2011/12 and the company's long-term goal is to achieve over 90 per cent. Regulatory capital investment in 2011/12, including £154 million of infrastructure renewals expenditure, was £680 million, an increase of 12 per cent compared with last year. United Utilities has now delivered approximately £1.3 billion of capital investment in the first two years of the 2010–15 period. This spend is broadly in line with the regulatory allowance, after adjusting for the construction output price index (COPI) which is consistent with Ofwat's methodology. Good progress in the delivery of outputs has also been achieved in the early part of the new regulatory period, reflecting a smoother and more efficient investment profile than that experienced in the 2005–10 period. We expect regulatory capital expenditure to be around £700 million in the 2012/13 financial year, consistent with our five-year programme.

## Business review (continued)

### OPERATIONAL PERFORMANCE (continued)

**Sludge processing** – A new £100 million sludge processing centre is being developed at the group's Davyhulme wastewater treatment works in Manchester. Sludge will arrive from seven feeder treatment works and will be processed using advanced thermal hydrolysis technology. The new facility will provide a range of benefits including energy self-sufficiency for the whole site, greater sludge disposal flexibility, with a wider choice of land disposal due to the advanced stage of the treated product, and improved sludge condition to enhance the efficiency of incineration. There will also be the option to pump the treated sludge to United Utilities' Shell Green sludge processing centre in Widnes.

**Private sewers** – The ownership of, and responsibility for, private sewers was transferred to the wastewater companies in England and Wales from 1 October 2011. We have been preparing for this for some time resulting in a smooth transition. The number of customer contacts, the increase in work volumes and the level of expenditure, thus far, has been a little below initial expectations. In addition, the mix of work has been slightly different to that initially anticipated, with a greater proportion of expenditure relating to enhancement capex, as we undertake investigations and remedial work on these newly acquired assets. As we have evolved our operating model, we have seen an increasing proportion of work relating to enhancement expenditure as we have progressed through the period since 1 October. We are attaining better asset information and, in addition to jetting and cleaning activity, we are undertaking remedial work to improve and, where appropriate, enhance the quality of the infrastructure, to bring it more in line with United Utilities' asset standards and to reduce the risk of future problems for our customers. This is all consistent with our drive to deliver good customer service, where we aim to complete the job efficiently and effectively and in a single visit where practicable. We have also experienced lower levels of operating expenditure and infrastructure renewals expenditure (IRE) than anticipated. In the second half of 2011/12, operating expenditure was £6 million and capital expenditure was £15 million, of which £9 million was IRE. This has also resulted in a positive impact on operating profit in the second half of 2011/12. In light of this, we have outlined a revision to the level and mix of our cost estimates for the period October 2011 to March 2015. This reduces our total estimate for operating expenditure by £15 million to around £40 million, with a £5 million reduction in total capital expenditure to around £120 million. Importantly, the mix is now expected to be more evenly split between IRE and enhancement capital expenditure, reflecting experience over the last few months, with a revised estimate of £60 million for each of these expenditures categories. This lower rate of spend is positive for customers as it should be beneficial to bills at the next price review and, alongside this, we are raising asset standards. It is also beneficial for the UUG group's investors, as costs are lower, a greater proportion of spend should be recoverable and we have the opportunity for additional growth in the regulatory capital value. We are still early into the transfer and will continue to review these cost estimates based on the levels and type of workload and activity experienced and will provide updated forecasts as appropriate.

### Key performance indicators:

**Financing outperformance** – United Utilities has secured over £300 million of financing outperformance across the 2010–15 period, when compared with Ofwat's allowed cost of debt of 3.6 per cent real, based on an average RPI inflation rate of 2.5 per cent per annum. Should average RPI inflation outturn at 3.5 per cent per annum across the five-year period, this would increase financing outperformance to around £400 million, net of the impact of the pensions inflation funding mechanism. United Utilities agreed a £200 million index linked loan with the European Investment Bank (EIB), drawn down between March and May 2011, at an average real interest rate of 1.2 per cent, which secures financing outperformance of around £20 million through to 2015. Subsequently, a further £200 million index-linked loan facility was agreed with the EIB and was drawn down in a number of tranches between November 2011 and March 2012 at an average interest rate of 0.9 per cent real. This is the best rate United Utilities has secured and generates further outperformance of over £15 million through to 2015.

## Business review (continued)

### OPERATIONAL PERFORMANCE (continued)

**Operating expenditure outperformance** – The business is targeting total operating expenditure outperformance over the 2010–15 period of at least £50 million, or approximately two per cent, compared with the regulatory allowance. This is in addition to the base operating expenditure efficiency targets set by Ofwat, which equate to a total of approximately £150 million over the five years. United Utilities is on track to meet its five-year target and has now delivered cumulative operating expenditure outperformance of over £20 million in the first two years of the regulatory period.

**Capital expenditure outperformance** – United Utilities is delivering significant efficiencies in the area of capital expenditure and expects to meet Ofwat's allowance after adjusting, through the regulatory methodology, for the impact of lower construction output prices. Capital expenditure and the delivery of outputs remain on track.

### Responsible manner

#### Actions:

##### Environment

**Leakage management** – The performance of the business in meeting its regulatory leakage target for 2010/11 was excellent, given the extreme winter weather, and United Utilities was one of only four water and sewerage companies to meet its regulatory leakage target in that year. This reflected strong year-round operational focus on leakage, an approach which we continued through 2011/12 and United Utilities has now met its leakage target for the sixth consecutive year. To help customers protect their homes in winter and prevent leakage from their own pipes, we undertook a customer awareness campaign and distributed over 100,000 advice packs.

**Environmental performance** – This is a high priority for the group and United Utilities has more than halved the number of major pollution incidents over the last few years. Wastewater treatment works compliance remains high at over 98 per cent, a slight improvement compared with the previous year. United Utilities is working more closely with the Environment Agency (EA), through its agreed protocol, to help minimise the occurrence and environmental impact of pollution incidents. This includes the sharing of resources, knowledge and expertise. The group is also enhancing its telemetry and flow monitoring equipment to provide early identification of incidents to enable prompt action to be taken to minimise the potential impact. Recognising that environmental performance is wide-ranging, the group is measuring itself against an EA composite measure as detailed in the key performance indicators below.

**Sustainable catchment management programme** – United Utilities owns over 56,000 hectares of land in the North West which it holds to protect the quality of water entering its reservoirs. The group has developed a sustainable catchment management programme which will help to protect and improve water quality and enhance biodiversity.

**Renewable energy** – United Utilities has a detailed carbon and renewable energy plan, which both contributes to sustainability and reduces costs. We are on track to meet our target of a 21 per cent reduction in carbon emissions by 2015 (measured from a 2005/06 baseline). Emissions in 2011/12 were 522,003 tonnes of carbon dioxide equivalent, a reduction of nine per cent on last year. We are now 13 per cent below our baseline position. United Utilities has consistently generated over 100 GWh of renewable electricity annually for the past three years, principally from sludge processing, with renewable energy equating to approximately 14 per cent of the group's total electricity consumption. United Utilities also reduced its energy purchases by over 20 GWh in 2011/12. The group has plans in place to increase renewable energy generation to 125 GWh per annum by 2015.

## Business review (continued)

### OPERATIONAL PERFORMANCE (continued)

#### Employees

We continue to be successful in attracting and retaining people and in achieving UK high performing levels of employee engagement. We have, over a period of 12 months, delivered much more training of a higher standard and at the same time reduced the associated cost. This year we delivered 24,000 days of training to employees, of which more than 6,700 days were health and safety related. In addition, over 300 employees have been supported through a wide range of further education courses. We currently have 80 apprentices and plan to recruit up to a further 40 apprentices each year through to 2015. We have also re-energised our graduate recruitment programme and in 2012 expect to recruit up to 20 graduates. The past year has seen us strengthen our focus on improving health and safety, with a programme led by the group's executive team. This has helped reduce our accident frequency rate for employees from 0.386 accidents per 100,000 hours worked in 2010/11, to 0.215 accidents per 100,000 hours worked in 2011/12. More detail is provided in the UUG group's annual CR report. Health and safety performance will continue to be a significant area of focus for the group, as we strive to improve our performance further.

#### Communities

We actively support our local communities and we have a number of community partnerships to help us engage with the people in our region. This year we have increased the number of partnerships that address social issues in our region, such as education, water efficiency and employability skills. We understand the impact we can have on the communities where we operate and undertake capital projects so we seek to work with those communities to leave a positive legacy after our projects have been delivered. We have continued our award winning 'United Futures' programme with our partner, Groundwork, to help regenerate neighbourhoods after we have finished our work there. In addition, we have expanded our innovative 'Community Fund' where local community groups are invited to apply for small scale grants to support their work. During the year, we have contributed approximately £2 million supporting our local communities, providing debt advisory services and over 19,000 hours volunteered by our employees.

#### Key performance indicators:

**Leakage** – United Utilities met its economic level of leakage rolling target for the sixth consecutive year in 2011/12, with a performance of 453 megalitres per day versus the regulatory target of 464 megalitres per day. The aim is to meet our regulatory leakage target each year.

**Environmental performance** – The EA computes a composite measure which incorporates a broad range of areas including pollution. United Utilities improved to a mid-ranking position for 2009/10 improving from its position in 2008/09, when it was ranked tenth out of ten water and sewerage companies. The group has reduced further the number of major pollution incidents and this has contributed to an improved performance score for 2010/11 (the latest assessment available) and United Utilities retains a mid-ranking position. United Utilities aims to move from this average relative position to the first quartile in the medium-term.

**Corporate responsibility** – The group has a strong focus on corporate responsibility and UUG is the only UK water company to have a 'World Class' rating as measured by the Dow Jones Sustainability Index. The group aims to retain this 'World Class' rating each year.

## Business review (continued)

### FINANCIAL PERFORMANCE

#### Revenue

United Utilities has delivered a good set of financial results for the year ended 31 March 2012. Revenue increased by £52 million to £1,565 million, principally reflecting a 4.5 per cent nominal (0.2 per cent real price decrease plus 4.7 per cent RPI inflation) regulated price increase, partially offset by the ongoing impact of customers switching to meters and lower commercial volumes. The impact of meter switching was in line with our expectations, although commercial volumes were lower than expected, particularly in the second half of the year when the North West experienced an increase in unemployment. We would expect to recover the majority of this revenue shortfall through the regulatory methodology at the next price review.

#### Operating profit

Underlying operating profit decreased slightly by £2 million to £594 million, primarily as a result of increases in infrastructure renewals expenditure, depreciation and property rates, the impact of the transfer of private sewers and the new carbon reduction commitment charge, largely offset by the increase in revenue. Reported operating profit rose by two per cent to £592 million, as last year was impacted by one-off restructuring costs of £16 million which reduced operating profit in the prior period.

#### Investment income and finance expense

Investment income and finance expense of £276 million was £53 million higher than last year, principally reflecting £43 million of net fair value losses on debt and derivative instruments, compared with £19 million of net fair value gains in 2010/11. The £43 million net fair value loss in the period is largely due to losses on the regulatory swap portfolio resulting from a significant decrease in sterling interest rates during the period. The group uses these swaps to effectively fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by the regulator at each price review. The group has continued to benefit from fixing the majority of its remaining debt for the 2010–15 financial period, providing a net effective nominal interest rate of approximately five per cent. Partially offsetting these losses, there has been a net fair value gain during the period due to widening credit spreads in the market, affecting the fair value of our fair value option debt.

The indexation of the principal on index-linked debt amounted to a net charge in the income statement of £100 million, compared with a net charge of £103 million last year. This reflected lower RPI inflation in respect of the group's index-linked debt with a three month lag. This reduction was primarily offset by additional finance expense relating to the £400 million index-linked loan facilities provided by the European Investment Bank (EIB), which were drawn down in various tranches between March 2011 and March 2012. The first £200 million of facilities were drawn down at an average real interest rate of 1.2 per cent, with the second £200 million at 0.9 per cent, the lowest rate the group has achieved to date. The indexation charge does not represent a cash flow and is more than matched by an inflationary uplift to the regulatory capital value. The group had approximately £2.7 billion of index-linked debt as at 31 March 2012.

#### Profit before taxation

Underlying profit before taxation was £362 million, £3 million higher than last year. This underlying measure adjusts for the impact of one-off items, principally from restructuring and reorganisation within the business, and fair value movements in respect of debt and derivative instruments. Reported profit before taxation decreased by 12 per cent to £315 million, primarily as a result of net fair value losses on debt and derivative instruments.



## **Business review (continued)**

### **FINANCIAL PERFORMANCE (continued)**

#### **Taxation**

The current taxation charge was £61 million in the year and the current taxation effective rate was 19 per cent, compared with 12 per cent in the previous year. The current year charge includes a £10 million credit following agreement with the UK tax authorities of prior years' taxation matters, without which the effective rate would have been 22 per cent.

The group has recognised a net deferred taxation credit of £77 million for the year. This includes a £105 million credit, of which £50 million had already been recognised in first half of 2011/12, relating to the changes substantively enacted by the UK Government to reduce the mainstream rate of corporation taxation from 26 per cent to 24 per cent from 1 April 2012. A net deferred taxation credit of £99 million was also recognised in 2010/11, to reflect a similar two per cent staged reduction in the rate of corporation taxation.

An overall taxation credit of £16 million has been recognised for the year ended 31 March 2012. Excluding the impact of the reduction in the corporation taxation rate and the impact of the prior year taxation adjustments, the total taxation charge would be £83 million or 26 per cent compared with an £98 million charge or 27 per cent last year.

The taxation benefit of £33 million relating to pension contributions for deficit funding has been recorded in the statement of comprehensive income, rather than the income statement, as the actuarial movements giving rise to the deficit were previously recorded there. Associated deferred taxation movements of £29 million are also included in the statement of comprehensive income. The group made a net cash taxation payment during the year of £5 million, primarily reflecting the £35 million cash taxation inflow relating to prior years' taxation matters, which largely offset the cash taxation paid in the year. In the previous year, the group's net taxation payment was £47 million.

#### **Profit after taxation**

Underlying profit after taxation was £267 million. This is based on the underlying profit before taxation figure less an underlying taxation charge of £95 million, which includes an adjustment for the deferred taxation credit in relation to the change in the mainstream rate of corporation taxation and the credit relating to prior years' taxation matters. Reported profit after taxation, from continuing operations, was £331 million compared with £375 million last year.

#### **Cash flow**

Net cash generated from continuing operating activities for the year ended 31 March 2012 was £493 million, compared with £768 million last year. This decrease is mainly due to a £232 million increase in the amount owed by UUG, included within the £241 million increase in trade and other receivables. The group's net capital expenditure was £502 million, principally in the regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under International Financial Reporting Standards.

Net debt including derivatives at 31 March 2012 was £5,109 million, compared with £4,809 million at 31 March 2011. This expected increase reflects expenditure on the regulatory capital investment programmes and payments of interest, alongside the accelerated pension deficit repair payment, partly offset by operating cash flows.

## Business review (continued)

### FINANCIAL PERFORMANCE (continued)

#### Debt financing and interest rate management

Gearing (measured as group net debt divided by United Utilities Water PLC's regulatory capital value adjusted for actual capital expenditure) remained flat at 59 per cent at 31 March 2012, compared with the position at 31 March 2011, and remains comfortably within Ofwat's 55 per cent to 65 per cent assumed gearing range. This is the net effect of three main factors: indexation of the principal of the group's index-linked debt, the accelerated pension deficit repair payment and growth in the regulatory capital value. The group's pensions deficit has reduced to £92 million, on an accounting basis, compared with a deficit of £195 million at 31 March 2011. Taking account of this small deficit, and treating it as debt, gearing increases slightly to 60 per cent.

At the year end, United Utilities Water PLC had long-term credit ratings of A3/BBB+ and United Utilities PLC had long-term credit ratings of Baa1/BBB- from Moody's Investors Service and Standard & Poor's Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies.

Cash and short-term deposits at 31 March 2012 amounted to £321 million. Between March and May 2011, United Utilities Water PLC drew down a £200 million index-linked loan facility with the EIB. The group also renewed £150 million of bank facilities during 2011/12. In addition, in November 2011, United Utilities Water PLC agreed a further £200 million index-linked loan facility with the EIB which was drawn down between then and March 2012. United Utilities has headroom to cover its projected financing needs into 2014.

The group has access to the international debt capital markets through its €7 billion euro medium-term note programme which provides for the periodic issuance by United Utilities PLC and United Utilities Water PLC of debt instruments on terms and conditions determined at the time the instruments are issued. The programme does not represent a funding commitment, with funding dependent on the successful issue of the debt securities.

Long-term borrowings are structured or hedged to match assets and earnings, which are largely in sterling, indexed to UK retail price inflation and subject to regulatory price reviews every five years.

Very long-term sterling inflation index-linked debt is the group's preferred form of funding as this provides a natural hedge to assets and earnings. At 31 March 2012, approximately 52 per cent of the group's net debt was in index-linked form, representing around 31 per cent of United Utilities Water PLC's regulatory capital value, with an average real interest rate of 1.7 per cent. The long-term nature of this funding also provides a good match to the group's long-life infrastructure assets and is a key contributor to the group's average term debt maturity profile which is approximately 25 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, to manage exposure to long-term interest rates, the debt is generally swapped to create a floating rate sterling liability for the term of the liability. To manage exposure to medium term interest rates, the group fixed interest costs for a substantial proportion of the group's debt for the duration of the 2010-15 regulatory period at around the time of the price review.

Following the 2009 price review, the group re-assessed its interest rate hedging policy with a view to further reducing regulatory risk. To help address the uncertainty as to how Ofwat may approach the setting of the cost of debt allowance at the next price review in 2014, United Utilities has revised its interest rate management strategy to extend its fixed interest rate hedge out to a 10-year maturity on a reducing balance basis. The intention is to extend the interest rate hedge each year to eventually achieve a 10-year rolling average interest rate on the group's nominal debt. United Utilities believes that this revised interest rate hedging policy, which provides for a longer fixing of interest rates, will put the group in a more flexible position to respond to whatever approach Ofwat adopts to the industry cost of debt in future.

## **Business review (continued)**

### **FINANCIAL PERFORMANCE (continued)**

#### **Liquidity**

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits. The group has a €2 billion euro-commercial paper programme and further liquidity is provided by committed but undrawn credit facilities.

In line with the UUG board's treasury policy, United Utilities aims to maintain a robust headroom position. Available headroom at 31 March 2012 was £581 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover the group's projected financing needs into 2014.

United Utilities believes that it operates a prudent approach to managing banking counterparty risk. Counterparty risk, in relation to both cash deposits and derivatives, is controlled through the use of counterparty credit limits. United Utilities' cash is held in the form of short-term (generally no longer than three months) money market deposits with prime commercial banks.

United Utilities operates a bilateral, rather than a syndicated, approach to its core relationship banking facilities. This approach spreads maturities more evenly over a longer time period, thereby reducing refinancing risk and providing the benefit of several renewal points rather than a large single refinancing requirement.

#### **Pensions**

As at 31 March 2012, the group had a net retirement benefit, or pension, deficit of £92 million, compared with a net pension deficit of £195 million at 31 March 2011. This £103 million positive movement principally reflects payment of the £100 million accelerated deficit repair contribution.

The group has sought to adopt a more sustainable approach to the delivery of pension provision and in advance of the start of the 2010–15 regulatory period amended the terms of its defined benefit pension schemes, the details of which were included in the 2010 annual report and financial statements. United Utilities also reduced its future pension obligations as a result of the sale of non-regulated activities.

The group stated previously that it would continue to evaluate its pensions investment strategy to de-risk further its pension provision and introduced an inflation funding mechanism (the details of which were included in the 2011 report and financial statements), which facilitates a move to a lower risk investment strategy. This has allowed United Utilities to reduce the allocation of its pension assets to 25 per cent in equities and other high risk assets, from 34 per cent at 31 March 2011. In addition, United Utilities has adopted the use of more prudent longevity assumptions. The group has also increased its interest rate hedge to around 65 per cent of pension scheme liabilities. Although any additional payments under this mechanism would reduce financing outperformance, there would be a positive benefit to the pensions surplus or deficit position.

From an accounting perspective, IAS 19 treats the inflation funding mechanism as a schedule of contributions rather than a pension scheme asset. This means that the liabilities position can change to reflect a change in market expectations of long-term inflation, without a commensurate movement in assets. The change in inflation has decreased the present value of the liabilities during the year to 31 March 2012. This accounting treatment means that there is likely to be a degree of volatility in future IAS 19 pension valuations.

Further detail is provided in note 19 ('Retirement benefit obligations') of these consolidated financial statements.

## Business review (continued)

### FINANCIAL PERFORMANCE (continued)

#### Underlying profit

In considering the underlying results for the period, the directors have excluded fair value movements on debt and derivative instruments and one-off items. Reported operating profit and profit before taxation from continuing operations are reconciled to underlying operating profit, underlying profit before taxation and underlying profit after taxation (non-GAAP measures) as follows:

	Year ended 31 March 2012	Year ended 31 March 2011
	£m	£m
<b>Operating profit</b>		
Operating profit per published results	591.5	580.2
One-off items <sup>(1)</sup>	2.6	16.2
Underlying operating profit	594.1	596.4
<i>Net finance expense</i>	£m	£m
Finance expense	(315.5)	(255.9)
Investment income	39.3	32.3
Net finance expense	(276.2)	(223.6)
Net fair value losses/(gains) on debt and derivative instruments	43.2	(19.2)
Adjustment for interest on swaps and debt under fair value options	7.2	5.7
Adjustment for net pension interest expense	3.3	3.8
Adjustment for capitalisation of interest costs	(9.7)	(4.4)
Underlying net finance expense	(232.2)	(237.7)
	£m	£m
<b>Profit before taxation</b>		
Profit before taxation per published results	315.3	356.6
One-off items <sup>(1)</sup>	2.6	16.2
Net fair value losses/(gains) on debt and derivative instruments	43.2	(19.2)
Adjustment for interest on swaps and debt under fair value option	7.2	5.7
Adjustment for net pension interest expense	3.3	3.8
Adjustment for capitalisation of interest costs	(9.7)	(4.4)
Underlying profit before taxation	361.9	358.7
<b>Profit after taxation</b>	£m	£m
Underlying profit before taxation	361.9	358.7
Reported taxation	15.6	18.7
Deferred taxation credit – change in taxation rate	(104.6)	(99.0)
Agreement of prior years' UK taxation matters	5.9	(17.4)
Taxation relating to underlying profit before taxation adjustments	(12.1)	(0.6)
Underlying profit after taxation	266.7	260.4

(1) Principally relates to restructuring and other reorganisation costs within the business.

## Business review (continued)

### FINANCIAL PERFORMANCE (continued)

#### Underlying operating profit reconciliation

2011/12 is the first year in which the group has presented the consolidated financial statements as a single segment and therefore the table below provides a reconciliation between group underlying operating profit and United Utilities Water PLC historical cost regulatory underlying operating profit (non-GAAP measures) as follows:

	Year ended 31 March 2012 £m
<b>Continuing operations</b>	
<b>Underlying operating profit</b>	
Group underlying operating profit	594.1
Underlying operating profit not relating to United Utilities Water	(10.9)
Infrastructure renewals accounting	40.2
Other differences	(3.9)
	<hr/>
United Utilities Water statutory underlying operating profit	619.5
Revenue recognition	2.6
Infrastructure renewals accounting	(2.5)
Non-appointed business	(7.0)
	<hr/>
United Utilities Water regulatory underlying operating profit	612.6
	<hr/> <hr/>

### PRINCIPAL RISKS AND UNCERTAINTIES

We manage risk through our corporate risk management framework. As part of this, we maintain a process that regularly assesses the nature and magnitude of internal and external risks. Mitigation measures are used in a prioritised manner to reduce exposure and ensure resilience. The UUG executive reviews significant risks so that the board can determine the nature and extent of those risks it is willing to take in achieving our strategic objectives. The UUG audit and risk committee regularly reviews the framework's effectiveness and the UUG group's compliance with it.

#### Key developments during the year

The legislative reform proposed by the government's recently published Water White Paper (Water for Life) is now one stage nearer. The likely impact on the industry, positive or negative, will not be fully understood until the draft Water Bill is published and ultimately becomes legislation.

Ofwat has also started the process of preparing the ground for the 2014 price review process. This includes a consultation with stakeholders about 'Future Price Limits' which asks for consideration of a number of proposals for change that may be required to facilitate the aims of the Water White Paper.

## Business review (continued)

### PRINCIPAL RISKS AND UNCERTAINTIES (continued)

#### Government market reform agenda

##### Risk

The government's White Paper (Water for Life) highlights a number of areas which government will focus on to reform the water industry. These include:

- protecting water and the natural environment;
- tackling water pollution;
- tackling over abstraction;
- water and the green economy;
- reforming and extending competition;
- supporting growth and innovation;
- affordability and bad debt; and
- changing the way we use and value water.

A draft Water Bill is expected to be published before Parliament's summer recess, which commences on 18 July 2012, and should deliver many of the aspects set out in the White Paper. Changes to the industry are expected to include extending competition to all non-household customers for both water and wastewater, the removal of barriers to the trading of abstraction licences and facilitating bulk supplies of water, reform of the special merger regime to allow more mergers of water companies and reform of the inset appointment regime. There is also a proposal (in the government's White Paper) to replace the 'costs principle' which underpins network access.

Ofwat plans to consult on the methodology for the 2014 price review in the autumn of 2012.

##### Mitigation

The group has been fully engaged in all government and Ofwat consultations in relation to competition, industry reform and the price setting process.

In respect of competition, a relatively small proportion of the group's profits derive from the retailing of water and wastewater services to non-household customers. If competition is expanded, there would be opportunities for the group to participate in a wider market in England and potentially Scotland. However, we recognise that reforms to the pricing rules that govern access to the group's water network and greater upstream competition could put at risk a greater proportion of the group's profits.

We have raised our concerns with Ofwat and will be proposing an alternative to the 'costs principle', seeking to ensure that key underlying principles (on both cost of entry and efficiency of provision) are reflected in any replacement.

#### Future price limits – average cost to serve

##### Risk

It is expected that market reform will result in two price limits, one for retail and one for wholesale. Ofwat proposes to set an average cost to serve for non-contestable customers in the retail price limit. This proposal could result in us having a significant cost recovery shortfall over the next five-year price control period.

##### Mitigation

We have raised and explained our concerns with Ofwat and made alternative proposals as part of the consultation process and continue to make strong representation to Ofwat on this issue, citing the market evidence from investors and analysts to support our case.

## Business review (continued)

### PRINCIPAL RISKS AND UNCERTAINTIES (continued)

#### Future price limits – licence modifications

##### Risk

Ofwat has made proposals to modify the licences of the water and wastewater industry to:

- allow it to remove reference to the use of the retail price index (RPI) in price setting; and
- allow flexibility in the number of price limits set and the duration of price controls.

##### Mitigation

All 21 water companies have rejected Ofwat's proposals and the regulator is now consulting with the wider water sector before making its decision on this later in 2012.

#### Capital investment programmes

##### Risk

The core business requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities.

Delivery of capital investment programmes could be affected by a number of factors including adverse legacy effects of earlier capital investments (such as increased maintenance, repair, reinstatement or renewal costs) or amounts budgeted in prior capital investment programmes proving insufficient to meet the actual amount required. This may affect the group's ability to meet regulatory and other environmental performance standards.

##### Mitigation

Capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for outperformance and any necessary corrective actions.

The UUG executive directors are incentivised, as part of their bonusable measures, on time, cost and quality of delivery of our capital investment programme.

#### Service incentive mechanism

##### Risk

For the 2010–15 period, Ofwat has introduced a new comparative incentive mechanism to reward or penalise water companies' service performance, replacing the Overall Performance Assessment (OPA). The Service Incentive Mechanism (SIM) compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well they deal with those contacts. Depending on UUG's relative performance under SIM it could receive a revenue penalty (up to one per cent of turnover) or reward (up to 0.5 per cent of turnover) when price limits are next reset in 2014.

##### Mitigation

The group has been monitoring and measuring customer satisfaction for a number of years and results have been improving consistently. We have already improved our SIM score, as detailed in our KPIs. To build on this success, we have a dedicated project team to ensure our processes, behaviours and systems provide consistent and excellent service to our customers. The company's focus is on ensuring right first time service delivery to its customers, thus avoiding the need for 'unwanted' contacts and reducing associated operating costs. Where 'unwanted' contacts do arise, then there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score. Capital costs of enhanced systems to improve performance are dealt with through the Capital Incentive Scheme. These actions are intended to ensure that the company's performance under SIM is optimised thereby mitigating the risk of a penalty at the next price setting.

## **Business review (continued)**

### **PRINCIPAL RISKS AND UNCERTAINTIES (continued)**

#### **Serviceability assessment**

##### **Risk**

The group is required to maintain the serviceability of its water and wastewater assets, ensuring it continues to deliver a level of service and performance that is at least as good as in the past. Where serviceability falls below required reference levels of performance, Ofwat deploys a staged approach to regulatory action to secure corrective actions and could make financial adjustments at the next price setting if these actions did not restore service performance. If performance was to continue to decline, the group may incur additional operating or capital expenditure to restore performance.

##### **Mitigation**

The various indicators of performance are closely and routinely monitored by management. The company's capital investment programme is targeted to seek to maintain stable serviceability of the company's water and wastewater assets. Similarly, operational practice is intended to ensure stable serviceability. Where adverse trends develop and there is a risk of serviceability deviating from stable, then corrective action can be identified and taken.

#### **Pension scheme obligations**

##### **Risk**

The group participates in a number of pension arrangements. The principal schemes are defined benefit schemes, although these have been closed to new employees since October 2006. The assets of these schemes are held in trust funds independent of group finances, with the funds being well diversified and professionally managed. The group's current schemes had a combined IAS 19 deficit of £92 million as at 31 March 2012, compared with a deficit of £195 million as at 31 March 2011.

##### **Mitigation**

Increases to pension fund deficits may result in an increased liability for the group, the size of the liability depending on a number of factors, including levels of contributions and actuarial assumptions. In the 2009 water price review, Ofwat took account of broadly 50 per cent of the pension deficit shown in UUW's final business plan over a 10-year period (subject to reaffirmation at the next price review) for the regulated business and allowed for half of this deficit when setting its overall price controls for the 2010–15 period. In response to the size of its ongoing pension risks and pension costs the group introduced a series of changes for employees in its defined benefit (DB) schemes. These changes, which came into force on 31 March 2010, should result in reduced costs and risks, including deficit, associated with DB liabilities in future. In conjunction with the trustees, the group continues to monitor and to look to reduce the investment strategy risks for the pension schemes, including the group's exposure to investment risks.



## **Business review (continued)**

### **PRINCIPAL RISKS AND UNCERTAINTIES (continued)**

#### **Failure to comply with applicable law or regulation**

##### **Risk**

The group is subject to various laws and regulations in the UK and internationally. Regulatory authorities may, from time to time, make enquiries of companies within their jurisdiction regarding compliance with regulations governing their operations. In addition to regulatory compliance proceedings, the group could become involved in a range of third party proceedings relating to, for example: land use; environmental protection; health and safety and water quality. Amongst others, these may include civil actions by third parties for infringement of rights or nuisance claims relating to odour or other matters. Furthermore, the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business cannot always be predicted and, from time to time, interpretation of existing laws or regulations may also change or the approach to their enforcement may become more rigorous. If the group fails to comply with applicable law or regulations, in particular in relation to its water and wastewater licences, or has not successfully undertaken corrective action, regulatory action could be taken that could include the imposition of a financial penalty (of up to 10 per cent of relevant regulated turnover) or the imposition of an enforcement order requiring the group to incur additional capital or operating expenditure to remedy its non-compliance. In the most extreme cases, non-compliance may lead to revocation of a licence or the appointment of a special administrator.

##### **Mitigation**

The group endeavours to comply with all legal requirements in accordance with its business principles and robust processes are in place to seek to mitigate against non-compliance. The group continually monitors legislative and regulatory developments and, where appropriate, participates in consultations to seek to influence their outcome, either directly or through industry trade associations for wider issues. The group seeks appropriate funding for any additional compliance costs in the regulated business as part of the price determination process.

#### **Events, service interruptions, systems failures, water shortages or contamination of water supplies**

##### **Risk**

The group controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. The group is also dependent on the ability to access, utilise and communicate remotely via electronic software applications mounted on corporate information technology hardware and communicating through internal and external networks which are not wholly under its control.

In exceptional circumstances, such as prolonged drought, system failure or catastrophic damage, a significant interruption of service provision could occur

Such consequences may arise due to a number of circumstances either within or outside the company's control. For example from water shortages, the failure of an asset or an element of a network or supporting plant and equipment, human error, an individual's malicious intervention or unavoidable resource shortfalls.

Such instances have a low probability, but if materialised could result in significant loss of life, environmental damage and/or economic and social disruption.

The group could be fined for breaches of statutory obligations or be held liable to third parties or be required to provide an alternative water supply of equivalent quality, which could increase costs.

## Business review (continued)

### PRINCIPAL RISKS AND UNCERTAINTIES (continued)

#### Mitigation

The group operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The processes continue to be refined, alongside related risk management and business continuity procedures which complement the governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Disaster Recovery processes also exist for the recovery of applications, all recognising that possible events can have varying causes, impacts and likelihoods.

Sustainability of our water supply is also managed through regional aqueduct networks which will be enhanced by the West East Link pipeline. While the group seeks to ensure that it has appropriate processes and preventative controls in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of customers, regulators, government and the wider stakeholder community. The group also maintains insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost-effectively. The licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers (by way of interim determination) in the event of a catastrophic incident.

#### Material litigation

##### Risk

In February 2009, United Utilities International Limited (UUIL) was served with notice of a multiparty 'class action' in Argentina related to the issuance and payment default of a US\$230 million bond by Inversora Electrica de Buenos Aires S.A. (IEBA), an Argentine project company set up to purchase one of the Argentine electricity distribution networks which was privatised in 1997. UUIL had a 45 per cent shareholding in IEBA which it sold in 2005. The claim is for a non-quantified amount of unspecified damages and purports to be pursued on behalf of unidentified consumer bondholders in IEBA. UUIL has filed a defence to the action and will vigorously resist the proceedings given the robust defences that UUIL has been advised that it has on procedural and substantive grounds.

In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water PLC (Uuw) in respect of Uuw's discharges of water and treated effluent into the canal. Uuw filed a Defence and Counterclaim in support of its believed entitlement to make discharges into the canal without charge and await MSCC's response. Although Uuw won a 'summary judgment' application against MSCC in January on a significant element of the claim, MSCC has served notice that it intends to appeal this decision.

#### Mitigation

The group faces the general risk of litigation in connection with its businesses. In most cases, liability for litigation is difficult to assess or quantify; recovery may be sought for very large and/or indeterminate amounts and the existence and magnitude of liability may remain unknown for substantial periods of time. The group robustly defends litigation, where appropriate, and seeks to minimise its exposure to such claims by early identification of risks and compliance with its legal and other obligations. Based on the facts and matters currently known and the provisions carried in the group's statement of financial position, the directors are of the opinion that the possibility of the disputes referred to in this risk section having a material adverse effect on the group's financial position is remote.

## Directors' report

The directors present their report and the audited financial statements of United Utilities PLC and its subsidiaries for the year ended 31 March 2012.

### Principal activities and business review

The company is a public limited company registered in England and Wales. Its registered office address is at Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP.

The company is the intermediate holding company of a group which owns and operates water and wastewater assets in the North West of England.

The business review (pages 3-33), which includes the chief executive officer's statement and the financial performance section (pages 23-28), provides a balanced analysis of the development and performance of the group's business during the financial year, and the position of the group's business at the year end, and forms part of this directors' report. A summary of key performance indicators can be found in the performance section of the business review on page 6. A summary of the principal risks and uncertainties can be found on pages 28 to 33. The company's principal subsidiary undertakings, and the associated companies and joint ventures in which the group participates, are listed in note 13 to the consolidated financial statements.

### Dividends

The directors have not recommended a final dividend for the year ended 31 March 2012 (2011: nil).

### Directors

The directors who held office during the year and to date are given below:

PA Aspin	
M Carmedy	(resigned 31 October 2011)
JR Houlden	
SL Mogford	(appointed 4 April 2011)

### Directors' indemnities and insurance

UUG has in place contractual entitlements for directors of subsidiary and certain associated companies to claim indemnification by UUG in respect of certain liabilities which might be incurred by them in the course of their duties as directors. These arrangements, which constitute qualifying third party indemnity provision and qualifying pension scheme indemnity provision, have been established in compliance with the relevant provisions of the Companies Act 2006. They include provision for UUG to fund the costs incurred by directors in defending certain claims against them in relation to their duties as directors of UUG or its subsidiaries. UUG also maintains an appropriate level of directors' and officers' liability insurance for both UUG and all its subsidiary companies. Directors and officers of the UUG group are covered under this insurance policy where they have been asked by the group to carry out duties on behalf of the group.

## Directors' report (continued)

### Political and charitable donations

United Utilities does not support any political party and does not make what are commonly regarded as donations to any political party or other political organisations. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the group and political stakeholders. This includes promoting United Utilities' activities at any of the main political parties' annual conferences.

The period 2011/12 saw an increase in stakeholder engagement along a number of policy themes as the industry examined its future development. The group incurred expenditure of £12,328 (2011: £5,000) as part of this process. At the 2011 United Utilities Group PLC annual general meeting, an authority was taken to cover such expenditure. A similar resolution will be put to the shareholders at the 2012 United Utilities Group PLC annual general meeting to authorise the company and its subsidiaries to make such expenditure.

Charitable donations by the group in the year amounted to £5,345,093 (2011: £5,193,987). Of this, £5,000,000 went to the United Utilities Trust Fund, an independent grant-making trust helping people facing severe financial challenges, whilst the remainder was in support of local charitable causes and those of interest to employees.

### Employees

The company's policies on employee consultation and on equal opportunities for disabled employees can be found in the 'Our approach to doing business' section on page 8. For further information on the average number of employees during the year, go to page 59.

### Environmental, social and community matters

Details of the group's approach to corporate responsibility, relating to the environment and social and community issues, can be found in the 'Our approach to doing business' section on page 8.

### Essential contractual relationships

Certain suppliers to the group contribute key goods or services, the loss of which could cause disruption to the group's services. However, none are so vital that their loss would affect the viability of the group as a whole nor is the business of the group overly dependent on any one individual customer.

### Policy on payment of creditors

The group's policy is in line with the CBI Code of Prompt Payment (copies are available from the CBI, Centre Point, 103 New Oxford Street, London, WC1A 1DU). Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance. The group makes every effort to comply with the payment terms as agreed with its suppliers subject to there being no dispute with the invoices received. As at 31 March 2012, the average credit period taken for trade purchases was 29 days for the group (2011: 31 days). At 31 March 2012, no average credit period has been calculated for the company due to the company no longer making external purchases (2011: 43 days).

### Approach to technology development

The UUG group is committed to using innovative, cost-effective and practical solutions for providing high quality services and we recognise the importance of ensuring that we focus properly our investment in the development of technology and that we have the right skills to apply technology to achieve sustainable competitive advantage and also that we continue to be alert to emerging technological opportunities.

### Financial instruments

The risk management objectives and policies of the group in relation to the use of financial instruments can be found in note 18 to the financial statements.

## Directors' report (continued)

### Property, plant and equipment

The group holds significant land assets; however, the vast majority of these are water catchment assets which are an integral and essential part of the operation of the group's regulated business. The nature of these assets, which are primarily moorland areas and which could not be sold by the group, means that it is impractical to obtain meaningful market values for the land. Other land owned by the group, the majority of which relates to operational sites, does not have a market value materially different from historic cost.

### Events occurring after the reporting period

Details of events after the reporting period are included in note 29 to the consolidated financial statements on page 103.

### Information given to the auditor

Each of the persons who is a director at the date of approval of this report confirms that:

(1) so far as he or she is aware, there is no relevant audit information of which the company's auditor is unaware; and

(2) he has taken all the steps that he/she ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006.

### Auditor

During the year Deloitte LLP resigned as auditor of the group and KPMG Audit Plc were appointed.

In accordance with section 489 of the Companies Act 2006, a resolution for the reappointment of KPMG Audit Plc as auditor of the group is to be proposed at the forthcoming Annual General Meeting.

Approved by the board on 1 June 2012 and signed on its behalf by:

Russ Houlden  
Director

## **Statement of directors' responsibilities in respect of the financial statements**

The directors are responsible for preparing the Annual Report and the Group and Parent Company Financial Statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## **Independent auditor's report**

### **to the members of United Utilities PLC**

We have audited the financial statements of United Utilities PLC for the year ended March 2012 set out on pages 40 to 103. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report 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 Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities Statement set out on page 37, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm).

### **Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matter prescribed by the Companies Act 2006**

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

## **Independent auditor's report (continued)**

**to the members of United Utilities PLC**

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company Financial Statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

John Luke (Senior Statutory Auditor)  
for and on behalf of KPMG Audit Plc  
Statutory Auditor  
Chartered Accountants  
St James Square, Manchester M2 6DS  
United Kingdom  
1 June 2012



## Consolidated income statement

for the year ended 31 March

	Note	2012 £m	Re-presented* 2011 £m
<b>Continuing operations</b>			
<b>Revenue</b>	1,2	1,564.9	1,513.3
Employee benefits expense:			
excluding restructuring costs	3	(135.4)	(142.8)
restructuring costs	3	(2.6)	(3.1)
Total employee benefits expense	3	(138.0)	(145.9)
Other reorganisation costs		-	(13.1)
Other operating costs	4	(388.0)	(358.1)
Other income	4	4.8	4.9
Depreciation and amortisation expense	4	(297.8)	(290.5)
Infrastructure renewals expenditure		(154.4)	(130.4)
<b>Total operating expenses</b>		(973.4)	(933.1)
<b>Operating profit</b>	4	591.5	580.2
Investment income	5	39.3	32.3
Finance expense	6	(315.5)	(255.9)
Investment income and finance expense		(276.2)	(223.6)
<b>Profit before taxation</b>		315.3	356.6
Current taxation charge		(60.9)	(43.3)
Deferred taxation charge		(28.1)	(37.0)
Deferred taxation credit – change in taxation rate		104.6	99.0
<b>Taxation</b>	7	15.6	18.7
<b>Profit after taxation from continuing operations</b>		330.9	375.3
<b>Discontinued operations</b>			
Profit after taxation from discontinued operations	8	5.1	103.7
<b>Profit after taxation</b>		336.0	479.0

\* The comparatives have been re-presented to include loss on disposal of property, plant and equipment of £2.7 million within other operating costs rather than other income as previously presented, as this better reflects the nature of expenditure.

## Consolidated statement of comprehensive income

for the year ended 31 March

	Note	2012 £m	2011 £m
<b>Profit after taxation</b>		336.0	479.0
<b>Other comprehensive income</b>			
Actuarial losses on defined benefit pension schemes	19	(24.3)	(44.7)
Net fair value losses on cash flow hedges		-	(0.2)
Revaluation of investments	13	-	1.1
Reclassification from other reserves arising on disposal of financial asset investment	8	-	(6.6)
Reclassification from other reserves arising on disposal of subsidiaries	8	-	1.8
Reclassification from cumulative exchange reserve arising on disposal of subsidiaries	8	-	(26.1)
Taxation on items taken directly to equity	7	4.4	11.7
Foreign exchange adjustments		(1.9)	0.7
<b>Total comprehensive income</b>		314.2	416.7

## Consolidated and company statements of financial position

at 31 March

	Note	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
<b>ASSETS</b>					
<b>Non-current assets</b>					
Property, plant and equipment	10	8,644.5	8,274.9	0.4	0.4
Goodwill	11	5.0	5.0	-	-
Other intangible assets	12	89.5	93.9	-	-
Investments	13	3.3	2.3	6,100.0	6,176.5
Trade and other receivables	15	1.1	-	-	-
Deferred tax asset	20	-	-	17.7	29.5
Derivative financial instruments	18	567.5	363.3	138.7	99.1
		<u>9,310.9</u>	<u>8,739.4</u>	<u>6,256.8</u>	<u>6,305.5</u>
<b>Current assets</b>					
Inventories	14	47.4	47.6	-	-
Trade and other receivables	15	2,036.6	1,798.7	1,239.4	1,682.6
Cash and short-term deposits	16	321.2	255.2	308.2	237.0
Derivative financial instruments	18	49.9	2.0	0.1	-
		<u>2,455.1</u>	<u>2,103.5</u>	<u>1,547.7</u>	<u>1,919.6</u>
<b>Total assets</b>		<u>11,766.0</u>	<u>10,842.9</u>	<u>7,804.5</u>	<u>8,225.1</u>
<b>LIABILITIES</b>					
<b>Non-current liabilities</b>					
Trade and other payables	22	(378.0)	(249.8)	-	-
Borrowings	17	(5,728.1)	(5,203.6)	(689.7)	(660.8)
Retirement benefit obligations	19	(92.0)	(195.0)	(51.1)	(52.1)
Deferred tax liabilities	20	(1,245.2)	(1,293.1)	-	-
Provisions	21	(4.0)	(9.3)	-	-
Derivative financial instruments	18	(159.7)	(84.6)	-	(12.8)
		<u>(7,607.0)</u>	<u>(7,035.4)</u>	<u>(740.8)</u>	<u>(725.7)</u>
<b>Current liabilities</b>					
Trade and other payables	22	(445.9)	(433.0)	(1,317.0)	(1,800.0)
Borrowings	17	(159.8)	(140.8)	(820.7)	(861.3)
Current income tax liabilities		(101.2)	(87.3)	-	-
Provisions	21	(6.3)	(14.5)	(0.4)	(2.2)
Derivative financial instruments	18	(0.1)	(0.4)	(0.1)	(0.4)
		<u>(713.3)</u>	<u>(676.0)</u>	<u>(2,138.2)</u>	<u>(2,663.9)</u>
<b>Total liabilities</b>		<u>(8,320.3)</u>	<u>(7,711.4)</u>	<u>(2,879.0)</u>	<u>(3,389.6)</u>
<b>Total net assets</b>		<u>3,445.7</u>	<u>3,131.5</u>	<u>4,925.5</u>	<u>4,835.5</u>
<b>EQUITY</b>					
<b>Capital and reserves attributable to equity holders of the company</b>					
Share capital	23,24	881.8	881.8	881.8	881.8
Share premium account	23	1,430.0	1,430.0	1,430.0	1,430.0
Revaluation reserve	23	158.8	158.8	-	-
Cumulative exchange reserve	23	(5.0)	(3.1)	-	-
Retained earnings	23	980.1	664.0	2,613.7	2,523.7
<b>Shareholders' equity</b>		<u>3,445.7</u>	<u>3,131.5</u>	<u>4,925.5</u>	<u>4,835.5</u>

These financial statements for the group and United Utilities PLC (company number: 2366616) were approved by the board of directors on 1 June 2012 and signed on its behalf by:

Russ Houlden  
Director

## Consolidated statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Revaluation reserve £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
<b>Group</b>						
At 1 April 2011	881.8	1,430.0	158.8	(3.1)	664.0	3,131.5
Profit after taxation	-	-	-	-	336.0	336.0
<b>Other comprehensive income</b>						
Actuarial losses on defined benefit pension schemes	-	-	-	-	(24.3)	(24.3)
Taxation on items taken directly to equity (note 7)	-	-	-	-	4.4	4.4
Foreign exchange adjustments	-	-	-	(1.9)	-	(1.9)
<b>Total comprehensive (expense)/income</b>	-	-	-	(1.9)	316.1	314.2
<b>At 31 March 2012</b>	<u>881.8</u>	<u>1,430.0</u>	<u>158.8</u>	<u>(5.0)</u>	<u>980.1</u>	<u>3,445.7</u>

	Share capital £m	Share premium account £m	Revaluation reserve £m	Cumulative exchange reserve £m	Other reserves £m	Retained earnings £m	Total £m
<b>Group</b>							
At 1 April 2010	881.8	1,430.0	158.8	22.3	3.8	451.9	2,948.6
Profit after taxation	-	-	-	-	-	479.0	479.0
<b>Other comprehensive income</b>							
Actuarial losses on defined benefit pension schemes	-	-	-	-	-	(44.7)	(44.7)
Net fair value losses on cash flow hedges	-	-	-	-	(0.2)	-	(0.2)
Revaluation of investments	-	-	-	-	1.1	-	1.1
Reclassification from other reserves arising on disposal of financial asset investment	-	-	-	-	(6.6)	-	(6.6)
Reclassification from other reserves arising on disposal of subsidiaries	-	-	-	-	1.8	-	1.8
Reclassification from cumulative exchange reserve arising on disposal of subsidiaries	-	-	-	(26.1)	-	-	(26.1)
Taxation on items taken directly to equity (note 7)	-	-	-	-	0.1	11.6	11.7
Foreign exchange adjustments	-	-	-	0.7	-	-	0.7
<b>Total comprehensive (expense)/income</b>	-	-	-	(25.4)	(3.8)	445.9	416.7
<b>Transactions with owners</b>							
Dividends	-	-	-	-	-	(233.8)	(233.8)
<b>At 31 March 2011</b>	<u>881.8</u>	<u>1,430.0</u>	<u>158.8</u>	<u>(3.1)</u>	<u>-</u>	<u>664.0</u>	<u>3,131.5</u>

## Company statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
<b>Company</b>				
At 1 April 2011	881.8	1,430.0	2,523.7	4,835.5
Profit after taxation	-	-	112.1	112.1
<b>Other comprehensive income</b>				
Actuarial losses on defined benefit pension schemes	-	-	(28.6)	(28.6)
Taxation on items taken directly to equity (note 7)	-	-	6.5	6.5
<b>Total comprehensive income</b>	-	-	90.0	90.0
<b>At 31 March 2012</b>	<u>881.8</u>	<u>1,430.0</u>	<u>2,613.7</u>	<u>4,925.5</u>

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
<b>Company</b>				
At 1 April 2010	881.8	1,430.0	2,534.2	4,846.0
Profit after taxation	-	-	247.4	247.4
<b>Other comprehensive income</b>				
Actuarial losses on defined benefit pension schemes	-	-	(32.6)	(32.6)
Taxation on items taken directly to equity (note 7)	-	-	8.5	8.5
<b>Total comprehensive income</b>	-	-	223.3	223.3
<b>Transactions with owners</b>				
Dividends	-	-	(233.8)	(233.8)
<b>At 31 March 2011</b>	<u>881.8</u>	<u>1,430.0</u>	<u>2,523.7</u>	<u>4,835.5</u>

## Consolidated and company statements of cash flows

for the year ended 31 March

		Group Re-presented*		Company	
	Note	2012 £m	2011 £m	2012 £m	2011 £m
<b>Operating activities</b>					
Cash generated from continuing operations	27	492.8	767.9	65.5	323.0
Interest paid		(167.2)	(165.8)	(22.3)	(24.8)
Interest received and similar income		28.3	40.2	7.7	1.5
Tax paid		(39.8)	(46.5)	(38.2)	(54.3)
Tax received		35.0	-	35.0	-
<b>Net cash generated from operating activities (continuing operations)</b>		349.1	595.8	47.7	245.4
<b>Net cash generated from operating activities (discontinued operations)</b>		-	13.7	-	-
<b>Investing activities</b>					
Proceeds from disposal of discontinued operations		3.5	268.4	-	-
Transaction costs, deferred consideration and cash disposed		2.0	(97.9)	-	-
Proceeds from disposal of discontinued operations net of transaction costs, deferred consideration and cash disposed		5.5	170.5	-	-
Purchase of property, plant and equipment		(502.2)	(475.4)	-	-
Purchase of increased shareholding in joint venture		-	(5.0)	-	-
Purchase of other intangible assets		(17.3)	(20.2)	-	-
Proceeds from sale of property, plant and equipment		4.8	9.8	-	-
Grants and contributions received		13.0	12.7	-	-
Purchase of investments	13	(2.2)	-	-	-
<b>Net cash used in investing activities (continuing operations)</b>		(498.4)	(307.6)	-	-
<b>Net cash used in investing activities (discontinued operations)</b>		-	(52.7)	-	-
<b>Financing activities</b>					
Proceeds from borrowings		446.3	94.1	48.5	30.9
Repayment of borrowings		(231.7)	(112.6)	(25.0)	(25.2)
Dividends paid to equity holders of the company	9	-	(233.8)	-	(233.8)
<b>Net cash (used in)/generated from financing activities (continuing operations)</b>		214.6	(252.3)	23.5	(228.1)
<b>Net cash used in financing activities (discontinued operations)</b>		-	(4.8)	-	-
Effects of exchange rate changes (continuing operations)		0.5	-	-	(1.9)
Effects of exchange rate changes (discontinued operations)		-	(1.3)	-	-
<b>Net increase in cash and cash equivalents (continuing operations)</b>		65.8	35.9	71.2	15.4
<b>Net decrease in cash and cash equivalents (discontinued operations)</b>		-	(45.1)	-	-
Cash and cash equivalents at beginning of the year	16	246.8	256.0	236.9	221.5
Cash and cash equivalents at end of the year	16	312.6	246.8	308.1	236.9

\* The comparatives have been re-presented to show grants and contributions received of £12.7 million separately within investing activities (2011: previously included within decrease in provisions and payables as part of cash generated from continuing operations).

## Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below.

### **a) Basis of preparation**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU), including International Accounting Standards (IAS) and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments, the transfer of assets from customers and the revaluation of infrastructure assets to fair value on transition to IFRS.

The preparation of financial statements, in conformity with generally accepted accounting principles (GAAP) under IFRS, requires management to make estimates and assumptions that affect the amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting periods presented. Although these estimates are based upon management's best knowledge of the amount, event or actions, actual results ultimately may differ from these estimates.

The adoption of the following standards and interpretations, at 1 April 2011, has had no material impact on the group's financial statements:

#### **'Improvements to IFRSs (2010)'**

This is a collection of amendments to seven standards as part of the International Accounting Standards Board's (IASB) programme of annual improvements. The improvements were issued in May 2010, are effective for periods commencing on or after 1 January 2011 and were endorsed by the EU on 18 February 2011.

#### **IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.'**

The interpretation addresses the interaction between a minimum funding requirement and the limit placed by IAS 19 on the measurement of the defined benefit asset or liability. The interpretation was issued in July 2007 and amended in November 2009. It is effective for periods commencing on or after 1 January 2011 and was endorsed by the EU on 19 July 2010.

### **Going concern**

The directors have a reasonable expectation that the group has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern policy in preparing the financial statements. This conclusion is based upon, amongst other matters, a review of the group's financial projections together with a review of the cash and committed borrowing facilities available to the group.

### **Operating profit**

Operating profit is stated after charging operating expenses but before investment income and finance expense.

## Accounting policies (continued)

### **b) Basis of consolidation**

The group financial statements consolidate the financial statements of the company and entities controlled by the company (its subsidiaries), made up to 31 March each year, and incorporate the results of its share of joint ventures using proportionate consolidation.

The results of subsidiaries and joint ventures acquired or disposed of during the year are included in the consolidated income statement from the date control is obtained or until the date that control ceases, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used under the relevant local GAAP into line with those used by the group.

### **Subsidiaries**

Control is achieved where the company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one-half of the voting rights of an investee entity so as to obtain benefits from its activities. In the parent company accounts, investments are held at cost less provision for impairment.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired is credited to the income statement in the period of acquisition. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

### **Joint ventures**

Joint ventures are entities in which the group holds an interest on a long-term basis and which are jointly controlled with one or more parties under a contractual arrangement. The group's share of joint venture income, expenses, assets, liabilities and cash flows is included in the consolidated financial statements on a proportionate consolidation basis using the same accounting methods as adopted for subsidiaries.

### **c) Revenue recognition**

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided. Where relevant, this includes an estimate of the sales value of units supplied to customers between the date of the last meter reading and the period end, exclusive of value added tax and foreign sales tax.

The group recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. Should the group consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned or collectability is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred income.

### **d) Borrowing costs and finance income**

Except as noted below, all borrowing costs and finance income are recognised in the income statement in the period in which they are accrued.

Transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are included in the initial fair value of that instrument.

Where borrowing costs are attributable to the acquisition, construction or production of a qualifying asset, such costs are capitalised as part of the specific asset.



## Accounting policies (continued)

### e) Taxation

The taxation expense represents the sum of current taxation and deferred taxation.

#### Current taxation

Current taxation, including UK corporation tax and foreign tax, is based upon the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at each reporting date.

Taxable profit differs from the net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Current taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the current taxation is also dealt with in equity.

#### Deferred taxation

Deferred taxation is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are provided, using the liability method, on all taxable temporary differences at each reporting date. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred taxation liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred taxation is measured at the average tax rates that are expected to apply in the periods in which the temporary timing differences are expected to reverse based upon tax rates and laws that have been enacted or substantively enacted at each reporting date.

The carrying amount of deferred taxation assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the deferred taxation is also dealt with in equity.

### f) Property, plant and equipment

Property, plant and equipment comprises water and wastewater infrastructure assets and overground assets (including properties and plant and equipment).

The useful economic lives of these assets are as follows:

- Water and wastewater infrastructure assets:
  - Impounding reservoirs 200 years;
  - Mains and raw water aqueducts 30 to 300 years;
  - Sewers 60 to 300 years;
  - Sea outfalls 77 years;
- Buildings 10 to 60 years;
- Operational assets 5 to 80 years; and
- Fixtures, fittings, tools and equipment 3 to 40 years.

## Accounting policies (continued)

### **f) Property, plant and equipment (continued)**

#### **Water and wastewater infrastructure assets**

Infrastructure assets comprise a network of water and wastewater systems. Expenditure on the infrastructure assets, including borrowing costs where applicable, relating to increases in capacity or enhancements of the network is treated as additions. Amounts incurred in maintaining the operating capability of the network in accordance with defined standards of service are expensed in the year in which the expenditure is incurred. Infrastructure assets are depreciated by writing off their cost, less the estimated residual value, evenly over their useful economic lives.

Employee costs incurred in implementing the capital schemes of the group are capitalised within infrastructure assets.

#### **Other assets**

All other property, plant and equipment is stated at historical cost less accumulated depreciation.

Historical cost includes expenditure that is directly attributable to the acquisition of the items, including relevant borrowing costs, where applicable, for qualifying assets. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Freehold land and assets in the course of construction are not depreciated. Other assets are depreciated by writing off their cost, less their estimated residual value, evenly over their estimated useful economic lives, based on management's judgement and experience.

Depreciation methods, residual values and useful economic lives are reassessed annually and, if necessary, changes are accounted for prospectively. The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in other operating costs.

#### **Transfer of assets from customers**

Where the group receives from a customer an item of property, plant and equipment (or cash to construct or acquire an item of property, plant and equipment) that the group must then use, either to connect the customer to the network, or to provide the customer with ongoing access to a supply of goods or services, or to do both, such items are capitalised at their fair value and included within property, plant and equipment, with a credit of the same amount to deferred grants and contributions. The assets are depreciated over their useful economic lives and the deferred contributions released to revenue over the same period (or where the receipt of property, plant and equipment is solely to connect the customer to the network, the deferred contribution is released immediately to revenue). The interpretation has been applied to transfers of assets from customers received on or after 1 July 2009.

Assets transferred from customers are accounted for at fair value. If no market exists for the assets then incremental cash flows are used to arrive at fair value.

### **g) Intangible assets**

#### **Goodwill**

Goodwill arising on consolidation is recognised as an asset. Following initial recognition, goodwill is subject to impairment reviews, at least annually, and measured at initial value less accumulated impairment losses. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, or joint venture, the attributable amount of goodwill is included in the determination of the gain or loss on disposal.

Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

## Accounting policies (continued)

### **g) Intangible assets (continued)**

#### **Other intangible assets**

Other intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful economic lives. The carrying amount is reduced by any provision for impairment where necessary.

On a business combination, as well as recording separable intangible assets already recognised in the statement of financial position of the acquired entity at their fair value, identifiable intangible assets that arise from contractual or other legal rights are also included in the acquisition statement of financial position at fair value.

Internal expenditure is capitalised as internally generated intangibles only if it meets the criteria of IAS 38 'Intangible Assets'.

Amortisation periods for categories of intangible assets are:

- Computer software 3 to 10 years; and
- Other intangible assets 2 to 20 years.

### **h) Impairment of tangible and intangible assets excluding goodwill**

Intangible assets with definite useful economic lives and property, plant and equipment are reviewed for impairment at each reporting date to determine whether there is any indication that those assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cash flows, discounted on a pre-tax basis, using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash generating unit) is reduced to its recoverable amount. Impairment losses in respect of non-current assets are recognised in the income statement within operating costs.

Where an impairment loss subsequently reverses, the reversal is recognised in the income statement and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

### **i) Financial instruments**

Financial assets and financial liabilities are recognised and derecognised on the group's statement of financial position on the trade date when the group becomes/ceases to be a party to the contractual provisions of the instrument.

#### **Cash and short-term deposits**

Cash and short-term deposits include cash at bank and in hand, deposits and other short-term highly liquid investments which are readily convertible into known amounts of cash, have a maturity of three months or less from the date of acquisition and which are subject to an insignificant risk of change in value. In the consolidated statement of cash flows and related notes, cash and cash equivalents include cash and short-term deposits, net of bank overdrafts.

## Accounting policies (continued)

### i) Financial instruments (continued)

#### Financial investments

Investments (other than interests in associates, subsidiaries, joint ventures and fixed deposits) are initially measured at fair value, including transaction costs. Investments classified as available for sale in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period. Investments classified as loans and receivables in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' are measured at amortised cost.

#### Trade receivables

Trade receivables are initially measured at fair value, and are subsequently measured at amortised cost, less any impairment for irrecoverable amounts. Estimated irrecoverable amounts are based upon historical experience of the receivables balance.

#### Trade payables

Trade payables are initially measured at fair value and are subsequently measured at amortised cost.

#### Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

#### Equity instruments

Equity instruments issued by the group are recorded at the proceeds received, net of direct issue costs.

#### Borrowings

The group's default treatment is that bonds, loans and overdrafts are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently measured at amortised cost applying the effective interest method, except where they are designated within a fair value hedge relationship or as fair value through profit or loss. The difference between the net cash proceeds received at inception and the principal cash flows due at maturity is accrued over the term of the borrowing.

#### Borrowings designated within a fair value hedge relationship

Designation is made where it can be demonstrated from inception that a highly effective fair value hedge exists. Where designated, bonds and loans are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently adjusted for any change in fair value attributable to the risk being hedged at each reporting date, with the change being charged or credited to finance expense in the income statement.

Hedge accounting is discontinued prospectively when the hedging instrument is sold, terminated or exercised, or where the hedge relationship no longer qualifies for hedge accounting.

#### Borrowings designated at fair value through profit or loss

Designation is made where the requirements to designate within a fair value hedge cannot be met at inception despite there being significant fair value offset between the borrowing and the hedging derivative. Where designated, bonds and loans are initially measured at fair value being the cash proceeds received, and are subsequently measured at fair value at each reporting date with changes in fair value being charged or credited to finance expense in the income statement.

#### Derivative financial instruments

Derivative financial instruments are measured at fair value at each reporting date with changes in fair value being charged or credited to finance expense in the income statement. The group enters into financial derivatives contracts to manage its financial exposure to changes in market rates (see note 18).

## Accounting policies (continued)

### **j) Inventories**

Inventories are stated at cost less any allowance necessary to recognise damage and obsolescence.

Properties held for resale are included at the lower of cost and net realisable value. Cost includes the cost of acquiring and developing the sites, including borrowing costs where applicable.

Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

### **k) Employee benefits**

#### **Retirement benefit obligations**

The group operates two defined benefit pension schemes, which are independent of the group's finances, for the majority of its employees. Actuarial valuations of the schemes are carried out as determined by the pension scheme trustees using the projected unit credit method at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

Defined benefit assets are measured at fair value while liabilities are measured at present value. The difference between the two amounts is recognised as a surplus or obligation in the statement of financial position.

The cost of providing pension benefits to employees relating to the current year's service (including curtailment gains and losses) is included within the income statement within employee benefits expense. The difference between the expected return on scheme assets and interest cost on scheme liabilities is included within the income statement within investment income or finance expense.

Actuarial gains and losses are recognised outside the income statement in retained earnings and presented in the statement of comprehensive income.

In addition, the group also operates a defined contribution pension section within the United Utilities Pension Scheme. Payments are charged as employee costs as they fall due. The group has no further payment obligations once the contributions have been paid.

#### **Share-based compensation arrangements**

The UUG group operates equity-settled, share-based compensation plans in the shares of United Utilities Group PLC. In accordance with the transitional provisions, IFRS 2 'Share-based Payments' has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2004.

The group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on estimates of the number of options that are expected to vest. Fair value is based upon both simulation and binomial models, according to the relevant measures of performance in accordance with the advice of an expert.

At each reporting date, United Utilities Group PLC revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

## Accounting policies (continued)

### **l) Provisions**

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Expenditure that relates to an existing condition caused by past operations that does not contribute to current or future earnings is expensed. Liabilities for environmental remediation are recognised, and capitalised in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' as appropriate, when there is a legal or constructive obligation, environmental assessments indicate that clean-up is probable, and the associated costs can be reliably estimated.

### **m) Foreign currency translation**

#### **Transactions and balances**

Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange applicable on that date. Gains and losses arising on retranslation are included in net profit or loss for the period. Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity.

In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note 18).

### **Group companies**

On consolidation, the statements of financial position of overseas subsidiaries and joint ventures (none of which has the currency of a hyperinflationary economy) are translated into sterling at exchange rates applicable at each reporting date. The income statements are translated into sterling using the average rate unless exchange rates fluctuate significantly in which case the exchange rate at the date the transaction occurred is used. Exchange differences resulting from the translation of such statements of financial position at rates ruling at the beginning and end of the period, together with the differences between income statements translated at average rates and rates ruling at the period end, are dealt with as movements on the group's cumulative exchange reserve, a separate component of equity. Such translation differences are recognised as income or expense in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. The group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of implementation of IFRS 3 'Business Combinations' (1 April 1999) as sterling denominated assets and liabilities.

### **n) Grants and contributions**

Grants and contributions receivable in respect of property, plant and equipment are treated as deferred income, which is credited to the income statement over the estimated useful economic lives of the related assets.

### **o) Leases**

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

#### **Operating leases**

Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

## Accounting policies (continued)

### **p) Critical accounting judgements and key sources of estimation uncertainty**

In the process of applying its accounting policies, the group is required to make certain estimates, judgements and assumptions that it believes are reasonable based upon the information available. These estimates and assumptions affect the amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses recognised during the reporting periods presented.

On an ongoing basis, the group evaluates its estimates using historical experience, consultation with experts and other methods considered reasonable in the particular circumstances. Actual results may differ significantly from the estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known.

The following paragraphs detail the estimates and judgements the group believes to have the most significant impact on the annual results under IFRS.

### **Carrying value of property, plant and equipment**

The estimated useful economic lives of property, plant and equipment (PPE) are based upon management's judgement and experience. When management identifies that actual useful economic lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of PPE investment to the group, variations between actual and estimated useful economic lives could impact operating results both positively and negatively, although historically few changes to estimated useful economic lives have been required.

The group is required to evaluate the carrying values of PPE for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review requires management to make subjective judgements concerning the cash flows, growth rates and discount rates of the cash generating units under review.

### **Revenue recognition**

The group recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. When the group considers that the criteria for revenue recognition are not met for a transaction, revenue recognition is delayed until such time as the transaction becomes fully earned or collectability is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred income.

United Utilities Water PLC raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and wastewater customers with water meters, the receivable billed is dependent upon the volume supplied including the sales value of an estimate of the units supplied between the date of the last meter reading and the billing date. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based upon estimated usage from the last billing through to each reporting date. The estimated usage is based upon historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period that the revision to the estimates is determined. For customers who do not have a meter, the receivable billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

### **Allowance for doubtful receivables**

At each reporting date, the company and each of its subsidiaries evaluate the recoverability of trade receivables and record allowances for doubtful receivables based upon experience. These allowances are based upon, amongst other things, customer category and consideration of actual collection history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

## Accounting policies (continued)

### p) Critical accounting judgements and key sources of estimation uncertainty (continued)

#### Accounting for provisions and contingencies

The group is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The group routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses.

Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 28, unless the possibility of transferring economic benefits is remote.

#### Retirement benefits

The group operates two defined benefit schemes, which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based upon the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based upon information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 19. Profit before taxation and net assets are affected by the actuarial assumptions used. These assumptions include investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

#### Derivatives and borrowings – hedging

The group's default treatment is that borrowings are carried at amortised cost, whilst associated hedging derivatives are recognised at fair value. This accounting measurement mismatch has the potential to introduce considerable volatility to both the income statement and the statement of financial position. Therefore, where feasible, the group takes advantage of the provisions under IAS 39 'Financial Instruments: Recognition and Measurement' to fair value its borrowing instruments to reduce this volatility and better represent the economic hedges that exist between the group's borrowings and associated derivative contracts.

Where feasible, the group designates its financial instruments within fair value hedge relationships. In order to apply fair value hedge accounting, it must be demonstrated that the hedging derivative has been, and will continue to be, a highly effective hedge of the risk being hedged within the applicable borrowing instrument.

Borrowings are designated at fair value through profit or loss where the designation of such borrowings within a fair value hedge relationship is not feasible despite there being a significant fair value offset between the hedged item and the derivative, and where otherwise the inconsistent accounting treatment would result in a significant accounting measurement mismatch.

#### Derivatives and borrowings – valuation

Designated borrowings and derivatives recorded at fair value are valued using a net present value valuation model. The model uses applicable interest rate curve data at each reporting date to determine any floating cash flows. Projected future cash flows associated with each financial instrument are discounted to the reporting date using discount factors derived from the applicable interest curves adjusted for counterparty credit risk where appropriate. Discounted foreign currency cash flows are converted into sterling at the spot exchange rate at each reporting date.



## Accounting policies (continued)

### **p) Critical accounting judgements and key sources of estimation uncertainty (continued)**

#### **Derivatives and borrowings – valuation (continued)**

The valuation of debt designated in a fair value hedge relationship is calculated based upon the risk being hedged as prescribed by IAS 39 ‘Financial Instruments: Recognition and Measurement’. The group’s policy is to hedge its exposure to changes in the applicable underlying interest rate and it is this portion of the cash flows that is included in the valuation model (excluding any applicable company credit risk spread).

The valuation of debt designated at fair value through the profit or loss incorporates an assumed credit risk spread in the applicable discount factor. Credit spreads are determined based upon indicative pricing data.

#### **Taxation**

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the application of tax law and the result of negotiations with, and enquiries from, tax authorities in a number of jurisdictions.

### **q) Recently issued accounting pronouncements**

#### *International Financial Reporting Standards*

At the date of authorisation of these financial statements, the following relevant standards and interpretations were in issue but not yet effective. The directors anticipate that the group will adopt these standards and interpretations on their effective dates.

The directors anticipate that the adoption of the following standards and interpretations may have a material impact on the group’s financial statements:

- IFRS 9 ‘Financial Instruments – amendment’, issued in October 2010, is effective for periods commencing on or after 1 January 2015 but will not be considered for endorsement by the EU until the remaining elements of the project have been completed. Under the provisions of this standard, where the group has chosen to measure borrowings at fair value through the profit or loss the portion of the change in fair value due to changes in the group’s own credit risk will be recognised in other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year £21.3 million of gains would have been recognised in other comprehensive income rather than within profit or loss.

The directors anticipate that the adoption of the following standards and interpretations will have no material impact on the group’s financial statements:

- Amendments to IFRS 7 ‘Financial Instruments’, issued in October 2010, is effective for periods commencing on or after 1 July 2011 but was endorsed by the EU on 22 November 2011. This will have a material impact on the group’s financial statements only if it enters into any relevant transactions in the future;

All other standards and interpretations, which are in issue but not yet effective, are not considered relevant to the activities of the group.

## Notes to the financial statements

### 1. Total revenue

Total revenue, disclosed as required by IAS 18 'Revenue', recognised in the consolidated income statement is analysed as follows:

	2012 £m	2011 £m
Provision of goods and services (see note 2)	1,564.9	1,513.3
<b>Revenue</b>	<b>1,564.9</b>	<b>1,513.3</b>
Dividend income (see note 4)	-	0.1
Investment income (see note 5)	39.3	32.3
<b>Total revenue</b>	<b>1,604.2</b>	<b>1,545.7</b>

During the year ended 31 March 2012, £0.9 million of revenue was derived from exchanges of goods or services in relation to IFRIC 18 'Transfers of Assets from Customers' (2011: £0.4 million) (see note 22).

### 2. Segment reporting

As previously reported, United Utilities has reshaped its portfolio over the last few years, from a group with a wide-ranging set of activities and interests, such as telecommunications, business process outsourcing, gas and electricity distribution and metering and international utility operations, into a focused regulated UK water and wastewater business. The group completed its non-regulated disposal programme in November 2010 and the residual non-regulated activities now represent less than two per cent of operating profit.

The board of directors of United Utilities Group PLC (the board) in its capacity as the ultimate parent company is provided with information on a single segment basis for the purposes of assessing performance and allocating resources. The board reviews revenue, underlying operating profit, operating profit, assets and liabilities at a consolidated level.

In light of this, the group has a single segment for financial reporting purposes and the segmental information presented in previous years is no longer required to be disclosed separately within this note.

Segmental information in respect of discontinued operations in the prior year is given in note 8.

The group's revenue predominantly arises from the provision of services and is analysed by geographical area as follows:

	<i>Continuing operations</i>			<i>Discontinued operations</i>			<i>Total</i>
	UK	Rest of world	Total	UK	Rest of world	Total	
	£m	£m	£m	£m	£m	£m	£m
2012							
External revenue	1,548.9	16.0	1,564.9	-	-	-	1,564.9
Non-current assets*	8,686.3	57.1	8,743.4	-	-	-	8,743.4
	<i>Continuing operations</i>			<i>Discontinued operations</i>			<i>Total</i>
	UK	Rest of world	Total	UK	Rest of world	Total	
	£m	£m	£m	£m	£m	£m	£m
2011							
External revenue	1,496.2	17.1	1,513.3	296.3	57.1	353.4	1,866.7
Non-current assets*	8,321.1	55.0	8,376.1	-	-	-	8,376.1

\* Non-current assets exclude financial instruments.

The group does not rely on any major customers.

## Notes to the financial statements (continued)

### 3. Directors and employees

#### Directors' remuneration

	2012 £m	Restated* 2011 £m
Salaries	1.3	1.7
Benefits	0.3	0.2
Bonus	1.0	2.3
Post-employment benefits	-	0.3
Share-based payment charge	0.4	-
	<u>3.0</u>	<u>4.5</u>

\* The comparatives have been restated to include post-employment benefits of £0.3 million.

Included within the above is salary of £0.7 million (2011: £0.8 million) and bonus of £0.6 million (2011: £1.0 million) in respect of the highest paid director. The group paid £nil in the year (2011: £0.2 million) to the group's defined contribution pension scheme on behalf of the highest paid director. The highest paid director did not exercise share options in the year.

	2012 £m	2011 £m
Aggregate amounts receivable under long-term incentive plans	<u>0.1</u>	<u>0.9</u>

	2012 Number	2011 Number
Number of directors who received shares in respect of qualifying services	<u>3</u>	<u>4</u>
Number of directors who exercised share options	<u>2</u>	<u>3</u>
Number of directors accruing benefits under defined benefit schemes	<u>1</u>	<u>1</u>
Number of directors accruing benefits under defined contribution schemes	<u>-</u>	<u>4</u>

There were two directors with incentive plans which vested during the year ended 31 March 2012 (2011: three directors).

Details of the employee Sharesave Scheme and the executive share option scheme operated by United Utilities Group PLC are given in the UUG group financial statements.

All executive directors were either members of the defined benefit section or the defined contribution section of the group's pension scheme during the year or had opted for a cash allowance in lieu of their defined contribution pension entitlement (see note 19).

#### Remuneration of key management personnel

	2012 £m	2011 £m
Salaries and short-term employee benefits	5.7	7.1
Post-employment benefits	0.2	0.5
Share-based payments	0.7	-
	<u>6.6</u>	<u>7.6</u>

Key management personnel comprises all directors and certain senior managers who are members of the executive committee.

## Notes to the financial statements (continued)

### 3. Directors and employees (continued)

#### Employee benefits expense (including directors)

	2012 £m	2011 £m
<b>Group</b>		
<i>Continuing operations</i>		
Wages and salaries	194.7	174.6
Social security costs	15.8	13.4
Post-employment benefits excluding restructuring costs	17.5	17.1
Charged to capital schemes*	(92.6)	(62.3)
<b>Employee benefits expense excluding restructuring costs</b>	<b>135.4</b>	<b>142.8</b>
Restructuring costs	2.6	3.1
<b>Employee benefits expense attributable to continuing operations</b>	<b>138.0</b>	<b>145.9</b>
Less: employee benefits attributable to joint ventures	(1.8)	(1.9)
<b>Total employee benefits expense excluding joint ventures</b>	<b>136.2</b>	<b>144.0</b>

\* Central functional employee costs were recharged across the group in the prior year and capitalised indirectly, to the extent appropriate, from other operating costs. Following completion of the non-regulated disposal programme, such costs are now recharged to capital schemes directly from employee costs. For the group, this has resulted in an increase in capitalisation associated with employee benefit expense, previously included within 'other' in other operating costs.

Options over shares of the ultimate parent undertaking, United Utilities Group PLC have been granted to employees of the group under various schemes. Details of the terms and conditions of each share option scheme are given in the United Utilities Group PLC Annual Report 2012. Included within wages and salaries is an expense of £1.2m (2011: income of £0.1m) relating to a recharge of share-based payment costs/income from the ultimate parent undertaking.

The table below shows the nature of post-employment benefits:

	2012 £m	2011 £m
<b>Group</b>		
<i>Continuing operations</i>		
Defined pension expense – current service cost (see note 19)	13.3	11.9
Defined contribution pension costs (see note 19)	4.2	5.2
	<b>17.5</b>	<b>17.1</b>

#### Average number of employees during the year (full-time equivalent including directors)

	2012 number	2011 number
<b>Group</b>		
Continuing operations	5,096	4,735

The average number of employees during the prior year for discontinued operations is analysed as follows:

	2011 number
Non-regulated activities	1,656

## Notes to the financial statements (continued)

### 4. Operating profit

The following items have been charged/(credited) to the income statement in arriving at the group's operating profit from continuing operations:

	2012 £m	Re-presented* 2011 £m
<b>Other operating costs</b>		
Hired and contracted services	130.6	166.8
Materials	55.4	45.3
Power	50.3	49.1
Property rates	79.4	65.1
Charge for bad and doubtful receivables (see note 15)	34.5	30.6
Other operating leases payable:		
Property	3.3	4.9
Plant and equipment	0.8	0.8
Amortisation of deferred grants and contributions (see note 22)	(6.9)	(6.9)
Research and development expenses	1.6	0.9
Loss on disposal of property, plant and equipment	5.5	2.7
Loss on disposal of other intangible assets	2.6	2.8
Other	30.9	(4.0)
	<u>388.0</u>	<u>358.1</u>
<b>Other income</b>		
Dividend income	-	(0.1)
Other income	(4.8)	(4.8)
	<u>(4.8)</u>	<u>(4.9)</u>
<b>Depreciation and amortisation expense</b>		
Depreciation of property, plant and equipment: owned assets	278.0	258.3
Amortisation of other intangible assets	19.8	32.2
	<u>297.8</u>	<u>290.5</u>

\* The comparatives have been re-presented to include loss on disposal of property, plant and equipment of £2.7 million within other operating costs rather than within other income, as previously presented, as this better reflects the nature of the expenditure. In addition, loss on disposal of other intangible assets of £2.8 million in the prior year has been shown separately (2011: previously presented within other).

During the year, the group obtained the following services from its auditor, at the costs detailed below:

	2012 £m	2011 £m
Statutory audit of the financial statements	0.1	0.3
Other fees to the auditor:		
Local statutory audits for subsidiaries	0.1	0.2
Other audit related	-	0.1
Taxation advisory services	0.1	-
Regulatory reporting	0.1	0.1
Due diligence and transaction support	-	0.6
	<u>0.4</u>	<u>1.3</u>

The 2010/11 costs of £1.3 million relate to services provided by the group's previous auditor, Deloitte LLP.

Included in the above statutory audit fee is £20,000 in relation to the company for the year ended 31 March 2012 (2011: £30,000).

## Notes to the financial statements (continued)

### 5. Investment income

	2012 £m	2011 £m
Interest receivable on short-term bank deposits held at amortised cost	4.4	2.8
Interest receivable from ultimate parent undertaking (note 26)	34.9	29.5
	<u>39.3</u>	<u>32.3</u>

### 6. Finance expense

	2012 £m	2011 £m
<b>Interest payable</b>		
Interest payable on borrowings held at amortised cost	269.0	271.0
Intercompany interest – payable to discontinued operations	-	0.3
	<u>269.0</u>	<u>271.3</u>
<b>Fair value losses/(gains) on debt and derivative instruments<sup>(1)</sup></b>		
Fair value hedge relationships:		
Borrowings	210.0	(20.2)
Designated swaps	(205.0)	11.1
	<u>5.0</u>	<u>(9.1)</u>
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss <sup>(2)</sup>	19.1	(0.8)
Held for trading derivatives – economic hedge	(47.9)	1.1
	<u>(28.8)</u>	<u>0.3</u>
Held for trading derivatives - 2005-2010 regulatory hedges	-	(7.3)
Held for trading derivatives - 2010-2015 regulatory hedges	54.4	1.4
Held for trading derivatives - regulatory hedges >2015	18.2	-
Held for trading derivatives - electricity hedges	4.6	-
Net receipts on swaps and debt under fair value option	(7.7)	(6.2)
Held for trading derivatives – other <sup>(3)</sup>	(1.6)	(3.1)
Other	(0.9)	4.8
	<u>67.0</u>	<u>(10.4)</u>
Net fair value losses/(gains) on debt and derivative instruments <sup>(4)</sup>	<u>43.2</u>	<u>(19.2)</u>
Expected return on pension schemes' assets (see note 19)	(100.5)	(102.2)
Interest cost on pension schemes' obligations (see note 19)	103.8	106.0
Net pension interest expense	<u>3.3</u>	<u>3.8</u>
	<u>315.5</u>	<u>255.9</u>

#### Notes:

- (1) Fair value losses/(gains) on debt and derivative instruments includes foreign exchange gains of £22.3 million (2011: £15.2 million), excluding those on instruments measured at fair value through profit or loss. These gains are largely offset by fair value losses on derivatives.
- (2) Includes £21.3 million gains (2011: £4.1 million losses) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.
- (3) Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.
- (4) Includes £7.2 million income (2011: £5.7 million) due to interest on swaps and debt under fair value option.

Interest payable for the year ended 31 March 2012 is stated net of £9.7 million (2011: £4.4 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and other intangible assets during the year. This has been calculated by applying a capitalisation rate of 4.8 per cent (2011: 4.6 per cent) to expenditure on such assets as prescribed by IAS 23 (Revised 2007) 'Borrowing Costs'.

## Notes to the financial statements (continued)

### 7. Taxation

	2012 £m	2011 £m
<b>Continuing operations</b>		
<b>Current taxation</b>		
UK corporation tax	69.2	70.1
Foreign tax	1.3	1.9
Adjustments in respect of prior years	(9.6)	(28.7)
	<u>60.9</u>	<u>43.3</u>
<b>Deferred taxation</b>		
Current year	12.6	25.7
Adjustments in respect of prior years	15.5	11.3
	<u>28.1</u>	<u>37.0</u>
Change in taxation rate	(104.6)	(99.0)
Total deferred taxation credit for the year	<u>(76.5)</u>	<u>(62.0)</u>
Total taxation credit for the year	<u>(15.6)</u>	<u>(18.7)</u>

The tables below reconcile the notional tax charge at the UK corporation tax rate to the effective tax rate for the year:

	<i>Continuing operations</i>		<i>Discontinued operations</i>		<i>Total</i>	
	2012 £m	2012 %	2012 £m	2012 %	2012 £m	2012 %
Profit before taxation	315.3		-		315.3	
Tax at the UK corporation tax rate of 26 per cent	82.0	26.0	-	-	82.0	26.0
Adjustments in respect of prior years	5.9	1.9	-	-	5.9	1.9
Change in taxation rate	(104.6)	(33.2)	-	-	(104.6)	(33.2)
Net expenses not deductible/other	1.1	0.4	-	-	1.1	0.4
Total tax credit and effective tax rate for the year	<u>(15.6)</u>	<u>(4.9)</u>	<u>-</u>	<u>-</u>	<u>(15.6)</u>	<u>(4.9)</u>

	<i>Continuing operations</i>		<i>Discontinued operations</i>		<i>Total</i>	
	2011 £m	2011 %	2011 £m	2011 %	2011 £m	2011 %
Profit before taxation	356.6		23.8		380.4	
Tax at the UK corporation tax rate of 28 per cent	99.8	28.0	6.7	28.0	106.5	28.0
Adjustments in respect of prior years	(17.4)	(4.9)	1.8	7.6	(15.6)	(4.1)
Change in taxation rate	(99.0)	(27.7)	0.9	3.8	(98.1)	(25.8)
Net income not taxable/other	(2.1)	(0.6)	(0.2)	(0.8)	(2.3)	(0.6)
Total tax (credit)/charge and effective tax rate for the year	<u>(18.7)</u>	<u>(5.2)</u>	<u>9.2</u>	<u>38.6</u>	<u>(9.5)</u>	<u>(2.5)</u>

The deferred taxation credit for the year ended 31 March 2012 includes a credit of £104.6 million to reflect the change enacted on 5 July 2011 to reduce the mainstream rate of corporation tax from 26 per cent to 25 per cent and subsequent change enacted on 26 March 2012 to reduce the mainstream rate of corporation tax further to 24 per cent effective from 1 April 2012. A related deferred taxation charge of £3.9 million is included within items taken directly to equity.

## Notes to the financial statements (continued)

### 7. Taxation (continued)

The deferred taxation credit for the year ended 31 March 2011 includes £99.0 million which reflects both the change enacted on 27 July 2010 to reduce the mainstream rate of corporation tax from 28 per cent to 27 per cent and the subsequent change enacted on 29 March 2011 to reduce the mainstream rate of corporation tax from 27 per cent to 26 per cent effective from 1 April 2011.

There will be a further phased reduction in the mainstream corporation tax rate to 22 per cent by 1 April 2014. The total deferred taxation credit in respect of this further reduction is expected to be in the region of £100.0 million.

A taxation charge of £5.9 million (2011: £17.4 million credit) arose in the year in continuing operations in relation to the agreement of prior years' UK taxation matters.

#### Taxation on items taken directly to equity

<b>Group</b>	2012	2011
<i>Continuing operations</i>	£m	£m
<b>Current taxation</b>		
Relating to other pension movements	(33.1)	-
<b>Deferred taxation (see note 20)</b>		
On actuarial losses on defined benefit pension schemes	(5.8)	(11.6)
Relating to other pension movements	30.6	-
Change in taxation rate	3.9	-
On net fair value losses on cash flow hedges	-	(0.1)
	28.7	(11.7)
Total taxation credit on items taken directly to equity	(4.4)	(11.7)
<b>Company</b>	2012	2011
<i>Continuing operations</i>	£m	£m
<b>Current taxation</b>		
Relating to other pension movements	(7.7)	-
<b>Deferred taxation (see note 20)</b>		
On actuarial losses on defined benefit pension scheme	(6.9)	(8.5)
Relating to other pension movements	7.1	-
Change in taxation rate	1.0	-
	1.2	(8.5)
Total taxation credit on items taken directly to equity	(6.5)	(8.5)



## Notes to the financial statements (continued)

### 8. Discontinued operations

During the prior year, the group completed its non-regulated disposal programme which, including 2009/10 investment disposals, achieved a total enterprise value of £579.2 million. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' the relevant disposal groups were therefore classified as discontinued operations in the consolidated income statement and consolidated statement of cash flows.

	2012 £m	2011 £m
<b>Revenue</b>	-	353.4
Employee benefits expense:		
Excluding restructuring costs	-	(88.6)
Restructuring costs	-	(3.8)
Total employee benefits expense	-	(92.4)
Other reorganisation credits	-	7.0
Other operating costs	-	(225.9)
Depreciation and amortisation expense	-	(6.3)
<b>Operating profit</b>	-	35.8
Investment income and finance expense	-	(7.0)
Evaluation and disposal costs relating to discontinued operations	-	(5.0)
<b>Profit before taxation</b>	-	23.8
Current taxation charge	-	(1.8)
Deferred taxation charge	-	(7.4)
<b>Taxation</b>	-	(9.2)
<b>Profit after taxation</b>	-	14.6
Profit on disposal of discontinued operations after taxation	5.1	89.1
<b>Total profit after taxation from discontinued operations</b>	5.1	103.7

## Notes to the financial statements (continued)

### 8. Discontinued operations (continued)

The net assets and liabilities at disposal and the profit on disposal of discontinued operations after taxation is analysed as follows:

	2012 £m	2011 £m
<b>Total proceeds<sup>(1)</sup></b>	3.5	268.4
Property, plant and equipment	-	(176.7)
Goodwill (see note 11)	-	(17.9)
Other intangible assets	-	(119.6)
Investments (see note 13)	-	(6.6)
Non-current trade and other receivables	-	(59.4)
Inventories	-	(11.7)
Current trade and other receivables	-	(203.1)
Cash and short-term deposits	-	(50.0)
Trade and other payables	-	230.8
Joint venture debt	-	228.7
Provisions (see note 21)	-	17.9
Retirement benefit obligations (see note 19)	(0.4)	7.3
Deferred taxation assets (see note 20)	-	(4.0)
<b>Net assets disposed of</b>	(0.4)	(164.3)
Transaction and other costs of disposal	2.0	(45.9)
Reclassification from other reserves arising on disposal of financial asset investment	-	6.6
Reclassification from other reserves arising on disposal of subsidiaries	-	(1.8)
Reclassification from cumulative exchange reserve arising on disposal of subsidiaries	-	26.1
<b>Profit on disposal of discontinued operations after taxation</b>	5.1	89.1

(1) Total fair value of the 2010/11 proceeds comprised cash of £268.4 million. The enterprise value of £447.1 million incorporates cash consideration received added to the market value of the debt disposed of which at the date of disposal totalled £178.7 million. Combined with the cash consideration received from the disposal of investments in the prior year of £132.1 million, the non-regulated disposal programme achieved a total enterprise value of £579.2 million.

The profit on disposal of discontinued operations after taxation for the year ended 31 March 2012 relates primarily to the receipt of contingent consideration and the release of accrued costs of disposal in respect of certain elements of the group's prior year non-regulated disposal programme.

### 9. Dividends

Amounts recognised as distributions to equity holders of the company in the year comprise:

	2012 £m	2011 £m
<b>Ordinary shares</b>		
Final dividend for the year ended 31 March 2011 at nil pence per share (2010: 17.87 pence)	-	157.6
Interim dividend for the year ended 31 March 2012 at nil pence per share (2011: 8.64 pence)	-	76.2
	-	233.8
Proposed final dividend for the year ended 31 March 2012 at nil pence per share (2011: nil pence)	-	-

## Notes to the financial statements (continued)

### 10. Property, plant and equipment

	Land and buildings £m	Infra- structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
<b>Group Cost</b>						
At 1 April 2010	232.9	3,734.6	4,813.8	603.0	850.5	10,234.8
Additions	14.4	126.2	59.6	36.9	332.8	569.9
Transfers	4.2	84.0	323.1	12.4	(423.7)	-
Disposals	(3.3)	(67.7)	(33.0)	(224.7)	(13.6)	(342.3)
Currency translation differences	-	(3.0)	-	0.3	(0.1)	(2.8)
At 31 March 2011	248.2	3,874.1	5,163.5	427.9	745.9	10,459.6
Additions	1.9	169.4	64.3	37.3	387.5	660.4
Transfers	3.5	106.7	127.2	9.8	(247.2)	-
Disposals	(17.1)	(0.8)	(59.0)	(25.9)	(2.8)	(105.6)
Currency translation differences	(0.4)	(3.0)	-	(0.2)	-	(3.6)
<b>At 31 March 2012</b>	<b>236.1</b>	<b>4,146.4</b>	<b>5,296.0</b>	<b>448.9</b>	<b>883.4</b>	<b>11,010.8</b>
<b>Accumulated depreciation</b>						
At 1 April 2010	74.7	177.4	1,525.9	297.2	-	2,075.2
Charge for the year	8.1	26.6	187.4	41.6	-	263.7
Disposals	(2.8)	(31.8)	(26.8)	(91.5)	-	(152.9)
Currency translation differences	-	(1.5)	-	0.2	-	(1.3)
At 31 March 2011	80.0	170.7	1,686.5	247.5	-	2,184.7
Charge for the year	8.3	27.3	202.5	39.9	-	278.0
Disposals	(17.0)	-	(54.3)	(24.0)	-	(95.3)
Currency translation differences	(0.1)	(1.0)	-	-	-	(1.1)
<b>At 31 March 2012</b>	<b>71.2</b>	<b>197.0</b>	<b>1,834.7</b>	<b>263.4</b>	<b>-</b>	<b>2,366.3</b>
<b>Net book value at 31 March 2012</b>	<b>164.9</b>	<b>3,949.4</b>	<b>3,461.3</b>	<b>185.5</b>	<b>883.4</b>	<b>8,644.5</b>
Net book value at 31 March 2011	168.2	3,703.4	3,477.0	180.4	745.9	8,274.9

At 31 March 2012, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £331.8 million (2011: £241.7 million).

In addition to these commitments, the group has long-term expenditure plans which include investments to achieve improvements in performance mandated by Ofwat and to provide for future growth.

## Notes to the financial statements (continued)

### 10. Property, plant and equipment (continued)

	Fixtures, fittings, tools and equipment £m
<b>Company</b>	
<b>Cost</b>	
At 1 April 2010, 31 March 2011 and 31 March 2012	4.8
<b>Accumulated depreciation</b>	
At 1 April 2010, 31 March 2011 and 31 March 2012	4.4
<b>Net book value at 31 March 2011 and 31 March 2012</b>	0.4

The company had no contractual commitments for the acquisition of property, plant and equipment at 31 March 2012 or at 31 March 2011.

### 11. Goodwill

	£m
<b>Group</b>	
<b>Cost</b>	
At 1 April 2010	2.5
Additions	20.4
Disposals (see note 8)	(17.9)
<b>At 31 March 2011 and 31 March 2012</b>	5.0

Goodwill at 31 March 2012 and 31 March 2011 relates to the group's shareholding in AS Tallinna Vesi (Tallinn Water).

The company has no goodwill.

## Notes to the financial statements (continued)

### 12. Other intangible assets

	Computer software £m	Service concessions £m	Other £m	Total £m
<b>Group Cost</b>				
At 1 April 2010	216.1	127.8	23.8	367.7
Additions – purchased	18.3	21.5	0.8	40.6
Disposals	(1.3)	(149.6)	(14.2)	(165.1)
Currency translation differences	-	0.3	(0.2)	0.1
At 31 March 2011	233.1	-	10.2	243.3
Additions – purchased	18.3	-	-	18.3
Disposals	(39.3)	-	-	(39.3)
Currency translation differences	-	-	(0.6)	(0.6)
<b>At 31 March 2012</b>	<b>212.1</b>	<b>-</b>	<b>9.6</b>	<b>221.7</b>
<b>Amortisation</b>				
At 1 April 2010	114.2	33.0	11.9	159.1
Charge for the year	32.0	0.7	0.4	33.1
Disposals	(0.1)	(33.7)	(8.9)	(42.7)
Currency translation differences	-	-	(0.1)	(0.1)
At 31 March 2011	146.1	-	3.3	149.4
Charge for the year	19.6	-	0.2	19.8
Disposals	(36.7)	-	-	(36.7)
Currency translation differences	-	-	(0.3)	(0.3)
<b>At 31 March 2012</b>	<b>129.0</b>	<b>-</b>	<b>3.2</b>	<b>132.2</b>
<b>Net book value at 31 March 2012</b>	<b>83.1</b>	<b>-</b>	<b>6.4</b>	<b>89.5</b>
Net book value at 31 March 2011	87.0	-	6.9	93.9

The 'other' intangible assets category relates mainly to customer contracts and customer lists. The service concession assets related to operations which were sold as part of the non-regulated activities disposal programme during the prior year (see note 8).

At 31 March 2012, the group had entered into contractual commitments for the acquisition of other intangible assets amounting to £63.6 million (2011: £43.9 million).

The company has no other intangible assets. The company had no contractual commitments for the acquisition of other intangible assets at 31 March 2012 or 31 March 2011.

## Notes to the financial statements (continued)

### 13. Investments

	Other investments £m
<b>Group</b>	
At 1 April 2010	7.7
Additions	0.1
Revaluations	1.1
Disposals (see note 8)	(6.6)
At 31 March 2011	2.3
Additions	2.2
Disposals	(1.1)
Currency translation differences	(0.1)
<b>At 31 March 2012</b>	<b>3.3</b>

At 31 March 2012, the group's other investments mainly comprised of its investment in Muharraq Holding Company 1 Limited and its preference shares in Philwater Holdings Company Inc.

Details of principal operating subsidiary undertakings and joint ventures are set out below. These undertakings are included within the consolidated financial statements. A full list of the group's subsidiary undertakings is included in the company's annual return.

	Class of share capital held	Proportion of share capital owned/voting rights %	Nature of business
<b>Subsidiary undertakings</b>			
<b>Great Britain</b>			
United Utilities Water PLC	Ordinary	100.0*	Water and wastewater services and network management
United Utilities Property Services Limited	Ordinary	100.0	Property management
<b>Joint ventures</b>			
<b>Estonia</b>			
AS Tallinna Vesi	Ordinary	35.3*	Contract operations and maintenance services

\* Shares are held by subsidiary undertakings rather than directly by United Utilities PLC.

Joint management of AS Tallinna Vesi (Tallinn Water) is based on a shareholders' agreement. Tallinn Water's financial year end is not coterminous with that of the group. The most recent financial year ended on 31 December 2011.

In relation to the group's interests in joint ventures, the assets, liabilities, gross income and expenses are summarised below:

	2012 £m	2011 £m
<b>Group share of joint ventures</b>		
Non-current assets	49.1	52.4
Current assets	16.6	15.2
Non-current liabilities	(27.9)	(30.0)
Current liabilities	(6.7)	(6.7)
	<u>31.1</u>	<u>30.9</u>

## Notes to the financial statements (continued)

### 13. Investments (continued)

	2012 £m	2011 £m
<b>Group share of joint ventures</b>		
Gross income	15.7	121.1
Expenses	(8.1)	(94.8)
Taxation	(1.3)	(2.4)
<b>Profit after taxation</b>	<u>6.3</u>	<u>23.9</u>

Included within the prior year joint venture income statement measures disclosed in the table above are gross income of £108.3 million, expenses of £89.3 million and taxation of £0.5 million relating to entities that were disposed of during the year ended 31 March 2011 and hence were recorded within the results for discontinued operations (see note 8).

The joint ventures have no significant contingent liabilities to which the group is exposed and the group has issued guarantees of £5.4 million to its joint ventures (2011: £5.9m) which are included in the contingent liabilities total disclosed in note 28.

	Shares in subsidiary undertakings £m
<b>Company</b>	
At 1 April 2010	6,161.0
Additions	3,017.0
Impairment charge	(1,501.7)
Disposals	(1,499.8)
At 31 March 2011	6,176.5
Additions	125.9
Impairment charge	(18.3)
Disposals	(184.1)
<b>At 31 March 2012</b>	<u>6,100.0</u>

During the year ended 31 March 2012, there was an addition of £125.9 million investment in the ordinary shares of United Utilities Investments (No.2) Limited.

Also during the year, an impairment review was performed supporting the carrying value of the investment of £6,100.0 million. This resulted in an impairment of £17.3 million against investments in NB Telecom (IOM) Limited and an impairment of £1.0 million was also taken against investments in United Utilities Investments (No.3) Limited.

Total disposals during the year were £184.1 million of which £183.0 million related to the strike off of investments including £125.9 million investments in the ordinary shares of United Utilities Investments (No.2) Limited and £54.9 million in the ordinary shares of United Utilities Financial Services Limited. The disposals resulted in £205.2m realisation of value through receipt of dividends.

As reported in the prior year, additions of £3,017.0 million included £1,499.8 million investments in the ordinary shares of United Utilities Investments (No.7) Limited and a capital contribution of £17.4 million to United Utilities Utility Solutions Holdings Limited. Also, during the year ended 31 March 2011, the company entered into a stock lending agreement with United Utilities Investment Partnerships (No.2) LP (UIIP), transferring 476 million ordinary shares in United Utilities North West PLC resulting in additional investments in the parent companies of UIIP, being £1,187.9 million in United Utilities Employee Share Trust, £296.9 million in United Utilities (Jersey) Investments (No.6) Limited and £15.0 million in United Utilities Investments (No.5) Limited.

## Notes to the financial statements (continued)

### 13. Investments (continued)

Also in the prior year, an impairment of £1,500.8 million was taken against investments in United Utilities One Limited following a £1,500.8 million realisation of value through receipt of dividends. An impairment of £0.9 million was also taken against investments in United Utilities Investments (No.3) Limited.

The above mentioned transfer of ordinary shares in United Utilities North West PLC resulted in a disposal of £1,499.8 million.

### 14. Inventories

	2012 £m	2011 £m
<b>Group</b>		
Properties held for resale	42.3	42.9
Other inventories	5.1	4.7
	<u>47.4</u>	<u>47.6</u>

The company has no inventories.

### 15. Trade and other receivables

	2012 £m	<b>Group</b> 2011 £m	2012 £m	<b>Company</b> 2011 £m
Trade receivables	260.5	243.5	0.4	3.9
Less: allowance for doubtful receivables	(78.4)	(55.2)	(0.4)	(0.6)
Trade receivables net	<u>182.1</u>	<u>188.3</u>	-	<u>3.3</u>
Amounts owed by subsidiary undertakings	-	-	1,239.3	1,672.7
Amounts owed by ultimate parent undertaking (see note 26) *	1,735.2	1,501.9	-	0.1
Amounts owed by related parties (see note 26)	1.0	2.7	-	-
Other debtors	15.8	15.6	-	0.3
Prepayments and accrued income	<u>103.6</u>	<u>90.2</u>	<u>0.1</u>	<u>6.2</u>
	<u>2,037.7</u>	<u>1,798.7</u>	<u>1,239.4</u>	<u>1,682.6</u>

\* Included in net amounts owed by the ultimate parent undertaking is £9.0 million for the group (2011: £0.1 million) and £nil for the company (2011: £0.1 million) relating to net group tax relief receivable from United Utilities Group PLC.

Trade and other receivables have been analysed between non-current and current as follows:

	2012 £m	<b>Group</b> 2011 £m	2012 £m	<b>Company</b> 2011 £m
Non-current	1.1	-	-	-
Current	<u>2,036.6</u>	<u>1,798.7</u>	<u>1,239.4</u>	<u>1,682.6</u>
	<u>2,037.7</u>	<u>1,798.7</u>	<u>1,239.4</u>	<u>1,682.6</u>



## Notes to the financial statements (continued)

### 15. Trade and other receivables (continued)

Trade receivables do not carry interest and are stated net of allowances for doubtful receivables, an analysis of which is as follows:

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
At the start of the year	55.2	206.6	0.6	1.4
Amounts charged/(credited) to operating expenses				
- continuing operations	34.5	30.6	(0.1)	(0.8)
Amounts charged to operating expenses				
- discontinued operations	-	2.0	-	-
Trade receivables written off	(11.3)	(170.1)	-	-
Disposed of during the year	-	(13.9)	(0.1)	-
<b>At the end of the year</b>	<b>78.4</b>	<b>55.2</b>	<b>0.4</b>	<b>0.6</b>

At each reporting date, the company and each of its subsidiaries evaluate the recoverability of trade receivables and record allowances for doubtful receivables based upon experience.

During the year ended 31 March 2011, £131.1 million of debt was written off as a result of a detailed review of the group's trade receivables balance. This debt was significantly provided; therefore, the charge for bad and doubtful receivables as a result of this exercise was a lower amount of £2.5 million.

In the company, gross amounts owed by subsidiary undertakings relating to non-trading subsidiary undertakings are stated net of allowances for doubtful receivables, an analysis of which is as follows:

	2012 £m	2011 £m
<b>Company</b>		
At the start of the year	80.6	82.9
Amounts charged to operating expenses	8.1	2.2
Amounts written off	(1.4)	(4.5)
<b>At the end of the year</b>	<b>87.3</b>	<b>80.6</b>

### Ageing of gross receivables

The following table provides information regarding the ageing of gross receivables:

	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
<b>Group</b>				
<b>At 31 March 2012</b>				
Trade receivables - gross	139.7	55.2	65.6	260.5
Amounts owed by ultimate parent undertaking	235.4	-	1,499.8	1,735.2
Amounts owed by related parties	1.0	-	-	1.0
Other debtors	15.4	-	0.4	15.8
Prepayments and accrued income	103.6	-	-	103.6

## Notes to the financial statements (continued)

### 15. Trade and other receivables (continued)

#### Ageing of gross receivables (continued)

<b>Group</b>	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
<b>At 31 March 2011</b>				
Trade receivables - gross	147.2	43.4	52.9	243.5
Amounts owed by ultimate parent undertaking	-	37.4	1,464.5	1,501.9
Amounts owed by related parties	2.5	0.1	0.1	2.7
Other debtors	15.6	-	-	15.6
Prepayments and accrued income	90.2	-	-	90.2

The group manages its regulated bad debt risk by providing against gross trade receivables. This allowance is calculated by reference to customer categories rather than on the age profile of gross debtor balances. It is therefore not possible to age the allowance for doubtful receivables.

<b>Company</b>	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
<b>At 31 March 2012</b>				
Trade receivables - gross	-	-	0.4	0.4
Amounts owed by subsidiary undertakings – gross	255.0	136.2	935.4	1,326.6
Prepayments and accrued income	0.1	-	-	0.1
<b>At 31 March 2011</b>				
Trade receivables - gross	3.3	-	0.6	3.9
Amounts owed by subsidiary undertakings – gross	310.2	19.8	1,423.4	1,753.4
Other debtors	-	0.3	-	0.3
Prepayments and accrued income	6.2	-	-	6.2

Amounts owed by subsidiary undertakings are a sum of all subsidiary balances where the total of inter-company tax, debt, interest and trade balances is in a net receivable position. The recoverability of these balances has been assessed at the year end, and except for the allowance for doubtful receivables detailed below, the balances are deemed to be fully recoverable.

The directors consider that the carrying amount of trade and other receivables approximates to their fair value at 31 March 2012 and 31 March 2011.

### 16. Cash and cash equivalents

	2012 £m	<b>Group</b> 2011 £m	2012 £m	<b>Company</b> 2011 £m
Cash at bank and in hand	12.4	17.3	0.1	1.3
Short-term bank deposits	308.8	237.9	308.1	235.7
<b>Cash and short-term deposits</b>	<b>321.2</b>	<b>255.2</b>	<b>308.2</b>	<b>237.0</b>
Bank overdrafts (included in borrowings, see note 17)	(8.6)	(8.4)	(0.1)	(0.1)
<b>Cash and cash equivalents in the statement of cash flows</b>	<b>312.6</b>	<b>246.8</b>	<b>308.1</b>	<b>236.9</b>

Cash and short-term deposits include cash at bank and in hand, deposits and other short-term highly liquid investments which are readily convertible into known amounts of cash and have a maturity of three months or less.

## Notes to the financial statements (continued)

### 17. Borrowings

The following analysis provides information about the contractual terms of the group's borrowings:

<b>Group</b>	2012 £m	2011 £m
<b>Non-current liabilities</b>		
Bonds	4,491.1	4,208.5
Bank and other term borrowings	1,237.0	995.1
	<u>5,728.1</u>	<u>5,203.6</u>
<b>Current liabilities</b>		
Bonds	7.0	-
Bank and other term borrowings	111.0	98.9
Bank overdrafts (see note 16)	8.6	8.4
Amounts owed to ultimate parent undertaking	33.2	33.5
	<u>159.8</u>	<u>140.8</u>
	<u>5,887.9</u>	<u>5,344.4</u>

### Terms and debt repayment schedule

The principal economic terms and conditions of outstanding borrowings were as follows:

<b>Group</b>	Currency	Year of final repayment	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
<b>Borrowings in fair value hedge relationships</b>						
5.625% 300m bond	GBP	2027	340.9	377.8	310.2	327.7
5.75% 375m bond	GBP	2022	430.4	421.6	390.7	371.6
5.375% 150m bond	GBP	2018	177.1	176.1	163.8	162.8
5.00% 200m bond	GBP	2035	202.1	244.6	186.3	208.2
4.25% 500m bond	EUR	2020	460.1	471.7	436.2	452.0
4.55% 250m bond	USD	2018	163.6	179.2	155.4	165.2
5.375% 350m bond	USD	2019	235.0	262.8	225.0	242.4
5.02% JPY 10bn dual currency loan	JPY/USD	2029	76.7	95.6	73.5	87.9
<b>Borrowings designated at fair value through profit or loss</b>						
6.875% 400m bond	USD	2028	283.3	283.3	264.3	264.3
1.135% 3bn bond	JPY	2013	22.6	22.6	22.5	22.5

## Notes to the financial statements (continued)

### 17. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
<i>table continued from previous page</i>						
<b>Borrowings measured at amortised cost</b>						
1.5802%+RPI 100m IL bond	GBP	2042	116.7	122.1	102.8	116.3
1.7829%+RPI 100m IL bond	GBP	2040	123.6	122.5	109.5	116.7
1.9799%+RPI 100m IL bond	GBP	2035	128.3	123.8	115.3	117.9
3.375%+RPI 50m IL bond	GBP	2032	86.3	65.8	79.1	62.6
1.3258%+RPI 50m IL bond	GBP	2041	55.1	61.1	48.5	58.2
1.397%+RPI 50m IL bond	GBP	2046	55.4	61.1	48.2	58.2
1.3805%+RPI 35m IL bond	GBP	2056	36.5	41.7	28.5	40.1
1.435%+RPI 50m IL bond	GBP	2056	53.1	59.6	41.6	57.3
1.556%+RPI 50m IL bond	GBP	2056	55.6	59.8	43.5	57.5
1.5865%+RPI 50m IL bond	GBP	2056	56.2	60.1	43.7	57.8
1.591%+RPI 25m IL bond	GBP	2056	28.0	30.0	21.8	28.8
1.662%+RPI 100m IL bond	GBP	2056	115.2	120.3	89.7	115.7
1.815%+RPI 100m IL bond	GBP	2056	121.1	120.5	94.3	115.9
1.847%+RPI 100m IL bond	GBP	2056	123.0	121.0	95.4	116.4
1.5366%+RPI 50m IL bond	GBP	2043	58.1	60.9	51.0	58.0
1.7937%+RPI 50m IL bond	GBP	2049	61.3	60.8	55.8	57.9
1.585%+RPI 100m IL bond	GBP	2057	108.2	115.7	87.3	111.3
1.702%+RPI 50m IL bond	GBP	2057	56.8	58.4	45.6	56.1
2.40%+RPI 70m IL bond	GBP	2039	89.1	78.1	73.8	75.1
1.66%+RPI 35m IL bond	GBP	2037	39.3	40.1	31.7	38.6
1.97%+RPI 200m IL loan	GBP	2016	255.4	240.5	207.0	228.5
1.61%+RPI 50m IL loan	GBP	2020	61.7	54.9	51.5	52.8
1.73%+RPI 50m IL loan	GBP	2020	62.2	54.8	52.0	52.7
1.84%+RPI 50m IL loan	GBP	2020	62.6	54.8	52.4	52.7
1.88%+RPI 50m IL loan	GBP	2020	62.6	54.6	52.7	52.5
1.90%+RPI 50m IL loan	GBP	2020	62.9	54.7	52.8	52.6
1.93%+RPI 50m IL loan	GBP	2020	62.9	54.6	52.9	52.6
2.10%+RPI 50m IL loan	GBP	2020	63.6	54.5	53.7	52.4
2.46%+RPI 50m IL loan	GBP	2020	65.4	54.5	55.3	52.5
1.23%+RPI 50m IL loan	GBP	2029	49.4	52.0	42.9	50.0
1.29%+RPI 50m IL loan	GBP	2029	49.8	51.6	-	-
1.12%+RPI 50m IL loan	GBP	2029	48.0	51.3	-	-
1.10%+RPI 50m IL loan	GBP	2029	47.8	51.2	-	-
0.75%+RPI 50m IL loan	GBP	2029	43.9	50.1	-	-
0.76%+RPI 50m IL loan	GBP	2030	43.7	49.9	-	-
1.15%+RPI 50m IL loan	GBP	2030	46.5	49.7	-	-
1.11%+RPI 50m IL loan	GBP	2030	45.2	49.9	-	-
6.125% 425m bond	GBP	2015	489.7	429.7	472.3	430.9
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	6.5	7.0	6.5	6.7
1.30%+LIBOR (floating) 5bn bond	JPY	2017	40.9	38.3	41.0	37.8
Long-term bank borrowings - floating	GBP	2011-2012	-	-	199.9	200.0
Commission for New Towns loan - fixed	GBP	2053	53.1	30.1	49.9	30.4
Joint venture borrowings	Various	Various	27.9	27.9	30.1	30.1
Short-term bank borrowings - fixed	GBP	2012	110.8	110.8	46.3	46.3
<b>Other borrowings</b>						
Amounts owed to ultimate parent undertaking	GBP	2012	33.2	33.2	33.5	33.5
Bank overdrafts	GBP	2012	8.6	8.6	8.4	8.4
			<u>5,863.0</u>	<u>5,887.9</u>	<u>5,096.1</u>	<u>5,344.4</u>

## Notes to the financial statements (continued)

### 17. Borrowings (continued)

Borrowings are unsecured. Funding raised in currencies other than sterling is generally swapped to sterling to match funding costs to income and assets. Abbreviations used in the above table are defined below.

The following analysis provides information about the contractual terms of the company's borrowings:

Company	2012 £m	2011 £m
<b>Non-current liabilities</b>		
Bonds	689.7	660.8
	<u>689.7</u>	<u>660.8</u>
<b>Current liabilities</b>		
Bonds	7.0	-
Bank and other term borrowings	69.7	46.3
Bank overdraft	0.1	0.1
Amounts owed to subsidiary undertakings	710.7	781.4
Amounts owed to ultimate parent undertaking	33.2	33.5
	<u>820.7</u>	<u>861.3</u>
	<u><u>1,510.4</u></u>	<u><u>1,522.1</u></u>

### Terms and debt repayment schedule

The principal economic terms and conditions of outstanding borrowings were as follows:

Company	Currency	Year of final repayment	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
<b>Borrowings in fair value hedge relationships</b>						
4.55% 250m bond	USD	2018	163.6	179.2	155.4	165.2
5.375% 350m bond	USD	2019	235.0	262.8	225.0	242.4
<b>Borrowings measured at amortised cost</b>						
6.875% 400m bond	USD	2028	283.3	247.7	264.3	246.5
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	6.5	7.0	6.5	6.7
Short-term bank borrowings – fixed	GBP	2012	69.7	69.7	46.3	46.3
Amounts owed to subsidiary undertakings	GBP	2012	710.7	710.7	781.4	781.4
Amounts owed to ultimate parent undertaking	GBP	2012	33.2	33.2	33.5	33.5
<b>Other borrowings</b>						
Bank overdrafts	GBP	2012	0.1	0.1	0.1	0.1
			<u>1,502.1</u>	<u>1,510.4</u>	<u>1,512.5</u>	<u>1,522.1</u>

Borrowings are unsecured.

#### Currency:

GBP	pound sterling
EUR	euro
USD	United States dollar
JPY	Japanese yen

#### Index-linked debt:

IL	Index-linked debt – this debt is adjusted for movements in the Retail Price Index with reference to a base RPI established at trade date
RPI	The UK general index of retail prices (for all items) as published by the Office for National Statistics (Jan 1987=100)

## Notes to the financial statements (continued)

### 18. Financial instruments

#### Risk management

The UUG board is responsible for treasury strategy and governance, which is reviewed on an annual basis. The annual treasury strategy review covers the group's funding, liquidity, capital management and interest rate management strategies, along with the delegation of specific funding and hedging authorities to the treasury committee.

The treasury committee, a sub-committee of the UUG board, has responsibility for setting and monitoring the group's adherence to treasury policies along with oversight in relation to the activities of the treasury function.

Treasury policies cover the key financial risks: liquidity risk, credit risk, market risk (inflation, interest rate, electricity price and currency) and capital risk. These policies are reviewed by the treasury committee for approval on at least an annual basis, or following any major changes in treasury operations and/ or financial market conditions.

Day-to-day responsibility for operational compliance with the treasury policies rests with the treasurer. An operational compliance report is provided monthly to the treasury committee, which details the status of the group's compliance with the treasury policies and highlights the level of risk against the appropriate risk limits in place.

The group's treasury function does not act as a profit centre and does not undertake any speculative trading activity.

The group's exposure to risk and its objectives, policies and processes for managing risk and the methods used for measuring risk have changed since the prior year in respect of inflation, interest rate and electricity price risk, which is discussed in the respective sections below.

#### Liquidity risk

The group looks to manage its liquidity risk by maintaining liquidity within a UUG board approved duration range. Liquidity is actively monitored by the group's treasury function and is reported monthly to the treasury committee through the operational compliance report.

At 31 March 2012, the group had £991.2 million (2011: £1,184.6 million) of available liquidity, which comprised £321.2 million (2011: £255.2 million) cash and short-term deposits and £670.0 million (2011: £929.4 million) of undrawn committed borrowing facilities. Short-term deposits mature within three months and bank overdrafts are repayable on demand.

The group and company had available committed borrowing facilities as follows:

	<b>Group</b>		<b>Company</b>	
	2012	2011	2012	2011
	£m	£m	£m	£m
Expiring within one year	250.0	375.0	125.0	250.0
Expiring after one year but in less than two years	220.0	250.0	120.0	125.0
Expiring after more than two years	200.0	320.0	75.0	170.0
Total borrowing facilities	670.0	945.0	320.0	545.0
Offsetting bank guarantees	-	(15.6)	-	(15.6)
<b>Undrawn borrowing facilities</b>	<b>670.0</b>	<b>929.4</b>	<b>320.0</b>	<b>529.4</b>

At 31 March 2012, the group had an additional committed borrowing facility of £50.0 million and the company had an additional committed borrowing facility of £10.0 million expiring after more than two years that was not available to be drawn until September 2013.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

These facilities are arranged on a bilateral rather than a syndicated basis, which spreads the maturities more evenly over a longer time period, thereby reducing the refinancing risk by providing several renewal points rather than a large single financing point.

#### Maturity analysis

Concentrations of risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to group and company's financial liabilities with agreed repayment periods and derivatives on an undiscounted basis. Derivative cash flows have been shown net where there is a contractual agreement to settle on a net basis; otherwise the cash flows are shown gross.

	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Group</b>								
<b>At 31 March 2012</b>								
Bonds	10,049.4		214.0	190.2	168.0	594.0	144.0	8,739.2
Bank and other term borrowings	1,885.9		103.4	36.5	26.4	48.6	329.4	1,341.6
Amounts owed to ultimate parent undertaking	33.2		33.2	-	-	-	-	-
Adjustment to carrying value <sup>(2)</sup>	(6,080.6)	(6,080.6)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	5,887.9	(6,080.6)	350.6	226.7	194.4	642.6	473.4	10,080.8
Derivatives:								
Payable	962.4		87.5	75.1	70.2	40.1	35.4	654.1
Receivable	(1,481.6)		(158.2)	(184.1)	(127.6)	(59.1)	(58.6)	(894.0)
Adjustment to carrying value <sup>(2)</sup>	61.6	61.6						
<b>Derivatives – net assets</b>	<b>(457.6)</b>	<b>61.6</b>	<b>(70.7)</b>	<b>(109.0)</b>	<b>(57.4)</b>	<b>(19.0)</b>	<b>(23.2)</b>	<b>(239.9)</b>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Maturity analysis (continued)

	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Group</b>								
<b>At 31 March 2011</b>								
Bonds	10,119.2		166.3	173.9	191.8	169.0	595.0	8,823.2
Bank and other term borrowings	1,562.1		131.2	174.4	35.7	24.6	29.7	1,166.5
Amounts owed to ultimate parent undertaking	33.5		33.5	-	-	-	-	-
Adjustment to carrying value <sup>(2)</sup>	(6,370.4)	(6,370.4)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	5,344.4	(6,370.4)	331.0	348.3	227.5	193.6	624.7	9,989.7
Derivatives:								
Payable	1,085.9		89.8	69.7	80.5	52.8	47.4	745.7
Receivable	(1,439.7)		(116.4)	(101.6)	(145.2)	(88.0)	(56.6)	(931.9)
Adjustment to carrying value <sup>(2)</sup>	73.5	73.5						
<b>Derivatives – net assets</b>	<b>(280.3)</b>	<b>73.5</b>	<b>(26.6)</b>	<b>(31.9)</b>	<b>(64.7)</b>	<b>(35.2)</b>	<b>(9.2)</b>	<b>(186.2)</b>
	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Company</b>								
<b>At 31 March 2012</b>								
Bonds	1,053.0		42.8	36.2	36.3	36.4	36.4	864.9
Bank and other term borrowings	69.9		69.9	-	-	-	-	-
Amounts owed to ultimate parent undertaking	33.2		33.2	-	-	-	-	-
Amounts owed to subsidiary undertakings	710.7		710.7	-	-	-	-	-
Adjustment to carrying value <sup>(2)</sup>	(356.4)	(356.4)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	1,510.4	(356.4)	856.6	36.2	36.3	36.4	36.4	864.9
Derivatives:								
Payable	260.3		30.6	7.3	9.4	4.6	5.3	203.1
Receivable	(406.7)		(44.2)	(76.2)	(19.2)	(11.9)	(11.9)	(243.3)
Adjustment to carrying value <sup>(2)</sup>	7.7	7.7						
<b>Derivatives – net assets</b>	<b>(138.7)</b>	<b>7.7</b>	<b>(13.6)</b>	<b>(68.9)</b>	<b>(9.8)</b>	<b>(7.3)</b>	<b>(6.6)</b>	<b>(40.2)</b>



## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Maturity analysis (continued)

Company	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>At 31 March 2011</b>								
Bonds	1,082.8		36.2	43.0	36.6	36.6	36.7	893.7
Bank and other term borrowings	46.4		46.4	-	-	-	-	-
Amounts owed to ultimate parent undertaking	33.5		33.5	-	-	-	-	-
Amounts owed to subsidiary undertakings	781.4		781.4	-	-	-	-	-
Adjustment to carrying value <sup>(2)</sup>	(422.0)	(422.0)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	1,522.1	(422.0)	897.5	43.0	36.6	36.6	36.7	893.7
Derivatives:								
Payable	310.0		40.5	8.9	14.4	16.6	9.1	220.5
Receivable	(405.9)		(55.6)	(19.0)	(50.5)	(11.9)	(12.0)	(256.9)
Adjustment to carrying value <sup>(2)</sup>	10.0	10.0						
<b>Derivatives – net assets</b>	<b>(85.9)</b>	<b>10.0</b>	<b>(15.1)</b>	<b>(10.1)</b>	<b>(36.1)</b>	<b>4.7</b>	<b>(2.9)</b>	<b>(36.4)</b>

Notes:

- (1) Forecast future cash flows are calculated, where applicable, utilising forward interest rates based upon the interest environment at year end and are, therefore susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be 2.65 per cent over the life of each bond.
- (2) The carrying value of debt is calculated following various methods in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and therefore this adjustment reconciles the undiscounted forecast future cash flows to the carrying value of debt in the statement of financial position.

#### Credit risk

Credit risk arises principally from trade finance (the supply of services to customers) and treasury activities (the depositing of cash and holding of derivative and foreign exchange instruments). The group and company do not believe they are exposed to any material concentrations of credit risk.

The group manages its risk from trade finance through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the group's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. Considering the above, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 15).

The group manages its risk from treasury activities by establishing a total credit limit by counterparty, which comprises a counterparty credit limit and an additional settlement limit to cover intra day gross settlement cash flows. In addition, potential derivative exposure limits are also established to take account of potential future exposure which may arise under derivative transactions. These limits are calculated by reference to a measure of capital and credit ratings of the individual counterparties and are subject to a maximum single counterparty limit. A control mechanism to trigger a review of specific counterparty limits, irrespective of credit rating action, is in place. This entails daily monitoring of counterparty credit default swap levels and/or share price volatility. Credit exposure is monitored daily by the group's treasury function and is reported monthly to the treasury committee through the operational compliance report.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Credit risk (continued)

At 31 March the maximum exposure to credit risk for the group and company is represented by the carrying amount of each financial asset in the statement of financial position:

	<b>Group</b>		<b>Company</b>	
	2012	2011	2012	2011
	£m	£m	£m	£m
Cash and short-term deposits (see note 16)	321.2	255.2	308.2	237.0
Trade and other receivables (see note 15)	2,037.7	1,798.7	1,239.4	1,682.6
Investments (see note 13)	3.3	2.3	-	-
Derivative financial instruments	617.4	365.3	138.8	99.1
	<u>2,979.6</u>	<u>2,421.5</u>	<u>1,686.4</u>	<u>2,018.7</u>

Included within trade and other receivables for group are amounts owed by the ultimate parent undertaking of £1,735.2 million (2011: £1,501.9 million).

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2012 the group held £110.8 million (2011: £46.3 million) and the company held £69.7 million (2011: £46.3 million) as collateral in relation to derivative financial instruments (included within borrowings in note 17). In respect of cash and short-term deposits and derivative financial instruments, the group does not have a material exposure to any financial institutions based within the eurozone, with the exception of Germany, and has not experienced any significant credit issues during the financial year.

#### Market risk

The group's exposure to market risks primarily result from its financing arrangements and the economic return which it is allowed on the regulatory capital value (RCV).

The group uses a variety of financial instruments, including derivatives, in order to manage the exposure to these risks.

#### Inflation risk

The group earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. To the extent that nominal debt liabilities finance a proportion of the RCV, there is an asset liability mismatch which potentially exposes the group to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt.

The group's index-linked borrowings, which are linked to RPI inflation, form an economic hedge of the group's regulatory assets, which are also linked to RPI inflation. In particular, index-linked debt delivers a cash flow benefit compared to nominal debt, as the inflation adjustment on the index-linked liabilities is a deferred cash flow until the maturity of each financial instrument, providing a better match to the inflation adjustment on the regulated assets, which is recognised as a non-cash uplift to the RCV.

In addition, the group's pension obligations also provide an economic hedge of the group's regulatory assets. During the prior year, a revised pension scheme funding mechanism was introduced so that future contributions will be flexed for movements in RPI and smoothed over a rolling five-year period, providing a natural hedge against any inflationary uplift on the RCV.

The group seeks to manage this risk by identifying opportunities to amend the economic hedge currently in place where deemed necessary and subject to relative value. Inflation risk is reported monthly to the treasury committee in the operational compliance report.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Inflation risk (continued)

The carrying value of index-linked debt held by the group is as follows:

	2012	2011
	£m	£m
Index-linked debt	2,667.0	2,215.7

#### Sensitivity analysis

As required by IFRS 7, the sensitivity analysis has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2012 and 31 March 2011, respectively. As a result, this analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI on the group's index-linked borrowings.

Group	2012	2011
	£m	£m
<b>Impact on profit before taxation and equity</b>		
1 per cent increase in RPI	(27.2)	(22.6)
1 per cent decrease in RPI	27.2	22.6

Brackets denote a reduction in profit.

This table excludes the hedging aspect of the group's regulatory assets, which being property, plant and equipment, are not financial assets as defined by IAS 32 and are typically held at cost or deemed cost less accumulated depreciation on the consolidated statement of financial position. In addition, the table excludes the hedging aspect of the group's pension obligations.

The analysis assumes a one per cent change in RPI having a corresponding one per cent impact on this position over a 12-month period. It should be noted, however, that there is a time lag by which current RPI changes impact on the income statement and the analysis does not incorporate this factor. The portfolio of index-linked debt is either calculated on a three or eight month lag basis. Therefore, at the reporting date the index-linked interest and principal adjustments impacting the income statement are fixed and based upon the annual RPI change either three or eight months earlier.

The company has no material exposure to inflation risk.

#### Interest rate risk

The group's policy is to structure debt in a way that best matches its underlying assets and cash flows. The group earns an economic return on its RCV, comprising a real return through revenues, determined by the real cost of capital fixed by the regulator for each five-year regulatory pricing period, and an inflation return as an uplift to its RCV.

The preferred form of debt therefore is sterling index-linked debt which incurs fixed interest, in real terms, and forms a natural hedge of regulatory assets and cash flows.

Where conventional long-term debt is raised in a fixed-rate form, to manage exposure to long-term interest rates, the debt is generally swapped at inception to create a floating rate liability for the term of the liability through the use of interest rate swaps. These instruments are typically designated within a fair value accounting hedge.

To manage the exposure to medium-term interest rates, the group has fixed interest costs for a substantial proportion of the group's net debt for the duration of the current five-year regulatory pricing period. During the year, the group revised its interest risk management strategy to now extend the fixing of interest rates out to a ten-year maturity on a reducing balance basis seeking to lock in a rolling average interest rate on the group's nominal liabilities.

The group seeks to manage its risk by maintaining its interest rate exposure within a board approved range. Interest rate risk is reported monthly to the treasury committee through the operational compliance report.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Disclosures', the sensitivity analysis has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place at the reporting date. As a result, this analysis is not indicative of the years then ended, as these factors would have varied throughout the year.

The following assumptions were made in calculating the interest sensitivity analysis:

- fair value hedge relationships are fully effective;
- borrowings designated at fair value through profit or loss are effectively hedged by associated swaps;
- the main fair value sensitivity to interest rates in the statement of financial position (excluding the effect of accrued interest) is in relation to the fixed interest rate swaps which manage the exposure to medium-term interest rates;
- cash flow sensitivity in the statement of financial position to interest rates is calculated on floating interest rate net debt;
- the sensitivity excludes the impact of interest rates on post-retirement obligations;
- management have assessed one percent as a reasonably possible movement in UK interest rates; and
- all other factors are held constant.

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
<b>Impact on profit before taxation and equity</b>				
1 per cent increase in interest rate	82.9	61.0	(19.9)	(23.7)
1 per cent decrease in interest rate	<u>(87.4)</u>	<u>(63.6)</u>	<u>21.5</u>	<u>26.2</u>

Brackets denote a reduction in profit.

The exposure largely relates to the fair value movements on the group's fixed interest rate swaps which manage the exposure to medium-term interest rates.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Repricing analysis

The following tables categorise the group and company's borrowings, derivatives and cash deposits on the basis of when they reprice or, if earlier, mature. The repricing analysis demonstrates the group and company's exposure to floating interest rate risk.

<b>Group</b>	Total	1 year	1-2	2-3	3-4	4-5	More
<b>At 31 March 2012</b>	£m	or less	years	years	years	years	than 5
<b>Borrowings in fair value hedge relationships</b>	£m	£m	£m	£m	£m	£m	£m
Fixed rate instruments	2,229.4	-	-	-	-	-	2,229.4
Effect of swaps	-	2,229.4	-	-	-	-	(2,229.4)
	<u>2,229.4</u>	<u>2,229.4</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	305.9	-	22.6	-	-	-	283.3
Effect of swaps	-	305.9	(22.6)	-	-	-	(283.3)
	<u>305.9</u>	<u>305.9</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	570.6	111.1	0.3	0.3	430.1	0.4	28.4
Floating rate instruments	81.8	81.8	-	-	-	-	-
Index-linked instruments	2,667.0	2,667.0	-	-	-	-	-
	<u>3,319.4</u>	<u>2,859.9</u>	<u>0.3</u>	<u>0.3</u>	<u>430.1</u>	<u>0.4</u>	<u>28.4</u>
Effect of a fixed interest rate hedge	-	(1,831.3)	-	454.2	300.0	325.0	752.1
<b>Total external borrowings</b>	<u>5,854.7</u>	<u>3,563.9</u>	<u>0.3</u>	<u>454.5</u>	<u>730.1</u>	<u>325.4</u>	<u>780.5</u>
Amounts owed to ultimate parent undertaking	33.2	33.2	-	-	-	-	-
<b>Total borrowings</b>	<u>5,887.9</u>	<u>3,597.1</u>	<u>0.3</u>	<u>454.5</u>	<u>730.1</u>	<u>325.4</u>	<u>780.5</u>
Cash and short-term deposits	(321.2)	(321.2)	-	-	-	-	-
<b>Net borrowings</b>	<u>5,566.7</u>	<u>3,275.9</u>	<u>0.3</u>	<u>454.5</u>	<u>730.1</u>	<u>325.4</u>	<u>780.5</u>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Repricing analysis (continued)

<b>Group</b>	<b>Total</b>	<b>1 year</b>	<b>1-2</b>	<b>2-3</b>	<b>3-4</b>	<b>4-5</b>	<b>More</b>
<b>At 31 March 2011</b>	<b>£m</b>	<b>or less</b>	<b>years</b>	<b>years</b>	<b>years</b>	<b>years</b>	<b>than 5</b>
<b>Borrowings in fair value hedge relationships</b>		<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Fixed rate instruments	2,017.8	-	-	-	-	-	2,017.8
Effect of swaps	-	2,017.8	-	-	-	-	(2,017.8)
	<u>2,017.8</u>	<u>2,017.8</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	286.8	-	-	22.5	-	-	264.3
Effect of swaps	-	286.8	-	(22.5)	-	-	(264.3)
	<u>286.8</u>	<u>286.8</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	507.6	46.6	0.3	0.3	0.3	431.3	28.8
Floating rate instruments	283.0	283.0	-	-	-	-	-
Index-linked instruments	2,215.7	2,215.7	-	-	-	-	-
	<u>3,006.3</u>	<u>2,545.3</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>	<u>431.3</u>	<u>28.8</u>
Effect of a fixed interest rate hedge	-	(1,831.3)	-	-	1,381.3	450.0	-
<b>Total external borrowings</b>	<u>5,310.9</u>	<u>3,018.6</u>	<u>0.3</u>	<u>0.3</u>	<u>1,381.6</u>	<u>881.3</u>	<u>28.8</u>
Amounts owed to ultimate parent undertaking	33.5	33.5	-	-	-	-	-
<b>Total borrowings</b>	<u>5,344.4</u>	<u>3,052.1</u>	<u>0.3</u>	<u>0.3</u>	<u>1,381.6</u>	<u>881.3</u>	<u>28.8</u>
Cash and short-term deposits	(255.2)	(255.2)	-	-	-	-	-
<b>Net borrowings</b>	<u>5,089.2</u>	<u>2,796.9</u>	<u>0.3</u>	<u>0.3</u>	<u>1,381.6</u>	<u>881.3</u>	<u>28.8</u>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Repricing analysis (continued)

	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Company</b>							
<b>At 31 March 2012</b>							
<b>Borrowings in fair value hedge relationships</b>							
Fixed rate instruments	442.0	-	-	-	-	-	442.0
Effect of swaps	-	442.0	-	-	-	-	(442.0)
	<u>442.0</u>	<u>442.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	317.4	69.7	-	-	-	-	247.7
Floating rate instruments	7.1	7.1	-	-	-	-	-
	<u>324.5</u>	<u>76.8</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>247.7</u>
<b>Total external borrowings</b>	<u>766.5</u>	<u>518.8</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>247.7</u>
Amounts owed to subsidiary undertakings	710.7	710.7	-	-	-	-	-
Amounts owed to ultimate parent undertaking	33.2	33.2	-	-	-	-	-
Effect of a fixed interest rate hedge	-	400.0	-	(400.0)	-	-	-
<b>Total borrowings</b>	<u>1,510.4</u>	<u>1,662.7</u>	<u>-</u>	<u>(400.0)</u>	<u>-</u>	<u>-</u>	<u>247.7</u>
Cash and short-term deposits	(308.2)	(308.2)	-	-	-	-	-
<b>Net borrowings</b>	<u>1,202.2</u>	<u>1,354.5</u>	<u>-</u>	<u>(400.0)</u>	<u>-</u>	<u>-</u>	<u>247.7</u>
	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Company</b>							
<b>At 31 March 2011</b>							
<b>Borrowings in fair value hedge relationships</b>							
Fixed rate instruments	407.6	-	-	-	-	-	407.6
Effect of swaps	-	407.6	-	-	-	-	(407.6)
	<u>407.6</u>	<u>407.6</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	292.8	46.3	-	-	-	-	246.5
Floating rate instruments	6.8	6.8	-	-	-	-	-
	<u>299.6</u>	<u>53.1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>246.5</u>
<b>Total external borrowings</b>	<u>707.2</u>	<u>460.7</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>246.5</u>
Amounts owed to subsidiary undertakings	781.4	781.4	-	-	-	-	-
Amounts owed to ultimate parent undertaking	33.5	33.5	-	-	-	-	-
Effect of a fixed interest rate hedge	-	400.0	-	-	(400.0)	-	-
<b>Total borrowings</b>	<u>1,522.1</u>	<u>1,675.6</u>	<u>-</u>	<u>-</u>	<u>(400.0)</u>	<u>-</u>	<u>246.5</u>
Cash and short-term deposits	(237.0)	(237.0)	-	-	-	-	-
<b>Net borrowings</b>	<u>1,285.1</u>	<u>1,438.6</u>	<u>-</u>	<u>-</u>	<u>(400.0)</u>	<u>-</u>	<u>246.5</u>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Electricity price risk

The group is allowed a fixed amount of revenue by the regulator, in real terms, to cover electricity costs for each five-year regulatory pricing period. To the extent that electricity prices remain floating over this period, this exposes the group to volatility in its operating cash flows. The group's policy, therefore, is to manage this risk by fixing a proportion of electricity prices in a cost-effective manner.

During the year, the group extended its hedging policy, through the use of electricity swap contracts, to fix the price of a substantial proportion of its anticipated electricity usage out to the end of the AMP in 2015. Previously, the group had fixed electricity prices for up to two years directly with its energy supplier.

#### Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Disclosures,' the sensitivity analysis has been prepared on the basis of the amount of electricity swaps in place at the reporting date and, as a result, this analysis is not indicative of the years then ended, as this factor would have varied throughout the year.

	2012 £m
<b>Group</b>	
<b>Impact on profit before taxation and equity</b>	
10 per cent increase in commodity prices	4.3
10 per cent decrease in commodity prices	(4.3)

Brackets denote a reduction in profit.

#### Currency risk

Currency exposure principally arises in respect of funding raised in foreign currencies.

To manage exposure to currency rates, foreign currency debt is hedged into sterling through the use of cross currency swaps and these are typically designated within a fair value accounting hedge.

The group seeks to manage its risk by maintaining currency exposure within UUG board approved limits. Currency risk in relation to foreign currency denominated financial instruments is reported monthly to the treasury committee through the operational compliance report.

The group and company have no material net exposure to movements in currency rates.

#### Capital risk management

The group's objective when managing capital is to maintain a capital structure that enables its primary subsidiary, United Utilities Water PLC, to retain a credit rating of A3 from Moody's Investors Services (Moody's), which the group believes best mirrors the Water Services Regulation Authority's (Ofwat) assumptions in relation to capital structure. The strategy of targeting a credit rating of A3 has been consistently maintained since 2007.

One of Ofwat's primary duties is to ensure that water companies are able to finance their functions, in particular by securing a reasonable return on their capital. Therefore, mirroring Ofwat's assumptions for credit ratings (and hence capital structure) should help safeguard the group's ability to earn a reasonable return on its capital, securing access to finance at a reasonable cost and enabling the group to continue as a going concern in order to provide returns for shareholders and credit investors, and benefits for other stakeholders.

In order to maintain a credit rating of A3 the group needs to manage its capital structure with reference to the ratings methodology and measures used by Moody's. The ratings methodology is normally based upon a number of key ratios (such as RCV gearing and adjusted interest cover) and threshold levels as updated and published from time to time by Moody's.

The group looks to manage its risk by maintaining the relevant key financial ratios used by the credit rating agencies to determine a corporate's credit rating, within the thresholds approved by the UUG board. Capital risk is reported monthly to the treasury committee through the operational compliance report.

Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the rating agencies.



## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

Group	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
<b>Financial assets</b>				
<i>Non-current assets</i>				
Available for sale investments	2.5	2.5	1.4	1.4
Loans and receivables:				
Investments	0.8	0.8	0.9	0.9
Trade and other receivables	1.1	1.1	-	-
Derivative financial instruments:				
Fair value hedge derivatives – swaps	434.3	434.3	280.0	280.0
Held for trading derivatives – swaps <sup>(2)</sup>	133.2	133.2	83.3	83.3
<i>Current assets</i>				
Loans and receivables:				
Trade and other receivables	2,036.6	2,036.6	1,798.7	1,798.7
Cash and short-term deposits	321.2	321.2	255.2	255.2
Derivative financial instruments:				
Fair value hedge derivatives – swaps	48.4	48.4	-	-
Held for trading derivatives – swaps <sup>(2)</sup>	1.5	1.5	2.0	2.0
<b>Financial liabilities</b>				
<i>Non-current liabilities</i>				
Trade and other payables at amortised cost	(378.0)	(378.0)	(249.8)	(249.8)
Borrowings:				
Financial liabilities in hedge relationships:				
Fair value hedge	(2,085.9)	(2,229.4)	(1,941.1)	(2,017.8)
Financial liabilities designated at fair value through profit or loss	(305.9)	(305.9)	(286.8)	(286.8)
Other financial liabilities	(3,311.4)	(3,192.8)	(2,727.4)	(2,899.0)
	(5,703.2)	(5,728.1)	(4,955.3)	(5,203.6)
Derivative financial instruments:				
Fair value hedge derivatives – swaps	-	-	(2.3)	(2.3)
Held for trading derivatives – swaps <sup>(2)</sup>	(159.7)	(159.7)	(82.3)	(82.3)
<i>Current liabilities</i>				
Trade and other payables at amortised cost	(445.9)	(445.9)	(433.0)	(433.0)
Borrowings:				
Other financial liabilities	(159.8)	(159.8)	(140.8)	(140.8)
Derivative financial instruments:				
Held for trading derivatives – swaps <sup>(2)</sup>	(0.1)	(0.1)	(0.4)	(0.4)
Adjustment for accrued interest <sup>(1)</sup>	40.0	-	38.7	-
	(3,827.1)	(3,892.0)	(3,403.7)	(3,690.7)

#### Notes:

- (1) Fair values quoted include accrued interest of £40.0 million (2011: £38.7 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other payables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.
- (2) Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £134.5 million (2011: £85.3 million).

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Fair values (continued)

In order to determine the fair values in the table above, all borrowings and derivatives are valued using a discounted cash flow valuation model as described within the accounting policies on pages 46 to 56. In determining fair values, assumptions are made with regard to credit spreads based upon indicative pricing data.

In respect of the total change during the year in the fair value of financial liabilities designated at fair value through profit or loss for continuing operations of £19.1 million loss (2011: £0.8 million gain), £21.3 million gain (2011: £4.1 million loss) is attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £76.2 million profit (2011: £54.9 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £81.7 million (2011: £62.6 million).

Company	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
<b>Financial assets</b>				
<i>Non-current assets</i>				
Derivative financial instruments:				
Fair value hedge derivatives – swaps	132.0	132.0	99.1	99.1
Held for trading derivatives – swaps <sup>(2)</sup>	6.7	6.7	-	-
<i>Current assets</i>				
Loans and receivables:				
Trade and other receivables	1,239.4	1,239.4	1,682.6	1,682.6
Cash and short-term deposits	308.2	308.2	237.0	237.0
Derivative financial instruments:				
Held for trading derivatives – swaps	0.1	0.1	-	-
<b>Financial liabilities</b>				
<i>Non-current liabilities</i>				
Borrowings:				
Financial liabilities in hedged relationships:				
Fair value hedge	(398.6)	(442.0)	(380.4)	(407.6)
Other financial liabilities	(283.3)	(247.7)	(270.8)	(253.2)
	(681.9)	(689.7)	(651.2)	(660.8)
Derivative financial instruments:				
Held for trading derivatives – swaps <sup>(2)</sup>	-	-	(12.8)	(12.8)
<i>Current liabilities</i>				
Trade and other payables at amortised cost	(1,317.0)	(1,317.1)	(1,800.0)	(1,800.0)
Borrowings:				
Other financial liabilities	(820.2)	(820.7)	(861.3)	(861.3)
Derivative financial instruments:				
Held for trading derivatives - swaps	(0.1)	(0.1)	(0.4)	(0.4)
Adjustment for accrued interest <sup>(1)</sup>	6.2	-	6.2	-
	(1,126.7)	(1,141.2)	(1,300.8)	(1,316.6)

#### Notes:

- (1) Fair values quoted include accrued interest of £6.2 million (2011: £6.2 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other payables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.
- (2) Includes amounts owed by subsidiary undertakings of £6.7 million (2011: £12.8 million owed to subsidiary undertakings).

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Fair values (continued)

The following tables provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based upon observable market data (unobservable).

<b>Group</b>	Level 1	Level 2	Level 3	Total
<b>2012</b>	£m	£m	£m	£m
<b>Available for sale financial assets</b>				
Investments	-	2.5	-	2.5
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets	-	617.4	-	617.4
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities	-	(159.8)	-	(159.8)
Financial liabilities designated as fair value through profit or loss	-	(305.9)	-	(305.9)
	-	154.2	-	154.2

<b>Group</b>	Level 1	Level 2	Level 3	Total
<b>2011</b>	£m	£m	£m	£m
<b>Available for sale financial assets</b>				
Investments	-	1.4	-	1.4
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets	-	365.3	-	365.3
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities	-	(85.0)	-	(85.0)
Financial liabilities designated as fair value through profit or loss	-	(286.8)	-	(286.8)
	-	(5.1)	-	(5.1)

<b>Company</b>	Level 1	Level 2	Level 3	Total
<b>2012</b>	£m	£m	£m	£m
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets	-	138.8	-	138.8
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities	-	(0.1)	-	(0.1)
	-	138.7	-	138.7

<b>Company</b>	Level 1	Level 2	Level 3	Total
<b>2011</b>	£m	£m	£m	£m
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets	-	99.1	-	99.1
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities	-	(13.2)	-	(13.2)
	-	85.9	-	85.9

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

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations

The group participates in two major funded defined benefit pension schemes in the United Kingdom – the United Utilities Pension Scheme (UUPS) and the United Utilities PLC Group section of the Electricity Supply Pension Scheme (ESPS), both of which are closed to new employees. The assets of these schemes are held in trust funds independent of the group's finances.

The last actuarial valuations of UUPS and ESPS were carried out as at 31 March 2010. These valuations have been updated to take account of the requirements of IAS 19 'Employee Benefits' in order to assess the position at 31 March 2012 by projecting forward from the valuation date and have been performed by an independent actuary, Mercer Limited.

The group made total contributions of £149.7 million (2011: £133.0 million) to its pension schemes for the year ended 31 March 2012. The group also continues to pay contributions in respect of the defined contribution members and insurance premiums. Overall, the group expects to contribute around £50.0 million to its defined benefit schemes in the year ending 31 March 2013.

The group also operates a series of unfunded, unregistered retirement benefit schemes. The cost of the unfunded, unregistered retirement benefit schemes is included in the total pension cost, on a basis consistent with IAS 19 and the assumptions set out below.

Information about the pension arrangements for executive directors is contained in note 3.

The main financial assumptions used by the actuary to calculate the defined benefit obligations of UUPS and ESPS were as follows:

	2012 %pa	2011 %pa
<b>Group and Company</b>		
Discount rate	5.00	5.50
Expected return on assets – UUPS	4.45	5.65
Expected return on assets – ESPS	5.00	6.10
Pensionable salary growth and pension increases	3.25	3.35
Price inflation	3.25	3.35

The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

	2012 years	2011 years
<b>Group and Company</b>		
Retired member - male	26.5	25.1
Non-retired member – male (currently aged 45)	28.3	26.6
Retired member - female	29.8	28.9
Non-retired member – female (currently aged 45)	31.7	30.4

Current studies continue to show faster rates of life expectancy improvement than had previously been forecast. Studies have also illustrated that mortality rates vary significantly according to the demographics of the schemes' members. These factors have been considered in order to update the life expectancies disclosed above and the resulting calculation of the defined benefit pension obligations of the group during the year.

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

At 31 March, the fair value of the schemes' assets and liabilities recognised in the statement of financial position were as follows:

	Schemes' assets %	2012 £m	Schemes' assets %	2011 £m
<b>Group</b>				
Equities	14.9	315.4	34.1	585.1
Other non-equity growth assets	9.6	203.5	-	-
Gilts	2.0	41.6	2.5	43.7
Bonds	58.4	1,233.0	46.6	800.6
Other	15.1	319.5	16.8	288.5
Total fair value of schemes' assets	100.0	2,113.0	100.0	1,717.9
Present value of defined benefit obligations		(2,205.0)		(1,912.9)
<b>Net retirement benefit obligations</b>		<b>(92.0)</b>		<b>(195.0)</b>
	Schemes' assets %	2012 £m	Schemes' assets %	2011 £m
<b>Company</b>				
Equities	19.4	138.5	39.1	240.7
Other non-equity growth assets	12.5	89.3	-	-
Gilts	2.0	14.1	6.0	36.6
Bonds	52.0	371.5	42.3	260.5
Other	14.1	100.6	12.6	77.8
Total fair value of schemes' assets	100.0	714.0	100.0	615.6
Present value of defined benefit obligations		(765.1)		(667.7)
<b>Net retirement benefit obligations</b>		<b>(51.1)</b>		<b>(52.1)</b>

To develop the expected long-term rate of return on asset assumptions, the group considered the current level of expected returns on risk-free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based upon the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The group's actual return on the schemes' assets was a gain of £319.3 million (2011: £134.9 million) and the company's actual return on the schemes' assets was a gain of £93.7 million (2011: £32.9 million gain).

The assets as at 31 March 2012, in respect of the UUPS, included in the breakdown above, have been allocated to each asset class based upon the return the assets are expected to achieve and not based upon the physical assets held. The reason for this being that the UUPS has entered into a variety of derivative transactions in order to change the return characteristics of the physical assets held and in order to reduce undesirable market and liability risks.

The 'Other' element of the portfolio is set aside for collateral purposes linked to the derivative contracts entered into, as described above. The collateral portfolio, in addition to providing sufficient liquidity to maintain the derivative transactions, is expected to achieve a return in excess of LIBOR.

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

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

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
At the start of the year	(1,912.9)	(2,182.2)	(667.7)	(393.0)
Interest cost on pension schemes' obligations	(103.8)	(112.6)	(36.1)	(31.1)
Actuarial losses	(243.1)	(70.5)	(86.3)	(34.6)
Curtailments/settlements:				
arising on reorganisation	(1.2)	392.1	0.7	(0.2)
arising on amendment of pension obligations	-	-	-	2.9
Member contributions	(6.8)	(7.1)	(0.5)	(0.6)
Benefits paid	76.1	82.8	25.9	23.9
Current service cost	(13.3)	(15.4)	(1.1)	(1.1)
Business combinations	-	-	-	(233.9)
<b>At the end of the year</b>	<b>(2,205.0)</b>	<b>(1,912.9)</b>	<b>(765.1)</b>	<b>(667.7)</b>

At 31 March 2012, £8.7 million (2011: £7.6 million) of the group's and company's defined benefit obligations related to unfunded, unregistered benefit plans.

Movements in the fair value of the schemes' assets were as follows:

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
At the start of the year	1,717.9	1,910.9	615.6	360.6
Expected return on pension schemes' assets	100.5	109.1	36.0	30.9
Actuarial gains	218.8	25.8	57.7	2.0
Member contributions	6.8	7.1	0.5	0.6
Benefits paid	(76.1)	(82.8)	(25.9)	(23.9)
Curtailments/settlements arising on reorganisation	(4.6)	(385.2)	(4.6)	(5.5)
Company contributions	149.7	133.0	34.7	62.1
Business combinations	-	-	-	188.8
<b>At the end of the year</b>	<b>2,113.0</b>	<b>1,717.9</b>	<b>714.0</b>	<b>615.6</b>

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

The net pension expense before taxation recognised in the income statement in respect of the defined benefit schemes is summarised as follows:

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
<b>Continuing operations</b>				
Current service cost	(13.3)	(11.9)	(1.1)	(1.1)
Curtailments/settlements arising on reorganisation	(5.4)	(3.4)	(3.5)	(47.9)
<b>Pension expense charged to operating profit</b>	<b>(18.7)</b>	<b>(15.3)</b>	<b>(4.6)</b>	<b>(49.0)</b>
Expected return on schemes' assets	100.5	102.2	36.0	30.9
Interest on schemes' obligations	(103.8)	(106.0)	(36.1)	(31.1)
<b>Pension expense charged to investment income and finance expense (see note 6)</b>	<b>(3.3)</b>	<b>(3.8)</b>	<b>(0.1)</b>	<b>(0.2)</b>
<b>Net pension expense charged before taxation</b>	<b>(22.0)</b>	<b>(19.1)</b>	<b>(4.7)</b>	<b>(49.2)</b>

Defined benefit pension costs excluding curtailments/settlements arising on reorganisation included within employee benefit expense were £13.3 million (2011: £11.9 million) comprising current service costs. Total post-employment benefits expense excluding curtailments/settlements arising on reorganisation charged to operating profit of £17.5 million (2011: £17.1 million) comprise the defined benefit costs described above of £13.3 million (2011: £11.9 million) and defined contribution pension costs of £4.2 million (2011: £5.2 million). (See note 3).

Company defined benefit pension costs excluding curtailments/settlements arising on reorganisation included within employee benefit expense were £1.1 million (2011: £1.1 million) comprising current service costs. Total company post-employment benefits expense excluding curtailments/settlements arising on reorganisation charged to operating profit of £1.1 million (2011: £2.5 million) comprise the defined benefit costs described above of £1.1 million (2011: £1.1 million) and defined contribution pension costs of £nil (2011: £1.4 million).

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
<b>Discontinued operations</b>				
Current service cost	-	(3.5)	-	-
Curtailment/settlements arising on reorganisation	-	3.0	-	-
<b>Pension expense charged to operating profit</b> (see note 4)	-	(0.5)	-	-
Expected return on pension schemes' assets	-	6.9	-	-
Interest on pension schemes' obligations	-	(6.6)	-	-
<b>Net pension interest income credited to investment income and finance expense</b>	-	0.3	-	-
Curtailment/settlement arising on disposal and (charged)/credited to profit on disposal of discontinued operations (see note 8)	(0.4)	7.3	(0.4)	-
<b>Net pension (expense)/income (charged)/credited before taxation</b>	(0.4)	7.1	(0.4)	-

The reconciliation of the opening and closing net pension obligation included in the statement of financial position is as follows:

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
At the start of the year	(195.0)	(271.3)	(52.1)	(32.4)
Expense recognised in the income statement - continuing operations	(22.0)	(19.1)	(4.7)	(49.2)
(Expense)/income recognised in the income statement - discontinued operations	(0.4)	7.1	(0.4)	-
Contributions paid	149.7	133.0	34.7	62.1
Actuarial losses gross of taxation	(24.3)	(44.7)	(28.6)	(32.6)
<b>At the end of the year</b>	(92.0)	(195.0)	(51.1)	(52.1)

Included in the 2012 group contributions paid of £149.7 million was an accelerated deficit repair contribution of £100.0 million and an £8.8 million inflation funding mechanism payment to UUPS. Details of the inflation mechanism entered into by UUPS with the company as part of a pension de-risking strategy, are included within the 2011 Report and Financial Statements. Included within the 2011 group contributions paid of £133.0 million were lump sum payments of £31.8 million in relation to the disposal of the non-regulated activities and £16.8 million in relation to the bulk transfer from the schemes to Welsh Water Dwr Cymru's pension arrangements, following the termination of the Welsh Water contract.

Actuarial gains and losses are recognised directly in the statement of comprehensive income. At 31 March 2012, a cumulative pre-taxation loss of £289.5 million (2012: £265.2 million) had been recorded directly in the statement of comprehensive income for the group and a cumulative loss of £148.0 million (2011: £119.4 million) for the company had been recorded directly in the statement of comprehensive income.



## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

The history of the schemes for the current and prior years is as follows:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
<b>Group</b>					
Present value of defined benefit obligations	(2,205.0)	(1,912.9)	(2,182.2)	(1,696.9)	(1,964.4)
Fair value of schemes' assets	2,113.0	1,717.9	1,910.9	1,483.8	1,863.2
<b>Net retirement benefit obligations</b>	<u>(92.0)</u>	<u>(195.0)</u>	<u>(271.3)</u>	<u>(213.1)</u>	<u>(101.2)</u>
Experience adjustments on schemes' liabilities	(33.0)	25.2	1.8	(8.9)	23.8
Experience adjustments on schemes' assets	218.8	25.8	365.2	(496.4)	(239.9)
	<u>2012 £m</u>	<u>2011 £m</u>	<u>2010 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
<b>Company</b>					
Present value of defined benefit obligations	(765.1)	(667.7)	(393.0)	(303.2)	(361.4)
Fair value of schemes' assets	714.0	615.6	360.6	283.5	346.0
<b>Net retirement benefit obligations</b>	<u>(51.1)</u>	<u>(52.1)</u>	<u>(32.4)</u>	<u>(19.7)</u>	<u>(15.4)</u>
Experience adjustments on schemes' liabilities	(11.0)	(12.7)	-	2.0	16.4
Experience adjustments on schemes' assets	57.7	2.0	70.3	(91.0)	(68.6)

#### Defined contribution pension costs

The schemes also include a defined contribution section which constitutes around two per cent of the total asset value.

During the year, the group made £4.2 million (2011: £5.2 million) of contributions (see note 3) to defined contribution schemes relating to continuing operations and £nil (2011: £9.9 million) relating to discontinued operations, which are included in arriving at operating profit. Included within contributions in respect of discontinued operations in the prior year were £5.9 million in relation to the United Utilities Electricity Services Limited section of the Electricity North West Group of the ESPS. The 2011 contributions included £5.9 million cash contributions to United Utilities Electricity Services Limited, which was disposed of during 2011. Further details of this scheme are included within note 19 of the 2011 Report and Financial Statements.

The company made £0.9 million (2011: £1.4 million) of contributions to defined contribution schemes. These amounts were recharged to United Utilities Water PLC as they relate to services provided to United Utilities Water PLC by employees of the company.

## Notes to the financial statements (continued)

### 20. Deferred tax liabilities/(assets)

The following are the major deferred tax liabilities and assets recognised by the group and company, and the movements thereon, during the current and prior year:

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
<b>Group</b>				
At 1 April 2010	1,461.7	(76.0)	(30.3)	1,355.4
(Credited)/charged to the income statement	(89.7)	34.3	0.8	(54.6)
Credited to equity	-	(11.6)	(0.1)	(11.7)
Disposals (see note 8)	(4.0)	2.6	5.4	4.0
At 31 March 2011	1,368.0	(50.7)	(24.2)	1,293.1
(Credited)/charged to the income statement	(78.1)	(0.1)	1.6	(76.6)
Charged to equity	-	28.7	-	28.7
<b>At 31 March 2012</b>	<b>1,289.9</b>	<b>(22.1)</b>	<b>(22.6)</b>	<b>1,245.2</b>
	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
<b>Company</b>				
At 1 April 2010	(0.1)	(9.1)	(0.7)	(9.9)
Charged/(credited) to the income statement	-	4.0	(15.1)	(11.1)
Credited to equity	-	(8.5)	-	(8.5)
At 31 March 2011	(0.1)	(13.6)	(15.8)	(29.5)
Charged to the income statement	-	0.1	10.5	10.6
Charged to equity	-	1.2	-	1.2
<b>At 31 March 2012</b>	<b>(0.1)</b>	<b>(12.3)</b>	<b>(5.3)</b>	<b>(17.7)</b>

Certain deferred tax assets and liabilities have been offset in accordance with IAS 12 'Income Taxes'.

A deferred tax asset has been recognised in the company's statement of financial position as the group is profit making and as such, it is anticipated that when the deferred tax assets reverse it will be possible to surrender any losses arising as group relief.

## Notes to the financial statements (continued)

### 21. Provisions

	Restructuring £m	Other £m	Group Total £m	Restructuring £m	Other £m	Company Total £m
At 1 April 2010	18.6	35.2	53.8	5.3	2.5	7.8
Charged/(credited) to the income statement	9.8	23.9	33.7	(5.0)	(5.3)	(10.3)
Utilised in the year	(24.2)	(21.6)	(45.8)	1.4	3.3	4.7
Disposals (see note 8)	(0.2)	(17.7)	(17.9)	-	-	-
At 31 March 2011	4.0	19.8	23.8	1.7	0.5	2.2
Charged/(credited) to the income statement	2.6	(3.9)	(1.3)	0.1	(0.3)	(0.2)
Utilised in the year	(6.0)	(6.2)	(12.2)	(1.6)	-	(1.6)
<b>At 31 March 2012</b>	<b>0.6</b>	<b>9.7</b>	<b>10.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.4</b>

The restructuring provision as at 31 March 2012 and 31 March 2011 relates to severance costs as a result of group reorganisation. Other provisions principally relate to contractual and legal claims against the group and represent management's best estimate of the value of settlement and costs, the timing is dependent upon the resolution of the relevant legal claims.

Provisions have been analysed between current and non-current as follows:

	Restructuring £m	Other £m	Group Total £m	Restructuring £m	Other £m	Company Total £m
<b>At 31 March 2012</b>						
Non-current	-	4.0	4.0	-	-	-
Current	0.6	5.7	6.3	0.2	0.2	0.4
	<u>0.6</u>	<u>9.7</u>	<u>10.3</u>	<u>0.2</u>	<u>0.2</u>	<u>0.4</u>
<b>At 31 March 2011</b>						
Non-current	-	9.3	9.3	-	-	-
Current	4.0	10.5	14.5	1.7	0.5	2.2
	<u>4.0</u>	<u>19.8</u>	<u>23.8</u>	<u>1.7</u>	<u>0.5</u>	<u>2.2</u>

### 22. Trade and other payables

	2012 £m	Group 2011 £m
<b>Non-current</b>		
Deferred grants and contributions	366.5	241.1
Other creditors	11.5	8.7
	<u>378.0</u>	<u>249.8</u>

The company has no non-current trade and other payables.

## Notes to the financial statements (continued)

### 22. Trade and other payables (continued)

	2012 £m	Group 2011 £m	2012 £m	Company 2011 £m
<b>Current</b>				
Trade payables	40.2	39.7	0.2	3.3
Amounts owed to ultimate parent undertaking	0.6	-	-	0.1
Amounts owed to subsidiary undertakings:				
Group tax relief payable	-	-	28.1	39.5
Other	-	-	1,275.7	1,730.1
Other tax and social security	4.4	4.4	-	0.7
Deferred grants and contributions	6.9	6.7	-	-
Other creditors	2.5	2.9	2.8	2.9
Accruals and deferred income	391.3	379.3	10.2	23.4
	<u>445.9</u>	<u>433.0</u>	<u>1,317.0</u>	<u>1,800.0</u>

The average credit period taken for trade purchases is 29 days for the group (2011: 31 days). At 31 March 2012, no average credit period has been calculated for the company due to the company no longer making external purchases (2011: 43 days).

The directors consider that the carrying amount of trade payables approximates to their fair value at both 31 March 2012 and 31 March 2011.

### Deferred grants and contributions

	2012 £m	Re-presented* 2011 £m
<b>Group</b>		
At the start of the year	247.8	182.6
Cash received during the year	13.0	12.7
Transfers of assets from customers	120.4	59.8
Credited to income statement – revenue (see note 1)	(0.9)	(0.4)
Credited to the income statement – other operating expenses (see note 4)	(6.9)	(6.9)
<b>At the end of the year</b>	<u>373.4</u>	<u>247.8</u>

\* The comparatives have been re-presented to show transfer of assets from customers of £59.8 million separately (2011: previously included within amounts received during the year).

Deferred grants are those amounts received under government grant schemes.

### 23. Shareholders' equity

	2012 £m	2011 £m
<b>Group</b>		
Share capital	881.8	881.8
Share premium account	1,430.0	1,430.0
Revaluation reserve	158.8	158.8
Cumulative exchange reserve	(5.0)	(3.1)
Retained earnings	980.1	664.0
	<u>3,445.7</u>	<u>3,131.5</u>

The revaluation reserve reflects the revaluation of infrastructure assets to fair value on transition to IFRS.

	2012 £m	2011 £m
<b>Company</b>		
Share capital	881.8	881.8
Share premium account	1,430.0	1,430.0
Retained earnings	2,613.7	2,523.7
	<u>4,925.5</u>	<u>4,835.5</u>

## Notes to the financial statements (continued)

### 23. Shareholders' equity (continued)

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The amount of group profit for the financial year dealt with in the company's income statement is £112.1 million (2011: £247.4 million profit) after accounting for dividends received from subsidiary undertakings of £317.0 million (2011: £1,783.5 million) and impairment of investments of £18.3 million (2011: £1,501.7 million) (see note 13).

### 24. Share capital

Company	2012 number	2012 £	2011 number	2011 £
<b>Issued, called up and fully paid</b>				
Ordinary shares of 100.0 pence each	881,787,478	881,787,478	881,787,478	881,787,478
Deferred A shares of 100.0 pence each	1	1	1	1
	<u>881,787,479</u>	<u>881,787,479</u>	<u>881,787,479</u>	<u>881,787,479</u>

The company has one class of ordinary shares which carry no right to fixed income. The deferred A share carries no voting rights nor a right to fixed income.

### 25. Operating lease commitments

Group	Property 2012 £m	Plant and equipment 2012 £m	Property 2011 £m	Plant and equipment 2011 £m
<b>Commitments under non-cancellable operating leases due</b>				
Within one year	3.3	0.8	3.6	0.7
In the second to fifth years inclusive	8.8	0.6	11.9	0.5
After five years	252.5	-	249.0	-
	<u>264.6</u>	<u>1.4</u>	<u>264.5</u>	<u>1.2</u>

In respect of the group's commitment to significant property leases, there are no contingent rentals payable, or restrictions on dividends, debt or further leasing imposed by these lease arrangements. Wherever possible, the group ensures that it has the benefit of security of tenure where this is required by operational and accommodation strategies. Escalation of rents is via rent reviews at agreed intervals.

Company	Property 2012 £m	Plant and equipment 2012 £m	Property 2011 £m	Plant and equipment 2011 £m
<b>Commitments under non-cancellable operating leases due</b>				
Within one year	0.5	-	0.4	0.1
In the second to fifth years inclusive	0.3	-	0.7	0.1
After five years	0.1	-	-	-
	<u>0.9</u>	<u>-</u>	<u>1.1</u>	<u>0.2</u>

## Notes to the financial statements (continued)

### 26. Related party transactions

#### Group

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

#### Trading transactions

The following transactions were carried out with the group's joint ventures:

	<b>Sales of services</b>		<b>Purchases of goods and services</b>	
	2012 £m	2011 £m	2012 £m	2011 £m
Joint ventures	1.1	44.2	0.3	9.5
	<u>1.1</u>	<u>44.2</u>	<u>0.3</u>	<u>9.5</u>
	<b>Amounts owed by related parties</b>		<b>Amounts owed to related parties</b>	
	2012 £m	2011 £m	2012 £m	2011 £m
Joint ventures (see notes 15, 22)	1.0	2.7	-	-
	<u>1.0</u>	<u>2.7</u>	<u>-</u>	<u>-</u>

Included within the comparatives in the table above are amounts relating to entities disposed of during the year ended 31 March 2011.

Sales of services to related parties were on the group's normal trading terms.

The amounts outstanding are unsecured and will be settled in accordance with normal credit terms. The group has issued guarantees of £5.4 million (2011: £5.9 million) to its joint ventures (see note 13).

No allowance has been made for doubtful receivables in respect of the amounts owed by related parties (2011: £0.3 million). No expense has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (2011: £nil).

Details of transactions with key management are disclosed in note 3.

#### Non-trading transactions

The following transactions were carried out with the group's ultimate parent undertaking, United Utilities Group PLC:

	<b>Interest receivable</b>		<b>Interest payable</b>	
	2012 £m	2011 £m	2012 £m	2011 £m
Ultimate parent undertaking	34.9	29.6	-	-
	<u>34.9</u>	<u>29.6</u>	<u>-</u>	<u>-</u>
	<b>Amounts owed by related parties</b>		<b>Amounts owed to related parties</b>	
	2012 £m	2011 £m	2012 £m	2011 £m
Ultimate parent undertaking	1,735.2	1,501.9	33.8	33.6
	<u>1,735.2</u>	<u>1,501.9</u>	<u>33.8</u>	<u>33.6</u>

## Notes to the financial statements (continued)

### 26. Related party transactions (continued)

#### Company

The company receives dividend income, pays and receives interest and recharges costs to and from subsidiary undertakings and its ultimate parent company in the normal course of business.

Total dividend income received during the year amounted to £317.0 million (2011: £1,783.5 million), total interest receivable during the year from subsidiary undertakings was £4.8 million (2011: £17.0 million), total fair value gains during the year from subsidiary undertakings was £23.5 million (2011: £26.2 million loss) and total recharges were £29.0 million (2011: £75.5 million). In addition, total interest payable during the year from the ultimate parent company was £0.1 million (2011: £25.6 million receivable). Amounts outstanding at 31 March 2012 between the parent company, subsidiary undertakings and ultimate parent undertaking are provided in notes 15, 17, 20 and 22.

The company guaranteed intra-group loans made by subsidiary undertakings of £343.9 million (2011: £343.9 million). Balances will be settled in accordance with normal credit terms. An allowance for doubtful receivables of £87.3 million (2011: £80.6 million) has been made for amounts owed by subsidiary undertakings. In the year ended 31 March 2012, an expense of £8.1 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2011: £2.2 million) (see note 15).

The company has a £400 million intercompany interest rate swap with United Utilities Water PLC with a 5 year maturity date up to 31 March 2015, as part of the 2010-2015 regulatory hedging programme. During the year the company received net interest of £4.3 million (2011: £1.6 million) and £19.5 million was credited through the income statement (2011: £12.8 million charge).

### 27. Cash generated from operations

	Group Re-presented <sup>(1)</sup>		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
<b>Continuing operations</b>				
Profit/(loss) before taxation	315.3	356.6	112.6	235.7
Adjustment for investment income and finance expense	276.2	223.6	(6.7)	(8.3)
Operating profit/(loss)	591.5	580.2	105.9	227.4
Adjustments for:				
Depreciation of property, plant and equipment	278.0	258.3	-	-
Amortisation of other intangible assets	19.8	32.2	-	-
Loss on disposal of property, plant and equipment	5.5	2.7	-	-
Loss on disposal of other intangible assets	2.6	2.8	-	-
Amortisation of deferred grants and contributions	(6.9)	(6.9)	-	-
Equity-settled share-based payments (credit)/charge	1.2	(0.1)	-	-
Other non-cash movements <sup>(2)</sup>	(0.1)	-	(105.7)	(24.6)
Changes in working capital:				
Decrease/(increase) in inventories	(0.1)	2.1	-	-
(Increase)/decrease in trade and other receivables	(240.9)	(22.8)	314.6	43.1
(Decrease)/increase in provisions and payables	(157.8)	(80.6)	(249.3)	77.1
<b>Cash generated from continuing operations</b>	<b>492.8</b>	<b>767.9</b>	<b>65.5</b>	<b>323.0</b>

(1) The comparatives for the group have been re-presented to show amortisation of deferred grants and contributions separately (2011: previously included within (decrease)/increase in provision and payables), along with the reclassification of grants and contributions received which were previously included in decrease in provisions and payables, now shown separately on the consolidated statement of cashflows, within investing activities.

## Notes to the financial statements (continued)

### 27. Cash generated from operations (continued)

(2) The group has received property, plant and equipment of £120.4 million (2011: £59.8 million) in exchange for the provision of future goods and services (see accounting policies, notes 1 and 22). Material non-cash transactions for the company during the year ended 31 March 2012 include disposals of the company's investment in its subsidiaries United Utilities Investments No.2 Limited (£125.9 million) and United Utilities Financial Services Limited (£54.9 million) and the impairment of NB Telecom (IOM) Limited (£17.3 million) offset by non-cash settled dividends received from United Utilities Investment No.2 Limited of £125.0 million, United Utilities Financial Services Limited £78.0m and United Utilities Investment Holdings Limited £107.0 million. There were no further material non-cash transactions during the year. Material non-cash transactions for the company in the prior year included impairment of the company's investment in its subsidiary United Utilities One Limited (£1,500.7 million, see note 13) offset by non-cash settled dividends received from United Utilities One Limited of £1,517.5 million.

In the prior year, the company acquired £1,499.8 million of ordinary shares in United Utilities Investment (No.7) Limited by transfer of an inter-company receivable balance (see note 13).

In the prior year, the company increased its investments by £1,187.9 million in United Utilities Employee Share Trust, £296.9 million in United Utilities (Jersey) Investments (No.6) Limited and £15.0 million in United Utilities Investments (No.5) Limited, following its transfer of 476 million ordinary shares in United Utilities North West PLC to United Utilities Investment Partnerships (No.2) LP (see note 13).

### 28. Contingent liabilities

The group has entered into performance guarantees as at 31 March 2012, where a financial limit has been specified of £85.2 million (2011: £104.5 million).

The company guaranteed loans of group undertakings up to a maximum of £1,439.9 million (2011: £1,246.1 million), including £1,086.0 million (2011: £902.2 million) relating to United Utilities Water PLC's loans from the European Investment Bank and £343.9 million (2011: £343.9 million) relating to intra-group loans made by subsidiary undertakings.

The company has entered into performance guarantees as at 31 March 2012, where a financial limit has been specified of £77.6 million (2011: £94.6 million).

### 29. Events after the reporting period

There are no events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2012.

### 30. Ultimate parent undertaking

The company's immediate and ultimate parent undertaking and controlling party is United Utilities Group PLC, a company incorporated in Great Britain.

The smallest group in which the results of the company are consolidated is that headed by United Utilities PLC.

The largest group in which the results of the company are consolidated is that headed by United Utilities Group PLC. The consolidated accounts of this group are available to the public and may be obtained from: The Company Secretary, United Utilities Group PLC, Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP.