

United Utilities Water PLC

DIRECTORS' REPORT & FINANCIAL STATEMENTS

For the year ended 31 March 2006



FINANCIAL STATEMENTS
For the year ended 31 March 2006

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Managing Director's Statement

Performance

The board is pleased to report another good set of financial results. Revenue increased by 8.3 per cent to £1,229.3 million, reflecting allowed price increases of 5% above inflation. Operating profit increased to £513.8 million, up 12.8 per cent on last year, primarily reflecting the increase in revenue and cost efficiencies. Looking beyond the financial results, the board has been pleased with progress on important areas such as customer service and leakage, and continued support for community programmes.

United Utilities Water has reduced its leakage level in the year by around 50 megalitres per day, to 470 megalitres per day. In line with an action plan agreed with Ofwat, it achieved its economic level of leakage at 31 March 2006. Meeting this year-end spot leakage target places the business in a strong position to sustain performance at around this level in order to achieve Ofwat's 12-month rolling leakage target of 470 megalitres per day for 2006/07. The company will be spending around £70 million on finding and fixing leaks over the next four years, in addition to its water mains rehabilitation and replacement programmes. Reservoir levels are currently over 87% full, in line with expectations for this time of year. The business expects to maintain a healthy supply-demand balance, avoiding the need for water restrictions.

Stakeholders

We are committed to listening and responding to the needs of our different stakeholders: employees, customers, investors, regulators and our commercial partners. Understanding their requirements and then managing and reporting our performance is central to how we run our business. For me, the cornerstone of this approach is our employees. I would like to thank all our employees for their continuing commitment and hard work.

Although water and wastewater customers have continued to benefit from overall improved levels of efficiency, there is scope for further improvement. The business intends to focus on improving its efficiency and a number of initiatives are already in place and are progressing well. The new customer billing system, which will improve customer service and increase efficiency, was implemented during the year and the entire customer base has been successfully migrated onto it.

The future

United Utilities Water maintains its strategic focus to improve efficiency and quality of service and we are well placed to build on our current successes. We are on track to deliver better performance for all our stakeholders during the period to 2010.



Charlie Cornish
Managing Director

Operating and Financial Review

NATURE OF THE BUSINESS

Business Overview

United Utilities Water PLC is a public limited company registered in England and Wales, providing wastewater and water services in north west England. The company was incorporated on 1 April 1989 under the Companies Act 1985.

United Utilities Water PLC is a subsidiary of United Utilities PLC. United Utilities PLC Group ("the group") is one of the largest operators of water and wastewater systems in the UK, including the provision of operations and maintenance, and shared services activities to Dwr Cymru Welsh Water and capital investment partners for Scottish Water and Southern Water. The group also owns and operates an electricity network, operates a gas network and provides multi-utility metering and connections services. The group is also a leading provider of outsourced business services and technology solutions.

The activities of United Utilities Water PLC are controlled within the group through the United Utilities North West division. This division also controls the electricity distribution assets owned by United Utilities Electricity PLC in north west England.

Wastewater collection, treatment and disposal operations

In accordance with its licence, United Utilities Water is responsible for the collection, treatment and disposal of domestic wastewater, trade effluent (non-domestic wastewater) and surface water in north west England. Surface water, mainly from groundwater infiltration and highway drainage, forms a major part of the wastewater which United Utilities Water must treat. In some cases, separate sewers are provided for foul water and surface water, so that uncontaminated surface water may be piped directly to a watercourse. United Utilities Water's wastewater treatment works provide a range of treatments. These include primary, secondary and tertiary treatment involving a variety of physical, chemical and biological processes. Treated liquid final effluent is discharged into rivers, estuaries or via sea outfalls. A by-product of the treatment of wastewater is sewage sludge. Sewage sludge is also treated by a range of physical, chemical and biological processes. Currently, around three-quarters of the end-product is recycled to agricultural land as a soil conditioner or used in land reclamation and one-quarter is incinerated or disposed to landfill.

Water supply operations, treatment and distribution

United Utilities Water obtains water from various sources including reservoirs, rivers and aquifers. All water supplied is treated in order to meet the appropriate standards enforced by the Drinking Water Inspectorate, the government regulator of drinking water in England and Wales. The type of treatment varies from disinfection only, for some borehole sources, to more complex processes using coagulation, sedimentation, clarification and filtration and activated carbon adsorption for certain waters. United Utilities Water monitors water quality by analysing samples regularly for both microbiological and chemical parameters. Treated water is delivered to the end customer through a network of large diameter trunk mains to smaller trunk mains, service reservoirs and water towers and distribution mains.

Customers, billing and debt collection

United Utilities Water places great importance on customer relations. It manages the sales, billing, cash collection and debt management activities and systems for 3.1 million domestic and business customers in north west England and has responsibility for improving the quality of service and the range of services provided to these customers.

Economic Regulation

The business is a monopoly and is subject to incentive-based economic regulation which imposes caps on increases in customer prices, rewards efficiency and high standards of customer service and penalises inefficiency and poor standards of customer service.

The UK government awarded Instruments of Appointment ('licences') for the provision of wastewater services and water supply in 1989. These licences continue in force for an indefinite period, subject to potential termination rights as set out below. United Utilities Water holds the licence for an area of north west England which comprises 3.1 million homes and businesses. The Water Industry Act 1991 (the 'Act'), as amended by the Water Act 2003 (the 'WA 2003'), provides for the appointment (by way of licensing) of water and sewerage undertakers. Economic regulation pursuant to these licences is currently the responsibility of the Water Services Regulation Authority (until 31 March 2006 the Director General of Water Services). The Authority continues to be known as 'Ofwat'. Ofwat also exercises powers under UK competition legislation, most significantly the Competition Act 1998 and the Enterprise Act 2002.

Ofwat regulates wastewater and water charges by capping the average increase in charges that a company can impose in any year. Ofwat conducts a periodic review and sets price caps every five years. This price cap is set by reference to inflation as measured by the retail price index in the UK plus an adjustment factor known as 'K', which is specific to each company and which can vary for each year of the review period. The size of a company's K factor (which can be positive, negative or zero) reflects the scale of its capital investment programme, its cost of capital, and its operational and environmental obligations, taking into account the scope for it to improve its efficiency. Unlike 'rate of return' economic regulation, such as exists in much of the United States, 'price cap' regulation in the UK is performance-based. Companies are incentivised to be efficient, both in terms of their operating costs and in the implementation of their capital expenditure programme. The benefit of any efficiency savings achieved through effective management is retained by the companies for a period of five years, after which time the benefit is passed to customers via the subsequent price setting process. The cost of any under-performance due to poor management is borne by the companies. Companies are also incentivised to provide a high quality of service and penalised if they provide a poor quality of service by means of an adjustment to the K factor at the subsequent price review. The last periodic review was completed in December 2004 and covers the

period from 1 April 2005 to 31 March 2010. In the last review, Ofwat set the following K factors, being the amount by which prices are allowed to rise above inflation in each of the five financial years commencing on 1 April 2005:

2005/06	5.0 per cent
2006/07	6.4 per cent
2007/08	4.4 per cent
2008/09	3.5 per cent
2009/10	3.0 per cent

Unexpected costs or savings arising from changes in certain regulatory assumptions during a review period are recorded and agreed by the company and Ofwat. This process, known as 'logging up and down', allows prices to be adjusted up or down at the next periodic review to compensate (companies or customers) for the unexpected change. In addition, where the change exceeds the specified materiality thresholds, the company can request, and Ofwat can instigate, a re-setting of its price limit during the five-year period, known as an Interim Determination of K ('IDoK'). All water and sewerage companies' licences now include a 'shipwreck' or 'substantial effect' clause, which allows companies' price limits to be revised when events beyond their control have a significant effect on their costs or revenues. This clause is now included in United Utilities Water's licence, allowing appropriate adjustment for unforeseen events both adverse and favourable.

Environmental regulation

The water and wastewater industry in the UK is subject to substantial domestic and European Union regulation, placing significant statutory obligations on United Utilities Water with regard to, among other factors, the quality of treated water supplied and of wastewater treatment. European directives (including the Drinking Water Directive, the Bathing Water Directive and the Urban Wastewater Treatment Directive) are transposed into UK law by primary and secondary legislation such as the Water Supply (Water Quality) Regulations 2000, the Water Industry Act 1991, the Water Resources Act 1991 and the Environmental Protection Act 1990.

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

- The Environment Agency, which is responsible for conserving and redistributing water resources and securing the proper uses of those resources, including the licensing of water abstraction. The Agency also regulates discharges to controlled waters, including discharges from wastewater treatment works;
- The Drinking Water Inspectorate, which enforces drinking water quality standards; and
- English Nature (intended to be re-formed as Natural England from October 2006), which is responsible for the protection of designated sites for nature conservation, e.g. Sites of Special Scientific Interest. There is a statutory requirement to manage these sites to conserve or improve biodiversity. As a result of new UK government targets, English Nature is seeking improvements to approximately 50 per cent of the sites within United Utilities' ownership.

RESOURCES

People

Good industrial relations remain a priority for United Utilities Water. The company continues to recognise and work in partnership with trade unions. A statement of principles governs the approach to labour relations across the company. 99 per cent of employees within the company are now represented by trade unions for collective bargaining purposes under the terms of a voluntary collective agreement, underpinned by the 'Together in Partnership' agreement. This Partnership is continuing to develop and is now being supported by joint training programmes, which have been very well received. The relationships with key union players are maturing and the company has received positive feedback from the unions on the partnership approach.

United Utilities Water remains committed to maintaining high standards of health and safety in every area of its business. The company's health and safety aims and objectives are integrated into the business planning processes. Progress is monitored regularly at all levels throughout the business.

The Company is committed to improving its employees' skills through training and development and nurturing a culture in which employees feel valued. The company encourages employees to work to their full potential and respects the dignity and rights of every employee and supports them in performing various roles in society. The company is equally committed to involving employees through open and regular communications about business developments and issues of general interest, both formally and informally.

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. The company gives equal consideration to applicants with disabilities in its employment criteria and will modify equipment and working practices wherever it is safe and practical to do so, both for new employees and for those employees that are disabled during the course of their employment. Additionally, the company is committed to providing full support and appropriate training for employees who become disabled during the course of their employment so that they can continue to work in a position appropriate to their experience and abilities.

Operating facilities

United Utilities Water's wastewater operations involve owning and managing assets, which include:

- 40,325 kilometres of sewers;
- 1,739 pumping stations;
- 371 storage tanks;
- 3,076 combined sewer overflows;
- 583 wastewater treatment works; and
- 34 sludge treatment facilities.

United Utilities Water's water operations involve owning and managing assets, which include:

- 184 raw water impounding reservoirs and associated catchments;
- 1,444 kilometres of raw water aqueducts;
- 113 water treatment works;
- 1,443 kilometres of treated water large diameter trunk mains;
- 455 service reservoirs and water towers storing treated water;
- 626 pumping stations; and
- 39,919 kilometres of trunk and distribution mains.

As at 31 March 2006, United Utilities Water had the principal operating facilities shown in the table below, all of which are owned by United Utilities Water and are freehold, except Sandon Dock, which is leasehold.

Location	Description	Approximate area in hectares
Bowland Estate, Lancashire	Reservoir/gathering grounds	10,120
Haweswater Estate, Lake District, Cumbria	Reservoir/gathering grounds	9,900
Longdendale Estate, Derbyshire	Reservoir/gathering grounds	7,490
West Pennine Moors, Lancashire	Reservoir/gathering grounds	6,872
Thirlmere Estate, Lake District, Cumbria	Reservoir/gathering grounds	4,850
Huntington, near Chester, Cheshire	Water treatment works	107
Dayvuhulme, Greater Manchester	Wastewater treatment works	89
Prescot, Merseyside	Water treatment works	84
Woodgate Hill, Greater Manchester	Water treatment works	40
Shell Green, Widnes, Cheshire	Sludge processing centre	12
Watchgate, Cumbria	Water treatment works	12
Sandon Dock, Liverpool	Wastewater treatment works	8

Note: One hectare equals 2.47 acres

In addition to the properties described above, the company occupies various non-operational properties consisting primarily of offices, depots, warehouses and workshops. These are either owned by the company or leased. It is anticipated that the company will be able to negotiate renewals of any expiring leases, or relocate the relevant facilities, without having a material adverse impact on the company. The most significant of these non-operational properties are operations and customer centres in Warrington.

PRINCIPAL RISKS AND UNCERTAINTIES

The board is responsible for the company's system of internal controls and for reviewing its effectiveness. Each year management review all controls, including financial, operational and compliance controls and risk management procedures. The internal control system is designed to manage, rather than to eliminate, the risk of failure to achieve the company's business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The key features of the internal control system are:

- a control environment with clearly defined organisation structures operating within a framework of policies and procedures covering every aspect of the business;
- comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- a bi-monthly board review of financial and non-financial performance to assess progress towards objectives;
- regular monitoring of risks and control systems throughout the year, supported by the use of risks and issues databases;
- a self-certification process, whereby management are required to confirm that the system of internal control is operating effectively;
- a group internal audit function provides independent scrutiny of internal control systems and risk management procedures;
- a bi-monthly risk management forum attended by senior management at which key risks are scrutinised;
- an annual risk assessment exercise involving self-assessment by management of all business risks in terms of impact, likelihood and control strength and an objective challenge of that assessment by the internal audit team;
- health and safety performance reviews carried out by our in-house safety professionals in addition to the normal health and safety risk assessment and management processes carried out within each of the operating businesses;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements and internal audit reviews; and

- established procedures, set out in a group internal control manual, for planning, approving and monitoring major capital expenditure, major projects which includes short and long-term project budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

There are a number of potential risks and uncertainties that could have a material impact on the company's long term performance.

Failure to deliver the capital investment programmes

The company requires significant capital expenditure for additions to, or replacement of, plant and equipment for its facilities and networks. The price limits set by Ofwat take into account the level of capital expenditure expected to be incurred during the relevant five-year price review period and the associated funding costs. Historically, the company has financed the expenditures from cash flows from operations and from debt financing. There can be no assurance that cash flows from operations will not decline, or that additional debt financing or other sources of capital will be available to meet these requirements.

Failure to deliver operational performance or cost savings implicit in the regulatory review

Operating cost savings to be achieved during the current five-year regulatory period are implicit in the regulatory review. To assist the achievement of these operating cost savings a business change programme is underway. If the operating cost savings are not achieved, or the business change programme is not delivered, then the company's profitability would suffer. Similarly, if operational performance were to deteriorate, this may be reflected by less favourable outcomes from future price reviews and the company's profitability would suffer.

Environmental regulations could increase the company's costs

Various government environmental protection and health and safety laws and regulations govern the wastewater and water businesses. These laws and regulations establish, amongst other things, standards for drinking water and discharges into the environment, which affect the company's operations. In addition, the company is required to obtain various environmental permissions from regulatory agencies for its operations. The company endeavours to comply with all regulatory standards. However, historically the company has not been in total compliance and cannot guarantee in the future that it will be in total compliance at all times with these laws and regulations. Should the company fail to comply, it would face fines imposed by the courts or otherwise face sanction by the regulators.

Service interruptions or contamination to water supplies

In addition to the capital investment programmes, the company controls and operates water and wastewater networks and undertakes maintenance of the associated assets with the objective of providing a continuous service. Historically, there have been interruptions to the supply of services, the majority of which relate to minor issues that are rectified promptly. However, the failure of a key asset could cause a more significant interruption to the supply of services (in terms of duration or number of customers affected), which may have an adverse effect on the company's operating results or financial position.

Non-recovery of customer debt

The company manages the billing, cash collection and debt management activities for 3.1 million domestic and business wastewater and water customers. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply for non-payment and the limiting of a supply with the intention of enforcing payment for certain premises including domestic dwellings. Non-recovery of debt is therefore a risk to the company and may cause the company's profitability to suffer, although allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable.

Pension scheme obligations may require the company to make additional contributions to the schemes

The company participates in a number of pension schemes. The principal schemes are funded defined benefit schemes and the assets of the schemes are held in trust funds independent of company finances. These schemes are controlled on a United Utilities PLC group level. The company increased pension contribution rates to the United Utilities Pension Scheme and the United Utilities Group of the Electricity Supply Pension Scheme in 2003/04 and the results of the full actuarial valuation resulted in further increases being required to the United Utilities Pension Scheme and the United Utilities Group of the Electricity Supply Pension Scheme from 1 April 2005. A one-off lump sum contribution of £113.8 million was made by the company on 31 March 2005. This contribution was calculated to equal the capitalised value of the company's funding obligations to the schemes for the next five years (based on the actuarial valuation as at 31 March 2004) and represents advance payment of certain employer contributions which would have been made to the schemes during that period. As a consequence the company's proportion of the schemes was estimated to have a combined post-tax obligation of £11.9 million as at 31 March 2006, compared to a post-tax obligation of £41.2 million at 31 March 2005. However, the company continues to monitor the funding of the schemes and cannot guarantee that during the next five years further contributions will not be required to eliminate continuing shortfalls in the schemes. This may adversely affect the financial position of the company. Should long-term investment returns remain lower than the rate assumed by the actuaries in their pension scheme valuations, or interest rates reduce further leading to an increased deficit, the profitability of the company may be further adversely affected and the company required to increase its contributions to eliminate this under-funding. Currently, anticipated future pensions contributions and a proportion of existing pension scheme deficits are recoverable through the price limits established by Ofwat.

Operating risk

Managing the company's businesses is dependent upon the ability to process a large number of transactions efficiently and accurately. Operational risk and losses can result from fraud, employee errors, failure to properly document transactions or to obtain proper internal authorisation, failure to comply with regulatory requirements and business principles, resource shortages, equipment failures, natural disasters or the failure of external systems. Although the company has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures and to staff training, it is only possible to be reasonably, but not absolutely, certain that such procedures will be effective in controlling each of the operational risks faced by the company.

LONG TERM STRATEGY, BUSINESS OBJECTIVES AND PERFORMANCE

United Utilities Water PLC's strategy is to outperform its regulatory contract (effective April 2005) pursuant to which the company operates the water and wastewater networks.

The key objectives of United Utilities Water are to:

- deliver improved customer service through more efficient processes, systems and higher first time resolution;
- deliver sustainable operating and capital expenditure efficiencies; and
- enable its people to achieve their full potential.

Good progress has already been made in meeting the efficiency challenges set by Ofwat. Successful delivery of the capital investment programme is vital and the partnership framework approach that has been developed will help to optimise the company's performance. The current strategy is to target customer service and operational performance improvement. With further real price increases ahead, the company should continue to deliver strong profit growth. Overall the company's progress means that it has a strong platform from which to develop.

Our progress on our strategic objectives is monitored by the Board of Directors by reference to key performance indicators. Performance in 2005/06 against these measures is set out in the table below, together with the prior year performance data.

Key performance indicators

	2006	2005 (Restated)
<i>Financial</i>		
Revenue	£1,229.3m	£1,135.1m
Operating profit	£513.8m	£455.3m
Profit before tax	£275.1m	£240.4m
Gearing ⁽¹⁾	57%	62%
Interest cover ⁽²⁾	2.2	2.2
Capital expenditure	454.4	707.0
<i>Non-financial</i>		
Leakage ⁽³⁾	470 Ml/day	519 Ml/day
Water quality – mean zonal compliance ⁽⁴⁾	99.94%	99.92%
Non-compliant wastewater treatment works ⁽⁵⁾	0.4%	0.002%
Pollution incidents ⁽⁶⁾	8	9
Overall Performance Assessment (OPA) ⁽⁷⁾	395	395
Customer Service measure – telephone answering ⁽⁸⁾	99.0%	93.9%

⁽¹⁾ Gearing is measured as borrowings net of cash and short-term deposits divided by total capital employed. Total capital employed is shareholders' equity plus borrowings net of cash and short-term deposits. Due to the adoption of FRS 25, the £130 million preference shares have been classified as debt in the gearing calculation in 2006 (see note 25). The 2005 net debt does not include this reclassification. If the standard had been adopted in 2005, the gearing would have been 64 per cent.

⁽²⁾ Interest cover is the number of times the net finance expense is covered by operating profit from continuing operations before restructuring costs. The 2005 calculation has not been adjusted for the impact of FRS 25 and FRS 26, which have been applied from 1 April 2005.

⁽³⁾ The Ofwat Regulatory spot leakage target was 470 megalitres per day.

⁽⁴⁾ Mean zonal compliance is a measure introduced by the Drinking Water Inspectorate in 2004. It is the average of the zonal percentage compliances of every one of a water company's zones. Figures stated are for the calendar years to December 2005 and December 2004.

⁽⁵⁾ The number of non-compliant wastewater treatment works measured per head of population served.

⁽⁶⁾ Number of pollution incidents and consent breach prosecutions based on calendar years to 31 December 2005 and 2004.

⁽⁷⁾ The OPA at March 2005 is per the 'Levels of service for the water industry in England and Wales 2004/05' report. The March 2005 OPA was reported as 399 in the 2005 Regulatory accounts being the company's best estimate at that time. The OPA at March 2006 is the company's current best estimate.

⁽⁸⁾ The percentage of telephone calls answered within 30 seconds was 99.0 per cent, against a regulatory target of 86.0 per cent.

Financial Review

Revenue increased by 8.3 per cent to £1,229.3 million in 2005/06, largely due to an allowed price increases of 5.0 per cent and inflation of 3.45 per cent. Operating profit increased by 12.8 per cent to £513.8 million in 2005/06, primarily reflecting the increase in revenue and cost efficiencies. Capital investment for the year was £454.1 million (2004/05 - £707.0 million). This is within the regulatory allowance for the year and reflects the re-phasing of expenditure from the first year of the capital programmes to future years. Capital expenditure is likely to peak at around £900 million in the third year of the five-year programme, and then gradually reduce as the business moves towards the conclusion of the 2005-10 regulatory review period.

The most significant transaction undertaken by the company with its shareholders was an equity injection of £400m on 22 March 2006 (generated via the second stage of a rights issue by United Utilities PLC that raised a total of £508 million in the period).

Dividend and dividend policy

Following the introduction of 'FRS 21 – Events after the Balance Sheet Date', the company no longer recognises a proposed final dividend in its current year figures (see note 1(a)). In 2005/06, United Utilities Water dividends recognised in the period were £226.6 million. This figure represents a dividend payment relating to the financial year 2004/05 of £137.5 million and an interim payment in 2005/06 of £89.1 million. The final dividend proposed for 2005/06 is £156.1 million.

The company's dividend policy is to distribute the theoretical maximum consistent with the 5 year regulatory contract. The earnings available for distribution comprise the return on equity assumed by the regulatory contract plus or minus any out-performance or under-performance over the period of the contract. Annual distributions are based on this policy.

Business Performance

United Utilities Water maintained water supplies to all customers during 2005/06 without the need for any water use restrictions. Improvements made to the water supply system during the year will help ensure security of supply in dry weather and during maintenance of key water distribution mains. The leakage level in the year reduced by around 50 megalitres per day to 470 megalitres per day. In line with an action plan agreed with Ofwat, the company achieved its economic level of leakage at 31 March 2006. Meeting this year-end spot leakage target places the business in a strong position to sustain performance at around this level in order to achieve Ofwat's twelve-month rolling leakage target of 470 megalitres per day for 2006/07. In addition to its water mains rehabilitation and replacement programmes, the company will be spending around £70 million on finding and fixing leaks over the next four years. Reservoir levels are approximately 87 per cent full at the date of this report, in line with expectations for the time of year. The business expects to maintain a healthy supply-demand balance throughout the year, avoiding the need for water restrictions. Water meters were also installed in 30,032 domestic properties under the free meter option scheme, whereby customers can have a meter fitted free of charge and are given an opportunity to switch to metered billing.

United Utilities Water met or outperformed its key internal outputs targets during the year. It replaced 802 kilometres of water mains, restored a number of properties from the low pressure and flooding registers and is on track to deliver its water treatment works quality programme. Drinking water quality has continued to improve and 2005 mean zonal compliance was 99.94 per cent, up from 99.92 per cent the previous year.

During 2005/06, United Utilities Water has maintained its improved performance on non-compliant wastewater treatment works (measured per head of population served) reducing from 15 per cent in 2003/04 to 0.4 per cent in 2005/06 (2004/05 – 0.002 per cent). As part of the capital investment programme, 8 continuous discharge and 43 unsatisfactory intermittent discharge (UID) improvement projects were delivered during the year.

In the calendar year ended December 2005, the business was prosecuted on eight separate occasions relating to pollution incidents and consent breaches (nine to December 2004). The company continues to work closely with the Environment Agency, highlighting the reduction in pollution incidents as a particular target for the business. Investment in odour control systems also increased, addressing an issue that has become of growing concern to some customers.

The company has continued to focus upon the health and safety of its employees. The United Utilities North West business gained Occupational Health and Safety (OHSAS):18001 accreditation and was awarded a four-star rating in the British Safety Council audit in January. The company has also cut the incidence rate for notifiable and reportable accidents to 7.87 in 2005/06 (per thousand employees) from 9.09 in 2004/05.

Furthermore, the Overall Performance Assessment (OPA) score indicates that service levels have been maintained, as measured by Ofwat at 395 points in 2005/06 (2004/05 - 395 points). Regulatory targets on all customer service measures have been met or exceeded. The number of telephone calls answered within 30 seconds was 99.0 per cent, against a regulatory target of 86.0 per cent.

Business Impacts

To ensure that higher levels of performance continue to be achieved following the acceptance of Ofwat final price determinations in December 2004, initiatives have been put in place to improve efficiency and reduce cost:

- at the start of the year, the Customer Sales and Service Delivery businesses were merged to form United Utilities North West. This has rationalised operations and reduced management costs;
- a new customer billing system was implemented to improve customer service and increase efficiency and the entire customer base has been successfully migrated onto it;
- there has been increased focus on work planning, scheduling and field force productivity, and a new mobile communications system has been implemented;
- the company has been looking at ways of optimising the way it manages its major assets in the North West, through its Integrated Performance Management project. The successful pilot programmes have now been extended across the region;
- a number of transformation initiatives have been developed, which are primarily focused around implementing a range of business process changes to improve the way the business operates; and
- additionally, the company is continuing to increase its focus on service and performance levels and new programmes and initiatives are being introduced to link remuneration and performance for all staff.

The company has a number of initiatives in place to leverage its increasing size and achieve additional efficiencies, particularly in the area of procurement. Earlier in the year the United Utilities group signed a contract with a sole supplier to provide high-pressure and medium density polyethylene pipes to United Utilities Water, in addition to servicing the water and gas outsourcing contracts in the infrastructure management

business. These initiatives should help to offset other cost pressures. For example, the business expects energy costs to increase by over 30 per cent in 2006/07.

The capital investment partnership framework approach is now embedded into the business. A range of integrated work teams have been set up to help reduce project management costs. A new project and investment management system to support delivery of the capital programmes is now up and running and benefits have also been realised through relocation of activities, shared systems and greater collaboration through the supply chain.

At the time the water price review was concluded in December 2004, it was recognised that there was potential for additional investment relating to projects that were not part of United Utilities Water's 2005-10 regulatory contract, but which might be confirmed as additional obligations during this period by the regulators. These potential projects, with an estimated maximum value of £500 million, continue to be the subject of discussions with the regulators and the evaluation process is not expected to be concluded before the end of the 2006 calendar year.

Approximately £200 million of funding was provided in the 2000-05 period to deliver a number of obligations, primarily relating to the unsatisfactory intermittent discharge (UID) programme, which have been carried over into AMP 4. United Utilities Water, in its negotiations with the Environment Agency and Ofwat, is seeking to finalise requirements relating to those UID outputs and expects the bulk of this capital expenditure programme to be incurred over the next two financial years.

During the year, significant improvements have been made in managing cash collection and the problems associated with long-standing customer debt. Processes are in place to manage water customer debt in a way that is fair to customers and effective for the business. Furthermore, a range of initiatives remain available that provide support, such as the vulnerable customer tariff, an arrears allowance scheme and money advice services. United Utilities Water has a leading role in the Debt Focus Group of Water UK, an industry-wide body, looking at ways to improve the Department for Work and Pensions' 'Water Direct' scheme. It continues to lobby for changes to the benefits system to extend the range of state benefits from which deductions can be made and to improve the take-up of such schemes.

CAPITAL STRUCTURE

Liquidity and resources

The company's primary source of liquidity is cash generated from its ongoing business operations. As reflected in the cashflow statement on page 19, in the financial year ended 31 March 2006, net cash generated from the company's continuing operating activities was £785.0 million, compared with £605.9 million in 2004/05. The water regulator has established price increase limits to 2010 which will provide certainty for a large majority of the company's revenues from ongoing operations, providing both a stable and a predictable source of funds.

Treasury policy

United Utilities PLC's treasury function operates with the delegated authority of, and under policies approved by, the United Utilities Water PLC board. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. It seeks to ensure that sufficient funding is available to meet foreseeable needs and maintains reasonable headroom for contingencies. Long term borrowings are structured or hedged to match earnings, which are largely in sterling, indexed to inflation and subject to regulatory price reviews every five years. Exposure to interest rate movements for the following 12 months is largely eliminated at the start of each financial year using short-term hedges. The credit quality of counterparties and individual aggregate exposures are reviewed annually.

Debt financing

Moody's Investor Service rates the credit of United Utilities Water PLC as A2 on a long-term basis with a stable outlook and P1 on a short-term basis. Equivalent ratings published by Standard and Poor's Rating Services are A- long-term with a stable outlook and A2 short-term. The company's borrowings net of cash and short-term deposits of £3,262.4 million at 31 March 2006 comprised £3,071.0 million of bonds, £429.4 million of loans from the European Investment Bank (EIB – the company's largest investor), £80.2 million of long-term leasing, £287.1 million of bank loans and other borrowings, £130.0 million redeemable preference shares and £47.8 million of bank overdrafts and temporary borrowings offset by £742.4 million of cash and short-term deposits, and £40.7 million loans to other group companies.

Shorter-term liquidity

Short-term liquidity requirements are met from the company's normal operating cashflow. Further liquidity is provided by cash and short-term deposit balances, the company's US\$1.5 billion euro commercial paper programme, supported by committed bank facilities and committed but undrawn long-term credit facilities. Cash and short-term deposit balances were £742.4 million at 31 March 2006, compared with £491.0 million at 31 March 2005.

Bank overdrafts and temporary borrowings, which are repayable in less than one year, were £47.8 million at 31 March 2006, compared with £28.8 million at 31 March 2005. The weighted average rate of interest on bank overdrafts was 5.57 per cent (2004/05 - 5.16 per cent). The company had available unutilised committed bank facilities of £415 million (2004/05 - £365 million), of which £165 million expires within one year (2004/05 - £25 million), £50 million expires after one year but in less than two years (2004/05 - £nil), and the remaining £200 million expires in more than two years (2004/05 - £340 million). Although unutilised during the financial year ended 31 March 2006, the US\$1.5 billion euro commercial paper programme still provides for the periodic issuance of notes by United Utilities Water. United Utilities Water has entered into £415 million of credit facilities, as noted above, used primarily as support for the US\$1.5 billion euro commercial paper programme.

Longer-term liquidity

The company has effective access to the international debt capital markets through its €5 billion medium-term note programme, which provides for the periodic issuance by United Utilities Water of debt instruments on terms and conditions determined at the time that the instruments are

issued. This programme does not represent a funding commitment, with funding only becoming committed when debt securities have been successfully issued. The currencies in which borrowings are held are disclosed in note 19 to the financial statements.

The company arranged £75 million of new five-year medium-term committed bank facilities. In addition, an agreement for £200 million of funding from EIB remained undrawn at the year-end. The company's term loans were £3,787.5 million at 31 March 2006, compared with £3,771.2 million at 31 March 2005. Amounts repayable after more than five years comprise bank and other loans repayable between 2011 and 2053. Fixed interest rates, for amounts after more than five years, range from 1.135 per cent to 14.83 per cent on £1,940.7 million (including £130 million of preference shares – see note 1(a) and note 19) (2004/05 - £1,396.4 million) and are at floating rates on £447.8 million (2004/05 - £452.6 million) of these loans.

Interest rate and foreign currency management

The company manages interest rate exposure by seeking to match financing costs as closely as possible with the revenues generated by its assets. The company uses a combination of interest rate swaps, futures and funding instruments to hedge exposure to interest rate volatility. The company's use of derivative instruments relates directly to underlying indebtedness; no speculative or trading transactions are undertaken. The proportion of borrowings at effective fixed rates of interest for a period greater than one year is set in conjunction with the level of floating rate borrowings and projected regulatory revenues that are exposed to inflationary adjustments (index linked). In addition, the company aims to manage its short-term budgetary commitments by ensuring that the majority of floating rate interest is fixed for periods of less than one year through the use of exchange traded financial futures. The company has limited exposure to foreign currency exchange rate movements. Interest rate management and funding policies are set by the board.

In order to hedge the interest cost implicit in the regulatory contracts, the company fixes interest rates for the duration of each five-year review period by typically swapping fixed rate debt to floating at the time of issue and then swapping back to fixed rate at the outset of each five-year regulatory contract period. FRS 26 limits the use of hedge accounting, thereby increasing the potential volatility of the profit and loss account. However, this has no cash flow impact and the effect of FRS 26 should broadly balance out over the 2005-10 period.

Summary

The board has reviewed the business plan and considers that the company has sufficient liquidity to meet the anticipated financial commitments for the next 12 months. In total, at 31 March 2006, unutilised committed facilities of £250.0 million expiring in more than one year, together with cash and short-term deposits of £742.4 million and undrawn funding from EIB of £200 million, provide substantial pre-funding for the company.

ACCOUNTING ISSUES

The financial statements for the year ended 31 March 2006 have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and, except for the treatment of certain grants and contributions (note (f)), with the Companies Act 1985. Further details as to adoption of new accounting standards are included in note 1 of the financial statements.

CRITICAL ACCOUNTING POLICIES

The company prepares its financial statements in accordance with accounting principles generally accepted in the United Kingdom. As such, the company is required to make certain estimates, judgements and assumptions that it believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. On an ongoing basis, the company 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 company's accounting policies are detailed in note 1 of the financial statements. The following paragraphs detail the policies the company believes to have the most significant impact on the annual results under UK GAAP.

Carrying value of long-lived assets

The company's accounting policy for tangible fixed assets is detailed in note 1(e) of the financial statements. The carrying value of tangible fixed assets under UK GAAP as at 31 March 2006 was £6,432.9 million. The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of fixed asset investment to the company, variations between actual and estimated useful lives could impact operating results both positively and negatively, although historically, few changes to estimated useful lives have been required.

Renewals accounting

Under UK GAAP, the depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on the company's asset management plan, which has been certified by Halcrow Management Sciences Limited, an independent infrastructure management consultant approved by Ofwat. Variations between actual infrastructure spend and estimated spend are included in the balance sheet, with the principle being to 'equalise' the effect of annual spend variations on the charge to the profit and loss account. Therefore, the independently certified asset management plan has an impact on the company's operating profit and changes in the plan assumptions could give rise to a different operating profit. These assumptions include judgements relating to the condition and performance of infrastructure assets.

Deferred tax

The company accounts for deferred tax on a discounted basis, as permitted by UK GAAP. The deferred tax provision under UK GAAP as at 31 March 2006 is £333.4 million. The balance sheet provision is discounted using the rates of interest at the balance sheet date on UK gilts with similar maturity dates and currencies to those of the deferred tax assets and liabilities. Therefore, the company uses 15+ years UK gilt rate to reflect the long-life nature of infrastructure and operational assets. An increase or decrease in applicable discount rates of 0.1 per cent would change the balance sheet provision at 31 March 2006 by approximately £9.0 million and the tax charge, for the year then ended, by the same amount.

Revenue recognition

Under UK GAAP, the company recognises revenue generally at the time of delivery and when collection of the resulting debt is reasonably assured. Should management 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. Payments received in advance of revenue recognition are recorded as deferred revenue. The company raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review process. For customers with water meters, the receivable billed is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. Meters are read on a cyclical basis and the company recognises revenue for unbilled amounts based on estimated usage from the last billing through to the end of the financial year. The estimated usage is based on historic 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.

Provision for doubtful debts

At each balance sheet date, the company evaluates the collectability of trade debtors and records provisions for doubtful debts based on experience. These provisions are based on, amongst other things, comparisons of the relative age of accounts and consideration of actual write off history. The actual level of debt collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

Accounting for provisions and contingencies

The company 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 company 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, and estimates performed by independent parties and outside counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. In accordance with UK GAAP, a provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made of the obligation 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, unless the possibility of transferring economic benefits is remote.

Pensions

United Utilities Group PLC operates two defined benefit schemes, one of which has a defined contribution section, 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. Under UK GAAP, the pension cost under FRS17 is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 20 of the financial statements. These assumptions include investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

Derivatives and borrowings

The company's default treatment is for borrowings to be carried at amortised cost, whilst derivatives are recognised separately on the balance sheet at fair value with movements in those fair values reflected through the profit and loss account. This has the potential to introduce considerable volatility to both the profit and loss account and balance sheet. Therefore, for fair value hedges, changes in the recognised value of hedged debt that are attributable to the hedged risk are adjusted through the profit and loss account. In the case of cashflow hedges, movements in the fair value of derivatives are deferred within reserves until they can be recycled through the profit and loss account to offset the future effect of changes in the hedged risk. In order to apply this treatment, it must be demonstrated that the derivative has been, and will continue to be, an effective hedge of the hedged risk within the debt item. Changes in the fair value of all derivatives are recognised in the profit and loss account, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity. The company applies the fair value option through profit or loss where the complexity of the swaps means that they are disallowed from being allocated in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. This area is considered to be of significance due to the magnitude of the company's level of borrowings.

RESEARCH AND DEVELOPMENT

The company 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 company 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 company also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure by the company was £0.9 million in the year ended 31 March 2006 (2004/05 - £0.5 million).

POST BALANCE SHEET EVENTS

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 2006.

FORWARD LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to the financial condition, results of operations and business of the company. Statements that are not historical facts, including statements about the board's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential', 'reasonably possible', 'targets' and variations of these words and similar expressions are intended to identify forward-looking statements, which are based on current plans, estimates and projections, and therefore investors should not rely on them. Forward-looking statements speak only as of the date they are made, and the company undertakes no obligation to update publicly any of them in light of new information or future events. The company may also make written and/or oral forward-looking statements, in the annual report to shareholders, in proxy statements, in offering circulars and prospectuses, in press releases and other written materials and in oral statements made by officers, directors or employees to third parties, including financial analysts. Forward-looking statements involve inherent risks and uncertainties. The company cautions investors that a number of important factors could cause actual results to differ materially from those anticipated or implied in any forward-looking statements. These factors include: (i) the effect of, and changes in, regulation and government policy; (ii) the effects of competition and price pressures; (iii) the ability of the company to achieve cost savings and operational synergies; (iv) the ability of the company to service its future operations and capital requirements; (v) the timely development and acceptance of new products and services by the company; (vi) the effect of technological changes; and (vii) the company's success in managing the risks of the foregoing. The company cautions that the foregoing list of important factors does not address all the factors that could cause results to differ materially.

Directors' Report

for the year ended 31 March 2006

The directors present their report and the audited financial statements of the company for the year ended 31 March 2006.

Profit and dividends

The results for the year, set out in the profit and loss account on page 17, show that turnover for the year ended 31 March 2006 increased to £1,229.3 million, an increase of 8.3 per cent over the previous year. Profit for the year before tax was £275.1 million (2005 - £240.4 million).

The company has adopted Financial Reporting Standard ("FRS") 21 'Events after the balance sheet date' in the year, which requires that dividends are only recognised in the financial statements if they are declared in that financial year. Dividends declared after the balance sheet date are not recognised as a liability. This has resulted in the final dividend for the year to 31 March 2005 of 25.85 pence per share, which was declared after 31 March 2005, being recognised in the current year financial statements.

An interim dividend of £89.1 million (2005 - £68.3 million) was paid in March 2006. The directors recommend a final dividend of £156.1m million (2005 - £137.5 million) for the year to 31 March 2006.

Regulation

As required by paragraph 3.1 of Condition K of the Instrument of Appointment granted by the Secretary of State for the Environment of the Company as a water and sewerage undertaker under the Water Industry Act 1991 ("the Licence"), the directors state that they are satisfied that as at 31 March 2006, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of United Utilities Water PLC, the Company would have had available to it sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the Company so that the purpose of the order could have been achieved.

The directors have issued a certificate under Condition F6A of the Licence stating that the Company will have available to it sufficient financial and management resources and facilities to enable it to carry out, for at least twelve months, its regulated activities. This certificate also confirms that all contracts entered into with any associated company included all necessary provision and requirements concerning the standard of service to be supplied by the Company to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

The contract of appointment with the auditors satisfies the requirements of paragraph 9.2 of Condition F of the Licence, namely that "the auditors will provide such further explanation or clarification of their reports, and such further information in respect of the matters which are the subject of their reports, as the Director General may reasonably require".

Business review and principle activities

The company is a wholly owned subsidiary of United Utilities PLC and operates as part of the group's licensed multi-utility division.

The company's principal activities are the management and operation of water and wastewater assets.

The Managing director's review and the operating and financial review on pages 3 to 13 report on the company's activities during the year and on likely future developments. A summary of key performance indicators can be found in the operating and financial review. The directors, in preparing the operating and financial review, have not sought to comply with the ASB's 2006 Reporting Statement on operating and financial reviews.

Principal risks

The principal risks and uncertainties are commented on within the operating and financial review on page 6.

Research and development

The Company is committed to developing innovative, cost-effective and practical solutions for providing high quality services and standards to our customers, and for the benefit of the wider community and the development of the business. It seeks to take, as part of this process, maximum advantage of wide-ranging expertise, abilities and facilities within the Company.

Employment policies

Employees are key to achieving our business goals and the Company is committed to improving the skills of its people. The Company respects the dignity and rights of every employee, supports them in performing various roles in society and challenges prejudice and stereotyping. The Company is committed to involving employees through open and regular communications about business changes to allow a free flow of information and ideas.

We participate extensively in Business in the Community programmes, encourage wider opportunities for women and for people from ethnic minorities and we actively support employees with disabilities.

Proper attention to health and safety is an indispensable part of the Company's commitment to high standards in every aspect of the business.

The Company encourages participation in the United Utilities PLC Group's all employee share schemes.

Supplier payment policy and practice

The policy is normally to pay suppliers according to agreed terms of business. These terms are agreed upon entering into binding contracts and the Company seeks to adhere to the payment terms provided the relevant goods and services have been supplied in accordance with the contracts. The Company had 25 days of purchases (2005 - 33 days) outstanding at the end of the financial year.

Directors

The directors of the Company during the year ended 31 March 2006 are set out below. All were directors for the whole year except where otherwise indicated. There are no other directors' interests that require disclosure under Companies Act 1985.

Non-executive directors:

P G S Entwistle

D E Morton JP

Executive directors:

J E Roberts* Chairman (and Chief Executive, United Utilities PLC - resigned 31 March 2006)

R D Armstrong (resigned 31 March 2006)

J A Barnes

S G Batey*

S Beaumont (resigned 5 July 2006)

M Beesley

K Budinger (resigned 31 October 2005)

C Cornish*

G Dixon

C H Elphick

J Lang

*Director, United Utilities PLC. Details of directors' interests in ordinary shares of United Utilities PLC are set out in note 5 to the accounts.

At no time in the year did any director have a material interest in any contract or arrangement, which was significant in relation to the Company's business. At 31 March 2006, the directors and their immediate families had various interests in United Utilities Group PLC shares, which have been disclosed in note 5 of the statutory accounts. None of the directors or immediate families had any interests in the company.

Directors' and officers' insurance

The company maintains an appropriate level of directors' and officers' insurance whereby directors are indemnified against liabilities to third parties to the extent permitted by the Companies Act.

Directors' responsibilities in respect of the preparation of the financial statements

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period. In preparing those accounts, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed subject to material departures disclosed and explained in the financial statements; 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 confirm that the financial statements comply with the above requirements. The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have a general responsibility for the system of internal control and for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Information given to auditors

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

- (1) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (2) the director 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 auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

Independent Auditor

A resolution to reappoint Deloitte & Touche LLP as the auditor of the company will be proposed at the forthcoming Annual General Meeting.

Registered address

United Utilities Water PLC, Dawson House, Great Sankey Warrington WA5 3LW Registered number: 2366678

By order of the board



Martin Beesley
Director 14 July 2006

Independent auditors' report

to the members of United Utilities Water PLC

We have audited the financial statements of United Utilities Water PLC for the year ended 31 March 2006, which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses, the reconciliation of movement in shareholders' funds and the related notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' 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 auditors

As described in the statement of directors' responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and international Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and are properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion, the directors' report is consistent with the financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report for the above year and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

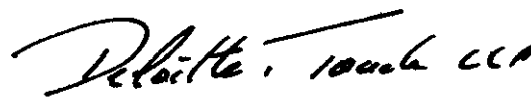
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.



Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

Manchester

14 July 2006

Profit and loss account

For the year ended 31 March	Note	2006 £m	2005 Restated £m
Turnover	1(c), 2	1,229.3	1,135.1
Net operating costs (including exceptional charges in 2006 of £0.7m, 2005 – £14.1m)	3	(715.5)	(679.8)
Operating Profit		513.8	455.3
Net interest payable and other similar charges	7	(238.7)	(214.9)
Profit on ordinary activities before taxation		275.1	240.4
Tax on profit on ordinary activities	8	(112.0)	(36.8)
Profit for the financial year		163.1	203.6

The above results for the current and preceding financial year relate to continuing operations. Prior year results have been restated to show the effects of applying FRS 17 'Retirement Benefits' and FRS 21 'Events after the balance sheet date' as outlined in note 1(a) and note 25.

Statement of total recognised gains and losses

For the year ended 31 March	Note	2006 £m	2005 Restated £m
Profit for the financial year		163.1	203.6
Adjustment following adoption of FRS 26	25	26.8	-
Deferred tax adjustment following adoption of FRS 26	25	(8.0)	-
Actuarial gains/(losses) on defined benefit pension schemes	20	53.5	(1.6)
Deferred tax attributable to actuarial gains	20	(16.1)	0.5
Total recognised gains and losses for the financial year		219.3	202.5
Prior year adjustments - as explained in note 1(a)	1(a), 25	(125.1)	-
Total gains and losses since last annual report		94.2	202.5

Reconciliation of movements in shareholders' funds

For the year ended 31 March	Note	2006 £m	2006 £m	2005 £m	2005 £m
Opening shareholders' funds at 1 April 2004 as previously stated					2,256.2
Prior year adjustment – adoption of FRS 17	25			(178.7)	
Prior year adjustment – deferred tax impact of adoption of FRS17	25			53.6	
Prior year adjustment – adoption of FRS21	25			134.9	
					9.8
Opening shareholders' funds at 1 April 2004 as restated					2,266.0
Profit for the financial year				203.6	
Dividends	9			(212.3)	
Actuarial losses on pension assets net of deferred tax				(1.1)	
Net movement in shareholder funds for the year					(9.8)
Closing shareholders' funds at 31 March 2005 as restated	22		2,256.2		2,256.2
Net gains on adjustment following adoption of FRS 26	1a, 25	18.8			
Preference share capital reclassified as debt	1a	(130.0)			
			(111.2)		
Opening shareholders' funds at 1 April 2005 as restated	22		2,145.0		
Profit for the financial year	22	163.1			
Dividends	9	(226.6)			
Actuarial gains on pension assets net of deferred tax		37.4			
New share capital issued	22	400.0			
Net movement in shareholders' funds in the year			373.9		
Closing shareholders' funds	22		2,518.9		

Balance Sheet

As at 31 March

	Note	2006 £m	2005 Restated £m
Fixed assets			
Tangible assets	10	6,432.9	6,292.6
Investments	11	0.3	0.3
		6,433.2	6,292.9
Current assets			
Stock		3.2	2.8
Debtors	12	322.5	241.5
Investments	13	738.0	491.0
Cash at bank and in hand		4.4	-
		1,068.1	735.3
Creditors:			
Amounts falling due within one year	14	(565.2)	(1,037.4)
		502.9	(302.1)
Net current assets/(liabilities)			
		6,936.1	5,990.8
Total assets less current liabilities			
		6,936.1	5,990.8
Creditors:			
Amounts falling due after more than one year	15	(4,070.1)	(3,467.3)
		(335.2)	(226.1)
Provisions for liabilities and charges	17		
		(335.2)	(226.1)
Net assets		2,530.8	2,297.4
Pension liability	20	(11.9)	(41.2)
Net assets including pension liability		2,518.9	2,256.2
Capital and reserves			
Share capital	21	1,025.3	755.3
Share premium account	21	647.8	647.8
Profit and loss account	22	845.8	853.1
Equity Shareholders' funds		2,518.9	2,256.2

The 2005 comparative figures have been restated as described in notes 1(a) and note 25.

Approved by the board of directors on 14 July 2006 and signed on its behalf by



Martin Beesley
Finance Director

Cash flow statement

For the year ended 31 March

	Note	2006 £m	2006 £m	2005 Restated £m	2005 Restated £m
Net cash inflow from operating activities	26		785.0		605.9
Returns on investments and servicing of finance					
Interest received		16.5		9.9	
Interest paid		(226.4)		(222.0)	
Interest element of finance lease repayments		(6.2)		(5.6)	
Termination of interest rate swap contracts		-		19.7	
Income received from current asset investments		0.3		2.3	
Non-equity dividends paid		(9.1)		(9.1)	
Net cash outflow from returns on investment and servicing of finance			(224.9)		(204.8)
Taxation			-		13.5
Capital expenditure and financial investment					
Purchase of tangible fixed assets		(508.4)		(735.5)	
Grants and contributions received		19.5		17.6	
Disposal of tangible fixed assets		10.2		2.3	
Net cash outflow for capital expenditure			(478.7)		(715.6)
Acquisitions and disposals	28		-		0.1
Equity dividends paid			(226.6)		(203.2)
Cash outflow before management of liquid resources and financing			(145.2)		(504.1)
Management of liquid resources					
Increase in short term deposits			(247.0)		(212.2)
Financing	29		385.7		734.1
Movement in cash and overdrafts	30		(6.5)		17.8

Notes to the accounts

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements except for the adoption of the new accounting standards discussed below.

(a) Basis of preparation of financial statements

The financial statements of United Utilities Water PLC have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and, except for the treatment of certain grants and contributions (note (f)), with the Companies Act 1985.

The preparation of financial statements in conformity with generally accepted accounting principles in the United Kingdom requires management to make estimates and assumptions that affect the:

- reported amounts of assets and liabilities;
- disclosure of contingent assets and liabilities at the date of the financial statements; and
- reported amounts of revenues and expenses during the financial year.

Actual results could differ from these estimates.

The financial statements reflect the adoption of FRS 17 'Retirement Benefits', FRS 21 'Events after the Balance Sheet Date', FRS 25 'Financial Instruments: Disclosure and Presentation' and FRS 26, 'Financial Instruments: Measurement'.

The prior period figures have been restated, as set out in note 25, to:

- remove the pension costs, prepayments and provisions under SSAP 24 and to include the cost, liability and asset position under FRS 17. Retained profits for the year ended 31 March 2005 were reduced by £2.5m.
- amend the dividends, to reflect only dividends in the financial statements that have been declared in that financial year. Dividends declared after the balance sheet date are not recognised as a liability.

Prior year figures have not been restated in respect of FRS 25 and FRS 26 as the company has chosen to apply prospectively these standards as permitted under the transitional provisions of FRS 25 and FRS 26. In accordance with FRS 25, 130,000,000 7% £1 redeemable preference shares have been presented wholly as debt due after more than one year. In 2005 they were presented as equity. The impact of recognising the preference shares as debt on the balance sheet is to increase creditors falling due after more than one year by £130,000,000 and to reduce non-equity share capital by the same amount as at 31 March 2006. The impact on the profit and loss account for the year ended 31 March 2006 is to increase the interest charge by £9,100,000 and to reduce dividends paid to non-equity shareholders within the reconciliation of movement in shareholder's funds by the same amount. Following the adoption of FRS 26, the fair value of debt, derivatives and deferred income reduced by £26.8 million, deferred tax increased by £8.0 million and reserves increased by £18.8 million, at the beginning of the financial year.

(b) Cash

In the cash flow statement and related notes, cash includes cash at bank, deposits repayable on demand and overdrafts. Deposits are repayable on demand if they are, in practice, available within 24 hours without penalty.

(c) Turnover

Turnover represents the income receivable in the ordinary course of business for services provided and excludes VAT. This includes an estimate of the sales value of units supplied to customers between the date of the last meter reading and the year end.

(d) Research and development

Expenditure on research and development is expensed as incurred.

(e) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, overground plant and equipment and operational assets). Employee costs incurred in implementing the capital schemes of the Company are capitalised within fixed assets.

(i) Infrastructure assets

Infrastructure assets comprise a network of water and wastewater systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with defined standards of service is treated as an addition, which is included at cost after deducting related grants and contributions. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is classified as infrastructure renewals expenditure.

The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on the Company's independently certified asset management plan.

(ii) Other assets

Additions are included at cost. Freehold land is not depreciated. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated economic lives based on management's judgement and experience, which are principally as follows:

Buildings 30-60 years
Operational assets 5-80 years
Fixtures, fittings, tools and equipment 3-40 years
Computer software 3-10 years

(iii) Carrying value of tangible fixed assets

The carrying values of tangible fixed assets are reviewed for impairment wherever circumstances indicate that the carrying value of such assets may not be recoverable.

(f) Grants and contributions

Capital contributions towards infrastructure assets are deducted from the cost of those assets. This is not in accordance with Schedule 4 to the Companies Act 1985 under which the infrastructure assets should be stated at their purchase price or production cost and the capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

Notes to the accounts (continued)

The directors are of the opinion that, although provision is made for depreciation of infrastructure assets (see note (e)(i)), these assets have no finite economic lives and the capital contributions would therefore remain in the balance sheet in perpetuity. The treatment otherwise required by the Companies Act 1985 would not present a true and fair view of the Company's effective investment in infrastructure assets. The financial effect of this accounting policy is set out in note 10.

Grants and contributions receivable in respect of other tangible fixed assets are treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

(g) Leased assets

Assets financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised in the balance sheet and the corresponding capital cost is shown as an obligation to the lessor. Leasing repayments comprise both a capital and a finance element. Where the lease is of a fixed interest rate nature, the finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Where the lease is of a floating interest rate nature, the finance element written off to the profit and loss account reflects the floating interest rate charge incurred during the period on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease.

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

(h) Fixed asset investments

Fixed asset investments are stated at the lower of cost and recoverable amount.

(i) Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence.

(j) Current asset investments

Current asset investments are stated at the lower of cost and net realisable value.

(k) Pensions

The company participates in the following pension schemes sponsored by the United Utilities Group: the United Utilities Pension Scheme (UUPS) and the United Utilities Group of the Electricity Supply Pension Scheme (ESPS). UUPS has both a defined benefit section and a defined contribution section, the defined contribution section constituting less than 0.5 per cent of the total asset value of UUPS.

ESPS is a defined benefit scheme and is closed to new employees. Under FRS 17, the current service cost is calculated using the Projected Unit Method and will therefore increase as the members of the scheme approach retirement.

The pension schemes are independent of the company's finances.

Actuarial valuations of the defined benefit schemes are performed at intervals of not more than three years and the rates of contribution payable are determined on the advice of the Scheme Actuary for each scheme having regard to the results of these actuarial valuations.

The cost of providing pensions is expensed in line with the requirements of FRS 17. The actuarial assumptions adopted are determined by United Utilities PLC after taking advice from their actuarial advisors, Mercer Human Resource Consulting Limited. The actuarial assumptions adopted affect the operating results and are disclosed in note 20; they include assumptions for the long term investment return expected to be achieved on the schemes' assets and the long term increases expected to apply to pensionable earnings, pension increases and deferred pension increases. Actual experience may differ from the assumptions adopted.

The company has adopted the full provisions of FRS 17 for the first time in these financial statements effective from 1 April 2004, having previously applied the multi-employer exemption. The disclosure requirements are set out in note 20, together with details of pension and funding arrangements.

(l) Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained on government bonds with similar maturity dates and currencies to those of the deferred tax assets or liabilities.

(m) Financial instruments

To 31 March 2005

Debt instruments

New borrowings were stated at net proceeds received after deduction of issue costs. The issue costs of debt instruments were amortised at a constant rate over the life of the instrument.

Notes to the accounts (continued)

Interest rate swaps and financial futures

Interest rate swap agreements and financial futures were used to manage interest rate exposure. Instruments designated as a hedge of a debt instrument were accounted for on an accruals basis, with amounts payable or receivable in respect of those instruments recognised as adjustments to interest expense of the designated liability.

Realised gains and losses that occurred from the early termination of such instruments designated as a hedge were deferred and amortised to interest expense over the period of the hedged position, to the extent that the originally designated liability remained outstanding.

In order to have qualified for hedge accounting, the notional amount of the company's interest rate swaps and financial futures must not have exceeded the amount of its existing variable rate debt and must have changed the interest rate characteristics of the underlying debt, while the contractual maturities cannot have exceeded the maturities of the debt.

Currency swaps

The company entered into currency swaps to manage its exposure to fluctuations in currency rates. Principal amounts were revalued at exchange rates ruling at the date of the company balance sheet and included in the sterling value of debt. In order for such swaps to have qualified for hedge accounting, the forward contract/currency swap must have related to an existing asset, liability or firm commitment, have been in the same currency as the hedged item and have reduced the risk of foreign currency exchange movements to the company's operations. Where they did, exchange gains and losses were taken directly to reserves and included in the statement of total recognised gains and losses in accordance with SSAP 20 'Foreign currency translation'. From 1 April 2005 (upon adoption of FRS 26 'Financial Instruments: Measurement') Financial assets and financial liabilities are recognised on the company's balance sheet when the company becomes a party to the contractual provisions of the instrument.

Cash and short-term deposits

In the cash flow statement and related notes, cash and short-term deposits includes cash at bank and in hand, deposits, other short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash within three months and which are subject to an insignificant risk of change in value.

Financial investments

Investments (other than fixed deposits) are recognised and derecognised on a trade date and are initially measured at fair value, including transaction costs. Investments are classified as held-to-maturity, held-for-trading, loans and receivables or available-for-sale. Held-to-maturity investments and loans and receivables are measured at amortised cost. Held-for-trading and available-for sale investments are measured at subsequent reporting dates at fair value. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in net profit or loss for the period. For available-for-sale investments, 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.

Trade receivables

Trade receivables are stated at nominal value less allowances for estimated irrecoverable amounts.

Trade payables

Trade payables are stated at their nominal value.

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 company after deducting all of its liabilities.

Equity instruments

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

Bank borrowings

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis to the profit and loss using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Derivative financial instruments and hedge accounting

Interest rate swap agreements and financial futures are used to manage interest rate exposure, while the company enters into currency swaps to manage its exposure to fluctuations in currency rates. The company does not use derivative financial instruments for speculative purposes. All financial derivatives are recognised in the balance sheet at fair value. Changes in the fair value of all derivative financial instruments are recognised in the profit and loss within finance expense as they arise, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity.

Where hedge accounting has not been applied, the company may elect to designate a financial liability at inception as fair value through profit or loss provided the financial liability meets the conditions specified in FRS 26 'Financial Instruments: Measurement'. Where possible, hedge accounting is applied.

Fair value hedges

For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in profit or loss. Gains or losses from remeasuring the derivative are recognised in profit or loss.

Where changes in the fair value of a derivative differ to changes in the fair value of the hedged item attributable to the risks being hedged, the hedge ineffectiveness is recorded in the profit and loss within finance costs.

Hedge accounting is discontinued prospectively when the hedging instrument is sold, terminated or exercised, where the hedge relationship no longer meets the criteria for hedge accounting in accordance with UK GAAP, or where the hedge designation is revoked. Any adjustment that has been recognised to the hedged item, for which the effective interest rate is used, is amortised to the profit and loss account and is based on the recalculated effective interest rate at the time at which amortisation commences.

Notes to the accounts (continued)

Financial assets and liabilities designated at fair value through profit or loss

The company applies this designation where the complexity of the swaps means that they are disallowed from being allocated in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. The otherwise inconsistent accounting treatment that would have resulted allows the company to satisfy the criteria for this designation. The treatment of financial assets and liabilities designated at fair value through profit and loss is consistent with the company's documented risk management strategy.

(n) Environmental remediation

Environmental expenditure that relates to current or future revenues is expensed or capitalised as appropriate. Expenditure that relates to an existing condition caused by past operations and does not contribute to current or future earnings is expensed.

Liabilities for environmental costs are recognised when there is a legal or constructive obligation, environmental assessments or clean-ups are probable, and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites.

(o) Share-based compensation arrangements

The costs of short-term and long-term incentive awards are expensed on a straight-line basis over the period in which performance is measured. The amount to be expensed is based upon management's estimate of the probability that the performance criteria will be met.

In respect of the ShareSave schemes of United Utilities PLC, no compensation expense is recorded for the difference between the exercise price and the share price at the date of grant or exercise, as the group is taking advantage of the exemption permitted by UITF 17 'Employee share schemes' in respect of Inland Revenue approved SAYE schemes.

Notes to the accounts (continued)

2 Segmental information

The Company operated in the United Kingdom in one class of business as stated in the Directors' report.

3 Net operating costs

	2006 £m	2005 Restated £m
Employee costs:		
Wages and salaries	107.3	109.2
Social security costs	9.1	8.6
Pension cost (note 20)	20.2	19.4
	136.6	137.2
Less charged to capital schemes	(43.8)	(45.2)
	92.8	92.0
Charged to profit and loss account		
Depreciation		
Owned non-infrastructure fixed assets	189.4	200.5
Non-infrastructure fixed assets held under finance leases	1.7	1.7
	191.1	202.2
Non-infrastructure depreciation	102.0	47.1
Infrastructure depreciation	293.1	249.3
	31.6	28.8
Raw materials and consumables		
Other operating costs include:		
Other operating costs	302.0	299.0
Auditors' remuneration	0.2	0.2
Amortisation of grants and contributions	(4.7)	(4.1)
Research and development	0.9	0.5
Operating leases:		
- hire of plant and machinery	1.6	2.0
- land and buildings	1.4	1.4
Exceptional charge – restructuring provision (note 17)	0.7	14.1
Other income (note 4)	(4.1)	(3.4)
	298.0	309.7
Total net operating costs	715.5	679.8

Managed service fees and asset charges from parent and fellow subsidiary undertakings are contained within other operating costs. Fees payable to Deloitte & Touche LLP for non-audit services during the year were £0.1 million, primarily relating to regulatory work (2005 - £0.1 million). The Deloitte & Touche LLP audit fee for 2005/06 in relation to the Company amounted to £0.1 million (2005 - £0.1 million).

Employee costs including business restructuring exceptional items, net of charges to capital schemes, amount to £93.5 million (2005 - £106.1million). Included within the 2004/05 exceptional restructuring costs of £14.1m are £8.7m of past service costs as disclosed in note 20.

Notes to the accounts (continued)

4 Other income (see note 3)

	2006 £m	2005 £m
Profit on disposal of fixed assets	2.9	2.1
Net rents receivable	1.2	1.3
Other income	4.1	3.4

5 Directors

The aggregate emoluments of the directors in 2006 amounted to £1,883,534 in respect of services allocated to the Company (2005 -£1,566,426).

Emoluments comprise salaries, fees, taxable benefits and the value of short-term incentive awards. The emoluments of the highest paid director, C Cornish, in respect of services allocated to the Company amounted to £352,537 (2005 - £392,312). The pension payments attributable to the highest paid director are disclosed in the Group accounts. The emoluments of J E Roberts and S G Batey are not included in the aggregate emoluments figures. The emoluments of these two directors are disclosed in the accounts of United Utilities PLC.

There were 7 directors (2005 - 7) who had incentive plans which vested during the year ended 31 March 2006, with an aggregate value of £582,448 (2005 - £330,968).

At 31 March 2006 and the prior year, the directors and their families had the following interests, all of which were beneficial interests, in the ordinary and A shares and options to subscribe for ordinary and A shares in United Utilities PLC (details of the interests of J E Roberts, S G Batey and C Cornish in United Utilities PLC are disclosed in that company's accounts).

Details of the employee sharesave scheme and the executive share option scheme operated by United Utilities PLC are given in that company's accounts.

	Interest in shares at 31 March 2006				Interest in shares at 31 March 2005 or date of appointment			
	Ordinary Shares	A Shares	Executive Option scheme	Employee sharesave scheme	Ordinary Shares	A Shares	Executive Option scheme	Employee sharesave scheme
R Armstrong	30,448	-	-	2,909	30,080	4,569	-	2,909
J A Barnes	30,803	-	24,489	1,442	13,534	2,570	25,645	3,545
S Beaumont	10,758	-	27,258	2,909	10,185	-	27,547	2,909
M Beesley	6,769	-	578	465	5,299	456	14,494	1,178
G Dixon	8,637	-	5,585	2,609	4,584	1,802	12,961	3,169
C H Elphick	18,402	-	-	3,556	19,007	-	-	3,556
P G S Entwistle	2,332	-	-	-	1,500	832	-	-
J Lang	5,799	-	-	2,909	543	70	-	2,909
D E Morton	-	-	-	-	-	-	-	-

Four directors exercised options during the year (2005 – four).

Notes to the accounts (continued)

5 Directors (continued)

With the exception of G Dixon, all executive directors are members of, and contribute to the United Utilities Pension Scheme, which is an exempt approved pension scheme with defined benefit and defined contribution sections of membership. It contains sections which are open to all eligible employees. It provides pensions and other benefits to members within Revenue & Customs limits. The scheme provides a pension for them on normal retirement at age 60 of between 1/30th and 1/45th of pensionable earnings for each completed year of service. The maximum pension is two thirds of pensionable earnings. Early retirement is possible from the age of 50 if the company agrees.

G Dixon is a member of, and contributes to, the Electricity Supply Pension Scheme, a defined benefit scheme, which provides on normal retirement at the age of 60 a pension equal to 1/80th of pensionable earnings for each completed year of service (plus 3/80ths cash). Early retirement is possible from the age of 50 if the company agrees.

The Finance Act 1989 restricts the pensions benefits that can be paid by the Scheme to directors who joined the company after 1 June 1989 because the earnings cap limits pensionable earnings for calculating benefits. The company has put in place for some of the executive directors affected separate arrangements, the effect of which is to provide for them the same total pension benefits as for those executives who are not limited by the cap. These arrangements are unfunded.

6 Employees

	2006	2005
Average number of persons employed during the year		
Licensed utility operations	3,470	3,430

7 Net interest payable and similar charges

	2006 £m	2005 £m
Interest payable and similar charges:		
On bank loans, overdrafts and other loans	208.9	213.4
On finance leases	3.2	3.3
On borrowings from parent and fellow subsidiary undertakings	33.1	40.0
Interest payable before preference share dividends and fair value adjustments	245.2	256.7
Preference share dividends	9.1	-
Fair value loss on debt and derivative instruments	13.1	-
Total interest payable and similar charges	267.4	256.7
Investment income		
Income received from current asset investments	(0.3)	(3.1)
Interest receivable and similar income		
- Parent and fellow subsidiary undertakings	(4.6)	(9.8)
- External	(16.5)	(28.9)
Net return on pension scheme (see note 20)	(7.3)	-
Net interest payable and similar charges	238.7	214.9

From 1 April 2005, 130,000,000 £1 seven per cent redeemable preference share dividends have been disclosed within interest payable and similar charges following the adoption of FRS 25. Preference share dividends are disclosed within dividends in the 2005 comparatives (see note 1(a) and note 9).

Notes to the accounts (continued)

8 Taxation on profit on ordinary activities

(a) Analysis of charge in the year

	2006 £m	2006 £m	2005 Restated £m	2005 Restated £m
Current tax:				
UK corporation tax at 30%		10.9		-
Prior year tax adjustments		-		(1.0)
Total ordinary current tax		10.9		(1.0)
Deferred tax:				
Origination and reversal of timing differences	75.0		77.8	
Increase in discount	26.3		(36.8)	
Prior year tax adjustments	-		1.0	
Total deferred tax		101.3		42.0
Tax charge on profit on ordinary activities excluding exceptional items		112.2		41.0
Tax on exceptional items				
Deferred tax:				
Origination and reversal of timing differences	(0.2)		(4.2)	
Total tax on exceptional items		(0.2)		(4.2)
Tax charge on profit on ordinary activities		112.0		36.8

Total deferred tax for the period, including exceptional items, is £101.1 million charge (2005 - £37.8 million charge).

The prior year tax adjustments relate to the agreement of prior year tax returns.

b) Factors affecting current tax charge/(credit) for the year

The table below reconciles the notional tax charge at the UK corporation tax rate to the actual charge for taxation

	2006 £m	2005 Restated £m
Profit on ordinary activities before tax	275.1	240.4
UK corporation tax rate	30.0	30.0
Capital allowances in excess of depreciation	(9.3)	(31.2)
Utilisation of tax losses	(9.2)	1.3
Other timing differences	(8.7)	0.1
Prior year tax adjustments	-	(0.4)
(Non-taxable income)/ non-deductible expenses	1.2	(0.2)
Actual current tax rate	4.0	(0.4)

Notes to the accounts (continued)

9 Dividends

	2006 £m	2005 Restated £m
2005 final dividend	137.5	134.9
2006 interim dividend	89.1	68.3
Preference share dividend	-	9.1
	226.6	212.3

Dividends are recognised in the year in which they are authorised by the Directors in accordance with FRS21 'Events after the balance sheet date'. Accordingly, the comparative result and position have been restated for the impact of this accounting standard, as described in note 1(a).

From 1 April 2005, the 7 per cent redeemable preference shares have been reclassified as a liability and the dividend has been recognised within interest payable (see note 1(a) and note 7).

United Utilities Water PLC has increased its ordinary dividend payment to United Utilities North West PLC by 11.5 per cent to £226.6m for the year. The dividend policy is consistent with the Company's performance and the management of the economic risks of the business.

10 Tangible fixed assets

	Land and buildings £m	Infrastructure assets £m	Operational structures £m	Fixtures, fittings tools and equipment £m	Assets in course of construction £m	Total £m
Cost:						
At 1 April 2005	207.2	3,875.7	3,186.6	572.8	1,058.8	8,901.1
Additions	4.2	113.4	88.5	70.6	177.4	454.1
Grants and contributions	-	(13.4)	-	-	-	(13.4)
Transfers	3.1	136.7	450.2	13.1	(603.1)	-
Disposals	(18.2)	-	(35.0)	(129.2)	-	(182.4)
At 31 March 2006	196.3	4,112.4	3,690.3	527.3	633.1	9,159.4
Depreciation						
At 1 April 2005	62.6	1,276.6	927.7	341.6	-	2,608.5
Charge for the year	7.8	102.0	121.4	61.9	-	293.1
Disposals	(12.0)	-	(35.0)	(128.1)	-	(175.1)
At 31 March 2006	58.4	1,378.6	1,014.1	275.4	-	2,726.5
Net book value						
At 31 March 2006	137.9	2,733.8	2,676.2	251.9	633.1	6,432.9
At 31 March 2005	144.6	2,599.1	2,258.9	231.2	1,058.8	6,292.6

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view (see note 1 (f)). As a consequence, the net book value of fixed assets, as adjusted for depreciation, is £119.7 million (2005 £106.3 million) lower than it would have been had this treatment not been adopted.

Notes to the accounts (continued)

10 Tangible fixed assets (continued)

Infrastructure renewals

Expenditure on maintaining the operating capability of the water and wastewater network in accordance with defined standards of service is capitalised, and depreciation is charged based on the expenditure set out in the company's independently verified Asset Management Plan for the period 1 April 2005 to 31 March 2010, in accordance with FRS 15.

The amount of excess depreciation over expenditure is as follows:

	£m
Excess depreciation over expenditure at 1 April 2005	-
Expenditure on maintaining the network in the year	70.7
Depreciation for the year	(102.0)
Excess depreciation over expenditure at 31 March 2006	(31.3)

Within tangible fixed assets are operational structures held under finance leases at the following amounts:

Operational structures:	2006	2005
	£m	£m
Cost at 31 March	81.0	81.0
Accumulated Depreciation at 31 March	(13.1)	(11.4)
Net book value at 31 March	67.9	69.6

The depreciation charge for the year for assets held under finance leases is £1.7 million (2005 - £1.7 million).

	2006	2005
	£m	£m
Capital commitments: Contracted but not provided for	154.0	225.8

11 Fixed asset investments

	Other investments
	£m
Cost at 1 April 2005 and 31 March 2006	0.3

Details of other investments, all of which are unlisted and registered in England and Wales are:

Other Investments	Description of holding	Proportion held	Nature of business
WRc PLC	'A' Ordinary shares of £1 each	9.84%	Water and wastewater research
	8% convertible unsecured loan stock 2014	26.54%	
Paypoint Network Limited	Ordinary shares of 1 pence each	0.6%	Cash collection service
	Deferred shares of 1 pence each	0.6%	

Notes to the accounts (continued)

12 Debtors

	Note	2006 £m	2005 Restated £m
Trade debtors		101.1	95.2
Amounts owed by parent and fellow subsidiary undertakings		65.9	57.5
Other debtors		7.6	18.4
Prepayments and accrued income		84.7	70.4
Current derivative financial instruments	19	35.6	-
Non-current derivative financial instruments	19	27.6	-
		322.5	241.5

Amounts owed by parent and fellow subsidiary undertakings include £40.7 million floating rate loans (2005 - £40.7 million).

13 Current asset investments

	2006 £m	2005 £m
Short-term deposits	738.0	191.0
Managed funds and other short-term investments	-	300.0
	738.0	491.0

Short-term deposits comprise short term highly liquid investments with a maturity of three months or less. The effective interest rate on short-term deposits during the year ended 31 March 2006 was 4.60 per cent (2005 - 4.50 per cent). These deposits have a weighted average maturity of 15 days.

14 Creditors : amounts falling due within one year

	2006 £m	2005 Restated £m
Loans (note 19)	36.3	254.1
Bank overdrafts (note 19)	23.9	13.0
Obligations under finance leases (note 19)	5.0	0.8
Derivative financial instruments (note 19)	62.2	-
Trade creditors	21.6	25.7
Amounts owed to parent and fellow subsidiary undertakings	77.7	286.0
Other creditors	-	0.7
Taxation and social security	38.6	27.5
Deferred grants and contributions (note 16)	4.7	4.3
Accruals and deferred income	295.2	425.3
	565.2	1,037.4

Included in amounts owed to parent and fellow subsidiary undertakings is £23.9 million (2005 - £227.9 million), which is included in borrowings due in less than one year within note 19.

Notes to the accounts (continued)

15 Creditors : amounts falling due after more than one year

	2006 £m	2005 £m
Loans (note 19)	3,303.4	2,862.6
130,000,000 7 per cent £1 redeemable preference shares (note 19)	130.0	-
Obligations under finance leases (note 19)	75.2	80.2
Derivative financial instruments (note 19)	25.0	-
Amounts owed to parent and fellow subsidiary undertakings (note 19)	447.8	442.4
Other creditors	4.6	2.5
Deferred grants and contributions (note 16)	84.1	79.6
	4,070.1	3,467.3

16 Deferred grants and contributions

	£m
At 1 April 2005	83.9
Received in the year	9.6
Profit and loss account	(4.7)
At 31 March 2006	88.8

17 Provisions for liabilities and charges

	Restructuring £m	Deferred Tax (note 18) £m	Total £m
At 31 March 2005 (restated)	5.4	220.7	226.1
Adoption of FRS 26	-	8.0	8.0
At 1 April 2005	5.4	228.7	234.1
Charged to the profit and loss account	0.7	101.1	101.8
Reclassified to the pension deficit	-	3.6	3.6
Utilised in the year	(4.3)	-	(4.3)
At 31 March 2006	1.8	333.4	335.2

The majority of the restructuring provision is expected to be utilised within the next 12 months.

18 Deferred tax (see note 17)

	2006 £m	2005 Restated £m
Accelerated capital allowances	1,165.0	1,139.5
Short-term timing differences	(54.6)	(115.5)
Undiscounted provision for deferred tax	1,110.4	1,024.0
Discount	(777.0)	(803.3)
Discounted provision for deferred tax	333.4	220.7

Following the adoption of FRS 17, the opening deferred tax asset/liability has been restated (see note 25) as deferred tax in relation to the pension deficit is netted off within the pension deficit.

Notes to the accounts (continued)

19 Borrowings

	2006 £m	2005 £m
Bank overdrafts and temporary borrowings	47.8	28.8
Term loans	3,787.5	3,771.2
Preference shares	130.0	-
Finance leases	80.2	81.0
	4,045.5	3,881.0

130,000,000 £1 seven per cent redeemable preference shares have been reclassified from equity at the beginning of the current financial year following the adoption of FRS 25 (see note 1(a)).

The borrowings are repayable as follows:

Within one year	89.1	495.8
From one to two years	966.3	49.4
From two to three years	433.0	909.8
From three to four years	158.0	417.9
From four to five years	10.6	159.1
After five years	2,388.5	1,849.0
	4,045.5	3,881.0

The company consider the following financial instruments to be significant:

Financial Instruments	Maturity	Carrying Value £m
Euro 1,000m 6.625% notes	8 November 2007	690.8
Euro 600m 4.875% notes	18 March 2009	420.3
Euro 500m 4.25% notes	24 January 2020	337.6
£300m 5.625% notes	20 December 2027	317.7

On total borrowings, before the impact of derivative instruments, interest rates range from 0.75 per cent to 14.83 per cent on £3,444.9 million (2005 - £3,256.0 million) and are at floating rates on £600.6 million (2005 - £625.0 million).

Bank overdrafts

Bank overdrafts are repayable on demand.

The weighted average rate of interest on bank overdrafts was 5.57 per cent (2005 - 5.16 per cent).

Term loans

Amounts repayable on term loans after more than five years, before the impact of derivative instruments, comprise loans repayable between 2011 and 2053. Interest rates range from 1.135 per cent to 14.83 per cent on £1,940.7 million (2005 - £1,396.4 million) and are at floating rates on £447.8 million (2005 - £452.6 million).

The weighted average rate of interest on term loans, before the impact of derivative instruments, was 5.02 per cent (2005 - 5.39 per cent).

The company had available unutilised committed bank facilities of £415.0 million (2005 - £365.0 million). Of the amounts unutilised, £165m expires within one year (2005 - £25m), £50m expires after more than one year but in less than two years (2005 - £nil) and the remaining £200m expires in more than two years (2005 - £340m).

Preference shares

Preference shares included in the current year above are made up of 130,000,000 £1 seven per cent redeemable preference shares that have been reclassified from share capital in the current year following the adoption of FRS 25. The preference shares have a redemption date of 1 October 2099. The weighted average interest rate on preference shares was 7.00 per cent.

Finance leases

An analysis of finance lease repayments is given in note 23.

The weighted average interest rate on finance leases was 6.37 per cent (2005 - 5.97 per cent).

Notes to the accounts (continued)

Note 19 Borrowings (continued)

Currency and interest rates swaps

Funding raised in foreign currency is swapped to sterling to match funding costs to income. The analysis of borrowings below details the currency in which items were raised and the amounts involved before and after currency hedging.

The company borrowings were denominated in the following currencies:

	Currency before hedging 2006 £m	Currency after hedging 2006 £m	2005 £m
Fixed rate borrowings			
Sterling	1,641.4	1,662.1	1,233.5
United States Dollars*	230.1	240.1	454.6
Euros*	1,464.3	1,448.7	1,463.7
Japanese Yen*	83.2	94.0	104.2
	3,419.0	3,444.9	3,256.0
Floating rate borrowings			
Sterling	589.5	589.5	400.2
United States Dollars*	-	-	200.0
Japanese Yen*	-	-	12.3
Hong Kong Dollars*	11.1	11.1	12.5
	600.6	600.6	625.0

*Included in the above table is a loan with Japanese yen principal paying a United States dollar coupon. Included in fixed rate borrowings are sterling denominated loans of £450.0 million for which the principal and interest are linked to the retail price index (RPI).

The functional currency of the company is sterling. The fair values of the company's financial instruments are shown on page 36.

Taking into account all derivative instruments, including those not designated as a hedge relationship, borrowings can be analysed as follows:

	Fixed rate borrowings			Floating rate borrowings		Total
	Weighted average interest rates	Average period for which rate is fixed	At fixed interest rates	Weighted average interest rate in 05/06	At floating interest rates	
	%	Years	£m	%	£m	£m
2006	5.57	10.3	3,785.8	5.37	259.7	4,045.5
2005	6.00	4.80	3,386.9	5.00	494.1	3,881.0

Debt items held at fair value through the profit and loss:

	At 1 April 2005*	Movement in year due to:			Total impact recognised in the profit and loss account	At 31 March 2006	Payable at maturity
		Interest rates / exchange rates	Carrying value	Credit risk			
		£m	£m	£m	£m		
US\$400m 6.875% due August 2028	229.7	11.7	-	(1.3)	10.4	240.1	\$400m
JPY1bn due 2007**	4.9	-	-	-	-	4.9	JPY1bn
JPY3bn due 2013**	14.8	(1.2)	-	-	(1.2)	13.6	JPY3bn

* Opening values have been shown for illustrative purposes as FRS 26 has been applied prospectively from 1 April 2005.

**Due to the short duration of these bonds, the credit margin is very narrow and, due to the inactive market, difficult to estimate. Therefore, changes in value shown in the table are only from interest and exchange rate differences.

Notes to the accounts (continued)**Note 19 Borrowings (continued)****Summary of financial instruments**

	2006 Carrying Value £m	2006 Fair Value £m	2005 Carrying Value £m	2005 Fair Value £m
Financial assets				
Non-current assets				
Derivative financial instruments	27.6	27.6	-	-
Current assets				
Loans and receivables	40.7	40.7	40.7	40.7
Cash and cash equivalents	4.4	4.4	-	-
Derivative financial instruments	35.6	35.6	-	-
Financial liabilities				
Non-current liabilities				
Borrowings	(3,956.4)	(4,072.9)	(3,385.2)	(3,485.9)
Derivative financial instruments	(25.0)	(25.0)	-	-
Current liabilities				
Borrowings	(89.1)	(89.1)	(495.8)	(495.8)
Derivative financial instruments	(62.2)	(62.2)	-	-

Financial instruments and risk management

The primary financial risks faced by the company are interest rate risk and exchange rate risk.

The board has reviewed and agreed policies for managing each of these risks, as summarised below. The board has also approved all of the classes of financial instruments used by the company. The company's treasury function, which is authorised to conduct the day-to-day treasury activities of the company, reports at least annually to the board. The use of financial derivatives is governed by the company's policies approved by the board, which provide written principles on the use of financial derivatives.

All of the company's activities involve analysis, acceptance and management of some degree of risk or combination of risks. The most important types of financial risk are credit risk, liquidity risk and market risk. Market risk includes foreign exchange, interest rate and equity price risks. The company's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls and to monitor the risks and limits continually by means of reliable and up-to-date systems. The company modifies and enhances its risk management policies and systems to reflect changes in markets and products. The Group Audit Committee, under authority delegated by the board, formulates high level risk management policy, monitors risk and receives reports that allow it to review the effectiveness of the company's risk management policies.

Credit risk management

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance, treasury and leasing activities. The company has dedicated standards, policies and procedures to control and monitor all such risks.

Liquidity management

The company maintains a strong liquidity position and manages the liquidity profile of its assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are met when due.

Market risk management

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates, equity and commodity prices will reduce the company's profit or the value of its portfolios. The management of market risk is undertaken using risk limits approved by the finance director under delegated authority.

The company uses a variety of financial instruments, including derivatives, when raising finance for its operations in order to manage any exposure arising from funding activity. The company's activities expose it to the financial risks of changes in foreign currency exchange rates and interest rates. The company uses foreign currency swap contracts, interest rate swap contracts and financial futures to hedge these exposures. The company does not use derivative financial instruments for speculative purposes.

The counterparties to derivative instruments consist of financial institutions and other bodies with good credit ratings. Although the company is potentially exposed to credit loss in the event of non-performance by counterparties, such credit risk is controlled through credit rating reviews of the counterparties and by limiting the total amount of exposure to any one party. The company does not believe it is exposed to any material concentrations of credit risk.

The company borrows in the major global debt markets in a range of currencies at both fixed and floating rates of interest, using derivatives, where appropriate, to generate the desired effective currency profile and interest basis.

Under an interest rate swap, the company agrees with another party to exchange at specific intervals the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. The notional principal of these instruments reflects the extent of the company's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

Notes to the accounts (continued)**Note 19 Borrowings (continued)**

Under a currency swap, the company agrees with another party to exchange the principal amount of two currencies, together with interest amounts in the two currencies agreed by reference to a specific interest rate basis and the principal amount. The principal of these instruments reflects the extent of the company's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

As noted above, the company uses derivatives to manage its exposure to currency risk on its borrowings. The company makes no significant sales or purchases in currencies other than its functional currency. Accordingly, the company has no material unhedged foreign currency exposures.

Financial instruments utilised by the company can be summarised as follows:

Interest rate swaps

Interest rate swaps are used solely to manage floating rate borrowings in order to reduce the financial risk to the company from potential future changes in medium-term interest rates.

Financial futures

Financial futures are used to manage the company's exposure to possible future changes in short-term interest rates.

Forward contracts

The company generally hedges foreign exchange transaction exposures up to one year forward. Hedges are put in place using forward contracts at the time that the forecast exposure becomes reasonably certain.

Currency swaps

The company uses currency swaps to hedge currency exposure where debt is raised in one currency to fund in a different currency.

Fair values of financial instruments

The fair value of derivative instruments has been calculated by discounting the future cashflows of the individual contracts using the appropriate market interest rate and currency rates. Where interpolation occurs at points along the curve this can significantly affect the value given to these instruments. As such, changes in the frequency of points taken along the curve can affect the value of these instruments. In addition, any changes in the assumed rates input to these models could give rise to significant changes in value. The fair values of currency and interest rate swaps exclude the related accrued interest receivables and payables, which are shown in the balance sheet separately within trade and other payables and receivables.

Fair values have been estimated using the following methods and assumptions:

Non-current investments

The fair value of investments, for which there are no quoted market prices, approximates to their carrying value. The company's long-term investments are detailed in note 11. The carrying value of the company's unlisted investments is £0.3 million (2005 - £0.3 million).

Current assets and liabilities

Financial instruments included within current assets and liabilities (excluding cash and borrowings) are generally short-term in nature and accordingly their fair values approximate to their book values.

Borrowings and non-equity interests (excluding foreign exchange contracts)

The carrying values of cash and short-term borrowings and current asset investments approximate to their fair values because of the short-term maturity of these instruments. The fair value of long-term borrowings is estimated by discounting the future cashflows to net present values using appropriate market interest rates prevailing at the year end.

Currency and interest rate swaps

The company enters into currency and interest rate swaps in order to manage its foreign currency and interest rate exposures.

The analysis in the table below illustrates the sensitivity of the market value of the company's financial instruments to changes in interest rates. The analysis assumes an instantaneous 1.0 per cent (100 basis points) move in interest rates for all maturities and currencies from their levels at 31 March 2006 with all other variables held constant.

	Market Value 31-Mar-06 £m	+1% movement in interest rate £m	Market Value change -1% movement in interest rate £m
Interest rate movement			
Long-term debt	(4,072.9)	121.0	(140.6)
Derivatives	(24.0)	(43.8)	58.6

Notes to the accounts (continued)**Note 19 Borrowings (continued)****Hedges**

Achieving hedge accounting under FRS 26 'Financial Instruments: Measurement' is based on measuring the effectiveness of the derivative as a hedge instrument as well as fulfilling hedge documentation rules. The effectiveness test compares the change in fair value of the designated derivative and the change in fair value of the hedged item to determine if this ratio falls within the permitted range of 80 per cent to 125 per cent. Any derivative that falls outside the permitted range is classified as held for trading. Gains or losses on the derivative are recognised immediately in the profit and loss except where the derivative is designated within an effective cashflow hedge relationship, in which case the gains and losses are deferred in equity and are recycled through the profit and loss at the time the hedged item is recognised in the profit and loss. Where a derivative does fall within the permitted range but is not 100 per cent effective, the ineffective element is recognised in the profit and loss account immediately. Those derivative instruments that are not designated in a hedging relationship are classified as held for trading.

Where fair value hedges occur, shown in the table below, these hedges are managing interest rate risk and/or currency risk in relation to financing.

The company had no cash flow hedges as at 31 March 2006. The company largely manages all its financing cash flows over the five-year regulatory period; however, the majority of these hedges did not qualify for hedge accounting as they would be overlaid onto transactions which are already within fair value hedge relationships.

The company has no regular way transactions, and has not pledged collateral in relation to any of its derivative instruments.

The fair value of the derivative financial instruments as at 31 March 2006 was as follows:

	Assets fair value £m	Liabilities fair value £m
Current		
Held for trading derivatives	35.6	(62.2)
Non-current		
Fair value hedge derivatives	27.6	(25.0)

The notional value of the financial instruments at 31 March 2006 was as follows:

	Cash instruments assets millions	Cash instruments liabilities millions	Derivative asset legs millions	Derivative liabilities legs millions	Total millions
Japanese yen	-	(17,000.0)	17,000.0	-	-
Sterling	738.0	(2,048.7)	3,744.5	(5,529.9)	(3,096.1)
Euros	-	(2,100.0)	2,100.0	-	-
United States dollars	-	(400.0)	400.0	-	-
Hong Kong dollars	-	(150.0)	150.0	-	-

For the year ended 31 March 2005 the following disclosures are relevant as required by FRS 13 'Derivatives and other financial instruments: Disclosure':

The carrying value of debt is shown in the balance sheet at the hedged rate. The impact of using the hedged currency rates as opposed to translation at year end exchange rates is £(17.1) million.

Unrecognised gains and losses on financial assets and liabilities for which hedge accounting has been used at the balance sheet date are £151.8 million and £136.3 million respectively.

As at 31 March 2005 the company anticipated that £85.2 million of these gains and £62.1 million of these losses would have been realised in the year ended 31 March 2006. Of the unrecognised gains and losses on hedges as at 1 April 2004 the net gain recognised in the profit and loss account for the year ended 31 March 2005 was £44.2 million.

Notes to the accounts (continued)

20 Retirement benefits

Defined benefit schemes

The company participates in the following pension schemes sponsored by the United Utilities Group: the United Utilities Pension Scheme (UUPS) and the United Utilities Group of the Electricity Supply Pension Scheme (ESPS). UUPS has both a defined benefit section and a defined contribution section, the defined contribution section constituting less than 0.5 per cent of the total asset value of UUPS. ESPS is a defined benefit scheme and is closed to new employees. Under FRS 17, the current service cost is calculated using the Projected Unit Method and will therefore increase as the members of the scheme approach retirement.

The pension schemes are independent of the company's finances.

Actuarial valuations of the defined benefit schemes were carried out at 31 March 2004. The results of these actuarial valuations were updated by a qualified and independent actuary consistent with the requirements of FRS 17.

On 31 March 2005, the company made lump sum payments of £110.9 million and £2.9 million to UUPS and ESPS respectively. The payments were in lieu of the estimated company contributions that would have been payable for the defined benefit members over the five years from 1 April 2005. Subject to the results of the actuarial valuations as at 31 March 2007, the company contributions are expected to resume from 1 April 2010. In the meantime, the company will continue to pay contributions in respect of the defined contribution members and insurance premiums. Other payments will be made by the company in accordance with the funding agreement between the schemes' trustees and United Utilities PLC.

The company does not expect to make any contribution in respect of the defined benefit members over the year to 31 March 2007.

The total defined benefit pension cost for the period was £12.9 million (2005 - £28.1 million), of which £Nil is included within exceptional restructuring costs (2005 - £8.7 million) in respect of pension severance benefits. A pension obligation of £17.0 million, net of deferred tax of £5.1million, is included in the balance sheet at 31 March 2006 (2005 - obligation of £58.9 million, net of deferred tax of £17.7 million).

Information about pension arrangements for executive directors is contained in note 5.

The main financial assumptions used by the actuary were as follows:

	At 31 March 2006	At 31 March 2005
Discount rate	4.90%	5.40%
Expected return on assets	6.10%	6.60%
Pensionable salary growth – UUPS	3.75%	4.10%
Pensionable salary growth – ESPS	3.80%	4.30%
Pension increases	2.80%	2.80%
Price inflation	2.80%	2.80%

As at 31 March 2006, the fair value of the plan assets, together with the liabilities in the plans recognised in the balance sheet, and the expected rates of return were as follows:

	Plan assets at 31 March 2006 %	Long-term rate of return expected at 31 March 2006 %	Value at 31 March 2006 £m	Plan assets at 31 March 2005 %	Long-term rate of return expected at 31 March 2005 %	Value at 31 March 2005 £m
Equities	66.6	7.1	746.8	63.7	7.6	593.0
Gilts	22.3	4.1	250.1	18.6	4.6	173.1
Bonds	11.0	4.9	123.4	14.9	5.4	138.7
Property	0.1	7.1	1.1	0.1	7.6	0.9
Cash	-	4.1	-	2.7	4.6	25.1
Total fair value of assets	100.0		1,121.4	100.0		930.8
Present value of liabilities			(1,138.4)			(989.7)
Net retirement benefit obligation			(17.0)			(58.9)
Related deferred tax asset			5.1			17.7
Net pension obligation			(11.9)			(41.2)

Notes to the accounts (continued)

20 Retirement benefits (continued)

The net pension expense before taxation recognised in the profit and loss account in respect of the defined benefit schemes is summarised as follows:

	2006 £m	2005 £m
Current service cost	(20.2)	(19.4)
Past service cost – exceptional restructuring costs	-	(8.7)
Expected return on plan assets	53.3	43.4
Interest on plan obligations	(46.0)	(43.4)
Net pension expense before taxation	(12.9)	(28.1)

The above amounts are all recognised within operating costs except for expected return on plan assets and interest on plan obligations which have been recognised within net interest payable and similar charges.

The reconciliation of the opening and closing balance sheet position is as follows:

	2006 £m	2005 £m
At 1 April	(58.9)	(159.7)
Expenses recognised in the profit and loss account	(12.9)	(28.1)
Contributions paid	1.3	130.5
Actuarial gains/(losses) gross of taxation	53.5	(1.6)
At 31 March	(17.0)	(58.9)

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses.

The history of the plan for the current and prior period is as follows:

	2006	2005
Actual return less expected return on scheme assets		
Amount/£m	168.3	7.2
Percentage of scheme assets	15.0%	0.8%
Experience gains and losses arising on scheme liabilities		
Amount/£m	-	(2.3)
Percentage of the present value of scheme liabilities	-	0.2%
Changes in assumptions underlying the present value of the scheme liabilities		
Amount/£m	(114.7)	(6.5)
Percentage of the present value of scheme liabilities	10.1%	0.7%
Total actuarial gain/(loss) recognised in the Statement of total recognised gains and losses/£m	53.5	(1.6)
Percentage of scheme liabilities	(4.7)%	0.2%

21 Called up share capital and share premium accounts

	2006 £m	2005 £m
Authorised share capital		
1,050,000,000 ordinary shares of £1 each	1,050.0	650.0
223,437,000 preference shares of £1 each	223.4	223.4
Allotted and fully paid share capital		
931,930,000 ordinary shares of £1 each	931.9	531.9
93,437,000 zero per cent preference shares of £1 each	93.4	93.4
130,000,000 seven per cent redeemable preference shares of £1 each	-	130.0
	1,025.3	755.3
Share premium account	647.8	647.8

Notes to the accounts (continued)

21 Called up share capital and share premium accounts (continued)

On 22 March 2006 the company increased its authorised ordinary share capital from 650,000,000 to 1,050,000,000 and issued 400,000,000 £1 ordinary shares at par.

Zero per cent preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the Company. However, preference shareholders receive priority to other classes of shareholders on a winding up, liquidation or other return of capital to shareholders of the Company.

Following the application of FRS25 'Financial instruments: Disclosures and Presentation', 130,000,000 seven per cent preference shares of £1 each have been recognised as financial liabilities, as described in note 1(a). The seven per cent preference shares have a redemption date of 1 October 2099.

22 Share capital and reserves

	Note	Called Up Share Capital £m	Share Premium Account £m	Profit and loss account £m	Total £m
As at 31 March 2005 as previously reported		755.3	647.8	844.3	2,247.4
Adoption of FRS 17 net of deferred tax	25	-	-	(125.1)	(125.1)
Actuarial losses on defined benefit pension schemes net of deferred tax	25	-	-	(1.1)	(1.1)
Adjustment to 2005 operating profit net of deferred tax following adoption of FRS 17	25	-	-	(2.5)	(2.5)
Adoption of FRS 21	25	-	-	137.5	137.5
As at 31 March 2005 as restated		755.3	647.8	853.1	2,256.2
Net gains upon adoption of FRS 26	25	-	-	18.8	18.8
Reclassification of preference shares upon adoption of FRS 25		(130.0)	-	-	(130.0)
As at 1 April 2005 as restated		625.3	647.8	871.9	2,145.0
Share capital issued in the year	21	400.0	-	-	400.0
Profit for the financial year		-	-	163.1	163.1
Actuarial gains on defined benefit schemes		-	-	53.5	53.5
Deferred tax charge arising on actuarial gains on defined benefit schemes		-	-	(16.1)	(16.1)
Dividends charged	9	-	-	(226.6)	(226.6)
As at 31 March 2006		1,025.3	647.8	845.8	2,518.9

Pension reserves

	Note	2006 £m	2005 Restated £m
Profit and loss account excluding pension obligation		857.7	894.3
FRS 17 pension obligation, net of related deferred tax	20	(11.9)	(41.2)
Profit and loss account		845.8	853.1

23 Obligations under finance leases

	Minimum lease payments:		Present value of minimum lease payments:	
	2006 £m	2005 £m	2006 £m	2005 £m
Less than one year	5.0	0.8	5.0	0.8
Between one and five years	32.9	27.5	32.9	27.5
After five years	42.3	52.7	42.3	52.7
	80.2	81.0		
Present value of lease obligations			80.2	81.0
Less amount due for settlement within 12 months			(5.0)	(0.8)
Amount due for settlement after 12 months			75.2	80.2

Notes to the accounts (continued)

23 Obligations under finance leases (continued)

It is the company's policy to lease certain of its fixtures and equipment under finance leases. The average lease term is eight years. For the year ended 31 March 2006, the average effective borrowing rate was 6.37 per cent. Interest rates are fixed at the contract date and thus expose the company to fair value interest rate risk. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. The directors consider that the fair value of the company's lease obligations approximates to their carrying amount. The company's obligations under finance leases are secured by the lessors' title to the leased assets.

24 Operating leases

The Company is committed to make the following payments during the year:	Land and buildings 2006 £m	Plant and machinery 2006 £m	Land and buildings 2005 £m	Plant and machinery 2005 £m
Non-cancellable operating leases which expire:				
Within one year	-	0.3	-	0.2
Between two and five years	-	0.9	-	1.2
After five years	1.0	-	0.9	-
	1.0	1.2	0.9	1.4

25 Prior year adjustments and adoption of new accounting standards

As a result of the adoption of FRS21 'Events after the balance sheet date' and FRS17 'Retirement Benefits' explained in note 1 (a), the profit and loss account, statement of total recognised gains and losses and balance sheet have been restated. The effect of these changes in accounting policy on the financial statements is disclosed in the table below:

Prior year adjustments	2005 financial statements £m	FRS 17 adoption £m	FRS 21 adoption £m	Restated 2005 Financial Statements £m
Profit and loss account				
Operating profit	458.9	(3.6)	-	455.3
Net interest payable and similar charges	(214.9)	-	-	(214.9)
Tax credit/(charge)	(37.9)	1.1	-	(36.8)
	206.1	(2.5)	-	203.6
Dividends	(214.9)	-	2.6	(212.3)
Transfer (from)/to reserves	(8.8)	(2.5)	2.6	(8.7)
Balance sheet				
Fixed assets	6,292.9	-	-	6,292.9
Stock	2.8	-	-	2.8
Debtors	366.5	(125.0)	-	241.5
Short term investments	491.0	-	-	491.0
Creditors: amounts falling due within one year	(1,174.9)	-	137.5	(1,037.4)
Creditors: amounts falling due after more than one year	(3,467.3)	-	-	(3,467.3)
Provisions	(263.6)	37.5	-	(226.1)
Pension liability	-	(41.2)	-	(41.2)
Net assets	2,247.4	(128.7)	137.5	2,256.2
Share capital	755.3	-	-	755.3
Share premium	647.8	-	-	647.8
Profit and loss reserve	844.3	(128.7)	137.5	853.1
	2,247.4	(128.7)	137.5	2,256.2

Notes to the accounts (continued)

25 Prior year adjustments and adoption of new accounting standards (continued)

The total impact of £128.7m on the reserves at 31 March 2005 following the adoption of FRS 17 is made up of £125.1m opening reserves impact (£178.7m), net of deferred tax (£53.6m), £1.1m actuarial gains net of deferred tax during the year to 31 March 2005 and the profit and loss account impact of £2.5m.

Adoption of accounting standards at 1 April 2005

The effect of the change in accounting policy from SSAP 24 'Accounting for Pension Costs' to FRS 17 'Retirement Benefits' on the 2005/06 figures has not been disclosed as the directors consider that this is not practicable. This is due to the fact that since the adoption of FRS 17 'Retirement Benefits' on 1 April 2005, no financial information, in accordance with SSAP 24, has been prepared by the company's actuary.

FRS 25 and FRS 26 have been applied prospectively, resulting in £130.0 million of preference shares being reclassified from equity to debt at 1 April 2005 and the fair value of debt, derivatives and deferred income being reduced by £26.8 million, deferred tax increased by £8.0 million and reserves increased by £18.8 million, at 1 April 2005. (See reconciliation of movements in shareholders' funds).

26 Reconciliation of operating profit to net cash inflow from operating activities

	2006 £m	2005 restated £m
Operating profit	513.8	455.3
Depreciation	293.1	249.3
Amortisation of grants and contributions	(4.7)	(4.1)
Profit on disposal of tangible fixed assets	(2.9)	(2.1)
Stock increase	(0.4)	(0.4)
Debtors increase	(21.0)	(111.8)
Creditors increase	10.7	14.3
Movement in other provisions	(3.6)	5.4
Net cash inflow from operating activities	785.0	605.9

27 Reconciliation of net cash flow to movement in net debt

	Note	2006 £m	2005 restated £m
Movement and overdrafts in the year		(6.5)	17.8
Cash flow from increase/(decrease) in debt and lease financing		14.3	(734.1)
Cash used to increase liquid resources		247.0	212.2
Changes in net debt resulting from cash flows		254.8	(504.1)
Exchange and other non-cash adjustments	30	(43.9)	(4.9)
Movement in net debt in the year	30	210.9	(509.0)
Opening net debt (restated)	30	(3,473.3)	(2,840.3)
Net debt at 31 March	30	(3,262.4)	(3,349.3)

28 Acquisitions and disposals

	2006 £m	2005 £m
Disposals:		
Current assets	-	0.1

Notes to the accounts (continued)

29 Financing

	2006 £m	2005 £m
Issue of shares	400.0	-
New loans	449.4	779.4
Loans repaid	(462.9)	(45.3)
Finance lease repayments	(0.8)	-
Net cash inflow from financing	385.7	734.1

30 Analysis of changes in net debt

	At 31 March 2005 £m	Opening Adjustment* £m	At 1 April 2005 restated £m	Cashflow £m	Non-cash Movements £m	At 31 March 2006 £m
Cash at bank and in hand	-	-	-	4.4	-	4.4
Overdrafts	(13.0)	-	(13.0)	(10.9)	-	(23.9)
	(13.0)	-	(13.0)	(6.5)	-	(19.5)
Parent undertaking loans	40.7	-	40.7	-	-	40.7
Debt due after one year	(3,305.0)	(124.0)	(3,429.0)	(408.3)	(43.9)	(3,881.2)
Debt due within one year	(482.0)	-	(482.0)	421.8	-	(60.2)
Finance leases	(81.0)	-	(81.0)	0.8	-	(80.2)
	(3,840.3)	(124.0)	(3,964.3)	7.8	(43.9)	(4,000.4)
Current asset investments	491.0	-	491.0	247.0	-	738.0
Net debt	(3,349.3)	(124.0)	(3,473.3)	254.8	(43.9)	(3,262.4)

*The opening net debt has been adjusted following the adoption of FRS 25 and FRS 26 as described in note 1(a)

31 Related party transactions

In accordance with the exemption set out in Financial Reporting Standard 8 'Related Party Disclosures', the Company has not disclosed transactions with its ultimate holding company or any members of the United Utilities PLC group. United Utilities PLC is the ultimate controlling party as defined by FRS 8.

The following transactions were carried out with THUS Group plc:

	2006 £m	2005 £m
Sale of goods	0.1	-
Purchase of goods	0.3	-

United Utilities PLC, our ultimate parent undertaking, owns 21.7% of the shareholding of the ordinary share capital of THUS Group plc.

32 Ultimate parent undertaking

The accounts of the Company are consolidated in the group accounts of the ultimate parent undertaking, United Utilities PLC, a company registered in England and Wales. Copies of the accounts of United Utilities PLC may be obtained from the Company Secretary, United Utilities PLC, Dawson House, Great Sankey, Warrington WA5 3LW.

Regulatory accounting information

The Regulatory Accounts on pages 45 to 61 have been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Water Services Regulation Authority.

Turnover and net operating assets for the non-appointed business are above the 1% threshold, defined by Regulatory Accounting Guidelines, and, therefore, the current cost profit and loss account, balance sheet and cash flow statement show the figures for the appointed business only. The 2005 comparative figures have been restated to show the appointed business only.

Director's responsibilities in respect of the preparation of the regulatory accounts

The directors consider that all Regulatory Accounting Guidelines issued by the Water Services Regulation Authority which they consider to be applicable to these financial statements have been followed. After making enquiries, the directors are of the opinion that

the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt a going concern basis in preparing these financial statements

In addition, the directors have responsibility for ensuring that the company keeps proper accounting records sufficient to enable the historical cost and current cost information required by Condition F of the licence to be prepared, having regard to all Regulatory Accounting Guidelines. The directors are also required to confirm in the financial statements that, in their opinion, the Company was in compliance with paragraph 3.1 of Condition K of the licence relating to the availability of the rights and assets, at the end of the financial year.

Independent accountants' report

INDEPENDENT ACCOUNTANTS' REPORT TO THE WATER SERVICES REGULATION AUTHORITY ("THE WSRA") AND UNITED UTILITIES WATER PLC ("THE COMPANY")

We have audited the Regulatory Accounts of the Company for the year ended 31 March 2006 on pages 45 to 61 which comprise;

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account and the regulatory historical cost balance sheet; and
- the regulatory current cost accounting statements for the Appointed Business, comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement, the notes to the current cost cash flow statement and the related notes numbered 1 to 14 of the current cost accounts including the statement of accounting policies on which the Regulatory Accounts have been prepared.

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991 (the "Regulatory Licence"). Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Company and the WSRA, for our audit work, for this report, or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the appointment and the Regulatory Accounting Guidelines (being versions 1.03, 2.03, 3.05, 4.02 and 5.04), the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company. There are differences between United Kingdom Generally Accepted Accounting Principles ("UK GAAP") and the basis of preparation of information provided in the Regulatory Accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the WSRA, the Directors and auditors

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

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out above.

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

Independent accountants' report (continued)

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the Appointee in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guidelines for the classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets) and whether the regulatory current cost accounting statements on pages 47 to 61 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F of the Regulatory Licence and whether the information is in agreement with the Appointee's underlying accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05, and Regulatory Accounting Guideline 4.02.

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

Basis of audit opinion

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

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

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 45 to 46 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disappplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn upon this basis with that drawn upon under Companies Act 1998 is given on page 59.

Audit opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2006 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 50, the state of the Company's affairs at 31 March 2006 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those Conditions, Guidelines and accounting policies.

We are also required to report in respect of various specific obligations of the Company as set out in its Instrument of Appointment. In respect of these obligations, we report that in our opinion:-

- a) proper accounting records have been kept by the Appointee as required by paragraph 3 of Condition F of the instrument;
- (b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA;
- (c) the regulatory historical cost accounting statements on pages 45 to 46 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA; and
- (d) the regulatory current cost accounting statements on pages 47 to 48 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the WSRA.



Deloitte & Touche LLP
Chartered Accountants
Manchester

14 July 2006

Summarised historical cost profit and loss accounts

For the year ended 31 March

	2006	2006	2006	2005	2005	2005
	Appointed	Non-	Total	Restated	Restated	Restated
	£m	appointed	£m	Appointed	Non -	Total
		£m		£m	appointed	£m
Turnover	1,219.7	9.6	1,229.3	1,126.2	8.9	1,135.1
Operating costs (including exceptional items)	(721.2)	(3.5)	(724.7)	(691.2)	(3.5)	(694.7)
Operating income	4 2.9	-	2.9	2.1	-	2.1
Operating profit	501.4	6.1	507.5	437.1	5.4	442.5
Other income	5 1.5	-	1.5	4.4	-	4.4
Interest receivable	6 28.4	-	28.4	38.7	-	38.7
Interest payable	6 (267.4)	-	(267.4)	(256.7)	-	(256.7)
Profit on ordinary activities before taxation	263.9	6.1	270.0	223.5	5.4	228.9
Taxation – Current	(9.1)	(1.8)	(10.9)	1.0	-	1.0
- Deferred	(99.5)	-	(99.5)	(32.7)	(1.6)	(34.3)
Profit for the year	155.3	4.3	159.6	191.8	3.8	195.6
Dividends	(226.6)	-	(226.6)	(208.5)	(3.8)	(212.3)
Transfer (from)/to reserves	(71.3)	4.3	(67.0)	(16.7)	-	(16.7)

The 2005 figures have been restated to reflect the adoption of FRS 17 "Retirement benefits" and FRS 21 "Events after the balance sheet date". The impact of the restatement is disclosed in note 13.

Differences between the historic regulatory accounts and the statutory accounts are detailed in note 14.

Summarised historical cost balance sheets

At 31 March

	2006 Appointed £m	2006 Non – appointed £m	2006 Total £m	2005 Appointed Restated £m	2005 Non – appointed Restated £m	2005 Total Restated £m
Fixed Assets						
Tangible fixed assets	6,445.1	-	6,445.1	6,281.2	-	6,281.2
Investments	0.3	-	0.3	0.3	-	0.3
Total Fixed Assets	6,445.4	-	6,445.4	6,281.5	-	6,281.5
Current assets						
Stock	3.2	-	3.2	2.8	-	2.8
Debtors	277.9	3.9	281.8	200.8	-	200.8
Cash at bank	4.4	-	4.4	-	-	-
Short-term investments	778.6	-	778.6	531.7	-	531.7
Total current assets	1,064.1	3.9	1,068.0	735.3	-	735.3
Creditors: amounts falling due within one year						
Borrowings	(89.2)	-	(89.2)	(495.8)	-	(495.8)
Other creditors	(473.2)	2.0	(471.2)	(539.0)	1.6	(537.4)
Total creditors	(562.4)	2.0	(560.4)	(1,034.8)	1.6	(1,033.2)
Net current assets/(liabilities)	501.7	5.9	507.6	(299.5)	1.6	(297.9)
Total assets less current liabilities	6,947.1	5.9	6,953.0	5,982.0	1.6	5,983.6
Creditors: amounts falling due after more than one year						
Borrowings	(3,956.3)	-	(3,956.3)	(3,385.3)	-	(3,385.3)
Other creditors	(41.6)	-	(41.6)	(43.6)	-	(43.6)
	(3,997.9)	-	(3,997.9)	(3,428.9)	-	(3,428.9)
Provisions for liabilities and charges						
- Deferred tax	(326.7)	(1.6)	(328.3)	(215.6)	(1.6)	(217.2)
- Other provisions	(30.6)	-	(30.6)	(5.4)	-	(5.4)
Deferred income	(88.8)	-	(88.8)	(83.9)	-	(83.9)
Net assets employed	2,503.1	4.3	2,507.4	2,248.2	-	2,248.2
Capital and reserves						
Called up share capital	1,025.4	-	1,025.4	755.3	-	755.3
Share premium	647.8	-	647.8	647.8	-	647.8
Profit and loss account	829.9	4.3	834.2	845.1	-	845.1
Capital and reserves	2,503.1	4.3	2,507.4	2,248.2	-	2,248.2

The 2005 figures have been restated to reflect the adoption of FRS 17 "Retirement benefits" and FRS 21 "Events after the balance sheet date". The impact of the restatement is disclosed in note 13.

Current cost profit and loss account for the Appointed Business

For year ended 31 March	Note	2006 £m	2005 Restated £m
Turnover	2	1,219.7	1,126.2
Current cost operating costs	3	(809.4)	(777.0)
Operating (charge)/income	2	(1.4)	1.3
		408.9	350.5
Working capital adjustment	2	3.2	8.6
Current cost operating profit		412.1	359.1
Other income	5	1.5	4.4
Interest payable	6	28.4	38.7
Interest receivable	6	(267.4)	(256.7)
Financing adjustment		87.0	99.8
Current cost profit on ordinary activities before taxation		261.6	245.3
Taxation			
- Current tax		(9.1)	1.0
- Deferred tax		(99.6)	(32.7)
Current cost profit attributable to shareholders		152.9	213.6
Dividends		(226.6)	(208.5)
Transfer (from)/to reserves		(73.7)	5.1

Turnover and net operating assets for the non-appointed business are above the 1% threshold, defined by Regulatory Accounting Guidelines, and, therefore, the current cost profit and loss account show the figures for the appointed business only. The 2005 comparative figures have been restated to show the non-appointed business only. The 2005 figures have also been restated to reflect the adoption of FRS17 'Retirement benefits' and FRS21 'Events after the balance sheet date'. The impact of the restatement is disclosed in note 13.

Expenditure relating to aqueduct security of supply has been classified as described in note 14.

Current cost balance sheet for the Appointed Business

For year ended 31 March	Note	2006 £m	2005 Restated £m
Tangible assets	7	41,640.8	40,587.2
Third party contributions since 1989/90		(262.7)	(230.4)
Working capital	9	(138.7)	(133.7)
Net operating assets		41,239.4	40,223.1
Cash and investments		783.3	531.9
Non-trade debtors		75.0	19.9
Non-trade creditors due within one year		(248.0)	(719.1)
Creditors due after one year		(3,997.8)	(3,428.9)
Provisions for liabilities and charges			
- Deferred tax		(326.8)	(215.6)
- Other provisions		(1.8)	(5.4)
Net assets employed		37,523.3	36,405.9
Capital and reserves			
Called up share capital		1,025.4	755.4
Share premium account		647.8	647.8
Profit and loss account		(260.4)	(242.9)
Current cost reserve	10	36,110.5	35,245.6
		37,523.3	36,405.9

The 2005 comparative figures have been restated to show the non-appointed business only. The 2005 figures have also been restated to reflect the adoption of FRS17 'Retirement benefits' and FRS21 'Events after the balance sheet date'. The impact of the restatement is disclosed in note 13.

Current cost cash flow statement

For the year ended 31 March

	2006 Appointed £m	2006 Non- appointed £m	2006 Total £m	2005 Appointed Restated £m	2005 Non- appointed Restated £m	2005 Total Restated £m
Net cash flow from operating activities*	785.0	-	785.0	605.9	-	605.9
Returns on investments and servicing of finance						
Interest received	16.5	-	16.5	9.9	-	9.9
Interest paid	(226.4)	-	(226.4)	(222.0)	-	(222.0)
Interest in finance lease rentals	(6.2)	-	(6.2)	(5.6)	-	(5.6)
Termination of interest rate swap contracts	-	-	-	19.7	-	19.7
Income received from current asset investments	0.3	-	0.3	2.3	-	2.3
Non-equity dividends paid	(9.1)	-	(9.1)	(9.1)	-	(9.1)
Net cash outflow from returns on investments and servicing of finance	(224.9)	-	(224.9)	(204.8)	-	(204.8)
Taxation received	-	-	-	13.5	-	13.5
Capital expenditure						
Gross cost of purchase of fixed assets	(443.1)	-	(443.1)	(669.2)	-	(669.2)
Receipt of grants and contributions	32.4	-	32.4	17.6	-	17.6
Infrastructure renewals expenditure	(78.2)	-	(78.2)	(66.3)	-	(66.3)
Disposal of fixed assets	10.2	-	10.2	2.3	-	2.3
Net cash outflow from investing activities	(478.7)	-	(478.7)	(715.6)	-	(715.6)
Acquisitions and disposals	-	-	-	0.1	-	0.1
Equity dividends paid	(226.6)	-	(226.6)	(203.2)	-	(203.2)
Management of liquid resources						
Increase in short-term deposits	(247.0)	-	(247.0)	(212.2)	-	(212.2)
Net cash outflow before financing	(392.2)	-	(392.2)	(716.3)	-	(716.3)
Financing	385.7	-	385.7	734.1	-	734.1
Movement in cash and overdrafts	(6.5)	-	(6.5)	17.8	-	17.8

*Net cash flow from operating activities has been restated to separately identify non-appointed business cash flows (see below).

Notes to the current cost cash flow statement

For the year ended 31 March

	2006 Appointed £m	2006 Non- appointed £m	2006 Total £m	2005 Appointed £m	2005 Non- appointed £m	2005 Total £m
Reconciliation of current cost operating profit to net cash flow from operating activities						
Current cost operating profit	412.1	6.1	418.2	359.1	5.4	364.5
Working capital adjustment	(3.2)	-	(3.2)	(8.6)	-	(8.6)
Changes in stock	(0.4)	-	(0.4)	(0.4)	-	(0.4)
Receipts from other income	1.2	-	1.2	1.3	-	1.3
Current cost depreciation	280.5	-	280.5	296.1	-	296.1
Effect of other deferrals and accruals on operating activity cashflow	(5.6)	-	(5.6)	(4.9)	-	(4.9)
Current cost loss/ (profit) on disposal of fixed assets	1.4	-	1.4	(1.3)	-	(1.3)
Increase in debtors and prepaid expenses	(17.1)	(3.9)	(21.0)	(111.8)	-	(111.8)
Increase/(decrease) in creditors and accrued expenses	41.6	(2.2)	39.4	4.7	(5.4)	(0.7)
Infrastructure renewals expenditure	78.2	-	78.2	66.3	-	66.3
Movement in other provisions	(3.7)	-	(3.7)	5.4	-	5.4
Net cash inflow from operating activities	785.0	-	785.0	605.9	-	605.9

	2006 £m	2005 £m
Analysis of cash flows for headings netted in the cash flow statement		
Financing		
Issue of shares	400.0	-
New loans	449.4	779.4
Loans repaid	(462.9)	(45.3)
Finance lease repaid	(0.8)	-
Net cash inflow from financing	385.7	734.1

Analysis of changes in net debt

	At 31 March 2005 £m	Opening Adjustment* £m	At 1 April 2005 restated £m	Cashflow £m	Non-cash Movements £m	At 31 March 2006 £m
Cash at bank and in hand	-	-	-	4.4	-	4.4
Overdrafts	(13.0)	-	(13.0)	(10.9)	-	(23.9)
	(13.0)	-	(13.0)	(6.5)	-	(19.5)
Parent undertaking loans	40.7	-	40.7	-	-	40.7
Debt due after one year	(3,305.0)	(124.0)	(3,429.0)	(408.3)	(43.9)	(3,881.2)
Debt due within one year	(482.0)	-	(482.0)	421.8	-	(60.2)
Finance leases	(81.0)	-	(81.0)	0.8	-	(80.2)
	(3,840.3)	(124.0)	(3,964.3)	7.8	(43.9)	(4,000.4)
Current asset investments	491.0	-	491.0	247.0	-	738.0
Net debt	(3,349.3)	(124.0)	(3,473.3)	254.8	(43.9)	(3,262.4)

*The opening net debt has been adjusted following the adoption of FRS 25 and FRS 26 as described in note 13.

Notes to the current cost accounts

1 Statement of accounting policies

These accounts have been prepared in accordance with guidance issued by the Director General of Water Services for modified real term financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance in the context of assets which are valued at their current cost value to the business.

An Asset Management Plan (AMP) survey of existing assets as at 31 March 2003 was undertaken during 2003/04 and the adjustments to asset values as a result of that exercise were included within the tangible fixed asset note in 2004/05. The current cost depreciation figures included in the 2004/05 current cost operating costs have been based upon the revised values. In the intervening years, between AMP surveys, values are restated to take account of changes in the general level of inflation as measured by changes in the Retail Price Index (RPI).

(a) Tangible fixed assets

Assets in operational use are valued at depreciated modern equivalent asset value (replacement cost for current operating capacity). To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for the possible funding of future replacements by contributions from third parties and to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business.

(i) Operational assets

Non-specialised operational assets are valued on the basis of open market value for existing use at 31 March 2003 and have been expressed in real terms by indexing using the Retail Price Index (RPI) since that date.

Specialised operational assets are valued on the basis of information provided by the Asset Management Plan (AMP). Values are adjusted by changes in RPI between Periodic Reviews. The unamortized portion of third party contributions received is deducted in arriving at net operating assets (as described below).

(ii) Infrastructure assets

Mains, sewers, impounding and raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost determined principally on the basis of data provided by the AMP.

In the intervening years, values are restated to take account of inflation as measured by changes in the RPI over the year.

(iii) Other fixed assets

All other fixed assets are valued principally on the basis of data provided by the AMP. Between Periodic Reviews, values are restated for inflation as measured by changes in the RPI.

(b) Grants and other third party contributions

Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

(c) Real financial capital maintenance adjustments

These adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

(i) Working capital adjustment

This is calculated by applying the change in RPI over the year to the opening total of trade debtors and stock less trade creditors.

(ii) Financing adjustment

This is calculated by applying the change in RPI over the year to the opening balance of net monetary assets and liabilities.

(iii) Depreciation adjustment

This is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historical cost profit.

(iv) Disposal of fixed assets adjustment

This is the difference between the book values of realised assets in the current cost financial statements and in the historical cost financial statements.

(d) Allocation of costs to principal services

Direct costs are charged to the sub-service areas to which they are attributable, as defined in RAG4, whereas business activities and indirect costs are allocated on an activity basis using quantitative measures such as headcount and other methods reflecting consumption of service.

Notes to the current cost accounts (continued)

2 Analysis of turnover and operating income of the appointed business

For the year ended 31 March	2006					2005
	Water Services £m	Sewerage Services £m	Total £m	Water Services Restated £m	Sewerage Services Restated £m	Total Restated £m
Turnover						
Tariff basket						
- Measured	172.9	262.9	435.8	160.5	222.7	383.2
- Unmeasured	314.6	330.5	645.1	311.5	316.7	628.2
- Trade effluent	-	25.1	25.1	-	25.9	25.9
	487.5	618.5	1,106.0	472.0	565.3	1,037.3
Non-tariff basket						
- Revenue	-	-	-	0.3	-	0.3
- Large user revenues	56.4	42.6	99.0	44.5	28.9	73.4
- Other sources	1.6	0.4	2.0	2.6	1.0	3.6
- Third party services	11.2	1.5	12.7	10.4	1.2	11.6
	556.7	663.0	1,219.7	529.8	596.4	1,126.2
Operating Income						
Current cost (loss)/profit on disposal of fixed assets	(0.5)	(0.9)	(1.4)	1.1	0.2	1.3
Working capital adjustment	1.5	1.7	3.2	4.0	4.6	8.6

Notes to the current cost accounts (continued)

3 Current cost operating costs for the year ended 31 March 2006

Service Analysis	Water Services				Sewerage Services		
	Resource and treatment £m	Distribution £m	Water supply Subtotal £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewerage Service subtotal £m
Direct costs							
Employment costs	11.2	9.0	20.2	3.6	10.2	7.9	21.7
Power	6.7	7.8	14.5	3.5	13.1	6.1	22.7
Hired and contracted services	3.1	14.8	17.9	10.8	3.8	8.1	22.7
Materials and consumables	8.6	0.6	9.2	-	5.1	4.3	9.4
Service charges	13.1	-	13.1	2.3	3.8	-	6.1
Other direct costs	1.5	0.7	2.2	0.4	0.2	0.1	0.7
Total direct costs	44.2	32.9	77.1	20.6	36.2	26.5	83.3
General and support expenditure	18.1	25.2	43.3	6.3	32.2	13.1	51.6
Functional expenditure	62.3	58.1	120.4	26.9	68.4	39.6	134.9
Operating expenditure							
Customer services			31.2				31.4
Scientific services			6.5				3.3
Other business activities			2.1				2.2
Total business activities			39.8				36.9
Local authority rates			18.6				24.9
Doubtful debts			17.5				19.8
Exceptional items			0.3				0.3
Total opex less third party services			196.6				216.8
Third party services-operating expenditure			13.0				-
Total operating expenditure			209.6				216.8
Capital maintenance							
Infrastructure renewals/expenditure	5.7	43.0	48.8	29.0	-	0.4	29.5
Infrastructure renewals accruals/ (prepayment)	5.2	(1.0)	4.2	24.2	-	0.3	24.5
Current cost depreciation (allocated)	57.0	22.7	79.7	18.5	101.7	24.0	144.2
Amortisation of deferred credits			(3.5)				(2.3)
Business activities current cost							
Depreciation (non-allocated)			30.0				25.9
Capital maintenance excluding third party services			159.2				221.8
Third party services – capital maintenance			2.0				-
Total capital maintenance			161.2				221.8
Total operating costs			370.8				438.6
CCA (MEA) values:							
Service activities	4,224.1	9,180.7	13,404.8	24,920.8	2,531.0	548.2	28,000.0
Business activities			107.7				93.7
Total			13,512.5				28,093.7
Services for the third parties			34.6				0.0
Total			13,547.1				28,093.7

The depreciation charge from associated companies has been reclassified as business activities capital cost in accordance with RAG4. The cost of services provided by Vertex Data Science Limited, an associated company of United Utilities Water PLC, has been analysed across operating costs as if the services were carried out by United Utilities Water PLC, in accordance with RAG4 guidelines.

Notes to the current cost accounts (continued)

3 Current cost operating costs for the year ended 31 March 2005

Service Analysis	Water Services				Sewerage Services			
	Resource and Treatment (restated) £m	Distribution (restated) £m	Water supply Subtotal (restated) £m	Sewerage (restated) £m	Sewage Treatment (restated) £m	Sludge treatment and disposal (restated) £m	Sewerage Service Subtotal (restated) £m	
Direct costs								
Employment costs	11.9	11.2	23.1	3.5	14.7	8.2	26.4	
Power	5.4	6.4	11.8	2.2	10.3	4.6	17.1	
Hired and contracted services	2.3	14.7	17.0	9.2	3.7	9.3	22.2	
Materials and consumables	7.5	1.4	8.9	0.2	5.1	4.0	9.3	
Service charges	12.6	-	12.6	1.9	3.9	-	5.8	
Other direct costs	-	1.3	1.3	0.3	0.5	0.3	1.1	
Total direct costs	39.7	35.0	74.7	17.3	38.2	26.4	81.9	
General and support expenditure	19.9	22.2	42.1	3.9	28.4	16.7	49.0	
Functional expenditure	59.6	57.2	116.8	21.2	66.6	43.1	130.9	
Operating expenditure								
Customer services			30.9				31.2	
Scientific services			7.5				3.7	
Other business activities			3.6				3.6	
Total business activities			42.0				38.5	
Local authority rates			21.9				18.5	
Doubtful debts			18.5				20.9	
Exceptional items			7.1				7.1	
Total opex less third party services			206.3				215.9	
Third party services-operating expenditure			11.5				0.0	
Total operating expenditure			217.8				215.9	
Capital maintenance								
Infrastructure renewals/expenditure	5.2	37.9	43.1	22.9		0.3	23.2	
Infrastructure renewals accruals/ (prepayment)	-	14.1	14.1	(29.8)	-		(29.8)	
Current cost depreciation (allocated)	54.2	20.3	74.5	17.8	100.4	22.7	140.9	
Amortisation of deferred credits			(2.9)				(2.1)	
Business activities current cost								
Depreciation (non allocated)			42.3				38.0	
Capital maintenance excluding third party services			171.1				170.2	
Third party services – capital maintenance			2.0				-	
Total capital maintenance			173.1				170.2	
Total operating costs			390.9				386.1	
CCA (MEA) values:								
Service activities	4,132.1	8,912.7	13,044.8	24,296.1	2,009.9	1,002.3	27,308.3	
Business activities			111.2				89.4	
Total			13,156.0				27,397.7	
Services for the third parties			33.5				-	
Total			13,189.5				27,397.7	

The depreciation charge from associated companies has been reclassified as business activities capital cost in accordance with RAG4. The cost of services provided by Vertex Data Science Limited, an associated company of United Utilities Water PLC, has been analysed across operating costs as if the services were carried out by United Utilities Water PLC, in accordance with RAG4 guidelines.

Notes to the current cost accounts (continued)

4 Operating Income		2006	2005		
		£m	£m		
Profit on disposal of fixed assets		2.9	2.1		
<hr/>					
5 Other income		2006	2005		
		£m	£m		
Income received from current asset investments		0.3	3.1		
Net rents receivable		1.2	1.3		
Other income		1.5	4.4		
<hr/>					
6 Net interest payable		2006	2005		
		£m	£m		
Interest payable and similar charges:					
On bank loans, overdrafts and other loans		208.9	213.4		
On finance leases		3.2	3.3		
Group undertakings		33.1	40.0		
Preference share dividends		9.1	-		
Fair value loss on derivatives		13.1	-		
Total interest payable and similar charges		267.4	256.7		
Interest receivable and similar income:					
Group undertakings		(4.6)	(9.8)		
External		(16.5)	(28.9)		
Net return on pension scheme		(7.3)	-		
Total interest receivable and similar income		(28.4)	(38.7)		
Net interest payable		239.0	218.0		
<hr/>					
7 Current cost analysis of fixed assets by asset type as at 31 March 2006					
Total Services	Specialised operational assets	Non-specialised operational assets	Infrastructure assets	Other tangible assets	Total
	£m	£m	£m	£m	£m
Gross replacement cost:					
At 1 April 2005	8,350.4	128.2	34,983.9	555.2	44,017.7
RPI adjustment	197.4	3.0	827.0	13.2	1,040.6
Disposals	(40.5)	(0.4)	-	(180.2)	(221.1)
Additions	196.5	5.0	119.9	63.8	385.2
At 31 March 2006	8,703.8	135.8	35,930.8	452.0	45,222.4
Depreciation					
At 1 April 2005	3,029.3	46.4	-	354.8	3,430.5
RPI Adjustment	70.8	1.0	-	8.3	80.1
Disposals	(39.8)	(0.4)	-	(169.3)	(209.5)
Charge for the year	216.1	7.7	-	56.7	280.5
At 31 March 2006	3,276.4	54.7	-	250.5	3,581.6
Net book value					
At 31 March 2006	5,427.4	81.1	35,930.8	201.5	41,640.8
At 1 April 2005	5,321.1	81.8	34,983.9	200.4	40,587.2

Notes to the current cost accounts (continued)

7 Current cost analysis of fixed assets by asset type as at 31 March 2006

Water Services	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other tangible assets £m	Total £m
Gross replacement cost:					
At 1 April 2005	2,994.1	78.2	10,888.6	294.2	14,255.1
RPI adjustment	70.8	1.8	257.4	7.0	337.0
Disposals	(11.4)	(0.2)	-	(87.4)	(99.0)
Additions	71.6	2.4	57.8	30.6	162.4
At 31 March 2006	3,125.1	82.2	11,203.8	244.4	14,655.5
Depreciation					
At 1 April 2005	855.1	27.5	-	183.0	1,065.6
RPI adjustment	20.0	0.6	-	4.3	24.9
Disposals	(10.8)	(0.2)	-	(82.1)	(93.1)
Charge for the year	75.0	4.7	-	31.3	111.0
At 31 March 2006	939.3	32.6	-	136.5	1,108.4
Net book value:					
At 31 March 2006	2,185.8	49.6	11,203.8	107.9	13,547.1
At 1 April 2005	2,139.0	50.7	10,888.6	111.2	13,189.5
Sewerage Services					
	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other tangible assets £m	Total £m
Gross replacement cost:					
At 1 April 2005	5,356.3	50.0	24,095.3	261.0	29,762.6
RPI adjustment	126.6	1.2	569.6	6.2	703.6
Disposals	(29.1)	(0.2)	-	(92.8)	(122.1)
Additions	124.9	2.6	62.1	33.2	222.8
At 31 March 2006	5,578.7	53.6	24,727.0	207.6	30,566.9
Depreciation					
At 1 April 2005	2,174.2	18.9	-	171.8	2,364.9
RPI adjustment	50.8	0.4	-	4.0	55.2
Disposals	(29.0)	(0.2)	-	(87.2)	(116.4)
Charge for the year	141.1	3.0	-	25.4	169.5
At 31 March 2006	2,337.1	22.1	-	114.0	2,473.2
Net book value:					
At 31 March 2006	3,241.6	31.5	24,727.0	93.6	28,093.7
As at 1 April 2005	3,182.1	31.1	24,095.3	89.2	27,397.7

Notes to the current cost accounts (continued)

8 Regulatory capital value

	2006 £m
Opening RCV for the year	6,201
Capital expenditure	509
Infrastructure renewals expenditure	102
Infrastructure renewals charge	(103)
Grants and contributions	(14)
Depreciation	(300)
Outperformance of regulatory assumptions (5 years in arrears)	(39)
	<hr/>
Closing RCV carried forward	6,356
	<hr/>
Average RCV (2005/06 year average prices)	6,218

The figures quoted are as published by Ofwat in March 2005 (at March 2005 prices) and therefore do not agree with other actual values reflected in the Company's regulatory financial statements. All costs have been indexed to March 2006 (RPI - 195.0) prices, except for the average RCV, which is shown at year average prices (RPI - 193.1), in accordance with Ofwat's regulatory accounting guidelines.

9 Working Capital

	2006 £m	2005 Restated £m
Stocks	3.2	2.8
Trade debtors	122.4	95.2
Trade creditors	(23.9)	(25.7)
Short-term capital creditors	(94.4)	(154.5)
Infrastructure renewals accrual	(28.8)	-
Other trade accruals	(74.7)	(85.4)
Trade payments in advance	(78.2)	-
Payroll related taxation and social security	(2.9)	(2.8)
Group trade creditors	(14.9)	(32.9)
Prepayments and other debtors	53.5	69.6
	<hr/>	<hr/>
Total working capital	(138.7)	(133.7)

2005 working capital has been restated in order to exclude balances relating to the non-appointed business.

10 Movement on current cost reserve

	2006 £m	2005 £m
At 1 April	35,245.6	32,913.3
AMP adjustment	-	1,239.4
RPI adjustments:		
Fixed assets	960.4	1,208.1
Working capital	(3.2)	(8.6)
Financing	(87.0)	(99.8)
Grants and third party contributions	(5.3)	(6.8)
	<hr/>	<hr/>
At 31 March	36,110.5	35,245.6

Notes to the current cost accounts (continued)

11 Information in respect of transactions with any other business or activity of the appointee or any associated company

To the best of their knowledge, the directors of United Utilities Water PLC declare that all appropriate transactions with associated companies have been disclosed and material transactions with associated companies are at arm's length and no cross-subsidy has occurred. The materiality level of transactions used for reporting is 0.5% of turnover.

Borrowings and sums lent

The following loans from associated companies existed at 31 March 2006:

	£m	Interest rate	Repayment date
United Utilities PLC – 400 million US \$ bonds	240.1	6.88%	August 2028
North West Water LLC £205.5m loan	205.5	3.91% to 5.34%	July 2034

United Utilities Water PLC operates a daily zero balancing sweep banking arrangement with its parent United Utilities PLC. This has resulted in a total of £0.9 million net interest payable to United Utilities PLC for the year.

The following loans to associated companies existed at 31 March 2005:

	£m	Interest rate	Repayment date
United Utilities PLC	40.0	5.07% to 5.37%	On demand

Dividends paid to associated undertakings

During the year, dividends payable to United Utilities North West PLC totalled £226.6 million. This comprised a final dividend for the year ended 31 March 2005 of £137.5 million and an interim dividend of £89.1 million. A 7 per cent preference share dividend of £9.1 million has been included within finance costs.

Notes to the current cost accounts (continued)

11 Information in respect of transactions with any other business or activity of the appointee or any associated company (continued)

Supply of services

Services supplied to United Utilities Water PLC from associated companies

Nature of transaction	Company	Terms of supply	Total value of service £m
Managed services	Vertex Data Science Limited	Market tested rates based on actual activity undertaken and other market testing	53.4
Systems and software development	Vertex Data Science Limited	Market tested rates based on actual activity undertaken and other market testing	18.5
Group management charge	United Utilities PLC	Recharge of costs	13.5
Water meter supply and installation	United Utilities Networks Limited	Recharge of costs	11.2

Note - The Group management charge of £13.5 million (2005 - £17.4 million) from United Utilities PLC represents 50.6 per cent (2005 - 53.3 per cent) of the total management charge to subsidiaries. Approximately 80 per cent of the charge is allocated by activity (2004 - 80 per cent).

The Vertex charging arrangements for the Managed Services are based on agreed billing schedules with glide-path reductions in costs with annual variations based on actual activity.

Services supplied by United Utilities Water PLC to associated companies:

Nature of transaction	Company	Terms of supply	Total value of service £m
Shared services	United Utilities Electricity PLC	Recharge of costs	14.6
New connections	United Utilities Networks Limited	Recharge of costs	14.0

Note - Shared services include support, accounting and procurement services.

Turnover of associated companies based on Regulatory Accounting Guideline 5.04 commentary for the year ended 31 March 2006:

	Turnover of associated company £m
Vertex Data Science Limited	420.4
United Utilities Electricity PLC	282.2
United Utilities Networks Limited	170.3

Notes to the current cost accounts

12 Infrastructure accounting

In the preparation of the statutory accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS 15 – ‘Tangible Fixed Assets’. However for the purposes of the Regulatory Accounts, Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the statutory accounts and the historic cost balance sheet is set out below:

	2006	2005
Note	£m	£m
Cost		
Cost at 31 March per Regulatory accounts	2,759.0	2,600.5
Adjustment to opening balance	1,275.2	1,208.9
Infrastructure renewals expenditure capitalised in the year	78.2	66.3
Cost at 31 March per Statutory accounts	<u>4,112.4</u>	<u>3,875.7</u>
Depreciation		
At 31 March per Regulatory accounts	(1.1)	(1.1)
Adjustment to opening balance	1,277.7	1,230.6
Depreciation charge for Infrastructure Renewals Expenditure in Regulatory accounts	107.0	50.6
Adjustment to depreciation charge for Infrastructure Renewals Expenditure in Regulatory accounts	14 (5.0)	(3.5)
At 31 March 2006 per Statutory accounts	<u>1,378.6</u>	<u>1,276.6</u>
Net Book Value		
At 31 March 2005 per Regulatory accounts	2,760.1	2,601.6
Adjustment for Infrastructure renewals accounting	(31.3)	(6.0)
Adjustment to Statutory Infrastructure Renewals Expenditure charge	5.0	3.5
At 31 March 2006 per Statutory accounts	<u>2,733.8</u>	<u>2,599.1</u>
Provisions for liabilities and charges		
At 31 March per Regulatory Accounts (restated)	(358.9)	(222.6)
Less infrastructure renewals accrual	31.3	-
Adjustment to the Statutory infrastructure renewals accrual	(2.5)	-
Less deferred tax relating to reclassifications at 31 March 2006	(5.1)	(3.5)
At 31 March 2006 per Statutory accounts	<u>(335.2)</u>	<u>(226.1)</u>
Debtors		
At 31 March per Regulatory accounts	281.8	200.8
Adjustment to reclassify Intercompany loans from Short-term investments	40.7	40.7
At 31 March per statutory accounts	<u>322.5</u>	<u>241.5</u>

Notes to the current cost accounts

13 Prior year adjustments and adoption of new accounting standards

As a result of the adoption of FRS21 'Events after the balance sheet date' and FRS17 'Retirement Benefits' explained in note 1 (a) to the statutory accounts, the profit and loss account and balance sheet have been restated. The effect of these changes in accounting policy on the historic cost profit and loss account and balance sheet are disclosed in the table below:

Prior year adjustments	2005	FRS 17 adoption	FRS 21 adoption	Restated 2005
	Financial Statements £m			Financial Statements £m
Profit and loss account				
Operating profit	446.1	(3.6)	-	442.5
Other income	4.4	-	-	4.4
Net interest payable and similar charges	(218.0)	-	-	(218.0)
Tax credit/(charge)	(34.4)	1.1	-	(33.3)
	198.1	(2.5)	-	195.6
Dividends	(214.9)	-	2.6	(212.3)
Transfer (from)/to reserves	(16.8)	(2.5)	2.6	(16.7)
Balance sheet				
Fixed assets	6,281.5	-	-	6,281.5
Stock	2.8	-	-	2.8
Debtors	325.8	(125.0)	-	200.8
Short term investments	531.7	-	-	531.7
Creditors: amounts falling due within one year	(1,170.7)	-	137.5	(1,033.2)
Creditors: amounts falling due after more than one year	(3,387.7)	(41.2)	-	(3,428.9)
Provisions	(260.1)	37.5	-	(222.6)
Deferred income	(83.9)	-	-	(83.9)
Net assets	2,239.4	(128.7)	137.5	2,248.2
Share capital	755.3	-	-	755.3
Share premium	647.8	-	-	647.8
Profit and loss reserve	836.3	(128.7)	137.5	845.1
	2,239.4	(128.7)	137.5	2,248.2

The total impact of £128.7m on the reserves at 31 March 2005 following the adoption of FRS 17 is made up of £125.1m opening deficit net of deferred tax, £1.1m actuarial gains net of deferred tax during the year to 31 March 2005 and the profit and loss account impact of £2.5m.

Adoption of accounting standards at 1 April 2005

FRS 25 – 'Financial Instruments: Disclosure and Presentation' and FRS 26 – 'Financial Instruments: Measurement' have been applied prospectively, resulting in £130.0 million of preference shares being reclassified from equity to debt at 1 April 2005 and the fair value of debt, derivatives and deferred income being reduced by £26.8 million, deferred tax increased by £8.0 million and reserves increased by £18.8 million, at 1 April 2005.

Notes to the current cost accounts

14 Differences between historic cost regulatory accounts and statutory accounts

Profit and loss account

The regulatory accounts historic cost operating profit is £6.3m lower than the statutory accounts due to the following differences in accounting treatment:

- For the purpose of the Regulatory Accounts, £1.2m (2004/05 - £1.3m) income from rents receivable is disclosed within other income and not operating income;
- During 2005/06 £7.5 million (2004/05 - £11.5 m) of expenditure relating to aqueduct security of supply work has been capitalised in the statutory accounts based on the Company's interpretation of FRS15 and the company has used a 5 year period to calculate the infrastructure renewals charge. In the regulatory accounts aqueduct security of supply work has been classified as infrastructure renewals expenditure and a 15 year period has been used to calculate the infrastructure renewals charge, based upon the company's interpretation of RAG 2.03. This has resulted in an additional £5.1m (2004/05 - £11.5m) infrastructure renewals charge in the regulatory accounts. An adjustment of £1.5 million (2004/05 - £3.5 million) has also been made to the deferred taxation charge as a result of this treatment.

For the purpose of the regulatory accounts £0.3m (2004/05 - £3.1m) income from current asset investments is disclosed within other income and not net interest payable and similar charges.

Balance Sheet

In the preparation of the statutory accounts, the Company has followed industry practice and applied the infrastructure renewals accounting basis as set out in FRS 15 "tangible fixed assets". However, for the purpose of the regulatory accounts, Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting. The infrastructure renewals accrual of £28.8 million in 2006 (2005 - £nil) is therefore shown within provisions for liabilities and charges. An infrastructure renewals accrual of £31.3m is within fixed assets in the statutory accounts. The difference between the infrastructure renewals accrual in the statutory accounts and the regulatory accounts arises from the following differences in interpretation of infrastructure renewals accounting:

- During 2005/06 £7.5 million (2004/05 - £11.5 million) of expenditure relating to aqueduct security of supply work has been capitalised in the statutory accounts based on the Company's interpretation of FRS15. This expenditure has been classified as infrastructure renewals expenditure in the regulatory accounts based upon the company's interpretation of RAG 2.03. An adjustment of £1.6 million (2004/05 - £3.5 million) has also been made to the deferred taxation charge as a result of this treatment.
- The company has used a 5 year period to calculate the infrastructure renewals charge in the statutory accounts in contrast to a 15 year period in the regulatory accounts.

For the purposes of the regulatory accounts, loans to parent and fellow subsidiary undertakings of £40.7 million (2005 - £40.7 million) are disclosed within short term investments, not debtors. For the purposes of the regulatory accounts, deferred income is classified separately.

For the purpose of the regulatory accounts, total deferred income of £88.8m (2005 - £83.9m) is shown on the face of the balance sheet in contrast to the statutory accounts which include £4.7 million of deferred income within creditors falling due within one year (2005 - £4.3 million) and £84.1 million of deferred income within creditors falling due after more than one year (2005 - £79.6 million).

For the purposes of the regulatory accounts the pension deficit, net of deferred tax, has been included within creditors: amounts falling due after more than one year. For the purposes of the statutory accounts, the pension deficit, net of deferred tax, is shown on the face of the balance sheet.

Directors' pay and standards of performance

During the year ended 31 March 2006 remuneration has been paid by United Utilities Water PLC (UUW PLC hereafter) to the directors as a result of arrangements linking directors' remuneration to levels of performance against service standards in connection with activities subject to price regulation.

For the purposes of this disclosure the UUW PLC directors can be split into three categories:

- United Utilities North West (UUNW) directors (For the purpose of this disclosure, C Cornish, who sits on the board of UUPLC is classified in his role as a director of UUNW);
- Group directors; and
- Non-executive directors.

At the start of each financial year, a bonus scheme is implemented for all employees including directors.

Through the United Utilities North West (UUNW) bonus scheme, the UUNW directors received remuneration linked to Water service standards. As part of the scheme, their performance was assessed against the following water service measures:

- achieve the target percentage score in the customer satisfaction index (experience rating);
- achieve the target points score in Ofwat's overall performance assessment (OPA);
- achieve the quality outputs relating to treatment works, UIDs, flooding register;
- achievement of NW90 ferrous water mains outputs; and
- achieve targeted reduction in bacteriological compliance failures.

The measure relating to OPA score was not achieved and part of the bacteriological compliance measure failed its target. The other measures were achieved and eligible employees received a bonus payment on these elements.

The total payment made to directors of UUW PLC in respect of service standards in the year ended 31 March 2006 was £39,290.

For the forthcoming year, the United Utilities North West bonus scheme has been revised and continues to reflect the importance of achieving service standards. Performance will again be assessed against key measures including leakage, bacteriological compliance and OPA scores, which are routinely used by Ofwat to determine company performance.

The non-executive directors were paid no remuneration linked to water service standards. The group directors partake in a different bonus scheme as documented in the United Utilities PLC accounts and receive no bonus in respect of service standards.

Five year summary

Current cost profit and loss account for the Appointed business

For the year ended 31 March

	2006	2005 Restated	2004	2003	2002
	£m	£m	£m	£m	£m
Turnover	1,219.7	1,155.5	1,088.9	1,056.9	1,056.7
Current cost operating costs	(809.4)	(797.2)	(766.4)	(761.8)	(735.7)
Operating income	(1.4)	1.4	3.0	0.9	1.6
Working capital adjustment	3.2	8.8	4.3	3.0	0.5
	412.1	368.5	329.8	299.0	323.2
Other income	1.5	4.5	9.8	10.0	1.2
Net interest	(239.0)	(223.7)	(202.7)	(173.7)	(164.4)
Financing adjustment	87.0	102.4	76.9	82.0	34.3
Current cost profit on ordinary activities before taxation	261.6	251.7	213.8	217.3	194.3
Taxation	(108.7)	(33.7)	43.3	(58.4)	(23.9)
Current cost profit on ordinary activities after taxation	152.9	218.0	257.1	158.9	170.4
Dividends	(226.6)	(213.9)	(223.0)	(223.6)	(225.3)
Transfer (from)/to reserves	(73.7)	4.1	34.1	(64.7)	(54.9)

Note: all figures in the summary have been restated at current year prices using movements in the average RPI. The 2005 figures have been restated to reflect the adoption of FRS 17 and FRS 21. In addition, the 2006 figures reflect the adoption of FRS 25 and FRS 26. Years previous to 2005 have not been restated. The impact of the restatement is disclosed in note 13.

Current cost balance sheet for the Appointed business

At 31 March

	2006	2005 Restated	2004	2003	2002
	£m	£m	£m	£m	£m
Tangible fixed assets	41,640.8	41,545.9	39,928.7	39,391.0	38,651.6
Third party contributions since 1989/90	(262.7)	(235.9)	(222.9)	(212.8)	(200.2)
Working capital	(138.7)	(140.6)	(284.5)	(170.4)	(96.9)
Net operating assets	41,239.4	41,169.4	39,421.3	39,007.8	38,354.5
Cash & investments	783.3	544.5	337.8	535.5	259.6
Non-trade debtors	75.0	20.4	42.8	30.7	6.6
Non-trade creditors	(248.0)	(736.1)	(202.3)	(273.5)	(161.3)
Creditors due after one year	(3,997.8)	(3,528.0)	(3,246.9)	(3,053.6)	(2,618.3)
Provisions	(328.6)	(264.7)	(231.6)	(269.9)	(211.9)
Dividends payable	-	-	(142.5)	(142.5)	(143.4)
Net assets employed	37,523.3	37,205.5	35,978.6	35,834.5	35,485.8
Capital and reserves					
Called up share capital	1,025.4	773.2	797.9	710.4	724.3
Share premium account	647.8	663.1	684.3	702.1	715.9
Profit and loss account	(260.4)	(309.0)	(271.1)	(313.1)	(253.4)
Current cost reserve	36,110.5	36,078.2	34,767.5	34,735.1	34,299.0
Total capital and reserves	37,523.3	37,205.5	35,978.6	35,834.5	35,485.8

Note: All figures in the summary have been restated at current year prices using movements in the year end RPI. The 2005 figures have been restated to reflect the adoption of FRS 17 and FRS 21. Years previous to 2005 have not been restated. The impact of the restatement is disclosed in note 13.

Regulatory accounts commentary

This review should be read in conjunction with the Chairman's statement, the Operating and Financial Review and the directors' report attached to the statutory financial statements.

Movements from prior year and five year trends

Turnover and operating costs

The factors outlined in the Operating and Financial review contribute to the movements in turnover and operating costs from the prior year.

Over the five year period turnover has been impacted by two price reviews and an interim determination. The AMP3 determination reduced income in 2002, and then increased it over the next three years.

The 2003 interim determination increased turnover by a further 4.5% and the AMP4 determination included an initial increase of 5.6%.

Measured sales, including large user revenues now represent 43 per cent of total sales, compared with 39 per cent in 2001/02 as new properties are always connected with a measured supply. The switch from unmeasured to measured methods of billing has also led to small decreases in per capita consumption.

Operating costs over the period have increased due to the increasing quality and environmental requirements placed upon the business, increasing materials and power costs and increased depreciation charges as a result of the extensive capital programme.

Net interest

Due to increased cash requirements caused by the Company's capital expenditure programme, borrowing has increased over the last five years offset by increases in share capital in 2004/05 and 2005/06. As a direct consequence net borrowing costs have risen over the period.

Financing adjustment

The increase in the financing adjustment over the five year period is a result of the uplift in the RPI figure and increased borrowing to fund the capital programme. Note 1 c(ii) on page 50 contains further explanation on this adjustment.

Taxation

The factors outlined in the Operating and Financial Review contributes to the movements in taxation during the current year. With the exception of 2003/04, the tax charge over the period has remained relatively consistent. The credit in 2003/04 was principally due to the impact of increased UK government bond rates on the discount of the full potential liability.

Dividends

The basis of the dividend is outlined on page 57 under the heading "Dividends paid to associated undertakings".

Tangible fixed assets

Tangible assets increased each year as a result of the continued investment as part of the asset management programme together with the RPI adjustment to restate the asset values in real terms, offset by the depreciation in the year. During 2004/05, adjustments were made to the current cost asset base following the 2004 Periodic Review in line with Ofwat instructions.

Third party contributions

Movements over the five year period in third party contributions are broadly in line with the increase in tangible fixed assets.

Working capital

Movements in working capital for the period are outlined in note 9 on page 56. Short-term capital creditors over the period reflect the profiling of the capital programme over the AMP periods. The infrastructure renewals accrual reflects the programme and the movement to a nil balance in 2004/05. Accrued income has been reclassified from trade payments in advance to prepayments and accrued income in the period. The overall increase in the five year period is mainly due to an increase in capital accruals in line with the increase in capital investment.

Cash and investments

The increase over the five year period is as a result of prefunding our capital expenditure needs. Long-term debt is raised when the market opportunity presents itself. The sums raised are placed in short-term investments until required by the business.

Non-trade debtors

The increase in non-trade debtors in the year is mainly due recognition of derivatives following the adoption of FRS 26.

Non-trade creditors

The increase in the period reflects the new borrowing as a result of the agreed asset management plan offset by a reclassification of debt less than one year as discussed above.

Creditors due after one year

The increased level of creditors since 2002 predominantly reflects the long-term debt raised to fund the capital investment programme, and the subsequent prefunding as detailed above.

Current Cost Reserve

The increase over the period mainly reflects the RPI and AMP adjustment to tangible fixed assets (see note 10).

Called up share capital

The increase in the current year is described in note 21. The increase in 2004 was due to the issue of 100 million £1 nominal shares at par value.

Provisions

The increase in provisions from 2001/02 mainly reflects the implementation of FRS 19 'Deferred taxation'. The increase in the period mainly reflects capital allowances in excess of depreciation and the creation of a restructuring provision in 2004/05.

Significant movements in the Infrastructure Renewals Charge and Current Cost Depreciation

Infrastructure Renewals Charge

The infrastructure renewals charge (IRC) is made to the profit and loss account to represent the maintenance asset value during the year. The calculation of the regulatory IRC is based on infrastructure renewals income and expenditure (IRE) over a 15 year period to March 2020. The data for this calculation has been derived from the U UW business plan to 31 March 2010 together with information from the Final Business Plan submitted to Ofwat in May 2004. The data from the Final Business Plan submission has been adjusted for an efficiency factor based on the Final Determination relating to the Large Diameter Trunk Main cleaning programme and sewer flooding. The IRE in 2005/06 totals £48.8m and £29.4m for the Water and Wastewater Services respectively. During the period the IRC for these two services totalled £53.0m and £53.9m giving accruals of £4.3m and £24.5m respectively. It is intended that all expenditure will be charged to the profit and loss account over the 15 year period and that the accrual will be wound through to zero by March 2020.

The 15 year period is used as RAG1.03 requires that the infrastructure renewals accounting policy should be based on an operational assessment of activity over a 'reasonably long period'.

The IRC in 2004/05 was based on the company's interpretation of FRS15 renewals accounting, whereby expenditure was charged to the profit and loss account over the AMP3 period. The increase in the IRC in 2005/06 reflects this change in methodology together with an increase in the level of expenditure.

Current cost depreciation

Current cost depreciation has reduced from £296.1 million to £280.5 million. This reduction is primarily due to £21.6 million higher level of accelerations in 2004/05 and £31.8 million impact of out of life assets, offset by £31 million of depreciation relating to assets commissioned in the year and £6.8 million impact of inflation.

Atypical amounts

Atypical operating costs in the year totalled £6.0 million principally relating to increased legal costs and IT contract tender costs.

Changes in the treatment of expenditure

There have been no material changes in the treatment of expenditure in 2005/06 except for the adoption of new accounting standards as described in note 13.

Basis of allocation of expenditure

The revenues, costs, assets and liabilities are directly allocated to the appointed business and any other activity or associated company, except where they relate to common support services. Those relating to common support services are apportioned on the basis of the demands made on each of these support services by each principal service or activity. Note 1(d) on page 50 also outlines the cost allocation policy to principal services.

Donations to charitable trusts assisting customers or similar funds,

United Utilities Water has made donations of £3.0m to United Utilities independent charitable trust. U UW intend donating a further £12m – £13m over the next four years.