

United Utilities PLC

Report and Financial Statements

31 March 2013

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Directors, advisers and other information

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Terms used in this report:

United Utilities PLC's ultimate parent company is United Utilities Group PLC. 'UUG' means United Utilities Group PLC and 'United Utilities', 'the group' or 'the UUG group' means United Utilities Group PLC and its subsidiary undertakings.

Cautionary statement:

This financial 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 financial report and the company undertakes no obligation to update these forward-looking statements. Nothing in this financial report should be construed as a profit forecast.

Certain regulatory performance data contained in this financial report is subject to regulatory audit.

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 2013.

Profit and dividends

The results for the year, set out in the profit and loss account on page 18 show that profit for the year after tax was £321.6 million (2012: £336.0 million).

The directors have not recommended a final ordinary dividend (2012: £nil). Interim ordinary dividends of £432.6 million (2012: £nil) have been declared and paid during the year.

Principal activity and review of business

The company is a public limited company registered in England and Wales.

The company is the intermediate holding company of a group which owns and operates water and wastewater assets in the North West of England. There have not been any significant changes in the company's principal activity in the year under review and no changes are currently planned.

The company's principal subsidiary undertakings, and joint ventures in which the group participates, are listed in note 13 to the consolidated financial statements.

The ultimate parent company of United Utilities PLC ("UU PLC") is United Utilities Group PLC ("UUG").

Financial and operational performance

Key performance indicators

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

	2012/13	2011/12
Financial KPIs		
Revenue	£1,636.0m	£1,564.9m
Underlying ⁽¹⁾ operating profit	£607.1m	£594.1m
Underlying ⁽¹⁾ profit before taxation	£386.8m	£361.9m
Underlying ⁽¹⁾ profit after taxation	£291.0m	£266.7m
Regulatory capital expenditure	£786.5m	£679.5m
Gearing: net debt to regulatory capital value ⁽²⁾	60%	59%

PERFORMANCE SUMMARY

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Operating profit	604.5	591.5
Profit before taxation	337.2	315.3
Profit after taxation	307.0	330.9

⁽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 page 5.

⁽²⁾ Regulatory capital value (RCV) defined as Ofwat's published RCV in outturn prices adjusted for actual capital expenditure to date

Directors' report (continued)

- Further customer service improvements: moved up to 14th position on Ofwat's SIM measure
- Met water and wastewater asset serviceability standards
- Outperformed regulatory leakage target again
- Accelerated the capital investment programme with investment up 16% at £787m for the year
- Much improved capex governance process – Time: Cost: Quality index up from c50% to c90%
- Delivered to date all 2010-15 price review capital investment Environment Agency commitments
- Reinvesting any capex outperformance for operational improvement and customer benefits
- Customers will benefit from opex outperformance in 2015-20 regulatory period
- Reinvesting part of the financing outperformance in private sewers for customer benefits
- RCV gearing of 60% in the middle of Ofwat's range
- Underlying operating profit up £13m to £607m

Revenue

The group has delivered a good set of financial results for the year ended 31 March 2013. Revenue increased by £71 million to £1,636 million, principally as a result of the impact of the regulated price increase for 2012/13 of 5.8% nominal (0.6% real price increase plus 5.2% RPI inflation) partially offset by reduced volumes and the ongoing impact of customers switching to meters. The impact of meter switching was in line with our expectations while commercial and domestic volumes continued to be impacted by the persisting tough economic climate. We would expect to recover a substantial element of any regulated turnover shortfall through the regulatory methodology.

Operating profit

Underlying operating profit increased slightly by £13 million to £607 million, primarily as a result of an increase in revenue largely offset by an expected increase in depreciation alongside higher infrastructure renewals expenditure, power and operating costs. Reported operating profit rose by two per cent to £605 million.

Profit before taxation

Underlying profit before taxation was £387 million, £25 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 increased by 7 per cent to £337 million.

Profit after taxation

Underlying profit after taxation was £291 million. This is based on the underlying profit before taxation figure less an underlying taxation charge of £96 million, which includes an adjustment for the deferred taxation credit in relation to the change in the mainstream rate of corporation taxation, the credit relating to prior years' taxation matters and taxation relating to underlying profit before taxation adjustments. Reported profit after taxation, from continuing operations, was £307 million compared with £331 million last year.

Directors' report (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 2013	Year ended 31 March 2012
	£m	£m
Operating profit		
Operating profit per published results	604.5	591.5
One-off items ⁽¹⁾	2.6	2.6
Underlying operating profit	607.1	594.1
Net finance expense	£m	£m
Finance expense	(302.1)	(315.5)
Investment income	34.8	39.3
Net finance expense	(267.3)	(276.2)
Net fair value losses on debt and derivative instruments	41.5	43.2
Adjustment for interest on swaps and debt under fair value options	8.3	7.2
Adjustment for net pension interest expense	11.5	3.3
Adjustment for capitalisation of interest costs	(14.3)	(9.7)
Underlying net finance expense	(220.3)	(232.2)
	£m	£m
Profit before taxation		
Profit before taxation per published results	337.2	315.3
One-off items ⁽¹⁾	2.6	2.6
Net fair value losses on debt and derivative instruments	41.5	43.2
Adjustment for interest on swaps and debt under fair value option	8.3	7.2
Adjustment for net pension interest expense	11.5	3.3
Adjustment for capitalisation of interest costs	(14.3)	(9.7)
Underlying profit before taxation	386.8	361.9
	£m	£m
Profit after taxation		
Underlying profit before taxation	386.8	361.9
Reported taxation	(30.2)	15.6
Deferred taxation credit – change in taxation rate	(53.0)	(104.6)
Agreement of prior years' UK taxation matters	(0.7)	5.9
Taxation relating to underlying profit before taxation adjustments	(11.9)	(12.1)
Underlying profit after taxation	291.0	266.7

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

The group also has a number of operational KPI's, the performance in respect of these has been discussed in the 2012/13 UUG annual report.

Directors' report (continued)

Political and charitable donations

We do not support any political party and do 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 us as a group and our political stakeholders. This includes promoting United Utilities' activities at any of the main political parties' annual conferences.

The period 2012/13 saw an increase in stakeholder engagement along a number of policy themes as the industry examined its future development. The group incurred expenditure of £16,211 (2012: £12,328) as part of this process. At the 2012 UUG AGM, an authority was taken to cover such expenditure. A similar resolution will be put to the UUG shareholders at the 2013 AGM to authorise the group to make such expenditure.

Charitable donations by the group in the year amounted to £5,273,253 (2012: £5,345,093). 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.

Research and development

The group undertakes research primarily to provide improved standards of service to customers, together with continuing improvements in business efficiency. Its intention is to strengthen its understanding of science and technology in relation to its range of wastewater and water treatment processes to ensure that treatment plants are able to meet the required current and future standards of environmental performance. The group is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The group also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the group was £1.3 million in the year ended 31 March 2013 (2012: £1.6 million).

Events after the balance sheet date

There were no events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2013.

Principal risks and uncertainties

We manage risk through line management supported by our corporate risk management framework which aims for continuous improvement. With an overarching mandate from and commitment by the board, the framework consists of four key areas: governance; approach; guidance; and process.

The application of our framework involves regular review of internal and external risk environments, the assessment of factors that will limit or prevent the achievement of our company objectives and the prioritised implementation of controls and mitigation to manage the exposure and build resilience.

The UUG audit and risk committee regularly reviews the framework's effectiveness and our compliance with it. There is also twice yearly formal reporting of the most significant risks and profile summary to the UUG board. These activities facilitate the determination of the nature and extent of those risks we are willing to take in pursuing our objectives and accords with good corporate governance practice.

Directors' report (continued)

Key developments during the year

Regulatory related risks have featured prominently in our risk profile over the last 12 months with key areas of focus typically being the Government's market reform agenda and Ofwat's proposals for future price limits. In addition, two other risks under the regulatory category which were highlighted in our half year accounts continue to exist but are reduced risks for the group:

- i. the risk of potential change in RPI methodology with the potential impact to RCV and income has now reduced due to the Office of National Statistics recommending no change to RPI methodology; and
- ii. the risk of breach of EU legislation relating to intermittent discharge spill criteria at combined sewer overflows (CSO) following the 'Whitburn' case.

There are two ongoing pieces of material litigation worthy of note but, based on the facts and matters currently known to us and the provisions carried in the group's statement of financial position, our directors are of the opinion that the possibility of the disputes having a material adverse effect on the group's financial position is remote.

Government market reform agenda

The Government's White Paper (Water for Life) highlighted key policy priorities for the water industry. A draft Water Bill was published on 10 July 2012 and incorporates changes to legislation that would be required to enable many of the changes set out in the White Paper. These include measures to introduce competition and the removal of barriers to entry. The scale and impact of retail and upstream competition will depend on the mechanisms set out in an expected new draft Bill and what ultimately becomes legislation. As a result and until this publication, there is significant uncertainty about the potential impacts; however, these could include: increased costs, reduced income and reduced confidence in the RCV mechanism leading to a rise in future costs of borrowing.

Control/Mitigation

We have been fully engaged, as has the whole industry, in all Government and Ofwat consultations in relation to competition and industry reform.

We are also making determined efforts to retain customers in area, win out of area customers and prepare for a more competitive environment and the potential opportunities that this may bring.

Future price limits and the price control review 2014

In May 2012, Ofwat published a document setting out the key principles it expects to follow in future price reviews. Ofwat then undertook a lengthy and ongoing consultation over its proposals for reform of the methodology and approach for setting prices from 2015, the most recent of which was the draft methodology issued on 28 January 2013. The principal decision to date is that Ofwat will set two binding retail price controls (one for household and one for non-household) and two binding wholesale controls (one for water and one for wastewater). Other proposals include: household/non-contestable retail cost recovery based on an average cost to serve; the introduction of a new 'Totex' menu approach to assessing cost assumptions; the setting of a lower cost of capital and the potential for different approaches to sharing the benefits of outperformance between shareholders and customers. These areas contribute to a wider risk of failing to achieve a successful Final Determination following Ofwat's price control review which could result in loss of income and profit, significant cost recovery shortfall, a reduction in allowed expenditure (both capital and operating expenditure) and the ability to outperform. There will also be additional costs for preparing for and administering separate price controls for retail and wholesale.

Control/Mitigation

We have raised and explained our concerns with Ofwat and, where appropriate, made alternative proposals as part of the consultation process. We continue to make strong representation to Ofwat on these issues, particularly in relation to the 'cost to serve' proposals.

More generally, a successful price control review (meeting the needs of customers and stakeholders) is being targeted through a dedicated 2014 price review programme team whose activities are focused on appropriate deliverables and stakeholder engagement. The final price review methodology proposals are due to be issued later this summer.

Directors' report (continued)

Failure to comply with applicable law or regulations

We are subject to various UK and international laws and regulations associated with water and wastewater service, health and safety, the environment, property/land management and the general running of a company. If we fail to comply, or become involved in third party proceedings including civil actions by third parties for infringement of rights or nuisance, we could face a range of outcomes. These include financial penalties (of up to 10 per cent of relevant regulated turnover), the imposition of an enforcement order requiring additional capital/operating expenditure, or compensation following litigation. In more extreme circumstances, impacts could ultimately include the revocation of our licence to operate or the appointment of a special administrator.

Control/Mitigation

We have robust processes in place to identify risks to our compliance with legal and regulatory obligations. This includes the continual monitoring of legislative and regulatory developments, the training of employees in new developments and the participation in consultations to influence their outcome, either directly or through industry trade associations for wider issues. Funding for any additional compliance costs in our regulated business is sought as part of the price determination process. We also robustly defend litigation where appropriate and seek to minimise our exposure by establishing a provision and seeking recovery wherever possible.

Material litigation

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 Eléctrica 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 subsequently appealed to the Court of Appeal who dismissed Uuw's summary judgment. Uuw was then granted permission to appeal to the Supreme Court, the hearing to be in the next 6 to 12 months.

Control/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.

Pension deficit risk

The group participates in a number of pension arrangements (note 19 for further details). Estimates of the amount and timing of future funding for these schemes are based on various actuarial assumptions and other factors including, among other things, the actual and projected market performance of the scheme assets, future long-term bond yields, average life expectancies and relevant legal requirements. The impact of these assumptions and other factors may require the group to make additional contributions to these pension schemes which, to the extent they are not recoverable under the regulatory price determination process, could materially adversely affect the group's financial position.

Directors' report (continued)

Pension deficit risk (continued)

Control/Mitigation

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) and allowed for half of this deficit when setting its overall price controls for the 2010–15 period. In response to the size of our ongoing pension risks and pension costs we introduced a series of changes for employees in 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 the future. In conjunction with the trustees we continue to monitor and to look to reduce the investment strategy risks for the pension schemes, including our exposure to investment risks. We are also engaged with Ofwat on the appropriate allowance for pension deficits for the next price review period.

Counterparty risk

The group participates in treasury activities including the depositing of cash and holding of derivatives and foreign exchange instruments. Although we do not consider there to be an imminent exposure, a potential loss of deposits, financial assets or hedge due to bank failure, error or delay in receiving funds from a bank or sequestration could impact cash flow, the ability to meet debt obligations, credit rating and cost of borrowing.

Control/Mitigation

Risks from treasury activities are covered by policies set by the treasury committee with operational management the responsibility of the treasury department. These include establishing a total credit limit for each 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 exposures. These limits are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty. In respect of cash, short-term deposits and derivative financial instruments, the group does not have a material exposure to any financial instruments based within the Eurozone with the exception of Germany and has not experienced any credit issues in the financial year.

Customer service risk

Failure to deliver good customer service can be caused by failures in supply and quality requirements (see below) and also the effectiveness of communication and response. The Service Incentive Mechanism (SIM), introduced by Ofwat for the 2010–15 period, replacing the Overall Performance Assessment (OPA), compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well a company then deals with those contacts. Depending on UUW's relative performance under SIM it could receive a revenue penalty (up to 1 per cent of turnover in 2010–15) or reward (up to 0.5 per cent of turnover in 2010–15) when price limits are next reset in 2014.

Control/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). We have an overall customer experience programme covering a range of initiatives to improve customer service, responding to our customers' requirements and focusing on people, processes and systems. The company's focus is on ensuring right first time service delivery to our customers, thus avoiding the need for 'unwanted' contacts and reducing associated operating costs. Where 'unwanted' contacts do arise, there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score. 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 review.

Directors' report (continued)

Bad debt risk

The service we provide is predominantly in the North West of England where the level of socio-economic deprivation is much higher than in any other region, leading, amongst other things, to an increased risk of bad debt. The law prohibits the disconnection of a water supply from certain premises including domestic dwellings as a method of enforcing payment.

Control/Mitigation

Bad debt risk is managed in-house by the customer collections department whose approach includes the adoption of best practice collection techniques and segmentation of customers based on their credit risk profile.

Operational service risk

The group controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. Physical, environmental, technological, or human factors, either within or outside the company's control, could result in impacts ranging from a decline in performance to interruptions and environmental impact. Ofwat could make financial adjustments at the next price review if corrective actions do not restore service to the required reference levels for each of their serviceability measures and could go on to force additional operating or capital expenditure if performance were to continue to decline. Additionally, depending on the nature and extent of an operational service incident, we could be fined for breaches of statutory obligations, be held liable to third parties or be required to provide an alternative water supply of equivalent quality, at additional cost.

Control/Mitigation

Operational processes combined with the capital investment programme are targeted to maintain stable serviceability of the company's water and wastewater assets and to minimise the chance of significant operational events occurring. The various indicators of performance are closely and routinely monitored by management. There are also governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Where adverse trends in performance or asset integrity develop, corrective action is identified and taken. The sustainability and resilience of our water supply is also managed through regional aqueduct networks allowing flexibility and we operate emergency plans, incident management and disaster recovery processes for the response and/or recovery of operational service failures. Insurance cover is also in place against loss and liabilities associated with significant risks.

Capital delivery risk

Our 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 our 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 our ability to meet regulatory and other environmental performance standards.

Control/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. Directors are incentivised, as part of their bonusable measures, on time, cost and quality of delivery of our capital investment programme.

Directors' report (continued)

Secure supply of safe clean drinking water risk

A secure and reliable supply of safe, clean drinking water is critical for our way of life. There are several events, either within or outside our control, that could put at risk this key requirement. These include inadequate supply and demand prediction, leakage performance issues, operational or asset failures, changes to abstraction licences, low rainfall or malicious acts. Depending on the nature and extent of these circumstances, the impact to the group may include: failure to meet the security of supply index or quality standards with associated regulatory penalties, increased frequency of hosepipe bans and drought permits and additional operational activity and cost. In extreme and remote circumstances, impacts may include unavoidable water resource shortfalls or an impact on public health.

Control/Mitigation

Our management of water catchments is designed to ensure reliable yields of good quality raw water. In addition, our Water Resources Management Plan compares future demand with availability, analyses historic droughts and climate change data and seeks to inform the delivery of supply enhancements and demand reductions. It covers leakage reduction programmes, enhanced water efficiency and network enhancements. We also maintain a drought management plan which includes processes, supporting communication plans and options for reserve supplies.

Our treatment of water is based on quality assurance procedures and water supply is through an increasingly integrated network. Security measures are in place to protect these assets and our capital investment programme targets improvements to water quality and supply. This is all supported by testing regimes through our scientific services department and drinking water safety plans to ensure that risks to drinking water quality are identified and managed across our entire network. We also operate emergency and incident management processes should there ever be a need for alternative water supply of equivalent quality.

Significant and catastrophic events

Our core activity involves the building, control and operation of water and wastewater networks and the maintenance of the associated assets with the objective of providing a continuous service. This includes major construction work and operations above and below ground and includes the use of vehicles, equipment and chemicals subject to a variety of physical and environmental factors/conditions. In exceptional and remote circumstances, such as the failure of an asset, an element of a network or supporting systems, plant or equipment, the impact could be significantly greater than operational service failures set out in other risks in this section. These could range from environmental impact, economic and social disruption to loss of life. Such consequences may arise due to a number of circumstances either within or outside our control e.g. human error, an individual's malicious intervention or unavoidable resource shortfalls.

Whilst we seek to ensure that we have 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 our customers, regulators, government and the wider stakeholder community. We 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 our costs.

Control/Mitigation

We have developed and continue to focus on a strong safety and health culture throughout the organisation and seek to achieve the highest safety standards not simply to comply with legislation but to contribute to our overall business performance while protecting employees, contractors and the public from harm. In support of this, the business operates a Health and Safety Management System (HSMS) which sets out minimum expectations and requirements including monitoring the occupational health of individuals when appropriate.

We operate long-standing, well tested and appropriately resourced incident response and escalation procedures. Our 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.

Directors' report (continued)

Significant and catastrophic events (continued)

Disaster recovery processes also exist for the recovery of IT applications, all recognising that possible events can have varying causes, impacts and likelihoods. The sustainability and resilience of our water supply is also managed through regional aqueduct networks which are enhanced by the West East Link pipeline. We also maintain 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.

Going concern

The directors' considerations in preparing these financial statements on a going concern basis are set out in the accounting policies section.

Directors

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

PA Aspin
JR Houlden
SL Mogford

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.

Employment policies

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 is possible and wherever it is safe and practical to do so.

Supplier payment policy and practice

Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance. As at 31 March 2013, the average credit period taken for trade purchases was 36 days for the group (2012: 29 days). At 31 March 2013 and 31 March 2012, no average credit period has been calculated for the company due to the company no longer making external purchases.

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.

Internal controls and risk management

The board is responsible for ensuring that the company has sound risk management and internal control systems in place, and for reviewing its effectiveness. It is supported in this role by the audit and risk committee of UUG, the internal audit function, the financial control team and the external auditor. The key features of this internal control framework include policies and procedures for planning, approving and monitoring major capital expenditure and clearly defined comprehensive business planning and financial reporting procedures, and monthly meetings by the executive team to review financial and non-financial performance and key operational issues. Alongside these processes, risk management is well embedded in our on-going business as usual approach. All areas of the business and support departments are responsible for monitoring changes to their areas of activity, and identifying any associated risk as a result of these changes which might prevent us from achieving our objectives and identify actions to mitigate those risks as far as is reasonably practicable and cost-effective to do so. These internal control and risk management systems, which are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss, have been in place continually for the year under review. On behalf of the board, the audit and risk committee of UUG completed its annual review of the effectiveness of the risk management and internal control processes up to the date of the annual report in accordance with the revised Turnbull Guidance on Internal Control. There were no significant failings or weaknesses identified in this review.

Risks impacting our business due to regulatory changes have dominated our risk review agenda at board meetings; the principal risks and uncertainties to the business are explained on pages 6 to 12. We continue to work with all key parties to represent the best interests of our stakeholders, and where we can identify actions to mitigate the adverse consequences of these potential regulatory changes we are working hard to address these changes to our business in a proactive manner.

Disclosure of information 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 or she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself 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.

Directors' report (continued)

Auditor

Our auditor, KPMG, has informed us that for administrative reasons and to instigate the orderly wind down of business, they wish to formally change the entity which conducts the company's audit from KPMG Audit Plc to KPMG LLP. KPMG Audit Plc has indicated that it will not stand for reappointment at our 2013 AGM, however KPMG LLP will seek election at this meeting. Our board has decided to recommend KPMG LLP to be appointed as external auditor to the company at the AGM and an authority for the directors to set the remuneration of the auditor will also be sought.

Approved by the board and signed on its behalf by:

JR Houlden
Director
4 June 2013

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRS) 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 company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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 31 March 2013 set out on pages 18 to 80. 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 15, 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 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 Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

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 2013 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
St James' Square,
Manchester
M2 6DS
4 June 2012

Consolidated income statement

for the year ended 31 March

	Note	2013 £m	2012 £m
Continuing operations			
Revenue	1,2	1,636.0	1,564.9
Employee benefits expense:			
excluding restructuring costs	3	(127.5)	(135.4)
restructuring costs	3	(2.6)	(2.6)
Total employee benefits expense	3	(130.1)	(138.0)
Other operating costs	4	(414.1)	(388.0)
Other income	4	3.1	4.8
Depreciation and amortisation expense	4	(329.2)	(297.8)
Infrastructure renewals expenditure		(161.2)	(154.4)
Total operating expenses		(1,031.5)	(973.4)
Operating profit	4	604.5	591.5
Investment income	5	34.8	39.3
Finance expense	6	(302.1)	(315.5)
Investment income and finance expense		(267.3)	(276.2)
Profit before taxation		337.2	315.3
Current taxation charge		(82.0)	(60.9)
Deferred taxation charge		(1.2)	(28.1)
Deferred taxation credit – change in taxation rate		53.0	104.6
Taxation	7	(30.2)	15.6
Profit after taxation from continuing operations		307.0	330.9
Discontinued operations			
Profit after taxation from discontinued operations	8	14.6	5.1
Profit after taxation		321.6	336.0

Consolidated statement of comprehensive income

for the year ended 31 March

	Note	2013 £m	2012 £m
Profit after taxation		321.6	336.0
Other comprehensive income			
Actuarial gains/(losses) on defined benefit pension schemes	19	42.1	(24.3)
Taxation on items taken directly to equity	7	(10.0)	4.4
Foreign exchange adjustments		0.6	(1.9)
Total comprehensive income		354.3	314.2

Consolidated and company statements of financial position

at 31 March

	Note	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
ASSETS					
Non-current assets					
Property, plant and equipment	10	8,990.7	8,644.5	-	0.4
Goodwill	11	5.0	5.0	-	-
Other intangible assets	12	99.9	89.5	-	-
Investments	13	5.7	3.3	4,655.1	6,100.0
Trade and other receivables	15	2.2	1.1	-	-
Retirement benefit surplus	19	15.1	-	-	-
Deferred tax asset	20	-	-	6.4	17.7
Derivative financial instruments	18	659.2	567.5	163.7	138.7
		<u>9,777.8</u>	<u>9,310.9</u>	<u>4,825.2</u>	<u>6,256.8</u>
Current assets					
Inventories	14	39.6	47.4	-	-
Trade and other receivables	15	1,884.9	2,036.6	2,792.5	1,239.4
Cash and short-term deposits	16	201.1	321.2	270.5	308.2
Derivative financial instruments	18	62.0	49.9	-	0.1
		<u>2,187.6</u>	<u>2,455.1</u>	<u>3,063.0</u>	<u>1,547.7</u>
Total assets		<u>11,965.4</u>	<u>11,766.0</u>	<u>7,888.2</u>	<u>7,804.5</u>
LIABILITIES					
Non-current liabilities					
Trade and other payables	22	(419.8)	(378.0)	-	-
Borrowings	17	(6,007.4)	(5,728.1)	(727.9)	(689.7)
Retirement benefit obligations	19	-	(92.0)	(23.0)	(51.1)
Deferred tax liabilities	20	(1,219.0)	(1,245.2)	-	-
Provisions	21	(3.4)	(4.0)	-	-
Derivative financial instruments	18	(196.2)	(159.7)	-	-
		<u>(7,845.8)</u>	<u>(7,607.0)</u>	<u>(750.9)</u>	<u>(740.8)</u>
Current liabilities					
Trade and other payables	22	(438.9)	(445.9)	(1,081.3)	(1,317.0)
Borrowings	17	(198.3)	(159.8)	(945.5)	(820.7)
Current tax liabilities		(102.4)	(101.2)	-	-
Provisions	21	(8.8)	(6.3)	(0.2)	(0.4)
Derivative financial instruments	18	(3.8)	(0.1)	(0.9)	(0.1)
		<u>(752.2)</u>	<u>(713.3)</u>	<u>(2,027.9)</u>	<u>(2,138.2)</u>
Total liabilities		<u>(8,598.0)</u>	<u>(8,320.3)</u>	<u>(2,778.8)</u>	<u>(2,879.0)</u>
Total net assets		<u>3,367.4</u>	<u>3,445.7</u>	<u>5,109.4</u>	<u>4,925.5</u>
EQUITY					
Capital and reserves attributable to equity holders of the company					
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	(4.4)	(5.0)	-	-
Retained earnings	23	901.2	980.1	2,797.6	2,613.7
Shareholders' equity		<u>3,367.4</u>	<u>3,445.7</u>	<u>5,109.4</u>	<u>4,925.5</u>

These financial statements for the group and United Utilities PLC (company number: 2366616) were approved by the board of directors on 4 June 2013 and signed on its behalf by:

JR 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
Group						
At 1 April 2012	881.8	1,430.0	158.8	(5.0)	980.1	3,445.7
Profit after taxation	-	-	-	-	321.6	321.6
Other comprehensive income						
Actuarial gains on defined benefit pension schemes (note 19)	-	-	-	-	42.1	42.1
Taxation on items taken directly to equity (note 7)	-	-	-	-	(10.0)	(10.0)
Foreign exchange adjustments	-	-	-	0.6	-	0.6
Total comprehensive income	-	-	-	0.6	353.7	354.3
Transactions with owners						
Dividends (note 9)	-	-	-	-	(432.6)	(432.6)
At 31 March 2013	<u>881.8</u>	<u>1,430.0</u>	<u>158.8</u>	<u>(4.4)</u>	<u>901.2</u>	<u>3,367.4</u>

	Share capital £m	Share premium account £m	Revaluation reserve £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
Group						
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
Other comprehensive income						
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)
Total comprehensive (expense)/income	-	-	-	(1.9)	316.1	314.2
At 31 March 2012	<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>

Company statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2012	881.8	1,430.0	2,613.7	4,925.5
Profit after taxation	-	-	609.8	609.8
Other comprehensive income				
Actuarial gains on defined benefit pension schemes	-	-	9.1	9.1
Taxation on items taken directly to equity (note 7)	-	-	(2.4)	(2.4)
Total comprehensive income	-	-	616.5	616.5
Transactions with owners				
Dividends	-	-	(432.6)	(432.6)
At 31 March 2013	<u>881.8</u>	<u>1,430.0</u>	<u>2,797.6</u>	<u>5,109.4</u>

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

Cash flow statements

	Note	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
Operating activities					
Cash generated from continuing operations	27	1,023.4	492.8	465.0	65.5
Interest paid		(168.3)	(167.2)	(22.9)	(22.3)
Interest received and similar income		38.7	28.3	1.3	7.7
Tax paid		(55.2)	(39.8)	(54.1)	(38.2)
Tax received		-	35.0	-	35.0
Net cash generated from operating activities (continuing operations)		838.6	349.1	389.3	47.7
Net cash used in operating activities (discontinued operations)		(1.4)	-	-	-
Investing activities					
Proceeds from disposal of discontinued operations		-	3.5	-	-
Transaction costs, deferred consideration and cash disposed		-	2.0	-	-
Proceeds from disposal of discontinued operations net of transaction costs, deferred consideration and cash disposed		-	5.5	-	-
Purchase of property, plant and equipment		(625.6)	(502.2)	-	-
Purchase of other intangible assets		(35.3)	(17.3)	-	-
Proceeds from sale of property, plant and equipment		2.9	4.8	-	-
Grants and contributions received		16.3	13.0	-	-
Proceeds from disposal of investments		0.9	-	-	-
Purchase of investments	13	(3.0)	(2.2)	-	-
Net cash used in investing activities (continuing operations)		(643.8)	(498.4)	-	-
Financing activities					
Proceeds from borrowings		147.9	446.3	38.7	48.5
Repayment of borrowings		(39.4)	(231.7)	(33.0)	(25.0)
Dividends paid to equity holders of the company	9	(432.6)	-	(432.6)	-
Net cash (used in)/generated from financing activities (continuing operations)		(324.1)	214.6	(426.9)	23.5
Effects of exchange rate changes (continuing operations)		-	0.5	-	-
Net (decrease)/ increase in cash and cash equivalents (continuing operations)		(129.3)	65.8	(37.6)	71.2
Net decrease in cash and cash equivalents (discontinued operations)		(1.4)	-	-	-
Cash and cash equivalents at beginning of the year	16	312.6	246.8	308.1	236.9
Cash and cash equivalents at end of the year	16	181.9	312.6	270.5	308.1

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 2012, has had no material impact on the group's financial statements:

Amendments to IFRS 7 'Financial Instruments'

This amendment introduces new disclosure requirements about transfers of financial assets which will impact the group only if it enters into any relevant transactions in the future.

Going concern

The directors have a reasonable expectation that the company 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 as well as consideration of the group's capital adequacy. In addition, the directors considered, amongst other matters, the regulator's legal duty to ensure that United Utilities Water PLC is able to finance its activities.

Operating profit

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

b) Basis of consolidation

The group financial statements consolidate the financial statements of the company and entities controlled by the company (its subsidiaries) 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.

Accounting policies (continued)

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.

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 on 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 corporation taxation is also dealt with in equity.

Accounting policies (continued)

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 on 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.

Employee and other related costs incurred in implementing the capital schemes of the group are capitalised.

Water and wastewater infrastructure assets

Infrastructure assets comprise a network of water and wastewater pipes and 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.

Accounting policies (continued)

f) Property, plant and equipment (continued)

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). This 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.

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.

Accounting policies (continued)

Other intangible assets (continued)

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.

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.

Accounting policies (continued)

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 on 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. 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.

The default treatment of measuring at amortised cost, whilst associated hedging derivatives are recognised at fair value, presents an accounting measurement mismatch that has the potential to introduce considerable volatility to both the income statement and the statement of financial position. Therefore, where feasible, the company takes advantage of the provisions under FRS 26 '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 company's borrowings and associated derivative contracts.

Where feasible, the company 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 designated within a fair value hedge relationship

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 19).

Accounting policies (continued)

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.

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.

j) Inventories

Inventories are stated at the lower of cost and net realisable value. For properties held for sale, 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.

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.

Accounting policies (continued)

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.

Transactions and balances

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. Operating leases are leases that do not transfer substantially all the risks and rewards of ownership to the lessee.

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

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, judgements 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.

Accounting policies (continued)

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 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.

Accounting policies (continued)

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

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.

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. All of the standards in issue but not yet effective have been endorsed by the EU except where noted. 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' 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 the statement of other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year, £1.5 million of losses would have been recognised in the statement of other comprehensive income rather than within the income statement.
- IAS 19 'Employee Benefits' was amended in June 2011 and is effective for periods commencing on or after 1 January 2013. The impact on the group will be to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit surplus/ (obligations). The group has assessed the impact of the revised standard, the impact on the results for the year ended 31 March 2013 would be to recognise a net interest cost of £1.5 million in the income statement as opposed to the net pension interest cost of £11.5 million (the interest cost of £108.3 million net of the expected return on plan assets of £96.8 million). There would be no impact on either the net retirement benefit surplus/ (obligations) or related deferred tax balance within the statement of financial position.
- IFRS 11 'Joint Arrangements' is effective for periods commencing on or after 1 January 2014 and replaces IAS 31 'Interests in Joint Ventures'. IFRS 11 removes the option currently taken by the group to proportionately consolidate its joint ventures and requires equity accounting. The impact on the income statement and statement of financial position for the year ended 31 March 2013 would be that the group's interests in its joint ventures' assets, liabilities, income and expenses, as summarised in note 14, would be presented separately in the statement of financial position and income statement. There would be no impact on net assets.

Accounting policies (continued)

q) Recently issued accounting pronouncements (continued)

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 IAS 1 'Presentation of items of Other Comprehensive Income' is effective for periods commencing on or after 1 July 2012. The impact of the amendments will be that items, which may be reclassified to profit and loss in the future, will be presented separately in the statement of other comprehensive income from those that would never be reclassified to profit and loss.
- IFRS 10 'Consolidated Financial Statements' is effective for periods commencing on or after 1 January 2014 and builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated accounts of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess.
- IFRS 12 'Disclosures of Interests in Other Entities' is effective for periods commencing on or after 1 January 2014 and includes the disclosure requirements for all forms of interest in other entities, including subsidiaries, associates, joint arrangements and unconsolidated structured entities.
- IFRS 13 'Fair Value Measurement' is effective for periods commencing on or after 1 January 2013 and aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS.
- 'Improvements to IFRSs (2011),' this is a collection of amendments to five standards as part of the International Accounting Standards Board's (IASB) programme of annual improvements. The improvements were issued in May 2012 and are effective for periods commencing on or after 1 January 2013.

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:

	2013 £m	2012 £m
Provision of goods and services (see note 2)	1,636.0	1,564.9
Revenue	1,636.0	1,564.9
Investment income (see note 5)	34.8	39.3
Total revenue	1,670.8	1,604.2

During the year ended 31 March 2013, £1.8 million of revenue was derived from exchanges of goods or services in relation to IFRIC 18 'Transfers of Assets from Customers' (2012: £0.9 million) (see note 22).

2. Segment reporting

The board of directors of United Utilities Group PLC (the board) 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 therefore no further detailed segmental information is provided in this note.

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

	<i>Continuing operations</i>		
	Rest of		
	UK	world	Total
	£m	£m	£m
2013			
External revenue	1,620.5	15.5	1,636.0
Non-current assets*	<u>9,047.0</u>	<u>56.5</u>	<u>9,103.5</u>

	<i>Continuing operations</i>		
	Rest of		
	UK	world	Total
	£m	£m	£m
2012			
External revenue	1,548.9	16.0	1,564.9
Non-current assets*	<u>8,686.3</u>	<u>57.1</u>	<u>8,743.4</u>

* Non-current assets exclude financial instruments and post retirement benefit surplus.

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

Notes to the financial statements (continued)

3. Directors and employees

Directors' remuneration

	2013 £m	2012 £m
Salaries	1.2	1.3
Benefits	0.3	0.3
Bonus	1.2	1.0
Share-based payment charge	0.8	0.4
	<u>3.5</u>	<u>3.0</u>

Included within the above is aggregate emoluments of £2.0 million (2012: £1.6 million) in respect of the highest paid director. The group paid £nil in the year (2012: £nil) 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.

	2013 £m	2012 £m
Aggregate amounts receivable under long-term incentive plans	-	0.1

	2013 Number	2012 Number
Number of directors who received shares in respect of qualifying services	3	3
Number of directors who exercised share options	1	2
Number of directors accruing benefits under defined benefit schemes	1	1
Number of directors accruing benefits under defined contribution schemes	-	-

There was one director with incentive plans which vested during the year ended 31 March 2013 (2012: two 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

	2013 £m	2012 £m
Salaries and short-term employee benefits	6.8	5.7
Post-employment benefits	0.2	0.2
Share-based payments	1.5	0.7
	<u>8.5</u>	<u>6.6</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)

	2013 £m	2012 £m
Group		
<i>Continuing operations</i>		
Wages and salaries	204.2	194.7
Social security costs	16.1	15.8
Post-employment benefits excluding restructuring costs	22.0	17.5
Charged to regulatory capital schemes	(114.8)	(92.6)
Employee benefits expense excluding restructuring costs	127.5	135.4
Restructuring costs	2.6	2.6
Employee benefits expense attributable to continuing operations	130.1	138.0
Less: employee benefits attributable to joint ventures	(2.1)	(1.8)
Total employee benefits expense excluding joint ventures	128.0	136.2

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 2013. Included within wages and salaries is an expense of £1.9m (2012: income of £1.2m) relating to a recharge of share-based payment costs from the ultimate parent undertaking.

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

	2013 £m	2012 £m
Group		
<i>Continuing operations</i>		
Defined pension expense (see note 19)	16.5	13.3
Defined contribution pension costs (see note 19)	5.5	4.2
	22.0	17.5

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

	2013 number	2012 number
Group		
Continuing operations	5,301	5,096

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:

	2013 £m	2012 £m
Other operating costs		
Hired and contracted services	112.8	130.6
Materials	54.9	55.4
Power	62.1	50.3
Property rates	81.3	79.4
Charge for bad and doubtful receivables (see note 15)	35.5	34.5
Legal and professional expenses	5.8	4.1
Accommodation costs	7.6	5.5
Movement in other provisions (see note 21)	4.9	(3.9)
Cost of properties disposed	10.7	3.4
Operating leases payable:		
Property	2.9	3.3
Plant and equipment	0.9	0.8
Amortisation of deferred grants and contributions (see note 22)	(7.1)	(6.9)
Research and development expenses	1.3	1.6
Loss on disposal of property, plant and equipment	6.6	5.5
Loss on disposal of other intangible assets	3.2	2.6
Other	30.7	21.8
	<u>414.1</u>	<u>388.0</u>
Other income		
Other income	(3.1)	(4.8)
	<u>(3.1)</u>	<u>(4.8)</u>
Depreciation and amortisation expense		
Depreciation of property, plant and equipment: owned assets	305.9	278.0
Amortisation of other intangible assets	23.3	19.8
	<u>329.2</u>	<u>297.8</u>

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

	2013 £m	2012 £m
Statutory audit services – audit of the financial statements	0.1	0.1
Statutory audit of subsidiary accounts	0.1	0.1
Regulatory reporting	0.1	0.1
Statutory and regulatory audit of parent and subsidiary entities	0.3	0.3
Taxation advisory services	-	0.1
Other non audit fees	0.1	-
	<u>0.4</u>	<u>0.4</u>

Included in the above statutory audit fee is £20,000 in relation to the company for the year ended 31 March 2013 (2012: £20,000).

Notes to the financial statements (continued)

5. Investment income

	2013 £m	2012 £m
Interest receivable on short-term bank deposits held at amortised cost	2.3	4.4
Interest receivable from ultimate parent undertaking (note 26)	32.5	34.9
	<u>34.8</u>	<u>39.3</u>

6. Finance expense

	2013 £m	2012 £m
Interest payable		
Interest payable on borrowings held at amortised cost	249.1	269.0
	<u>249.1</u>	<u>269.0</u>
Fair value losses/(gains) on debt and derivative instruments⁽¹⁾		
Fair value hedge relationships:		
Borrowings	99.0	210.0
Designated swaps	(93.5)	(205.0)
	<u>5.5</u>	<u>5.0</u>
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss ⁽²⁾	17.6	19.1
Held for trading derivatives – economic hedge	(13.5)	(47.9)
	<u>4.1</u>	<u>(28.8)</u>
Held for trading derivatives - 2010-2015 regulatory hedges	(16.1)	54.4
Held for trading derivatives - regulatory hedges >2015	52.6	18.2
Held for trading derivatives - electricity hedges	1.5	4.6
Net receipts on swaps and debt under fair value option	(7.6)	(7.7)
Held for trading derivatives – other ⁽³⁾	4.0	(1.6)
Other	(2.5)	(0.9)
	<u>31.9</u>	<u>67.0</u>
Net fair value losses on debt and derivative instruments ⁽⁴⁾	<u>41.5</u>	<u>43.2</u>
Expected return on pension schemes' assets (see note 19)	(96.8)	(100.5)
Interest cost on pension schemes' obligations (see note 19)	108.3	103.8
	<u>11.5</u>	<u>3.3</u>
Net pension interest expense	<u>302.1</u>	<u>315.5</u>

Notes:

- (1) Fair value losses/(gains) on debt and derivative instruments includes foreign exchange gains of £14.6 million (2012: £22.3 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 £1.5 million losses (2012: £21.3 million gains) 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 £8.3 million income (2012: £7.2 million) due to interest on swaps and debt under fair value option.

Interest payable for the year ended 31 March 2013 is stated net of £14.3 million (2012: £9.7 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 4.3 per cent (2012: 4.8 per cent) to expenditure on such assets as prescribed by IAS 23 (Revised 2007) 'Borrowing Costs'.

Notes to the financial statements (continued)

7. Taxation

	2013 £m	2012 £m
Continuing operations		
Current taxation		
UK corporation tax	87.2	69.2
Foreign tax	1.3	1.3
Adjustments in respect of prior years	(6.5)	(9.6)
	<u>82.0</u>	<u>60.9</u>
Deferred taxation		
Current year	(4.6)	12.6
Adjustments in respect of prior years	5.8	15.5
	<u>1.2</u>	<u>28.1</u>
Change in taxation rate	(53.0)	(104.6)
Total deferred taxation credit for the year	<u>(51.8)</u>	<u>(76.5)</u>
Total taxation credit for the year	<u>30.2</u>	<u>(15.6)</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>Continuing operations</i>	
	2013 £m	2013 %	2012 £m	2012 %
Profit before taxation	<u>337.2</u>		<u>315.3</u>	
Tax at the UK corporation tax rate of 24 per cent (2012: 26 per cent)	80.9	24.0	82.0	26.0
Adjustments in respect of prior years	(0.7)	(0.2)	5.9	1.9
Change in taxation rate	(53.0)	(15.7)	(104.6)	(33.2)
Net expenses not deductible/other	3.0	0.8	1.1	0.4
Total tax charge/(credit) and effective tax rate for the year	<u>30.2</u>	<u>8.9</u>	<u>(15.6)</u>	<u>(4.9)</u>

The deferred taxation credit for the year ended 31 March 2013 includes a credit of £53.0 million to reflect the change enacted on 3 July 2012 to reduce the mainstream rate of corporation tax from 24 per cent to 23 per cent effective from 1 April 2013. A related deferred taxation charge of £0.9 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 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.

There will be a further phased reduction in the mainstream corporation tax rate to 20 per cent effective from 1 April 2015. The total deferred taxation credit in respect of this further reduction is expected to be in the region of £150.0 million.

For a group of our size, negotiations with tax authorities in relation to tax returns can span a number of years. The net adjustment of £0.7 million credit (2012: £0.4 million) in respect of prior years relates to those matters agreed in the current year.

Taxation on items taken directly to equity

Group	2013	2012
<i>Continuing operations</i>	<i>£m</i>	<i>£m</i>
Current taxation		
Relating to other pension movements	(15.6)	(33.1)
Deferred taxation (see note 20)		
On actuarial gains/(losses) on defined benefit pension schemes	9.7	(5.8)
Relating to other pension movements	15.0	30.6
Change in taxation rate	0.9	3.9
	<u>25.6</u>	<u>28.7</u>
Total taxation charge/(credit) on items taken directly to equity	<u>10.0</u>	<u>(4.4)</u>
 Company	 2013	 2012
<i>Continuing operations</i>	<i>£m</i>	<i>£m</i>
Current taxation		
Relating to other pension movements	(4.6)	(7.7)
Deferred taxation (see note 20)		
On actuarial losses on defined benefit pension scheme	2.1	(6.9)
Relating to other pension movements	4.4	7.1
Change in taxation rate	0.5	1.0
	<u>7.0</u>	<u>1.2</u>
Total taxation charge/(credit) on items taken directly to equity	<u>2.4</u>	<u>(6.5)</u>

Notes to the financial statements (continued)

8. Discontinued operations

Discontinued operations represent the retained obligations of business sold in prior years. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', the post-tax results of discontinued operations are disclosed separately in the consolidated income statement and consolidated statement of cash flows.

The profit after taxation from discontinued operations is analysed as follows:

	2013 £m	2012 £m
Total proceeds		3.5
Net assets disposed of	-	(0.4)
Transaction and other costs of disposal	14.6	2.0
Profit after taxation from discontinued operations	14.6	5.1

The profit after taxation from discontinued operations for the year ended 31 March 2013 relates primarily to the release of accrued costs of disposal in respect of certain elements of the group's non-regulated disposal programme.

9. Dividends

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

	2013 £m	2012 £m
Ordinary shares		
Final dividend for the year ended 31 March 2012 at 16.50 pence per share (2011: nil pence)	145.5	-
Interim dividend for the year ended 31 March 2013 at 8.85 pence per share (2012: nil pence)	78.0	-
Interim dividend for the year ended 31 March 2013 at 23.71 pence per share (2012: nil pence)	209.1	-
	432.6	-

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
Group Cost						
At 1 April 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)
At 31 March 2012	236.1	4,146.4	5,296.0	448.9	883.4	11,010.8
Additions	6.5	75.8	67.0	27.9	484.0	661.2
Transfers	11.9	164.4	172.3	8.2	(356.8)	-
Disposals	(4.6)	(0.6)	(38.2)	(33.2)	(1.3)	(77.9)
Currency translation differences	0.1	0.3	-	-	-	0.4
At 31 March 2013	250.0	4,386.3	5,497.1	451.8	1,009.3	11,594.5
Accumulated depreciation						
At 1 April 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)
At 31 March 2012	71.2	197.0	1,834.7	263.4	-	2,366.3
Charge for the year	9.9	28.9	226.6	40.5	-	305.9
Disposals	(4.6)	(0.1)	(31.9)	(31.8)	-	(68.4)
At 31 March 2013	76.5	225.8	2,029.4	272.1	-	2,603.8
Net book value at 31 March 2013	173.5	4,160.5	3,467.7	179.7	1,009.3	8,990.7
Net book value at 31 March 2012	164.9	3,949.4	3,461.3	185.5	883.4	8,644.5

At 31 March 2013, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £358.3 million (2012: £331.8 million).

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

Notes to the financial statements (continued)

10. Property, plant and equipment (continued)

	Fixtures, fittings, tools and equipment £m
Company	
Cost	
At 1 April 2011 and 31 March 2012	4.8
Disposals	(4.8)
At 31 March 2013	-
Accumulated depreciation	
At 1 April 2011 and 31 March 2012	4.4
Charge for the year	0.4
Disposals	(4.8)
At 31 March 2013	-
Net book value at 31 March 2013	-
Net book value at 31 March 2012	0.4

The company had no contractual commitments for the acquisition of property, plant and equipment at 31 March 2013 or at 31 March 2012.

11. Goodwill

	£m
Group	
Cost and net book value	
At 1 April 2011, 31 March 2012 and 31 March 2013	5.0

Goodwill at 31 March 2013 and 31 March 2012 relates to the group's shareholding in AS Tallinna Vesi (Tallinn Water).

Company

The company has no goodwill.

Notes to the financial statements (continued)

12. Other intangible assets

	Computer software £m	Other £m	Total £m
Group			
Cost			
At 1 April 2011	233.1	10.2	243.3
Additions	18.3	-	18.3
Disposals	(39.3)	-	(39.3)
Currency translation differences	-	(0.6)	(0.6)
At 31 March 2012	212.1	9.6	221.7
Additions	36.1	0.8	36.9
Disposals	(41.9)	-	(41.9)
Currency translation differences	-	0.1	0.1
At 31 March 2013	206.3	10.5	216.8
Amortisation			
At 1 April 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)
At 31 March 2012	129.0	3.2	132.2
Charge for the year	22.5	0.8	23.3
Disposals	(38.6)	-	(38.6)
At 31 March 2013	112.9	4.0	116.9
Net book value at 31 March 2013	93.4	6.5	99.9
Net book value at 31 March 2012	83.1	6.4	89.5

The 'other' intangible assets category relates mainly to customer contracts, customer lists and capitalised development expenditure.

At 31 March 2013, the group had entered into contractual commitments for the acquisition of other intangible assets amounting to £13.2 million (2012: £63.6 million).

Company

The company has no other intangible assets. The company had no contractual commitments for the acquisition of other intangible assets at 31 March 2013 or 31 March 2012.

Notes to the financial statements (continued)

13. Investments

	Other investments £m
Group	
At 1 April 2011	2.3
Additions	2.2
Revaluations	(1.1)
Disposals	(0.1)
At 31 March 2012	3.3
Additions	3.0
Disposals	(0.9)
Currency translation differences	0.3
At 31 March 2013	5.7

During the year the group increased its investment in Muharraq Holding Company 1 Limited by £3.1 million and disposed of its investment in Philwater Holdings Company Inc for consideration of £0.9 million.

At 31 March 2013, the group's other investments mainly comprised its investment in Muharraq Holding Company 1 Limited.

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
<i>Subsidiary undertakings</i>			
Great Britain			
United Utilities Water PLC	Ordinary	100.0*	Water and wastewater services and network management
United Utilities Property Services Limited	Ordinary	100.0	Property management
<i>Joint ventures</i>			
Estonia			
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 2012.

Notes to the financial statements (continued)

13. Investments (continued)

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

	2013 £m	2012 £m
Group share of joint ventures		
Non-current assets	46.8	49.1
Current assets	17.5	16.6
Non-current liabilities	(28.2)	(27.9)
Current liabilities	(8.0)	(6.7)
	<u>28.1</u>	<u>31.1</u>
	2013 £m	2012 £m
Group share of joint ventures		
Gross income	15.1	15.7
Expenses	(7.4)	(8.1)
Taxation	(1.3)	(1.3)
Profit after taxation	<u>6.4</u>	<u>6.3</u>

The joint ventures have no significant contingent liabilities to which the group is exposed. The group has issued guarantees of £5.2 million in support of its joint ventures (2012: £5.4m) which are included in the contingent liabilities total disclosed in note 28.

	Shares in subsidiary undertakings £m
Company	
At 1 April 2011	6,176.5
Additions	125.9
Impairment charge	(18.3)
Disposals	(184.1)
At 31 March 2012	<u>6,100.0</u>
Additions	1,605.9
Impairment charge	(1,499.9)
Disposals	(1,550.9)
At 31 March 2013	<u>4,655.1</u>

During the year ended 31 March 2013, there were additions of £1,605.9 million which included a £1,499.8 million investment in the ordinary shares of United Utilities North West Limited and a £25.4 million investment in the ordinary shares of United Utilities International Limited.

The remaining addition relates to the acquisition of the shares of United Utilities BV from United Utilities (Europe) Limited, an indirect subsidiary of United Utilities Contract Solutions Holdings Limited, for an amount equal to the carrying amount in United Utilities (Europe) Limited (£80.7m). This amount was less than fair value. As a result of this transfer and the subsequent strike off of United Utilities Contract Solutions Holdings Limited, the company's investment in United Utilities Contract Solutions Holdings Limited fell below the amount at which it was stated in the company's accounting records. As there has been no overall loss to the company, the directors consider that the company's investment of £105m in United Utilities Contract Solutions Holdings Limited should instead be re-allocated to the company's investment in United Utilities BV. The group financial statements are not affected by this transfer.

Notes to the financial statements (continued)

13. Investments (continued)

Also during the year, there was an impairment of £1,499.9 million in relation to the investment in United Utilities Investments (No.7) Limited following a £1,499.8 million realisation of value through receipt of dividends.

Total disposals during the year of £1,550.9 million include a £1,187.9 million investment in the ordinary shares of United Utilities Employee Share Trust Limited, £15.0 million in the ordinary shares of United Utilities Investments (No.5) Limited, £297.0 million in the ordinary shares of United Utilities (Jersey) Investments (No.6) Limited, and £51.1 million in the ordinary shares of NB Telecom (IOM) Limited prior to the strike off of the company following a £51.4 million realisation of value through receipt of dividends.

As reported in the prior year, there was an addition of £125.9 million investment in the ordinary shares of United Utilities Investments (No.2) Limited, and impairment charges were recognised in relation to NB Telecom (IOM) Limited of £17.3 million and United Utilities Investments (No.3) Limited.

Total disposals during the prior 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.

14. Inventories

	2013 £m	2012 £m
Group		
Properties held for resale	33.8	42.3
Other inventories	5.8	5.1
	<u>39.6</u>	<u>47.4</u>

Group

The company has no inventories.

15. Trade and other receivables

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
Trade receivables	190.1	182.1	-	-
Amounts owed by subsidiary undertakings	-	-	2,792.5	1,239.3
Amounts owed by ultimate parent undertaking (see note 26) *	1,558.0	1,735.2	-	-
Amounts owed by related parties (see note 26)	1.0	1.0	-	-
Other debtors	19.5	15.8	-	-
Prepayments and accrued income	118.5	103.6	-	0.1
	<u>1,887.1</u>	<u>2,037.7</u>	<u>2,792.5</u>	<u>1,239.4</u>

* Included in net amounts owed by the ultimate parent undertaking is £9.0 million for the group (2012: £9.0 million) and £nil for the company (2012: £nil) relating to net group tax relief receivable from United Utilities Group PLC.

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.

Notes to the financial statements (continued)

15. Trade and other receivables (continued)

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

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
Non-current	2.2	1.1	-	-
Current	1,884.9	2,036.6	2,792.5	1,239.4
	<u>1,887.1</u>	<u>2,037.7</u>	<u>2,792.5</u>	<u>1,239.4</u>

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

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
At the start of the year	78.4	55.2	0.4	0.6
Amounts charged/(credited) to operating expenses	35.5	34.5	-	(0.1)
Trade receivables written off	(26.4)	(11.3)	-	-
Disposed of during the year	-	-	-	(0.1)
At the end of the year	<u>87.5</u>	<u>78.4</u>	<u>0.4</u>	<u>0.4</u>

At each reporting date, the group evaluates the recoverability of trade receivables and records allowances for doubtful receivables based upon experience.

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:

	2013 £m	2012 £m
Company		
At the start of the year	87.3	80.6
Amounts charged to operating expenses	1.4	8.1
Amounts written off	-	(1.4)
At the end of the year	<u>88.7</u>	<u>87.3</u>

At 31 March 2013 and 31 March 2012, the group had no trade receivables that were past due and not individually impaired.

At each reporting date, the company evaluates the recoverability of amounts owed by subsidiary undertakings and records allowances for doubtful receivables based on an assessment of the company's ability to pay.

Notes to the financial statements (continued)

15. Trade and other receivables (continued)

The following table provides information regarding the ageing of net trade receivables that were past due and individually impaired:

Group	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2013				
Trade receivables	114.3	37.9	32.6	184.8
Group	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2012				
Trade receivables	110.4	29.8	35.0	175.2

At 31 March 2013, the group had £5.3 million (2012: £6.9 million) of trade receivables that were not past due.

At 31 March 2013 and 31 March 2012 the company had trade receivables of £0.4 million which were past due. These trade receivables were fully impaired. The company had £nil (2012: £nil) which was not past due.

The directors consider that the carrying amount of trade and other receivables approximates to their fair value at 31 March 2013 and 31 March 2012.

16. Cash and cash equivalents

16. Cash and cash equivalents				
	Group		Company	
	2013	2012	2013	2012
	£m	£m	£m	£m
Cash at bank and in hand	14.0	12.4	84.1	0.1
Short-term bank deposits	187.1	308.8	186.4	308.1
Cash and short-term deposits	201.1	321.2	270.5	308.2
Bank overdrafts (included in borrowings, see note 17)	(19.2)	(8.6)	-	(0.1)
Cash and cash equivalents in the statement of cash flows	181.9	312.6	270.5	308.1

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:

Group	2013 £m	2012 £m
Non-current liabilities		
Bonds	4,633.7	4,491.1
Bank and other term borrowings	1,373.7	1,237.0
	<u>6,007.4</u>	<u>5,728.1</u>
Current liabilities		
Bonds	21.0	7.0
Bank and other term borrowings	125.9	111.0
Bank overdrafts (see note 16)	19.2	8.6
Amounts owed to ultimate parent undertaking	32.2	33.2
	<u>198.3</u>	<u>159.8</u>
	<u>6,205.7</u>	<u>5,887.9</u>

Terms and debt repayment schedule

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

Group	Currency	Year of final repayment	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Borrowings in fair value hedge relationships						
5.375% 150m bond	GBP	2018	179.9	178.6	177.1	176.1
4.55% 250m bond	USD	2018	178.1	189.7	163.6	179.2
5.375% 350m bond	USD	2019	256.4	277.8	235.0	262.8
4.25% 500m bond	EUR	2020	485.3	495.0	460.1	471.7
5.75% 375m bond	GBP	2022	451.5	441.0	430.4	421.6
5.625% 300m bond	GBP	2027	362.4	394.6	340.9	377.8
5.02% JPY 10bn dual currency loan	JPY/USD	2029	80.1	96.6	76.7	95.6
5.00% 200m bond	GBP	2035	215.6	256.0	202.1	244.6
Borrowings designated at fair value through profit or loss						
1.135% 3bn bond	JPY	2013	21.0	21.0	22.6	22.6
6.875% 400m bond	USD	2028	302.4	302.4	283.3	283.3

Notes to the financial statements (continued)

17. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
<i>table continued from previous page</i>						
Borrowings measured at amortised cost						
Short-term bank borrowings - fixed	GBP	2013	125.6	125.6	110.8	110.8
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	-	-	6.5	7.0
6.125% 425m bond	GBP	2015	483.7	428.6	489.7	429.7
1.97%+RPI 200m IL loan	GBP	2016	270.2	248.7	255.4	240.5
1.30%+LIBOR (floating) 5bn bond	JPY	2017	37.3	35.4	40.9	38.3
2.46%+RPI 50m IL loan	GBP	2020	72.4	56.3	65.4	54.5
2.10%+RPI 50m IL loan	GBP	2020	70.6	56.3	63.6	54.5
1.93%+RPI 50m IL loan	GBP	2020	70.0	56.4	62.9	54.6
1.90%+RPI 50m IL loan	GBP	2020	69.9	56.5	62.9	54.7
1.88%+RPI 50m IL loan	GBP	2020	69.7	56.3	62.6	54.6
1.84%+RPI 50m IL loan	GBP	2020	69.7	56.6	62.6	54.8
1.73%+RPI 50m IL loan	GBP	2020	69.2	56.6	62.2	54.8
1.61%+RPI 50m IL loan	GBP	2020	68.7	56.7	61.7	54.9
0.47%+RPI 100m IL loan	GBP	2023	97.5	99.9	-	-
1.29%+RPI 50m IL loan	GBP	2029	58.3	53.4	49.8	51.6
1.23%+RPI 50m IL loan	GBP	2029	57.9	53.7	49.4	52.0
1.12%+RPI 50m IL loan	GBP	2029	56.4	52.9	48.0	51.3
1.10%+RPI 50m IL loan	GBP	2029	56.1	52.9	47.8	51.2
0.75%+RPI 50m IL loan	GBP	2029	52.1	51.7	43.9	50.1
1.15%+RPI 50m IL loan	GBP	2030	54.9	51.4	46.5	49.7
1.11%+RPI 50m IL loan	GBP	2030	54.2	51.5	45.2	49.9
0.76%+RPI 50m IL loan	GBP	2030	51.9	51.5	43.7	49.9
3.375%+RPI 50m IL bond	GBP	2032	95.9	68.0	86.3	65.8
1.9799%+RPI 100m IL bond	GBP	2035	148.4	127.7	128.3	123.8
1.66%+RPI 35m IL bond	GBP	2037	45.3	41.4	39.3	40.1
2.40%+RPI 70m IL bond	GBP	2039	102.4	80.6	89.1	78.1
1.7829%+RPI 100m IL bond	GBP	2040	143.9	126.4	123.6	122.5
1.3258%+RPI 50m IL bond	GBP	2041	64.7	63.0	55.1	61.1
1.5802%+RPI 100m IL bond	GBP	2042	137.0	126.0	116.7	122.1
1.5366%+RPI 50m IL bond	GBP	2043	68.4	62.9	58.1	60.9
1.397%+RPI 50m IL bond	GBP	2046	66.1	63.0	55.4	61.1
1.7937%+RPI 50m IL bond	GBP	2049	69.9	62.7	61.3	60.8
Commission for New Towns loan - fixed	GBP	2053	55.9	29.9	53.1	30.1
1.847%+RPI 100m IL bond	GBP	2056	142.3	125.0	123.0	121.0
1.815%+RPI 100m IL bond	GBP	2056	140.3	124.4	121.1	120.5
1.662%+RPI 100m IL bond	GBP	2056	133.8	124.2	115.2	120.3
1.591%+RPI 25m IL bond	GBP	2056	32.6	31.0	28.0	30.0
1.5865%+RPI 50m IL bond	GBP	2056	65.3	62.1	56.2	60.1
1.556%+RPI 50m IL bond	GBP	2056	64.7	61.8	55.6	59.8
1.435%+RPI 50m IL bond	GBP	2056	62.0	61.5	53.1	59.6
1.3805%+RPI 35m IL bond	GBP	2056	42.6	43.1	36.5	41.7
1.702%+RPI 50m IL bond	GBP	2057	66.1	60.3	56.8	58.4
1.585%+RPI 100m IL bond	GBP	2057	126.0	119.5	108.2	115.7
Joint venture borrowings	Various	Various	28.2	28.2	27.9	27.9
Other borrowings						
Amounts owed to ultimate parent undertaking	GBP	2013	32.2	32.2	33.2	33.2
Bank overdrafts	GBP	2013	19.2	19.2	8.6	8.6
			<u>6,502.2</u>	<u>6,205.7</u>	<u>5,863.0</u>	<u>5,887.9</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	2013 £m	2012 £m
Non-current liabilities		
Bonds	727.9	689.7
	<u>727.9</u>	<u>689.7</u>
Current liabilities		
Bonds	-	7.0
Bank and other term borrowings	81.9	69.7
Bank overdraft (see note 16)	-	0.1
Amounts owed to subsidiary undertakings	831.4	710.7
Amounts owed to ultimate parent undertaking	32.2	33.2
	<u>945.5</u>	<u>820.7</u>
	<u>1,673.4</u>	<u>1,510.4</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 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Borrowings in fair value hedge relationships						
4.55% 250m bond	USD	2018	178.1	189.7	163.6	179.2
5.375% 350m bond	USD	2019	256.4	277.8	235.0	262.8
Borrowings measured at amortised cost						
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	-	-	6.5	7.0
Short-term bank borrowings – fixed	GBP	2013	81.9	81.9	69.7	69.7
Amounts owed to subsidiary undertakings	GBP	2013	831.4	831.4	710.7	710.7
Amounts owed to ultimate parent undertaking	GBP	2013	32.2	32.2	33.2	33.2
6.875% 400m bond	USD	2028	302.4	260.4	283.3	247.7
Other borrowings						
Bank overdrafts	GBP	2013	-	-	0.1	0.1
			<u>1,682.4</u>	<u>1,673.4</u>	<u>1,502.1</u>	<u>1,510.4</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.

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 2013, the group had £721.1 million (2012: £991.2 million) of available liquidity, which comprised £201.1 million (2012: £321.2 million) cash and short-term deposits and £520.0 million (2012: £670.0 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:

	Group		Company	
	2013	2012	2013	2012
	£m	£m	£m	£m
Expiring within one year	220.0	250.0	120.0	125.0
Expiring after one year but in less than two years	50.0	220.0	25.0	120.0
Expiring after more than two years	250.0	200.0	60.0	75.0
Total borrowing facilities	520.0	670.0	205.0	320.0
Offsetting bank guarantees	-	-	-	-
Undrawn borrowing facilities	520.0	670.0	205.0	320.0

At 31 March 2013, the group had additional committed borrowing facilities of £100.0 million and the company had additional committed borrowing facilities of £20.0 million expiring after more than two years, £50.0 million (£10.0 million company) available to be drawn from September 2013 and £50.0 million (£10.0 million company) available to be drawn from January 2014.

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 available to be drawn from 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 ⁽¹⁾ £m	Adjust- ment ⁽²⁾ £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
Group								
At 31 March 2013								
Bonds	9,873.4		190.1	169.9	595.6	145.4	182.7	8,589.7
Bank and other term borrowings	2,056.1		170.6	26.9	49.4	331.6	56.5	1,421.1
Amounts owed to ultimate parent undertaking	32.2		32.2	-	-	-	-	-
Adjustment to carrying value ⁽²⁾	(5,756.0)	(5,756.0)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	6,205.7	(5,756.0)	392.9	196.8	645.0	477.0	239.2	10,010.8
Derivatives:								
Payable	1,064.9		97.7	80.8	52.3	46.3	77.0	710.8
Receivable	(1,643.9)		(152.3)	(174.6)	(86.9)	(85.3)	(143.9)	(1,000.9)
Adjustment to carrying value ⁽²⁾	57.8	57.8						
Derivatives – net assets	(521.2)	57.8	(54.6)	(93.8)	(34.6)	(39.0)	(66.9)	(290.1)

Notes to the financial statements (continued)

18. Financial instruments (continued)

Maturity analysis (continued)

Group	Total ⁽¹⁾ £m	Adjust- ment ⁽²⁾ £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
At 31 March 2012								
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 ⁽²⁾	(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 ⁽²⁾	61.6	61.6						
Derivatives – net assets	(457.6)	61.6	(70.7)	(109.0)	(57.4)	(19.0)	(23.2)	(239.9)
Company								
At 31 March 2013								
Bonds	1,022.3		38.0	38.0	37.9	37.8	37.6	833.0
Bank and other term borrowings	81.9		81.9	-	-	-	-	-
Amounts owed to ultimate parent undertaking	32.2		32.2	-	-	-	-	-
Amounts owed to subsidiary undertakings	831.4		831.4	-	-	-	-	-
Adjustment to carrying value ⁽²⁾	(294.4)	(294.4)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	1,673.4	(294.4)	983.5	38.0	37.9	37.8	37.6	833.0
Derivatives:								
Payable	349.0		17.2	(4.9)	2.7	4.0	5.5	324.5
Receivable	(519.4)		(37.3)	(18.7)	(19.9)	(19.8)	(19.7)	(404.0)
Adjustment to carrying value ⁽²⁾	7.6	7.6						
Derivatives – net assets	(162.8)	7.6	(20.1)	(23.6)	(17.2)	(15.8)	(14.2)	(79.5)

Notes to the financial statements (continued)

18. Financial instruments (continued)

Maturity analysis (continued)

Company	Total ⁽¹⁾ £m	Adjust- ment ⁽²⁾ £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
At 31 March 2012								
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 ⁽²⁾	(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 ⁽²⁾	7.7	7.7						
Derivatives – net assets	(138.7)	7.7	(13.6)	(68.9)	(9.8)	(7.3)	(6.6)	(40.2)

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 trading (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 trading 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:

	Group		Company	
	2013	2012	2013	2012
	£m	£m	£m	£m
Cash and short-term deposits (see note 16)	201.1	321.2	270.5	308.2
Trade and other receivables (see note 15)	1,887.1	2,037.7	2,792.5	1,239.4
Investments (see note 13)	5.7	3.3	-	-
Derivative financial instruments	721.2	617.4	163.7	138.8
	<u>2,815.1</u>	<u>2,979.6</u>	<u>3,226.7</u>	<u>1,686.4</u>

Included within trade and other receivables for group are amounts owed by the ultimate parent undertaking of £1,558.0 million (2012: £1,735.2 million).

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2013 the group held £125.6 million (2012: £110.8 million) and the company held £81.9 million (2012: £69.7 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. The pension scheme funding mechanism ensures 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:

	2013 £m	2012 £m
Index-linked debt	2,853.9	2,667.0

Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Disclosures', the sensitivity analysis has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2013 and 31 March 2012, 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	2013 £m	2012 £m
Increase/(decrease) in profit before taxation and equity		
1 per cent increase in RPI	(29.1)	(27.2)
1 per cent decrease in RPI	29.1	27.2

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. The group's interest risk management strategy is to fix 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.

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
Increase/(decrease) in profit before taxation and equity				
1 per cent increase in interest rate	94.9	82.9	(18.7)	(19.9)
1 per cent decrease in interest rate	(96.9)	(87.4)	16.9	21.5

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.

Group	Total	1 year	1-2	2-3	3-4	4-5	More
At 31 March 2013	£m	or less	years	years	years	years	than 5
Borrowings in fair value hedge relationships		£m	£m	£m	£m	£m	£m
Fixed rate instruments	2,329.3	-	-	-	-	-	2,329.3
Effect of swaps	-	2,329.3	-	-	-	-	(2,329.3)
	<u>2,329.3</u>	<u>2,329.3</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	323.4	21.0	-	-	-	-	302.4
Effect of swaps	-	302.4	-	-	-	-	(302.4)
	<u>323.4</u>	<u>323.4</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Borrowings measured at amortised cost							
Fixed rate instruments	584.1	125.9	0.3	429.0	0.4	0.5	28.0
Floating rate instruments	82.8	82.8	-	-	-	-	-
Index-linked instruments	2,853.9	2,853.9	-	-	-	-	-
	<u>3,520.8</u>	<u>3,062.6</u>	<u>0.3</u>	<u>429.0</u>	<u>0.4</u>	<u>0.5</u>	<u>28.0</u>
Effect of a fixed interest rate hedge	-	(1,831.3)	200.0	-	325.0	252.1	1,054.2
Total external borrowings	<u>6,173.5</u>	<u>3,884.0</u>	<u>200.3</u>	<u>429.0</u>	<u>325.4</u>	<u>252.6</u>	<u>1,082.2</u>
Amounts owed to ultimate parent undertaking	32.2	32.2	-	-	-	-	-
Total borrowings	<u>6,205.7</u>	<u>3,916.2</u>	<u>200.3</u>	<u>429.0</u>	<u>325.4</u>	<u>252.6</u>	<u>1,082.2</u>
Cash and short-term deposits	(201.1)	(201.1)	-	-	-	-	-
Net borrowings	<u>6,004.6</u>	<u>3,715.1</u>	<u>200.3</u>	<u>429.0</u>	<u>325.4</u>	<u>252.6</u>	<u>1,082.2</u>

Notes to the financial statements (continued)

18. Financial instruments (continued)

Repricing analysis (continued)

Group	Total	1 year	1-2	2-3	3-4	4-5	More
At 31 March 2012	£m	or less	years	years	years	years	than 5
		£m	£m	£m	£m	£m	£m
Borrowings in fair value hedge relationships							
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>
Borrowings designated at fair value through profit or loss							
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>
Borrowings measured at amortised cost							
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
Total external borrowings	<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	-	-	-	-	-
Total borrowings	<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)	-	-	-	-	-
Net borrowings	<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)

	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
Company							
At 31 March 2013							
Borrowings in fair value hedge relationships							
Fixed rate instruments	467.5	-	-	-	-	-	467.5
Effect of swaps	-	467.5	-	-	-	-	(467.5)
	<u>467.5</u>	<u>467.5</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Borrowings measured at amortised cost							
Fixed rate instruments	342.3	81.9	-	-	-	-	260.4
Floating rate instruments	-	-	-	-	-	-	-
	<u>342.3</u>	<u>81.9</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>260.4</u>
Total external borrowings	<u>809.8</u>	<u>549.4</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>260.4</u>
Amounts owed to subsidiary undertakings	831.4	831.4	-	-	-	-	-
Amounts owed to ultimate parent undertaking	32.2	32.2	-	-	-	-	-
Effect of a fixed interest rate hedge	-	400.0	(400.0)	-	-	-	-
Total borrowings	<u>1,673.4</u>	<u>1,813.0</u>	<u>(400.0)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>260.4</u>
Cash and short-term deposits	(270.5)	(270.5)	-	-	-	-	-
Net borrowings	<u>1,402.9</u>	<u>1,542.5</u>	<u>(400.0)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>260.4</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
Company							
At 31 March 2012							
Borrowings in fair value hedge relationships							
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>
Borrowings measured at amortised cost							
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>
Total external borrowings	<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)	-	-	-
Total borrowings	<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)	-	-	-	-	-
Net borrowings	<u>1,202.2</u>	<u>1,354.5</u>	<u>-</u>	<u>(400.0)</u>	<u>-</u>	<u>-</u>	<u>247.7</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.

The group has used 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.

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.

Group	2013 £m	2012 £m
Increase/(decrease) in profit before taxation and equity		
10 per cent increase in commodity prices	4.4	4.3
10 per cent decrease in commodity prices	(4.4)	(4.3)

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 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Financial assets				
<i>Non-current assets</i>				
Available for sale investments	5.7	5.7	2.5	2.5
Loans and receivables:				
Investments	-	-	0.8	0.8
Trade and other receivables	2.2	2.2	1.1	1.1
Derivative financial instruments:				
Fair value hedge derivatives – swaps	514.2	514.2	434.3	434.3
Held for trading derivatives – swaps ⁽²⁾	145.0	145.0	133.2	133.2
<i>Current assets</i>				
Loans and receivables:				
Trade and other receivables	1,884.9	1,884.9	2,036.6	2,036.6
Cash and short-term deposits	201.1	201.1	321.2	321.2
Derivative financial instruments:				
Fair value hedge derivatives – swaps	62.0	62.0	48.4	48.4
Held for trading derivatives – swaps ⁽²⁾	-	-	1.5	1.5
Financial liabilities				
<i>Non-current liabilities</i>				
Trade and other payables at amortised cost	(419.8)	(419.8)	(378.0)	(378.0)
Borrowings:				
Financial liabilities in hedge relationships:				
Fair value hedge	(2,209.3)	(2,329.3)	(2,085.9)	(2,229.4)
Financial liabilities designated at fair value through profit or loss	(302.4)	(302.4)	(305.9)	(305.9)
Other financial liabilities	(3,792.2)	(3,375.7)	(3,311.4)	(3,192.8)
	(6,303.9)	(6,007.4)	(5,703.2)	(5,728.1)
Derivative financial instruments:				
Fair value hedge derivatives – swaps	-	-	-	-
Held for trading derivatives – swaps ⁽²⁾	(196.2)	(196.2)	(159.7)	(159.7)
<i>Current liabilities</i>				
Trade and other payables at amortised cost	(438.9)	(439.0)	(445.9)	(445.9)
Borrowings:				
Financial liabilities designated at fair value through profit or loss	(21.0)	(21.0)	-	-
Other financial liabilities	(177.3)	(177.3)	(159.8)	(159.8)
	(198.3)	(198.3)	(159.8)	(159.8)
Derivative financial instruments:				
Held for trading derivatives – swaps ⁽²⁾	(3.8)	(3.8)	(0.1)	(0.1)
Adjustment for accrued interest ⁽¹⁾	40.4	-	40.0	-
	(4,705.4)	(4,449.4)	(3,827.1)	(3,892.0)

Notes:

- (1) Fair values quoted include accrued interest of £40.4 million (2012: £40.0 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 £143.5 million (2012: £134.5 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 page 29. 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 £17.5 million loss (2012: £19.1 million loss), £1.5 million loss (2012: £21.3 million gain) is attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £74.7 million profit (2012: £76.2 million profit). The carrying amount is £99.2 million (2012: £81.7 million) higher than the amount contracted to settle on maturity.

Company	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Financial assets				
Non-current assets				
Derivative financial instruments:				
Fair value hedge derivatives – swaps	153.5	153.5	132.0	132.0
Held for trading derivatives – swaps ⁽²⁾	10.2	10.2	6.7	6.7
Current assets				
Loans and receivables:				
Trade and other receivables	2,792.5	2,792.5	1,239.4	1,239.4
Cash and short-term deposits	270.5	270.5	308.2	308.2
Derivative financial instruments:				
Held for trading derivatives – swaps	-	-	0.1	0.1
Financial liabilities				
Non-current liabilities				
Borrowings:				
Financial liabilities in hedged relationships:				
Fair value hedge	(434.5)	(467.5)	(398.6)	(442.0)
Other financial liabilities	(302.4)	(260.4)	(283.3)	(247.7)
	(736.9)	(727.9)	(681.9)	(689.7)
Derivative financial instruments:				
Held for trading derivatives – swaps ⁽²⁾	-	-	-	-
Current liabilities				
Trade and other payables at amortised cost	(1,081.3)	(1,081.3)	(1,317.0)	(1,317.1)
Borrowings:				
Other financial liabilities	(945.5)	(945.5)	(820.2)	(820.7)
Derivative financial instruments:				
Held for trading derivatives - swaps	(0.9)	(0.9)	(0.1)	(0.1)
Adjustment for accrued interest ⁽¹⁾	6.5	-	6.2	-
	468.6	471.1	(1,126.7)	(1,141.2)

Notes:

(1) Fair values quoted include accrued interest of £6.5 million (2012: £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 (2012: £6.7 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).

Group 2013	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	-	5.7	-	5.7
Financial assets at fair value through profit or loss				
Derivative financial assets	-	721.2	-	721.2
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	-	(200.0)	-	(200.0)
Financial liabilities designated as fair value through profit or loss	-	(323.4)	-	(323.4)
	-	203.5	-	203.5

Group 2012	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	-	2.5	-	2.5
Financial assets at fair value through profit or loss				
Derivative financial assets	-	617.4	-	617.4
Financial liabilities at fair value through profit or loss				
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

Company 2013	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets	-	163.7	-	163.7
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	-	(0.9)	-	(0.9)
	-	162.8	-	162.8

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

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

Notes to the financial statements (continued)

19. Retirement benefit surplus/(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 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 2013 by projecting forward from the valuation date and have been performed by an independent actuary, AON Hewitt Limited.

The group made total contributions of £93.0 million (2012: £149.7 million) to its pension schemes for the year ended 31 March 2013. Overall, the group expects to contribute around £27.1 million to its defined benefit schemes in the year ending 31 March 2014. The group also continues to pay contributions in respect of the defined contribution members and insurance premiums.

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:

	2013 %pa	2012 %pa
Group and Company		
Discount rate	4.60	5.00
Expected return on assets*	4.60	4.45
Pensionable salary growth and pension increases	3.30	3.25
Price inflation	3.30	3.25

* The 2012 expected return on assets has been re-presented to show the combined weighted average expected return on assets (the expected return on assets was previously shown separately for the UUPS and ESPS schemes).

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

	2013 years	2012 years
Group and Company		
Retired member - male	26.7	26.5
Non-retired member – male	28.5	28.3
Retired member - female	30.0	29.8
Non-retired member – female	31.9	31.7

Notes to the financial statements (continued)

19. Retirement benefit surplus/(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 %	2013 £m	Schemes' assets %	2012 £m
Group				
Equities	14.9	363.9	14.9	315.4
Other non-equity growth assets	10.6	259.0	9.6	203.5
Gilts	2.1	50.7	2.0	41.6
Bonds	60.5	1,477.4	58.4	1,233.0
Other	11.9	291.0	15.1	319.5
Total fair value of schemes' assets	100.0	2,442.0	100.0	2,113.0
Present value of defined benefit obligations		(2,426.9)		(2,205.0)
Net retirement benefit surplus/ (obligations)		15.1		(92.0)
	Schemes' assets %	2013 £m	Schemes' assets %	2012 £m
Company				
Equities	19.1	155.5	19.4	138.5
Other non-equity growth assets	13.6	110.7	12.5	89.3
Gilts	2.1	16.9	2.0	14.1
Bonds	53.4	435.4	52.0	371.5
Other	11.8	96.7	14.1	100.6
Total fair value of schemes' assets	100.0	815.2	100.0	714.0
Present value of defined benefit obligations		(838.2)		(765.1)
Net retirement benefit obligations		(23.0)		(51.1)

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 £309.5 million (2012: £319.3 million) and the company's actual return on the schemes' assets was a gain of £104.2 million (2012: £93.7 million gain).

The assets as at 31 March 2013, 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 surplus/(obligations) (continued)

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

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
At the start of the year	(2,205.0)	(1,912.9)	(765.1)	(667.7)
Interest cost on pension schemes' obligations	(108.3)	(103.8)	(37.5)	(36.1)
Actuarial losses	(170.6)	(243.1)	(61.8)	(86.3)
Curtailments/settlements arising on reorganisation	(0.6)	(1.2)	-	0.7
Member contributions	(6.8)	(6.8)	(0.5)	(0.5)
Benefits paid	80.3	76.1	27.8	25.9
Current service cost	(15.9)	(13.3)	(1.1)	(1.1)
At the end of the year	(2,426.9)	(2,205.0)	(838.2)	(765.1)

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

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
At the start of the year	2,113.0	1,717.9	714.0	615.6
Expected return on pension schemes' assets	96.8	100.5	33.3	36.0
Actuarial gains	212.7	218.8	70.9	57.7
Member contributions	6.8	6.8	0.5	0.5
Benefits paid	(80.3)	(76.1)	(27.8)	(25.9)
Curtailments/settlements arising on reorganisation	-	(4.6)	-	(4.6)
Company contributions	93.0	149.7	24.3	34.7
At the end of the year	2,442.0	2,113.0	815.2	714.0

Notes to the financial statements (continued)

19. Retirement benefit surplus/(obligations) (continued)

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

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
<i>Continuing operations</i>				
Current service cost	(15.9)	(13.3)	(1.1)	(1.1)
Curtailments/settlements arising on reorganisation	(0.6)	(5.4)	-	(3.5)
Pension expense charged to operating profit	(16.5)	(18.7)	(1.1)	(4.6)
Expected return on schemes' assets	96.8	100.5	33.3	36.0
Interest on schemes' obligations	(108.3)	(103.8)	(37.5)	(36.1)
Pension expense charged to investment income and finance expense (see note 6)	(11.5)	(3.3)	(4.2)	(0.1)
Net pension expense charged before taxation	(28.0)	(22.0)	(5.3)	(4.7)

Defined benefit pension costs excluding curtailments/settlements arising on reorganisation included within employee benefit expense were £15.9 million (2012: £13.3 million) comprising current service costs. Total post-employment benefits expense excluding curtailments/settlements arising on reorganisation charged to operating profit of £21.4 million (2012: £17.5 million) comprise the defined benefit costs described above of £15.9 million (2012: £13.3 million) and defined contribution pension costs of £5.5 million (2012: £4.2 million). (See note 3).

Notes to the financial statements (continued)

19. Retirement benefit surplus/(obligations) (continued)

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
Discontinued operations				
Curtailment/settlement arising on disposal and charged to profit on disposal of discontinued operations (see note 8)	-	(0.4)	-	(0.4)
Net pension expense before taxation	-	(0.4)	-	(0.4)

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

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
At the start of the year	(92.0)	(195.0)	(51.1)	(52.1)
Expense recognised in the income statement - continuing operations	(28.0)	(22.0)	(5.3)	(4.7)
Expense recognised in the income statement - discontinued operations	-	(0.4)	-	(0.4)
Contributions paid	93.0	149.7	24.3	34.7
Actuarial gains/(losses) gross of taxation	42.1	(24.3)	9.1	(28.6)
At the end of the year	15.1	(92.0)	(23.0)	(51.1)

Included in the 2013 group contributions paid of £93.0 million (2012: £149.7 million) were regular accelerated deficit repair contributions of £65.0 million (2012: £100.0 million) and an inflation funding mechanism payment of £10.0 million (2012: £8.8 million). Details of the inflation mechanism, entered into with the group as part of a pension de-risking strategy, are included within the 2011 annual report.

Actuarial gains and losses are recognised directly in the statement of comprehensive income. At 31 March 2013, a cumulative pre-tax loss of £247.4 million (2012: £289.5 million) had been recorded directly in the statement of comprehensive income for the group and a cumulative loss of £138.9 million (2012: £148.0 million) for the company had been recorded directly in the statement of comprehensive income.

Notes to the financial statements (continued)

19. Retirement benefit surplus/(obligations) (continued)

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

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Group					
Present value of defined benefit obligations	(2,426.9)	(2,205.0)	(1,912.9)	(2,182.2)	(1,696.9)
Fair value of schemes' assets	2,442.0	2,113.0	1,717.9	1,910.9	1,483.8
Net retirement benefit surplus/ (obligations)	<u>15.1</u>	<u>(92.0)</u>	<u>(195.0)</u>	<u>(271.3)</u>	<u>(213.1)</u>
Experience adjustments on schemes' liabilities	6.3	(33.0)	25.2	1.8	(8.9)
Experience adjustments on schemes' assets	<u>212.7</u>	<u>218.8</u>	<u>25.8</u>	<u>365.2</u>	<u>(496.4)</u>
	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Company					
Present value of defined benefit obligations	(838.2)	(765.1)	(667.7)	(393.0)	(303.2)
Fair value of schemes' assets	815.2	714.0	615.6	360.6	283.5
Net retirement benefit obligations	<u>(23.0)</u>	<u>(51.1)</u>	<u>(52.1)</u>	<u>(32.4)</u>	<u>(19.7)</u>
Experience adjustments on schemes' liabilities	(2.4)	(11.0)	(12.7)	-	2.0
Experience adjustments on schemes' assets	<u>70.9</u>	<u>57.7</u>	<u>2.0</u>	<u>70.3</u>	<u>(91.0)</u>

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 £5.5 million (2012: £4.2 million) of contributions (see note 3) to defined contribution schemes relating to continuing operations, which are included in arriving at operating profit.

The company made £1.2 million (2012: £0.9 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
Group				
At 1 April 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
At 31 March 2012	1,289.9	(22.1)	(22.6)	1,245.2
(Credited)/charged to the income statement	(47.9)	(0.1)	(3.8)	(51.8)
Charged to equity	-	25.6	-	25.6
At 31 March 2013	1,242.0	3.4	(26.4)	1,219.0
	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
Company				
At 1 April 2012	(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
At 31 March 2012	(0.1)	(12.3)	(5.3)	(17.7)
Charged to the income statement	-	-	4.3	4.3
Charged to equity	-	7.0	-	7.0
At 31 March 2013	(0.1)	(5.3)	(1.0)	(6.4)

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 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)
At 31 March 2012	0.6	9.7	10.3	0.2	0.2	0.4
Charged to the income statement	2.6	4.9	7.5	-	-	-
Utilised in the year	(1.6)	(4.0)	(5.6)	(0.1)	(0.1)	(0.2)
At 31 March 2013	1.6	10.6	12.2	0.1	0.1	0.2

The restructuring provision as at 31 March 2013 and 31 March 2012 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
At 31 March 2013						
Non-current	-	3.4	3.4	-	-	-
Current	1.6	7.2	8.8	0.1	0.1	0.2
	1.6	10.6	12.2	0.1	0.1	0.2
At 31 March 2012						
Non-current	-	4.0	4.0	-	-	-
Current	0.6	5.7	6.3	0.2	0.2	0.4
	0.6	9.7	10.3	0.2	0.2	0.4

22. Trade and other payables

	2013 £m	Group 2012 £m
Non-current		
Deferred grants and contributions	410.0	366.5
Other creditors	9.8	11.5
	419.8	378.0

Company

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

Notes to the financial statements (continued)

22. Trade and other payables (continued)

	2013 £m	Group 2012 £m	2013 £m	Company 2012 £m
Current				
Trade payables	52.7	40.2	0.1	0.2
Amounts owed to ultimate parent undertaking	1.0	0.6	-	-
Amounts owed to subsidiary undertakings:				
Group tax relief payable	-	-	62.9	28.1
Other	-	-	1,005.7	1,275.7
Other tax and social security	4.7	4.4	-	-
Deferred grants and contributions	9.0	6.9	-	-
Other creditors	2.6	2.5	2.8	2.8
Accruals and deferred income	368.9	391.3	9.8	10.2
	<u>438.9</u>	<u>445.9</u>	<u>1,081.3</u>	<u>1,317.0</u>

The directors consider that the carrying amount of trade payables approximates to their fair value at both 31 March 2013 and 31 March 2012.

Deferred grants and contributions

	2013 £m	2012 £m
Group		
At the start of the year	373.4	247.8
Cash received during the year	16.3	13.0
Transfers of assets from customers	38.2	120.4
Credited to income statement – revenue (see note 1)	(1.8)	(0.9)
Credited to the income statement – other operating expenses (see note 4)	(7.1)	(6.9)
At the end of the year	<u>419.0</u>	<u>373.4</u>

23. Shareholders' equity

	2013 £m	2012 £m
Group		
Share capital	881.8	881.8
Share premium account	1,430.0	1,430.0
Revaluation reserve	158.8	158.8
Cumulative exchange reserve	(4.4)	(5.0)
Retained earnings	901.2	980.1
	<u>3,367.4</u>	<u>3,445.7</u>

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

	2013 £m	2012 £m
Company		
Share capital	881.8	881.8
Share premium account	1,430.0	1,430.0
Retained earnings	2,797.6	2,613.7
	<u>5,109.4</u>	<u>4,925.5</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 results of the company for the financial year was a profit of £609.8 million (2012: £112.1 million profit) after accounting for dividends received from subsidiary undertakings of £3,638.9 million (2012: £317.0 million) and impairment of investments of £1499.9 million (2012: £18.3 million) (see note 13).

24. Share capital

Company	2013 number	2013 £	2012 number	2012 £
Issued, called up and fully paid				
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 2013 £m	Plant and equipment 2013 £m	Property 2012 £m	Plant and equipment 2012 £m
Commitments under non-cancellable operating leases due				
Within one year	2.9	0.8	3.3	0.8
In the second to fifth years inclusive	9.2	0.6	8.8	0.6
After five years	255.6	-	252.5	-
	<u>267.7</u>	<u>1.4</u>	<u>264.6</u>	<u>1.4</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 2013 £m	Property 2012 £m
Commitments under non-cancellable operating leases due		
Within one year	-	0.5
In the second to fifth years inclusive	-	0.3
After five years	0.1	0.1
	<u>0.1</u>	<u>0.9</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:

	Sales of services		Purchases of goods and services	
	2013 £m	2012 £m	2013 £m	2012 £m
Joint ventures	1.3	1.1	0.7	0.3
	<hr/>	<hr/>	<hr/>	<hr/>
	Amounts owed by related parties		Amounts owed to related parties	
	2013 £m	2012 £m	2013 £m	2012 £m
Joint ventures (see note 15)	1.0	1.0	-	-
	<hr/>	<hr/>	<hr/>	<hr/>

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 £5.2 million (2012: £5.4 million) in support of its joint ventures (see note 13).

No allowance has been made for doubtful receivables in respect of the amounts owed by related parties (2012: £nil million). No expense has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (2012: £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:

	Interest receivable			
	2013		2012	
	£m		£m	
Ultimate parent undertaking	32.5		34.9	
	Amounts owed by related parties		Amounts owed to related parties	
	2013	2012	2013	2012
	£m	£m	£m	£m
Ultimate parent undertaking	1,558.0	1,735.2	33.2	33.8

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 £3,638.9 million (2012: £317.0 million), total interest receivable during the year from subsidiary undertakings was £21.9 million (2012: £4.8 million), total fair value gains during the year from subsidiary undertakings was £23.9 million (2012: £23.5 million gain) and total recharges were £22.7 million (2012: £29.0 million). In addition, total interest receivable during the year from the ultimate parent company was £32.3 million (2012: £0.1 million receivable). Amounts outstanding at 31 March 2013 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 (2012: £343.9 million). Balances will be settled in accordance with normal credit terms. An allowance for doubtful receivables of £88.7 million (2012: £87.3 million) has been made for amounts owed by subsidiary undertakings. In the year ended 31 March 2013, an expense of £1.4 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2012: £8.1 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 £5.0 million (2012: £4.3 million) and £3.5 million was credited through the income statement (2012: £19.5 million credit).

27. Cash generated from operations

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
Continuing operations				
Profit before taxation	337.2	315.3	616.3	112.6
Adjustment for investment income and finance expense	267.3	276.2	(34.9)	(6.7)
Operating profit	604.5	591.5	581.4	105.9
Adjustments for:				
Depreciation of property, plant and equipment	305.9	278.0	0.4	-
Amortisation of other intangible assets	23.3	19.8	-	-
Loss on disposal of property, plant and equipment	6.6	5.5	-	-
Loss on disposal of other intangible assets	3.2	2.6	-	-
Amortisation of deferred grants and contributions	(7.1)	(6.9)	-	-
Equity-settled share-based payments charge	-	1.2	-	-
Other non-cash movements ⁽¹⁾	(1.9)	(0.1)	(95.0)	(105.7)
Changes in working capital:				
Decrease/(increase) in inventories	7.8	(0.1)	-	-
(Increase)/decrease in trade and other receivables	(26.6)	(240.9)	35.2	314.6
Increase/(decrease) in provisions and payables	107.7	(157.8)	(57.0)	(249.3)
Cash generated from continuing operations	1,023.4	492.8	465.0	65.5

Notes to the financial statements (continued)

27. Cash generated from operations (continued)

(1) The group has received property, plant and equipment of £38.2 million (2012: £120.4 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 2013 include disposals of the company's investment in its subsidiaries amounting to £1,550.9 million and impairments of £1,499.9 million offset by non-cash settled dividends received of £3,145.8 million. There were no further material non-cash transactions during the year. Material non-cash transactions for the company in the prior year included disposals of the company's investment in its subsidiaries amounting to £180.8 million and the impairment of the company's investment in its subsidiary NB Telecom (IOM) Limited (£17.3 million) offset by non-cash settled dividends received of £310.0 million.

28. Contingent liabilities

The group has entered into performance guarantees as at 31 March 2013, where a financial limit has been specified of £72.1 million (2012: £85.2 million).

The company guaranteed loans of group undertakings up to a maximum of £1,464.9 million (2012: £1,439.9 million), including £1,121 million (2012: £1,086.0 million) relating to United Utilities Water PLC's loans from the European Investment Bank and £343.9 million (2012: £343.9 million) relating to intra-group loans made by subsidiary undertakings.

The company has entered into performance guarantees as at 31 March 2013, where a financial limit has been specified of £66.9 million (2012: £77.6 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 2013.

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.