2366678

United Utilities Water Limited

Report and Financial Statements

31 March 2015

Contents

Strategic report

Directors, advisers and other information

Non-executive directors
Dr John McAdam
Dr Catherine Bell
Stephen Carter
Mark Clare
Brian May
Sara Weller

Executive directors
Steve Mogford
Steve Fraser
Russ Houlden

Secretary
Simon Gardiner

Auditor
KPMG LLP
1 St Peter's Square
Manchester
M2 3AE

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

Developments in the year:
United Utilities Water Limited (formerly United Utilities Water PLC) adopted IFRS during the year and as part of this exercise it re-registered as a private limited company, undertook a reduction of share capital and created a new financing subsidiary resulting in it preparing consolidated financial statements for the first time (see page 58 for further information).

Terms used in this report:
United Utilities Water Limited's ultimate parent company is United Utilities Group PLC. 'UUG' means United Utilities Group PLC and 'United Utilities' or 'the UUG group' means United Utilities Group PLC and its subsidiary undertakings. The 'group' means United Utilities Water Limited and its subsidiary undertakings. The 'company' or 'UUW' means United Utilities Water Limited. The 'regulated business' or 'regulated activities', means the licensed water and wastewater activities undertaken by United Utilities Water Limited in the North West of England.

Cautionary statement:
This report contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this report and the group undertakes no obligation to update these forward-looking statements. Nothing in this report should be construed as a profit forecast.

Strategic report

Chairman's and Chief Executive Officer's statement

Performance

The last 12 month period was the fifth and final year of the 2010–15 regulatory period. Our objective over this period was to deliver improved and sustainable underlying performance for the benefit of customers, the environment and shareholders. We are pleased to report that we achieved this.

Customers

Customer satisfaction remains a priority and we were the most improved water company over the 2010–15 regulatory period. Our improvements have helped reduce further the number of customers who need to contact us about the service they receive by around 75 per cent over the five-year period. We continually review the causes of customer dissatisfaction and revise our training, policies, processes and systems to drive improvement. We were pleased that our improved customer satisfaction performance over the period took us out of Ofwat's service incentive mechanism (SIM) penalty zone, thereby also benefiting shareholders.

Ofwat will change the process it uses to assess customer satisfaction during the next five-year regulatory period. This new SIM measure has been piloted over the last 12 months and has helped us identify that, while customer satisfaction with our services is continually improving, we could do better in keeping customers informed whilst we are resolving their issue. This will be a key area of focus for us in continuing to deliver improving satisfaction.

Modern customer relationship management (CRM) systems can offer a much improved customer experience as well as efficiencies in customer-facing operations. We were pleased to receive Ofwat's support for our plan to invest in a new CRM system in the 2015–20 period and we are already in the detailed design phase before implementation.

Our assets

The reliable and efficient operation of our assets is critical to both customer service and our environmental performance.

Targeted investment in our assets, processes and the people who operate them has supported an improvement in our environmental performance as measured by the Environment Agency (EA), positioning us again as one of the best performers in our sector.

Performance against indices used by the Drinking Water Inspectorate (DWI) to measure water quality has also improved and we achieved our best ever performance over the last year.

Asset serviceability was assessed as stable or improving over the last 12 months, representing a significant and sustained improvement since the start of the 2010–15 regulatory period. We were delighted to outperform our leakage target for the year – the ninth successive year in which we have met or beaten our target.

Strategic report

The improvements made early in the 2010–15 regulatory period to our project and risk management processes have supported the successful delivery of our capital programme. We invested a substantial £3.8 billion in the renewal and upgrade of our assets across the last five years, with over £850 million invested over the last 12 months. We measure the effectiveness of our investment using our Time, Cost and Quality index for which we scored 97 per cent this year – ahead of our targets and consistent with the good performance of the previous year. We have already invested around £40 million to accelerate project delivery relating to schemes due to be delivered early in the 2015–20 period and to secure associated benefits.

A difficult economic environment

Although unemployment in the North West has reduced over the last 12 months, our region has the highest proportion of disadvantaged households in England and therefore customer indebtedness continues to be a significant challenge for us.

Our collections team continues to work hard to contain bad debt levels. During the year we implemented data sharing with the credit reference agency 'Experian' and this is helping to identify those customers who could pay their bill but choose not to. For those struggling to pay, we continue to offer a wide range of ways to help them back into regular payment. This includes an independently administered trust fund for which we increased our annual contribution using a cash tax refund from HMRC. We also gained customer support to launch a social tariff for those customers who receive Pension Credit.

Business retail

The Water Act 2014 confirmed plans to open the English business retail market for water and wastewater services in 2017. Our experience of the Scottish business retail market is invaluable ahead of the English market opening and work is in hand to prepare our business retail and wholesale teams to address this development. We are actively engaged in the creation of a market operating company that will govern and facilitate the switching of their retailer by business customers.

Strategy

Our Strategic Direction Statement, 'Playing our part to support the North West' reflects extensive consultation with customers and other stakeholders to create our best view of what the next 25 years holds for our region. This includes economic, social and environmental developments such as the predicted impact of climate change.

Our recently updated Water Resources Management Plan, which describes the projected pattern of water resource activity in our region until 2040, was approved by the Secretary of State in February 2015. This plan projects that the majority of the North West will be in surplus, benefiting from an integrated network that supports movement of water around the region to accommodate its changing supply and demand balance. Our plan includes a new Thirlmere pipeline to extend our integrated network to encompass West Cumbria. This will reduce abstraction from Ennerdale, thus protecting sensitive ecology, and improve security of supply for customers.

As a lone agent, United Utilities could not deliver the scale of required environmental improvement at an acceptable level of cost. Instead we are committed to partnering with others who can support the achievement of our required outcomes – such as our 'Turning tides' partnership with the EA, local authorities, the Marine Conservation Society and other interested parties to improve bathing waters in the North West.

Strategic report

Price Review

The 2015–20 Price Review represented a significant departure from previous reviews and proved to be a demanding period for both companies and regulators. Building on some of the changes introduced in the Water Act 2014, the Price Review introduced:

- significantly enhanced customer consultation on the content and pricing of companies' business plans;
- a new pricing structure involving four price caps: business retail, domestic retail, wholesale water and wholesale wastewater;
- new outcome delivery incentives (ODIs) providing penalties or rewards for company performance in aspects of its performance identified by customers as a priority;
- a new SIM measure providing continuing focus on customer satisfaction; and
- preparation for full opening of the retail market for business customers.

In formulating our 2015–20 business plan, we sought the views of over 27,000 customers, as well as the views of our regulators and other stakeholders, to shape a plan that strikes the right balance for all our stakeholders. We worked closely with our regulators over the last year and our final plan re-submission in October 2014 took account of Ofwat's upper-quartile efficiency targets across many aspects of our operations. Ofwat's final determination in December represented a further efficiency challenge of £188 million, in the context of a wholesale total expenditure (totex) allowance of £5.3 billion. Whilst challenging to deliver, the final determination has not required us to revisit the key components of our business plan.

In the final analysis, the board considered Ofwat's proposal tough but, on balance, acceptable and confirmed its acceptance in January 2015.

Robust capital structure

To support the retention of a robust capital structure, we aim to maintain efficient access to debt capital markets throughout the economic cycle. The board believes that it is appropriate to keep gearing, measured as net debt to regulatory capital value, within our existing target range of 55 to 65 per cent. We also aim to maintain, as a minimum, our existing credit ratings of A3 with Moody's and BBB+ with Standard & Poor's for United Utilities Water Limited.

2015–20 performance

We are focused on continuous improvement and our new operating model for our wholesale business is employing technology and new work processes to deliver enhanced customer satisfaction and operational efficiency.

Measurement of our progress across the next five years will use a mix of existing and new measures, which reflect the revised structure and features of this price control. This forthcoming period will see a greater emphasis on operational excellence as a means of earning financial rewards.

We expect that our environmental and water quality regulators, the EA and the DWI respectively, will continue to use a basket of established measures to assess our performance. New for the next period is a revised SIM measure and a series of ODIs, to which are attached penalties and rewards. We will also focus more on total expenditure, rather than on the individual measures of opex and capex, in line with Ofwat's move to this way of assessing costs.

We have refined our key performance indicators (KPIs) for the 2015–20 period, which will recognise the tougher operational and financial targets inherent in the final determination settlement. We do not intend to set targets for the 2015–20 period until we have more experience of operating under the new arrangements. However, more detail of these KPIs is provided within this report on pages 38 to 39 and we intend to publish our performance annually.

Strategic report

Responsible business

Our aim is to operate in an environmentally sustainable, economically beneficial and socially responsible manner. In recognition of this focus, we retained our 'World Class' rating as measured by the Dow Jones Sustainability Index, achieving industry leading status in the multi-utility/water sector in the most recent assessment.

We are delighted to have led a North West pilot for the Energy and Efficiency Industrial Partnership, backed by UK Skills, in which we leveraged our investment in a new apprentice skills training facility in Bolton to help young people find employment. The programme involves skills training, interview technique and work experience and early trials have shown an over 60 per cent success rate in finding full-time employment for participants. Following the success of the pilot, the programme is now being rolled out across the UK.

Our employees

None of our progress over the last 12 months would have been achieved without the enthusiasm and commitment of the people who work for United Utilities – both our employees and those working for our sub-contracting partners that represent us in the field. We would like to thank them for their dedication and hard work in supporting customers and the environment every day of the year.

We work hard to sustain high levels of engagement by our employees. The group has seen significant change over the last four years and our plans will engage our teams for further improvements. Employee engagement is 79 per cent, well above the UK transitional norm and just below the norm for high performing UK companies.

Health and safety remains a key focus area. This year we placed greater emphasis on the 'health' component with investment in a new gym at our main office, along with measures to assist our employees in assessing their health and in securing faster access to treatment should it be necessary.

Our board

We strive to operate in a manner that reflects the highest standards of corporate governance. Our company structure and governance standards are designed to ensure that our board continues to provide sound and prudent governance in compliance with the principles of the UK Corporate Governance Code.

We are pleased to welcome Lord Stephen Carter to the board following his appointment in September 2014 as an independent non-executive director. Stephen is Chief Executive at Informa plc and his operational expertise and previous public services roles will be an asset to the board.

Outlook

We are encouraged by our operational and customer service performance improvements and believe we can improve further. Substantial investment in our assets will continue, delivering additional benefits for our customers and the environment. We have made significant and sustained performance improvements over the last five years and, combined with our 'systems thinking' approach to operating the business, this provides a solid foundation for the future.

Dr John McAdam
Chairman

Steve Mogford
Chief Executive Officer

Strategic report

Our vision and strategy

Achieving our vision

Our vision is to become a leading North West service provider and one of the best UK water and wastewater companies. We will deliver this by providing the best service to customers at the lowest sustainable cost and in a responsible manner.

Our 25-year strategy

In order to maintain a reliable, high quality water service for our customers in the future, we have to look a long way ahead and anticipate those changes and core issues that are likely to impact on our activities. Our long-term strategy helps us to define what we need to deliver over the shorter term.

The water industry makes a wide ranging contribution to society, from the health of people and the environment to the strength of the economy.

In the next 25 years, we will face many challenges and opportunities including:

- climate change and its implications for water resources and flooding;
- the emergence of a more open, competitive UK water market;
- more rigorous environmental regulations; and
- the ever-present need to combine affordable bills with a modern, responsive water and wastewater service.

By anticipating these changes and balancing them with our customers' priorities, we can meet the future with confidence.

How we will achieve our 25-year strategy

Our Strategic Direction Statement, 'Playing our part to support the North West' (which can be downloaded at corporate.unitedutilities.com/future), sets out our long-term strategy for the next quarter century.

It examines the challenges ahead and explains how we will focus our resources and talents in order to meet them. We consulted with thousands of customers and stakeholders to ensure their expectations are reflected in our plans.

Their feedback helped create our five customer promises which, together with the 11 outcomes (shown on page 9), will guide the way we deliver our services, now and long into the future.

Our customer promises

- Provide great water
- Dispose of wastewater
- Give customers value for money
- Deliver a service customers can rely on
- Protect and enhance the environment

Strategic report

These customer promises are reflected in our business plan for the next five years, which focuses on providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

Our approach to doing business

Our long-term strategy is underpinned by our responsible approach to doing business, which is explained on pages 15 and 16.

Strategic delivery

Our five-year plan for 2010–15 was focused on improving customer satisfaction, meeting our statutory obligations and delivering shareholder value. This plan was designed to build a platform to enable us to effectively deliver our long-term strategy.

A summary of our key achievements across 2010–15 is shown on pages 22 and 23.

As we begin the next five-year period to 2020 we are looking to build on our recent achievements, retaining our focus on delivering high levels of service to customers at the lowest sustainable cost, all whilst acting responsibly. This is designed to help us achieve our vision of becoming a leading North West service provider and one of the best UK water and wastewater companies.

Our focus on delivering for our customers includes striving to be a leading company in the areas our regulator benchmarks for the industry, such as on customer satisfaction (SIM). We also assess our performance against other leading organisations in the North West through an independent brand tracker survey.

As detailed in the economic regulation section on pages 18 to 20, the regulatory environment has evolved for the 2015–20 period, and our key performance indicators are also evolving to reflect this. With the move to a more outcomes based approach, the new outcome delivery incentives (ODIs) are key metrics to assess performance across a wide range of operational measures. In the now separated business retail price control, with the expansion of competition, measuring the impact of customer gains and losses is an important metric.

Metrics for assessing lowest sustainable costs include our outperformance against the new totex model (replacing separate opex and capex models for 2010–15) and financing levels set by Ofwat. With the retail household price control now being separated, we are also introducing a new KPI to measure our costs in this area.

The degree to which our actions are viewed as responsible is taken from performance measures set by the industry regulator, the Environment Agency and those which measure global best practice, as defined by the Dow Jones Sustainability Index.

Our KPI performance for 2010–15 is shown on pages 23 to 25 and further details on our 2015–20 KPIs are shown on pages 38 to 39.

In addition, executive bonuses and long-term incentives are intrinsically linked to our financial and operational performance and further details are provided on pages 84 to103 of the UUG accounts.

Strategic report

Our strategy
To deliver value by providing:

The best service to customers: Delivering excellent services to our customers by anticipating and responding to their needs.

Customer promises: deliver a service customers can rely on, provide great water, dispose of wastewater

Customer outcomes:
- Customer are highly satisfied with our service and find it easy to do business with us
- Drinking water is safe and clean
- Customers have a reliable supply of water now and into the future
- Wastewater is removed and treated without customers ever noticing
- The risk of sewer flooding for homes and businesses is reduced

At the lowest sustainable cost: Providing services as efficiently as possible on a cost basis that can be sustained over the long-term

Customer promise: give value for money

Customer outcomes:
- Customer bills are fair
- We support those customers who are struggling to pay
- The North West's economy is supported by our activities and investment

In a responsible manner: Managing responsibly our interaction with the environment, the communities where we operate and our employees

Customer promise: protect and enhance the environment

Customer outcomes:
- The natural environment is protected and improved in the way we deliver our services
- The North West's bathing and shellfish waters are cleaner through our work
- Our services and assets are fit for a changing climate

How we create value

Today we benefit from the strategic decisions and work delivered by our predecessors over the last 150 years to provide the North West with good quality water and to reduce the environmental impact of the wastewater we treat.

The work we do today will help to ensure customers of the North West continue to enjoy an effective, efficient service for many generations to come.

We create value for our stakeholders principally by agreeing and then delivering, or outperforming, our regulatory contract. The way we use our key resources and interact with our ever-evolving external environment, influenced by our long-term strategic approach, helps to achieve value creation. This also facilitates the delivery of our five customer outcomes alongside ensuring investors receive an appropriate return

Strategic report

External environment

Economic

Changes in the economy, such as inflation, interest rates, or unemployment levels, can influence our ability to create value. Whilst outside of our direct control, we can mitigate some of the potential adverse impact associated with market movements, such as on inflation and interest rates, through our hedging strategies. More details about the economic environment are described on page 21.

Technological

Advances in technology can be used to help deliver improvements in the quality or cost of our service. Embracing innovation, using modern technology or techniques, is at the heart of how we do business. For example, our Davyhulme sludge recycling centre which employed a ground-breaking configuration of thermal hydrolysis to maximise energy generation from sludge, won an Annual Institute of Chemical Engineers award for innovation in 2013/14. We also have to be mindful of our customers' ever increasing use of technology and we have been improving our website and using text messages and social media to expand communication options with customers. More information on how we are embracing innovation is shown within our 2014/15 performance on pages 26 to 35.

Political and regulatory

Over a long time-frame the political and regulatory environment can change significantly. In the 26 years since the water industry was privatised by the UK government, we have seen substantial tightening of laws and regulations. Whilst to some extent, changes to the regulatory environment are outside of our direct control, maintaining a good reputation is important to enable positive participation in regulatory discussions. By positively engaging and using our industry knowledge, we can help influence future policy with the aim of achieving the best outcome for our customers, shareholders and other stakeholders.

Social

We see some significant societal trends that we plan to address in our long-term strategy. The North West remains the most socially and economically deprived region in England and so we can anticipate continued hardship for a number of communities and difficulties for some customers in paying their bills. We will remain committed to supporting these customers through a suite of payment assistance schemes and looking at new ways to help, like the introduction of our social tariff in 2015. We anticipate an increase in the North West population of around 600,000 by 2040 (more than the population of a large city such as Liverpool). We are planning to ensure our services and supporting infrastructure meet the needs of this growing population, which will include a higher proportion of older people.

Natural

Planning far into the future ensures that we are prepared for the changing natural environment, most notably the effects of climate change. We have a responsibility to return water to the environment safely and we are focused on reducing pollution incidents, caused by spills from our network. We can make an important contribution to protecting and enhancing the natural environment by using fewer natural resources and we are reducing our carbon footprint as well

Strategic report

as increasing renewable energy production. More detail across each of these areas is provided within 'Our natural environment' section on pages 17 and 18.

Key resources

People

Our employees play a critical role in increasing long-term value generation. Fundamental to the decisions we take and operational performance we deliver is a skilled, engaged and motivated team. We place a strong emphasis on providing comprehensive training and development opportunities. Our latest engagement score is reported in 'Our performance 2014/15' on page 29. Management has a range of incentives which focus on performance over a number of years, rather than just the current year, to encourage the delivery of benefits over the longer term.

Our suppliers and contractors provide us with essential services which we rely on to deliver our strategy. It is vital that we work closely with them, for example on large capital projects where the delivery of projects on time, to budget and with minimal customer impact has economic, societal and environmental benefits. Close collaboration is important to help support the delivery of these benefits and, for example, our suppliers contributed significantly towards our c£7 billion estimated contribution to the regional economy over the 2010–15 period. 'Our responsible approach to doing business' on pages 15 to 16 outlines the standards we expect of our suppliers.

Financing

We aim to maintain a robust and responsible capital structure, balancing both equity and debt to achieve a strong investment grade credit rating. Our proactive equity and credit investor programmes allow us to engage effectively with investors. Issuing new debt is particularly important as our capital investment is largely financed through a mix of debt and cash generated from our operations. We maintain access to a broad range of sources of finance in a number of markets across which best relative value is sought when issuing new debt. The European Investment Bank is our largest lender with c£1.9 billion of debt and undrawn facilities.

Locking in long-term debt at good relative value can help keep our finance costs low and enables us potentially to outperform the industry-allowed cost of debt. Sustained low-cost finance across the industry benefits customer bills. The average life of our term debt is over 20 years. Our prudent financial risk management policies covering credit, liquidity, interest rate, inflation and currency risk help reduce the group's exposure to the economic and regulatory environment.

Assets

Our fixed assets (including all our reservoirs, treatment works and pipes) have a replacement cost of around £80 billion which is the estimated amount it would cost for another company to build similar assets and networks. However, it is not the replacement cost of our assets upon which we are allowed to earn a return, through our revenues. We earn a return on our regulatory capital value (RCV), a regulatory measure of our capital base, which is currently just over £10 billion, so it is this asset value which is more important economically.

Many of our assets are long-term in nature – for example, our impounding reservoirs have a useful economic life of around 200 years. By carefully reviewing our potential capital projects, considering the most efficient long-term solutions, we can save future operating costs, also

Strategic report

helping to reduce future customer bills. Embracing innovation in our asset configuration and work processes can help to make our future service better, faster or cheaper.

Since privatisation in 1989, total capital investment of over £14 billion has provided substantial benefits to our customers and our region's environment as well as contributing to the North West economy through job creation, both within our group and in our supply chain. Disciplined investment, along with RPI inflation, also grows our RCV, increasing future revenues.

We need to continue with a substantial investment programme for the foreseeable future in order to meet ever more stringent environmental standards and to maintain and improve the current standards of our assets and services.

However, in deciding on our investment strategy, we have to be mindful of the impact on our customers' bills, and this is why, for example, we are spreading some of the environmental spend required by European legislation over the next 15 years.

Natural resources

Whilst rainfall in the North West of England is greater than other parts of the country, and thus supply is not as constrained, it is still in everyone's interest to make the most of this precious resource. We have encouraged customers to use water more efficiently and have increased the number of households fitted with meters. We also have a regulatory annual leakage target which we aim to meet each year.

We own over 55,000 hectares of land around our reservoirs. Through our sustainable catchment management programme (SCAMP), we can effectively manage these catchments to protect and enhance water quality and to provide other benefits such as an improved natural environment. Over the past five years we have invested £12 million through this programme. Our new Catchment Wise project is looking at working with others to improve the lakes, rivers and coastal waters where we return wastewater.

As well as water and our catchment land, another key resource is waste. Sludge from wastewater can be processed to generate renewable energy, helping to save power costs and protect the environment. Our advanced digestion facility at Davyhulme is one of the largest works of its type in the world. We also recycle waste by supplying treated biosolids to agriculture, which provides a valuable resource to farmers.

Shorter term (up to five years)

Ofwat, our economic regulator, determines the prices we can charge our customers to provide them with water and wastewater services.

Ofwat sets our regulatory contract following the receipt of our five-year plan proposals (see 'Regulatory environment' section on pages 18 to 19 for further details).

By submitting a robust, balanced plan, we can help ensure we receive a regulatory contract that allows for the best overall outcome for our customers, shareholders and the environment.

Once each five-year regulatory contract is set, we create value principally by delivering or outperforming it by providing the best service to customers, at the lowest sustainable cost and in a responsible manner. Investing in our people to ensure a committed, capable and motivated workforce is a major contributor to delivering high performance. Some of the key ways we create value over this shorter time frame are by:

Strategic report

- improving customer service – which will improve efficiency, reduce costs and reduce potential penalties/increase rewards from Ofwat, under its service incentive mechanism (SIM);

- enhancing our debt collection activities – which will reduce our retail costs. Alongside this, we continue to provide comprehensive support for customers struggling to pay;

- raising low-cost finance – which helps us outperform the finance costs allowed in our regulatory contract;

- implementing our hedging strategies, such as fixing medium-term interest rates and power costs, to reduce the volatility of these costs, helping us meet our regulatory contract;

- minimising total costs on a sustainable basis, such as on power, materials and property rates – which helps us meet or outperform totex costs allowed in our regulatory contract;

- delivering our operational and regulatory commitments – which helps ensure we achieve high levels of customer service and meet environmental standards. Our performance can also result in potential financial rewards or penalties such as those linked to our outcome delivery incentives (ODIs), which include reliably delivered high-quality water and reducing pollution and sewer flooding incidents;

- meeting our regulatory leakage target – which provides water resource and customer supply benefits and avoids any unfunded expenditure requirements from our regulators; and

- increasing our production of renewable energy from waste – which helps protect us from rising energy costs and reduces our carbon footprint.

Over the 2010–15 regulatory period, outperformance was generated mainly through efficiency savings on operating costs, capital expenditure and financing costs. Ofwat's SIM assessment also rewarded companies who performed well on customer service, or penalised companies who performed badly, relative to other water companies.

Our KPIs over this period, including for 2014/15, were reflective of these potential areas for outperformance, and how we performed is described within 'Our performance 2014/15' section on pages 25 to 35. 'Key achievements 2010-15' on pages 22 to 23 also outlines our progress over the last five years, particularly in the important area of customer service.

Ofwat has evolved the regulatory framework so that, over the 2015–20 period, the way we can add value has changed. Operating costs and capital investment are no longer separately assessed as they are now combined into a new 'Totex' methodology. There will be additional rewards or penalties based on performance as measured through a range of ODIs. Ofwat is continuing with its SIM assessment for household customers with a similar incentive and penalty framework. Companies are still incentivised to outperform in the area of financing costs. The progressive opening up of the retail market for business customers will also encourage companies to improve service. We will continue to improve our service to help us win more out of area customers and, importantly, to retain our existing customers.

Our KPIs for 2015–20 have evolved to reflect the changes in the regulatory framework and further details of these are shown on pages 38 to 39.

Strategic report

Our responsible approach to doing business

We are committed to delivering our services in a responsible way and our approach to responsible business practice is outlined in our Business Principles document available on our website at corporate.unitedutilities.com/united-utilities-business-principles. Some of the key components of our approach are set out in more detail below:

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

Environment: Whether it's treating and delivering drinking water for our customers, or returning treated wastewater to rivers and the sea, we're acutely aware of our responsibility to the environment. We continue to invest to protect and, where appropriate, enhance the natural environment of the North West. We continue to consider the impacts of climate change on the services we deliver and adapt accordingly. Our greenhouse gas disclosures can be found on pages 104 to 105 of the 2015 UUG annual report and financial statements.

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

Employees: Health and safety is paramount and we strongly focus on our performance in this area. High employee engagement is a key contributor to our performance and we place significant emphasis on maintaining and strengthening levels of engagement. Our policies on maternity, paternity, adoption, personal and special leave go beyond the minimum required by law.

For disabled applicants and existing employees, we are committed to fulfilling our obligations in accordance with the relevant legislation. Applicants with disabilities are given equal consideration in the application process. Disabled colleagues have equipment and working practices modified for them as far as possible and wherever it is safe and practical to do so. We value diversity, providing equality of opportunity and recruiting and promoting on merit.

Delivering good value: We are committed to honouring our responsibility to our shareholders, credit investors and those who provide us with goods and services. How we create value for our stakeholders is set out on pages 9 to 14. We work with suppliers whose business principles, conduct, and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, supporting us in the delivery of wider social, economic and environmental benefits.

Running our business with integrity

We have procedures and policies in place to ensure we act in accordance with the Universal Declaration of Human Rights.

Given the long life of our infrastructure, we take a long-term view of our operations and key to the group's strategic objectives is the goal to operate in a more sustainable manner. Sustainability is fundamental to the manner in which we undertake our business and the group has, for many years, included corporate responsibility (CR) factors as a strategic consideration

Strategic report

in its decision making. Our UUG board-level CR committee (see pages 82 and 83 of the 2015 UUG annual report and financial statements) develops and oversees our CR strategy and this continuing focus helped the group retain our Dow Jones Sustainability Index 'World Class' rating.

A UUG breakdown of male: female directors, senior managers and staff can be found in the table below:

	Male	Female
	2015	**2015**
UUG group board	6 (75%)	2 (25%)
Senior managers		
- Executive team*	4 (57%)	3 (43%)
- Other senior managers	39 (80%)	10 (20%)
Wider employees	3428 (63%)	1986 (37%)

*Figures exclude CEO and CFO who are included in UUG group board figures

We also have 15 (79 per cent) male and 4 (21 per cent) female employees who are appointed as statutory directors of subsidiary group companies but who do not fulfil the Companies Act 2006 definition of 'senior managers'.

Our operating environment

Our industry and market

Every day, over 50 million household and business consumers in England and Wales receive water and wastewater services. These are served by 10 licensed companies which provide both water and wastewater services.

Additionally, there are licensed companies which provide water-only services and tend to be smaller in size. As each company in the water sector operates as a regional monopoly for its services, they are subject to regulation in terms of both price and performance.

The privatisation of the industry over two decades ago has been widely perceived as a success, making a significant contribution to public health. It has led to improvements in the quality of services provided to customers, higher environmental standards and superior quality drinking water at lower estimated costs to customers than if the water sector was still owned by the UK Government. The water industry currently invests around £80 million a week in maintaining and improving assets and services.

Our customers

United Utilities Water Limited holds licences to provide water and wastewater services to a population of approximately seven million people in the North West of England. We provide services to approximately three million households in our region and this generates around two-thirds of our total revenues. We also serve approximately 200,000 businesses, ranging in size from large manufacturing companies to small shops. Our focus over recent years has been on improving customer satisfaction.

For our business customers we have been extending the range of value-added services we offer, including our on-site engineering solutions and water efficiency advice.

Strategic report

Our households pay just over £1 per day on average for the combined water and wastewater services we provide. Our price determination for 2015–20 means customers will benefit from below inflation increases to average household bills for the decade to 2020. Our objective is to continue to provide our customers with high quality drinking water to meet all their daily needs and environmentally responsible wastewater collection and treatment at a price that represents good value for money.

We are continuing to invest heavily for our customers. During the five-year period to 2015, we delivered a capital investment programme of around £3.8 billion as we continued to improve our asset base, delivering further benefits for customers. Capital investment will continue at high levels in the 2015–20 period and is expected to remain high beyond 2020 as we continue to:

- upgrade our region's water and wastewater networks;
- maintain our ageing assets;
- deliver a cleaner environment;
- provide high quality water to our customers; and
- improve our customers' experience.

We have a strong focus on effective delivery of our capital programme, a key driver of value, for all of our stakeholders.

Our natural environment

We plan far into the future to ensure we are prepared for the changing natural environment, most notably the effects of climate change. With severe dry periods becoming increasingly common, we must ensure we continue to have resilient water resources and an infrastructure capable of moving water efficiently around the region. The potential effect of climate change on our future water resources is included in our 25-year Water Resource Management Plan. We must seek to tackle flooding incidents caused by the intensive bursts of rainfall, which are becoming more frequent due to changing weather patterns, and ensure we are able to meet increased demand on our sewerage network as the regional population is expected to increase. A phased, long-term approach ensures that the necessary work can be delivered whilst not placing too much pressure on customer bills.

We have a responsibility to return water to the environment safely. Spills from our network can lead to pollution which can damage the natural environment and could lead to loss of reputation and financial penalties, depending on their severity. Our number of serious pollution incidents has decreased over recent years and it is an important area of focus within our 25-year Strategic Direction Statement. The Environment Agency assesses water companies' performance across a basket of measures including pollution and its overall assessment is included as one of our KPIs (see page 25) with all of the pollution sub-measures also reported within our Corporate Responsibility pages on our website.

We can make an important contribution to protecting and enhancing the natural environment by using fewer natural resources. We have been driving down our carbon footprint over the last decade and have plans to halve emissions by 2035, from a 2005/06 starting position. Our greenhouse gas disclosures can be found on pages 104 to 105 of the 2015 UUG annual report and financial statements. Less than 10 per cent of our waste goes to landfill and our use of recycled products is increasing. We are increasing our renewal energy production with plans to

Strategic report

further increase this over the longer term. This will provide environmental benefits and add value to shareholders through energy cost savings.

Our regulatory environment

Economic regulation

The water industry currently operates within five-year planning cycles known as Asset Management Plan (AMP) periods. Prior to the start of each five-year period, companies submit their business plans which include their projected expenditure in order to enhance and maintain their assets. Following review of these plans, Ofwat sets the prices each company can charge their customers across the period. We have just finished the 2010–15 (AMP5) period and price controls for the 2015–20 (AMP6) period were set in December 2014, when Ofwat published their final determinations.

Ofwat assesses companies' operational performance across a wide range of measures, including some of our key performance indicators (KPIs) such as service incentive mechanism (SIM), leakage and, from April 2015, outcome delivery incentives (ODIs). Where performance falls short of expectations, Ofwat can take measures, such as enforcement actions or penalties, in order to protect customers' interests. Operational performance and customer service remain high priorities for us, as they are key contributors in our drive to create value, as explained in more detail on pages 9 to 16 in the 'How we create value' section.

Ofwat review 2015–20

Ofwat introduced a number of important changes for the 2015–20 (AMP6) price review, with the aim of evolving the sector in order to meet future challenges and placing greater focus on customers' needs.

Moving away from one single price control, there are now four separate price controls:

- wholesale water, covering the physical supply of water;
- wholesale wastewater, covering the removal and treatment of wastewater;
- household retail, covering customer-facing activities (principally customer contact, billing, meter reading and cash collection) for household customers; and
- non-household retail, covering customer-facing activities for business customers.

Separate retail price controls should provide retail businesses with greater incentives and focus on delivering more efficient service to business customers as competition expands, and also to household customers under a new average cost to serve approach.

This new retail household model allows each water company only to charge its customers an amount based on the average costs of the industry plus any allowed company-specific adjustments, such as our £20 million per annum special allowance to reflect the very high levels of deprivation in the North West (see 'Economic environment' on pages 18 to 20).

The way companies' operating and capital costs are assessed has been modified to encourage companies to utilise the most efficient, sustainable solutions under a new 'totex' model.

Strategic report

There is also a move to a more outcomes-based approach, with greater emphasis being placed on customer engagement to agree the outcomes.

Environmental and quality regulation

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

- **Defra** is the UK Government department responsible for water policy and regulations in England and Wales; it also sets drinking water quality and environmental standards (many based on European law) which water companies must meet. www.gov.uk/defra
- **The Environment Agency** controls how much water can be drawn from the environment and the quality of water returned to rivers and the sea. The EA produces an assessment of water and wastewater companies' annual performance, and we include this as one of our KPIs, see page 25. www.gov.uk/government/organisations/environment-agency
- **The Drinking Water Inspectorate** is responsible for ensuring compliance with the drinking water quality regulations. www.dwi.gov.uk
- **The Consumer Council for Water** represents customers' interests relating to price, service and value for money. It also investigates customer complaints about water quality. www.ccwater.org.uk
- **WATRS** – an independent service designed to adjudicate disputes that have not been resolved through the water company's customer service teams or by referring the matter to the Consumer Council for Water. www.watrs.org
- **Natural England** is responsible for the protection of designated sites for nature conservation, e.g. Sites of Specific Scientific Interest. Companies are required to manage these sites and to protect and enhance biodiversity. www.naturalengland.org.uk

We aim to maintain and enhance wide-ranging relationships with key people within all of these regulatory bodies to help shape balanced investment programmes which address the needs of all of our stakeholders and contribute to our ability to create value.

Regulatory risks

Given the complex legal and regulatory environment within which we operate, there is a range of risks to which we are exposed. Risks can be in the form of possible non-compliance with existing laws or regulations or failure to meet the terms of our current 2015–20 regulatory contract. We also face risks in relation to potential future changes in legislation or regulation. See pages 39 to 44 for more details in respect of these risks.

Impact of environmental legislation

European Union environmental legislation will require us and other UK water companies to incur additional capital investment to ensure compliance with more stringent standards. We do, however, recognise that in our region we cannot achieve this alone and we are partnering with others who also have a role to play, such as the Environment Agency, local authorities and other interest groups such as the North West Rivers Trusts.

Strategic report

The revised Bathing Water Directive, effective from 2015, sets higher standards for bathing waters. Under the previous standards North West beaches achieved over 90 per cent bathing water compliance. The new standards are likely to prove very challenging to meet. As one of many contributors to bathing water and shellfish quality we have planned investment of over £200 million across 2015–20 to achieve our 'Contribution to Bathing Waters Improved' performance commitment to help ensure compliance with the higher standards. We will work in partnership with other organisations to ensure investment is as efficient as possible.

The Water Framework Directive sets an objective that European member states should achieve 'good' status for all surface water beyond 2027. Considerable capital investment is required to meet this, which we are spreading over 12 years, balancing the needs of current and future customers. Our 2015-20 plan includes around £400 million of investment to achieve our 'Contribution to Rivers Improved' performance commitment, which includes schemes relating to a number of environmental drivers within the Water Framework Directive as well as other environmental legislation.

The Habitats Directive requires member states to maintain biodiversity by protecting natural habitats and certain wild species. For example, one of the key drivers for our planned Thirlmere pipeline project is to help protect England's largest species of freshwater mussels in West Cumbria.

Our competitive environment

Comparative competition

Our main competitors to benchmark our performance against are the other nine water and wastewater companies (WaSCs) across England and Wales. We are the second largest WaSC based on the size of our asset base, as measured by Regulatory Capital Value (RCV). We, along with these other nine companies, comprise the vast majority of the total water and wastewater sector.

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

We have a strong drive on improving both absolute and relative performance as we aim to deliver good service to our customers, thereby helping to build a platform for us to create value.

Away from the water sector, in line with our vision to be a leading North West service provider, we also benchmark our customer service performance against other leading service providers in our region. In addition, as a publicly listed FTSE 100 company, the other UK and worldwide listed utilities are competitors from an investment perspective.

Direct competition

Currently only very large business customers are allowed to choose their water supplier. Under this arrangement, the new water supplier would buy water directly from the regional water company and be allowed to use its network for this water supply. Although very few users have switched supplier in England, the 2014 Water Act aims to open up future retail competition to all business customers, including sewerage as well as water services from 2017. We have been building our capability to ensure we are in a strong position as the competitive business retail market evolves.

Strategic report

The Water Act also paves the way for the future introduction of competition for certain parts of the wholesale, or upstream, business (for example the input of raw or treated water into a water company's network or the removal of wastewater for treatment), although any such reforms are not expected until 2020 at the earliest. We are fully engaged with regards to market reform, being always mindful of the potential impact on our customers and the value implications for our shareholders.

Our economic environment

Although many economic factors are outside of the direct control of the group, we do, where appropriate, aim to manage the associated risks and opportunities, for the benefit of our customers and shareholders.

Whilst the North West unemployment rate has followed the national trend downwards, at 5.7 per cent for the quarter ending March 2015, it remains above the UK average of 5.5 per cent.

A report, 'Department for Communities and Local Government, Indices of Deprivation 2010', published in March 2011, highlighted that the North West had more of the most deprived areas in England than any other region. Even as the North West economy recovers it is unlikely to have a significant impact on deprivation, which is the principal driver of our higher than average costs to serve our household customers. This is currently recognised by Ofwat through a special allowance for deprivation of £20 million per annum over the 2015–20 period.

Bad debts remain a risk to which we are exposed, particularly with the continuing tightening of real disposable incomes and the impact of recent welfare reforms likely to intensify. Whilst our debt management processes have been externally benchmarked as efficient and effective, we will continue to refine and enhance them whilst also helping customers back into making regular payment through use of manageable payment plans.

Interest rates have remained below the long-term trend and we have benefited from this as we have made further drawdowns on our £500 million loan signed in 2013/14 and £100 million of new debt raised in 2014/15. Comparatively low interest rates have also been beneficial to our future cost of debt as we continue with our interest rate hedging strategy.

RPI inflation has declined recently, impacted by the significant fall in oil prices over the winter, and was 0.9 per cent at March 2015. The prices we charge our customers (and therefore revenues), as well as our asset base, are linked to RPI inflation, so lower RPI will mean slightly lower growth on these measures. However, we also have a large quantity of index-linked debt which means our finance costs decrease as inflation falls, providing a partial economic offset to revenue (although this is not a perfect hedge as changes to revenue and index-linked finance costs are based on differing lagged measures of inflation). Our pension liabilities are linked to inflation, which provides an additional economic offset against our asset base. Overall, we are currently more inflation-hedged than the other listed water and wastewater companies so we are better protected in a low inflation environment.

United Utilities' total contribution to the regional economy over 2010–15 was estimated at £7 billion. Direct economic contributions from our activities include the purchase of goods and services and providing extensive employment. There is also an indirect economic contribution, for example when our suppliers, in turn, make purchases from their suppliers and when people whose jobs are supported by United Utilities spend their personal incomes.

Strategic report

Key achievements 2010–15

Our focus on improving customer service

Great customer service relies on understanding what our customers need, anticipating problems, resolving complaints quickly and courteously and developing new, innovative services that fit into people's busy lifestyles. We want our customers to trust us and have confidence in our service.

Over the last five years, we have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. We have placed a strong emphasis on striving for first time resolution of customer enquiries, keeping customers informed of progress until resolution. This has been underpinned by investment in our people in terms of better training and improved systems. We have enhanced our customer feedback process to help us respond to customers' evolving needs and continuously improve.

The introduction of the service incentive mechanism (SIM) as a measure of customer satisfaction over this regulatory period has provided us with a strong benchmark of water industry comparative performance. SIM results sit alongside our other, ongoing, research on customer expectations and satisfaction.

Key achievements to date include:

- We were the most improved water and wastewater company as measured under Ofwat's three-year SIM assessment from 2011/12 to 2013/14. As well as benefiting customers, this improved performance also resulted in us avoiding a revenue penalty of up to c.£80 million in Ofwat's final determination;
- Customer complaints reduced by approximately 75 per cent over the 2010-15 period;
- Complaints warranting Consumer Council for Water (CCW) investigation reduced from 63 in 2010/11 to zero in 2012/13 and 2013/14 and two in 2014/15;
- We are consistently third behind only John Lewis and Marks & Spencer on the customer service brand tracker measure out of 10 leading service providers in the North West; and
- Awarded 'Best Utility' in the Top 50 Contact Centre Awards and received the 'Service to the Water Industry' award presented by the House Builders Federation.

Other operational improvements

We have been working hard to improve our performance in achieving statutory compliance and on-time delivery of schemes contributing to water quality and environmental improvement.

Highlights include:

- Delivered stable asset serviceability performance or better on all four water and wastewater measures for 2013/14 and 2014/15, avoiding a potential serviceability penalty of tens of millions of pounds;

Strategic report

- Upper quartile sector performance on Ofwat's annual key performance indicators and on the Environment Agency's assessment of water and wastewater companies 2013/14;
- Met or outperformed annual leakage targets in each of the last nine years;
- Efficiency improvements in delivering our capital programme allowed us to reinvest over £200 million of savings into projects which improve services to customers or benefit the environment; and
- Sustainable operating cost efficiencies have helped us to exceed our outperformance target of £50 million over 2010–15 against our allowed operating costs. This was in addition to efficiency targets set by Ofwat of approximately £150 million over the five years.

Financing outperformance

Our treasury function has continued to deliver a good performance, raising debt at better rates than allowed by the regulator, and we exceeded our financing outperformance target of £300 million across the 2010–15 period.

Overall, we are pleased with the significant progress we have made over the last five years, although we know that we still have plenty more to do.

Our operational key performance indicators (KPIs) 2010–15

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

These operational KPIs feed through from all of our strategic themes: the best service to customers; at the lowest sustainable cost; and in a responsible manner.

Group objective/KPI	Definition	Target	Performance
Best service to customers			
Serviceability	Ofwat rates each company's assets as 'improving', 'stable', 'marginal' or 'deteriorating' across four categories covering water and wastewater infrastructure and non-infrastructure	To hold at least a stable rating for all four asset classes, which is consistent with Ofwat's target	2014/15: 2 x improving, 2 x stable 2013/14: 1 x improving, 3 x stable 2012/13: 1 x improving, 3 x stable 2011/12: 1 x improving, 2 x stable. 1 x marginal 2010/11: 3 x stable, 1 x marginal

Strategic report

Service incentive mechanism – qualitative	Ofwat derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 19 water companies (previously 21 up to 2012/13). Each company receives a score in the range of zero to five, with five being the highest attainable score	To move to the first quartile in the medium-term	Significant improvement recognised by Ofwat in the final determination
Service incentive mechanism – quantitative	Ofwat derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 19 water companies (previously 21 up to 2012/13). Each company receives a SIM point total, where the lowest score represents the best performance	To move to the first quartile in the medium-term	Significant improvement recognised by Ofwat in the final determination
Lowest sustainable cost			
Opex outperformance	Progress to date on cumulative operating expenditure outperformance versus Ofwat's allowed operating costs over the 2010–15 period	Total opex outperformance over the 2010–15 period of at least £50m	2010–15: Exceeded £50m target
Financing outperformance	Progress to date on financing expenditure outperformance secured versus Ofwat's allowed cost of debt of 3.6% real over the 2010–15 period	Total financing outperformance over the 2010–15 period of at least £300m	2010–15: Exceeded £300m target
Capex outperformance	Capital expenditure (excluding private sewers and transitional investment) progress to date against Ofwat's capital expenditure allowance for the 2010–15 period, after adjusting, through the regulatory methodology, for the impact of construction output prices	To meet Ofwat's revised capital expenditure allowance for the 2010–15 period (after reinvesting around £200m of outperformance)	2010–15: Reinvested over £200m of outperformance
Responsible manner			

Strategic report

Leakage – average annual leakage	Average annual water leakage from our network quantified in megalitres per day	To meet our regulatory leakage target, as set by Ofwat, each year	2014/15: 454Ml/d – Met target 2013/14: 452Ml/d – Met target 2012/13: 457Ml/d – Met target 2011/12: 453Ml/d – Met target 2010/11: 464Ml/d – Met target
Environment Agency performance assessment	Composite assessment produced by the Environment Agency, measuring the absolute and relative performance of the 10 water and wastewater companies across a broad range of areas, including pollution.	To be a first quartile performer on a consistent basis	Delivered another upper quartile performance in 2013/14 (latest available) assessment
Dow Jones Sustainability Index rating	Independent rating awarded using sustainability metrics covering economic, environmental, social and governance performance	To retain 'World Class' rating each year	2014/15: 'World Class' 2013/14: 'World Class' 2012/13: 'World Class' 2011/12: 'World Class' 2010/11: 'World Class'

Our performance and the progress we have made against our objectives and their associated KPIs are included within the business performance section below.

Our performance 2014/15

Step change in performance in 2010-15 regulatory period delivers benefits for all stakeholders

- Significant customer service improvements, as measured through Ofwat's SIM mechanism
- Much improved delivery of capital investment programme; Time:Cost:Quality index above 95 per cent
- Investment totalling c£3.8 billion over the five years, enhancing assets and services for customers
- Upper quartile operational performance on Ofwat and Environment Agency KPI assessments

Strategic report

- Strong shareholder returns and dividend policy delivered
- Exceeded regulatory outperformance targets, enabling us to reinvest c£280 million to benefit customers
- Responsible business practice, reflected by Dow Jones Sustainability Index 'World Class' rating

Strong financials

- Strong balance sheet
- Solid credit ratings

Good platform to deliver further value in next regulatory period

- Already a leading operational performer, providing a solid foundation for further improvements
- 'Systems thinking' approach, leveraging technology and data intelligence to improve efficiency
- Regulatory capital investment of £3.5 billion+; network resilience, customer and environmental benefits
- Robust capital structure and strong credit ratings
- Below inflation growth in average household bills for the decade to 2020

OPERATIONAL PERFORMANCE

We aim to deliver long-term shareholder value by providing:

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

Throughout the 2010–15 period, we demonstrated a strong link between performance and employee remuneration and we intend to continue with this approach across the new regulatory period.

Best service to customers

Improving customer service will continue to be a significant area of management focus and we see opportunities to deliver further benefits for our customers.

Customer service – our continuing strong focus on dealing effectively with customer enquiries has helped us deliver further improvements in our performance, as measured by Ofwat's service incentive mechanism (SIM) and outlined in the KPIs section (see panel). This is also reflected in a reduction in the number of customer complaints received, which has contributed to

Strategic report

improvements in opex efficiency. The overall number of customer complaints have reduced by approximately 75 per cent across the 2010–15 period.

Our significant improvements over the regulatory period were recognised by Ofwat in the final determination in December 2014, resulting in the group avoiding a revenue penalty. Over this period, we have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. We have placed a strong emphasis on striving for first time resolution of customer enquiries, keeping customers informed of progress until resolution. This has been underpinned by investment in our people in terms of better training and improved systems. We have also enhanced our customer feedback process to help us respond to customers' evolving needs and continually improve.

Leading North West service provider – we are pleased to have been consistently ranked third out of 10 leading organisations in the North West, through an independent brand tracker survey which is undertaken quarterly. This covers key attributes such as 'reputation', 'trustworthy' and 'customer service'. We are behind only Marks & Spencer and John Lewis, and ahead of seven other major organisations covering utilities, telecoms, media and banking services.

Robust water supply – our customers continue to benefit from our robust water supply and demand balance, along with high levels of water supply reliability. We continue to supply a high level of water quality, with mean zonal compliance in excess of 99.9 per cent.

Mitigating sewer flooding – we have continued to invest heavily in schemes designed to mitigate the risk of flooding of our customers' homes, including incidence based targeting on areas more likely to experience flooding and defect identification through CCTV sewer surveys. Our plan for the 2015–20 period includes a target of reducing sewer flooding incidents by over 40 per cent, in line with customers' affordability preferences. Our wastewater network will continue to benefit from significant investment going forward as we adapt to weather patterns likely to result from climate change.

Asset serviceability – we have a range of actions to help support the serviceability of our assets. We are improving the robustness of our water treatment processes, refurbishing service reservoir assets, continuing with our comprehensive mains cleaning programme and optimising water treatment to reduce discoloured water events. Our good asset serviceability performance over the last few years was recognised by Ofwat in the final determination, in December 2014, with United Utilities not receiving any penalty.

Ofwat KPIs – our overall good operational performance is reflected in Ofwat's latest (2013/14) key performance indicators report. The balance of ratings for United Utilities across the 15 assessment measures represented an upper quartile performance, in respect of the 10 water and sewerage companies. Our performance in 2014/15 has improved further, although the industry comparatives are not available until later in the year.

Lowest sustainable cost

Power and chemicals – our asset optimisation programme continues to provide the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power assets to generate renewable energy. We have already substantially locked in our power commodity costs across 2015–20, providing greater cost certainty for the regulatory period.

Strategic report

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

Debt collection – we highlighted in May 2014 that debt collection was likely to become more challenging for United Utilities, particularly as our region suffers from high levels of income deprivation. Notwithstanding our industry-leading debt management processes and wide-ranging schemes to help customers struggling to pay, including our trust fund, deprivation remains the principal driver of our higher than average bad debt and cost to serve. In 2014/15, bad debt expense has increased by £16 million, from 2.2 per cent to 3.1 per cent of regulated revenue, as a result of four main factors:

- the cumulative impact of economic factors on customers' ability to pay;
- under IFRS accounting, an increase in the number of customers re-commencing payment through our help-to-pay initiatives has resulted in additional revenue recognition and associated bad debt;
- a review of bad debt provisions for business customers in preparation for systems upgrades, ahead of full market opening; and
- a review of operational debt processes and bad debt provisions in domestic retail in preparation for the 2015–20 period.

Although bad debts will continue to be challenging for us, we do expect the level to fall to around 2.5 per cent of regulated revenue in 2015/16 as our recent reviews have resulted in an additional current year charge which is not expected to continue at the same level.

Pensions – United Utilities placed its pension provision on a more sustainable footing in 2010 and has subsequently taken additional steps to de-risk the pension scheme further. Further details on the group's pension provision are provided in the pensions section on page 35.

Capital delivery and regulatory commitments – the business is strongly focused on delivering its commitments efficiently and on time and has a robust commercial capital delivery framework in place. Regulatory capital investment in the year, including £148 million of infrastructure renewals expenditure and £30 million of transitional spend, was £869 million, an increase of £33 million compared with 2013/14. Following our rapid increase in our internal Time: Cost: Quality index (TCQi) score from around 50 per cent in 2010/11 to approximately 90 per cent in 2012/13, we further improved our score and have achieved over 95 per cent in both 2013/14 and 2014/15.

As we strive to improve efficiency further, we have implemented new contracting arrangements for the 2015–20 regulatory period to help deliver our regulatory capital investment programme of over £3.5 billion. We have re-tendered our engineering and construction partners and selected a single engineering partner and four new design and construction partners. We are involving our partners much earlier in project definition and packaging projects by type, geography and timing to deliver efficiencies. Projects will be allocated to partners on an incentive basis or competed between the partners and where appropriate third parties. Early results are encouraging. Our partners have come forward with a range of solutions, innovations and pricing which is building our confidence that the final determination targets we have accepted are tough but within reach.

Strategic report

Responsible manner

Acting responsibly is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility factors in its strategic decision making. Our environmental and sustainability performance across a broad front has received external recognition. United Utilities retained its 'World Class' rating in the Dow Jones Sustainability Index for the seventh consecutive year, achieving industry leading performance *status in the multi-utility/water sector in the most recent assessment.* Retaining 'World Class' status for this length of time is a significant achievement, particularly as the assessment standards continue to increase and evolve. Our listed parent company, United Utilities Group PLC, also holds membership of the FTSE 350 Carbon Disclosure Project Leadership Index. We are the only UK water company to hold both accolades.

Leakage – our strong, year round, operational focus on leakage and the implementation of a range of initiatives, such as active pressure management, enabled us to again beat our leakage target in 2014/15. Our leakage performance, alongside the network resilience improvements we are making, are helping us to maintain a robust water supply and demand balance, and deliver high levels of reliability for our customers.

Environmental performance – this is a high priority for United Utilities and we are pleased to be an upper quartile company in the Environment Agency's latest available performance metrics (2013/14).

Carbon footprint – we are committed to reducing our carbon footprint and increasing our generation of renewable energy. In 2014/15, our carbon footprint totalled 473,708 tonnes of carbon dioxide equivalent. We set a target of achieving a 21 per cent reduction in carbon emissions by 2015, measured from a 2005/06 baseline. We have achieved significant reductions and were pleased to meet this target in 2013/14. However, we narrowly missed the target in 2014/15, being 19 per cent below the baseline, impacted adversely by an 11 per cent increase in the carbon content in the UK energy mix in the year which increased our reported carbon emissions. Notwithstanding this, in 2014/15, we have purchased less electricity than in any of the previous 10 years and still achieved our highest ever renewable energy production of 144 GWh. This is the equivalent of c18 per cent of our total electricity consumption, up from c17 per cent in the previous year and c13 per cent in 2012/13. We are already implementing plans to significantly increase self-generation over the next few years, with a United Utilities Group PLC target of around 35 per cent of our electricity consumption by 2020.

Employees – we work hard to sustain high levels of engagement by our employees. The group has seen significant change over the last four years and our plans will engage our teams for further improvements. Employee engagement is 79 per cent, well above the norm for UK companies going through business transition and just below the norm for high performing UK companies, so our employees demonstrate a strong capability to adapt. We continue to be successful in attracting and retaining people and have continued to expand our apprentice and graduate programmes, having recruited a further 22 graduates and 32 apprentices in 2014/15, taking the current total to 56 graduates and 97 apprentices. As part of our health and safety improvement programme, we have implemented a number of initiatives which helped reduce the employee accident frequency rate to 0.112 accidents per 100,000 hours for 2014/15, compared with a rate of 0.137 in 2013/14 and 0.188 in the previous year. Whilst we are pleased with our performance improvement, we recognise we still have more to do. Health and safety will continue to be a significant area of focus, as we strive for continuous improvement.

Strategic report

Communities – we continue to support partnerships, both financially and in terms of employee time through volunteering, with other organisations across the North West that share our objectives. We recently set up Catchment Wise, our new approach to tackling water quality issues in lakes, rivers and coastal waters across the North West, and our 'Beachcare' employee volunteering scheme helps to keep our region's beaches tidy. We continue to support local communities, through contributions and schemes such as providing debt advisory services and our Community Fund, offering grants to local groups impacted by our capital investment programme.

Systems thinking approach

To support the delivery of our objectives, we are focused on continuous improvement and over the last few years have progressively instilled a 'systems thinking' approach into the way we run our business. This is an engineering-led approach which integrates the use of our assets, leverages data intelligence and employs technology and new work processes to deliver improved customer satisfaction and operational efficiency. We have made good progress over the last few years and this 'systems thinking' approach is expected to deliver benefits of over £100 million over the 2015–20 regulatory period, which are already built into our business plan assumptions.

The step change in performance of the business over the 2010–15 period has its origins in good management practice; constancy of purpose, clear objectives, attention to detail, good people and performance management. However, it was also clear to us that we could improve further if we took the learning from other sectors to transform the way a water company is run and we started that transformation over three years ago. There are five key phases of transformation:

- **'Systems thinking'** – we have progressively instilled an engineering-led 'systems thinking' approach which integrates the use of our assets, leverages data intelligence and employs technology and new work processes. We have audited our asset base and are investing in a new enterprise asset management system and field force scheduling system, supported by the recruitment of new people from other sectors with experience in these areas. By capturing and processing data from multiple information points, we are aiming for ever-improving asset intelligence. We have fitted sensors in our water networks to provide visibility as to how they are performing, helping us to reduce burst frequency, and we are currently piloting drainage system performance monitoring in our wastewater networks. We are building enhanced visibility of our assets and more effective monitoring and control, enabling us to make more informed and proactive management decisions. This should lead to better modelling and prediction of events before they occur, reducing reactive work and thereby improving efficiency, operational performance and, importantly, customer service.

- **Production lines** – for the last few years we have considered our treatment works as 'factories', each with its own production line. We have over 600 of these 'factories', small and large, producing clean water, bio waste and energy. Our business has been re-structured to create a strong focus on accountability and delivery, integrating the disciplines often found as functional silos in other companies. Our managers are responsible for the performance of their production lines including investment of capital to optimise operational performance, to deliver environmental or water quality requirements and to maximise energy production, providing a more integrated approach.

- **Organisational structure aligned with new price control** – we recognised that we would best address the regulatory reform agenda by aligning our organisational structure with the new price control, with three business areas: Wholesale, Domestic Retail and Business

Strategic report

Retail. We did this nearly three years ago and recruited a business retail team experienced in competitive utility markets.

- **Wholesale business split** – we subsequently subdivided our Wholesale business to concentrate on three business areas: Water, Wastewater and Energy, with a strong focus on increasing our renewable and self-generation to reduce the amount of electricity we purchase. Our people are all aligned to this model and our production leadership team has responsibility, authority and accountability for the performance of their assets using a total expenditure, whole life cost approach to decision management.

- **Integrated control centre** – underpinning our 'systems thinking' ethos is our recently opened integrated control centre in Warrington.

This has all been supported by a significant cultural change in the group over the last few years, which has helped United Utilities progress into a leading operational performer in the sector. A critical enabler has been our people and we continue to invest in attracting talent and in developing the best, giving us a powerful mix of water experience and knowledge of other sectors.

Financial performance

Financial KPIs	2015	2014
Turnover	£1,700.0m	£1,672.1m
Regulatory capital expenditure	£869m	£836m
Operating profit	£656.2m	£629.8m
Profit before tax	£328.3 m	£510.7m
RCV gearing	63%	61%
Interest cover	3.0	2.5

Revenue

The group has delivered a good set of financial results for the year ended 31 March 2015. Revenue increased by £27.9 million to £1,700.0 million. This increase principally reflects the allowed regulated price rise, partly offset by the previously announced special customer discount of £21 million.

Operating profit

Reported operating profit was up £26.4 million to £656.2 million, as we tightly managed our cost base despite the expected increase in depreciation and other cost pressures, including bad debt. As planned, there was also a £16.9 million reduction in infrastructure renewals expenditure this year as we transition from this regulatory period to the next.

Investment income and finance expense

Reported investment income and finance expense of £327.9 million was significantly higher than the £119.1 million expense in 2013/14. This £208.8 million increase principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £109.3 million gain in 2013/14 to a £123.3 million loss in 2014/15. The £123.3 million fair value loss is largely due to losses on the regulatory swap portfolio, resulting from a significant decrease in medium-term sterling interest rates during the period, partly offset by a gain from the unwinding of the

Strategic report

derivatives hedging interest rates to 2015. The group uses these swaps to fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by the regulator at each price review.

Offsetting this increase was a £35.9 million reduction in the indexation of the principal on our index-linked debt with a net charge in the income statement of £46.6 million, compared with a net charge of £82.5 million last year. This reflects the impact of lower RPI inflation on the group's index-linked debt. The group had approximately £3.1 billion of index-linked debt as at 31 March 2015 at an average real rate of 1.6 per cent.

Profit before taxation

Profit before taxation was £328.3 million; £182.4 million lower than last year, primarily due to a £202.4 million increase in finance expenses, mainly due to fair value losses offset by a £26.4 million increase in operating profit as discussed above.

Taxation

Consistent with our wider business objectives, we are committed to acting in a responsible manner in relation to our tax affairs. Our tax policies and objectives, which are approved by the board on a regular basis, ensure that we:

- only engage in reasonable tax planning aligned with our commercial activities and we always comply with what we believe to be both the letter and the spirit of the law;
- do not engage in aggressive or abusive tax avoidance; and
- are committed to an open, transparent and professional relationship with HMRC based on mutual trust and collaborative working.

Under the regulatory framework the group operates within, the majority of any benefit from reduced tax payments will typically not be retained by the group but will pass to customers via reduced bills. For 2013/14, the group agreed, over and above the normal regulatory rules, to voluntarily share with customers the one-off net cash benefit of £75 million due to the group, following the industry-wide agreement with HMRC in relation to the abolition of industrial buildings allowances in 2008.

In any given year, the group's effective cash tax rate may fluctuate from the standard UK rate due to the available tax deductions on pension contributions and capital investment. These deductions are achieved as a result of utilising tax incentives, which have been explicitly put in place by successive governments precisely to encourage such investment. This reflects responsible corporate behaviour in relation to taxation.

The group's effective cash tax rate may also fluctuate from the standard UK rate due to unrealised profits or losses in relation to treasury derivatives where the corresponding profits or losses are only taxed when realised. These movements are purely timing differences and are expected to continue going forward, following HMRC's recent review of the relevant tax rules.

The group operates solely in the UK, its customers are based here and as a result, all of the group's profits are taxable here.

In 2014/15, we paid corporation tax of £50.0 million, which represents an effective cash tax rate of 15 per cent, 6 per cent lower than the mainstream rate of corporation tax of 21 per cent. In 2013/14, we paid corporation tax of £79.0 million. For both years, the key reconciling items to

Strategic report

the mainstream rate were allowable tax deductions on net capital investment and timing differences in relation to fair value movements on treasury derivatives. In 2014/15 the group received an external tax refund of £1.3 million and a further intra-UUG group prior year settlement of £52.0 million. In 2013/14, the group also received an exceptional external tax refund of £74.6 million in relation to prior years' tax matters, covering a period of over 10 years in total.

The current tax charge was £56.6 million in 2014/15, compared with a charge of £75.8 million in the previous year. In addition, there were current tax credits of £9.4 million in 2014/15 and £152.0 million in 2013/14, both following agreement with the UK tax authorities of prior years' tax matters.

For 2014/15, the group recognised a deferred tax charge of £14.6 million, compared with a charge of £38.9 million in 2013/14. In addition, in 2014/15 the group recognised a deferred tax charge of £8.4 million relating to prior years' tax matters, compared to a deferred tax credit of £13.3 million in 2013/14. In 2013/14, the group also recognised a deferred tax credit of £156.1 million relating to the 3 per cent staged reduction in the mainstream rate of corporation tax, substantively enacted on 2 July 2013, to reduce the rate to 20 per cent by 2015/16.

The total tax charge, excluding one-off charges and credits, of £71.2 million for 2014/15 represents a rate of 22 per cent, similar to the rate in 2013/14.

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £140.0 million per annum, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees such as water abstraction charges.

Cash flow

Net cash generated from continuing operating activities for the year ended 31 March 2015 was £766.7million, compared with £741.9 million in the previous year. The group's net capital expenditure was £704.3 million, principally in the regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under IFRS.

Net debt including derivatives at 31 March 2015 was £6,359.0 million, compared with £6,083.7 million at 31 March 2014. This increase reflects expenditure on the regulatory capital expenditure programmes and payments of dividends, interest and tax, alongside fair value losses on the group's debt and derivative instruments, partly offset by operating cash flows.

Debt financing and interest rate management

Gearing (measured as group net debt divided by the group's regulatory capital value adjusted for actual capital expenditure) increased to 63 per cent at 31 March 2015, compared with 61 per cent at 31 March 2014, remaining within Ofwat's 55 per cent to 65 per cent assumed gearing range.

At 31 March 2015, UUW had long-term credit ratings of A3/BBB+ from Moody's Investors Service and Standard & Poor's Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. Both agencies have the company's ratings on stable outlook.

Strategic report

The UUG group has access to the international debt capital markets through its €7 billion euro medium-term note programme (EMTN). On 19 November 2014, the EMTN programme was updated adding a new financing subsidiary of UUW, United Utilities Water Finance PLC (UUWF), to issue new listed debt on behalf of UUW going forwards following UUW's re-registration as a private limited company. The EMTN programme provides for the periodic issuance by United Utilities PLC and UUWF (guaranteed by UUW) of debt instruments on terms and conditions determined at the time the notes are issued. The EMTN programme does not represent a funding commitment, with funding dependent on the successful issue of the notes.

Cash and short-term deposits at 31 March 2015 amounted to £180.0 million. Over 2015-20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our 2015-20 investment programme. In December 2013, UUW agreed a new £500 million term loan facility with the European Investment Bank (EIB) and as at 31 March 2015 UUW had drawn down £350 million on this facility, all on a floating rate basis. The remaining £150 million is expected to be drawn down during the first half of 2015/16. In March 2015, UUW signed a new £250 million index-linked term loan facility with the EIB. This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and we expect to draw the new loan in tranches over the next year or so. In the same month, UUW arranged a new £100 million, 10-year index-linked loan with an existing relationship bank, at a real interest rate of around 0.5 per cent. The group also agreed £120 million of committed bank facilities during 2014/15.

Following the year-end, UUWF issued two index-linked notes totalling £60 million, split by a £25 million, 10-year maturity and a £35 million, 15-year maturity. UUWF also issued a €52 million note (swapped to floating sterling) with a 12-year maturity. All these notes were issued via private placement off our EMTN programme.

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

Long-term sterling inflation index-linked debt provides a natural hedge to assets and earnings. At 31 March 2015, approximately 48 per cent of the group's net debt was in index-linked form, representing around 31 per cent of regulatory capital value, with an average real interest rate of 1.6 per cent. The long-term nature of this funding also provides a good match to the group's long-life infrastructure assets.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, to manage exposure to long-term interest rates, the debt is generally swapped to create a floating rate sterling liability for the term of the debt. To manage exposure to medium-term interest rates, the group fixes underlying interest costs on nominal debt out to 10 years on a reducing balance basis. This is supplemented by fixing substantially all remaining floating rate exposure across the forthcoming regulatory period around the time of the price control determination.

In line with this, the group has now fixed interest costs for substantially all of its floating rate exposure over the 2015–20 period, locking in an average annual interest rate of around 3.75 per cent (inclusive of credit spreads). For 2015/16, the rate is slightly higher, as we transition between the two regulatory periods.

Strategic report

Liquidity

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits and supported by committed but undrawn credit facilities. The UUG group's €7 billion euro medium-term note programme provides further support.

In line with the UUG board's treasury policy, United Utilities aims to maintain a robust liquidity position. Available headroom at 31 March 2015 was £309.7 million based on cash, short-term deposits, medium-term committed bank facilities, along with the undrawn portion of the EIB term loan facilities, net of short-term debt.

The group believes that it operates a prudent approach to managing banking counterparty risk. Counterparty risk, in relation to both cash deposits and derivatives, is controlled through the use of counterparty credit limits. United Utilities' cash is held in the form of short-term money market deposits with prime commercial banks.

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

Pensions

As at 31 March 2015, the group had an IAS 19 net pension surplus of £74.8 million, compared with a net pension deficit of £145.6 million at 31 March 2014. This £220.4 million favourable movement mainly reflects a decrease in inflation expectations alongside an increase in corporate credit spreads. In contrast, the scheme specific funding basis does not suffer from volatility due to inflation and credit spread movements as it uses a fixed inflation assumption via the inflation funding mechanism and a prudent, fixed credit spread assumption. Therefore, the recent inflation and credit spread movements have not had a material impact on the deficit calculated on a scheme specific funding basis or the level of deficit repair contributions.

The triennial actuarial valuations of the group's defined benefit pension schemes were carried out as at 31 March 2013 and the overall funding position has improved since March 2010. Following the de-risking measures we have implemented over recent years, our pension funding position remains well placed and in line with our expectations. There has been no material change to the scheduled cash contributions as assessed at the previous valuations in 2010.

Further detail is provided in note 13 ('Retirement benefit obligations') of these consolidated financial statements.

Our plans for 2015–20

The final determination for our 2015–20 price controls was published by Ofwat on 12 December 2014 and, after careful consideration, we accepted these proposals on 27 January 2015.

The final determination delivers value for all of our stakeholders, with a strong focus on customer benefits, including reduced bills in 2015/16, alongside continued high levels of investment which will provide further environmental benefits and a significant contribution to the regional economy. Household customers are also set to benefit from below inflation growth in average bills for the decade through to 2020.

Strategic report

We aim to maintain efficient access to debt capital markets throughout the economic cycle and believe that it is appropriate to keep gearing, measured as net debt to regulatory capital value, within our existing target range of 55% to 65%. This is supported by our aim to maintain, as minimum, our existing UUW credit ratings of A3 with Moody's and BBB+ with Standard & Poor's.

The key features of the delivery plans for each of the four price controls are set out below.

Wholesale water

The North West benefits from one of the youngest water networks in the country, with over 50 per cent of our network constructed or renewed in the last 30 years. This is a consequence of significant investment over previous regulatory cycles to improve water quality. We benefit from historic investment in the integration of our networks to create a core 'integrated supply zone.' The most recent addition to this was the West–East pipeline running approximately 50 kilometres between Liverpool and Manchester. As a consequence, we are able to provide one of the most efficient and flexible water services in the sector.

Customers told us they want to retain their current level of water services, but do not want to pay for water service improvements. This has driven our proposals for the next five years, where our core focus is to continue ongoing maintenance of the existing service to keep it working reliably now and in the future, managing costs carefully and reducing the number of customer contacts.

Key features of our plan mean that we aim to:

- maintain existing high levels of reliability in the delivery of day-to-day water services, making better use of technology to monitor remotely and control more of our source-to-tap assets;
- maintain existing high levels of water quality as measured at customers' taps and our water treatment works;
- reduce the number of contacts from customers regarding water quality;
- maintain leakage at or below the sustainable economic level;
- limit the impact on customers of increases in operating costs, such as chemicals and rates, by making cost savings elsewhere through the continuous improvement in the efficiency of our operations; and
- commence work to link 150,000 customers in West Cumbria to Thirlmere reservoir to ensure a long-term, reliable supply of drinking water and to support the sensitive ecology in that area.

Wholesale wastewater

The region's geography and weather, the legacy of the Industrial Revolution, population growth and long-term under investment in the region's wastewater infrastructure mean that new European environmental legislation has a significant impact on our plans for the next five years and beyond. Furthermore, the North West has one of the country's largest combined waste and surface water infrastructures and this has significant implications for river and bathing water quality in the heavy rainfall events anticipated under climate change. These are significant new challenges for our wastewater service and will drive high levels of capital expenditure in meeting statutory obligations.

Against this backdrop, customers told us that for the most part they wanted their wastewater services to remain stable. Whilst they want to see progress in reducing sewer flooding and in improving the environment, they are concerned about the impact that service improvements will have on their bills. We have responded to this by devising a balanced programme of work over the 2015–20 period and beyond that will progressively deliver our contribution to the UK

Strategic report

Government's compliance with European legislation. This also takes account of customers' views on the acceptable level of future bill increases.

In the next five-year period we aim to:

- build on the customer satisfaction improvements we have already delivered. We will continue to improve the way we operate our wastewater business, making better use of technology, automation and control to drive better customer service at reduced cost;
- reduce the number of our customers' properties exposed to sewer flooding by over 40 per cent, seeking opportunities to work in partnership with others to deliver schemes cost-effectively and promote the use of more sustainable drainage systems;
- improve the region's bathing waters, in light of tougher regulatory standards;
- work with other organisations to support them in delivering improvements to our region's beaches;
- improve the water quality in the North West's rivers and lakes through investment in our treatment works and at overflows, reducing pollution. We are engaging with stakeholders to explore innovative catchment management techniques to control diffuse pollution in our catchments;
- increase our production of renewable energy from waste to help protect customers from rising energy costs and reduce our carbon footprint; and
- constrain costs associated with taking responsibility for all private sewers and private pumping stations across the region, through improvements to our operating model and efficient delivery of our programme.

Household retail

Our focus for the current regulatory period has been, and continues to be, to improve the customer experience. This involves being more proactive with customers, anticipating problems before they materialise and improving our communication channels so that we are easier to do business with. We aim to reduce further the number of complaints and to resolve them whenever we can, avoiding the need for complaints to be referred to the Consumer Council for Water.

We aim to reduce the debt burden on the group and its customers by engaging with those who are struggling to pay, helping them to return to sustained payment behaviour. We are extending our options for assistance to hard-pressed customers by developing a social tariff that secures a high level of acceptability from customers. We remain committed to contribute annually to the United Utilities Trust Fund, which has proven effective in helping customers in difficulty return to regular payment.

Our domestic retail plan also sees us continuing our efforts to reduce the costs to serve our customers through systems and process improvement. This is particularly important under the new price control methodology which uses an industry average retail cost to serve to determine part of customer bills.

Non-household retail

We welcome the opportunity offered through the opening of the English non-household retail market to competition. Over the last three years we have recruited a management team with other sector experience to lead our business retail area, and separated this team from our domestic retail and wholesale business areas. This team has embarked on a transformation programme focused on getting the basics right against core customer needs, creating the culture of a business-to-business retailer.

Strategic report

Research has highlighted a need for a broader range of services targeted to different segments. We are developing these in our non-appointed business, ensuring that they are only paid for by customers who want these services.

Non-household customers tell us that the three most important things they look to their water supplier to deliver are: value for money; a reliable supply; and great customer service. With this in mind, through the course of the 2015–20 period we aim to:

- install meters in all business customer premises that give automated meter reads (AMR) to facilitate billing for actual consumption;
- build stronger relationships with customers to develop tailored plans to meet their needs;
- give customers greater choice in how they contact and transact with us; and
- increase first point resolution and case ownership, reducing cost to serve and improving customer satisfaction.

Our operational key performance indicators (KPIs) 2015–20

As we enter the next five years, we have refined our KPIs to reflect the changing regulatory environment. We will first report against these refined KPIs for the year ending 31 March 2016.

Our operational KPIs have evolved to reflect the move to a totex price control, with a totex outperformance measure replacing the previous separate opex outperformance and capex outperformance measures. We are including an outcome delivery incentive (ODI) KPI in our wholesale business to monitor our performance against these important new operational measures. This replaces the previous serviceability KPI which is incorporated within the ODI measures. With the retail household price control now being separated, we are introducing a new KPI to measure our costs in this area. In the business retail price control, with the expansion of competition, we are including a new KPI measuring the impact of customer gains and losses.

Operational KPIs 2015–20

Group objective/KPI	Definition
Best service to customers	
Wholesale outcome delivery incentive (ODI) composite	Net reward/(penalty) accrued across United Utilities' 18 wholesale financial ODIs
Service incentive mechanism – qualitative	Ofwat derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 18 water companies. Each company receives a score in the range of zero to five, with five being the highest attainable score
Service incentive mechanism – quantitative	Ofwat derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 18 water companies. Each company receives a SIM point total, where the lowest score represents the best performance
Business retail customer growth	Amount of additional revenue from winning customers from other water retail providers less the amount of revenue lost from losing customers to other water retail providers

Strategic report

Lowest sustainable cost	
Totex outperformance	Progress to date on cumulative totex outperformance across the wholesale water and wastewater price controls versus Ofwat's allowed totex over the 2015–20 period
Financing outperformance	Progress to date on financing expenditure outperformance secured versus Ofwat's allowed cost of debt of 2.59 per cent real over the 2015–20 period
Domestic retail cost to serve	Average cost to serve in our domestic retail business
Responsible manner	
Leakage – average annual leakage	Average annual water leakage from our network quantified in megalitres per day
Environment Agency performance assessment	Composite assessment produced by the Environment Agency, measuring the absolute and relative performance of the 10 water and wastewater companies across a broad range of areas, including pollution
Dow Jones Sustainability Index rating	Independent rating awarded using sustainability metrics covering economic, environmental, social and governance performance

Principal risks and uncertainties

We have developed a sophisticated approach to the assessment, management and reporting of risks, with a process aligned to ISO 31000:2009 and a well-established governance structure for the UUG board to review the nature and extent of the risks that we face and for the UUG audit committee to review process effectiveness. This process is supported by a central database, tools, templates and guidance to drive consistency.

Our risk profile currently illustrates circa 200 event-based risks. All event types (strategic, financial, operational, compliance and hazard) are considered in the context of our strategic themes (best service to customers; lowest sustainable cost; and responsible manner). For internal or external drivers, each event is assessed for the likelihood of occurrence and the negative financial or reputational impact on the UUG group and its objectives, should the event occur.

Responsibility for the assessment and management of the risk (including monitoring and updating) is assigned to the appropriate individual manager who is also responsible for reporting on assessment, management and control / mitigation at least twice a year, in line with the reporting to the UUG board at full and half-year statutory accounting reporting periods.

By their nature, event-based risks in the context of our strategic themes will include all combinations of high to low likelihood and high to low impact. Heat maps are typically used in various managerial and UUG reports either as a method to collectively evaluate the extent of all risks within a certain profile or to illustrate the effectiveness of mitigation for a single risk by plotting the gross, current (net of existing controls) and the selected target position in an individual risk statement.

Strategic report

However, reporting a small number of event-based risks ranked by combined event likelihood and potential impact could distort principal risk disclosure as it would overlook other risks with a lesser individual exposure that, if they materialised individually or in aggregate, could have a material impact on our business model, future performance, solvency or liquidity. Equally, event-based risks identified as part of our internal assessment process can be commercially sensitive, the disclosure of which could be detrimental to competitive advantage or our ability to mitigate risk over the longer term.

In order to address this, further understand the nature and extent of our entire profile and support the disclosure of principal risks, event-based risks are categorised (based on the event), when recorded onto the central database, into areas that define business activity or contributing factors where value can be lost. These categories have been set out under 'Risks' below to reflect the principal risks (aggregated), together with associated issues or areas of uncertainty, potential for material effect and the extent of control/mitigation.

Key features, developments over the last year and looking ahead

As expected, following the 2014 price determination our risk profile is returning to one based more on operational performance, compliance and delivery risk. We have challenging demands on customer benefits, operational performance and investment requirements in light of population growth, climate change and strict legal/regulatory requirements. Competition and market reform remain high on the agenda however, with the ongoing development of the non-household market and uncertainty surrounding the impact of upstream competition for water and wastewater services.

There continues to be an ongoing piece of material litigation worthy of note but, based on the facts currently known to us and the provisions in our statement of financial position, our directors remain of the opinion that the likelihood of these having a material adverse impact on our financial position is remote.

- In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against UUW in respect of UUW's discharges of water and treated effluent into the canal. Whilst the matter has not reached a final conclusion, the Supreme Court has found substantively in UUW's favour on a significant element of the claim and referred the remainder of the proceedings back to the High Court.

Risks

1. The regulatory environment and framework

Current key risks, issues or areas of uncertainty include:

- Market reform including non-household and upstream competition
- A possible change from using the retail prices index to the consumer prices index for regulatory indexation

Potential impacts

Changes to regulation and the regulatory regime (either through political or regulatory events) may increase costs of administration, reduce income and margin and lead to greater variability of returns.

Strategic report

Control mitigation

We engage in relevant government and regulatory consultations which may affect policy and regulation in the sectors where we operate. We also consult with customers to understand their requirements and proactively consider all the opportunities and threats associated with any potential change, exploiting opportunities and mitigating risks where appropriate.

2. Corporate governance and legal compliance

Current key risks, issues or areas of uncertainty include:

- Competition law and regulatory compliance whilst preparing for and operating within a changing competitive market
- Material litigation (see above)
- New higher fine levels for environmental offences

Potential impacts

Non-compliance with existing or future UK or international laws or regulations (especially given the highly regulated environment we operate in) could result in additional workload and operating costs in justifying or defending our position and financial penalties (including of up to 10 per cent of relevant regulated turnover for extreme events) and compensation following litigation is also possible, together with additional capital/operating expenditure as a result of the imposition of enforcement orders. In more remote but extreme circumstances, impacts could ultimately include licence revocation or the appointment of a special administrator.

Control mitigation

Legislative and regulatory developments are continually monitored. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Funding for any additional compliance costs in the regulated business is sought as part of the price determination process. The group also robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible.

3. Water and wastewater service

Current key risks, issues or areas of uncertainty include:

- Dealing with the impacts of population growth, climate change and weather conditions
- Meeting infrastructure investment requirements and balancing supply and demand
- Expected change to the abstraction licensing regime

Potential impacts

Operational performance problems or service failures can lead to increased regulatory scrutiny, regulatory penalties and/or additional operating or capital expenditure. In more extreme situations the group could also be fined for breaches of statutory obligations, be held liable to third parties and sustain reputational damage.

Control mitigation

Mitigation is provided through core business processes, including forecasting, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Ongoing integration of water and wastewater networks improves service provision and measures of success have been developed to monitor performance. We also undertake customer education programmes, seeking to minimise related operational issues.

Strategic report

4. Security, assets and operational resilience

Current key risks, issues or areas of uncertainty include:

- The threat of cybercrime and/or terrorism affecting our assets or operations

Potential impacts

Our resources, assets and infrastructure are exposed to various threats (malicious or accidental) and natural hazards which could impact the provision of vital services to the public and commercial business.

Control mitigation

Physical and technological security measures combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Ongoing integration of water and wastewater networks improves operational resilience and we maintain robust incident response, business continuity and disaster recovery procedures. We also maintain insurance cover for loss and liability and the licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers in the event of a catastrophic incident.

5. Human and IT resource

Current key risks, issues or areas of uncertainty include:

- Delivering required employee engagement, talent management, technological innovation and IT asset management

Potential impacts

Capacity, capability and effectiveness problems associated with human and IT resource will impact the efficiency and effectiveness of business activity, the ability to make appropriate decisions and ultimately meet targets. This can also affect the ability to recruit and retain knowledge/expertise or to recover effectively following an incident. In remote but extreme circumstances there is also the potential for higher levels of regulatory scrutiny, financial penalties, reputational damage and missed commercial opportunities.

Control mitigation

Developing our people with the right skills and knowledge, combined with delivering effective technology are important enablers to support the business to meet its objectives. Employees are kept informed regarding business strategy and progress through various communication channels. Training and personal development programmes exist for all employees in addition to talent management programmes and apprentice and graduate schemes. We focus on change programmes and innovative ways of working to deliver better, faster and more cost-effective operations.

6. Tax, treasury and financial control

Current key risks, issues or areas of uncertainty include:

- Stability of financial institutions and the world economy
- The speed of economic recovery
- Inflation/deflation
- Financial market conditions, interest rates and funding costs

Strategic report

Potential impacts

The failure of financial counterparties could result in additional financing cost, an adverse impact on the income statement and potential reputational damage. Variability in inflation (as measured by the UK Retail Prices Index) and changes in interest rates, funding costs and other market risks could adversely impact the economic return on the regulatory capital value (RCV) and affect our pension schemes with a requirement for the group to make additional contributions. In extreme but remote cases adverse market conditions could affect our access to debt capital markets and subsequently available liquidity and credit ratings.

Control mitigation

Refinancing is long-term with staggered maturity dates to minimise the effect of short-term downturns. Counterparty credit, exposure and settlement limits exist to reduce any potential future impacts. These are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty. The group also employs hedging strategies to stabilise market fluctuation for inflation, interest rates and commodities (notably energy prices). Sensitivity analysis is carried out as part of the business planning process, influencing the various financial limits employed. Continuous monitoring of the markets takes place including movements in credit default swap prices and movements in equity levels.

7. Programme delivery

Current key risks, issues or areas of uncertainty include:

- Supply chain security of supply and delivery of solutions, quality and innovation
- New contract delivery partnerships for the 2015–2020 period with a new approach to construction and design

Potential impacts

Failure to deliver capital or change programmes against relevant time, cost or quality measures could result in a failure to secure competitive advantage or operating performance efficiency and cost benefits. There is also the risk of increased delivery costs or a failure to meet our obligations and customer outcomes which, depending on the nature and extent of failure, could result in an impact at future price reviews, regulatory or statutory penalties and negative reputational impact with customers and regulators.

Control mitigation

We have a developed and clear view of our investment priorities which are built into our programmes, projects and integrated business and asset plans. We have created better alignment and integration between our capital delivery partners and engineering service provider including alignment with our operating model. Our programme and project management capabilities are well established with strong governance and embedded processes to support delivery, manage risks and achieve business benefits. We utilise a time, cost and quality index (TCQi) as a key performance indicator and enhance our performance through a dedicated programme change office to deliver change in a structured and consistent way. Supply chain management is utilised to deliver end-to-end contract management which includes contract strategy and tendering, category management, security of supply, price and price volatility and financial and operational service level performance.

Strategic report

8. Revenues

Current key risks, issues or areas of uncertainty include:

- Socio-economic deprivation in the North West
- Welfare reform and the impact on domestic bad debt
- Competition in the water and wastewater market and competitor positioning
- The standards of service to our customers

Potential impacts

Poor service to customers can result in financial penalties issued by the regulator through components of the service incentive mechanism for domestic customers and loss of revenue associated with commercial churn for commercial customers using 5 megalitres and above per annum. The proposed opening of the market for retail services to all non-household customers in England from 2017 generates both opportunities and risk associated with market share, scale and margin erosion. There is also much uncertainty surrounding the form of upstream reform which is now anticipated to materialise post-2019.

Control mitigation

For domestic retail there is a transformation plan in place covering a wide range of initiatives and activities to improve customer service, with a number of controls in place to monitor achievement against the plan. Similarly, we look to retain existing and acquire new commercial customers by striving to meet their needs more effectively. We monitor competitor activity and target a reduction in operating costs.

9. Health, safety and environmental

Current key risks, issues or areas of uncertainty include:

- Risks associated with excavation, tunnelling and construction work and working with water and wastewater
- Weather conditions

Potential impacts

Working with and around water, sewage, construction and excavation sites, plant and equipment exposes employees, contractors and visitors to various man-made and naturally occurring hazards which could cause harm to people and the environment. Depending on the circumstances the group could be fined for breaches of statutory obligations, be held liable to third parties and sustain reputational damage.

Control mitigation

We have developed a strong health, safety and environmental culture supported by strong governance and management systems which include policies and procedures which are certified to OHSAS 18001 and ISO 14001.

The Strategic report was approved by the board on 5 June 2015 and signed on its behalf by:

Russ Houlden
Chief Financial Officer

RHoulden

Corporate governance report

Introduction from Dr John McAdam, Chairman:

At United Utilities we aspire to the highest standards of board leadership, transparency and governance.

Our year

The focus of the board has been in the planning for the group's next five-year regulatory period for 2015 to 2020, and endeavouring to ensure the long-term success of the group for that period and beyond. The board has concentrated on pursuing the group's continuing strategy to provide the best service to customers, at the lowest sustainable cost and in a responsible manner, and in meeting the challenges of the financial year ended 31 March 2015.

Having the same directors on both the UUG and UUW boards (with the addition of Steven Fraser, managing director of UUW's Wholesale business, on the UUW board) reflects our vision which is to focus on our core water and wastewater business and become a leading North West service provider. Our governance processes also address Ofwat's published principles on board leadership, transparency and governance, and our statement can be found on our website at corporate.unitedutilities.com/corporate-governance.

We have achieved considerable progress against our strategy, particularly in customer service, although this is still a primary area of focus for the board. The implementation of our new operating model for our wholesale business employing new technology and new work processes will support us in achieving this target. The board is determined to maintain the rate of progress that has been achieved to date as we enter the next five-year period.

In January 2015, the board met to consider the best course of action in terms of accepting or rejecting Ofwat's 2015–20 final determination. The board concluded that, although this was a challenging price control, we have plans in place to maintain and improve services for customers.

Our approach

As individual directors we are cognisant of our statutory duties and in particular to promote the long-term success of our group. Our intention as directors is to hand over the business to our successors in a better and more sustainable position for the future. Information on our vision and strategy and the way in which we create value is included in the strategic report on pages 7 to 16.

Our people

Nick Salmon retired as a director on 25 July 2014 and we welcomed Stephen Carter to the board as an independent non-executive director on 1 September 2014. Stephen brings to the board table a strong career in government and regulation, having held a number of public sector roles, including serving a term as the founding chief executive of Ofcom. He is currently group chief executive at Informa plc, a FTSE 250 listed company.

We have maintained our target of at least 25 per cent of our board comprising of women, and in terms of diversity of experience, skills and personal attributes, we have great diversity around our board. Good board dynamics are vital to the proper interaction and working of a board of directors. Board directors need to work together effectively for the good of the group and, in

Corporate governance report

short, they need to get on with each other; clashes of personality are to be avoided as they do not facilitate constructive debate and challenge and effective communication.

Collectively, the directors have many years of experience gained across a variety of areas and industries. Some have spent part of their careers overseas, and whilst there is a huge diversity in their skills and experience, they have predominantly worked in regulated industries, as is appropriate. Around our board table, I believe we have individuals who will apply their skills and experience to the benefit of our business and speak up if they disagree but, equally, listen to the views of others.

Although there are time constraints for non-executive directors who also have an executive role, these individuals bring valuable current market experience to any board table. Similarly, we encourage our executive directors to serve as a non-executive director elsewhere to help broaden their experience, although this is restricted to one other directorship in a company which does not conflict with United Utilities' business.

Our approach to risk

We adopt a prudent approach to the way we manage the risks to our business; we feel this is appropriate for an organisation such as ours that provides a vital service to its customers, and is an approach that permeates the culture of our business. That being said, we are a commercial organisation operating within a regulated framework, and accepting some level of risk is a normal consequence of doing business. It is the board's and the executive team's role to understand the risks associated with each activity of the business and that actions are taken to mitigate these risks as they feel appropriate. The greatest risk to our business is ensuring that we get the constituent elements of our five-yearly business plans correct to ensure our financeability, and that they are agreed by Ofwat in its final determination, as we are bound by these plans for the following five-year period with limited opportunity to change them.

Dr John McAdam
Chairman

Code principle: Leadership

The UK Corporate Governance Code

UUW, as required by its licence, has 'had regard to' the UK Corporate Governance Code ('the Code', the current version of which was published by the Financial Reporting Council in 2012) since 2008. The company, in agreement with Ofwat, operates a structure that allows directors to be members of the boards of both the company, and its ultimate holding company UUG in order to increase the efficiency and effectiveness of the corporate governance structure. These arrangements have been in place since March 2011 and were in place throughout the year ended 31 March 2015. The only exception is Steven Fraser, managing director of the company's wholesale business, who is a director of UUW only. As a board member he provides the UUW board with additional insight into the operational challenges faced by the company.

United Utilities, both at UUG and UUW levels, fully supports Ofwat's drive for the highest standards of board leadership, transparency and governance in the industry and is fully cognisant of the long-term nature of the industry and its stewardship of UUW and its assets, for future generations of customers. The boards of both UUG and UUW are satisfied that current

Corporate governance report

practices and the application of the Code at both holding company and regulated company levels are entirely consistent with the principles proposed by Ofwat. A copy of our voluntary code can be found on our website at corporate.unitedutilites.com/corporate-governance.aspx

As a listed company and the ultimate holding company of UUW, UUG, as reported in its 2015 annual report already complies with the Code, and did so fully for the year ended 31 March 2015. The UUW board complies with the spirit of the Code and follows the 'comply or explain' regime. UUW does not duplicate the board committees already operating at the UUG level, as UUW represents 98 per cent of UUG group revenues. The activities of the UUG board committees, whose members are made up of entirely independent non-executive directors, are necessarily targeted towards UUW related matters, thus ensuring that the interests of UUW and its customers are safeguarded. An explanation of UUW's departures from the Code can be found on page 53. An explanation of how the UUG board committees' complied during the year ended 31 March 2015 with the provisions of the Code can be found on pages 58 to 110 of the UUG 2015 annual report.

Board meetings of UUG and UUW are, although held on the same day, kept entirely separate, thus ensuring that the board of each company takes decisions relating to and in the context of the entity in question. Any decisions of a regulatory nature are the responsibility of the UUW board.

The non-executive directors are independent in accordance with the Code, and the Chairman met the Code's independence criteria at the time of his appointment to the UUG board. Board succession is kept continually under review, during the year Nick Salmon stepped down from the board in July 2014 and Stephen Carter was appointed to the Board on 1 September 2014. The company was therefore compliant with the Ofwat licence obligation for there to be three independent non-executive directors serving on the board.

The board of directors

The biographical details of our directors are given on pages 54 to 57 and the details of the directors who served during the year and their attendance at scheduled board meetings are set out in the table below (figures shown in brackets show the maximum number of meetings which the directors could have attended). There were also a number of ad hoc board meetings held by means of telephone conferencing facilities, a number of which related to the price review process.

		Attendance at board meetings
Dr John McAdam	Chairman	8(8)
Steve Mogford	CEO	8(8)
Russ Houlden	CFO	8(8)
Dr Catherine Bell	Independent non-executive director	8(8)
Stephen Carter	Independent non-executive director	4(4)
Steven Fraser	Managing director wholesale	8(8)
Mark Clare	Independent non-executive director	7(8)
Brian May	Independent non-executive director	8(8)
Nick Salmon	Independent non-executive director	4(4)
Sara Weller	Independent non-executive director	8(8)

Corporate governance report

Notes:

(1) Nick Salmon retired from the board on 25 July 2014.

(2) Stephen Carter was appointed to the board on 1 September 2014.

(3) Mark Clare was unable to attend the UUW Board meeting in April 2014 due to a pre-existing commitment that he had prior to joining the Board on 1 November 2013.

Overview of the board's responsibilities

The board members are fully aware of their responsibilities, both individually and collectively, to promote the long-term success of the company and of the company's responsibilities as the regulated licence holder. The board is responsible for ensuring that the company is managed in accordance with its licensed responsibilities and delivering good customer service whilst having regard to other stakeholder interests. Consideration of the long-term interests of shareholders and bondholders, together with those of the wider interests of stakeholders represented by customers, employees, suppliers, the community, the environment and regulators are factored into the company's management processes.

The board is responsible for the assessment and management of the key issues and risks impacting the business. Accordingly, the board sets the company's overall direction, reviews management performance and reviews the company's approach to business planning, risk management and development of policies including health and safety.

The board has formally delegated specific responsibilities to the UUW capital investment committee to consider and approve expenditure and investment proposals within limits determined by the board and the internal control manual. The committee's members are the chief executive officer, the chief financial officer together with other members of the senior management team. Any projects in excess of £50 million are approved by the UUW board. Additionally, the UUG board has oversight of any project in excess of £50 million and any project which materially increases the group's risk profile. The UUG board has a schedule of matters reserved for its own decision, a copy of which can be found on the United Utilities website at corporate.unitedutilities.com/corporategovernance.aspx. There are no specific matters relating to the operation of the regulated activities of UUW that are included therein.

The UUW board delegates certain treasury matters to the chief financial officer and/or treasurer. However, any decisions taken are reported to the UUW board which has ultimate oversight and control.

UUW board activity in 2014/15

Customer

- Considered and approved the Charges Submission for 2015/16
- Met on two occasions with representatives of the 'Customer Challenge Group' to discuss and debate the impact on customers of the company's plans for the next five year period
- Reviewed updates on the company's performance on Service Incentive Mechanism, Serviceability indicators, water service and leakage, wastewater services and water levels and reservoir stocks

Business as usual

- Received updates on the Security and Emergency Measures Directive
- Approved a number of projects that were above delegated limits and which required the board's approval

Corporate governance report

- Received updates on UUW's top 10 capital projects and recent health and safety accidents and near misses
- Approved the award of electricity and gas supply contracts for the period 1 April 2015 to 31 March 2020
- Approved the award of a meter installation and maintenance contract
- Received briefings on sewer flooding and bathing waters
- Approved the award of a new facilities management services provider

Regulatory

- Received monthly updates on progress with the price review submission process and received briefings from the Regulation Director
- Received quarterly updates and the annual report on UUW's DWI water quality performance
- Received updates on the annual Regulatory Reporting process to Ofwat and reviewed and approved the 2014 Risk and Compliance Statement and KPI report
- Received an annual briefing on dam and reservoir safety
- Received an annual health and safety update.
- Received an update on cyber crime
- Approved the August 2014 Data Submission as part of PR14
- Extensively debated and approved the PR14 submission and received reports from advisors and internal and external audit on the Submission and thereafter revised and accepted the Final Determination

Governance

- Noted the retirement of Nick Salmon from the UUW board and approved the appointment of Stephen Carter as an independent non-executive director to the UUW board
- Granted Powers of Attorney to senior managers to authorise treasury and property related matters

Financial

- Reviewed UUW's proposed treasury activities for 2014/15
- Approved UUW's interim and final dividends and dividend policy for AMP6 to 31 March 2020
- Considered actuarial valuations for UUW's pension schemes
- Approved the UUW annual report and financial statements and regulatory accounts
- Approved the move to International Financial Reporting Standards (IFRS) as its accounting standard for the year ended 31 March 2015 and for future financial years.
- Approved the re-registration of UUW from a public to a private limited company.
- Approved a capitalisation of other reserves and a reduction of share capital to facilitate the move to IFRS

Conflicts of interest

Since 1 October 2008, all directors have been under a statutory duty to avoid any situation in which they have, or can have, a direct or indirect interest which conflicts or possibly may conflict with the interests of the company. As is permitted, the company's articles of association contain provisions which permit the unconflicted directors to authorise conflict situations and procedures

Corporate governance report

have been put in place for the disclosure of any conflicts by the directors to the board and for the consideration and, if appropriate, authorisation of such conflicts. The procedures permit any authorisation to be subject to any terms and/or conditions that the unconflicted directors think fit. All directors are asked on an annual basis if their other commitments and interests have changed and a brief report to the board is prepared. In any case, all the directors are required to notify the Chairman and/or company secretary if they believe a conflict situation might arise. Any potential issue of conflict relating to prospective directors would be addressed by the board.

The directors are at all times fully mindful of the fact that they hold a directorship in both UUW and UUG (with the exception of Steven Fraser). Since UUG disposed of the majority of its non-regulated activities, the potential for situations where potential conflicts of interest could arise has significantly diminished. UUG and UUW are, and operate, as distinct legal entities.

Reappointment of directors

Non-executive directors are reappointed annually reflecting their reappointment at the UUG AGM, if appropriate. Their appointment or removal would also be subject to provisions contained within the company's articles of association. Any term beyond six years for a non-executive director would be subject to particularly rigorous review, and will take into account the need for progressive refreshing of the board. A separate nomination committee is not felt to be necessary, as the succession planning needs of the board are dealt with by the UUG nomination committee.

Information, support and advice

Board papers are generally distributed electronically five days in advance of scheduled board meetings to enable directors to obtain a thorough understanding of the matters to be discussed, and seek clarification, if required. All directors have access to the advice and services of the company secretary and his team, who are responsible to the board for ensuring that board procedures are complied with. The appointment and removal of the company secretary are matters reserved to the UUG board. The board has access, through the company secretary, to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. The company also maintains an appropriate level of directors' and officers' insurance.

Code principle: Effectiveness

Induction and training

On joining the group directors receive a tailored induction programme, including an induction pack, time spent with other directors, the company secretary and the executive team. During the year, an induction programme for Stephen Carter was implemented. On appointment new directors are provided with information on the key duties of being a director of a regulated water company. This information is kept continually under review. During the year, the board's understanding of the regulatory environment in which the company operates was enhanced via additional briefings on the price review submission process. The board also received briefings on retail competition, the treatment of customer debt as well as regular briefings on wider regulatory matters.

Performance evaluation

During the year the UUG board undertook an externally facilitated evaluation of its board, committees and directors which aimed to build upon the internally facilitated evaluations conducted during the previous two years. The external evaluation was carried out by Lintstock Consultants. Given that there is a high degree of overlap (and common board membership) between the UUW and UUG boards, the board evaluation posed questions that were relevant to

Corporate governance report

both boards and the results and recommendations were also shared with both boards. (For further details see page 66 of the UUG accounts).

Code principle: Accountability

Board's approach to risk management and internal control
The board is responsible for determining the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The board is also responsible for ensuring that the company's risk management and internal control systems are effectively managed across the business and that they receive an appropriate level of scrutiny and board time.

The company's risks are predominantly those of all regulated water and wastewater companies. One of the most significant is that of failing to achieve our regulatory performance targets or failing to fulfil our obligations in any five-year planning cycle, leading potentially to the imposition of fines and penalties.
2014/15 has been an important year for the company in managing this risk as this year we submitted our business plan to Ofwat for the 2015–2020 period. The board engaged fully with the process to ensure the plan's robustness so that, having received the final determination, we are confident that the business can be managed within the parameters of the determination for the next five-year cycle.

As a result of the publication in September 2014 by the Financial Reporting Council of the 2014 UK Corporate Governance Code and associated guidance, the UUG board concluded, following the review by the UUG audit committee, that it was appropriate to adopt the going concern basis of accounting and to provide a long-term viability statement for UUG (as set out on page 75 of the UUG accounts). Assurance supporting these statements was provided by the review of: the company's key financial measures; the key credit financial ratios; the company's liquidity and the company's on-going ability to meet its financial covenants; and the contingent liabilities of the company.

As part of the assurance process, the board also took into account the principal risks and uncertainties facing the company, and the actions taken to mitigate those risks. These principal risks and uncertainties are detailed on pages 52 to 55 of the UUG accounts, as are the risk management processes and structures used to monitor and manage them. Biannually, the UUG board receives a report detailing management's assessment of the most significant risks facing the company. The report gives an indication of the level of exposure, subject to the mitigating controls in place, for the risk profile of the company. The UUG board also receives information during the year from the UUG treasury committee (to which the board has delegated matters of a treasury nature) including such matters as liquidity policy, the group's capital funding requirements and interest rate management.

Accordingly, given the high degree of overlap, between the business of UUG and UUW, the UUW board similarly concluded that it was appropriate to adopt the going concern basis of accounting and provide a long-term viability statement as set out below

Going concern basis of accounting

The directors have a reasonable expectation that the group has adequate resources for a period of at least 12 months form the date of approval of the financial statements and have therefore assessed that the going concern basis of accounting is appropriate in preparing the financial statements and that there are no material uncertainties to disclose.

Corporate governance report

This conclusion is based on a review of the resources available to the group, taking account of the group's financial projections together with available cash and committed borrowing facilities as well as consideration of the group's capital adequacy; consideration of the primary legal duty of United Utilities Water Limited's economic regulator, to ensure that water and wastewater companies can finance their functions; and any material uncertainties. In reaching this conclusion, the board has considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, the likelihood of their occurrence and the likely effectiveness of actions that the directors would consider undertaking.

Long term viability statement

The directors have assessed the viability of the group over a five-year period to March 2020, taking account of the group's current position and the potential impact of the principal risks documented in the strategic report. Based upon this assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2020.

In making this statement the directors have considered the resilience of the group, taking account of its current position, the principal risks facing the business in severe but reasonable scenarios and the effectiveness of any mitigating actions. This assessment has considered the potential impacts of these risks on the business model, future performance, solvency and liquidity over the period.

The directors have determined that the five-year period to March 2020 is an appropriate period over which to provide its viability statement. In making their assessment, the directors have taken account of the group's robust capital solvency position with a debt to RCV ratio of around 63 per cent, its ability to raise new finance in most market conditions, its key potential mitigating action of restricting dividend payments and the protections which exist under the regulatory model that a primary legal duty of UUW's economic regulator is to ensure that water and wastewater companies can finance their functions.

Significant issues considered in relation to the financial statements
With regard to the UUW financial statements the UUG audit committee and the UUW board reviewed a number of principal areas of judgement, these are disclosed on pages 79 and 80 of the UUG accounts.

External auditor
The company adheres to the UUG policy on non-audit services provided by the external auditor and in relation to auditor independence (see page 78 of the UUG accounts). The company's licence requires the preparation of audited regulatory accounts, given the statutory accounts. However, given the statutory accounts are already audited by KPMG, there are cost savings if KPMG also audits the regulatory accounts. Information on the assessment of the effectiveness of the external audit process can be found on page 78 of the UUG accounts.

The group last tendered its statutory audit in March 2011 when Deloitte were replaced by KPMG. The appointment of statutory auditor is a role delegated to the UUG audit committee.
The committee's terms of reference already provided for the competitive tender of the external audit contract every ten years and for the committee to be responsible for overseeing the tender process and agreeing the scope of the audit, but have been amended to reflect that the committee shall be responsible for agreeing the audit fee and the appointment of the audit engagement partner. Further information can be found on page 79 of the UUG accounts.

Corporate governance report

Licence obligations
The board receives reports about the performance of the company, and annually approves the Risk and Compliance Statement (the 'statement'). The statement sets out how the board pays particular regard, the awareness of and how it meets the obligations of its Licence.

Code principle: Remuneration

Directors' remuneration
The details of directors' remuneration can be found on pages 148 to 152. Further information on the group's approach to executive remuneration can be found in the Remuneration report within the UUG accounts.

Departures from the Code

<u>Section C of the Code – Code principle Accountability</u>
As UUG has an audit committee and the UUG group has a well resourced internal audit function in place (to which the UUW board has access and which reports to the UUW board on matters such as the company's regulatory returns to Ofwat), and, because the work of the audit committee is largely undertaken on behalf of the company, the UUW board concluded that having a separate audit committee for the company was not necessary. Membership of the audit committee consists entirely of independent non-executive directors who are also members of the UUW board. The report of the UUG audit committee can be found on pages 76 to 81 of the UUG accounts.

<u>Section D of the Code – Code principle Remuneration</u>
As UUG has a remuneration committee and because many aspects of executive directors' remuneration (namely employee share plans) operate at a UUG group level. The company remunerates its executive directors and senior management subject to the confines of UUG's remuneration policy. (For further details please see the remuneration report within the UUG accounts). In accordance with their letters of appointment the non-executive directors do not receive any remuneration from the company for their services to the UUW board. Membership of the UUG remuneration committee consists entirely of independent non-executive directors, who are also members of the UUW board.

<u>Section E of the Code – Code principle Relations with shareholders</u>
As a wholly owned subsidiary of UUG, this provision is not relevant to the company. UUG complies fully with this provision and makes a full disclosure in its annual report.

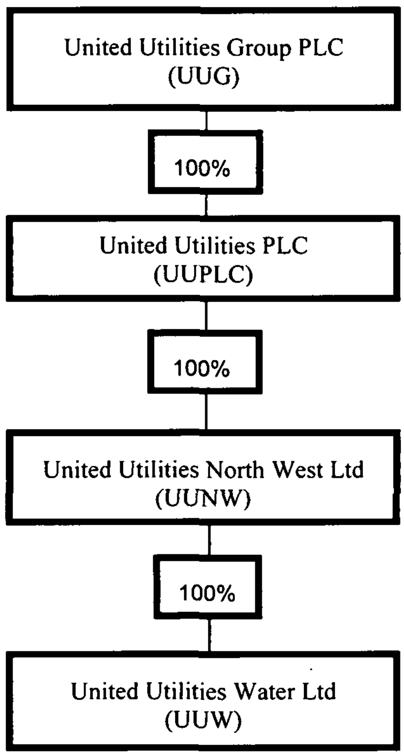
United Utilities group structure
As a group, United Utilities has a simple corporate structure (see summary structure chart below). UUG is the main listed entity with around 100,000 registered shareholders. Below UUG, there are two intermediate holding companies, one is United Utilities PLC (UUPLC)* (which is also the holding company for a number of non-regulated and legacy/dormant companies) and United Utilities North West Ltd
(UUNW)**. The regulated company UUW is a direct subsidiary of UUNW which in turn is a direct subsidiary of UUPLC. Neither UUPLC nor UUNW are operational entities, but are retained in the structure for legacy and administrative reasons.

*United Utilities PLC – was the listed entity prior to July 2008, when the group underwent a scheme of arrangement as part of the return of value to shareholders of the electricity distribution business.

Corporate governance report

**United Utilities North West Ltd – previously held the electricity distribution business prior to its disposal in 2007 and is retained for legal purposes.

United Utilities group structure chart



Biographical details of the board of directors

Dr John McAdam (67)
Chairman

Responsibilities: Responsible for the leadership of the board, setting its agenda and ensuring its effectiveness on all aspects of its role.
Qualifications: BSc (Hons) Chemical Physics, Diploma Advanced Studies in Science, PhD.
Appointment to the board: March 2011.
Skills and experience: *With over 16 years' service as a board director in a wide range of* companies, and as a current non-executive director serving on a number of other boards, John has a wealth of experience on which to draw in his role as Chairman and leader of the board.
Career experience: Appointed to the board of ICI plc in 1999 and became chief executive in 2003, a position held until ICI's takeover by Akzo Nobel.
Current directorships/business interests: Chairman of Rentokil Initial plc, senior independent director of J Sainsbury plc and a non-executive director of Rolls-Royce Holdings plc. He is also Chairman of United Utilities Group PLC.
Independence: John met the Code's independence criteria at the time of his initial appointment as Chairman of UUG.

Corporate governance report

Steve Mogford (58)
Chief Executive Officer (CEO)

Responsibilities: To manage the company's business and to implement the strategy and policies approved by the board.
Qualifications: BSc (Hons) Astrophysics/Maths/Physics.
Appointment to the board: March 2011.
Skills and experience: Steve's experience of the highly competitive defence market and complex design, manufacturing and support programmes has brought renewed focus to customer service and operational performance at United Utilities, and his perspective of the construction and infrastructure sector provides valuable experience relating to United Utilities' capital investment programme.
Career experience: Previously chief executive of SELEX Galileo, the defence electronics company owned by Italian aerospace and defence organisation Finmeccanica and chief operating officer at BAE Systems PLC, and a member of its PLC board, he spent his earlier career with British Aerospace PLC.
Current directorships/business interests: Senior independent director of Carillion PLC, vice-president of Liverpool School of Tropical Medicine. He is also chief executive officer of United Utilities Group PLC.

Russ Houlden (56)
Chief Financial Officer (CFO)

Responsibilities: To manage the company's financial affairs and to contribute to the management of the group's business.
Qualifications: BSc (Hons) Management Sciences, Fellow of the Chartered Institute of Management Accountants, Chartered Global Management Accountant and a Fellow of the Association of Corporate Treasurers.
Appointment to the board: October 2010.
Skills and experience: Russ's skills and experience in accounting, treasury, tax, M&A and investor relations in other commercial and regulated companies, along with his extensive experience of driving performance improvement and managing large capital investment programmes, provides the company with valuable expertise with regard to its drive for improvements in customer service, business development, operations, capital investment and financing.
Career experience: Chief financial officer at Telecom New Zealand. Previously finance director of Lovells, BT Wholesale, BT Networks and Information Services, ICI Polyurethanes and ICI Japan.
Current directorships/business interests: Member of the supervisory board and chairman of the audit committee of Orange Polska SA, the largest listed telecommunications company in Poland. He is a member of the main committee and chairman of the financial reporting committee of the 100 Group. He is also chief financial officer of United Utilities Group PLC.

Corporate governance report

Dr Catherine Bell (64)
Independent non-executive director

Qualifications: MA Geography, PhD Economic History.
Appointment to the board: March 2011.
Skills and experience: Catherine's civil service background and understanding of the operation of government departments and utility regulation are particularly valued given the regulated framework within which the business operates.
Career experience: Formerly a non-executive director of the Civil Aviation Authority and prior to that a former civil servant and acting permanent secretary at the Department for Trade and Industry. Previously a non-executive director of Ensus Limited and Swiss Re GB Plc.
Current directorships/business interests: Non-executive director and executive board member of the Department of Health and a non-executive director of National Grid Gas plc and National Grid Electricity Transmission plc. She is also an independent non-executive director of United Utilities Group PLC.

Stephen Carter (51)
Independent non-executive director

Qualifications: *Bachelor of Law.*
Appointment to the board: September 2014.
Skills and experience: As the CEO of a FTSE listed company, Stephen brings current operational experience to the board. His time spent in public service will provide additional insights to the board regarding regulation and government relations, and his experience in the media and technology industries will provide a new perspective for the board's discussions.
Career experience: Prior to his appointment as group chief executive at Informa plc on 1 January 2014, he was appointed CEO designate on 1 September 2013, having previously served on its board as an independent non-executive director and member of the audit committee. He has also held non-executive director positions at Travis Perkins plc and Royal Mail Holdings plc. Previous roles include president/managing director, Europe, Middle East & Africa, and a member of the executive management board at Alcatel Lucent Inc. Stephen has also held a number of public service roles, serving a term as the founding chief executive of Ofcom. He was formerly chairman of the board at Ashridge Business School. He is a Life Peer.
Current directorships/business interests: Group chief executive at Informa plc and a governor of the Royal Shakespeare Company. He is also an independent non-executive director of United Utilities Group PLC.

Mark Clare (57)
Senior independent non-executive director

Qualifications: Chartered Management Accountant (FCMA).
Appointment to the board: November 2013.
Skills and experience: As the CEO of a FTSE listed company, Mark brings additional current operational experience to the board. His time at British Gas and BAA means he has a strong background operating in a regulated environment and his extensive knowledge of customer-facing businesses is particularly valuable as the industry prepares for increased competition and pursues its continuous drive to improve customer service.
Career experience: Mark has been group chief executive at Barratt Developments plc since October 2006 and is also a trustee of the Building Research Establishment and the UK Green Building Council. Prior to joining Barratt, he was an executive director of Centrica plc and held a number of senior roles within both Centrica plc and British Gas. Mark has also been a non-executive director of BAA plc, the airports operator.
Current directorships/business interests: Group chief executive at Barratt Developments plc. He is also an independent non-executive director of United Utilities Group PLC.

Corporate governance report

Steve Fraser (39)
Managing director, UUW Wholesale

Responsibilities: To manage UUW's wholesale operations and contribute to the management of the company's business.
Qualifications: BA (Hons) Management Studies, MSc Engineering Project Management.
Appointment to the board: April 2013 (had previously served as a director between July 2009 and March 2011).
Skills and experience: Steve's experience in the construction and infrastructure sector provides the company with valuable expertise with regard to its drive for improvements in customer service, operations and capital expenditure.
Career experience: Steve Fraser joined United Utilities in 2005 from Bethell Group, where he was Operations Director. Prior to his current position of managing director, UUW Wholesale, he was responsible for running UU's Energy and Contracting Services business.
Current directorships/business interests: Supervisory Council Member of AS Tallinna Vesi.

Brian May (51)
Independent non-executive director

Qualifications: BSc (Hons) Actuarial Science, Chartered Accountant FCA.
Appointment to the board: September 2012.
Skills and experience: Brian joined Bunzl plc in 1993 as head of internal audit before becoming group treasurer, then finance director, Europe and Australasia, and is currently finance director. Brian's background and the various finance roles that he has held are major assets to the board in chairing both the UUG audit and treasury committees.
Career experience: Brian has been finance director at Bunzl plc since 2006 and prior to that held a number of senior finance roles within the company. Prior to joining Bunzl, Brian qualified as a chartered accountant with KPMG.
Current directorships/business interests: Finance director at Bunzl plc. He is also an independent non-executive director of United Utilities Group PLC.

Sara Weller (53)
Independent non-executive director

Qualifications: MA Chemistry.
Appointment to the board: March 2012.
Skills and experience: Sara's experience of customer-facing businesses, together with her knowledge of operating within a regulated environment, is a major asset to the board as the water industry prepares for the opening up of the sector to more competition and in improving customer service.
Career experience: Sara has wide-ranging business experience having worked for Mars, Abbey National and J Sainsbury plc and latterly as managing director of Argos from 2004 to 2011. She served as the senior independent director at Mitchells and Butlers from 2003 to 2006 and also chaired its remuneration committee from 2003 to 2010.
Current directorships/business interests: Non-executive director of Lloyds Banking Group plc and lead non-executive director for the Department for Communities and Local Government. Sara is chair of the Planning Inspectorate, (an executive agency of the Department of Communities and Local Government), a board member at the Higher Education Funding Council for England and a council member at Cambridge University. She is also an independent non-executive director of United Utilities Group PLC.

Directors' report

The directors present their management report and the audited financial statements for the year ended 31 March 2015.

Profit and dividends

The results for the year, set out in the consolidated income statement on page 65 show that profit for the year after tax was £258.1 million (2014: £717.4 million).

The directors have not recommended a final ordinary dividend (2014: £nil). An interim ordinary dividend of £180.6 million has been declared and paid during the year (2014: £153.0 million).

Business model

A description of the group's business model can be found within the Strategic Report earlier on within this annual report.

United Utilities Water Limited ("UUW") is a subsidiary of United Utilities North West Limited. The ultimate parent company of UUW is United Utilities Group PLC ("UUG").

Adoption of IFRS

Having previously reported under UK Generally Accepted Accounting Practice (UK GAAP), during the year ended 31 March 2015 the company adopted IFRS in accordance with revised reporting standards issued by the Financial Reporting Council which are designed to harmonise accounting standards in the UK.

The adoption of IFRS also aligns the company's accounting framework with that of its ultimate parent company, United Utilities Group PLC. Reflecting certain technical differences between the two accounting standards, most notably in that IFRS does not allow for the discounting of deferred tax liabilities (unlike UK GAAP), the transition to IFRS negatively impacted the distributable reserves position of the company. In order to strengthen its distributable reserves, the company undertook a reduction of share capital on 26 January 2015, as permitted under the Companies Act 2006 (see page 68).

In preparation for the reduction of share capital, on the 11 November 2014, the company was re-registered as a private limited company and accordingly changed its name to United Utilities Water Limited. As a private limited company, the company is no longer able to issue new listed debt securities to the public. To maintain efficient access to debt capital markets, United Utilities Water Finance PLC (UUWF) was incorporated as a new wholly-owned subsidiary of the company on 19 September 2014 to act as a financing subsidiary.

UUWF will raise new debt finance on behalf of the company, via the issuance of notes under the UUG group's London listed €7 billion Euro Medium Term Note Programme (EMTN Programme), as and when such finance is required. All finance raised by UUWF will be unconditionally and irrevocably guaranteed by the company and the proceeds of such financing will be on-lent by UUWF to the company reflecting the terms of the relevant note issue (see page 34).

Whilst the company has ceased to be the direct issuer of any new notes issued under the EMTN Programme, it will remain as the issuer of existing notes previously issued by the company that are currently outstanding. Accordingly, there has been no change to the terms and conditions of the company's existing listed debt portfolio and the company retains all of the associated obligations.

Due to the incorporation of UUWF as a subsidiary of the company, the company has prepared consolidated financial statements for the first time this financial year.

Directors' report

Corporate governance report

The corporate governance report on pages 45 to 57 including the remuneration report is hereby incorporated into this directors' report by reference. A copy of the 2012 UK Corporate Governance Code (the Code) as published by the Financial Reporting Council can be found at frc.co.uk/corporate-governance

Political and charitable donations

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

The period 2014/15 saw us engage with our stakeholders along a number of policy themes as the Water Bill made its way through Parliament and Market Reform planning continued. The group incurred expenditure of £21,600 (2014: £12,235) as part of this process. At the 2014 UUG AGM, an authority was taken to cover such expenditure. A similar resolution will be put to the UUG shareholders at the 2015 AGM to authorise such expenditure.

Research and development

The group undertakes research primarily to provide improved standards of service to customers, together with continuing improvements in business efficiency. Its intention is to strengthen its understanding of science and technology in relation to its range of wastewater and water treatment processes to ensure that treatment plants are able to meet the required current and future standards of environmental performance.

The group is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The group also undertakes specific projects with these and other research and development providers, manufacturers and with universities.

Research and development costs expensed by the group totalled £2.1 million in the year ended 31 March 2015 (2014: £2.4 million).

Events after the balance sheet date

There were no events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2015.

Going concern basis of accounting

The directors' considerations in preparing these financial statements on a going concern basis of accounting are set out in the corporate governance report.

Directors' report

Directors

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

Non-executive directors
Dr John McAdam
Dr Catherine Bell
Stephen Carter (appointed 1 September 2014)
Mark Clare
Brian May
Nick Salmon (retired 25 July 2014)
Sara Weller

Executive directors
Steve Mogford
Steve Fraser
Russ Houlden

Secretary
Simon Gardiner

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 group's business.

Directors' indemnities and insurance

The group has in place contractual entitlements for directors of the company to claim indemnification by the company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. These arrangements, which constitute qualifying third party indemnity provision and qualifying pension scheme indemnity provision, have been established in compliance with the relevant provisions of the Companies Act 2006 and have been in force throughout the financial year. They include provision for the group to fund the costs incurred by directors in defending certain claims against them in relation to their duties as directors of the company or its subsidiaries. The group also maintains an appropriate level of directors' and officers' liability insurance.

Employment policies

Our policies on maternity, paternity, adoption, personal and special leave go beyond the minimum required by law. For disabled applicants and existing employees, we are committed to fulfilling our obligations in accordance with the relevant legislation. Applicants with disabilities are given equal consideration in the application process. Disabled colleagues have equipment and working practices modified for them as far as is possible and wherever it is safe and practical to do so. 'Our responsible approach to doing business' section on page 15, and the group's business principles, which are available on our website at corporate.unitedutilities.com/united-utilities-business-principles explains the way in which we do business. Employees are encouraged to hold shares in UUG through the all employee share incentive plan.

Financial instruments

The risk management objectives and policies of the group in relation to the use of financial instruments can be found in note A4 to the financial statements.

Tangible assets

The group holds significant land assets; however, the vast majority of these are water catchment assets which are an integral and essential part of the operation of the group's regulated

Directors' report

business. The nature of these assets, which are primarily moorland areas and which could not be sold by the group, means that it is impractical to obtain meaningful market values for the land. Other land owned by the group, the majority of which relates to operational sites, does not have a market value materially different from historic cost.

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 2015, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of UUW, 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 12 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 auditor satisfies the requirements of paragraph 9.2 of Condition F of the Licence, namely that 'the auditor will provide such further explanation or clarification of its reports, and such further information in respect of the matters which are the subject of its reports, as the Director General may reasonably require.

Regulatory accounts measures

Appointed business only:	2015 £m	2014 £m
Operating profit per historical cost profit and loss account	690.7	677.2
Exceptional operating costs *	10.6	4.4
Underlying operating profit	701.3	681.6

Atypical operating expenditure items

In accordance with the requirements of Ofwat's Regulatory Accounting Guidelines, atypical items including those items treated as exceptional operating costs under the requirements of UK accounting standards are analysed as follows:

	2015 £m	2014 £m
Restructuring costs *	10.6	4.4

* see note 2 of the statutory financial statements

Significant movements in Infrastructure Renewals Charge and Current Cost Depreciation

The annual infrastructure renewals charge is based on infrastructure renewals spend for 2014/15, the Company Business Plan for Asset Management Plan (AMP) 5 and the Final Business Plan projections for AMP 6 and AMP 7 covering the period 2010 to 2025. The charge for the year ended 31 March 2015 is £151.1 million (2014: £145.2 million).

The current cost depreciation charge (net of deferred credits) for the year is £440.4 million (2014: £427.2 million). This increase of £13.2 million is mainly due to the impact of the 0.9 per cent RPI uplift of the asset base and increased depreciation from assets commissioned in in the

Directors' report

year, offset by depreciation on assets which became fully depreciated in the year, and lower accelerated depreciation in the year ended 31 March 2015.

Disclosure of information to the auditor

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

1. so far as he or she is aware, there is no relevant audit information of which the group's auditor is unaware; and
2. he or she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the group's auditor is aware of that information.

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

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditors will be deemed to be reappointed and KPMG LLP will therefore continue in office. The remuneration of the auditor will be agreed by the UUG Audit Committee.

Approved by the board and signed on its behalf by:

Russ Houlden
Chief Financial Officer
5 June 2015

Statement of directors' responsibilities in respect of the strategic report, the directors' report and the financial statements

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the group and the parent company financial statements in accordance with IFRSs as adopted by the EU and applicable law.

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

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

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

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

Independent auditor's report

to the members of United Utilities Water Limited

We have audited the financial statements of United Utilities Water Limited for the year ended 31 March 2015 set out on pages 65 to 119. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 63, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2015 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

J Luke

John Luke (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
One St Peter's Square, Manchester, M2 3AE
5 JUNE 2015

Consolidated income statement

for the year ended 31 March

	Note	2015 £m	2014 £m
Revenue	1	1,700.0	1,672.1
Employee benefits expense:			
excluding restructuring costs	2	(128.0)	(125.3)
restructuring costs	2	(10.6)	(4.4)
Total employee benefits expense	2	(138.6)	(129.7)
Other operating costs	3	(407.3)	(412.5)
Other income	3	3.1	2.3
Depreciation and amortisation expense	3	(352.8)	(337.3)
Infrastructure renewals expenditure		(148.2)	(165.1)
Total operating expenses		(1,043.8)	(1,042.3)
Operating profit		656.2	629.8
Investment income	4	0.2	6.6
Finance expense	5	(328.1)	(125.7)
Investment income and finance expense		(327.9)	(119.1)
Profit before taxation		328.3	510.7
Current taxation (charge)/credit	6	(47.2)	76.2
Deferred taxation charge	6	(23.0)	(25.6)
Deferred taxation credit – change in taxation rate	6	-	156.1
Taxation	6	(70.2)	206.7
Profit after taxation		258.1	717.4

All of the results shown above relate to continuing operations.

Consolidated and company statement of comprehensive income

for the year ended 31 March

	Note	2015 £m	2014 £m
Profit after taxation		258.1	717.4
Other comprehensive income			
Remeasurement gains/(losses) on defined benefit pension schemes	13	214.7	(191.8)
Taxation on items taken directly to equity	6	(42.9)	39.7
Total comprehensive income		429.9	565.3

None of the items in the table above will be prospectively reclassified to profit or loss.

Consolidated and company statement of financial position

at 31 March

Group and company	Note	2015 £m	2014 £m
ASSETS			
Non-current assets			
Property, plant and equipment	8	9,714.9	9,323.3
Intangible assets	9	144.9	110.1
Investments	A1	0.1	0.1
Retirement benefit surplus	13	74.8	-
Derivative financial instruments	A4	544.8	363.7
		10,479.5	9,797.2
Current assets			
Inventories		9.3	9.3
Trade and other receivables	10	388.6	369.7
Current tax assets		4.4	54.8
Cash and short-term deposits	11	180.0	2.6
Derivative financial instruments	A4	-	56.7
		582.3	493.1
Total assets		11,061.8	10,290.3
LIABILITIES			
Non-current liabilities			
Trade and other payables	16	(479.9)	(451.0)
Borrowings	12	(6,205.0)	(6,216.0)
Retirement benefit obligations	13	-	(145.6)
Deferred tax liabilities	14	(1,115.9)	(1,050.0)
Derivative financial instruments	A4	(196.6)	(52.3)
		(7,997.4)	(7,914.9)
Current liabilities			
Trade and other payables	16	(373.8)	(374.5)
Borrowings	12	(714.3)	(223.9)
Provisions	15	(12.2)	(15.6)
Derivative financial instruments	A4	(7.9)	(54.5)
		(1,108.2)	(668.5)
Total liabilities		(9,105.6)	(8,583.4)
Total net assets		1,956.2	1,706.9
EQUITY			
Capital and reserves attributable to equity holders of the company			
Share capital	17	100.0	1,025.3
Share premium account	17	-	647.8
Other reserve		-	174.7
Retained earnings		1,856.2	(140.9)
Shareholder's equity		1,956.2	1,706.9

These financial statements for the group and United Utilities Water Limited (company number: 2366678) were approved by the board of directors on 5 June 2015 and signed on its behalf by:

Russ Houlden
Chief Financial Officer

Consolidated and company statement of changes in equity

for the year ended 31 March

Group and company

	Share capital £m	Share premium account £m	Other reserve £m	Retained earnings £m	Total £m
At 1 April 2014	1,025.3	647.8	174.7	(140.9)	1,706.9
Profit after taxation	-	-	-	258.1	258.1
Other comprehensive income					
Remeasurement gains on defined benefit pension schemes (see note 13)	-	-	-	214.7	214.7
Taxation on items taken directly to equity (see note 6)	-	-	-	(42.9)	(42.9)
Total comprehensive income	-	-	-	429.9	429.9
Bonus issue of shares (see note 17)	174.7	-	(174.7)	-	-
Capital reduction (see note 17)	(1,100.0)	(647.8)	-	1,747.8	-
Dividends (see note 7)	-	-	-	(180.6)	(180.6)
At 31 March 2015	100.0	-	-	1,856.2	1,956.2

	Share capital £m	Share premium account £m	Other reserve £m	Retained earnings £m	Total £m
At 1 April 2013	1,025.3	647.8	174.7	(553.2)	1,294.6
Profit after taxation	-	-	-	717.4	717.4
Other comprehensive income					
Remeasurement losses on defined benefit pension schemes (see note 13)	-	-	-	(191.8)	(191.8)
Taxation on items taken directly to equity (see note 6)	-	-	-	39.7	39.7
Total comprehensive income	-	-	-	565.3	565.3
Dividends (see note 7)	-	-	-	(153.0)	(153.0)
At 31 March 2014	1,025.3	647.8	174.7	(140.9)	1,706.9

During the year ended 31 March 2015, the company adopted IFRS and, as a result, the other reserve was recognised. Following the transition to IFRS, the other reserve was used to issue bonus shares, which were subsequently cancelled. These transactions have resulted in a transfer from the other reserve to retained earnings (see page 58 for further information).

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The results of the company are the same as the group.

Consolidated and company statement of cash flows

for the year ended 31 March

Group and company	Note	2015 £m	2014 £m
Operating activities			
Cash generated from continuing operations	A2	950.3	927.5
Interest paid		(187.0)	(182.5)
Interest received and similar income		0.1	1.3
Tax paid		(50.0)	(79.0)
Tax received		53.3	74.6
Net cash generated from operating activities		766.7	741.9
Investing activities			
Purchase of property, plant and equipment		(661.0)	(659.7)
Purchase of intangible assets		(63.4)	(39.4)
Proceeds from sale of property, plant and equipment		2.0	2.3
Grants and contributions received	16	18.1	16.4
Proceeds from sale of investments		-	0.1
Net cash used in investing activities		(704.3)	(680.3)
Financing activities			
Proceeds from borrowings		1,482.1	386.7
Repayment of borrowings		(1,173.9)	(225.0)
Dividends paid to equity holders of the company	7	(180.6)	(153.0)
Net cash generated from financing activities		127.6	8.7
Net increase in cash and cash equivalents		190.0	70.3
Cash and cash equivalents at beginning of the year		(33.5)	(103.8)
Cash and cash equivalents at end of the year	11	156.5	(33.5)

Accounting policies

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

Basis of preparation

The financial statements have been prepared for the first time in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union (EU). Results for the comparative periods have been restated under IFRS as adopted for use in the EU.

The financial statements have been prepared on a going concern basis and the directors have set out factors considered in concluding the appropriateness of this presentation in the corporate governance report (see page 51).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments, accounting for the transfer of assets from customers and the revaluation of infrastructure assets to the carrying amount included in the United Utilities Group PLC consolidated financial statements, as deemed cost on transition to IFRS.

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

The disclosures required by IFRS 1 'First-time Adoption of International Financial Reporting Standards' concerning the transition from UK GAAP (United Kingdom generally accepted accounting practices) to IFRS are provided in note A7.

Basis of consolidation

The group financial statements consolidate the financial statements of the company and its subsidiary, United Utilities Water Finance PLC (UUWF). UUWF was incorporated as a wholly-owned subsidiary of the company on 19 September 2014. During the year ended 31 March 2015, UUWF has not undertaken any transactions other than issuing share capital of £50,000 to the company, therefore the group and company are materially the same. As such, the current year financial statements represent both the group and company, and the prior year financial statements represent the company only. For further information see the Directors' report on page 58.

Adoption of new and revised standards

The adoption of the following standards and interpretations, at 1 April 2014, has had no material impact on the group's financial statements.

IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosures of Interests in Other Entities'

This new suite of standards on consolidation replaces the existing accounting standards for subsidiaries and joint ventures, and makes limited amendments in relation to associates.

These standards further identify the concept of control in determining whether an entity should be consolidated within the parent company accounts; removes the choice to proportionally account for joint ventures requiring instead the application of the equity method; and includes related disclosure requirements.

Accounting policies

IFRIC 21 'Levies'

The standard clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy.

Critical accounting judgements and key sources of estimation uncertainty

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

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

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

Property, plant and equipment

The group recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure is a subjective area, particularly when projects have both elements within them. In addition, management capitalise time and resources incurred by the group's support functions on capital programmes.

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

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

Revenue recognition and allowance for doubtful receivables

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

United Utilities Water Limited raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and wastewater customers with water meters, the receivable billed is dependent on the volume supplied including the sales value of an estimate of the units supplied between the date of the last meter reading and the billing date. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based on estimated usage from the last billing through to each reporting date. The estimated usage is based on historical data, judgement and

Accounting policies

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 and revenue recognised is dependent on the rateable value of the property, as assessed by an independent rating officer.

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

Provisions and contingencies

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

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

Retirement benefits

The group operates two defined benefit schemes which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based 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 A5. Profit before taxation and net assets are affected by the actuarial assumptions used. The key assumptions include; discount rates, pay growth, mortality 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.

Derivative financial instruments

The model used to fair value the group's derivative financial instruments requires management to estimate future cash flows based on applicable interest rate curves. Projected cash flows are then discounted back using discount factors which are derived from the applicable interest rate curves adjusted for management's estimate of counterparty and own credit risk, where appropriate.

Taxation

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the application of UK tax law and the result of negotiations with, and enquiries from the UK tax authorities. For further information on accounting policies see note A8.

Accounting policies

Recently issued accounting pronouncements

At the date of authorisation of these financial statements, the following relevant standards and interpretations were in issue but not yet effective. All of the standards in issue but not yet effective have been endorsed by the EU except where noted. The directors anticipate that the group will adopt these standards and interpretations on their effective dates.

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

IFRS 9 'Financial Instruments'

The standard is effective for periods commencing on or after 1 January 2018 but has not yet been endorsed by the EU. Under the provisions of this standard, where the group has chosen to measure borrowings at fair value through profit or loss, the portion of the change in fair value due to changes in the group's own credit risk will be recognised in other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year, £4.6 million of losses would have been recognised in other comprehensive income rather than within the income statement.

The standard also broadens the scope of what can be included within a hedge relationship, which may enable the group's regulatory swaps to be designated within cash flow hedge relationships. If the standard had been adopted in the current year, with all such swaps being designated and all hedges being fully effective, £129.8 million of fair value losses would have been recognised in other comprehensive income rather than within the income statement.

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

Amendment to IAS 1 'Presentation of Financial Statements'

This amendment represents the International Accounting Standard Board's (IASB) first step in its disclosure initiative, is effective for periods commencing on or after 1 January 2016, but has not yet been endorsed by the EU. The narrow focus amendments clarify, rather than significantly change, existing requirements within the standard.

IFRS 15 'Revenue from Contracts with Customers'

This standard is effective for periods commencing on or after 1 January 2017, but has not yet been endorsed by the EU. The standard introduces a new revenue recognition model and replaces IAS 18 'Revenue', IAS 11 'Construction Contracts', IFRIC 13 'Customer Loyalty Programmes', IFRIC 15 'Agreements for the Construction of Real Estate', IFRIC 18 'Transfer of Assets from Customers' and SIC- 31 'Revenue - Barter Transactions Involving Advertising Services'.

Improvements to IFRS 2014

This is a collection of amendments to four standards as part of the IASB's programme of annual improvements. The improvements, issued in September 2014, are yet to be endorsed by the EU and are effective for periods commencing on or after 1 January 2016.

Improvements to IFRS (2012) and IFRS (2013)

This is a collection of amendments to 11 standards as part of the IASB's programme of annual improvements. The improvements were issued in December 2013 and are effective for periods commencing on or after 1 February 2015 and 1 January 2015 respectively.

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

Notes to the financial statements

1. Revenue and segment reporting

The group's revenue arises from the provision of services within the United Kingdom.

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

The group operates and is managed as one class of business, which is the provision of water and wastewater services, therefore no segmental information is required to be disclosed.

2. Directors and employees

Directors' remuneration

	2015 £m	2014 £m
Fees to non-executive directors	0.6	0.6
Salaries	1.4	1.4
Benefits	0.4	0.4
Bonus	0.7	0.7
Share-based payment charge	1.5	1.6
	4.6	4.7

Included within the above are aggregate emoluments of £2.2 million (2014: £2.0 million) in respect of the highest paid director. The highest paid director exercised share options during the current year.

A recharge of £312,000 during the year ended 31 March 2015 (2014: £66,000) was charged to other companies in the United Utilities group in relation to the provision of director services. No executive directors accrued benefits under defined benefit schemes, and all executive directors opted for a cash allowance in lieu of their defined contribution pension entitlement during the current and prior year.

Three directors (2014: three directors) received shares in United Utilities Group PLC in respect of qualifying services, and three directors (2014: two directors) exercised nil-cost share options in United Utilities Group PLC during the year. Three directors (2014: two directors) had long-term incentive plans which vested during the year. Aggregate amounts receivable of £2.4 million (2014: £1.7 million), were recognised during the year relating to long-term incentive plans.

Further information about the remuneration of individual directors and details of their pension arrangements are provided in note 9 of the regulatory accounts on pages 148 to 152.

Remuneration of key management personnel

	2015 £m	2014 £m
Salaries and short-term employee benefits	5.9	5.6
Post-employment benefits	0.2	0.3
Share-based payment charge	2.4	2.5
	8.5	8.4

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

Notes to the financial statements

2. Directors and employees (continued)

Employee benefits expense (including directors)

	2015 £m	2014 £m
Wages and salaries	206.3	204.0
Social security costs	18.1	18.6
Severance	6.7	4.4
Post-employment benefits:		
Defined benefit expense (see note 13)	23.1	19.1
Defined contribution pension costs (see note 13)	8.8	8.1
	31.9	27.2
Recharges	(3.3)	(1.9)
Charged to regulatory capital schemes	(121.1)	(122.6)
Employee benefits expense	138.6	129.7

Within employee benefits expense were £10.6 million (2014: £4.4 million) of restructuring costs.

A recharge of £3.3 million during the year ended 31 March 2015 (2014: £1.9 million) was charged to other companies in the United Utilities group in relation to the provision of employee services.

Options over shares of the ultimate parent undertaking, United Utilities Group PLC, have been granted to employees of the company under various schemes. Details of the terms and conditions of each share option scheme are given in the United Utilities Group PLC Annual Report 2015. Included within wages and salaries is an expense of £2.9 million (2014: £4.4 million) relating to a recharge of share-based payment costs from the ultimate parent undertaking.

Average number of employees during the year (including directors)

	2015 number	2014 number
Average number of employees (full-time equivalent)	5,057	5,061

The 2015 employee benefits expense of £263.0 million (2014: £254.2 million) includes the employee costs relating to the persons employed during the year noted above in addition to costs of £15.7 million (2014: £18.1 million) in relation to services provided by employees of United Utilities PLC who support United Utilities Water Limited. These costs have been incurred directly by United Utilities Water Limited throughout the year but relate to employees of United Utilities PLC. The average number of employees of United Utilities PLC providing services to the company during the year was 221 (2014: 268).

Notes to the financial statements

3. Operating profit

	2015 £m	2014 £m
Other operating costs		
Hired and contracted services	85.3	83.3
Property rates	80.3	87.6
Power	67.9	62.7
Materials	58.3	50.4
Charge for bad and doubtful receivables (see note 10)	53.0	37.1
Regulatory fees	29.2	36.2
Accommodation	7.0	6.7
Loss on disposal of plant, property and equipment	5.1	6.4
Operating leases payable:		
Property	3.7	3.4
Plant and equipment	0.7	0.8
Legal and professional	3.5	4.3
Research and development	2.1	2.4
Loss on disposal of intangible assets	0.5	-
Movement in other provisions (see note 15)	(3.4)	10.9
Amortisation of deferred grants and contributions (see note 16)	(7.7)	(7.4)
Other	21.8	27.7
	407.3	412.5
Other income		
Other income	(3.1)	(2.3)
	(3.1)	(2.3)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (see note 8)	323.9	313.3
Amortisation of intangible assets (see note 9)	28.9	24.0
	352.8	337.3

During the year, the group obtained the following services from its auditor:

	2015 £000	2014 £000
Audit services		
Statutory audit – group and company	223	155
Regulatory reporting	30	30
	253	185
Audit related services	-	15
Other non-audit services	112	100
	365	300

4. Investment income

	2015 £m	2014 £m
Interest receivable on short-term bank deposits held at amortised cost	0.2	-
Interest receivable on taxation settlement	-	4.3
Net pension interest income (see note 13)	-	2.3
	0.2	6.6

Notes to the financial statements

5. Finance expense

	2015 £m	2014 £m
Interest payable		
Interest payable on borrowings held at amortised cost	185.4	221.1
Interest payable on borrowings from parent and fellow subsidiary undertakings	4.6	4.8
Preference share dividends (see note 7)	9.1	9.1
	199.1	235.0
Fair value losses/(gains) on debt and derivative instruments(1)		
Fair value hedge relationships:		
Borrowings	68.2	(129.4)
Designated swaps	(78.2)	116.2
	(10.0)	(13.2)
Financial instruments at fair value through profit or loss		
Borrowings designated at fair value through profit or loss(2)	65.0	(32.6)
Associated swaps(3)	(73.5)	53.6
	(8.5)	21.0
2010-2015 regulatory swaps(3)	(56.3)	(68.0)
2015+ regulatory swaps(3)	186.1	(67.6)
Electricity swaps(3)	(6.0)	4.2
Net receipts on swaps and debt under fair value option	19.1	13.8
Other swaps(3)(4)	1.1	6.4
Other	(2.2)	(5.9)
	141.8	(117.1)
Net fair value losses/(gains) on debt and derivative instruments(5)	123.3	(109.3)
Net pension interest expense (see note 13)	5.7	-
	328.1	125.7

(1) 'Fair value losses/(gains) on debt and derivative instruments' includes foreign exchange gains of £53.9 million (2014: £25.8 million), excluding those on instruments measured at fair value through profit or loss. These gains are largely offset by fair value losses on derivatives.

(2) Includes a £4.6 million loss (2014: £11.1 million) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.

(3) These swap contracts are not designated within an IAS 39 hedge relationship and are, as a result, classed as 'held for trading' under the accounting standard. These derivatives form economic hedges and, as such, management intend to hold these through to maturity.

(4) Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.

(5) Includes £18.0 million expense (2014: £13.6 million) due to interest on swaps and debt under fair value option.

Interest payable for the year ended 31 March 2015 is stated net of £20.9 million (2014: £19.4 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and intangible assets during the year. This has been calculated by applying a capitalisation rate of 3.1 per cent (2014: 3.8 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

Notes to the financial statements

6. Taxation

	2015 £m	2014 £m
Current taxation		
UK corporation tax	56.6	75.8
Adjustment in respect of prior years	(9.4)	(152.0)
Total current taxation charge/(credit) for the year	47.2	(76.2)
Deferred taxation		
Current year	14.6	38.9
Adjustment in respect of prior years	8.4	(13.3)
	23.0	25.6
Change in taxation rate	-	(156.1)
Total deferred taxation charge/(credit) for the year	23.0	(130.5)
Total taxation charge/(credit) for the year	70.2	(206.7)

The current taxation charge for the year ended 31 March 2014 includes a credit of £152.0 million, and an associated deferred taxation credit of £13.3 million relating to agreed matters in relation to prior years covering a period of over 10 years in total. In addition, deferred taxation credits for the year ended 31 March 2014 include a credit of £156.1 million, reflecting the staged reductions in the mainstream rate of corporation tax from 23 per cent in the year ended 31 March 2014 to 20 per cent effective from 1 April 2015.

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

	2015 £m	2015 %	2014 £m	2014 %
Profit before taxation	328.3		510.7	
Taxation at the UK corporation tax rate	68.9	21.0	117.5	23.0
Adjustment in respect of prior years	(1.0)	(0.3)	(165.3)	(32.4)
Change in taxation rate	-	-	(156.1)	(30.6)
Net expense/(income) not taxable/other	2.3	0.7	(2.8)	(0.5)
Total taxation charge/(credit) and effective tax rate for the year	70.2	21.4	(206.7)	(40.5)

Notes to the financial statements

6. Taxation (continued)

Taxation on items taken directly to equity

	2015 £m	2014 £m
Current taxation:		
Relating to other pension movements	-	(1.8)
Deferred taxation (see note 14)		
On remeasurement gains/(losses) on defined benefit pension schemes	42.9	(38.4)
Relating to other pension movements	-	1.5
Change in taxation rate	-	(1.0)
	42.9	(37.9)
Total taxation charge/(credit) on items taken directly to equity	42.9	(39.7)

7. Dividends

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

	2015 £m	2014 £m
Ordinary shares		
Second interim dividend for the year ended 31 March 2014 at 12.5 pence per share (2014: 9.6 pence per share)	116.6	89.0
Interim dividend for the year ended 31 March 2015 at 64.0 pence per share[1] (2014: 6.9 pence per share)	64.0	64.0
	180.6	153.0

[1] Based upon 100,000,000 shares following the capital reduction on 26 January 2015, see note 17.

The directors have not recommended a final ordinary dividend (2014: £nil).

The company's redeemable preference shares are included in the statement of financial position as a liability and, accordingly, dividends payable on them are included in net interest payable (see notes 5 and 12).

Notes to the financial statements

8. Property, plant and equipment

Group and company	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
Cost						
At 1 April 2013	245.0	4,329.5	5,494.3	454.9	1,008.9	11,532.6
Additions	11.4	87.7	127.6	34.1	431.4	692.2
Transfers	20.2	139.9	333.8	20.1	(514.0)	-
Disposals	(2.4)	(1.4)	(31.3)	(23.4)	-	(58.5)
At 31 March 2014	274.2	4,555.7	5,924.4	485.7	926.3	12,166.3
Additions	8.3	112.8	90.9	19.9	490.7	722.6
Transfers	27.2	219.9	272.8	18.3	(538.2)	-
Disposals	(4.1)	(0.4)	(27.2)	(33.6)	-	(65.3)
At 31 March 2015	305.6	4,888.0	6,260.9	490.3	878.8	12,823.6
Accumulated depreciation						
At 1 April 2013	75.3	205.7	2,026.4	272.1	-	2,579.5
Charge for the year	10.2	34.7	227.5	40.9	-	313.3
Transfers	-	-	(0.5)	0.5	-	-
Disposals	(2.0)	(0.6)	(25.6)	(21.6)	-	(49.8)
At 31 March 2014	83.5	239.8	2,227.8	291.9	-	2,843.0
Charge for the year	15.9	35.4	233.2	39.4	-	323.9
Disposals	(3.8)	-	(22.6)	(31.8)	-	(58.2)
At 31 March 2015	95.6	275.2	2,438.4	299.5	-	3,108.7
Net book value						
At 31 March 2015	210.0	4,612.8	3,822.5	190.8	878.8	9,714.9
Net book value						
At 31 March 2014	190.7	4,315.9	3,696.6	193.8	926.3	9,323.3

At 31 March 2015, the group and company had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £394.5 million (2014: £333.9 million).

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

Notes to the financial statements

9. Intangible assets

Group and company	Total £m
Cost	
At 1 April 2013	206.7
Additions	40.1
Disposals	(17.6)
At 31 March 2014	229.2
Additions	64.2
Disposals	(29.5)
At 31 March 2015	263.9
Accumulated amortisation	
At 1 April 2013	112.7
Charge for the year	24.0
Disposals	(17.6)
At 31 March 2014	119.1
Charge for the year	28.9
Disposals	(29.0)
At 31 March 2015	119.0
Net book value at 31 March 2015	144.9
Net book value at 31 March 2014	110.1

The group and company's intangible assets relate mainly to computer software.

At 31 March 2015, the group and company had entered into contractual commitments for the acquisition of other intangible assets amounting to £2.3 million (2014: £29.4 million).

10. Trade and other receivables

Group and company	2015 £m	2014 £m
Trade receivables	171.2	182.5
Amounts owed by parent and fellow subsidiary undertakings:		
Trading balances	2.7	7.3
Floating rate loan	40.0	40.0
Amounts owed by related parties (see note A6)	0.1	-
Other debtors	22.8	18.6
Prepayments and accrued income	151.8	121.3
	388.6	369.7

At 31 March 2015 and 31 March 2014, the group and company had no trade and other receivables classified as non-current.

Notes to the financial statements

10. Trade and other receivables (continued)

The carrying amounts of trade and other receivables approximate their fair value.

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

Group and company	2015 £m	2014 £m
At the start of the year	97.7	87.1
Amounts charged to operating expenses	53.0	37.1
Trade receivables written off	(50.2)	(26.5)
At the end of the year	100.5	97.7

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

At 31 March 2015 and 31 March 2014, the group and company had no trade receivables that were past due and not individually impaired.

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

Group and company	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
Trade receivables				
At 31 March 2015	124.5	43.5	3.2	171.2
At 31 March 2014	111.2	39.9	31.1	182.2

At 31 March 2015, the group and company had £nil million (2014: £0.3 million) of trade receivables that were not past due.

11. Cash and cash equivalents

Group and company	2015 £m	2014 £m
Cash at bank and in hand	2.4	2.6
Short-term bank deposits	177.6	-
Cash and short-term deposits	180.0	2.6
Bank overdrafts (included in borrowings, see note 12)	(23.5)	(36.1)
Cash and cash equivalents in the statement of cash flows	156.5	(33.5)

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

Notes to the financial statements

12. Borrowings

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

Group and company	2015 £m	2014 £m
Non-current liabilities		
Bonds	3,457.1	3,793.1
Bank and other term borrowings	1,827.7	1.463.4
Amounts owed to intermediate parent undertaking	920.2	959.5
	6,205.0	6,216.0
Current liabilities		
Bonds	425.9	-
Bank and other term borrowings	57.1	28.8
Bank overdraft	23.5	36.1
130,000,000 7.0 per cent £1.00 redeemable preference shares	130.0	130.0
Amounts owed to intermediate parent undertaking	77.8	29.0
	714.3	223.9
	6,919.3	6,439.9

The £130.0 million 7.0 per cent redeemable preference shares have been presented as amounts falling due within one year as they may be redeemed by not less than 30 days' written notice served by the group or the shareholder. Preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the group. However, preference shareholders receive priority to other classes of shareholders on a winding up, liquidation or other return of capital to shareholders of the group. The preference shares have a latest redemption date of 1 October 2099.

Notes to the financial statements

12. Borrowings (continued)

Terms and debt repayment schedule

The principal economic terms and conditions of outstanding borrowings, along with fair value and carrying value were as follows:

Group and company	Currency	Year of final repayment	Fair value 2015 £m	Carrying value 2015 £m	Fair value 2014 £m	Carrying value 2014 £m
Borrowings in fair value hedge relationships			**1,777.6**	**1,803.3**	**1,708.1**	**1,733.5**
5.375% 150m bond	GBP	2018	175.1	167.0	173.7	167.7
4.25% 500m bond	EUR	2020	427.5	424.1	473.6	476.2
5.75% 375m bond	GBP	2022	457.9	432.4	432.4	409.2
5.625% 300m bond	GBP	2027	391.2	408.1	347.4	363.3
5.02% JPY 10,000m dual currency loan	JPY/USD	2029	75.4	86.3	68.1	79.7
5.00% 200m bond	GBP	2035	250.5	285.4	212.9	237.4
Borrowings designated at fair value through profit or loss			**333.7**	**333.7**	**268.7**	**268.7**
6.875% 400m bond (owed to intermediate parent)	USD	2028	333.7	333.7	268.7	268.7
Borrowings measured at amortised cost			**5,521.2**	**4,782.3**	**4,742.0**	**4,437.7**
Short-term bank borrowings – fixed	GBP	2015	46.7	46.7	28.5	28.5
6.125% 425m bond	GBP	2015	447.6	425.9	466.2	427.3
1.97% + RPI 200m IL loan	GBP	2016	271.9	264.1	265.1	257.1
1.30% + LIBOR 5,000m bond	JPY	2017	29.2	28.8	30.0	29.7
2.46% + RPI 50m IL loan	GBP	2020	67.0	58.5	68.7	57.9
2.10% + RPI 50m IL loan	GBP	2020	65.8	58.5	67.2	57.8
1.93% + RPI 50m IL loan	GBP	2020	65.5	58.6	66.7	58.0
1.90% + RPI 50m IL loan	GBP	2020	65.5	58.7	66.6	58.1
1.88% + RPI 50m IL loan	GBP	2020	65.2	58.6	66.4	57.9
1.84% + RPI 50m IL loan	GBP	2020	65.3	58.8	66.5	58.1
1.73% + RPI 50m IL loan	GBP	2020	65.1	58.8	66.1	58.2
1.61% + RPI 50m IL loan	GBP	2020	64.8	58.9	65.7	58.3
0.47% + RPI 100m IL loan	GBP	2023	105.0	103.8	95.8	102.6
0.49% + RPI 100m IL loan	GBP	2025	101.6	99.9	-	-
1.29% + RPI 50m IL (amortising) loan	GBP	2029	59.3	55.4	55.4	54.8
1.23% + RPI 50m IL (amortising) loan	GBP	2029	59.1	55.8	55.0	55.2
1.12% + RPI 50m IL (amortising) loan	GBP	2029	58.2	55.0	53.6	54.4
1.10% + RPI 50m IL (amortising) loan	GBP	2029	58.0	54.9	53.4	54.3
0.75% + RPI 50m IL (amortising) loan	GBP	2029	55.6	53.7	49.5	53.1
1.15% + RPI 50m IL (amortising) loan	GBP	2030	56.8	53.4	52.0	52.8
1.11% + RPI 50m IL (amortising) loan	GBP	2030	56.8	53.5	50.8	52.9
0.76% + RPI 50m IL (amortising) loan	GBP	2030	55.4	53.6	49.3	53.0
0.709% + LIBOR 100m (amortising) loan	GBP	2032	97.7	100.0	89.2	100.0
0.691%+ LIBOR 150m (amortising) loan	GBP	2032	146.2	150.0	-	-
3.375% + RPI 50m IL bond	GBP	2032	110.9	72.0	97.2	70.2
0.573% + LIBOR (amortising) loan	GBP	2033	96.1	100.0	-	-
1.9799% + RPI 100m IL bond	GBP	2035	174.9	135.0	148.8	131.7
1.66% +RPI 35m IL bond	GBP	2037	52.9	43.0	45.5	42.6
2.40% + RPI 70m IL bond	GBP	2039	117.2	83.8	102.3	82.9
1.7829% + RPI 100m IL bond	GBP	2040	177.4	133.6	142.9	130.3
1.3258% + RPI 50m IL bond	GBP	2041	80.7	66.7	65.6	65.0
1.5802% + RPI 100m IL bond	GBP	2042	171.7	133.2	137.0	129.9
1.5366% + RPI 50m IL bond	GBP	2043	85.0	66.5	68.4	64.8

Notes to the financial statements

12. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2015 £m	2015 Carrying value 2015 £m	Fair value 2014 £m	2014 Carrying value 2014 £m
Borrowings measured at amortised cost (continued)						
1.397% + RPI 50m IL bond	GBP	2046	85.0	66.6	66.0	65.0
1.7937% + RPI 50m IL bond	GBP	2049	95.0	66.3	73.8	64.7
Commission for New Towns (amortising) loan – fixed	GBP	2053	55.6	29.3	51.9	29.5
1.847% + RPI 100m IL bond	GBP	2056	186.8	129.9	150.8	128.4
1.815% + RPI 100m IL bond	GBP	2056	185.5	129.3	148.7	127.9
1.662% + RPI 100m IL bond	GBP	2056	178.8	129.1	142.0	127.6
1.591% + RPI 25m IL bond	GBP	2056	43.6	32.2	34.6	31.8
1.5865% + RPI 50m IL bond	GBP	2056	86.9	64.5	69.5	63.8
1.556% + RPI 50m IL bond	GBP	2056	86.9	64.2	68.4	63.5
1.435% + RPI 50m IL bond	GBP	2056	84.2	63.9	65.9	63.2
1.3805% + RPI 35m IL bond	GBP	2056	58.2	44.7	45.3	44.3
1.702% + RPI 50m IL bond	GBP	2057	88.7	62.6	69.9	61.9
1.585% + RPI 100m IL bond	GBP	2057	172.1	124.2	133.9	122.8
Preference shares (owed to immediate parent undertaking)	GBP	2099	130.0	130.0	130.0	130.0
Amounts owed to intermediate parent undertaking	GBP	Various	664.3	664.3	719.8	719.8
Bank overdrafts	GBP	2015	23.5	23.5	36.1	36.1
			7,632.5	6,919.3	6,718.8	6,439.9

IL Index-linked debt – this debt is adjusted for movements in the Retail Prices Index with reference to a base RPI established at the trade date

RPI The UK general index of retail prices (for all items) as published by the Office of National Statistics (Jan 1987=100)

Borrowings are unsecured. Funding raised in currencies other than sterling is swapped to sterling to match funding costs to income and assets.

13. Retirement benefit obligations

Defined benefit schemes

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

Group and company	2015 £m	2014 £m
Current service cost	(16.7)	(16.3)
Curtailments/settlements	(4.8)	(1.4)
Administration expenses	(1.6)	(1.4)
Pension expense charged to operating profit	(23.1)	(19.1)
Net pension interest (expense)/income (charged)/credited to finance expense (see note 5)/investment income (see note 4)	(5.7)	2.3
Net pension expense charged before taxation	(28.8)	(16.8)

Notes to the financial statements

13. Retirement benefit obligations (continued)

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £18.3 million (2014: £17.7 million) comprising current service costs and administrative expenses. Total post-employment benefits expense excluding curtailments/ settlements charged to operating profit of £27.1 million (2014: £25.8 million) comprise the defined benefit costs described above of £18.3 million (2014: £17.7 million) and defined contribution pension costs of £8.8 million (2014: £8.1 million) (see note 2).

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

Group and company	2015 £m	2014 £m
At the start of the year	(145.6)	38.1
Expense recognised in the income statement	(28.8)	(16.8)
Contributions paid	34.5	24.9
Remeasurement gains/(losses) gross of taxation	214.7	(191.8)
At the end of the year	74.8	(145.6)

Included in the contributions paid of £34.5 million (2014: £24.9 million) were pre-paid accelerated deficit repair contributions of £8.0 million (2014: £nil) and an inflation funding mechanism payment of £4.5 million (2014: £8.2 million).

Remeasurement gains and losses are recognised directly in the statement of comprehensive income.

Group and company	2015 £m	2014 £m
The return on plan assets, excluding amounts included in interest	550.0	56.9
Actuarial losses arising from changes in financial assumptions	(372.4)	(81.4)
Actuarial gains arising from changes in demographic assumptions[1]	8.0	27.2
Actuarial gains/(losses) arising from experience	29.1	(194.5)
Remeasurement gains/(losses) on defined benefit pension schemes	214.7	(191.8)

Note:
[1]Following investigations carried out as part of the last triennial scheme funding valuation performed in March 2013.

For more information in relation to the group's and company's defined benefit pension schemes see note A5.

Defined contribution schemes

During the year, the group and company made £8.8 million (2014: £8.1 million) of contributions (see note 2) to defined contribution schemes relating to continuing operations, which are included in arriving at operating profit.

Notes to the financial statements

14. Deferred tax liabilities

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

Group and company	Accelerated taxation depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2013	1,239.6	8.8	(30.0)	1,218.4
(Credited)/charged to the income statement	(159.3)	-	28.8	(130.5)
Credited to equity (see note 6)	-	(37.9)	-	(37.9)
At 31 March 2014	1,080.3	(29.1)	(1.2)	1050.0
Charged/(credited) to the income statement	43.5	1.9	(22.4)	23.0
Charged to equity (see note 6)	-	42.9	-	42.9
At 31 March 2015	1,123.8	15.7	(23.6)	1,115.9

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

15. Provisions

Group and company	Severance £m	Other £m	Total £m
At 1 April 2013	1.4	8.5	9.9
Charged to the income statement	4.4	10.9	15.3
Utilised in the year	(3.5)	(6.1)	(9.6)
At 31 March 2014	2.3	13.3	15.6
Charged/(credited) to the income statement	6.7	(3.4)	3.3
Utilised in the year	(4.2)	(2.5)	(6.7)
At 31 March 2015	4.8	7.4	12.2

The group and company had no provisions classed as non-current at 31 March 2015 or 31 March 2014.

The severance provision as at 31 March 2015 and 31 March 2014 relates to severance costs as a result of group reorganisation.

Other provisions principally relate to contractual and legal claims against the group and company and represent management's best estimate of the value of settlement, the timing of which is dependent on the resolution of the relevant legal claims.

Notes to the financial statements

16. Trade and other payables

Group and company	2015 £m	2014 £m
Non-current		
Deferred grants and contributions	476.7	441.8
Other creditors	3.2	9.2
	479.9	451.0
Current		
Trade payables	39.6	40.1
Amounts owed to parent and fellow subsidiary undertakings	9.1	9.2
Amounts owed to related parties	-	0.1
Other taxation and social security	4.7	4.9
Deferred grants and contributions	9.1	8.9
Accruals and deferred income	311.3	311.3
	373.8	374.5
	853.7	825.5

The average credit period taken for trade purchases is 29 days (2014: 27 days).

The carrying amounts of trade and other payables approximate their fair value.

Deferred grants and contributions

Group and company	2015 £m	2014 £m
At the start of the year	450.7	419.0
Cash received during the year	18.1	16.4
Transfer of assets from customers	27.0	24.8
Credited to the income statement – revenue	(2.3)	(2.1)
Credited to the income statement – other operating expenses (see note 3)	(7.7)	(7.4)
	485.8	450.7

17. Share capital and share premium

Group and company	2015 £m	2014 £m
Issued, called up and fully paid		
100,000,000 (2014: 931,930,000) ordinary shares of £1.00 each	100.0	931.9
Nil (2014: 93,437,000) zero per cent preference shares of £1.00 each	-	93.4
130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each	130.0	130.0
	230.0	1,155.3
Less: 130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each designated as borrowings (see note 12)	(130.0)	(130.0)
	100.0	1,025.3
Share premium account	-	647.8

Notes to the financial statements

17. Share capital and share premium (continued)

Zero per cent preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the group. 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.

In accordance with IAS 32 'Financial Instruments: Presentation', 130,000,000 7 per cent preference shares of £1.00 each have been recognised as financial liabilities. The 7 per cent preference shares have a redemption date of 1 October 2099. For further information, see note 12.

On 26 January 2015 the company made a bonus share issue of 174,707,158 £1 ordinary shares from the other reserve created on adoption of IFRS, which increased the company share capital to £1,200.0 million.

On 26 January 2015 the company passed a resolution to reduce its capital, whereby the company cancelled 1,006,637,158 £1 ordinary shares; 93,437,000 £1 zero per cent coupon preference shares and £647.8 million from the share premium account. The reduction in share capital of £1,747.8 million that resulted has been credited to retained earnings. See page 58 for further information.

18. Operating lease commitments

Group and company	Property 2015 £m	Plant and equipment 2015 £m	Property 2014 £m	Plant and equipment 2014 £m
Commitments under non-cancellable operating leases due:				
Within one year	3.3	0.7	3.2	0.8
In the second to fifth years inclusive	11.4	0.5	11.2	0.5
After five years	280.3	-	258.0	-
	295.0	1.2	272.4	1.3

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

19. Events after the reporting period

There are no events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2015.

Notes to the financial statements

20. Ultimate parent undertaking

The company's immediate parent undertaking is United Utilities North West Limited, a company incorporated in Great Britain.

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

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

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

A1 Subsidiaries and other group undertakings

Details of the company's subsidiary undertakings and other investments, all of which are unlisted unless otherwise stated, are:

	Class of share capital held	Proportion of share capital owned %	Nature of business
Subsidiary undertakings **Great Britain**			
United Utilities Water Finance PLC[1]	Ordinary	100.00	Finance company
Other investments **Great Britain**			
WRc plc	A Ordinary	16.97	Water and wastewater research
PayPoint plc (listed)	Ordinary	0.05	Cash collection service
Lingley Mere Management[2] Company Limited	Ordinary (non-voting)	93.27	Estate management

[1] See page 58 for further information.
[2] See note A6 for further information.

The company's investments mainly comprise investments in WRc plc. These investments are held at fair value.

The company also has an interest in Rivington Heritage Trust which is limited by guarantee. The company is one of four equal guarantors of Rivington Heritage Trust. Its liability is limited to its guarantee of £1.00.

Notes to the financial statements

A2 Cash generated from operations

Group and company	2015 £m	2014 £m
Profit before taxation	328.3	510.7
Adjustment for investment income (see note 4) and finance expense (see note 5)	327.9	119.1
Operating profit	656.2	629.8
Adjustments for:		
Depreciation of property, plant and equipment (see note 8)	323.9	313.3
Amortisation of intangible assets (see note 9)	28.9	24.0
Loss on disposal of property, plant and equipment (see note 3)	5.1	6.4
Amortisation of deferred grants and contributions (see note 16)	(7.7)	(7.4)
Loss on disposal of intangible assets (see note 3)	0.5	-
Other non-cash movements	(1.2)	(2.0)
Changes in working capital:		
Increase in inventories	-	(3.7)
Increase in trade and other receivables	(18.9)	(8.2)
Decrease in trade and other payables	(21.7)	(24.6)
(Decrease)/increase in provisions (see note 15)	(3.4)	5.7
Pension contributions paid less pension expense charged to operating profit	(11.4)	(5.8)
Cash generated operations	950.3	927.5

The group and company have received property, plant and equipment of £27.0 million (2014: £24.8 million) in exchange for the provision of future goods and services (see notes 16 and A8).

A3 Net debt

Group and company	2015 £m	2014 £m
Net debt at start of the year	6,083.7	6,029.9
Net capital expenditure	704.3	680.3
Dividends	180.6	153.0
Interest and taxation	183.6	185.6
Non-cash movements and other	157.1	(37.6)
Operating cashflow	(950.3)	(927.5)
Net debt at end of the year	6,359.0	6,083.7

Net debt comprises borrowings, net of cash and short-term deposits, derivatives and a £40.0 million loan receivable from intermediate parent undertaking.

A4 Financial risk management

Risk management

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

The United Utilities Group PLC (UUG) treasury committee, a sub-committee of the UUG board, has responsibility for setting and monitoring the group's adherence to treasury policies, along with oversight in relation to the activities of the treasury function. Treasury policies cover the key financial risks: liquidity risk, credit risk, market risk (inflation, interest rate, electricity price and currency) and capital risk.

Notes to the financial statements

A4 Financial risk management (continued)

These policies are reviewed by the UUG treasury committee for approval on at least an annual basis, or following any major changes in treasury operations and/or financial market conditions.

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

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

Liquidity risk

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

At 31 March 2015, the group and company had £1,099.0 million (2014: £942.3 million) of available liquidity, which comprised £180.0 million cash and short-term deposits (2014: £2.6 million), £519.0 million (2014: £539.7 million) of undrawn committed borrowing facilities and £400.0 million (2014: £400.0 million) of undrawn term loan facilities. Short-term deposits mature within three months and bank overdrafts are repayable on demand.

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

Group and company	2015 £m	2014 £m
Expiring within one year	25.0	25.0
Expiring after one year but in less than two years [1]	165.0	675.0
Expiring after more than two years	330.0	325.0
Total borrowing facilities	520.0	1,025.0
Facilities drawn	(1.0)	(485.3)
Undrawn borrowing facilities	519.0	539.7

[1] Figure includes £50.0 million (2014: £650.0 million) facility provided by intermediate parent undertaking.

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

Notes to the financial statements

A4 Financial Risk Management (continued)

Maturity analysis

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

Group and company	Total[1]	Adjustment[2]	1 year or less	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years
At 31 March 2015	£m	£m	£m	£m	£m	£m	£m	£m
Bonds	9,102.5	-	554.4	104.5	134.7	256.5	484.6	7,567.8
Bank borrowings and other	2,466.2	-	113.8	348.9	84.2	85.8	86.9	1,746.6
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent borrowings	1,176.3	-	101.6	74.3	75.4	409.7	69.5	445.8
Adjustment to carrying value	(5,955.7)	(5,955.7)	-	-	-	-	-	-
Borrowings	6,919.3	(5,955.7)	899.8	527.7	294.3	752.0	641.0	9,760.2
Derivatives:								
Payable	680.8	-	62.1	67.3	96.6	46.4	383.0	25.4
Receivable	(1,032.7)	-	(79.6)	(81.0)	(156.7)	(210.6)	(502.3)	(2.5)
Adjustment to carrying value	11.6	11.6	-	-	-	-	-	-
Derivatives – net assets	(340.3)	11.6	(17.5)	(13.7)	(60.1)	(164.2)	(119.3)	22.9

	Total[1]	Adjustment[2]	1 year or less	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years
At 31 March 2014	£m	£m	£m	£m	£m	£m	£m	£m
Bonds	9,402.4	-	131.2	557.3	107.4	139.8	259.5	8,207.2
Bank borrowings and other	2,088.7	-	92.2	38.8	343.1	65.1	66.3	1,483.2
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent borrowings	1,362.9	-	52.5	509.8	22.8	23.3	24.5	730.0
Adjustment to carrying value	(6,544.1)	(6,544.1)	-	-	-	-	-	-
Borrowings	6,439.9	(6,544.1)	405.9	1,105.9	473.3	228.2	350.3	10,420.4
Derivatives:								
Payable	635.6	-	85.8	51.6	38.3	71.4	24.9	363.6
Receivable	(991.2)	-	(129.8)	(68.0)	(65.0)	(114.3)	(52.0)	(562.1)
Adjustment to carrying value	42.0	42.0	-	-	-	-	-	-
Derivatives – net assets	(313.6)	42.0	(44.0)	(16.4)	(26.7)	(42.9)	(27.1)	(198.5)

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

Notes to the financial statements

A4 Financial Risk Management (continued)

Credit risk

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

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade debtors are limited due to the group's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. Considering the above, the directors believe there is no further credit risk provision required in excess of the provision for bad and doubtful debts (see note 10).

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

At 31 March 2015 and 31 March 2014, the maximum exposure to credit risk for the group and company is represented by the carrying amount of each financial asset in the statement of financial position:

Group and company	2015 £m	2014 £m
Cash and short-term deposits	180.0	2.6
Trade and other receivables	388.6	369.7
Derivative financial instruments	544.8	420.4
	1,113.4	792.7

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2015, the group and company held £46.7 million (2014: £28.5 million) as collateral in relation to derivative financial instruments (included within borrowings in note 12).

Market risk

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

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

Notes to the financial statements

A4 Financial risk management (continued)

Inflation risk

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

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

In addition, the group's pension obligations also provide an economic hedge of the group's regulatory assets. The pension scheme's inflation funding mechanism (see note A5) ensures that future contributions will be flexed for movements in RPI and smoothed over a rolling five year period, providing a natural hedge against any inflationary uplift on the RCV.

The group seeks to manage this risk by identifying opportunities to amend the economic hedge currently in place where deemed necessary and subject to relative value.

Inflation risk is reported monthly to the UUG treasury committee in the operational compliance report.

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

	2015	2014
Group and company	£m	£m
Index-linked debt	3,083.8	2,936.8

The sensitivity analysis set out below has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2015 and 31 March 2014, respectively. As a result, this analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI on the group and company's index-linked borrowings.

Increase/(decrease) in profit before taxation and equity

	2015	2014
Group and company	£m	£m
1 per cent increase in RPI	(31.4)	(29.9)
1 per cent decrease in RPI	31.4	29.9

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

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

Notes to the financial statements

A4 Financial risk management (continued)

adjustments impacting the income statement account are fixed and based on the annual RPI change either three or eight months earlier.

Interest rate risk

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

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

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

To manage the exposure to medium-term interest rates, the group fixes underlying interest rates on nominal debt out to ten years in advance on a reducing balance basis. This is supplemented by managing residual exposure to interest rates within the relevant regulatory price control period by fixing substantively all residual floating underlying interest rates on projected nominal debt across the immediately forthcoming regulatory period at around the time of the price control determination.

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

Sensitivity analysis

The sensitivity analysis below has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place as at 31 March 2015 and 31 March 2014, respectively. As a result, this analysis is not indicative of the years then ended, as these factors would have varied throughout the year.

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

- fair value hedge relationships are fully effective;
- borrowings designated at fair value through profit or loss are effectively hedged by associated swaps;
- the sensitivity excludes the impact of interest rates on post-retirement obligations;
- management has assessed one per cent as a reasonably possible movement in UK interest rates; and
- all other factors are held constant.

Increase/(decrease) in profit before taxation and equity

Group and company	2015 £m	2014 £m
1 per cent increase in interest rate	171.2	100.6
1 per cent decrease in interest rate	(188.3)	(111.3)

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

Notes to the financial statements

A4 Financial risk management (continued)

Repricing analysis

The following tables categorise the group and company's borrowings, derivatives and cash deposits on the basis of when they reprice or, if earlier, mature. The £130.0 million redeemable preference shares have been classified as more than five years according to their latest redemption date of 1 October 2099.

The repricing analysis demonstrates the group and company's exposure to floating interest rate risk.

Group and company At 31 March 2015	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Borrowings in fair value hedge relationships							
Fixed rate instruments	1,803.3	-	-	-	167.0	424.1	1,212.2
Effect of swaps	-	1,803.3	-	-	(167.0)	(424.1)	(1,212.2)
	1,803.3	1,803.3	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	333.7	-	-	-	-	-	333.7
Effect of swaps	-	333.7	-	-	-	-	(333.7)
	333.7	333.7	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	632.0	473.1	0.4	0.5	0.5	0.6	156.9
Floating rate instruments	1,066.5	1,066.5	-	-	-	-	-
Index-linked instruments	3,083.8	3,083.8	-	-	-	-	-
	4,782.3	4,623.4	0.4	0.5	0.5	0.6	156.9
Effect of a fixed hedge for the term of the regulatory period	-	(2,656.3)	(250.0)	(125.0)	(50.0)	1,127.1	1,954.2
Total borrowings	6,919.3	4,104.1	(249.6)	(124.5)	(49.5)	1,127.7	2,111.1
Cash and short-term deposits	(180.0)	(180.0)	-	-	-	-	-
Net borrowings	6,739.3	3,924.1	(249.6)	(124.5)	(49.5)	1,127.7	2,111.1

Notes to the financial statements

A4 Financial risk management (continued)

At 31 March 2014	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Borrowings in fair value hedge Relationships							
Fixed rate instruments	1,733.5	-	-	-	-	167.7	1,565.8
Effect of swaps	-	1,733.5	-	-	-	(167.7)	(1,565.8)
	1,733.5	1,733.5	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	268.7	-	-	-	-	-	268.7
Effect of swaps	-	268.7	-	-	-	-	(268.7)
	268.7	268.7	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	615.3	28.8	427.7	0.4	0.5	0.5	157.4
Floating rate instruments	885.6	885.6	-	-	-	-	-
Index-linked instruments	2,936.8	2,936.8	-	-	-	-	-
	4,437.7	3,851.2	427.7	0.4	0.5	0.5	157.4
Effect of a fixed hedge for the term of the regulatory period	-	(2,031.3)	-	325.0	252.1	250.0	1,204.2
Total borrowings	6,439.9	3,822.1	427.7	325.4	252.6	250.5	1,361.6
Cash and short-term deposits	(2.6)	(2.6)	-	-	-	-	-
Net borrowings	6,437.3	3,819.5	427.7	325.4	252.6	250.5	1,361.6

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

The group has fixed the price on a substantial proportion of its anticipated net electricity usage out to the end of the AMP in 2020, partially through entering into electricity swap contracts.

Sensitivity analysis
The sensitivity analysis has been prepared on the basis of the amount of electricity swaps in place at the reporting date and as a result, this analysis is not indicative of the years then ended, as this factor would have varied throughout the year.

Increase/(decrease) in profit before taxation and equity

Group and company	2015 £m	2014 £m
10 per cent increase in commodity prices	4.8	2.6
10 per cent decrease in commodity prices	(4.8)	(2.6)

Notes to the financial statements

A4 Financial risk management (continued)

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

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

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

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

Capital risk management
The group's objective when managing capital is to maintain efficient access to debt capital markets throughout the economic cycle.

Assuming no significant changes to existing rating agencies' methodologies or sector risk assessments, the company aims to maintain, as a minimum, its existing credit ratings of A3 with Moody's Investors Services (Moody's) and BBB+ with Standard & Poor's Rating Services (Standard & Poor's) for the company and debt issued by its financing subsidiary, United Utilities Water Finance PLC.

In order to maintain existing credit ratings, the group needs to manage its capital structure with reference to ratings methodology and measures used by Moody's and Standard & Poor's. The ratings methodology is normally based on a number of key ratios (such as RCV gearing and adjusted interest cover and Funds from Operations (FFO) to debt) and threshold levels as updated and published from time to time by Moody's and Standard & Poor's.

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

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

Fair values
The table below sets out the valuation basis of financial instruments held at fair value and financial instruments where fair value has been separately disclosed in the notes as the carrying value is not a reasonable approximation of fair value.

Notes to the financial statements

A4 Financial risk management (continued)

Group and company

At 31 March 2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	384.3	-	384.3
Derivative financial assets – held for trading [1]	-	160.5	-	160.5
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[1][2]	-	(204.5)	-	(204.5)
Financial liabilities designated as fair value through profit or loss	-	(333.7)	-	(333.7)
Financial liabilities for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(1,702.2)	(75.4)	-	(1,777.6)
Other financial liabilities at amortised cost	(2,530.3)	(2,990.9)	-	(5,521.2)
	(4,232.5)	(3,059.7)	-	(7,292.2)

At 31 March 2014	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	306.7	-	306.7
Derivative financial assets – held for trading[1]	-	113.7	-	113.7
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[1][2]	-	(106.8)	-	(106.8)
Financial liabilities designated as fair value through profit or loss	-	(268.7)	-	(268.7)
Financial liabilities for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(1,640.0)	(68.1)	-	(1,708.1)
Other financial liabilities at amortised cost	(1,146.7)	(3,595.3)	-	(4,742.0)
	(2,786.7)	(3,618.5)	-	(6,405.2)

[1] These derivatives for economic hedges and, as such, management intend to hold these through to maturity. Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £152.2 million (2014: £83.2 million).

[2] Includes amount owed to intermediate parent undertaking of £nil (2014: £3.7 million).

Notes to the financial statements

A4 Financial risk management (continued)

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable).

The group has calculated fair values using quoted prices where an active market exists. In the absence of an appropriate quoted price, the group has applied discounted cash flow valuation models utilising market available data in line with prior periods.

In respect of the total change during the year in the fair value of financial liabilities designated at fair value through profit or loss, of £65.0 million loss (2014: £32.6 million loss), a £4.6 million loss (2014: £11.1 million loss) is attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £59.0 million profit (2014: £63.6 million). The carrying amount is £131.6 million (2014: £66.6 million) higher than the amount contracted to settle at maturity.

A5 Retirement benefits

Defined benefit schemes

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

The trustees are composed of representatives of both the employer and employees. The trustees are required by law to act in the interests of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day-to-day administration of the benefits.

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

Information about the pension arrangements for executive directors is contained in the directors' remuneration report.

Under the schemes, employees are entitled to annual pensions on retirement. Benefits are also payable on death and following other events such as withdrawing from active service. No other post-retirement benefits are provided to these employees.

The latest actuarial valuations of UUPS and ESPS were carried out as at 31 March 2013. The results of these valuations have been adjusted to take account of the requirements of IAS 19 'Employee Benefits' in order to assess the position at 31 March 2015 by projecting forward from the valuation date by the independent actuary, Aon Hewitt Limited.

Notes to the financial statements

A5 Retirement benefits (continued)

Funding requirements

The latest funding valuations of the schemes as at 31 March 2013 reported a deficit. The basis on which liabilities are valued for funding purposes differs to the basis required under IAS 19. Under UK legislation there is a requirement that pension schemes are funded prudently.

The group has a plan in place with the schemes' trustees to address the funding deficit by 31 December 2020, through a series of annual deficit recovery contributions.

The group and trustees have agreed long-term strategies for reducing investment risk in each scheme.

For UUPS this includes an asset liability matching policy which aims to reduce the volatility of the funding level of the pension plan by investing in assets such as fixed income swaps which perform in line with the liabilities so as to hedge against changes in swap yields. For ESPS, a partial hedge is in place to protect against changes in swap yields.

In addition, the group has had an Inflation Funding Mechanism (IFM) in place since 2010; details of this are outlined in the 2011 United Utilities Group PLC annual report. In 2013, it extended the mechanism to the ESPS, and increased the fixed percentage rate used to 3.0 per cent per annum from 2.75 per cent per annum. To the extent that inflation, as measured by the RPI index at each 31 March preceding the payment due date is different from 3.0 per cent per annum, the inflation reserve will increase/decrease. Additional contributions are then payable annually based on the size of the inflation reserve.

The duration of the combined schemes is around 20 years. The schemes' duration is an indicator of the weighted-average time until benefit payments are settled, taking account of the split of the defined benefit obligation between current employees, deferred members and the current pensioners of the schemes.

The group expects to make contributions of £47.3 million in the year ending 31 March 2016, comprising £24.1 million to UUPS and £3.4 million to ESPS in respect of accelerated deficit repair contributions, and £20.3 million and £0.5 million in respect of regular contributions to UUPS and ESPS respectively.

Impact of scheme risk management on IAS 19 disclosures

Under the prescribed IAS 19 basis, pension scheme liabilities are calculated based on current accrued benefits. Expected cash flows are projected forward allowing for RPI and the current member mortality assumptions. These projected cash flows are then discounted by an AA corporate bond rate, which comprises an underlying interest rate and a credit spread.

The group has de-risked its pension schemes through hedging strategies applied to the underlying interest rate and the forecast RPI. The underlying interest rate has been largely hedged through external market swaps, the value of which is included in the schemes' assets, and the forecast RPI has been largely hedged through the IFM, with RPI in excess of 3.0 per cent per annum being funded through an additional schedule of deficit contribution.

As a consequence, the reported statement of financial position under IAS 19 remains volatile to changes in credit spread which have not been hedged, primarily due to the difficulties in doing so over long durations; changes in inflation, as the IFM results in changes to the IFM deficit contributions rather than a change in the schemes' assets; and, to a lesser extent, changes in mortality as management has decided not to hedge this exposure due to its lower volatility in the short term and the relatively high hedging costs.

In contrast, the schemes' specific funding basis, which forms the basis for regular (non-IFM) deficit repair contributions, is unlikely to suffer from volatility due to credit spread or inflation. This is because a prudent, fixed credit spread assumption is applied, and inflation linked contributions are included within the IFM.

Notes to the financial statements

A5 Retirement benefits (continued)

In the IAS 19 assessment of financial position at 31 March 2015, price inflation fell by 0.3 per cent and, although the discount rate has fallen by 1.2 per cent, this masks a credit spread increase of 0.1 per cent. The price inflation reduction and credit spread increase results in substantially all of the reported £220.4 million improvement. During the year ended 31 March 2015, there has not been any significant change in the deficits on a scheme specific funding basis that impacts the level of deficit repair contributions.

Sensitivity of the key scheme assumptions

The measurement of the group's defined benefit obligation is sensitive to changes in key assumptions, which are described below. The sensitivity calculations presented below allow for the specified movement in the relevant key assumption, whilst all other assumptions are held constant. This approach does not take into account the inter-relationship between some of these assumptions or any hedging strategies adopted.

Asset volatility
If the schemes' assets underperform relative to the discount rate used to calculate the schemes' liabilities, this will create a deficit. The schemes hold some growth assets (equities, diversified growth funds and emerging market debt) which, though expected to outperform the discount rate in the long term, create volatility in the short term. The allocation to growth assets is monitored to ensure it remains appropriate given the schemes' long-term objectives.

Discount rate
An increase/decrease in the discount rate of 0.1 per cent would have resulted in a £45.0 million decrease/increase in the schemes' liabilities at 31 March 2015, although as long as credit spreads remain stable this will be largely offset by an increase in the value of the schemes' bond holdings and other instruments designed to hedge this exposure. The discount rate is based on AA corporate bond yields of a similar duration to the schemes' liabilities.

Price inflation
An increase/decrease in the inflation assumption of 0.1 per cent would have resulted in a £42.3 million increase/decrease in the schemes' liabilities at 31 March 2015, as a significant proportion of the schemes' benefit obligations are linked to inflation. In some cases, caps on the level of inflationary increases are in place to protect against extreme inflation. The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit. Any change in inflation out-turn results in a change to the cash contributions provided under the IFM.

Life expectancy
An increase/decrease in the mortality long-term improvement rate of 0.25 per cent would have resulted in a £34.5 million increase/decrease in the schemes' liabilities at 31 March 2015. The majority of the schemes' obligations are to provide benefits for the life of the member and, as such, the schemes' liabilities are sensitive to these assumptions.

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (GMP). The UK Government intends to implement legislation which could result in an increase in the value of GMP for males. This would increase the defined benefit obligation of the schemes. At this stage, until the Government develops its proposals and publishes guidance, it is not possible to quantify the impact of this change.

Notes to the financial statements

A5 Retirement benefits (continued)

Reporting

The results of the latest funding valuations at 31 March 2013 have been adjusted in order to assess the position at 31 March 2015, by taking account of experience over the period, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service costs, were measured using the projected unit credit method.

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

	2015 % pa	2014 % pa
Discount rate	3.1	4.3
Pensionable salary growth and pension increases	3.0	3.3
Price inflation	3.0	3.3

In assessing the financial assumptions, the group has taken into account the average duration of the schemes' liabilities.

Demographic assumptions

Mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S1NA year of birth tables with a one year age rating for males, reflecting actual mortality experience; and CMI 2014 (2014: CMI 2013) long-term improvement factors, with a long-term annual rate of improvement of 1.5 per cent per annum. The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

	2015 years	2014 years
Retired member – male	26.6	26.6
Non-retired member – male	28.3	28.4
Retired member – female	30.2	30.0
Non-retired member – female	32.0	31.9

Notes to the financial statements

A5 Retirement benefits (continued)

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

	Schemes' assets %	2015 £m	Schemes' assets %	2014 £m
Group				
Equities	9.8	227.2	6.1	104.8
Other non-equity growth assets	10.3	238.1	9.9	170.9
Gilts	16.5	382.4	13.6	235.1
Bonds	43.2	1,000.8	53.5	922.4
Other	20.2	468.8	16.9	291.8
Total fair value of schemes' assets	100.0	2,317.3	100.0	1,725.0
Present value of defined benefit obligations		(2,242.5)		(1,870.6)
Net retirement benefit surplus/(obligations)		74.8		(145.6)

The fair values in the table above are all based on quoted prices in an active market, where applicable.

The assets, in respect of UUPS, included in the table above, have been allocated to each asset class based on the return the assets are expected to achieve as UUPS has entered into a variety of derivative transactions to change the return characteristics of the physical assets held in order to reduce undesirable market and liability risks. As such, the breakdown shown separates the assets of the schemes to illustrate the underlying risk characteristics of the assets held.

Both of the schemes employ a strategy where the asset portfolio is made up of a growth element and a defensive element. Assets in the growth portfolio are shown as equities and other non-equity growth assets above, while assets held in the defensive portfolio represent the remainder of the schemes' assets.

The 'other' element of the portfolio is set aside for collateral purposes linked to the derivative contracts entered into, as described above. The collateral portfolio, comprising cash and eligible securities which are readily converted to cash, provides sufficient liquidity to manage the derivative transactions and is expected to achieve a return in excess of LIBOR.

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

	2015 £m	2014 £m
At the start of the year	1,725.0	1,626.8
Interest income on schemes' assets	73.4	74.3
The return on plan assets, excluding amounts included in interest	550.0	56.9
Member contributions	5.9	6.3
Benefits paid	(69.9)	(62.8)
Administration expenses	(1.6)	(1.4)
Group contributions	34.5	24.9
At the end of the year	2,317.3	1,725.0

Notes to the financial statements

A5 Retirement benefits (continued)

The group's actual return on the schemes' assets was a gain of £623.4 million (2014: £131.2 million loss), principally due to gains/losses on derivatives hedging the schemes' liabilities.

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

	2015 £m	2014 £m
At the start of the year	(1,870.6)	(1,588.7)
Interest cost on schemes' obligations	(79.1)	(72.0)
Actuarial losses arising from changes in financial assumptions	(372.4)	(81.4)
Actuarial gains arising from changes in demographic assumptions	8.0	27.2
Actuarial losses arising from experience	29.1	(194.5)
Curtailments/settlements	(4.8)	(1.4)
Member contributions	(5.9)	(6.3)
Benefits paid	69.9	62.8
Current service cost	(16.7)	(16.3)
At the end of the year	(2,242.5)	(1,870.6)

A6 Related party transactions

The aggregate disclosable transactions with the related parties of the group and company were with Lingley Mere Management Company Limited as follows:

Group and company	2015 £m	2014 £m
Sales of services	0.1	0.5
Purchases of goods and services	0.6	0.7
Amounts owed to related parties	-	0.1
Amounts owed by related parties	0.1	-

Lingley Mere Management Company Limited is a 100% owned subsidiary of Lingley Mere Business Park Development Company Limited, which is a 50% owned joint venture company established between United Utilities Property Services Limited and MUSE Developments Limited. United Utilities Property Services Limited is a 100% owned subsidiary of United Utilities PLC.

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

There were no guarantees in place with related parties (2014: £nil). No expense or allowance has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (2014: £nil).Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

A7 Adoption of International Financial Reporting Standards

The financial statements have been prepared for the first time in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union (EU). Results for the comparative periods have been restated under IFRS as adopted for use in the EU. The company's previously reported results for the year ended 31 March 2014 have been restated, the date of transition to IFRS being 1 April 2013.

The group is included in the consolidated accounts of its ultimate parent group, United Utilities Group PLC, which adopted IFRS for the first time in the year ended 31 March 2006. In accordance with IFRS 1 'First time adoptions of International Financial Reporting Standards', the group has measured its assets and liabilities at the carrying amounts that would be included in the United Utilities Group PLC consolidated financial statements.

Notes to the financial statements

A7 Adoption of International Financial Reporting Standards (continued)

The major areas of impact of adopting IFRS are summarised below:

Infrastructure accounting

The significant impact of IAS 16 relates to the accounting for water and wastewater infrastructure assets. Under UK GAAP, these assets were accounted for in accordance with renewals accounting by which the water and wastewater infrastructure networks are assumed to be single assets and the depreciation charged is the estimated level of annual expenditure assumed to maintain the operating capability of the networks. Actual expenditure is then capitalised as incurred.

Under IAS 16 this treatment is not permitted. Therefore, the significant parts within the infrastructure networks have been identified and, for each, a useful life and residual value determined so that each segment may be depreciated individually. The classification between operating expenditure and capital expenditure for amounts incurred in maintaining the networks has also been reassessed.

In addition, infrastructure assets have been valued at the carrying amount at which they have been included in United Utilities Group PLC's consolidated financial statements. This increases net assets by £22.6 million (net of deferred tax) as at 31 March 2014 compared with that previously reported. Included in this figure are capitalised borrowing costs of £45.6 million and assets transferred from customers of £274.4 million which have been recognised at fair value under IFRIC 18 'Transfers of assets from customers'. Grants and contributions of £101.4 million relating to the enhancement of the infrastructure network, previously deducted from the cost of Property, plant and equipment, have been credited to deferred income. Grants and contributions related to maintaining the operating capability of the infrastructure network are recognised in the income statement within infrastructure renewal expenditure.

The segments recognised within the water and wastewater networks have been based upon asset class (for example sewers, water mains and tunnels) since no single pipe or section of sewer is significant compared to the total value of the networks. This has led to the identification of 14 segments which have been assigned zero residual values at the end of their useful lives. The lives allocated to these segments range from 15 – 300 years. This treatment results in an additional depreciation charge of £36.4 million in the 2014 IFRS reported results when compared with UK GAAP. Since the UK GAAP classification of expenditure between operating expenses and costs to be capitalised remains the most appropriate treatment under IAS 16, this additional depreciation directly impacts profit before tax.

Retirement benefit obligations

Under FRS 17 'Retirement Benefits' (FRS 17) a deferred tax asset of £29.1 million was disclosed as a reduction to the pension deficit on the balance sheet at 31 March 2014. Deferred tax on pensions is disclosed within the deferred tax provision under IAS 19 'Employee Benefits' (IAS 19).

In addition, administration costs relating to the administration of benefits were previously recognised as a deduction from interest income under FRS 17, whereas under IAS 19 these are recognised as an employee benefit expense.

Deferred tax

Under FRS 19 'Deferred Tax', the company had elected to apply discounting to its deferred tax liability. Under IAS 12 'Income Taxes' (IAS 12), discounting of deferred tax balances is not permitted. The impact of eliminating discounting from the accounting for deferred tax is to increase the deferred tax charge in the year ended 31 March 2014 by £96.4 million and to increase the deferred tax liability at that date by £646.4 million. Other IAS 12 adjustments result in a £174.7 million reduction in the deferred tax charge and an increase in the deferred tax liability of £61.5 million for the year ended 31 March 2014.

Notes to the financial statements

A7 Adoption of International Financial Reporting Standards (continued)

The net impact of the above adjustments is to increase the deferred tax charge by £78.3 million and to increase the deferred tax liability by £707.9 million for the year ended 31 March 2014.

Reconciliation of statement of financial position at 1 April 2013

	UKGAAP £m	Infra-structure accounting £m	Retirement benefit obligations £m	Deferred tax £m	Other £m	IFRS £m
ASSETS						
Non-current assets						
Property, plant and equipment	8,650.7	395.8	-	-	(93.4)	8,953.1
intangible assets	0.6	-	-	-	93.4	94.0
Investments	0.2	-	-	-	-	0.2
Retirement benefit surplus	29.3	-	8.8	-	-	38.1
Derivative financial Instruments	505.8	-	-	-	-	505.8
	9,186.6	395.8	8.8	-	-	9,591.2
Current assets						
Inventories	5.6	-	-	-	-	5.6
Trade and other receivables	358.4	-	-	-	0.2	358.6
Derivative financial instruments	62.0	-	-	-	-	62.0
	426.0	-	-	-	0.2	426.2
Total assets	9,612.6	395.8	8.8	-	0.2	10,017.4
LIABILITIES						
Non-current liabilities						
Trade and other payables	(82.6)	(337.3)	-	-	0.2	(419.7)
Borrowings	(6,119.9)	-	-	-	-	(6,119.9)
Deferred tax liabilities	(394.3)	(13.0)	(8.8)	(802.3)	(0.1)	(1,218.5)
Provisions	(3.3)	-	-	-	-	(3.3)
Derivative financial instruments	(206.4)	-	-	-	-	(206.4)
	(6,806.5)	(350.3)	(8.8)	(802.3)	0.1	(7,967.8)
Current liabilities						
Trade and other payables	(402.0)	(2.3)	-	-	(0.3)	(404.6)
Borrowings	(308.4)	-	-	-	-	(308.4)
Current income taxation liabilities	(32.4)	-	-	-	-	(32.4)
Provisions	(6.6)	-	-	-	-	(6.6)
Derivative financial instruments	(3.0)	-	-	-	-	(3.0)
	(752.4)	(2.3)	-	-	(0.3)	(755.0)
Total liabilities	(7,558.9)	(352.6)	(8.8)	(802.3)	(0.2)	(8,722.8)
Total net assets	2,053.7	43.2	-	(802.3)	-	1,294.6
EQUITY						
Capital and reserves						
Share capital	1,025.3	-	-	-	-	1,025.3
Share premium account	647.8	-	-	-	-	647.8
Other reserve	-	174.7	-	-	-	174.7
Retained earnings	380.6	(131.5)	-	(802.3)	-	(553.2)
Shareholders' equity	2,053.7	43.2	-	(802.3)	-	1,294.6

Notes to the financial statements

A7 Adoption of International Financial Reporting Standards (continued)

Reconciliation of statement of financial position at 31 March 2014

	UKGAAP £m	Infra-structure accounting £m	Retirement benefit obligations £m	Deferred tax £m	Other £m	IFRS £m
ASSETS						
Non-current assets						
Property, plant and equipment	9,029.8	401.3	-	-	(107.8)	9,323.3
Intangible assets	1.8	-	-	-	108.3	110.1
Investments	0.1	-	-	-	-	0.1
Derivative financial Instruments	363.7	-	-	-	-	363.7
	9,395.4	401.3	-	-	0.5	9,797.2
Current assets						
Inventories	9.3	-	-	-	-	9.3
Trade and other receivables	370.2	-	-	-	(0.5)	369.7
Current tax asset	50.0	-	-	-	4.8	54.8
Cash at bank and in hand	-	-	-	-	2.6	2.6
Derivative financial instruments	56.7	-	-	-	-	56.7
	486.2	-	-	-	6.9	493.1
Total assets	9,881.6	401.3	-	-	7.4	10,290.3
LIABILITIES						
Non-current liabilities						
Trade and other payables	(79.9)	(371.0)	-	-	(0.1)	(451.0)
Borrowings	(6,216.0)	-	-	-	-	(6,216.0)
Retirement benefit obligations	(116.5)	-	(29.1)	-	-	(145.6)
Deferred tax liabilities	(342.1)	(5.6)	29.1	(731.5)	0.1	(1,050.0)
Derivative financial instruments	(52.3)	-	-	-	-	(52.3)
	(6,806.8)	(376.6)	-	(731.5)	-	(7,914.9)
Current liabilities						
Trade and other payables	(367.6)	(2.1)	-	-	(4.8)	(374.5)
Borrowings	(221.3)	-	-	-	(2.6)	(223.9)
Provisions	(15.6)	-	-	-	-	(15.6)
Derivative financial instruments	(54.5)	-	-	-	-	(54.5)
	(659.0)	(2.1)	-	-	(7.4)	(668.5)
Total liabilities	(7,465.8)	(378.7)	-	(731.5)	(7.4)	(8,583.4)
Total net assets	2,415.8	22.6	-	(731.5)	-	1,706.9
EQUITY						
Capital and reserves						
Share capital	1,025.3	-	-	-	-	1,025.3
Share premium account	647.8	-	-	-	-	647.8
Other reserve	-	174.7	-	-	-	174.7
Retained earnings	742.7	(152.1)	-	(731.5)	-	(140.9)
Shareholders' equity	2,415.8	22.6	-	(731.5)	-	1,706.9

Notes to the financial statements

A7 Adoption of International Financial Reporting Standards (continued)

Reconciliation of profit for the year ended 31 March 2014

	UKGAAP £m	Infrastructure accounting £m	Retirement benefit obligations £m	Deferred tax £m	IFRS £m
Continuing operations					
Revenue	1,670.0	2.1	-	-	1,672.1
Employee benefits expense:					
excluding restructuring costs	(123.9)	-	(1.4)	-	(125.3)
restructuring costs	(4.4)	-	-	-	(4.4)
Total employee benefits expense	(128.3)	-	(1.4)	-	(129.7)
Other operating costs	(412.9)	0.4	-	-	(412.5)
Other income	2.3	-	-	-	2.3
Depreciation and amortisation expense	(300.9)	(36.4)	-	-	(337.3)
Infrastructure renewals expenditure	(151.5)	(13.6)	-	-	(165.1)
Total operating expenses	(991.3)	(49.6)	(1.4)	-	(1,042.3)
Operating profit/(loss)	678.7	(47.5)	(1.4)	-	629.8
Investment income	4.3	-	2.3	-	6.6
Finance expense	(144.2)	19.4	(0.9)	-	(125.7)
Investment income and finance expense	(139.9)	19.4	1.4	-	(119.1)
Profit/(loss) before taxation	538.8	(28.1)	-	-	510.7
Current taxation charge	76.2	-	-	-	76.2
Deferred taxation charge	(89.3)	-	-	63.7	(25.6)
Deferred taxation credit – change in taxation rate	141.5	-	-	14.6	156.1
Taxation	128.4	-	-	78.3	206.7
Profit after taxation	667.2	(28.1)	-	78.3	717.4

Notes to the financial statements - appendices

A7 Adoption of International Financial Reporting Standards (continued)

Reconciliation of cash generated from operations for the year ended 31 March 2014

	UKGAAP £m	Infra-structure accounting £m	Defined benefit obligations £m	Other £m	IFRS £m
Profit before taxation	538.8	(28.1)	-	-	510.7
Adjustment for investment income and finance expense	139.9	(19.4)	(1.4)	-	119.1
Operating profit	678.7	(47.5)	(1.4)	-	629.8
Adjustments for:					
Depreciation of property, plant and equipment	452.3	(115.1)	-	(24.0)	313.2
Amortisation of intangible assets	-	-	-	24.0	24.0
Loss on disposal of property, plant and equipment	6.4	-	-	-	6.4
Amortisation of deferred grants and contributions	(6.9)	(0.5)	-	-	(7.4)
Other non-cash movements	-	(2.0)	-	-	(2.0)
Changes in working capital:					
Increase in inventories	(3.7)	-	-	-	(3.7)
Increase in trade and other receivables	(3.4)	-	-	(4.8)	(8.2)
Increase/(decrease) in trade and other payables	0.1	(29.4)	-	4.8	(24.5)
Increase in provisions	5.7	-	-	-	5.7
Pension contributions paid less pension expense charged to operating profit	(7.2)	-	1.4	-	(5.8)
Cash generated from continuing operations	1,122.0	(194.5)	-	-	927.5

Notes to the financial statements - appendices

A7 Adoption of International Financial Reporting Standards (continued)

Reconciliation of statement of cashflows for the year ended 31 March 2014

	UKGAAP £m	Infra-structure accounting £m	Other £m	IFRS £m
Operating activities				
Cash generated from continuing operations	1,122.0	(194.5)	-	927.5
Interest paid	(182.5)	-	-	(182.5)
Interest received and similar income	1.3	-	-	1.3
Tax paid	(79.0)	-	-	(79.0)
Tax received	74.6	-	-	74.6
Net cash generated from operating activities	936.4	(194.5)	-	741.9
Investing activities				
Purchase of property, plant and equipment	(896.3)	198.4	38.2	(659.7)
Purchase of intangible assets	(1.2)	-	(38.2)	(39.4)
Proceeds from sale of property, plant and equipment	2.3	-	-	2.3
Grants and contributions received	20.3	(3.9)	-	16.4
Proceeds from sale of investments	0.1	-	-	0.1
Net cash used in investing activities	(874.8)	194.5	-	(680.3)
Financing activities				
Proceeds from borrowings	386.7	-	-	386.7
Repayment of borrowings	(225.0)	-	-	(225.0)
Dividends paid to equity holders of the company	(153.0)	-	-	(153.0)
Net cash generated from financing activities	8.7	-	-	8.7
Net increase in cash and cash equivalents	70.3	-	-	70.3
Cash and cash equivalents at beginning of the year	(103.8)	-	-	(103.8)
Cash and cash equivalents at end of the year	(33.5)	-	-	(33.5)

Notes to the financial statements - appendices

A8 Accounting policies

Basis of consolidation

The group financial statements consolidate the financial statements of the company and entities controlled by the company (its subsidiaries). The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date control is obtained or until the date that control ceases, as appropriate.

Subsidiaries

Subsidiaries are entities controlled by the group. Control is achieved where the group is exposed to, or has the rights to, variable returns from its involvement in an entity and has the ability to affect those returns through its power over the entity. In the parent company accounts, investments are held at cost less provision for impairment.

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

Revenue recognition

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

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

Operating profit

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

Borrowing costs and finance income

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

Transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are included in the initial fair value of that instrument. Where borrowing costs are attributable to the acquisition, construction or production of a qualifying asset, such costs are capitalised as part of the specific asset.

Taxation

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

Current taxation

Current taxation is based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at each reporting date. Taxable profit differs from the net profit as reported in the income statement because it excludes items of income or expense that are

Notes to the financial statements - appendices

A8 Accounting Policies (continued)

taxable or deductible in other years and it further excludes items that are never taxable or deductible. Current taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the taxation is also dealt with in equity.

Deferred taxation

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

Deferred taxation liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred taxation is measured at the average tax rates that are expected to apply in the periods in which the temporary timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted at each reporting date.

The carrying amount of deferred taxation assets is reviewed at each reporting date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the deferred taxation is also dealt with in equity.

Property, plant and equipment

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

The useful economic lives of these assets are primarily as follows:

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

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

Water and wastewater infrastructure assets

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

Notes to the financial statements - appendices

A8 Accounting Policies (continued)

Other assets

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

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

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

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

Transfer of assets from customers and developers

Where the group receives from a customer or developer an item of property, plant and equipment (or cash to construct or acquire an item of property, plant and equipment) that the group must then use, either to connect the customer to the network, or to provide the customer with ongoing access to a supply of goods or services, or to do both, such items are capitalised at their fair value and included within property, plant and equipment, with a credit of the same amount to deferred grants and contributions. The assets are depreciated over their useful economic lives and the deferred contributions released to revenue over the same period (or where the receipt of property, plant and equipment is solely to connect the customer to the network, the deferred contribution is released immediately to revenue). This interpretation has been applied to transfers of assets from customers received on or after 1 July 2009. Assets transferred from customers or developers are accounted for at fair value. If no market exists for the assets then incremental cash flows are used to arrive at fair value.

Intangible assets

Intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful economic lives. The carrying amount is reduced by any provision for impairment where necessary. On a business combination, as well as recording separable intangible assets already recognised in the statement of financial position of the acquired entity at their fair value, identifiable intangible assets that arise from contractual or other legal rights are also included in the acquisition statement of financial position at fair value. Internal expenditure is capitalised as internally generated intangibles only if it meets the criteria of IAS 38 'Intangible Assets'.

Intangible assets, which relate primarily to computer software, are amortised over a period of three to 10 years.

Impairment of tangible and intangible assets

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

Notes to the financial statements - appendices

A8 Accounting Policies (continued)

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

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

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

Financial instruments

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

Cash and short-term deposits

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

Financial investments

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

Trade receivables

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

Trade payables

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

Financial liabilities and equity

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

Notes to the financial statements - appendices

A8 Accounting Policies (continued)

Equity instruments

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

Borrowings

The group's default treatment is that bonds, loans and overdrafts are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently measured at amortised cost applying the effective interest method. The difference between the net cash proceeds received at inception and the principal cash flows due at maturity is accrued over the term of the borrowing.

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

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

Borrowings designated within a fair value hedge relationship

Where designated, bonds and loans are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently adjusted for any change in fair value attributable to the risk being hedged at each reporting date, with the change being charged or credited to finance expense in the income statement.

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

Borrowings designated at fair value through profit or loss

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

Derivative financial instruments

Derivative financial instruments are measured at fair value at each reporting date with changes in fair value being charged or credited to finance expense in the income statement. The group enters into financial derivatives contracts to manage its financial exposure to changes in market rates (see note A4).

Derivatives and borrowings – valuation

Where an active market exists, designated borrowings and derivatives recorded at fair value are valued using quoted market prices. Otherwise, they are valued using a net present value valuation model. The model uses applicable interest rate curve data at each reporting date to determine any floating cash flows. Projected future cash flows associated with each financial instrument are discounted to the reporting date using discount factors derived from the applicable interest curves adjusted for counterparty credit risk where appropriate. Discounted

Notes to the financial statements - appendices

A8 Accounting Policies (continued)

foreign currency cash flows are converted into sterling at the spot exchange rate at each reporting date. Assumptions are made with regard to credit spreads based on indicative pricing data.

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

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

Inventories

Inventories are stated at the lower of cost and net realisable value.

Employee benefits

Retirement benefit obligations

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

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

The cost of providing pension benefits to employees relating to the current year's service (including curtailment gains and losses) is included within the income statement within employee benefits expense. The net interest on the schemes' obligation/surplus is included in the income statement within investment income or finance expense. Remeasurement gains and losses are recognised outside the income statement in retained earnings and presented in the statement of comprehensive income.

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

Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Expenditure that relates to an existing condition caused by past operations that does not contribute to current or future earnings is expensed.

Notes to the financial statements - appendices

A8 Accounting Policies (continued)

Foreign currency translation

Transactions and balances

Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange applicable on that date.

Gains and losses arising on retranslation are included in net profit or loss for the period.

In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note A4).

Grants and contributions

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

Leases

Leases are classified according to the substance of the transaction. Operating leases are leases that do not transfer substantially all the risks and rewards of ownership to the lessee.

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