Registered No: 2366616

United Utilities PLC

Annual Report and Financial Statements

31 March 2019

Contents

Directors, advisers and other information	2
Strategic report	3
Directors' report	30
Statement of directors' responsibilities in respect of the annual report and the financial statements	33
Independent auditor's report	34
Consolidated income statement	40
Consolidated statement of comprehensive income	41
Consolidated and company statements of financial position	42
Consolidated statement of changes in equity	43
Company statement of changes in equity	44
Consolidated and company statements of cash flows	45
Accounting policies	46
Notes to the financial statements	53

Directors, advisers and other information

Directors
PA Aspin
SR Fraser
JR Houlden
SL Mogford

Secretary
SR Gardiner

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

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

Terms used in this report:
United Utilities PLC's ultimate parent company is United Utilities Group PLC. 'UUG' means United Utilities Group PLC and 'United Utilities' or 'the UUG group' means United Utilities Group PLC and its subsidiary undertakings. 'UU' or 'the group' means United Utilities PLC and its subsidiary undertakings.

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

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

Strategic report

Our purpose and strategy

Our purpose is to provide great service to our customers and communities in the North West, creating long-term value for all of our stakeholders.

Our vision

Our vision is to be the best UK water and wastewater company.

Our strategy

We will realise our vision through delivering:

- The best service to customers
- At the lowest sustainable cost
- In a responsible manner

Our strategy is broken down into these three themes which form the framework for how we work towards our vision. Our operational performance measurement, risk assessment and remuneration policy are all aligned to these strategic themes.

Our core values

Our core values provide the cultural framework within which we are working towards achieving our vision, and we encourage our employees to live these values in everything they do in their daily work:

Customer focus
Customers are at the heart of everything we do, and we aim to provide a great and resilient service at the most efficient cost.

Innovation
We continually look for new ways to make our services better, safer, faster and cheaper.

Integrity
We make promises knowingly and keep them, behaving responsibly towards all of our stakeholders.

For more information in relation to our values and culture, please see pages 92 to 93 of the 2019 UUG Annual report and financial statements.

Our marketplace

We are the water and wastewater provider in the North West of England and are subject to economic, quality and environmental regulation.

Our industry and market
Customers in England and Wales are served by ten licensed water and wastewater companies, making up around 95 per cent of the industry, with the remainder being smaller licensed companies providing water-only services.

Since privatisation in 1989, the water industry has invested over £130 billion and delivered a significant contribution to improvements in public health. This investment has led to improvements in the quality of services, significantly higher environmental standards, and superior quality drinking water.

The advancement of technology and innovation makes way for more improvements as we continue to invest to improve services for the long term. Customer bills have declined in real terms in the current and last regulatory periods.

The water and wastewater companies are split regionally based on river catchment areas. United Utilities Water Limited (UUW) operates in the North West of England, and is the second largest of these companies based on the size of our asset base, measured by Regulatory Capital Value (RCV).

We provide water and wastewater services to a population of over seven million people, with over three million household customers making up around two-thirds of our total revenue, and over 200,000 businesses, ranging in size from large manufacturing companies to small shops.

Our competitive environment

Our main competitors are the other water and wastewater companies in England and Wales. Our vision is to be the best UK water and wastewater company, and so we regularly benchmark our performance against these peers.

Our regulators assess our comparative operational performance against the other water and wastewater companies in England and Wales:

- The Drinking Water Inspectorate (DWI) assesses our performance in the water business;
- The Environment Agency (EA) assesses our performance in the wastewater business; and
- Ofwat assesses our customer service performance through its qualitative and quantitative Service Incentive Mechanism (SIM) scores.

The EA performance assessment and qualitative and quantitative SIM scores are included in our operational key performance indicators (KPIs).

As well as assessment against our water peers, we benchmark our customer service performance against other leading service providers in our region.

Our political and regulatory environment

We are subject to regulation of price and performance by economic, quality and environmental regulators, as set out in the diagram. These bodies exist to help protect the interests of customers and the environment.

The political and regulatory framework can change significantly in the long term and we have seen substantial tightening of laws and regulations since privatisation of the water industry. To some extent these changes are outside our direct control. Maintaining good relationships with these bodies enables us to engage positively in order to influence future policy with the aim of achieving the best outcome for all of our stakeholders.

Our competitive advantages

Our pioneering Systems Thinking approach and prudent financial risk management give us a clear competitive advantage.

Systems Thinking improves efficiency and operational resilience. Prudent financial risk management delivers long-term predictability and resilience to financial shocks. These competitive advantages help us to deliver sustainable long-term value for stakeholders.

For more information in relation to our Systems Thinking approach and prudent financial risk management, please see page 17 of the 2019 UUG annual report and financial statements.

In addition to these competitive advantages, we are proud to be leading the industry across a host of measures:

- Fast-tracked business plan with the highest overall grades
- The most embedded innovation culture in the industry
- Sector-leading approach to affordability and vulnerability
- Sector-leading rating with the Environment Agency
- The highest levels of trust and confidence in our reporting
- High quality approach to customer engagement

Our business model

We consult and plan for short, medium and long-term horizons

We provide essential water and wastewater services to millions of customers every day, and this relies on a variety of key resources. How we manage these is influenced by external drivers and relationships with a variety of stakeholders.

Consultation with customers and other stakeholders forms an integral part of our planning process across the short, medium and long term, and our work delivers a range of long-term benefits for many different stakeholder groups. This value creation feeds back into the continuous cycle of what we do.

Our external drivers and relationships

Natural environment

- The natural environment is constantly changing, and we must adapt and prepare for future impacts such as climate change and population growth. Our use and return of water to the environment is a continuous cycle, and returning water cleanly and safely, as well as managing our catchment land effectively, allows this cycle to begin again from the best starting point.

Technology and innovation

- New technologies and innovative ideas present opportunities for us to make things faster, better, safer and cheaper. These can come from all over, which is why we encourage innovation externally and internally at all levels of the business, from our annual CEO Challenge and dedicated innovation team to our Innovation Lab.

Stakeholders

- Our work and the huge areas of land we manage puts us at the heart of communities in our region, and impacts a large variety of stakeholders. We build relationships and consult with them in developing and executing our plans.

Regulatory environment

- Sustainable business means preparing for future market reforms as well as meeting current regulatory commitments. We place great value on our relationships with economic, quality and environmental regulators, engaging actively and influencing where we can.

Political environment

- We engage with regional and national politicians as well as policy makers, through regular meetings and conferences, in relation to areas such as our local investment schemes, our economic contribution to the North West, and key policy issues affecting the water industry.

Economic environment

- We are impacted by market rate movements, such as interest rates and inflation, and seek to manage these prudently to reduce risk as far as practical. We operate in an area with high levels of extreme deprivation, so helping vulnerable customers is particularly important for us.

Our key resources

Natural resources

- We rely on natural sources of water that we collect for treatment, and manage large areas of catchment land in a sustainable way. We rely on watercourses where we return wastewater safely and cleanly to the environment, and we process bioresources from wastewater to generate renewable energy, which helps to reduce our carbon footprint and energy costs.

Assets

- Our significant capital investment programme helps to grow our business while building resilience and maintaining and enhancing sustainable long-term assets. We use telemetry across the network to manage our assets as one integrated network from our Integrated Control Centre as part of our Systems Thinking approach.

People

- We rely on employees and suppliers to deliver our services to customers. We are committed to attracting, developing, training and motivating a diverse and skilled workforce. We build effective relationships and work with suppliers who share our values. We have management incentives based on performance and a long-term incentive plan.

Financing

- Financing allows us to preserve intergenerational equity for customers while funding long-term capital investment. We maintain a robust capital structure with an appropriate level of gearing level and prudent risk management. We have long-term debt locked in at good relative value and maintain access to a range of markets. We proactively engage with equity and credit investors.

Key resources and the impact of external drivers

Natural resources

We rely on a variety of natural resources to deliver water and wastewater services, and we impact those natural resources through our operations, such is the circular nature of the water cycle. We also generate renewable energy from the sun and wind.

We rely on natural sources of water to supply customers. We hold abstraction licences for a number of reservoirs, rivers and boreholes that permit us to take water from the environment in a safe and sustainable way, which we then treat, store and transport across the region.

Nearly half the water we abstract originates from land we own and manage. Run-off from this land impacts the quality of the water, so managing it well helps us provide reliable and clean water, reducing risk and increasing our resilience. We help protect habitats and species designated as nationally and internationally important, many of which make their homes on this land.

We rely on watercourses to take effluent back into the environment after extensive cleaning to ensure it meets environmental consents. This protects the health of the natural environment, which enhances recreational value for our communities, protects rare species and wildlife habitats, and provides economic benefits such as underpinning the local tourism industry.

We extract bioresources from wastewater, using anaerobic digestion to break it down into biogas and biosolids. Biogas is used to generate renewable energy through combined heat and power plants, reducing our energy costs and carbon footprint. Biosolids are treated to provide a valuable source of nutrients and organic matter as high-quality fertiliser for farmers.

Impact of external drivers

Natural environment

Our long-term planning looks far into the future to ensure we are prepared for the challenges of a changing natural environment. The most significant anticipated impact comes from climate change, and in particular the long-term changes in average temperature and rainfall. Water companies must adapt to meet the challenges climate change presents, and this creates both risks and opportunities.

The main opportunity is the potential for water sharing. Our region typically receives higher average rainfall than other parts of the country, meaning the availability of raw water tends to be less constrained than in the comparatively drier south. Ofwat indicated in its initial assessment of company business plans for 2020–25 that it would provide us with £25.7 million funding for feasibility and planning work with respect to a potential north-south transfer of water as part of the development of strategic water resources options for the south and south east.

The main risks are the impact of prolonged severe dry periods, which constrain water resources, and intense periods of heavy rainfall, which increase the risk of flooding and pollution incidents.

Our response to climate change risk can be split into two areas: mitigation and adaptation.

- Mitigation – reducing carbon emissions to minimise our contribution to climate change.

The key contributor to climate change is an increase in greenhouse gases. There is global scientific agreement that as a result of human activity the amount of greenhouse gases in the atmosphere is increasing and affecting the global climate. We have been driving down our carbon footprint (net operational emissions in 2018/19 were over 70 per cent lower than 2005/06) and have plans to reduce it further, mainly through our energy strategy.

We have assessed our operational sites for their potential to generate renewable energy through either solar panels or wind turbines. We are working on plans to substantially increase our renewable energy production across the current regulatory period to 2020, mainly from solar, and this year we generated the equivalent of over 20 per cent of our electricity consumption through renewable energy. This provides environmental benefits as well as energy cost savings.

The anaerobic digestion of bioresources reduces our carbon emissions as well as saving energy costs and producing a high-quality fertiliser. Our advanced digestion facility at Davyhulme wastewater treatment works is one of the largest of its type, making the site energy self-sufficient, with surplus energy exported to the national grid.

- Adaptation – improving the resilience in our water and wastewater business.

The potential effect of climate change on our future water resources is considered in our 25-year Water Resources Management Plan, and we published two adaptation reports in 2011 and 2015 outlining our holistic, integrated and partnership approach to a range of short, medium and long-term challenges including climate change.

It is predicted that climate change will result in the North West experiencing higher daily temperatures all year, and a shift in our rainfall from summer to winter. More occurrences of heavy rainfall are expected, with higher rainfall in winter but more frequent and/or severe drought events predicted in summer.

We have first-hand experience of the impacts of extreme weather events on our operations and customers – during 2018 we experienced two weather extremes, with a deep freeze followed by rapid thaw in the early part of the year, and then extremely hot, dry weather coupled with significantly increased demand for water over the summer.

Coping with extreme hot, dry periods requires action in relation to both supply and demand.

Supply is managed by ensuring we continue to have resilient water resources and infrastructure capable of moving water efficiently around the region. We have an integrated supply zone covering the majority of our

region operated using our Systems Thinking approach. This helps us to manage water supply and demand and, where there is any potential shortfall, we bring more supplies online to meet demand. Generally this system is proficient, but there are areas that require further improvements to deal with future challenges. Our West East Link Main pipeline runs between Manchester and Liverpool, allowing transfer of water across our region, and the extreme dry weather in 2018 gave us cause to increase the capacity of this pipeline, as well as bringing additional groundwater sources online, both of which increased our resilience.

Demand is managed by encouraging and supporting customers to use water efficiently. We have increased our efforts in this area and ran a number of high profile campaigns in summer 2018 when demand was much higher than normal. We encourage customers to save water through education initiatives to raise awareness, sharing water saving tips on our website and through social media, and providing free water-saving devices. We work with external partners to expand our messaging further afield, and have increased the number of water meters installed, with 44 per cent of households in our region now fitted with meters.

Coping with periods of intense heavy rainfall requires action to cope with excess surface water drainage while minimising the risk of sewer flooding, pollution and spills.

Traditional interventions, such as storage tanks and enlarging sewers, are costly and subject to constraints for space, particularly in urban areas with little permeable ground. Innovation is needed to find new solutions, which is why we have increased our focus on the use of sustainable drainage solutions in recent years, working with partners to transform hard-grey areas into living planted places.

Our operations produce sludges, excavated materials and general office waste, which we are committed to managing in a sustainable way. Less than five per cent of our waste goes to landfill, we use recycled products where practical, and are working to reduce the use of plastics. We look for ways to reduce our use of raw materials to minimise our environmental impact and increase efficiency.

Stakeholders

Our catchment land is open to the public with an estimated nine million visits a year, providing access to the beauty and recreational benefits that the natural environment offers, and boosting the local tourism industry.

Much of our catchment land is managed by tenant farmers, or in partnership with other organisations such as the RSPB and Wildlife Trusts. We are increasingly looking at integrated catchment solutions, taking a holistic view of issues and solutions within catchments, working with others to improve the lakes, rivers and coastal waters in our region, and often utilising the natural environment as part of the solution. We have a long history of doing this through our award-winning sustainable catchment management programme (SCaMP), which has shown we can manage our catchment land to protect and enhance water quality and to provide other benefits such as an improving biodiversity.

We are one of many organisations with a role to play in boosting the quality of bathing water along the North West coast. With strict bathing water standards, we continue to work with partners to improve the quality of rivers and coastal waters, and we give the public real-time information on bathing water quality.

Technology and innovation

Innovation is one of our core values, and we embrace new treatment technologies and efficient approaches that use less resources. The development of connected technologies and Systems Thinking enables greater control and flexibility to operate our networks and assets to reduce our environmental impact.

Regulatory environment

Our regulatory framework shapes the way we manage natural resources and our interaction with the environment, and we work with our environmental regulators to agree long-term plans. The Environment Agency (EA) assesses water companies' performance across a basket of measures including regulatory compliance, pollution incidents and improvement plans.

Political environment

Many of our environmental regulations are based on EU legislation; therefore, there may be changes after the UK leaves the EU. The UK government published its 25-year Environment Plan for England and Wales in 2017, setting out its environmental ambitions. This plan, subject to any changes following exit from the EU, influences our activities and long-term investment plans.

The influence of devolved metro mayors in our region is starting to impact development and spatial planning, including the natural environment. Maintaining a close working relationship helps us work together to improve the natural environment in the region.

Global politics also impacts on what we do. See page 46 of the UUG 2019 Annual report for how we are contributing to the UN's Sustainable Development Goal to 'Ensure access to water and sanitation for all'.

Management and measurement

We have an ISO-accredited environment management system that covers the whole business, and is externally certified through six-monthly surveillance visits.

We have a comprehensive set of environmental strategies covering our approach to carbon management, waste and resources, biodiversity and water use.

We manage our own woodland in a sustainable way to protect water quality, conservation, access, recreation and timber, and have been Forest Stewardship Council® (FSC®) certified since 2003.

A number of our operational KPIs are directly linked to the protection and enhancement of the natural environment, such as leakage, EA performance assessment, and some of our wholesale outcome delivery incentives, such as measures of our contribution to improving rivers and bathing waters, and pollution incidents.

The principal risks and uncertainties that relate to this key resource are 'Health, safety and environmental risk', 'Water service risk' and 'Wastewater service risk'.

Link to our strategic themes

The best service to customers

Customers have told us they value the natural environment and want us to protect and enhance the region's natural resources as part of our activities, and this was one of the outcomes that we committed to deliver as part of our business plan for the 2015–20 regulatory period. Many of our outcome delivery incentives are directly linked to the environmental impacts of our water and wastewater services and to protecting and enhancing the environment. We help customers do their bit for the environment and save money on their bills through our water-saving initiatives and 'what not to flush' campaigns to prevent sewer blockages.

At the lowest sustainable cost

Our embedded innovation culture helps us find new ways of working that simultaneously reduce costs and protect natural resources. Our approach to catchment management aims to address issues at source rather than through increasingly expensive treatment methods. This approach, as well as our renewable energy generation, makes us less reliant on power and chemicals, which reduces treatment costs as well as carbon emissions and use of natural resources. The work we do to prepare our network to sustainably cope with extreme weather and the challenges of climate change can save repair and recovery costs as well as ensuring a more resilient service for customers.

In a responsible manner

Managing our dependency, use and impact on natural resources is a key expectation of many of our stakeholders. Our monitoring and management of leakage from our water network is a crucial part of responsible water management. We comply with abstraction licences and environmental discharge consents set by independent regulators to safeguard the responsible management of the environmental impact of the water and wastewater services we provide. In addition, our efforts to reduce our carbon footprint and use of

plastics makes an important contribution to protecting and enhancing the natural environment and mitigating climate change.

Assets

Our network assets and treatment works are essential to delivering water and wastewater services to customers and protecting public health, and our energy assets enable us to generate energy, which helps reduce costs and minimise our environmental impact.

We are investing around £3.9 billion across the 2015–20 period, and we expect to continue with a substantial investment programme for the foreseeable future to meet increasingly stringent environmental standards and to maintain and improve our assets and services.

Impact of external drivers

Natural environment

We must build increased resilience into all our assets to cope with the anticipated impacts of a changing climate in the long term, including improvements to flood defences. Our assets must be prepared to continue to comply with increasingly challenging environmental constraints in areas such as water abstraction and wastewater treatment levels.

Economic environment

When making strategic investment decisions we must consider the impact on customers' bills and ensure we maintain affordability. A phased, long-term approach to address all of the concerns and interests of our many stakeholders, including environmental regulators, ensures that the necessary work can be delivered without the costs placing too much pressure on customer bills. For example, we have agreed to spread some of the environmental spend required by current legislation over the next 15 years.

Regulatory environment

Many of our assets are very long-term in nature, such as our impounding reservoirs that can last hundreds of years. Through our economic regulation framework we earn a return, received through revenue, based on a measure of the value of our capital asset base, Regulatory Capital Value (RCV). This mechanism allows us to share the cost of building these long-term assets between the generations that will benefit from them.

Our RCV is over £11 billion, but the gross replacement cost of our fixed assets (including all our reservoirs, treatment works and pipes), i.e. the estimated amount it would cost for another company to build similar assets and networks, is around £90 billion.

Stakeholders

Many of our reservoirs are areas of natural beauty and we permit the public to enjoy access to this land, bringing recreational and health benefits. Other assets, such as our wastewater treatment plants, are close to residential areas and we work hard to minimise odours and other impacts.

New infrastructure projects, such as our West Cumbria pipeline, can impact local communities and we go to great lengths to consult in the planning stage.

Political environment

UK government priorities, including those of the National Infrastructure Commission, will impact the planning of large infrastructure projects. We anticipate an increase in the North West's population of around one million by 2045 (more than the population of a large city such as Liverpool). We are planning to ensure our services and infrastructure are able to meet the needs of this growing population, including new connections and higher demand on our water and wastewater networks.

Technology and innovation

It is important we have the right systems and procedures in place to monitor and control our assets efficiently and effectively. We embrace the opportunity that new technology and innovation presents. This is at the heart of our Systems Thinking approach.

The new Nereda process has transformed the wastewater treatment process, our use of robots in managing the water network has improved efficiency and customer service, and we are using drones to inspect assets with restricted access, which improves health and safety as well as reducing time and costs.

We use technology for renewable energy self-generation, for example our Davyhulme sludge recycling centre employs a groundbreaking configuration of thermal hydrolysis to maximise energy generation from sludge; and we built Europe's largest floating solar array on our reservoir in Godley, Greater Manchester.

Technological advances can give rise to new risks as well as opportunities. Cyber crime has been on the increase in recent years and, as the holder of customer information, is a threat we take very seriously.

Management and measurement

Our asset management policy, available to all employees on our intranet, details how we will operate, maintain and invest in our assets with the aim of delivering our customer promises and associated outcomes, as agreed at the price review for the current regulatory period.

We monitor the condition and performance of our assets and assess the risk to service provision. Our proactive and reactive maintenance programmes, and focus on asset health performance measures, ensure we are managing our assets in the most efficient way. Our wholesale outcome delivery incentives, which feature as one of our operational KPIs, include measures of asset health such as the resilience of our impounding reservoirs and maintaining our wastewater treatment works.

The principal risks and uncertainties that relate to this key resource are 'Security risk', 'Water service risk', 'Wastewater service risk', 'Compliance risk', and 'Supply chain and programme delivery'.

Link to our strategic themes

The best service to customers

Maintaining and enhancing our assets is essential in order for us to provide the best service to customers. Since privatisation in 1989, we have invested billions in our assets and this has provided substantial benefits to customers, including reduced supply interruptions, reduced sewer flooding incidents, and improved water quality.

At the lowest sustainable cost

We manage our assets in a holistic way that seeks to minimise whole life costs, helping us deliver efficient total expenditure (totex) without compromising on quality of service or long-term resilience. This approach helps us to save future operating costs, reduce future customer bills, and continue to operate in a sustainable manner.

In a responsible manner

We are committed to managing and operating our assets in a way that continues to create long-term value for all our stakeholders. Effective capital investment helps us to meet increasingly stringent environmental standards, which helps to enhance the region's environment, improving bathing waters and protecting indigenous wildlife and habitats.

People

We support thousands of jobs in the North West, including a growing graduate programme and we have been named one of the top 100 apprenticeship employers, helping to secure a legacy for the future in our region. We believe that the most effective decision-making comes from access to a diverse range of people with a broad set of viewpoints.

Fundamental to the performance we deliver is a skilled, engaged and motivated team of employees, suppliers and contractors. We provide comprehensive training and development opportunities for our employees. Competitive wages, benefits and long-term incentives have been shown to enhance quality of work, increase employee retention, and reduce absenteeism, as well as providing societal benefits. Employee retention also helps ensure efficient and effective training and higher levels of performance.

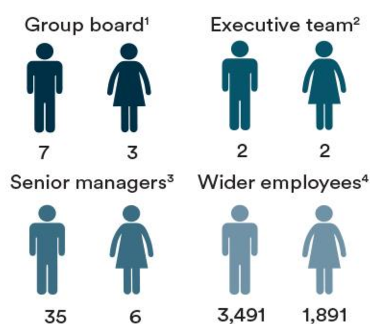
Impact of external drivers

Stakeholders

We are committed to protecting the health, safety and wellbeing of our people. This is fundamental to their welfare and to the reputation and performance of the company, and remains an area of focus as we strive for continuous improvement. We have implemented a number of initiatives over recent years to improve health and safety conditions for our employees, and have been awarded the workplace wellbeing charter.

We promote diversity and equal opportunity to drive a comprehensive and balanced skill set, and we recruit and promote employees on the basis of merit. Over the last few years, we have been striving to improve diversity across all types of role and all levels within our business. We established a Gender Equality Network in 2015 to provide role models, mentoring and opportunities. We target diverse shortlists and attraction campaigns for our apprentice and graduate schemes.

Women are represented at all levels of our company. Over a third of our combined board and executive team is female. See chart.



[1]Group board as at 31 March 2019.

[2]Executive team excludes CEO, CFO and COO, who are included in group board figures.

[3]As at 31 March 2019, there were 11 male and 3 female employees appointed as statutory directors of subsidiary group companies but who do not fulfil the Companies Act 2006 definition of 'senior managers'.

[4]Employees of each sex as at 31 March 2019.

Applicants with disabilities are given equal consideration in our application process, and disabled colleagues have equipment and working practices modified for them as far as possible where it is safe and practical to do so.

Economic environment

The availability of skilled engineers depends on economic and social conditions. Our award-winning apprentice scheme and graduate programme help ensure we can continue to attract and train a high calibre of engineers, in a profession which has seen declining numbers in the UK in recent years. Our employees are paid a competitive base salary plus benefits and the opportunity to join the employee healthcare scheme and our share incentive plan.

We work with suppliers and contractors whose business principles, conduct and standards align with our own. Our key suppliers have committed to our sustainable supply chain charter. We support the appointment of a small business commissioner to investigate companies who do not treat suppliers fairly, are a signatory to the Prompt Payment Code, and will fully comply with rules on reporting payments to suppliers.

Technology and innovation

We have an embedded culture of innovation, and it is one of our core values. We encourage ideas from our people as well as from outside our business, both ad hoc and formally through programmes such as our annual CEO challenge.

Management and measurement

We measure employee engagement through an annual survey, and regularly achieve engagement levels higher than the UK norm. We monitor and measure employee performance through annual reviews, and employees at all levels of the company participate in the bonus scheme, so they benefit from company success. The bonus performance measures are the same for all employees as those for the executive directors, and can be found on page 132 of the UUG 2019 Annual report.

We maintain a comprehensive A–Z suite of policies, which are available to all employees on our intranet. 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.

We convened a cross-company working group to draft our human rights policy statement and assess risks and potential impacts on our stakeholders. These are mapped to, and managed within, our corporate risk register. Our human rights policy can be found on our website, and this has links to other related policies including our modern slavery policy and slavery and human trafficking statement, and sustainable supply chain charter.

The principal risks and uncertainties that relate to this key resource are ‘Health, safety and environmental risk’ and ‘Resource risk’.

Link to our strategic themes

The best service to customers

Our employees and our supply chain act as the face of our business, and therefore are a crucial part of delivering the best service to customers across our entire business. Customer focus is one of our core values that we encourage our people to live by, and we recognise great customer service from individuals, such as through participation in the WOW! Awards.

At the lowest sustainable cost

Comprehensive training and development opportunities for our employees help to improve our internal skills base and therefore quality of work at an efficient cost, as well as creating a more engaged workforce. Management has a range of incentives that focus on performance over a number of years, rather than just the current year, to encourage the delivery of benefits over the longer term.

In a responsible manner

We work with schools, including encouraging the next generation of women into science, technology, engineering and mathematics careers, and with our supply chain partners to give young people not in education, employment or training the chance to gain hands-on experience and basic skills training in the workplace. We are a signatory to the Prompt Payment Code for our suppliers.

Financing

As a result of the long-term nature of our assets and the need to spread the cost between the generations of customers that benefit from them, it is necessary to raise financing in order to fund this investment.

We adopt a prudent approach to managing financial risks, with clear and transparent hedging policies, and our debt portfolio has a very long average life. We maintain a robust and sustainable capital structure, balancing both equity and debt financing, which helps us maintain a strong and stable investment grade credit rating. This enables efficient access to the debt capital markets across the economic cycle, long-term financial resilience, and reduces our exposure to fluctuating market conditions and regulatory changes.

Impact of external drivers

Economic environment

Changes in economic conditions and financial markets can influence our ability to create value through financing. We mitigate some of the impact through our financial hedging strategies, including our approach to hedging inflation and interest rates.

Interest rates have been comparatively low in recent years, and through our interest rate hedging policy we have progressively locked in these lower rates on our debt portfolio, benefiting our future cost of debt.

Our revenue and regulatory capital value (RCV) are linked to RPI inflation during the current regulatory period. Our inflation hedging policy aims to maintain around half our net debt in index-linked form (where it is economic to do so), as this provides a partial economic offset for our inflation exposure. Periods of lower inflation mean lower growth in revenue and the RCV, but also lower finance costs, and the reverse is true in periods of higher inflation.

Market sentiment can impact our financing. While much of this can be outside of our direct control, we can help inform and influence investor opinion through regular engagement.

Regulatory environment

Our ability to raise efficient financing at a cost cheaper than many of our peers provides the potential to outperform the industry-allowed cost of debt, and we have a long track record of aligning our financial risk management policies with the regulatory model.

We maintain an appropriate level of gearing, measured as net debt to regulatory capital value (RCV), within a target range of 55–65 per cent, which is broadly in line with regulatory assumptions for the ‘notional company’.

Our inflation hedging policy aligns with the current RPI-linked regulatory framework, and we have evolved our policy and began introducing CPI-linked debt in line with Ofwat’s transition towards CPIH inflation for the 2020–25 period. We issued the first ever CPI-linked notes by a UK utility in 2017 and have continued to increase our CPI exposure where there are good relative value opportunities, but we expect our index-linked debt to remain mostly in RPI-linked form until CPI or CPIH debt and swaps become available in sufficient size at an economic cost.

Our interest rate hedging policy is to fix nominal debt out to 10 years on a reducing balance basis, reducing our exposure to market fluctuations while managing uncertainty in Ofwat’s approach to setting the cost of debt at future price reviews. For 2015–20 we also substantively fixed all our nominal debt to the end of the period once the cost of debt was known, but we will not do this for 2020–25 as a result of Ofwat’s introduction of indexation on new debt.

Technology and innovation

New innovative ways of raising finance often emerge, for example accessing pockets of untapped investor demand via our Euro Medium Term Note (EMTN) programme, CPI-linked financing, and green bonds have become more prevalent in recent years. We monitor and assess these developments and continue to maintain access to a broad and diverse range of sources of finance in a number of markets, across which we seek the best relative value when issuing new debt.

Management and measurement

We have clearly articulated financial risk management policies, covering credit, liquidity, interest rate, inflation and currency risk.

We maintain relationships with a diverse range of banks, and we periodically refresh our EMTN programme to enable efficient debt issuance under pre-agreed contractual terms. The board delegates authority to the CFO, allowing us to respond quickly to attractive financing opportunities.

We aim to avoid a concentration of refinancing in any one year, and fund long-term where possible. We monitor liquidity forecasts, with a policy of having available resources to cover the next 15–24 months of projected cash flows to ensure forward funding needs are met.

As part of our planning process, we review key credit ratios against required thresholds for our target credit ratings. Performance against these ratios is regularly monitored, and we maintain relationships with the credit rating agencies to understand methodology changes.

The principal risk that relates to this key resource is ‘Financial risk’.

Link to our strategic themes

The best service to customers

Customers benefit from receiving service improvements earlier as a result of our ability to pre-fund investment in long-term assets, and keeping finance costs down helps us to ensure bills remain affordable. The financial resilience we build through our financial risk management helps to ensure we can continue to provide great service long into the future.

At the lowest sustainable cost

Locking in long-term debt and swaps at good relative value helps keep our finance costs low, and we monitor liquidity and headroom regularly to maintain adequate funding. Our approach and financial risk management reduce our risk exposure and help ensure the sustainability of our ability to efficiently finance our business.

In a responsible manner

Our environmental, social and governance performance and robust capital structure give equity and debt investors confidence in the long-term sustainability of our business, which reduces their investment risk. We do not use offshore financing vehicles, and our open and transparent reporting is trusted by Ofwat who rated us ‘self-assurance’ three years in a row.

Internal drivers

Systems Thinking

Our pioneering approach to operating our business, which we call Systems Thinking, is one of our competitive advantages and we set out more detail on this on page 17 of the UUG 2019 Annual report.

Systems Thinking is one of the main drivers of the operational performance improvements we have delivered in recent years, as well as helping us achieve significant cost savings.

We have embedded this way of thinking throughout our business, to put in place the telemetry backbone across our network, to gather and analyse data, and to set up our Integrated Control Centre (the ‘digital brain’ of our network) to remotely monitor and control our assets from our head office. This time and investment has given us a significant advantage.

The best way to demonstrate what Systems Thinking means in practice and the benefits it delivers is to give detailed operational examples.

Since 2015, we have included business insights in each year’s annual report covering our integrated control centre, our network sensors and telemetry backbone, our system-wide approach to sludge treatment, and our use of artificial intelligence to deliver advanced water network management.

We are rolling out artificial intelligence across our entire water network through a platform that can assess vast amounts of data on a wide range of factors such as weather, demand for water, pump performance and electricity prices. This was an idea developed through our Innovation Lab, and helps make decisions on the most cost-effective and efficient way to run water pumps, detect burst pipes, and minimise the risk of discoloured water.

Governance and risk management

Good governance lies at the heart of all successful organisations and leads to better management decisions. We strive to operate in a manner that reflects the highest standards of corporate governance, accountability and transparency. Our company structure and governance standards are designed to ensure our board continues to observe sound and prudent governance in compliance with the UK Corporate Governance Code.

Our board members have diversity in terms of experience, skills and personal attributes, and in terms of age, gender and ethnicity, helping to bring a breadth of views in considering strategic decisions and priorities.

We have an anti-bribery policy that all our employees must follow, and processes in place to monitor compliance with the policy. We operate an independently provided, confidential reporting helpline and web portal for employees to raise matters of concern in relation to fraud, dishonesty, corruption, theft, security and bribery, and all claims are fully investigated. Our audit committee has oversight of the policies and procedures in relation to anti-bribery and fraud.

Our anti-bribery policy is available to view online at: **unitedutilities.com/corporate/about-us/governance**

Our employees and representatives of our suppliers must comply with our sustainable supply chain charter. This explains that we will not tolerate corruption, bribery or anti-competitive actions, and we expect our suppliers to comply with applicable laws and regulations and, in particular, never to offer or accept any undue payment or other consideration, directly or indirectly, for the purposes of inducing any person or entity to act contrary to their prescribed duties.

Given the complex legal and regulatory environment within which we operate, and the critical nature of our infrastructure and service provision, we are exposed to a broad variety of risks. Mitigating exposure to potential risks helps us improve our resilience.

Accepting some level of risk is a normal and necessary consequence for a commercial organisation in order to run the business in a cost-effective way. However, as you would expect of the provider of an essential service, we adopt a prudent approach to managing risks to our business.

Values and culture

Our core values of customer focus, integrity and innovation start at the top and cascade through all levels of our business. They are interrelated – innovating to improve our services and acting with integrity in the way we conduct our activities helps us to continually improve customer service.

Customer focus

We have instilled a customer-centric approach right across our organisation, and this has been a key driver of the major improvement in customer service. Putting customers at the heart of what we do has helped deliver benefits for shareholders and wider stakeholders.

Integrity

Acting with integrity, both at board level and as a company, underpins our approach to responsible business and building trust. We actively encourage our employees to express their opinions and ideas through various engagement and social channels, such as our employee engagement surveys, intranet, and social media collaboration tool ‘Yammer’.

Innovation

Innovation is a critical enabler in creating value. We welcome new ideas and technologies from all levels of our business with employees given the opportunity to develop and present ideas to senior management, from our supply chain, and from industries across the world, including via our Innovation Lab.

Our core values underpin our strategic themes and contribute towards delivering our purpose and working towards our vision.

The culture of our company is a combination of our values, attitudes and behaviours, manifested in our operations and relations with all our stakeholders.

See how we are contributing to the UN's Sustainable Development Goal to 'Promote just, peaceful and inclusive societies and institutions' on page 46 of the UUG 2019 Annual report.

The United Utilities way of doing things is to behave as a responsible business and is set out in our 'Business Principles' document, which can be found on our website at: **unitedutilities.com/corporate/about-us/governance/business-principles**

How we create value for stakeholders

Identifying who our stakeholders are and engaging to understand what matters to them helps enable us to create long-term value

Why stakeholder engagement matters

Our purpose is to provide great service to customers and communities in the North West, creating long-term value for all of our stakeholders. To create this value, it is important to understand our stakeholders and what matters to them.

The provision of water and wastewater services creates a deep connection between the company and the communities we serve. Our work generates value for the North West economy, for example through job creation and delivering environmental improvements, which underpin the region's tourist economy.

We rely on shareholders to finance our activities, and we agree commitments with economic, quality and environmental regulators about what we will deliver within given time frames.

Politicians and the media can influence our priorities and the perceptions of our stakeholders. During the year there has been increased focus on the water sector, from several perspectives including corporate governance, resilience and levels of leakage.

We recognise that we do not operate in isolation and it is not our decision alone to determine what the region needs us to deliver. This is why it is essential we engage with stakeholders across the North West, so we can identify shared solutions to shared challenges.

Understanding what matters to stakeholders will only be achieved by building strong, constructive relationships and engaging regularly. We value the diverse perspectives that a broad range of stakeholders, representing different and often competing interests, can bring to our decision-making.

The relationships we build are subject to robust governance to ensure the insights generated are taken into account in decision-making at executive and board level. This is important to building trust. The board's corporate responsibility committee meets four times a year and stakeholder engagement is one of its standing agenda items. The chair of the independent customer challenge group, YourVoice, attends board meetings to provide its perspective.

The following pages detail how we engage with, and are influenced by, each of our key stakeholder groups, and the value we create for them. Our analysis of what matters most to stakeholders, and how these issues affect our ability to create long-term value in line with our purpose statement, is set out in our material issues matrix on page 24.

Customers

How we engage with and are influenced by customers

To deliver a great service in a way that customers value, we need to listen and engage with them in building new solutions. We engage with customers through a variety of channels, including webchat, text and social

media. We get feedback on customer interactions every day, and conduct more detailed weekly research on key themes that are important to them. We have changed how we communicate and deliver services based on customer feedback, such as the introduction of our customer app and redesign of customer bills. Our business plan for 2020–25 was shaped by unprecedented levels of customer engagement.

The independent customer challenge group, 'YourVoice', aims to ensure customers are at the heart of our business planning engagement, and the Chair regularly attends our board meetings. YourVoice continues to provide challenge and critical support on our delivery of commitments for the 2015–20 period as well as contributing to our business plan for 2020–25.

Top three material issues for customers

Both an external and internal factor - Customer service and operational performance

Both an external and internal factor - Affordability and vulnerability

Both an external and internal factor - Leakage and water efficiency

How we create value for customers

Short-term

- We focus on delivering a reliable service so customers can simply get on with their lives and not have to worry about their water and wastewater services
- When they do need to contact us, we provide a helpful service, talking and listening to customers so we can understand and meet their expectations
- We maintain bills that are good value for money through innovation and efficiency
- Where customers are struggling with affordability and vulnerability, we provide tailored support through Priority Services and payment assistance schemes

Long-term

- Our water and wastewater services make a major contribution to the long-term health and wellbeing of customers in our region
- Through long-term financing and the regulatory framework, we are delivering multi-million pound infrastructure projects, to improve our services and resilience for the long term. We ensure the cost of this is shared fairly and affordably between those that benefit now and in the future
- We focus on earning the trust of customers, for example by keeping personal details safe and through transparent reporting, to ensure they can have complete peace of mind

Link to strategic themes

Best service to customers

Engaging with customers helps us understand what they value most so that we can target our services accordingly.

At the lowest sustainable cost

By achieving sustainable cost reductions we can provide an efficient service, keeping bills low and enabling us to help vulnerable customers.

In a responsible manner

Customers value a company they can trust, and they care about protecting vulnerable people in society. They value the support we provide through our many assistance schemes.

Communities

How we engage with and are influenced by communities

Our work puts us at the heart of local communities, places where customers and employees live and work. When communities come together, whether that is around a particular issue or location, they can often make powerful representations to the company. We seek to develop strong relationships based on mutual trust, respect and an understanding of the impact our work has on everyday lives. We play a constructive role in tackling issues through engagement and investment, and by identifying the water-related issues that matter most to communities we can develop solutions in partnership with them.

We engage through facilitated workshops and community partnerships, such as the North West Hardship Hub to help customers in vulnerable circumstances. Issues raised by communities can present opportunities to improve what we do or to help others, while others can be complex and difficult to handle, with competing interests between different stakeholder groups, and require time and effort to work through.

Top three material issues for communities

External factor - Land management and access

Internal factor - Community investment

Both an external and internal factor - Trust, transparency and legitimacy

How we create value for communities

Short-term

- We look after beautiful landscapes and beaches and open our land to the public, which supports the regional tourism industry and gives communities the health and wellbeing benefits through access to relaxation and recreation
- We encourage employees to volunteer on projects that address local issues, helping to create better places and stronger communities
- Working in partnership with others means we can accomplish more together to tackle mutual issues, such as partnering to develop employability skills for those who need it most

Long-term

- The health and wellbeing benefits through our provision of access to nature for recreation and relaxation helps reduce the burden on health services
- We make a significant contribution to the regional economy through our activities, the people we employ, and the money we spend in our supply chain
- We work with teachers and children to raise awareness about water and the natural environment, giving the next generation an understanding of the true value water brings and how we can all play our part in protecting the services nature provides

Link to strategic themes

Best service to customers
Customers live and work in the local communities we serve and so they value the work we do to tackle issues together.

At the lowest sustainable cost
By operating at the lowest sustainable cost we are able to continue investing in local communities for the long term.

In a responsible manner
As they encompass a breadth and depth of people, communities bring a variety of views and issues to our attention, helping us find the most balanced approach in the best interests of all.

Employees

How we engage with and are influenced by employees

Our employees are the face of the company and we could not deliver our services without them. It is essential we build productive relationships based on trust, develop our employees and keep them engaged and motivated so we can meet the stretching objectives we set ourselves. Employees know our business better than anyone, with a diverse range of views and experience, making them well placed to identify opportunities for improvement.

We have a highly engaged workforce who take pride in their work, value opportunities to learn new skills, and maintain an open and honest dialogue with unions and the business. Line managers play a vital role in supporting employees, with regular one-to-one meetings, and our engagement survey regularly scores above the UK norm. Our new ‘employee voice’ will ensure their perspective is heard by the board. We have employee-led networks such as for gender, LGBT and disability, and encourage employees to share innovative ideas via many forums.

Top three material issues for employees

Internal factor - Health, safety and wellbeing

Both an external and internal factor - Diverse and skilled workforce

Internal factor - Employee relations

How we create value for employees

Short-term

- We have a strong focus on health, safety and wellbeing. We firmly believe that nothing we do is worth getting hurt for, and we aim to ensure all employees go home safe and well at the end of the day
- We invest in training and development to enable our employees to grow their skills and to help keep them motivated
- Listening to our employees helps create an engaged workforce, increasing job satisfaction, and through employee communications and conferences we update our people on business developments so they feel part of a team

Long-term

- Looking after the health, safety and wellbeing of our employees in the short term, by encouraging them to lead fitter and healthier lives and work in ways that reduce accidents, creates long-term health benefits which, in turn, reduces the burden on healthcare services
- Health, safety and wellbeing extends to mental as well as physical health, and we promote awareness of stress and other mental health issues, promoting an all-round healthy lifestyle in the long term
- We provide pension offerings that help support employees in later life

Link to strategic themes

Best service to customers

Well-trained, engaged and motivated employees who take pride in their work have the ability and drive to deliver the best service to customers.

At the lowest sustainable cost

Encouraging innovative ideas from employees can lead to cost reductions, and improving employee satisfaction reduces turnover which ensures training and development costs are efficient.

In a responsible manner

We take a responsible approach to protecting the health, safety and wellbeing of our employees.

Environment

How we engage with and are influenced by the environment

We rely on the environment as one of our key resources so it is important for the sustainability of our business that we protect and enhance it. For example, climate change will affect how much water is available and stakeholders are concerned about the resilience of supplies and look to water companies to adapt and take the necessary steps to reduce flood risk.

Given the environment has no voice of its own, we engage with interested groups such as environmental regulators, non-governmental organisations, customers and communities. We conduct facilitated workshops with stakeholders to understand their priorities and have undertaken a large number of customer research projects. We work with environmental partners across the North West to identify new ways to deliver improvements, and engage with several groups to explore opportunities to deliver shared environmental outcomes.

Top three material issues for the environment

Internal factor - Resilience

Both an external and internal factor - Environmental impacts

External factor - Climate change

How we create value for the environment

Short-term

- We meet increasingly stringent environmental consent levels, which help to improve the quality of rivers and bathing waters and so support tourism in the region
- We manage our land in a way that safeguards habitats for indigenous wildlife, as well as protecting wildlife that makes its home in rivers and other water bodies
- We have invested in new infrastructure, such as our West East Link Main, to allow us to transfer water around the region more efficiently to avoid depletion of individual water sources

Long-term

- Our investment in renewable energy generation is reducing our carbon footprint and contribution to climate change
- We innovate and invest in new technologies to solve environmental challenges for future generations
- We are working on campaigns to educate the public and younger generations on water usage to protect this valuable resource and reduce usage over time
- We plan far ahead to ensure our activities and investment enhance the long-term resilience of the environment

Link to strategic themes

Best service to customers

Customers care about the environment so providing the best service to customers involves protecting the places they live and love

At the lowest sustainable cost

Many of the ways we protect the environment also help us reduce cost, for example renewable energy generation reduces our energy costs as well as our carbon footprint

In a responsible manner

We manage water and wastewater in a responsible way that protects the environment and enhances its resilience.

Suppliers

How we engage with and are influenced by suppliers

As well as employees, we rely on suppliers to deliver our services, and the availability of goods and services in the market influences our strategy and how we operate. Good relationships with suppliers help ensure projects are delivered on time, to good quality, at efficient costs, and can bring innovative approaches and solutions that create shared value.

We engage through supplier workshops, including targeted sessions on innovation, and suppliers sign up to our sustainable supply chain charter and support the commitments set out within it, as they recognise the importance of acting responsibly. They often suggest new ways we can meet some of our own responsible business targets. Feedback from suppliers revealed it can be difficult to access the company, especially when they have new products and services that could help us be more efficient and deliver better service. We established our Innovation Lab to help address this issue.

Top three material issues for suppliers

External factor - NW regional economy

Internal factor - Responsible supply chain

External factor - Human rights

How we create value for suppliers

Short-term

- We spend significant amounts with our suppliers each year to help deliver maintenance and enhancement projects across our asset base, and this helps support thousands of jobs in our region
- By investing in our infrastructure we are helping to keep the economy flowing. We generate jobs through our capital programme and provide income for workers in the region
- While our operations and suppliers are mainly UK and European, they work closely with us to address human rights, in particular modern slavery

Long-term

- Supporting jobs through our supply chain in the short term catalyses the development of skills and jobs in the North West, providing a stimulus to benefit the regional economy in the long term
- Working together to develop innovations and new technologies means we can identify solutions that will make our services better in the future
- We act with integrity, giving suppliers confidence in the way we do business, which translates to transparency and fairness for our suppliers

Link to strategic themes

Best service to customers

Working on our behalf, suppliers are a face for our business. Ensuring they are motivated to deliver good quality work is enormously important to us when delivering the best service to customers.

At the lowest sustainable cost

Ensuring our suppliers deliver efficient cost is integral to delivering a sustainable low cost for customers, and the shared value of developing innovations together with suppliers can assist with this.

In a responsible manner

Working with responsible suppliers helps us achieve more and succeed together in tackling environmental and social issues.

Politicians

How we engage with and are influenced by politicians

Politicians influence the long-term national water strategy and environmental priorities, as well as other matters that affect how all businesses operate. Engagement with national and local government, as well as elected representatives and devolved administrations, on topics of public interest helps us to understand their issues so we can seek solutions to shared environmental, social, economic and governance issues.

We engage with regional and national politicians in different political parties on topics of shared interest. We play an active role in trade association Water UK.

Top three material issues for politicians

External factor - Political and regulatory environment

Both an external and internal factor - Leakage and water efficiency

Both an external and internal factor - Trust, transparency and legitimacy

Regulators

How we engage with and are influenced by regulators

Through proactive, constructive engagement with economic, quality and environmental regulators, we agree to deliver commitments over specified time frames. Read more about our regulatory environment on pages 5 and 8. We actively engage to shape the policy and regulatory framework within which we operate, covering customer, economic, environmental, social and governance matters. These priorities need to be balanced and viewed over a long-term horizon and maintaining relationships is key to this. The priorities and objectives of regulators can change over time so active engagement to provide our perspective around future policy is important to us.

We hold regular meetings with all our regulators, including working on joint projects such as Natural Course, which aims to build capacity to protect and improve the North West water environment.

Top three material issues for regulators

External factor - Political and regulatory environment

Internal factor - Resilience

Both an external and internal factor - Trust, transparency and legitimacy

Media

How we engage with and are influenced by the media

The media is intrinsically linked with all our other stakeholders, being influenced by the issues that matter to those stakeholders as well as influencing them through what it reports. It is through the media, and increasingly its social media platforms, that many of our stakeholders receive their information about us and our activities.

Given the essential nature of our services, it is important that coverage is fair, balanced and accurate, and this requires effective two-way dialogue between the company and the media. This is achieved through proactive engagement by our media team, which is available 24/7, providing content to media outlets, as well as dedicated resources to drive proactive messaging on social media channels.

Top three material issues for the media

External factor - Political and regulatory environment

Both an external and internal factor - Leakage and water efficiency

External factor - Social media

Managing our material issues

Our approach to materiality

Understanding what matters most to our stakeholders is a fundamental part of our planning and day-to-day service delivery. We consider these stakeholder priorities alongside our own assessment of what has the biggest impact on the company and its ability to create value, and the output is presented in the material issues matrix below.

This stakeholder materiality assessment informs decisions about what we report in documents such as this Annual Report. Setting out issues in this way helps ensure we understand key stakeholder priorities and consider their interests in strategic decision-making, helping us create long-term value.

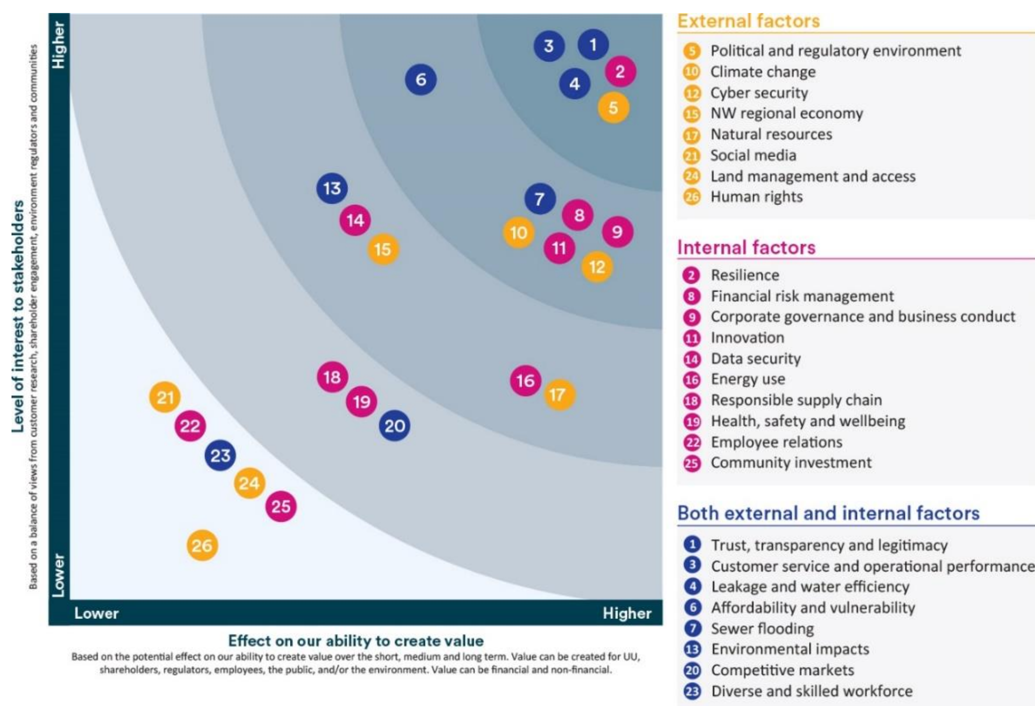
In defining the strategic relevance of an issue to the company, we have adopted the integrated reporting framework definition of materiality, which states: “A matter is material if it could substantively affect the organisation’s ability to create value in the short, medium or long term”. Value, in this context, may be created internally (for the company, shareholders and employees) and there can be external value (for customers, communities, suppliers and the environment). Value may also be financial or non-financial.

Our assessment of the level of interest to stakeholders is based on a balance of views obtained from customers, shareholders, regulators, communities, and subject matter experts from the company on an ongoing basis, as well as the extensive insights gathered for the regulatory price review process.

We have cross-referenced and aligned these issues with our principal risks and uncertainties, and our approach was reviewed by responsible business consultancy Corporate Citizenship, which commented that “alignment with UU’s way of creating value gives life and credibility to the materiality matrix” and this sends a very distinctive message about our business model and what we value.

Material issues matrix

We consolidated feedback from our various stakeholder groups, as detailed above, which resulted in a list of 26 material issues. These issues are impacted by factors that may be external, internal or both — for example, affordability and vulnerability affects customers due to external social and economic factors, and the support services we provide those customers with are an internal factor, so this issue is impacted by both. The 26 issues are plotted on the matrix below, from lower to higher in terms of level of interest to stakeholders and how much it can affect our ability to create value.



Our planning horizons

25+ years – reflecting the long-term nature of our business, which provides an essential service to customers, and helping us to define what we need to deliver in each five-year regulatory period to ensure long-term resilience

5 years – reflecting the regulatory review periods within which our revenue allowances are set, and helping us move towards achievement of our long-term goals

1 year – reflecting the annual targets we set to help move us towards achievement of our five-year goals

Our approach to planning

Our three business areas – wholesale water, wholesale wastewater, and household retail – align with the distinct price controls in Ofwat's regulatory model. Each area undertakes long, medium and short-term planning.

Long-term (25+ years) planning identifies requirements to cope with challenges and opportunities in line with our strategy. This influences our medium-term planning, which sets out how we will deliver the commitments agreed for each five-year regulatory period.

Short-term (one year) planning enables us to monitor and measure progress towards those regulatory commitments. We retain flexibility in these short-term plans to ensure we meet those commitments in the most effective and efficient way as circumstances change.

Long-term planning (25+ years)

In order to maintain a reliable, high-quality service for customers far into the future, we have to look a long way ahead to anticipate and plan for the changes and core issues that are likely to impact on our activities.

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

- Climate change;
- Population growth;
- The UK's exit from the European Union;
- A more open, competitive market;
- More stringent environmental regulations;
- Developments in technology; and
- Combining affordable bills with a modern, responsive service.

There is a section of our website that deals with our future plans, where we examine the challenges ahead and how we will focus our resources and talents in order to meet them.

This includes our 25-year Water Resources Management Plan (WRMP). Our current plan was published in 2015 covering the 2015–40 period, and we consulted with stakeholders during the year on our new draft WRMP covering the 2020–45 period. These long-term plans set out the investment needed to ensure we have sufficient water to continue supplying our customers, taking into account the potential impact of climate change.

We create long-term value for stakeholders by:

- Systems Thinking and innovation;
- Long-term planning and responding to challenges and opportunities, including management of water resources;

- Sustainable catchment management;
- Disciplined investment, based on a sustainable whole-life cost modelling approach, to ensure the resilience of our assets and network;
- Investing in our employees to maintain a skilled, healthy and motivated workforce;
- Close collaboration with suppliers; and
- Maintaining a robust and appropriate mix of debt and equity financing.

Medium-term planning (5 years)

Each five-year business plan aims to help us work towards our long-term plans and ultimately to achieve our vision.

We submit a balanced plan to Ofwat in order to agree a regulatory contract that allows for the best overall outcomes for our customers, shareholders and the environment.

Once each regulatory contract is set, we create value principally by delivering, or outperforming, that contract by providing the best service to customers, at the lowest sustainable cost, in a responsible manner.

In the 2015–20 period we are delivering:

The best service to customers

- Improving customer service further, fixing issues proactively before they impact customers, reducing the number of complaints, and improving our communication channels

At the lowest sustainable cost

- Minimising our total costs on a sustainable basis, enhancing debt collection activities to deliver a more efficient retail service, raising low-cost finance and managing financial risk to reduce volatility

In a responsible manner

- Meeting regulatory commitments to protect and enhance the environment, increasing our renewable energy generation to reduce our carbon footprint, and providing the best support for vulnerable customers

Wholesale water

Our wholesale water team are:

- Maintaining high levels of reliability and water quality, and reducing the number of times customers need to contact us;
- Making better use of technology for remote monitoring and control of assets;
- Maintaining leakage at or below the sustainable economic level;
- Limiting the customer impact of increases in operating costs, such as chemicals and rates, by making cost savings elsewhere through continuous improvement in operational efficiency; and
- Linking 150,000 customers in West Cumbria to Thirlmere reservoir to protect sensitive ecology in their previous water source and ensure a long-term, reliable supply of drinking water.

Wholesale wastewater

Our wholesale wastewater team are:

- Making better use of technology, automation and control to drive better customer service at lower costs;
- Reducing the number of customers' properties exposed to sewer flooding, working in partnerships to deliver cost-effective schemes and promoting the use of more sustainable drainage systems;

- Improving bathing water quality and working with other organisations to support them in delivering improvements to our region’s beaches;
- Improving water quality in rivers and lakes and engaging with others in our innovative catchment management approach;
- Increasing the production of renewable energy from waste; and
- Constraining the costs of taking responsibility for all private sewers and private pumping stations in the region.

Household retail

Our household retail team are:

- Continuing to improve the customer experience by being more proactive, anticipating problems before they materialise, and improving our communication channels in line with customer preference;
- Further reducing the number of customer complaints, and resolving them whenever we can to avoid the need for referral to the Consumer Council for Water;
- Reducing the debt burden for customers and the company by engaging with those who are struggling to pay, helping them return to sustained payment behaviour;
- Expanding our assistance offerings, including the social tariff, and contributing to our trust fund, ‘Restart’, which has proven effective in helping customers in difficulty return to regular payment; and
- Reducing the cost to serve our customers.

Our plans for the 2020–25 period are set out in our business plan submission.

Short-term planning (1 year)

Short-term planning helps us work towards our medium and long-term goals and is important to monitor and assess our progress against these. This approach helps us ensure the long-term resilience and sustainability of our business through short and medium-term goals that we can monitor and measure our progress against.

Before the start of each financial year, we develop a business plan for that year, which is reviewed and approved by the board. This sets our annual targets, which are designed to help deliver further improvements in service delivery and efficiency, and to help move us towards achievement of the five-year goals.

Performance against these annual targets determines annual bonuses for executive directors and employees right through the organisation. To avoid short-term decision-making and ensure management is focused on the long-term performance of the company, as well as these annual targets executive directors are also assessed against three-year performance, covering total shareholder return, sustainable dividends and customer service, through long-term incentive plans. Details of the 2018/19 annual bonus and vested long-term incentive plans for our executive directors are shown on pages 132 and 135 of the UUG 2019 Annual report.

The executive directors hold quarterly business review meetings with senior managers across the business to monitor and assess our performance against our annual targets, helping to ensure that we are on track to deliver our targets for the year, and longer term.

It is vital that we retain flexibility within this short-term planning so we can adapt to meet challenges that may arise during each year, and deliver high-quality and resilient services to customers in the most effective and cost-efficient way possible.

This may involve bringing enhancements forward to deliver improvements for customers early, investing further into the business to maintain service or delaying projects to occur later in the regulatory period in

order to prioritise expenditure and allow our people to spend their time dealing with any unexpected challenges that arise.

For example, during 2018/19 we needed to allocate additional resources to deal with the impact of extreme weather events. We entered the year having experienced a deep freeze followed by a rapid thaw, which had an impact on our levels of leakage, and it was not long before we entered a period of intense hot, dry weather that depleted reservoir levels and saw a surge in water demand.

In response, we substantially increased our leak detection teams and allocated resources to bring additional water resources into operation and increase pumping around the region to balance risk and support the worst affected areas. This resulted in us needing to commit to additional expenditure, but was managed in a way that maintained service for customers and we successfully met our leakage target for the year despite these challenges.

Our approach to resilience

In its initial assessment of our business plan for 2020–25, Ofwat commended our approach to resilience as sector-leading and said we set the standard for other companies to aspire to.

Innovation is a critical enabler for resilience, and our Systems Thinking approach gives us an advantage. Sensors across our network and remote monitoring and control from the Integrated Control Centre at head office allows us to spot issues and respond proactively before customers are impacted and/or the issue becomes more serious. For example, spotting changes in pressure in the network to identify issues so that we can send a team out to repair them before customers are affected.

As well as our use of innovation, we have enhanced our approach to resilience through lessons learned from previous events. We introduced new incident management procedures with detailed contingency plans and a director-led incident review board in response to events in 2015 and 2016. This was instrumental in the way we coped with extreme weather events in 2018, including both the freeze-thaw and the hot, dry summer.

Another development in our approach as a result of lessons learned was the introduction of Priority Services, which offers tailored support to the more vulnerable members of society in emergencies.

Operational resilience

The main risks to the resilience of our operational assets are the potential for failure of ageing infrastructure and the challenges presented by predictions for climate change and population growth.

Our business plan submission for 2020–25 contains proposals to address our biggest operational asset risk, the Haweswater Aqueduct that transports water from the Lake District to Greater Manchester.

Our draft 2019 Water Resources Management Plan considered a range of future challenges, including:

- Extreme drought, freeze-thaw, and flooding;
- Climate change (100 scenarios under the latest UK climate projections at the time of creating the plan, UKCP09); and
- Demand (population growth, economic trends and patterns of water use).

We assessed risks over the 2020–45 planning period and looked beyond this into the 2080s. We published two adaptation reports, in 2011 and 2015, which outline our holistic, integrated and partnership approach to a range of short and long-term challenges, including a changing climate.

Skills resilience

We have some key highly skilled roles, and our talent succession pipeline is critical to the seamless transfer of skills from one generation of employees to another.

We have active graduate and apprenticeship programmes, we have partnered with Teach First, and we are an active participant in the STEM (science, technology, engineering and mathematics) programme encouraging the younger generation to study and pursue careers in these fields.

Corporate and financial resilience

As a public listed company, we consistently adhere to the highest levels of governance, accountability and transparency.

Long-term financial resilience starts with a strong and robust balance sheet and a prudent risk management approach, and we believe we are at the frontier in this respect. We have maintained a responsible level of gearing and well-controlled pension position for many years, and our prudent financial risk management is one of our competitive advantages.

2020+

We will continue to contribute to improving bathing water quality

2022

We will extend our integrated water supply network into West Cumbria

2025

We will halve the risk of requiring drought permits to augment supply

2025+

We will work to enable future national water trading

2030

We will work with others to achieve 'Blue Flag' beaches along our coastline

2045

We will install additional water meters to achieve coverage of around 75 per cent of households

Key performance indicators

Financial KPIs

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

	Year ended 31 March 2019	Year ended 31 March 2018
Financial KPIs		
Revenue	£1,819m	£1,736m
Underlying operating profit (1)	£689m	£645m
Underlying profit before tax (1)	£491m	£396m
Underlying profit after tax (1)	£403m	£326m
Regulatory capital expenditure (2)	£821m	£816m
Gearing: net debt to regulatory capital value (3)	61%	61%
Performance summary		
Operating profit	£635m	£636m
Profit before tax	£467m	£458m
Profit after tax	£388m	£375m

Notes:

(1) Underlying profit measures have been provided to give a more representative view of business performance and represent non-GAAP measures that are reconciled to reported measures on page 32. Further details of underlying profit measures can be found on pages 66-67 of the UUG 2019 Annual Report.

(2) Regulatory capex represents fixed asset additions and infrastructure renewals expenditure using regulatory accounting guidelines; there is no equivalent GAAP measure.

(3) Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water shadow RCV (out-turn prices).

Financial performance

Revenue

Revenue was up £83 million, at £1,819 million, largely reflecting our allowed regulatory revenue changes.

As a result of Ofwat's annual wholesale revenue forecast incentive mechanism (WRFIM), we have reduced revenue by £8 million in 2018/19 and will reduce revenue by a further £14 million in 2019/20 (outturn prices). This consists of two components; firstly reflecting actual volumes being higher than our original assumptions during AMP6, and secondly reductions relating to the 2014/15 "AMP5 blind year", which are £4 million in 2018/19 and £5 million in 2019/20.

Operating profit

Underlying operating profit at £689 million was £44 million higher than last year. This reflects our allowed regulatory revenue changes, partly offset by an £18 million increase in IRE and a £16 million increase in depreciation. The remaining cost base has increased by £5 million as a result of small increases in employee costs, materials, bad debts and property rates, partly offset by a credit resulting from the settlement of an historical commercial claim.

Reported operating profit decreased by £1 million, to £635 million, reflecting the increase in underlying operating profit being more than offset by an increase in adjusted items. Adjusted items for 2018/19 included £36 million of costs associated with the dry weather of 2018, £7 million associated with the equalisation of pension benefits between males and females in relation to Guaranteed Minimum Pension (GMP) benefits, and £7 million of restructuring costs. Adjusted items in the prior year amounted to £9 million, of which £6 million related to restructuring costs.

Investment income and finance expense

The underlying net finance expense of £201 million was £51 million lower than last year, mainly due to the impact of lower RPI inflation on the group's index-linked debt.

Interest of £84 million on non index-linked debt was £8 million lower than last year, due to the lower rates locked in, including the full year impact of re-couponing a portion of the group's regulatory swap portfolio in the prior year. The indexation of principal on index-linked debt amounted to a net charge in the income statement of £98 million, compared with a net charge of £138 million last year. As at 31 March 2019, the group had approximately £3.8 billion of index-linked debt at an average real rate of 1.3 per cent.

The lower RPI inflation charge compared with last year contributed to the group's average underlying interest rate of 3.3 per cent being lower than the rate of 4.2 per cent for the year ended 31 March 2018. The average underlying interest rate represents the underlying net finance expense divided by average debt.

Reported net finance expense of £175 million was broadly in line with the £181 million expense in 2017/18, principally reflecting a decrease in the fair value gains on debt and derivative instruments, from a £47 million gain in 2017/18 to a £9 million gain in 2018/19, offset by the £39 million decrease in the indexation charge in the year.

The group has fixed the substantial majority of its non index-linked debt for the 2015–20 regulatory period.

Profit before tax

Underlying profit before tax was £491 million, £95 million higher than last year, primarily reflecting the £44 million increase in underlying operating profit and the £51 million decrease in underlying net finance expense. This underlying measure excludes the adjusted items, as outlined in the underlying profit measures table on page 32.

Reported profit before tax increased by £9 million to £467 million reflecting the £1 million reduction in reported operating profit more than offset by a £6 million reduction in reported net finance expense including fair value movements and a £4 million increase in our share of profits from joint ventures.

Tax

In addition to corporation tax, the group pays significant other contributions to the public finances on its own behalf as well as collecting and paying further amounts for its 5,000 strong workforce. The total payments for 2018/19 were around £241 million and included business rates, employment taxes, environmental taxes and other regulatory service fees such as water abstraction charges as well as corporation tax.

In 2018/19, we paid corporation tax of £28million, which represents an effective cash tax rate on underlying profits of 6 per cent, which is 13 per cent lower than the headline rate of corporation tax of 19 per cent. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes fair value movements on debt and derivative instruments and thereby enables a medium-term cash tax rate forecast. Our normal effective cash tax rate on underlying profits is around 11 per cent with the key reconciling items to the headline rate of corporation tax (currently at 19 per cent) being allowable tax deduction on capital investment and pension payments, these being deductions put in place by successive governments to encourage such investment and thus reflecting responsible corporate behaviour in relation to taxation. In the current year the effective rate is further reduced as a result of the phasing of quarterly tax payments and also the impact of increased underlying profits as the relevant quarterly payments relate to 2017/18 whereas the underlying profits relate to 2018/19. This phasing of tax payments will not be an issue going forward as from next year the quarterly instalment tax payment rules are being amended to ensure that payments become aligned with financial years.

The total tax charge for 2018/19 was £78 million as compared to a total tax charge of £82 million for 2017/18. For both periods, the total underlying tax effective rate remains in line with the headline rate (currently at 19 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium-term.

The current tax charge was £47 million in 2018/19, compared with £30 million in the previous year; the main differences being timing in nature with a corresponding equal and opposite adjustment to deferred tax. There were current tax credits of £3 million in 2018/19 and £7 million in 2017/18, following agreement of prior years' tax matters.

For 2018/19, the group recognised a deferred tax charge of £35 million, compared with a charge of £52 million for 2017/18. In addition, the group recognised a deferred tax credit of £1 million in 2018/19 and a deferred tax charge of £7 million in 2017/18 relating to prior years' tax matters.

Profit after tax

Underlying profit after tax of £403 million was £77 million higher than last year, principally reflecting the £95 million increase in underlying profit before tax.

Reported profit after tax was £388 million, compared with £374 million in the previous year, largely reflecting the £9 million increase in the reported profit before tax.

Underlying profit

Underlying profit measures have been provided to give a more representative view of business performance and represent non-GAAP measures that are reconciled to reported measures below. Further details of these measures can be found on pages 66 to 67 of the UUG 2019 Annual Report.

	Year ended 31 March 2019	Year ended 31 March 2018
Operating profit	£m	£m
Operating profit per published results	634.9	636.4
Flooding incidents (net of insurance proceeds recognised)	-	1.7
Non-household retail market reform	-	1.0
Dry weather event	36.1	-
GMP equalisation	6.6	-
Restructuring costs	7.2	6.0
Underlying operating profit	684.8	645.1
Net finance expense		
Finance expense	(222.5)	(218.6)
Investment income	47.6	37.4
Net finance expense per published results	(174.9)	(181.2)
Adjustments:		
Net fair value gains on debt and derivative instruments	(9.5)	(47.3)
Interest on derivatives and debt under fair value option	30.6	23.5
Net pension interest income	(9.5)	(7.1)
Capitalised borrowing costs	(37.4)	(39.7)
Underlying net finance expense	(200.7)	(251.8)
Profit before tax		
Share of profits of joint ventures	6.7	2.3
Profit before tax per published results	466.7	457.5
Adjustments:		
Flooding incidents	-	1.7
Non-household retail market reform	-	1.0
Dry weather event	36.1	-
GMP equalisation	6.6	-
Restructuring costs	7.2	6.0
Net fair value gains on debt and derivative instruments	(9.5)	(47.3)
Interest on derivatives and debt under fair value option	30.6	23.5
Net pension interest income	(9.5)	(7.1)
Capitalised borrowing costs	(37.4)	(39.7)
Underlying profit before tax	490.8	395.6
Profit after tax		
Underlying profit before tax	490.8	395.6
Reported tax charge	(78.6)	(82.3)
Agreement of prior years' tax matters	(4.2)	0.4
Tax in respect of adjustments to underlying profit before tax	(4.6)	11.8
Underlying profit after tax	403.4	325.5

Principal risks and uncertainties

Our management of risk underpins the delivery of our purpose and strategy and enables us to focus on providing a sustainable and resilient service for all customers and stakeholders for years to come.

In delivering our group-wide activity we are faced with a range of risks which can threaten the quality of the services we provide, introduce delays and ultimately increase cost and damage the reputation of the group. We anticipate and mitigate these risks through an embedded risk management framework which includes:

- A consistent and reliable enterprise-wide risk management process;
- A governance and reporting structure which enables the board to oversee and direct the control of risk;
- Definition of risk appetite by the board with an overarching general risk appetite supplemented where appropriate by specific risk appetites for certain risks;
- An ISO 31000:2018 aligned assessment and mitigation process; and
- Policies, practical guidance and training programmes to enable our people to identify, quantify and manage risk effectively.

Our risk identification and management activities are continuous and ongoing, with each functional area responsible for assessing, articulating and controlling relevant risks.

This includes horizon scanning of the internal and external business environment, to identify and review new and emerging risks that could lead to a future impact or emerging circumstances of existing risk that could affect the exposure in the short to medium term.

Risk events are assessed in their current state for the likelihood of occurrence based on the level of threat and the vulnerability of controls, together with the financial and reputational impacts should the identified events materialise. Where we are not satisfied that the current state is consistent with our general risk appetite, or where it could present an unacceptable risk in relation to a specific risk appetite, we determine an appropriate risk exposure as a target state and develop further mitigating controls to deliver this position within an appropriate time frame.

In order to maintain adequate oversight of risk, there are various steering groups and governance forums that focus on individual risks which then escalate and share progress to the group audit and risk board either directly or via the wholesale risk and resilience board.

A complete oversight of our enterprise-wide profile is presented every six months to the group board to highlight the nature and extent of the current risk exposure with focus on the most significant risks relative to the group's principal risks.

We categorise the nature of our principal risks to cover potential issues within the following four categories: Regulatory and legal; Core operations and service provision; Functional service and support; and Hazard-based.

Reports to the board highlight major risks based on the highest impact business risks across the group and wholesale operational risks. These comprise the ten highest scoring risks assessed on the basis of likelihood and financial impact for each of the two categories. In addition, the report covers risks which were scored highly for the severity of their impacts in their current state (net of control effectiveness) but remote on likelihood. The board report also highlights risks where there could be significant reputational impact or which relate to significant new or emerging risks or issues, but which are not encompassed within the other reported categories.

Key features and developments

Ofwat's Initial Assessment of Plans (IAP) following the price review submission recognised our leading approach to risk and resilience. Our approach is a combination of top-down assessment, where we consider the impacts on strategic delivery, and bottom-up where we consider localised operational performance, asset health and operational hazards. We have an established approach for the two elements, but continue to drive improved maturity through various initiatives which focus on improved appreciation of related data and

information to understand our long-term risk profile, to support decision-making and to deliver a cost-effective and proportionate risk management response which drives resilience.

These initiatives include:

- Continuation of our focus on cross-business consideration of strategic and tactical risks, for example an in-depth cyber risk assessment that took place throughout the year and Brexit contingency planning below;
- Improvement of our maturity in relation to risk appetite – we have commenced reporting against a general risk appetite boundary and, where appropriate, specific risk appetite boundaries enabling more targeted discussions over the last year (an approach we intend to continue to develop and embed);
- Development of the assessment and reporting of the full distribution of impacts, including possible maximum and minimum outcomes as well as more likely occurrences. This supports our focus on long-term resilience and tests our response and recovery plans and expectations;
- Ongoing development of our wholesale risk and asset planning process to prioritise investment and operational management through the identification of risks and issues and monitoring of strategic performance requirements; and
- An assurance-based strategy within the engineering and programme management team introducing programme and portfolio risk responsibilities and improving capability by focusing on reliable risk information, ownership and learning from risk events.

Profile features

Our risk profile, which currently consists of around 100 event-based risks is enterprise-wide, covering risk across the entire group and considering both internal and external drivers. By their nature, these risks will include many combinations of high to low likelihood and high to low impact.

Political and regulatory risk and uncertainty feature prominently within the profile, notably with the outcome of PR19 being delivered this calendar year. The possibility of ‘renationalisation’ is a key area of uncertainty as is the opening up to competition of wholesale operations (including the current focus on possible competition in bioresources and water abstraction) and the potential for competition covering domestic retail activities.

Our operations continue to be substantially UK-based, but the potential impacts of Brexit remain under review and have been reported to the group board. In common with other UK companies, a significant issue is the uncertainty surrounding the effects of any Brexit deal that the UK Government may ultimately deliver. Our review has considered the availability of European funding, the availability of critical goods (including chemicals and spare parts) through our supply chain, the price of goods and services due to tariff changes, exchange rate changes and potential inflationary shifts outside current predicted parameters, the effect to the labour resource of both the company and our delivery partners and our ability to collect cash were there to be an economic downturn. For each of these consequences, the impact assessment considers a range of possible impact scenarios and we have developed a contingency plan (in collaboration with Water UK) which has involved discussing the implications of Brexit with our key suppliers and capital delivery partners, as well as considering mitigation measures such as stockpiling and using alternative suppliers, a large proportion of which is already built into our multi-party frameworks.

Following the launch of non-household retail competition in April 2017, we have continued to monitor our operations in the market to review compliance risks and to ensure that we continue to operate in a manner that complements and promotes the ‘level playing field’.

From an operational risk perspective, the dominance of the penalty element of Ofwat’s outcome delivery incentive mechanism and the continuing effects of changes to the Environmental Sentencing Guidelines continue to be key features of evolving exposure. Reputationally, our core operations/service provision (notably water service) and health, safety and environmental risks have the highest focus for monitoring and reviewing control effectiveness based on the potential impact should the risk event occur.

We continue to adapt to and plan for climate change and its significant and permanent impacts on the water cycle, our operations and the broader operating environment. This includes consideration of the long-term viability of water and wastewater services such as water abstraction, drinking water supply and treatment capability, drainage and sewer capacity, wastewater treatment and its discharge efficiency and effectiveness. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) support and reinforce the need to consider climate-related risks and uncertainties. These continue to be factored into risk management and the likely effects of future changes are a critical consideration in our long and medium-term risk, operational and financial planning (see also Key resources on pages 6 to 15 and Our approach to resilience on pages 28 to 29). Our water service and wastewater service risks (summarised on pages 36 to 37) also reflect current key risks including the potential for extreme weather and climate change.

Material litigation

The group robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible. Litigation of a material nature is regularly reported to the group board.

Beyond that reported in previous years on the Argentina multiparty 'class action' and the Manchester Ship Canal Company matters (to which there have been no material developments), there is nothing specific to report on material litigation.

Principal risks and uncertainties

The ten principal risks (combinations of relevant event-based risks) identified in the risk map and described in more detail in the tables which follow, illustrate where value can be lost or gained and could have a material impact on the group's business model, future performance, solvency or liquidity. For each principal risk the nature and the extent of exposure is recorded, with alignment to our strategic themes and mitigating controls identified. Also described are key risks worthy of note, together with current issues and areas of uncertainty. These reflect changing/emerging circumstances which could affect the risk exposure of future activities and are therefore considered as part of the ongoing mitigation.

Regulatory and legal

(1) Political and regulatory risks (increased)

Potential change in the political and regulatory environment and/or frameworks

Main strategic theme:

At the lowest sustainable cost

Principal/significant impacts:

Potential for increased costs of administration, reduction in income, margin and greater uncertainty of returns.

Potential that reduced confidence among equity investors and difficult debt market conditions lead to funding pressures in the context of raising finance and refinancing debt on an ongoing basis.

In the event of renationalisation the business could be acquired below fair value.

Management and mitigation:

We regularly engage in relevant government and regulatory consultations which may affect policy and regulation in our industry as well as consulting with the opposition. We also consult our customers to better understand their requirements and proactively consider opportunities and threats associated with any potential change, exploiting opportunities and mitigating risks where appropriate. We keep customers and the public informed. We also provide information to the government, regulators, customers and the public as appropriate to help them to make informed decisions.

Current key risks, issues and uncertainties:

- Potential renationalisation of the water sector
- Further market reform including upstream competition in water resources and bioresources, as well as additional markets in future, and the potential for the introduction of domestic competition
- Final determination of PR19 and associated tougher regulatory targets
- Brexit and potential changes to the regulatory regime

(2) Conduct and compliance risk (stable)

The failure to meet all legal and regulatory obligations and responsibilities

Main strategic theme:

In a responsible manner

Principal/significant impacts:

The detrimental impact to customers and other stakeholders through inappropriate culture, behaviour or decisions and the potential to receive penalties of up to 10 per cent of relevant turnover and ultimately revocation of our licence or the appointment of a special administrator.

Management and mitigation:

Corporate social responsibility features prominently within the group. We work in collaboration with landowners, environmental organisations, community groups and other stakeholders to deliver enhanced environmental outcomes and engage with the community and support agencies regarding vulnerable customers and ensure diversity and equality of employees and an ethical supply chain.

Legislative and regulatory developments are continually monitored as is the governance framework utilised by the group. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Allowance for any material 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.

Current key risks, issues and uncertainties:

- The effects of Brexit on legislation/laws, enforcement and the regulatory regime
- Competition law requirements in relation to the non-household retail market and other competitive markets
- Current material litigation
- Continuing high fines for environmental offences
- Data management and governance (GDPR)

Core operations and service provision

(3) Water service risk (stable)

A failure to provide a secure supply of clean, safe drinking water and the potential for a negative impact on public confidence in water supply

Main strategic theme:

The best service to customers

Principal/significant impacts:

The potential for public health issues associated with poor water quality.

The potential for supply interruptions that could affect large populations within the region for long durations.

Management and mitigation:

Mitigation is provided through core business processes, including centralised planning and control, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Optimisation of operational and maintenance tasks together with targeted capital interventions help to ensure services to customers are maintained.

Our 25-year Water Resources Management Plan defines our strategy to achieve a long-term, best-value and sustainable plan for water supplies in the North West including consideration of multiple different climate change scenarios including a 2 degree (Celsius) global warming scenario (assessing systems resilience).

We continue to develop innovative solutions and invest in resilience to further support the delivery of water and wastewater services in the long term.

Current key risks, issues and uncertainties:

- Population growth
- Extreme weather, climate change and drought
- Expected change to the abstraction licensing regime
- Drinking water safety and security
- Critical asset failure
- Brexit, in particular the effects of a no-deal scenario on the chemicals supply chain

(4) Wastewater service risk (increased)

A failure to remove and treat wastewater

Main strategic theme:

The best service to customers

Principal/significant impacts:

The potential for sewer flooding or serious pollution to air, soil or water leading to harm or disruption to the public, businesses and the environment (wildlife, fish and natural habitats) resulting in fines and reputational damage.

Management and mitigation:

Mitigation is provided through core business processes, including centralised planning and control, quality assurance procedures, risk assessments, rigorous sampling/testing regimes and close management of discharge consent requirements. Optimisation of operational and maintenance tasks together with targeted capital interventions help to ensure services to customers are maintained.

Current key risks, issues and uncertainties:

- The effects of extreme weather on overloading the sewer network
- Pollution incidents
- Population growth
- Increased regulatory scrutiny and penalties
- Higher fine levels for environmental offences
- Climate change
- Brexit, in particular the effects of a no-deal scenario on the chemicals supply chain

(5) Retail and commercial risk (stable)

Failing to provide good and fair service to domestic customers and third-party retailers or a failure of or issue in relation to non United Utilities Water operations or businesses (including Water Plus)

Main strategic theme:

The best service to customers

Principal/significant impacts:

The potential for significant losses, regulatory penalties and long-term reputational damage associated with poor customer satisfaction. The potential for a significant increase in the bad debt charge, reducing profitability.

Management and mitigation:

For domestic retail there is a wide range of initiatives and activities focused on improving customer satisfaction, including proactive incident communication, complaints handling and use of appropriate tariffs. Bad debt risk is managed through the adoption of best practice collection techniques, segmentation of customers based on their credit risk profile and the use of data sharing to better understand customers' circumstances to determine the most appropriate collection and support activities. Our wholesale business maintains processes, systems, data and organisational capacity and capability to deal fairly with market participants and the central market operator in the Business Retail market in order to generate and collect revenue. Similarly strong governance applies to non United Utilities Water operations and businesses.

Current key risks, issues and uncertainties:

- Socio-economic deprivation in the North West
- Economic downturn (due to welfare reform, Brexit or other factor) and the effect on domestic bad debt
- Competition in the water and wastewater market and competitor positioning
- Non-household retail competition and the ability to treat other participants equally
- The challenges associated with being involved in a joint venture water retail business operating in a competitive environment

Functional service and support

(6) Financial risk (stable)

Potential inability to finance the business appropriately

Main strategic theme:

At the lowest sustainable cost

Principal/significant impacts:

The potential for worse credit ratings, associated funding costs or reduced access to debt capital markets leading to lower liquidity and adversely impacting the economic return on the regulatory capital value (RCV).

Tax inefficiencies, under or overpayment of tax, market fluctuations in inflation, interest rates and energy prices and a potential worsening of the pension scheme funding position could all lead to a significant increase in costs to the group.

Management and 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 manage the impact of market fluctuations for

inflation, interest rates and 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.

Current key risks, issues and uncertainties:

- Inflation/deflation
- Financial market conditions, interest rates and funding costs due to economic uncertainty (e.g. Brexit)
- Paying an appropriate amount of tax

(7) Supply chain and programme delivery (increased)

Potential ineffective delivery of capital, operational and change programmes/processes

Main strategic theme:

At the lowest sustainable cost

Principal/significant impacts:

The potential failure to meet our obligations and customer outcomes resulting in an impact at future price reviews, negative reputational impact with customers and regulators.

Management and mitigation:

Supply chain management is utilised to deliver an end-to-end contract management service, including contract strategy, tendering and category management, which provides a risk-based approach and relationship management programmes for suppliers. We prioritise our investment programmes, projects and integrated business and asset plans. We have created better alignment and integration between our capital delivery partners and engineering service providers including alignment with our operating model.

Our programmes 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.

Current key risks, issues and uncertainties:

- New partnership structure and arrangement in AMP 7
- Direct procurement for customers (DPC)
- Technical quality and innovation
- Brexit and increased uncertainty of availability of materials sourced from Europe

(8) Resources risk (stable)

Failing to provide appropriate resources (human, technological or physical resource) required to support business activity

Main strategic theme:

In a responsible manner

Principal/significant impacts:

The potential inability to recruit, retain or deploy knowledge and/or expertise.

The potential inability to respond and recover due to ineffective non resilient business activity.

Management and 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.

Current key risks, issues and uncertainties:

- Delivering required employee engagement
- Personal development, talent management and succession planning
- Optimising technology and innovation

Hazard-based

(9) Security risk (stable)

Potential for malicious activity (physical or technological) against people, assets or operations

Main strategic theme:

In a responsible manner

Principal/significant impacts:

The potential for a loss of data/information and the consequent effect on service provision.

The potential for catastrophic damage to UU property, infrastructure and non-infrastructure and the consequent effect on service provision.

Management and mitigation:

Physical and technological security measures and awareness training combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Externally, we work closely with our industry peers, the Centre for the Protection of National Infrastructure (CPNI), the National Cyber Security Centre (NCSC), the Drinking Water Inspectorate (DWI) and Defra to shape the sector approach to security, particularly cyber security, and to understand how we can best deliver the appropriate levels of protection to our business and in compliance with the new Network and Information Systems Directive (NIS). Ongoing system and network integration 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.

Current key risks, issues and uncertainties:

- Cyber crime
- Terrorism
- Fraud
- Ownership of critical national infrastructure and national infrastructure

(10) Health, safety and environmental (stable)

Potential harm to people (employees, contractors or the public) and the environment

Main strategic theme:

In a responsible manner

Principal/significant impacts:

The potential for serious injury or loss of life in remote, extreme circumstances.

The potential for catastrophic damage to private, public or commercial property/infrastructure including the consequent effect on water and wastewater service provision.

The potential for serious impact on wildlife, fish or natural habitats resulting in significant fines and reputational damage.

Management and mitigation:

Supported by strong governance and management systems certified to OHSAS 18001 we have developed a strong health and safety culture where 'nothing we do at United Utilities is worth getting hurt for'. We actively seek to improve health, safety and wellbeing across the group through targeted improvements and benchmarking against our peers. Also certified to ISO 14001, we seek to protect and improve the environment through the responsible delivery of our services. This includes helping to support rare species and habitats through targeted engagement and activity and commitment to reducing our carbon emissions by designing out waste from our operations, generating our own energy and looking at ways to reduce our use of raw materials. We also recognise the impact the environment can have on our service provision with extreme weather and climate change being integrated into our risk, planning and decision-making processes.

Current key risks, issues and uncertainties:

- Impounding reservoirs containing significant volumes of water
- Other critical asset failure
- Multiple hazards including process safety, use or accidental release of chemicals, excavation, tunnelling and construction work
- Fluvial and coastal flooding associated with climate change

Emerging risks and issues

We monitor the internal and external business environment, to identify and review new and emerging risks to our strategy or operations and emerging circumstances of existing risk that could affect our risk exposure in the short to medium term. If new and emerging risks or circumstances are too far into the future or we lack sufficient detail to make a reliable quantification, they are summarised as a watching brief and reported to the corporate responsibility committee and to the board in the six-monthly reporting cycle.

Some new and emerging risks of note are listed below, with emerging circumstances of existing risk included within the list of current key risks, issues and uncertainties in the principal risks section on pages 33 to 41.

The Strategic report was approved by the board on 12 June 2019 and signed on its behalf by:

JR Houlden
Chief Financial Officer

Directors' report

The directors present their report and the audited financial statements of United Utilities PLC and its subsidiaries for the year ended 31 March 2019.

Profit and dividends

The results for the year, set out in the consolidated income statement on page 56 show that profit for the year after tax was £388.1 million (2018: £375.2 million).

The directors have not recommended a final ordinary dividend (2018: £nil). Interim ordinary dividends of £274.5 million (2018: £267.1 million) have been declared and paid during the year.

Principal activity and review of business

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

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

The company's principal subsidiary undertakings, and joint ventures in which the group participates, are listed in note A8 to the consolidated financial statements.

The ultimate parent company of United Utilities PLC is United Utilities Group PLC.

Political donations

We do not support any political party and do not make what are commonly regarded as donations to any political party or other political organisations. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between 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 group incurred expenditure of £9,338 (2018:£21,662) as part of this process, the increase on the previous year as a result of a parliamentary reception hosted by the company to engage parliamentary stakeholders on its business plan development. At the 2018 UUG AGM, an authority was taken to cover such expenditure. A similar resolution will be put forward at the 2019 UUG AGM to authorise the company and its subsidiaries to make 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 whilst being operated in a cost-effective and efficient manner.

The group is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The group also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the group and charged to the income statement was £1.2 million in the year ended 31 March 2019 (2018: £1.2 million).

Carbon footprint

The group is committed to reducing its carbon footprint and increasing its generation of renewable energy. In 2018/19, the group's carbon footprint totalled 167,856 tonnes of carbon dioxide equivalent, which is a 71 per cent reduction since 2005/06.

For further information please visit unitedutilities.com/corporate/responsibility/environment/climate-change/.

Events after the reporting period

Details of events occurring after the reporting period are included in note 25 of the financial statements.

Going concern basis of accounting

The directors consider it appropriate to prepare the financial statements on the going concern basis, as explained in the basis of preparation paragraph on page 62.

Directors

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

PA Aspin
SR Fraser
JR Houlden
SL Mogford

Directors' indemnities and insurance

We have in place contractual entitlements for the directors of the company and of its subsidiaries 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 company 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 company also maintains an appropriate level of directors' and officers' liability insurance.

Employees

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. A copy of our business principles can be found at unitedutilities.com/corporate/about-us/governance/business-principles, which explains the way in which we do business and make it clear that our employees must seek to act with integrity and fairness and observe legal requirements. Anyone with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or through a confidential telephone line. Importance is placed on strengthening employees' engagement, measuring their views annually, and taking action to improve how they feel about the company and understand its direction. Employees are provided with regular information, through briefings and access to other online materials, to enable them to understand the financial and economic factors affecting the company's performance.

Amongst other initiatives, an Employee Voice Panel has been established; meetings will be held quarterly with the venue rotating around our region. The Panel will consist of circa 30 employees elected from across all employee segment groups and geographical areas. Panel members will be re-elected approximately every two years. The objectives of the Panel are to: provide the opportunity for a two-way channel of communication between the board and the workforce; provide insight to the board on how people think and feel about working for the company; and contribute to the monitoring and assessment of the culture of the business. During the year, we have had regard to employee interests, consulting with employees and their representatives and trade union representatives in relation to new pension arrangements introduced on 1 April 2019 and consulting with employee representatives in relation to organisational changes for support and managerial roles. The effect of our regard towards employees in relation to the decisions taken during the financial year is included in our s172(1) Statement on page 47.

Employees are encouraged to hold shares in UUG through the operation of an all employee share incentive plan. Information on the average number of employees can be found in note 3 on page 71.

Environmental, social and community matters

Details of our approach, as a responsible business, is set out in our business principles, which can be found on our website at unitedutilities.com/corporate/about-us/governance/business-principles/. Our approach to engagement with our environmental stakeholders and those in the communities we serve can be found on pages 18 to 22. The effect of our regard towards the environment, social and community matters in relation to the decisions taken during the financial year is included in our s172(1) Statement on page 47.

Our slavery and human trafficking statement can be found on our website at: unitedutilities.com/human-rights

Customers and suppliers and key stakeholders

Our approach to engagement with customers, suppliers, regulators and other key stakeholders can be found on pages 17 to 24. The effect of our regard towards customers, suppliers, regulators and other key stakeholders in relation to the decisions taken during the financial year is included in our s172(1) Statement on page 47.

Our sustainable supply chain charter sets out how we work with our suppliers, which can be found on our website at: unitedutilities.com/corporate/about-us/governance/suppliers/how-we-buy/sustainable-supply-chain/.

We are also a signatory to the Prompt Payment Code. We publish key statistics and other information on our payment practices in line with the Duty to Report on Payment Practices and Performance on the Department for Business, Energy & Industrial Strategy's website. Information is published on a six-monthly basis. For the six months to 31 March 2019, our average time taken to pay invoices was 24 days; in the previous six months it was 25 days.

Energy and Carbon

UUG's disclosure, in accordance with The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 can be found on page 145 of the UUG 2019 Annual report.

Financial instruments

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

Share capital

At 31 March 2019, the issued share capital of the company was £881,787,478 divided into 881,787,478 ordinary shares of £1 each. Details of our share capital and movements in our issued share capital are shown in note 22 to the financial statements on page 88.

Internal controls and risk management

The board is responsible for ensuring that the company has sound risk management and internal control systems in place, and for reviewing its effectiveness. It is supported in this role by the audit committee of UUG, the internal audit function, the financial control team and the external auditor. The key features of this internal control framework include policies and procedures for planning, approving and monitoring major capital expenditure and clearly defined comprehensive business planning and financial reporting procedures, and monthly meetings by the executive team to review financial and non-financial performance and key operational issues. Alongside these processes, risk management is well embedded in our ongoing business as usual approach. All areas of the business and support departments are responsible for monitoring changes to their areas of activity, identifying any associated risks as a result of these changes which might prevent us from achieving our objectives, and identifying actions to mitigate those risks as far as is reasonably practicable and cost-effective to do so. These internal control and risk management systems, which are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss, have been in place continually for the year under review.

On behalf of the board, the audit committee of UUG completed its annual review of the effectiveness of the risk management and internal control processes up to the date of the annual report in accordance with the

FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. There were no significant failings or weaknesses identified in this review.

The principal risks and uncertainties to the business are explained on pages 33 to 41. We continue to work with all key parties to represent the best interests of our stakeholders, and where we can identify actions to mitigate the adverse consequences of these risks we work hard to address them.

Information given to the auditor

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

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

2. he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information. This confirmation is given, and should be interpreted, in accordance with the provisions of s418 of the Companies Act 2006.

External auditor

KPMG are appointed as statutory auditor to all wholly owned companies in the United Utilities group. The company adheres to the UUG policy on non-audit services provided by the external auditor and in relation to auditor independence (see page 107 of the UUG 2019 Annual report and financial statements).

The UU board has decided to recommend KPMG LLP to be reappointed as external auditor to the company at the forthcoming UU AGM of and an authority for the directors to set the remuneration of the auditor will be sought.

Approved by the board and signed on its behalf by:

JR Houlden
Chief Financial Officer
12 June 2019

Non-financial information statement

The table below constitutes the company's non-financial Information statement ('the statement'), produced to comply with sections 414CA(1) and 414CB(1) of the Companies Act 2006. The statement is incorporated into the strategic report by cross reference. Our business principles set out how we behave as a business and are applicable to the areas of disclosure required by s414CB(1). Our business principles can be found on our website: **unitedutilities.com/corporate/about-us/governance/business-principles/**.

Reporting requirement	Information necessary to understand our business and its impact, policy, due diligence and outcomes	Policies, guidance and standards which govern our approach (some of which are only published internally)
Environmental matters	Reflecting the needs of the environment: › Natural resources – see page 6 › Natural environment – see pages 7 to 8, 10 › Reducing our carbon emissions – see page 7, 9, 41	› Waste and resource use policy › Environmental policy › Water resources management plan – see page 7, 25, 28 › Emissions target – see page 146 of the UUG 2019 annual report.
Employees	Reflecting the needs of employees: ›Competitive base salaries and benefits – see page 20 ›Health and safety – see page 20 ›Mental wellbeing – see page 20 ›Engagement – see page 20	› Health and safety policy › Equality, diversity and inclusion policy ›Flexible working arrangements ›Agency worker policy ›Mental wellbeing policy ›Human rights policy ›Board diversity policy ›Gender pay report 2018
Respect for human rights	Reflecting the needs of our stakeholders: ›Suppliers – see page 22 ›Employees and diversity within our workforce – see page 20	›Employee data protection policy ›Slavery and human trafficking statement ›Human rights policy › Equality, diversity and inclusion policy
Social matters	Reflecting the needs of our stakeholders: ›Customers – see page 17, 18 ›Community – see page 18, 19 ›Environment– see page 21 ›Suppliers – see page 22 ›Regulators – see page 23	›YourVoice ›Charitable matched funding guidance ›Volunteering policy ›Sustainable supply chain charter ›Commercial procurement policy
Anti-corruption and anti- bribery	›Employees – see page 20 ›Suppliers – see page 22	›Anti – bribery policy ›Fraud investigation and reporting processes ›Whistleblowing policy

		›Internal financial control processes ›Commercial procurement policy

Introduction

Throughout this annual report, we provide examples of how we: take into account the likely consequences of long-term decisions; build relationships with stakeholders; understand the importance of engaging with our employees; understand the impact of our operations on the communities in our region and the environment we depend upon; and attribute importance to behaving as a responsible business.

Statement by the directors in performance of their statutory duties in accordance with s172(1) Companies Act 2006

The board of directors of United Utilities PLC consider, both individually and together, that they have acted in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole (having regard to the stakeholders and matters set out in s172(1)(a-f) of the Act) in the decisions taken during the year ended 31 March 2019. In particular, by reference to the approval of our business plan ('our plan') for the period 2020–25, supported by the board assurance statement accompanying our plan:

- Our plan was designed to have a long-term beneficial impact on the company and to contribute to its success in delivering a better quality, more reliable water and wastewater service for customers in the North West of England to 2025 and beyond. We will continue to operate our business within tight budgetary controls and in line with our regulatory targets. Our plan was awarded 'fast-track' status and commended in relation to: customer engagement, affordability and vulnerability, resilience and innovation.

- Our employees are fundamental to the delivery of our plan. We aim to be a responsible employer in our approach to the pay and benefits our employees receive. The health, safety and well-being of our employees is one of our primary considerations in the way we do business (see page 20).

- Our duty, in accordance with the Water Industry Act 1991, is to provide a safe and secure supply of water and return wastewater safely to the environment. Our plan was informed by extensive engagement with customers, enabling us to gain an understanding of their views and priorities, communicating and listening through new channels and underpinned by working with the independent customer challenge group YourVoice. We have made a commitment to share the gains of out-performance with customers. We also aim to act responsibly and fairly in how we engage with our suppliers (see pages 39 to 41) and co-operate with our regulators (see page 41), all of whom are integral to the successful delivery of our plan.

- Our plan took into account the impact of the company's operations on the community and environment and our wider societal responsibilities, and in particular how we impact the regions we serve in the North West of England (see page 22). Several of the proposed performance measures in our plan will deliver environmental improvements.

- As the Board of Directors, our intention is to behave responsibly and ensure that management operate the business in a responsible manner, operating within the high standards of business conduct and good governance expected for a business such as ours and in doing so, will contribute to the delivery of our plan. The intention is to nurture our reputation, through both the construction and delivery of our plan, that reflects our responsible behaviour.

- As the Board of Directors, our intention is to behave responsibly toward our shareholders and treat them fairly and equally, so they too may benefit from the successful delivery of our plan.

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

The directors are responsible for preparing the Annual Report, Strategic Report, the Directors' Report and the Group and parent Company 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 the Group and parent Company financial statements in accordance with International Financial Reporting Standards as adopted by the EU (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, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

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 are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and 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.

Responsibility statement of the directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the strategic and directors' reports include a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Signed on behalf of the board:

JR Houlden
Chief Financial Officer
12 June 2019

Independent auditor's report

to the members of United Utilities PLC

1. Our opinion is unmodified

We have audited the financial statements of United Utilities PLC ("the Company") for the year ended 31 March 2019 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated and company statements of financial position, the Consolidated and company statements of changes in equity, the Consolidated and company statements of cashflows, and the related notes, including the accounting policies on pages 62 to 68 and 117 to 125.

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 2019 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (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 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the directors on 22 July 2011. The period of total uninterrupted engagement is for the eight financial years ended 31 March 2019. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2018), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Revenue recognition and allowance for household customer debt Revenue not recognised: £18.0 million (2018: £20.3 million) Provision for household customer debts: £52.9 million (2018: £63.4 million) *Refer to pages 66 to 67 and 118 (accounting policy), and page 82 to 83 (financial disclosures).*	
The Risk **Subjective estimation:** At each balance sheet date: - judgment is required to identify properties where there is little prospect that cash will be received for revenue that has been billed due to either the occupier	**Our Response** **Our procedures included:** ***Accounting analysis*** – Assessing the recognition of revenue where the collection of consideration is not probable on the date of sale for compliance with relevant accounting standards;

Independent auditor's report

to the members of United Utilities PLC

<table>
<tr><td>not being able to be identified or a past history of non-payment of bills relating to that property and therefore whether the revenue should be recognised; and

- assumptions involving a high degree of estimation uncertainty are required to assess the recoverability of trade receivables.

The effect of these matters is that, as part of our risk assessment, we determined that the recoverability of trade receivables has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (Accounting Policies note, page 67) disclose the sensitivities estimated by the Group.</td><td>Control observation – testing the group's controls over revenue recognition and provision for household customer debts, including reconciliations between sales and cash receipts systems and the general ledger;

Methodology choice – assessing the appropriateness of the customer debt provisioning policy based on historical cash collections, credits, re-bills and write-off information; and

Assessing transparency – assessing the adequacy of the group's disclosures of its revenue recognition and household customer debt provisioning policies, including the judgement involved in recording revenue and estimation uncertainty of the doubtful debts provision.

Our results:
- We found the amount of revenue recognised to be acceptable; and
- We considered the level of provisioning against household customer debts to be acceptable.</td></tr>
<tr><td colspan="2">Capitalisation of costs relating to the capital programme
£726.2 million (2018: £741.3 million)
Refer to page 67 and 119 to 120 (accounting policy), and page 78 (financial disclosures).</td></tr>
<tr><td>The Risk

Subjective classification:

The group has a substantial capital programme which has been agreed with the Water Services Regulation Authority (Ofwat) and therefore incurs significant annual expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets.

The determination of project costs as capital or operating expenditure is inherently judgemental. Costs capitalised include an allocation of overhead costs, relating to the proportion of time spent by support function staff, which is based on assumptions involving a high degree of judgement.

The effect of these matters is that, as part of our risk assessment, we determined that the costs capitalised has a high degree of judgement, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (Accounting policies section, page 67) disclose the sensitivities estimated by the Group.</td><td>Our Response

Our procedures included:

Accounting analysis – Assessing the group's capitalisation policy for compliance with relevant accounting standards;

Control observation – Testing controls over the application of the policy in the period including review of project business case submissions, and attending a sample of capital approval meetings to observe the judgements made and evaluating the documented conclusions;

Tests of details – Critically assessing the costs capitalised for a sample of projects against the capitalisation policy;

Tests of details – Identify and assess the impact of existing projects where the capitalisation rate has changed during the year;

Historical comparisons – Critically assess the proportion of capitalised overhead costs using historical comparisons and expected changes based upon corroborated enquiry and our sector knowledge; and</td></tr>
</table>

Independent auditor's report

to the members of United Utilities PLC

<table>
<tr><td></td><td>Assessing transparency – Assessing the adequacy of the group's disclosures of its capitalisation policy including the judgement involved in assessing expenditure as capital and the judgement relating to the allocation of overhead costs.

Our results:

We found the group's classification of expenditure as capital or operating to be acceptable.</td></tr>
<tr><td colspan="2">Retirement benefit obligation valuation
£3,425.2 million (2018: £3,498.7 million)
Refer to pages 67 to 68 and 123 to 124 (accounting policy), and pages 84 to 86 and 107 to 114 (financial disclosures).</td></tr>
<tr><td>The Risk

Subjective valuation:

The valuation of the retirement benefit obligations depends on a number of estimates, including the discount rates used to calculate the current value of the future payments the Group expects to pay pensioners, the rate of inflation that must be incorporated in the estimate of the future pension payments, and the life expectancy of pension scheme members.

There is a considerable amount of estimation uncertainty involved in setting the above assumptions and a small change in the assumptions and estimates may have a significant impact on the retirement benefit obligations.

The effect of these matters is that, as part of our risk assessment, we determined that the gross defined benefit pension obligations has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (note A5) disclose the sensitivity estimated by the Group .</td><td>Our Response

Our procedures included:

Our actuarial expertise – We used our own actuarial specialists to challenge key assumptions and estimates used in the calculation of the retirement benefit obligations. We also compared the IAS 19 valuation with the triennial funding valuations of the UK schemes notwithstanding that they were prepared on a different basis and as at different dates;

Methodology assessment – We used our own actuarial specialists to assess the appropriateness and consistency of the methodology applied by management in setting the key assumptions;

Benchmarking assumptions – we performed a comparison of key assumptions against our own benchmark ranges derived from externally-available data and against those used by other companies reporting on the same period;

Assessing external actuary's credentials – We assessed the competence and independence of the external actuary engaged by the Group; and

Assessing transparency – We considered the adequacy of the Group's disclosure in respect of retirement benefits, in particular the gross defined benefit obligation and the assumptions used, which are set out in note A5 to the financial statements.

Our results:
We found the resulting estimate of the retirement benefit obligations to be acceptable.</td></tr>
<tr><td colspan="2">Water plus joint venture investment and loans carrying value
£36.7 million investment in joint venture and £142.1 million loans to joint venture (2018: £37.3 million and £135.8 million respectively)
Refer to pages 68, 117 to 118, and 121 (accounting policy), and pages 79 to 80 (financial disclosures).</td></tr>
</table>

Independent auditor's report

to the members of United Utilities PLC

<table>
<tr><td>The Risk
Forecast-based estimate valuation:

The group's investment in the equity and loans to Water Plus are significant. The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash flows.</td><td>Our Response
Our procedures included:
Assessing methodology – We assessed whether the principles and integrity of the cash flow model are in accordance with relevant accounting standards;

Our valuation expertise – We challenged the assumptions used by the Group in the calculation of the discount rates, including comparisons with external data sources and by involving our own valuation specialist to assist us in assessing the discount rate assumptions applied;

Sensitivity analysis – We performed our own sensitivity analysis including a reasonably possible reduction in forecast cash flows and an alternative discount rate assumption to assess level of sensitivity to these changes; and

Assessing transparency – we assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to a reasonably possible change in the discount rate and cash flows reflected the risks inherent in the valuation.

Our results:
We found the resulting estimate of the recoverable amount of the investment in the equity and loans to Water Plus to be acceptable.</td></tr>
<tr><td colspan="2">Recoverability of the parent company's investment in United Utilities North West Limited
Investment in United Utilities North West Limited £3,907.1 million (2018: £3,907.1 million)
Refer to page 117 (accounting policy), and page 81 (financial disclosures).</td></tr>
<tr><td>The Risk
Low risk, high value

The carrying amount of the parent company's investment in United Utilities North West Limited represents 53.2% (2018: 50.3%) of the company's total assets. The recoverability is not at a high risk of significant misstatement or subject to significant judgement. However due to the materiality in the context of the parent company financial statements, this is considered to be the area that had the greatest effect on our overall parent company audit.</td><td>Our Response
Our procedures included:
Tests of detail – We compared the carrying amount of the investment with the draft balance sheet of United Utilities North West Limited to identify whether the net assets, being an approximation of the minimum recoverable amount, was in excess of the carrying amount.

Our results:
We found the group's assessment of the recoverability of the investment in United Utilities North West Limited to be acceptable.</td></tr>
</table>

Independent auditor's report

to the members of United Utilities PLC

3. Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £18.51 million (2018: £18.51 million), determined with reference to a benchmark of group profit before tax, normalised to exclude net fair value gains or losses on debt and derivative instruments of £9.5 million as disclosed in note 6, of £457.2 million, of which it represents 4.0 per cent (2018: 4.5 per cent).

Materiality for the parent company financial statements as a whole was set at £18.5 million (2018: £18.5 million), determined with reference to a benchmark of company net assets of £6,249.9 million, of which it represents 0.30 per cent (2018: 0.31 per cent).

We agreed to report to the audit committee any corrected or uncorrected identified misstatements exceeding £0.5 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the group's 33 (2018: 33) reporting components, we subjected six (2018: five) to full scope audits for group purposes.

For the residual components, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these.

The group team approved the component materialities, which ranged from £2.5 million to £19.5 million (2018: £2.5 million to £18.5 million), having regard to the mix of size and risk profile of the group across the components. The work on one of the seven reporting components (2018: one of six) was performed by component auditors and the rest, including the audit of the parent company, was performed by the group team. The group team instructed the component auditor as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The group team performed procedures on the items excluded from normalised group profit before tax.

The group team visited none (2018: none) of the component locations to assess the audit risk and strategy. Telephone conference meetings were held with the component auditor. At these meetings, the findings reported to the group team were discussed in more detail and any further work required by the group team was then performed by the component auditor.

4. We have nothing to report on going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the company or the group or to cease their operations and, as they have concluded, that the company's and the group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ('the going concern period').

Our responsibility is to conclude on the appropriateness of the directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the group and the company will continue in operation.

In our evaluation of the directors' conclusions, we considered the inherent risks to the group's and the company's business model and analysed how those risks might affect the group's and the company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the group's and the company's available financial resources over this period were:

- a significant increase required in total expenditure;
- funding to be obtained in line with forecast; and
- the impact of macro-economic factors on household customers' ability to pay.

As these were risks that could potentially cast significant doubt on the group's and the company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse

Independent auditor's report

to the members of United Utilities PLC

effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second-order impacts, such as the impact of Brexit and the erosion of customer or supplier confidence, which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement on page 62 of the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the group and company's use of that basis for a period of at least 12 months from the date of approval of the financial statements. We have nothing to report in these respects and we did not identify going concern as a key audit matter.

5. We have nothing to report on the strategic report and the directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in those reports;
- in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required 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.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 48, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Independent auditor's report

to the members of United Utilities PLC

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience and through discussion with the directors and other management (as required by auditing standards), and from inspection of the company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the company is subject to laws and regulations that directly affect the financial statements; including financial reporting legislation (including related companies legislation); distributable profits legislation and taxation legislation; and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation. We identified the following areas as those most likely to have such an effect: Ofwat, Environmental Agency, Drinking Water Inspectorate, health and safety, anti-bribery, employment law, regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the company's activities and legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any. Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and whom we owe our responsibilities

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.

William Meredith, for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
St Peter's Square, Manchester M2 3AE
12 June 2019

Consolidated income statement

for the years ended 31 March

	Note	2019 £m	2018 £m
Revenue	2	1,818.5	1,735.8
Employee benefits expense	3	(169.6)	(153.5)
Other operating costs	4	(449.3)	(423.4)
Other income	4	3.6	3.8
Depreciation and amortisation expense	4	(393.2)	(376.8)
Infrastructure renewals expenditure		(175.1)	(149.5)
Total operating expenses		(1,183.6)	(1,099.4)
Operating profit		634.9	636.4
Investment income	5	47.6	37.4
Finance expense	6	(222.5)	(218.6)
Investment income and finance expense		(174.9)	(181.2)
Share of profits of joint ventures	11	6.7	2.3
Profit before tax		466.7	457.5
Current tax charge	7	(44.6)	(23.5)
Deferred tax charge	7	(34.0)	(58.8)
Tax	7	(78.6)	(82.3)
Profit after tax		388.1	375.2

All of the results shown above relate to continuing operations.

Consolidated statement of comprehensive income

for the years ended 31 March

	Note	2019 £m	2018 £m
Profit after tax		388.1	375.2
Other comprehensive income			
Items that may be reclassified to profit or loss in subsequent periods:			
Cash flow hedge effectiveness*		0.4	-
Tax on items that may be reclassified to profit or loss	7	(0.1)	-
Foreign exchange adjustment		(0.8)	0.2
Other comprehensive income that may be reclassified to profit or loss		(0.5)	0.2
Items that will not be reclassified to profit or loss in subsequent periods:			
Remeasurement gains on defined benefit pension schemes	17	73.0	50.2
Change in credit assumptions for debt reported at fair value through profit or loss		6.6	-
Cost of hedging – cross-currency basis spread adjustment*		(2.2)	-
Tax on items that will not be reclassified to profit or loss	7	(13.1)	(8.5)
Other comprehensive income that will not be reclassified to profit or loss		64.3	41.7
Total comprehensive income		451.9	417.1

* On adoption of IFRS 9, the group has recognised the cost of hedging reserve and the cash flow hedging reserve as new components of equity. A reconciliation of movements in these reserves, including amounts reclassified from other comprehensive income to profit or loss during the year, is included in note 21.

Consolidated and company statements of financial position

at 31 March

	Note	Group 2019 £m	Group 2018 £m	Company 2019 £m	Company 2018 £m
ASSETS					
Non-current assets					
Property, plant and equipment	9	11,153.4	10,790.5	-	-
Intangible assets	10	202.7	197.7	-	-
Interests in joint ventures	11	79.0	75.2	39.1	39.1
Investments	12	11.5	7.1	4,008.3	4,176.0
Trade and other receivables	14	1,866.5	1,831.4	1,760.6	1,726.2
Retirement benefit surplus	17	483.9	344.2	110.1	80.1
Derivative financial instruments	A4	387.8	297.8		-
		14,184.8	13,543.9	5,918.1	6,021.4
Current assets					
Inventories	13	14.9	16.8	-	-
Trade and other receivables	14	261.9	270.0	1,413.8	1,611.3
Current tax asset		16.4	24.5	-	-
Cash and short-term deposits	15	339.3	510.0	12.1	9.6
Derivative financial instruments	A4	101.3	337.7	0.7	118.7
		733.8	1,159.0	1,426.6	1,739.6
Total assets		14,918.6	14,702.9	7,344.7	7,761.0
LIABILITIES					
Non-current liabilities					
Trade and other payables	20	(697.4)	(642.7)	-	-
Borrowings	16	(7,115.6)	(7,072.8)	(305.2)	(282.7)
Deferred tax liabilities	18	(1,146.0)	(1,098.8)	(17.1)	(13.5)
Derivative financial instruments	A4	(66.1)	(96.8)	-	-
		(9,025.1)	(8,911.1)	(322.3)	(296.2)
Current liabilities					
Trade and other payables	20	(326.9)	(285.6)	(57.7)	(94.4)
Borrowings	16	(773.8)	(901.0)	(714.6)	(1,332.4)
Provisions	19	(16.8)	(22.1)	-	-
Derivative financial instruments	A4	(13.8)	(4.2)	(0.2)	-
		(1,131.3)	(1,212.9)	(772.5)	(1,426.8)
Total liabilities		(10,156.4)	(10,124.0)	(1,094.8)	(1,723.0)
Total net assets		4,762.2	4,578.9	6,249.9	6,038.0
EQUITY					
Capital and reserves attributable to equity holders of the company					
Share capital	22	881.8	881.8	881.8	881.8
Share premium account		1,430.0	1,430.0	1,430.0	1,430.0
Other reserves		8.6	(1.8)	-	-
Retained earnings		2,441.8	2,268.9	3,938.1	3,726.2
Shareholders' equity		4,762.2	4,578.9	6,249.9	6,038.0

These financial statements for the group and United Utilities PLC (company number: 2366616) were approved by the board of directors and authorised for issue on 12 June 2019, and signed on its behalf by:

JR Houlden
Chief Financial Officer

Company statement of changes in equity

for the years ended 31 March

	Share capital £m	Share premium account £m	Other reserves* £m	Retained earnings £m	Total £m
Group					
At 31 March 2018	881.8	1,430.0	(1.8)	2,268.9	4,578.9
Adjustment on initial application of IFRS 9	-	-	12.7	(12.7)	-
Adjustment on initial application of IFRS 15	-	-	-	5.9	5.9
At 1 April 2018	881.8	1,430.0	10.9	2,262.1	4,584.8
Profit after tax	-	-	-	388.1	388.1
Other comprehensive income					
Remeasurement gains on defined benefit pension schemes (see note 17)	-	-	-	73.0	73.0
Change in credit assumption for debt reported at fair value through profit or loss	-	-	-	6.6	6.6
Cash flow hedge effectiveness	-	-	0.4	-	0.4
Cost of hedging – cross-currency basis spread Adjustment	-	-	(2.2)	-	(2.2)
Tax on items taken directly to equity (see note 7)	-	-	0.3	(13.5)	(13.2)
Foreign exchange adjustments	-	-	(0.8)	-	(0.8)
Total comprehensive income	-	-	(2.3)	454.2	451.9
Dividends (see note 8)	-	-	-	(274.5)	(274.5)
At 31 March 2019	881.8	1,430.0	8.6	2,441.8	4,762.2

	Share capital £m	Share premium account £m	Other reserves* £m	Retained earnings £m	Total £m
Group					
At 1 April 2017	881.8	1,430.0	(2.0)	2,119.1	4,428.9
Profit after tax	-	-	-	375.2	375.2
Other comprehensive income					
Remeasurement gains on defined benefit pension schemes (see note 17)	-	-	-	50.2	50.2
Tax on items taken directly to equity (see note 7)	-	-	-	(8.5)	(8.5)
Foreign exchange adjustments	-	-	0.2	-	0.2
Total comprehensive income	-	-	0.2	416.9	417.1
Dividends (see note 8)	-	-	-	(267.1)	(267.1)
At 31 March 2018	881.8	1,430.0	(1.8)	2,268.9	4,578.9

* Other reserves comprise the group's cumulative exchange reserve, merger reserve, cost of hedging reserve and cash flow hedging reserve. The cost of hedging and cash flow hedging reserves were included as separate components of equity for the first time in the year ended 31 March 2019 as a result of the group's adoption of IFRS 9 'Financial instruments' (see pages 168 to 169 accounting policies). A reconciliation of movements in these reserves is included in note 21.

Company statement of changes in equity

for the years ended 31 March

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2018	881.8	1,430.0	3,726.2	6,038
Profit after tax	-	-	482.6	482.6
Other comprehensive income				
Remeasurement gains on defined benefit pension schemes (see note 17)	-	-	4.6	4.6
Tax on items taken directly to equity (see note 7)	-	-	(0.8)	(0.8)
Total comprehensive income	**-**	**-**	486.4	486.4
Dividends (see note 8)	-	-	(274.5)	(274.5)
At 31 March 2019	881.8	1,430.0	3,938.1	6,249.9

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2017	881.8	1,430.0	3,654.7	5,966.5
Profit after tax	-	-	325.7	325.7
Other comprehensive income				
Remeasurement gains on defined benefit pension schemes (see note 17)	-	-	15.6	15.6
Tax on items taken directly to equity (see note 7)	-	-	(2.7)	(2.7)
Total comprehensive income	**-**	**-**	338.6	338.6
Dividends (see note 8)	-	-	(267.1)	(267.1)
At 31 March 2018	881.8	1,430.0	3,726.2	6,038.0

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The results of the company for the financial year was a profit after tax of £482.6 million (2018: £325.7 million).

Consolidated and company statements of cash flows

for the years ended 31 March

	Note	Group 2019 £m	Group 2018 £m	Company 2019 £m	Company 2018 £m
Operating activities					
Cash generated from operations	A1	962.9	960.7	663.7	301.0
Interest paid		(143.0)	(144.6)	(26.4)	(23.5)
Interest received and similar income		35.3	30.9	2.3	1.5
Tax paid		(37.9)	(35.5)	(27.5)	(33.9)
Net cash generated from operating activities		817.3	811.5	612.1	245.1
Investing activities					
Purchase of property, plant and equipment		(622.3)	(698.6)	-	-
Purchase of intangible assets		(39.9)	(36.1)	-	-
Proceeds from sale of property, plant and equipment		2.1	1.1	-	-
Grants and contributions received	20	35.2	23.7	-	-
Loans to joint ventures	A6	(6.0)	(26.5)	-	-
Proceeds from investments	12	1.0	1.0	-	-
Proceeds from disposal of business		-	8.9		-
Dividends received from joint ventures	11	2.2	3.3	-	-
Net cash used in investing activities		(627.7)	(723.2)	-	-
Financing activities					
Proceeds from borrowings		580.7	801.7	84.6	36.6
Repayment of borrowings		(668.6)	(345.9)	(419.7)	(55.2)
Dividends paid to equity holders of the company	8	(274.5)	(267.1)	(274.5)	(267.1)
Net cash generated from/(used in) financing activities		(362.4)	188.7	(609.6)	(285.7)
Net increase/(decrease) in cash and cash equivalents		(172.8)	277.0	2.5	(40.6)
Cash and cash equivalents at beginning of the year		497.9	220.9	9.6	50.2
Cash and cash equivalents at end of the year	15	325.1	497.9	12.1	9.6

Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. Further detail can be found in note A7.

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). They 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 fair value on transition to IFRS.

The preparation of financial statements, in conformity with 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 financial statements have been prepared on the going concern basis as the directors have a reasonable expectation that the group has adequate resources for a period of at least 12 months from the date of the approval of the financial statements, and that there are no material uncertainties to disclose.

In assessing the appropriateness of the going concern basis of accounting, the directors have reviewed the resources available to the group, taking account of the group's financial projections, together with its liquidity position with regards to available cash and undrawn committed borrowing facilities as well as consideration of the group's capital adequacy. The board has also 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 mitigating actions that the directors would consider undertaking.

Adoption of new and revised standards

The following standards, interpretations and amendments, effective for the year ended 31 March 2019, have had no material impact on the group's financial statements:

- amendments to IFRS 2 'Classification and Measurement of Share-based Payment Transactions' (issued on 20 June 2016).

The following standards, interpretations and amendments, effective for the year ended 31 March 2019, have had a material impact on the group's financial statements – this impact is discussed further below:

- IFRS 9 'Financial Instruments' (issued on 24 July 2014); and
- IFRS 15 'Revenue from Contracts with Customers' (issued on 28 May 2014) including amendments to IFRS 15: Effective date of IFRS 15 (issued on 11 September 2015).

IFRS 9 'Financial Instruments'

IFRS 9 'Financial Instruments' was adopted by the group on 1 April 2018. The standard replaces IAS 39 'Financial Instruments: Recognition and Measurement', and has been applied retrospectively in accordance with the standard's transition requirements. Comparative periods have not been restated, with any differences arising from retrospective application being recognised as an adjustment to retained earnings at the beginning of the period. This has resulted in retained earnings at the adoption date decreasing by £13.8 million with a corresponding credit of £13.8 million to the cost of hedging reserve, which is a separate component of equity newly recognised under IFRS 9. Further details of these adjustments are set out below.

Under IFRS 9, there is no longer a requirement for cross-currency basis spread adjustments to be incorporated in the test for the effectiveness of a hedge as was the case under IAS 39. IFRS 9 states that when an entity separates the foreign currency basis spread from a financial instrument, and excludes it from the designation of that financial instrument as the hedging instrument, the entity may apply the accounting such that the change in fair value resulting from the foreign currency basis spread can be recognised in other comprehensive income rather than in profit or loss to the extent that it relates to the hedged item. Under the standard this change in fair value relating to the basis spread adjustment, which effectively represents a

Accounting policies

liquidity charge inherent in foreign exchange contracts for exchanging currencies, shall be accumulated in a separate component of equity. This has been recorded as a cost of hedging reserve.

The group has adopted this accounting treatment under IFRS 9, resulting in the creation of a cost of hedging reserve with a brought forward balance of £13.8 million at 1 April 2018, being the accumulated fair value gains to date at this point relating to the basis spread adjustment on cross-currency swaps in place at the adoption date. The portion of the change in fair value due to changes in the cross-currency basis spread during the period, which has been recognised in other comprehensive income, has been a £2.2 million loss. This would have previously been incorporated within the fair value charge recognised in the income statement under IAS 39.A deferred tax credit of £0.4 million has been recognised in other comprehensive income during the period in relation to this basis spread adjustment.

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, which has been a £6.6 million gain during the period, has been recognised in other comprehensive income rather than within profit or loss, and has been taken directly to retained earnings, meaning no opening retained earnings adjustment has been required. A deferred tax charge of £1.1 million has been recognised in other comprehensive income during the period in relation to this gain.

On adoption of IFRS 9, there were no financial assets or liabilities initially designated at fair value through profit or loss that have subsequently been reclassified out of this category.

The group has reassessed the effectiveness of existing accounting hedges on adoption of IFRS 9 and the documentation that supports any designation. Financial instruments that had been designated in an accounting fair value hedge relationship under IAS 39 continue to be designated as such under IFRS 9; however, the group has reassessed its position with regards to designating non-financial risks in hedge relationships, and has determined that in order to give a more representative view of operating costs it would be appropriate to designate existing and future swaps as being in a cash flow hedge relationship provided they meet the criteria for designation. This means that only the impact of any hedging ineffectiveness is recognised through fair value in the income statement, with movements reflecting the effective part of the swaps being recognised in other comprehensive income. At the maturity date the amounts paid/received will be recognised against operating costs in the income statement, including the effect of any fair value movements reflecting hedge effectiveness previously recognised in other comprehensive income.

Previously, no income relating to these swaps would have been recognised against corresponding operating expenses, with the £4.2 million gain for the year being recognised in full as a fair value movement as part of finance expense. The treatment under IFRS 9 has led to the settlement of existing swaps in the period giving rise to income of £3.8 million recognised against operating expenses, with a fair value gain of £0.4 million recognised in other comprehensive income together with a corresponding increase in the cash flow hedge reserve as the hedge was fully effective. A deferred tax charge of £0.1 million has been recognised in other comprehensive income during the year in relation to this gain recognised in other comprehensive income.

On transition to the expected credit loss model for impairing financial assets in accordance with the standard, the group has not been significantly impacted as under IAS 39 the group had always used a model which used historic cash collection rates to form an expectation of the estimated recoverability of trade receivables at a point in time. The simplified approach, whereby the company recognises full lifetime credit losses on initial recognition, has been adopted.

IFRS 15 'Revenue from Contracts with Customers'

The group adopted IFRS 15 on 1 April 2018, applying the standard retrospectively with the cumulative effect of initial application recognised at the date of initial application as an adjustment to retained earnings. Prior period comparatives have therefore not been restated. The group has elected to use the practical expedient whereby any contracts that were completed in accordance with accounting standards as at 31 March 2018 need not be restated on an IFRS 15 basis. This transition approach, which was made in accordance with the IFRS 15 transitional provisions, has resulted in a £2.6 million increase in retained earnings and reduction in deferred income on the adoption date due to a change in the period over which revenue relating to connection activities is recognised. This has also given rise to a tax credit of £3.3 million

Accounting policies

relating to the adjustment, which has resulted in an increase in retained earnings at the adoption date. The tax credit is greater than the £2.6 million increase in retained earnings on adoption of IFRS 15 due to the different tax treatments of various connection activities that make up the adjustment.

The two main areas of the group's activities considered in the adoption of IFRS 15 are:

- the provision of core water and wastewater services, accounting for more than 96 per cent of the group's revenue; and
- capital income streams relating to diversions work, and activities, typically performed opposite property developers, that facilitate the creation of an authorised connection through which properties can obtain water and wastewater services.

The adoption of IFRS 15 had no impact on the timing or amount of revenue recognised in relation to core water and wastewater services, which are deemed to be distinct performance obligations under the contracts with customers, though following the same pattern of transfer to the customer who simultaneously receives and consumes both of these services over time. No significant judgements are required in identifying customers of these services. In accordance with IFRS 15, revenue relating to these activities will be recognised over time as these performance obligations are satisfied.

There are two categories of capital income, both of which will be impacted by the adoption of IFRS 15:

- diversions relating to the relocation of water and wastewater assets; and
- activities that facilitate the creation of an authorised connection through which properties can obtain water and wastewater services.

The adoption of IFRS 15 did not result in any net income statement impact relating to diversions as income was previously recognised in line with the completion of diversion work. However, whereas this income was included in the income statement as a credit within infrastructure renewals expenditure (IRE) due to it representing a contribution towards these costs, under IFRS 15 it is now recognised within revenue, resulting in an increase in both the revenue and IRE expense balances. The adoption of the standard in the year has caused both balances to increase by £11.1 million. As there was no net impact to the income statement, there was also no net impact to earnings per share or diluted earnings per share as a result of this element of the new standard.

Significant judgement is required in relation to accounting for activities that facilitate an authorised network connection through which water and wastewater services can be delivered. Establishing such an authorised connection can involve a number of activities performed opposite developers, which are considered to be neither separable nor distinct and instead form a bundle of activities necessary to establish an authorised connection from which network access can be obtained and water and wastewater services can be provided. Costs incurred by the group in carrying out these activities are capitalised as property, plant and equipment to the extent they result in the creation or enhancement of assets. These activities are considered to form part of the group's ordinary activities associated with the operation, maintenance and expansion of a water and wastewater network and, because they are deemed to result in an exchange transaction, we have determined that they fall within the scope of IFRS 15 as transactions arising from contracts with customers.

In addition, as the group has a legal obligation to keep a connection in place for as long as a property requires water and wastewater services, these initial connection activities are deemed to result in a broader ongoing performance obligation that is not distinct from the ongoing supply of water and wastewater services. The right to benefit from this connection, and obtain water and wastewater services through it, is deemed to be transferable from the initial developer to subsequent occupants of a connected property. Accordingly, under IFRS 15, the element of the performance obligation associated with the connection activities is deemed to be satisfied over the period of time that water and wastewater services are expected to be provided through the connection, compared with the prior treatment under which deferred amounts were released to the income statement over the useful economic life of the related assets or, for certain items, immediately to the income statement. This estimated period is a matter of judgement. We estimate that an average connection will be in place for a period of 60 years and therefore revenue associated with connection activities will be recognised evenly over this period.

Accounting policies

Contract liabilities are accounted for within deferred revenue. These contract liabilities relate to the revenue which is held on the balance sheet in respect of connection activities. As stated above, revenue is released and recognised evenly over a period of 60 years; therefore deferred income on the balance sheet will also be reduced evenly over the 60 year period on a connection-by-connection basis. The group will hold no material contract assets, meaning there will be no material impairments to contract assets under IFRS 9 given the new requirement to provide for expected credit losses for contract assets.

As noted above, we have applied IFRS 15 retrospectively, with the cumulative effect of initially applying the standard recognised as an adjustment to the opening retained earnings balance at the date of initial application, resulting in an increase of £2.6 million in retained earnings with the corresponding decrease being to deferred income. In line with the standard, contracts which were completed in accordance with current accounting standards at the date of initial application were not restated on an IFRS 15 basis. The impact of the change on ongoing revenue as a result of the revised period over which income is released to the income statement is that revenue of £13.4 million was recognised in the year relating to the amortisation of deferred income; had IFRS 15 not been adopted, this revenue recognised in the year would have been £9.9 million. The adoption of IFRS 15 has therefore resulted in an increase of revenue of £3.5 million. This has directly impacted the amount of revenue and profit of the group with the corresponding decrease of the adoption of IFRS 15 being in deferred income on the balance sheet.

New and revised standards not yet effective

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

IFRS 16 'Leases'

This standard, which replaces IAS 17 'Leases', IFRIC 4 'Determining Whether an Arrangement Contains a Lease', SIC-15 'Operating Leases – Incentives', and SIC-27 'Evaluating the Substance of Transactions in the Legal Form of a Lease', is effective for periods commencing on or after 1 January 2019. The group therefore adopted the standard on 1 April 2019 with the 31 March 2020 financial statements being the first which will be presented with IFRS 16 being applied. Under the provisions of the new standard, most leases, including the majority of those previously classified as operating leases where the group is the lessee, will be brought onto the statement of financial position as both a right-of-use asset and an offsetting lease liability. The typical items which the group leases include land, buildings, and vehicles. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 'Property, Plant and Equipment' and the liability increased for the accretion of interest (being the unwinding of the discounting applied to the future lease payments) and reduced by lease payments. The group does not act as a lessor.

The key judgements associated with adoption of this standard relate to the identification and classification of contracts containing a lease within the scope of IFRS 16, and the discount rate to use in calculating the present value of future lease payments on which the reported lease liability and right-of-use asset is based when the rate is not implicit in the lease contract.

The group has reassessed whether contracts it has entered into are, or contain, leases as defined by the new standard, so the new standard is being applied to a different population of contracts to those previously identified as containing leases under IAS 17 and IFRIC 4. Some new contracts have been identified as leases, while other contracts previously identified as operating leases under IAS 17 and IFRIC 4 will not be accounted for as leases under the new standard.

Due to the nature of the group's operations, many of the current operating leases have long remaining terms, which causes the discount rate to be a key factor in determining the value of the lease liability. Where the interest rate is not implicit in the lease, which is the case for materially all of the group's leases recognised under IFRS 16, the discount rate which is used to calculate the lease liability will be based on the relevant group company's nominal incremental borrowing rate adjusted for the payment profile and term of each lease.

Accounting policies

The group intends to use the modified retrospective transitional approach permitted by the standard in which the right-of-use asset and lease liability brought onto the balance sheet on the adoption date will be based on the present value of future lease payments at the adoption date calculated using the appropriate discount rate at 1 April 2019. Under this approach there will be no effect on retained earnings recognised on transition. After the initial adoption of the standard, lease liabilities and right-of-use assets for new leases will be based on the corresponding discount rate at the date the new contract is entered into. Prior year comparatives will not be restated.

The group intends to apply recognition exemptions permitted by the standard in relation to short-term leases and leases of low-value items.

Based on the appropriate incremental borrowing rates at 31 March 2019, the right-of-use asset and liability brought onto the group's balance sheet is estimated to be £54.8 million, of which £3.3 million relates to the company. Absent new leases being entered into or cancellation of existing leases, the income statement charge in the year of adoption in respect of these leases is estimated to be £3.8 million for the group and £0.5 million for the company, split between £2.2 million and £0.3 million of depreciation of the assets for the group and company respectively, and £1.6 million and £0.2 million in relation to the finance charge recognised on the liabilities for the group and company respectively. This compares with £3.7 million and £0.3 million of operating lease expenses that would have been recognised under IAS 17 for the group and company respectively. The group does not expect the adoption of IFRS 16 to impact its ability to comply with any banking or financing covenants.

The actual impacts of adopting the standard on 1 April 2019 may differ from the figures quoted above as new accounting policies may be subject to change until the group presents its first financial statements that include the date of initial application.

Critical accounting judgements and key sources of estimation uncertainty

In the process of applying its accounting policies set out in note A8, 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 carrying 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. Changes to these estimates, judgements and assumptions could have a material effect on the financial statements.

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

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

Revenue recognition and allowance for doubtful receivables

Accounting judgement - 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. There are two different criteria whereby management does not recognise revenue for amounts which have been billed to the customer on the basis that collectability is not reasonably assured. These are as follows:

- the customer has not paid their bills for a period of at least two years; and
- the customer has not paid their bills in the preceding two years; however, has previously had statements de-recognised and has more than their current year debt outstanding.

This two-criteria approach resulted in £18.0 million of amounts billed not being recognised as revenue during the year (net of cash receipts and credits). Had management made an alternative judgement that

Accounting policies

where customers have paid in the preceding two years, and have more than their current year debt outstanding, the recoverability of the entirety of their debt was deemed to be reasonably assured (i.e. the second criteria were disapplied), the required adjustment to revenue would have been £12.8 million lower. Payments received in advance of revenue recognition are recorded as deferred income.

Accounting estimate - at each reporting date, the company and each of its subsidiaries evaluate the estimated recoverability of trade receivables and record allowances for doubtful receivables based on experience. Judgements associated with 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. At 31 March 2019, the allowance for doubtful receivables relating to household customer debt of £52.9 million was supported by a six-year cash collection projection. Based on a five-year or seven-year cash collection projection the allowance for doubtful receivables would have been £50.9 million or £53.5 million respectively.

Accounting estimate - the company raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic 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 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. Revenue recognised for unbilled amounts for these customers at 31 March 2019 was £47.2 million. Had actual consumption been five per cent higher or lower than the estimate of units supplied this would have resulted in revenue recognised for unbilled amounts being £4.2 million higher or lower respectively. 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.

Property, plant and equipment

Accounting judgement - 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 requires an accounting judgement, particularly when projects have both elements within them. Enhancement spend was 26 per cent of total spend in relation to infrastructure assets during the year. A change of +/- one per cent would have resulted in £2.4 million less/more expenditure being charged to the income statement during the period. In addition, management capitalises time and resources incurred by the group's support functions on capital programmes, which requires accounting judgements to be made in relation to the appropriate capitalisation rates. Support costs allocated to PPE represent 58 per cent of total support costs. A change in allocation of +/- one per cent would have resulted in £0.8 million less/more expenditure being charged to the income statement during the period.

Accounting estimate - the estimated useful economic lives of PPE and intangible assets is based on management's 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 and intangibles investment to the group, variations between actual and estimated useful economic lives could impact operating results both positively and negatively. As such this is a key source of estimation uncertainty, although historically few changes to estimated useful economic lives have been required. The depreciation and amortisation expense for the year was £393.2 million. A 10 per cent increase in average asset lives would have resulted in a £38.9 million reduction in this figure and a 10 per cent decrease in average asset lives would have resulted in a £39.5 million increase in this figure.

Retirement benefits

Accounting estimate - 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. Profit before tax and net assets are affected by the actuarial assumptions used.

Accounting policies

The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions. It should be noted that actual rates may differ from the assumptions used due to changing market and economic conditions and longer or shorter lives of participants and, as such, this represents a key source of estimation uncertainty. Sensitivities in respect of the assumptions used during the year are disclosed in note A5.

Joint ventures – Water Plus

Accounting estimate - the group has an equity interest in Water Plus Group Limited, a joint venture with Severn Trent PLC, the recoverability of which is considered with reference to the present value of the estimated future cash flows of the joint ventures. Please see note 11 for details of the significant estimates relating to the recoverable amount of this investment, as well as an assessment of how sensitive the recoverable amount is to reasonably possible downside scenarios.

Derivative financial instruments

Accounting estimate - 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. Sensitivities relating to derivative financial instruments are included in note A4.

Notes to financial statements

1. Segmental reporting

The board is provided with information on a single segment basis for the purposes of assessing performance and allocating resources and as such, the group has a single segment for financial reporting purposes and therefore no further detailed segmental information is provided in this note.

2. Revenue

The group's revenue predominantly arises from the provision of services within the United Kingdom, with less than one per cent of external revenue and non-current assets being overseas.

	2019 £m	2018 £m
Wholesale water charges	767.3	719.2
Wholesale wastewater charges	905.8	876.5
Residential retail charges	86.7	91.1
Other	58.6	49.8
	1,818.5	1,735.8

In accordance with IFRS 15, revenue has been disaggregated based on what is recognised in relation to the core services of supplying clean water and the removing and treating of wastewater. Each of these services is deemed to give rise to a distinct performance obligation under the contract with customers, though following the same pattern of transfer to the customer who simultaneously receives and consumes both of these services over time.

Residential retail charges relate solely to the margin applied to the wholesale amounts charged to residential customers. The wholesale charges and retail margin are combined in arriving at the total revenues relating to water and wastewater services provided to household customers.

Other revenues comprise a number of smaller non-core income streams including those relating to energy generation and export, and those associated with activities, typically performed opposite property developers, which impact the group's capital network assets including diversions works to relocate water and wastewater assets, and activities that facilitate the creation of an authorised connection through which properties can obtain water and wastewater services.

Notes to financial statements

3. Directors and employees

Directors' remuneration

	2019 £m	2018 £m
Salaries	1.9	1.8
Benefits	0.4	0.5
Bonus	1.0	0.9
Share-based payment charge	2.4	1.9
	5.7	5.1

Included within the above are aggregate emoluments of £2.3 million (2018: £2.3 million) in respect of the highest paid director.

No directors accrued benefits under defined benefit schemes during the current year (2018: no directors). All directors opted for a cash allowance in lieu of their company pension scheme entitlement (2018: all directors).

Four directors (2018: four directors) received shares in United Utilities Group PLC in respect of qualifying services. Four directors (2018: four directors) had long-term incentive plans which vested during the year. Aggregate amounts receivable relating to long-term incentive plans of £1.1 million (2018: £0.8 million) were recognised during the year. Details of the employee Sharebuy scheme and the executive share scheme operated by United Utilities Group PLC are given in the UUG 2019 Annual report and financial statements.

Remuneration of key management personnel

	2019 £m	2018 £m
Salaries and short-term employee benefits	5.5	5.6
Severance	-	0.6
Post-employment benefits	-	-
Share-based payment charge	3.1	2.4
	8.6	8.6

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

Notes to financial statements

3. Directors and employees (continued)

Employee benefits expense (including directors)

Group	2019 £m	2018 £m
Wages and salaries	234.2	220.7
Employee related taxes and levies	24.1	22.8
Severance	4.8	3.7
Post-employment benefits:		
Defined benefit pension expense (see note 17)	18.0	32.2
Defined contribution pension expense (see note 17)	23.0	12.1
	41.0	44.3
Charged to regulatory capital schemes	(134.5)	(138.0)
Employee benefits expense	169.6	153.5

Within employee benefits expense there were £7.2 million (2018: £6.0 million) of restructuring costs, £6.6 million of costs associated with the equalisation of Guaranteed Minimum Pension (GMP) benefits (2018: nil) and £1.4 million (2018: nil) of costs incurred in relation to the group's response to the severe dry weather event experienced during the year.

Conditional share awards in relation to shares of the ultimate parent undertaking, United Utilities Group PLC, have been granted to employees of the group under various schemes. Details of the terms and conditions of each scheme are given in the 2019 UUG Annual report and financial statements. Included within wages and salaries is an expense of £4.0 million (2018: £3.2 million) relating to a recharge of share-based payment costs from the ultimate parent undertaking.

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

Group	2019 number	2018 number
Average number of employees during the year	5,267	5,223

Company

The average number of employees during the year was 239 (2018: 259). These employees were engaged in the provision of services to United Utilities Water Limited, and as such employee costs of £17.6 million (2018: £19.8 million) in relation to these employees have been incurred directly by that company during the year.

Notes to financial statements

4. Operating profit

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

	2019 £m	2018 £m
Other operating costs		
Hired and contracted services	112.2	97.7
Property rates	94.7	90.5
Materials	77.8	67.3
Power	72.8	70.4
Regulatory fees	32.5	29.7
Charge for bad and doubtful receivables (see note 14)	26.5	20.8
Cost of properties disposed	4.7	9.8
Loss on disposal of property, plant and equipment	3.9	6.8
Operating leases payable:		
Property	2.8	3.5
Plant and equipment	1.3	0.7
Compensation from insurers	-	(3.6)
Settlement of commercial claims	(9.9)	-
Other expenses	30.0	30.4
	449.3	423.4
Other income		
Other income	(3.6)	(3.8)
	(3.6)	(3.8)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (see note 9)	357.3	348.4
Amortisation of intangible assets (see note 10)	35.9	28.4
	393.2	376.8

During the current year, as a result of the group's response to a severe dry weather event, there were £36.1 million of expenses incurred, comprising £24.2 million of other operating costs, £10.5 million of infrastructure renewals expenditure, and £1.4 million of employee costs (see note 3).

During the prior year, as a result of two significant flooding incidents caused by storms Desmond and Eva in December 2015, there were £5.3 million of expenses incurred, comprising £2.9 million of operating costs, and £2.4 million of infrastructure renewals expenditure. Insurance compensation of £3.6 million relating to the flooding incidents was recognised as part of a final settlement of the insurance claim. In addition, in the prior year, there were £1.0 million of market reform restructuring costs relating to the non-household retail market opening to competition in April 2017.

Total other operating costs are stated net of £0.2 million (2018: £1.4 million) of costs recharged to Water Plus at nil margin under transitional service agreements.

Research and development expenditure for the year ended 31 March 2019 was £1.2 million (2018: £1.2 million).

Other income relates primarily to property rental income.

Notes to financial statements

4. Operating profit (continued)

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

	2019 £000	2018 £000
Audit services:		
Statutory audit - group and company	85	73
Statutory audit - subsidiaries	310	268
	396	341
Non-audit services:		
Regulatory audit services provided by the statutory auditor	47	46
Other non-audit services	65	80
	507	467

5. Investment income

	2019 £m	2018 £m
Interest receivable on short-term bank deposits held at amortised cost	3.3	1.5
Interest receivable on loan to joint ventures held at amortised cost (see note A6)	4.3	3.4
Net pension interest income (see note 17)	9.5	7.1
Interest receivable from ultimate parent undertaking (see note A6)	30.5	25.4
	47.6	37.4

Notes to financial statements

6. Finance expense

	2019 £m	2018 £m
Interest payable		
Interest payable on borrowings held at amortised cost[1]	232.0	265.9
	232.0	265.9
Fair value losses/(gains) on debt and derivative instruments		
Fair value hedge relationships:		
Borrowings[2]	47.4	(149.2)
Designated swaps[2] [3]	(29.7)	159.6
	17.7	10.4
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss[4]	32.8	(27.8)
Associated swaps[5] [6]	(37.1)	63.7
	(4.3)	35.9
Fixed interest rate swaps[5]	19.1	(87.4)
Electricity swaps[7]	-	(8.0)
Net receipts on derivatives and debt under fair value option	(40.6)	(20.4)
Other swaps[5][8]	-	2.2
Realisation of fair value loss on settlement of borrowings held at amortised cost[9]	-	23.1
Other	(1.4)	(3.1)
	(22.9)	(93.6)
Net fair value gains on debt and derivative instruments[10]	(9.5)	(47.3)
	222.5	218.6

Notes:

(1) Includes a £98.3 million (2018: £137.8 million) non-cash inflation uplift expense in relation to the group's index-linked debt.

(2) Includes foreign exchange losses of £37.6 million (2018: £56.5 million gains), excluding those on instruments measured at fair value through profit or loss. These gains/losses are largely offset by fair value losses/gains on derivatives.

(3) Under the provisions of IFRS 9 'Financial instruments', changes in fair value resulting from changes to the foreign currency basis spread (£2.2 million gain) are recognised in other comprehensive income rather than profit or loss as they relate to items designated in an accounting hedge relationship. In the prior year, there was an £8.1 million gain on designated swaps recognised within profit or loss.

(4) Under the provisions of IFRS 9 'Financial instruments', changes in fair value due to changes in the group's own credit risk (£6.6 million gain) are recognised in other comprehensive income rather than within profit or loss. In the prior year, there was a £24.0 million loss, which was recognised within profit or loss.

(5) These swap contracts are not designated within an IFRS 9 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 intends to hold these through to maturity.

(6) Includes a £3.8 million gain caused by the settlement of certain cross-currency interest rate swap liabilities.

(7) From 1 April 2018, under the provisions of IFRS 9, electricity swaps have been designated within cash flow hedge relationships. Gains or losses resulting from the effective portion of the hedge are recognised within other comprehensive income in the cash flow hedge reserve. Any other gains or losses are recognised immediately in the income statement. The cash flow hedges are deemed to be fully effective and, therefore, have no impact on net fair value gains in the income statement. In the prior year, the electricity swaps were not designated within a hedge relationship and an £8.0 million gain was recognised in net fair value gains in the income statement.

(8) Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost, which matured during the year ended 31 March 2018.

(9) The fair value loss in the prior year results from the partial close-out of £50.0 million RPI index-linked notes due April 2043. The portion of the notes closed out had a nominal value of £30.0 million (carrying value £41.3 million), and were purchased at a fair value of £64.4 million resulting in a £23.1 million fair value loss.

(10) Includes £30.6 million income (2018: £23.5 million) due to net interest on derivatives and debt under fair value option.

Notes to financial statements

6. Finance expense (continued)

Interest payable is stated net of £37.4 million (2018: £39.7 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 (2018: 3.6 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

7. Tax

	2019 £m	2018 £m
Current tax		
UK corporation tax	47.4	30.2
Adjustments in respect of prior years	(2.8)	(6.7)
Total current tax charge for the year	44.6	23.5
Deferred tax		
Current year	35.4	51.7
Adjustments in respect of prior years	(1.4)	7.1
Total deferred tax charge for the year	34.0	58.8
Total tax charge for the year	78.6	82.3

The adjustments in respect of prior years relate to agreement of prior years' UK tax matters.

The table below reconciles the notional tax charge at the UK corporation tax rate to the total tax charge and total effective tax rate for the year:

	2019 £m	2019 %	2018 £m	2018 %
Profit before tax	466.7		457.5	
Tax at the UK corporation tax rate	88.7	19.0	86.9	19.0
Adjustments in respect of prior years	(4.2)	(1.0)	0.4	0.1
Deferred tax rate adjustment/other	(5.9)	(1.3)	(5.0)	(1.1)
Total tax charge and effective tax rate for the year	78.6	16.7	82.3	18.0

The deferred tax rate adjustment/other mainly comprises the deferred tax movement calculated at the future tax rate from April 2020 of 17 per cent rather than the current rate of 19 per cent.

The adjustments in respect of prior years relate to agreement of prior years' UK tax matters.

For the current year, there is also an adjustment for items included in retained earnings, following the adoption of IFRS 15 (see accounting policies for further details).

Notes to financial statements

7. Tax (continued)

The table below reconciles the notional tax charge at the UK corporation tax rate to the total current tax charge for the year:

	2019 £m	2018 £m
Profit before tax	466.7	457.5
Profit before tax multiplied by the standard rate of UK corporation tax of 19%	88.7	86.9
Relief for capital allowances in place of depreciation	(91.0)	(88.8)
Disallowance of depreciation charged in the accounts	64.8	60.6
Financial transactions timing differences	1.0	(13.3)
Pension timing differences	(11.7)	(11.0)
Relief for capitalised interest	(7.1)	(7.5)
Other timing differences	4.5	2.3
Adjustments to tax charge in respect of prior years	(2.8)	(6.7)
Joint venture profits	(1.3)	(0.4)
(Income not taxable)/expenses not deductible for tax purposes	(1.8)	0.4
Depreciation charged on non-qualifying assets	1.3	1.0
Current tax charge for the year	44.6	23.5

The group's current tax charge is lower than the UK headline rate of 19 per cent, primarily due to the availability of capital allowances; tax deductions in relation to capital expenditure available instead of accounting depreciation and put in place by successive governments to encourage such investment.

There are also various other adjustments where there is a simple timing difference between recognition of the income or expense in the accounts and in the related tax computations submitted to HMRC. These include unrealised profits or losses in relation to financing and related treasury derivatives, pension contributions and capitalised interest.

The year-on-year movement in financial transactions timing differences is sensitive to fair value movements on treasury derivatives and can, therefore, fluctuate significantly from year to year.

The joint venture profits are mainly our share of profits relating to AS Tallinna Vesi which have already been fully taxed in Estonia.

For all of the timing differences, the corresponding deferred tax movements are at 17 per cent as the rate of corporation tax will reduce to 17 per cent from April 2020.

Tax on items taken directly to equity

Group	2019 £m	2018 £m
Deferred tax (see note 18)		
On remeasurement gains on defined benefit pension schemes	12.4	8.5
On net fair value gains recognised in other comprehensive income	0.8	-
Total tax charge on items taken directly to equity	13.2	8.5

Notes to financial statements

7. Tax (continued)

Company	2019 £m	2018 £m
Deferred tax (see note 18)		
On remeasurement gains on defined benefit pension schemes	0.8	2.7
Total tax charge on items taken directly to equity	0.8	2.7

8. Dividends

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

	2019 £m	2018 £m
Ordinary shares		
Interim dividend for the year ended 31 March 2019 at 20.49 pence per share (2018: 20.04 pence)	180.7	176.8
Interim dividend for the year ended 31 March 2019 at 10.64 pence per share (2018: 10.24 pence)	93.8	90.3
	274.5	267.1

Notes to financial statements

9. Property, plant and equipment

Group	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 2017	354.2	5,243.1	7,033.2	496.8	942.3	14,069.6
Additions	2.4	70.7	122.2	10.1	535.9	741.3
Transfers	12.0	72.6	141.8	23.4	(249.8)	-
Disposals	(1.4)	(0.1)	(46.4)	(3.7)	-	(51.6)
At 31 March 2018	367.2	5,386.3	7,250.8	526.6	1,228.4	14,759.3
Additions	5.5	60.8	126.3	11.6	522.0	726.2
Transfers	(12.1)	43.3	87.3	6.5	(125.0)	-
Disposals	(0.9)	-	(42.3)	(6.5)	-	(49.7)
At 31 March 2019	**359.7**	**5,490.4**	**7,422.1**	**538.2**	**1,625.4**	**15,435.8**
Accumulated depreciation						
At 1 April 2017	111.6	345.9	2,870.7	335.9	-	3,664.1
Charge for the year	9.4	39.5	260.9	38.6	-	348.4
Disposals	(1.3)	-	(39.3)	(3.1)	-	(43.7)
At 31 March 2018	119.7	385.4	3,092.3	371.4	-	3,968.8
Charge for the year	8.3	35.4	279.3	34.3	-	357.3
Transfers	(0.5)	0.5	-	-	-	-
Disposals	(0.6)	-	(37.7)	(5.4)	-	(43.7)
At 31 March 2019	**126.9**	**421.3**	**3,333.9**	**400.3**	**-**	**4,282.4**
Net book value at 31 March 2018	247.5	5,000.9	4,158.5	155.2	1,228.4	10,790.5
Net book value at 31 March 2019	**232.8**	**5,069.1**	**4,088.2**	**137.9**	**1,625.4**	**11,153.4**

During the year ended 31 March 2019, there was a transfer of £17.8 million and associated £0.5 million accumulated depreciation from land and buildings to infrastructure assets following a data cleanse exercise in respect of the fixed asset register.

At 31 March 2019, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £300.7 million (2018: £430.1 million).

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

Company

The company had no property, plant and equipment or contractual commitments for the acquisition of property, plant and equipment at 31 March 2019 or 31 March 2018.

Notes to financial statements

10. Intangible assets

Group	Total £m
Cost	
At 1 April 2017	357.2
Additions	38.4
At 31 March 2018	395.6
Additions	40.9
At 31 March 2019	436.5
Accumulated amortisation	
At 1 April 2017	169.5
Charge for the year	28.4
At 31 March 2018	197.9
Charge for the year	35.9
At 31 March 2019	233.8
Net book value at 31 March 2018	197.7
Net book value at 31 March 2019	202.7

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

At 31 March 2019, the group had entered into contractual commitments for the acquisition of intangible assets amounting to £1.5 million (2018: £2.8 million).

Company

The company had no intangible assets or contractual commitments for the acquisition of intangible assets at 31 March 2019 or 31 March 2018.

11. Joint ventures

Group	Total £m
At 1 April 2017	75.2
Share of profits of joint ventures	2.3
Dividends received from joint ventures	(3.3)
Currency translation differences	1.0
At 31 March 2018	75.2
Share of profits of joint ventures	6.7
Dividends received from joint ventures	(2.2)
Currency translation differences	(0.7)
At 31 March 2019	**79.0**

The group's interests in joint ventures mainly comprise its interests in Water Plus Group Limited (Water Plus) and AS Tallinna Vesi (Tallinn Water). Water Plus is jointly owned and controlled by the group and Severn Trent PLC under a joint venture agreement. Joint management of Tallinn Water is based on a shareholders' agreement.

Notes to financial statements

11. Joint ventures (continued)

As at 31 March 2019, the carrying value of the group's equity interest in Water Plus was £36.7 million (2018: £37.3 million), which includes £16.9 million (2018: £16.9 million) representing the group's 50 per cent share of goodwill included in Water Plus's statement of financial position.

Following a deterioration in the working capital position of Water Plus since the non-household water retail market in England opened to competition on 1 April 2017, the carrying value of the group's interest in the Water Plus joint venture has been assessed relative to its estimated recoverable amount in order to determine whether it is impaired. In performing this assessment, consideration has been given to information provided by Water Plus, including the results of its own impairment testing carried out in respect of its goodwill and intangible assets in accordance with IAS 36 'Impairment of Assets'. Having reviewed and challenged this information, the group estimates that the recoverable amount of the Water Plus joint venture is in excess of its carrying value and therefore no impairment is required.

The recoverable amount has been calculated based on Water Plus's value in use, which is determined by discounting the estimated future cash flows of the Water Plus business to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the business, for which estimates of future cash flows have not been adjusted.

The cash flows used in the value in use assessment go out to 31 March 2024, with a terminal growth rate of 2.0 per cent applied at this date based on long-term projections of CPIH, to which Water Plus's cash flows tend to be aligned. These cash flows were based on Water Plus's five-year business plan as agreed with its board, and were discounted using a pre-tax discount rate of 8.0 per cent based on a CAPM model underpinned by observable inputs.

The key assumptions to which the recoverable amount is most sensitive are the forecast future cash flows, which are subject to the delivery of Water Plus's business plan, and the discount rate. These therefore represent key areas of estimation uncertainty. At 31 March 2019, the estimated recoverable amount of the group's interest in the Water Plus joint venture exceeded its carrying amount by £59.5 million. An increase in the discount rate to 10.4 per cent or a reduction in forecast cash flows of 25 per cent, both of which are considered reasonably possible, would have, in isolation, led to an impairment loss being recognised for the year ended 31 March 2019.

In addition to the equity interest in the Water Plus joint venture, the group has issued loans of £142.1 million to Water Plus, further details of which can be found in note A6. At 31 March 2019, these loans were deemed to be fully recoverable.

As at 31 March 2019, the carrying value of the group's 35.3 per cent interest in Tallinn Water was £42.4 million (2018: £38.0 million). Tallinn Water has disclosed a contingent liability of EUR 28.6 million in its latest financial statements relating to possible third-party claims. If this contingent liability materialises in the future, this would impact the group's share of profits of the joint venture and the joint venture's carrying value under the equity method of accounting. In addition, Tallinn Water is currently involved in a regulatory dispute, the outcome of which is currently uncertain. At this stage, the group does not consider this to be an indicator that its interest in Tallinn Water may be impaired.

There are no restrictions on the ability of the group's joint ventures to transfer funds to the group in the form of cash dividends, or to repay loans or advances made by the group.

Details of transactions between the group and its joint ventures are disclosed in note A6.

Company

At 31 March 2019, the Company had investments in joint ventures of £39.1 million (2018: £39.1 million).

Notes to financial statements

12. Investments

Group	Total £m
At 1 April 2017	9.0
Reduction in investment stake	(1.0)
Currency translation differences	(0.9)
At 31 March 2018	7.1
Change in fair value	4.4
Reduction in investment stake	(1.0)
Currency translation differences	1.0
At 31 March 2019	**11.5**

During the year, the group reduced its investment in Muharraq Holding Company 1 Limited through a £1.0 million (2018: £1.0 million) repayment of a shareholder loan.

At 31 March 2019, the group's investments mainly comprised its investment in Muharraq Holding Company 1 Limited. These investments are held at fair value.

Company	Shares in subsidiary undertakings £m
At 1 April 2017	4,181.2
Impairment	(5.0)
At 31 March 2018	4,176.1
Impairment	(1.6)
Disposal	(166.2)
Net book value at 31 March 2019	4,008.3

During the year ended 31 March 2019, the company disposed of a £166.2 million investment in the ordinary shares of United Utilities Utility Solutions Holdings Limited ("UUUSHL"). This was achieved through UUUSHL, which had undertaken a capital reduction, distributing £239.7 million to the company as a dividend prior to being liquidated. The dividend was settled as a reduction in the intercompany balances between the two entities; no cash was transferred as part of this transcation. This resulted in the company recognising a profit on disposal of this investment of £73.4 million during the year.

In addition to this, an impairment of £1.6 million (2018: £5.0 million) was recognised in relation to the investment in United Utilities (Tallinn) B.V. This was due to a decrease in the fair value of its investment in Tallinna Vesi.

13. Inventories

Group	2019 £m	2018 £m
Properties held for resale	4.7	9.0
Other inventories	10.2	7.8
	14.9	16.8

Company

The company had no inventories at 31 March 2019 or 31 March 2018**.**

Notes to financial statements

14. Trade and other receivables

	Group		Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Trade receivables	102.2	116.7	0.2	0.2
Amounts owed by subsidiary undertakings	-	-	1,401.3	1,602.1
Amounts owed by ultimate parent undertaking (see note A6)	1,730.8	1,699.4	1,730.8	1,699.4
Amounts owed by other related parties (see note A6)	182.9	179.7	42.1	35.8
Other debtors and prepayments	34.4	40.8	-	-
Accrued income	78.1	64.8	-	-
	2,128.4	2,101.4	3,174.4	3,337.5

At 31 March 2019 the group had £1,866.5 million (2018: £1,831.4 million) and the company had £1,760.6 million (2018: £1,726.2 million) of trade and other receivables classified as non-current. These included £1,718.4 million (2018: £1,690.4 million) relating to amounts owed by the ultimate parent undertaking and £42.1 million (2018: £35.8 million) relating to amounts owed by other related parties.

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

The carrying amount of trade and other receivables approximates to their fair value at 31 March 2019 and 31 March 2018.

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

	2019	2018
Group	£m	£m
At the start of the year	63.4	85.4
Amounts charged to operating expenses (see note 4)	26.5	20.8
Trade receivables written off	(33.4)	(44.6)
Amounts charged to deferred income	-	1.6
Amounts charged to infrastructure renewals expenditure	-	0.2
At the end of the year	56.5	63.4

Amounts charged to deferred income relate to amounts invoiced for which revenue has not yet been recognised in the income statement.

Amounts charged to infrastructure renewals expenditure relate to amounts invoiced in relation to contributions towards the cost of infrastructure renewals incurred as a result of carrying out infrastructure diversions works.

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

At 31 March 2019 and 31 March 2018, the group had no trade receivables that were past due and not individually impaired.

Notes to financial statements

14. Trade and other receivables (continued)

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

Company	2019 £m	2018 £m
At the start of the year	95.2	89.4
Amounts charged to operating expenses	0.7	5.8
At the end of the year	95.9	95.2

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

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

Group	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
Trade receivables				
At 31 March 2019	63.8	25.6	1.8	91.2
At 31 March 2018	77.5	24.4	4.2	106.1

At 31 March 2019, the group had £11.0 million (2018: £10.6 million) of trade receivables that were not past due.

Company

At 31 March 2019 and 31 March 2018, the company had no trade receivables that were past due.

The carrying amount of trade and other receivables approximates to their fair value at 31 March 2019 and 31 March 2018.

15. Cash and cash equivalents

	Group		**Company**	
	2019 £m	2018 £m	2019 £m	2018 £m
Cash at bank and in hand	4.7	1.0	0.1	0.1
Short-term bank deposits	334.6	509.0	12.0	9.5
Cash and short-term deposits	339.3	510.0	12.1	9.6
Book overdrafts (included in borrowings, see note 16)	(14.2)	(12.1)	-	-
Cash and cash equivalents in the statement of cash flows	325.1	497.9	12.1	9.6

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.

Book overdrafts, which result from cash management practices, represent the value of cheques issued and payments initiated that had not cleared as at the reporting date.

Notes to financial statements

16. Borrowings

Group	2019 £m	2018 £m
Non-current liabilities		
Bonds	4,814.6	4,723.4
Bank and other term borrowings	2,301.0	2,349.4
	7,115.6	7,072.8
Current liabilities		
Bonds	441.9	583.2
Bank and other term borrowings	243.6	243.7
Book overdrafts (see note 15)	14.2	12.1
Amounts owed to ultimate parent undertaking	74.1	62.0
	773.8	901.0
	7,889.4	7,973.8

For further details of the principal economic terms and conditions of outstanding borrowings see note A3.

Company	2019 £m	2018 £m
Non-current liabilities		
Bonds	305.2	282.7
Current liabilities		
Bonds	-	432.4
Bank and other term borrowings	100.0	116.5
Amounts owed to subsidiary undertakings	540.5	721.5
Amounts owed to ultimate parent undertaking	74.1	62.0
	714.6	1,332.4
	1,019.8	1,615.1

Borrowings are unsecured and are measured at amortised cost. The carrying amounts of borrowings approximate their fair value.

17. Retirement benefit surplus

Defined benefit schemes

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

		Group		**Company**
	2019 £m	2018 £m	2019 £m	2018 £m
Current service cost	6.2	27.3	1.1	1.7
Curtailments/settlements	9.0	2.3	1.1	0.1
Administrative expenses	2.8	2.6	1.0	0.8
Pension expense charged to operating profit	18.0	32.2	3.2	2.6
Net pension interest income credited to investment income (see note 5)	(9.5)	(7.1)	(2.2)	(1.6)
Net pension expense charged before tax	8.5	25.1	1.0	1.0

Notes to financial statements

17. Retirement benefit surplus (continued)

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £9.0 million (2018: £29.9 million) for the group and £2.1 million (2018: £2.5 million) for the company, comprising current service costs and administrative expenses.

Total post-employment benefits expense excluding curtailments/settlements charged to operating profit of £32.0 million (2018: £42.0 million) for the group and £2.1 million (2018: £2.5 million) for the company comprise the defined benefit costs described above of £9.0 million (2018: £29.9 million) for the group and £2.1 million (2018: £2.5 million) for the company, and defined contribution pension costs of £23.0 million (2018: £12.1 million) for the group and £nil (2018: £nil) for the company (see note 3).

Curtailments/settlements includes a charge relating to the equalisation of GMP benefits of £6.6 million (2018: £nil) for the group and £1.1 million (2018: £nil) for the company (see note A5 for further details).

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

		Group		**Company**
	2019	2018	2019	2018
	£m	£m	£m	£m
At the start of the year	344.2	247.5	80.1	53.0
Expense recognised in the income statement	(8.5)	(25.1)	(1.0)	(1.0)
Contributions paid	75.2	71.6	26.4	12.5
Remeasurement gains gross of tax	73.0	50.2	4.6	15.6
At the end of the year	483.9	344.2	110.1	80.1

Included in the group contributions paid of £75.2 million (2018: £71.6 million) and company contributions paid of £26.4 million (2018: £12.5 million) were deficit repair contributions for the group of £66.1 million (2018: £43.0 million) and for the company of £24.9 million (2018: £10.2 million), enhancements to benefits provided on redundancy for the group of £1.6 million (2018: £1.5 million) and for the company of £0.2 million (2018: £0.3 million), administration expenses for the group of £0.5 million (2018: £0.6 million) and for the company of £0.2 million (2018: £0.3 million) an inflation funding mechanism payment of £nil (2018: £0.4 million) for the group and £nil (2018: £0.1 million) for the company. Following the 2018 actuarial valuation, contributions in relation to current service cost decreased to £7.0 million (2018: £26.2 million, 2016 actuarial valuation) for the group and £1.1 million (2018: £1.6 million, 2016 actuarial valuation) for the company.

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

		Group		**Company**
	2019	2018	2019	2018
	£m	£m	£m	£m
The return on plan assets, excluding amounts included in interest	58.5	(60.0)	11.4	(13.5)
Actuarial (losses)/ gains arising from changes in financial assumptions	(160.6)	85.1	(39.0)	21.8
Actuarial gains arising from changes in demographic assumptions	70.9	43.2	20.7	11.6
Actuarial gains/(losses) arising from experience	104.2	(18.1)	11.5	(4.3)
Remeasurement gains on defined benefit pension schemes	73.0	50.2	4.6	15.6

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

Notes to financial statements

17. Retirement benefit surplus (continued)

Defined contribution schemes

During the year, the group made £23.0 million (2018: £12.1 million) of contributions and the company made £nil (2018: £nil) of contributions to defined contribution schemes which are included in employee benefit expense (see note 3).

18. 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	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2017	1,011.4	42.1	(22.0)	1,031.5
Charged to the income statement (see note 7)	38.5	7.9	12.4	58.8
Charged to equity (see note 7)	-	8.5	-	8.5
At 31 March 2018	1,049.9	58.5	(9.6)	1,098.8
Charged/(credited) to the income statement (see note 7)	26.8	11.3	(4.1)	34.0
Charged to equity (see note 7)	-	12.4	0.8	13.2
At 31 March 2019	1,076.7	82.2	(12.9)	1,146.0

Company	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2017	(0.1)	9.1	(0.4)	8.6
Charged to the income statement	-	2.0	0.2	2.2
Charged to equity (see note 7)	-	2.7	-	2.7
At 31 March 2018	(0.1)	13.8	(0.2)	13.5
Charged/(credited) to the income statement	-	4.1	(1.3)	2.8
Charged to equity (see note 7)	-	0.8	-	0.8
At 31 March 2019	(0.1)	18.7	(1.5)	17.1

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

Notes to financial statements

19. Provisions

Group	Severance £m	Other £m	Total £m
At 1 April 2017	3.7	22.8	26.5
Charged to the income statement	3.7	1.0	4.7
Utilised in the year	(4.8)	(4.3)	(9.1)
At 31 March 2018	2.6	19.5	22.1
Charged to the income statement	4.8	(0.3)	4.5
Utilised in the year	(4.6)	(5.2)	(9.8)
At 31 March 2019	2.8	14.0	16.8

The group had no provisions classed as non-current at 31 March 2019 or 31 March 2018.

The severance provision as at 31 March 2019 and 31 March 2018 relates to severance costs as a result of group reorganisation.

Other provisions principally relate to contractual, legal and environmental claims against the group 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.

Company

The company had no provisions at 31 March 2019 or 31 March 2018.

20. Trade and other payables

Group	2019 £m	2018 £m
Non-current		
Deferred grants and contributions	671.2	617.0
Other creditors	26.2	25.7
	697.4	642.7

Company

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

	Group		Company	
	2019 £m	2018 £m	2019 £m	2018 £m
Current				
Trade payables	34.4	27.9	0.1	0.2
Amounts owed to ultimate parent undertaking	8.0	12.2	5.8	10.4
Amounts owed to subsidiary undertakings	-	-	45.8	72.1
Amounts owed to other related parties	0.6	1.4	-	0.6
Other tax and social security	5.4	5.3	-	-
Deferred grants and contributions	13.3	8.8	-	-
Accruals and other creditors	230.4	189.4	6.0	11.1
Deferred income	34.8	40.6	-	-
	326.9	285.6	57.7	94.4

The average credit period taken for trade purchases for the group is 25 days (2018: 23 days) and for the company is nil days (2018: nil days).

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

Notes to financial statements

20. Trade and other payables (continued)

Deferred grants and contributions

	2019 £m	2018 £m
Group		
At the start of the year	625.8	579.2
Amounts capitalised during the year	35.7	23.7
Transfers of assets from customers	39.4	34.2
Credited to income statement – revenue	(7.4)	(3.3)
Credited to the income statement – other operating costs (see note 4)	(6.0)	(6.4)
Credited to equity – IFRS 15 opening balance adjustment	(2.6)	-
Credited to allowance for bad and doubtful receivables	(0.4)	(1.6)
At the end of the year	684.5	625.8

21. Other reserves

	Cumulative exchange reserve £m	Cost of hedging reserve £m	Cash flow hegding reserve £m	Total £m
At 31 March 2018	(1.8)	-	-	(1.8)
Adjustment on initial application of IFRS 9	(1.1)	13.8	-	12.7
At 1 April 2018	(2.9)	13.8	-	340.6
Other comprehensive income				
Change in fair value recognised in other comprehensive income	-	(2.2)	3.5	1.3
Amounts reclassified from other comprehensive income to profit or loss	-	-	(3.1)	(3.1)
Tax on items taken directly to equity	-	0.4	(0.1)	0.3
Foreign exchange adjustments	(0.8)	-	-	(0.8)
At 31 March 2019	**(3.7)**	**12.0**	**0.3**	**8.6**

The cost of hedging and cash flow hedging reserves were included as separate components of equity for the first time in the year ended 31 March 2019 as a result of the group's adoption of IFRS 9 'Financial instruments' (see accounting policies on pages 65 and 66). The cumulative exchange reserve had a balance of £(2.0) million at 1 April 2017 with Foreign exchange adjustments recognised in other comprehensive income of £0.2 million during the year ended 31 March 2018.

22. Share capital

	2019 number	2019 £	2018 number	2018 £
Group and Company				
Issued, called up and fully paid				
Ordinary shares of 100.0 pence each	881,787,478	881,787,478	881,787,478	881,787,478
Deferred A shares of 100.0 pence each	1	1	1	1
	881,787,479	881,787,479	881,787,479	881,787,479

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

Notes to financial statements

23. Operating lease commitments

Group	Property 2019 £m	Plant and equipment 2019 £m	Property 2018 £m	Plant and equipment 2018 £m
Commitments under non-cancellable operating leases due				
Within one year	2.6	0.5	2.6	0.6
In the second to fifth years inclusive	9.0	0.4	9.4	0.4
After five years	279.8	-	279.9	-
	291.4	0.9	291.9	1.0

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

Company	Property 2019 £m	Property 2018 £m
Commitments under non-cancellable operating leases due		
In the second to fifth years inclusive	-	0.1
After five years	-	0.1
	-	0.2

All leases for which the Company had commitments have been terminated during the year.

24. Contingent liabilities

The group and company have determined that the possibility of any outflow in respect of performance guarantees issued is remote and, as such, there are no contingent liabilities to be disclosed in respect of these for the group (2018: none) or the company (2018: none).

25. Events after the reporting period

After the reporting period, the group paid accelerated deficit repair contributions of £103.0 million to its defined benefit pension schemes, further details of which are included in note A5. In addition to this, the group increased its CPI-linked debt by executing a £100 million CPI-linked bank loan with a 10-year maturity, and entered into inflation swaps against three existing RPI-linked bonds with aggregate notional value of £100.4 million, swapping cash flows from RPI- to CPI-linkage. None of these events have been included in the financial statements for the year ended 31 March 2019 as they represent non-adjusting events after the reporting period.

26. Ultimate parent undertaking

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

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

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

Notes to the financial statements – appendices

A1. Cash generated from operations

	Group		Company	
	2019 £m	2018 £m	2019 £m	2018 £m
Profit before tax	466.7	457.5	489.5	329.4
Adjustment for investment income (see note 5) and finance expense (see note 6)	174.9	181.2	(44.1)	(22.3)
Adjustment for share of profits of joint ventures (see note 11)	(6.7)	(2.3)	-	-
Operating profit	634.9	636.4	445.4	307.1
Adjustments for:				
Depreciation of property, plant and equipment (see note 9)	357.3	348.4	-	-
Amortisation of intangible assets (see note 10)	35.9	28.4	-	-
Loss on disposal of property, plant and equipment (see note 4)	3.9	6.8	-	-
Amortisation of deferred grants and contributions (see note 20)	(12.9)	(6.4)	-	-
Impairment of investments (see note 12)	-	-	1.6	5.0
Profit on disposal (see note 12)				
Strike off of investments	-	-	166.2	-
Non-cash dividends	-	-	(239.7)	-
Other non-cash movements	-	(3.3)	-	-
Changes in working capital:				
Decrease in inventories (see note 13)	1.9	5.6	-	-
(Increase)/decrease in trade and other receivables	(16.4)	2.6	184.4	(40.7)
Increase/(decrease) in trade and other payables	20.8	(14.0)	129.0	39.5
Decrease in provisions (see note 19)	(5.3)	(4.4)	-	-
Pension contributions paid less pension expense charged to operating profit	(57.2)	(39.4)	(23.2)	(9.9)
Cash generated from operations	962.9	960.7	663.7	301.0

The group has received property, plant and equipment of £39.4 million (2018: £34.2 million) in exchange for the provision of future goods and services (see notes 20 and A7).

Notes to the financial statements – appendices

A2. Net Debt

Group	2019 £m	2018 £m
At the start of the year	6,929.3	6,639.4
Net capital expenditure	624.9	701.0
Dividends (see note 8)	274.5	267.1
Interest	107.7	113.6
Inflation uplift on index-linked debt (see note 6)	98.3	137.8
Tax	37.9	35.5
Loans to joint ventures	6.0	26.5
Fair value movements:		
Net fair value gains on debt and derivative instruments recognised in finance expense (see note 6)	(9.5)	(47.3)
Net fair value gains on debt and derivative instruments recognised in other comprehensive income (see note 21)	(4.8)	-
Less: net receipts on debt and derivatives under fair value option (see note 6)	40.6	20.4
Less: foreign exchange gains on investments measured at fair value through profit or loss	1.0	-
Other	(2.2)	(4.0)
Cash generated from operations (see note A1)	(962.9)	(960.7)
At the end of the year	7,140.8	6,929.3

Net debt comprises borrowings, net of cash and short-term deposits and derivatives.

The movements from financing activities is £274.5 million (2018: £267.1 million), which relates solely to dividend movements. Other financing movements in the statement of cash flows, such as proceeds from borrowings and repayment of borrowings, do not affect the total net debt figure as the cash generated or used in these activities offsets against the associated decrease or increase in liabilities.

Of the total increase in net debt in the year, £123.4 million (2018: £106.9 million) relates to non-cash movements.

Notes to the financial statements – appendices

A3. Borrowings

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	Currency	Year of final repayment	Fair value 2019 £m	Carrying value 2019 £m	Fair value 2018 £m	Carrying value 2018 £m
Borrowings in fair value hedge relationships			**2,749.3**	**2,765.8**	**2,905.9**	**2,895.3**
5.375% 150m bond	GBP	2018	-	-	157.9	150.8
4.55% 250m bond	USD	2018	-	-	181.2	178.8
5.375% 350m bond	USD	2019	-	-	256.5	253.6
4.25% 500m bond	EUR	2020	449.7	441.9	478.8	466.4
5.75% 375m bond	GBP	2022	424.5	406.2	435.3	411.5
2.0% 450m bond	GBP	2025	453.1	456.7	299.6	301.5
2.867% 320m bond	HKD	2026	31.5	32.3	-	-
2.92% 739m bond	HKD	2026	72.7	74.9	65.9	66.9
1.129% 52m bond	EUR	2027	45.2	46.0	45.0	44.5
2.37% 830m bond	HKD	2027	78.7	82.0	70.6	72.4
5.625% 300m bond	GBP	2027	390.7	393.5	388.6	393.2
5.02% JPY 10bn dual currency loan	JPY/USD	2029	92.0	99.4	86.9	95.0
2.058% 30m bond	EUR	2030	26.9	27.9	27.0	26.7
2.625% 250m bond	GBP	2031	260.0	253.0	-	-
1.641% 30m bond	EUR	2031	26.2	26.4	25.7	25.0
2.9% 600m bond	HKD	2031	58.9	56.3	52.4	48.3
1.707% 28m bond	EUR	2032	24.3	26.0	23.9	24.7
1.653% 26m bond	EUR	2032	22.3	23.7	21.9	22.4
1.70% 30m bond	EUR	2033	25.8	27.9	25.4	26.4
5.0% 200m bond	GBP	2035	266.8	291.7	263.3	287.2
Borrowings designated at fair value through profit or loss			**373.9**	**373.9**	**347.7**	**347.7**
6.875% 400m bond	USD	2028	373.9	373.9	347.7	347.7
Borrowings measured at amortised cost			**5,855.5**	**4,749.6**	**5,859.9**	**4,730.8**
Short-term bank borrowings - fixed	GBP	2019	152.0	152.0	161.5	161.5
1.61%+RPI 50m EIB IL loan	GBP	2020	68.5	65.3	67.6	63.7
1.73%+RPI 50m EIB IL loan	GBP	2020	68.5	65.2	67.8	63.6
1.84%+RPI 50m EIB IL loan	GBP	2020	68.6	65.1	67.9	63.5
1.90%+RPI 50m EIB IL loan	GBP	2020	68.6	65.1	67.9	63.4
1.93%+RPI 50m EIB IL loan	GBP	2020	68.6	65.0	67.9	63.4
1.88%+RPI 50m EIB IL loan	GBP	2020	68.4	64.9	67.7	63.3
2.10%+RPI 50m EIB IL loan	GBP	2020	68.6	64.8	68.0	63.2
2.46%+RPI 50m EIB IL loan	GBP	2020	69.0	64.9	68.6	63.2
0.80%+LIBOR 100m loan	GBP	2022	102.6	100.0	102.6	100.0
0.47%+RPI 100m IL loan	GBP	2023	121.3	115.0	117.9	112.2
0.49%+RPI 100m IL loan	GBP	2025	120.3	110.7	116.2	107.9
0.013%+RPI 25m IL bond	GBP	2025	29.9	27.6	28.1	26.9
0.1275%+RPI 100m IL loan	GBP	2026	117.5	109.2	111.7	106.5
0.01%+RPI 20m IL bond	GBP	2028	23.4	23.2	22.1	22.9
1.23%+RPI 50m EIB (amortising) IL loan	GBP	2029	48.1	44.2	51.2	47.4
1.29%+RPI 50m EIB (amortising) IL loan	GBP	2029	50.5	46.1	53.4	49.2
1.12%+RPI 50m EIB (amortising) IL loan	GBP	2029	49.7	45.7	52.6	48.8
1.10%+RPI 50m EIB (amortising) IL loan	GBP	2029	49.7	45.7	52.5	48.8
0.75%+RPI 50m EIB (amortising) IL loan	GBP	2029	50.3	46.8	52.9	49.8

Notes to the financial statements – appendices

A3. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2019 £m	Carrying value 2019 £m	Fair value 2018 £m	Carrying value 2018 £m
Borrowings measured at amortised cost (continued)						
0.76%+RPI 50m EIB (amortising) IL loan	GBP	2030	50.3	46.6	52.8	49.6
1.15%+RPI 50m EIB (amortising) IL loan	GBP	2030	51.0	46.5	53.7	49.4
1.11%+RPI 50m EIB (amortising) IL loan	GBP	2030	51.1	46.6	53.7	49.6
0.178%+RPI 35m IL bond	GBP	2030	43.3	38.6	40.4	37.6
0.245%+CPI 20m IL bond	GBP	2031	21.2	21.0	20.3	20.6
0.01%+RPI 38m IL bond	GBP	2031	44.7	43.3	42.4	42.6
3.375%+RPI 50m IL bond	GBP	2032	126.2	79.5	122.4	76.9
0.709%+LIBOR 100m EIB (amortising) loan	GBP	2032	81.0	81.2	86.6	87.5
0.691%+LIBOR 150m EIB (amortising) loan	GBP	2032	126.0	126.6	134.4	135.9
0.573%+LIBOR 100m EIB (amortising) loan	GBP	2033	86.4	87.5	92.0	93.8
0.511%+LIBOR 150m EIB (amortising) loan	GBP	2033	133.6	135.9	141.6	145.3
0.01%+RPI 100m EIB (amortising) IL loan	GBP	2033	106.7	102.2	109.6	106.4
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.0	76.6	82.2	79.7
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	82.3	78.7	81.8	79.3
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	82.3	78.7	81.8	79.3
1.9799%+RPI 100m IL bond	GBP	2035	217.8	148.6	208.3	143.9
0.873%+LIBOR 100m EIB (amortising) loan	GBP	2035	100.6	100.0	99.6	100.0
0.840%+LIBOR 75m (amortising) loan	GBP	2035	75.9	75.0	75.2	75.0
0.01%+RPI 26.5m IL bond	GBP	2036	31.7	33.2	30.1	31.8
0.379%+CPI 20m IL bond	GBP	2036	21.3	21.0	20.7	20.6
0.01%+RPI 29m IL bond	GBP	2036	34.6	32.3	32.9	32.5
0.093%+CPI 60m IL bond	GBP	2037	60.6	62.5	58.8	61.4
1.66%+RPI 35m IL bond	GBP	2037	62.9	47.7	61.9	46.5
2.40%+RPI 70m IL bond	GBP	2039	138.0	93.0	135.9	90.7
1.7829%+RPI 100m IL bond	GBP	2040	221.9	147.0	219.0	142.4
1.3258%+RPI 50m IL bond	GBP	2041	102.9	73.4	100.7	71.1
1.5802%+RPI 100m IL bond	GBP	2042	215.5	146.6	214.7	142.0
1.5366%+RPI 50m IL bond	GBP	2043	43.6	29.2	43.2	28.3
1.397%+RPI 50m IL bond	GBP	2046	109.3	73.3	109.1	71.0
0.359%+CPI 32m IL bond	GBP	2048	32.3	32.9	32.0	32.4
1.7937%+RPI 50m IL bond	GBP	2049	122.9	72.9	122.9	70.7
Commission for New Towns (amortising) loan - fixed	GBP	2053	54.6	27.4	56.2	27.9
1.847%+RPI 100m IL bond	GBP	2056	229.9	143.9	232.2	140.3
1.815%+RPI 100m IL bond	GBP	2056	228.0	143.3	231.7	139.8
1.662%+RPI 100m IL bond	GBP	2056	221.6	143.0	222.0	139.5
1.5865%+RPI 50m IL bond	GBP	2056	109.3	71.5	109.2	69.7
1.591%+RPI 25m IL bond	GBP	2056	54.6	35.6	54.7	34.8
1.556%+RPI 50m IL bond	GBP	2056	108.8	71.1	108.6	69.3
1.435%+RPI 50m IL bond	GBP	2056	106.1	70.8	105.9	69.1
1.3805%+RPI 35m IL bond	GBP	2056	73.5	49.6	73.5	48.4
1.585%+RPI 100m IL bond	GBP	2057	215.3	137.6	218.9	134.2
0.387%+CPI 33m IL bond	GBP	2057	32.3	33.6	33.2	33.0
1.702%+RPI 50m IL bond	GBP	2057	111.2	69.4	112.9	67.7
Amounts owed to ultimate parent undertaking	GBP	2019	74.1	74.1	62.0	62.0
Book overdrafts (see note 15)	GBP	2019	14.2	14.2	12.1	12.1
			8,978.7	**7,889.4**	**9,113.5**	**7,973.8**

Notes to the financial statements – appendices

A3. Borrowings (continued)

IL Index-linked debt – this debt is adjusted for movements in the Consumer or Retail Prices Indices with reference to a base CPI or RPI established at trade date
CPI The UK general index of consumer prices (for all items) as published by the Office for National Statistics (May 2015 = 100)
RPI The UK general index of retail prices (for all items) as published by the Office for National Statistics (Jan 1987 = 100)
EIB Borrowings that are held with the European Investment Bank

Borrowings in the above table are unsecured. Funding raised in currencies is swapped to sterling to match funding costs to income and assets.

During the year, the group issued a further £150 million fixed rate notes in addition to the £300m fixed rate notes issued in the prior year. These notes were issued under the same terms with year of final repayment being 2025 and coupon rate of 2.0%.

In April 2019, the group increased its CPI-linked debt by executing a £100 million CPI-linked bank loan with a 10-year maturity. This has not been recorded in the financial statements at 31 March 2019 as it represents a non-adjusting event after the reporting period.

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

Company	Currency	Year of final repayment	Fair value 2019 £m	Carrying value 2019 £m	Fair value 2018 £m	Carrying value 2018 £m
Borrowings in fair value hedge relationships			**-**	**-**	**437.7**	**432.4**
4.55% 250m bond	USD	2018	-	-	181.2	178.8
5.375% 350m bond	USD	2019	-	-	256.5	253.6
Borrowings measured at amortised cost			**1,088.5**	**1,019.8**	**1,247.7**	**1,182.7**
Short-term bank borrowings – fixed	GBP	2019	100.0	100.0	116.5	116.5
Amounts owed to subsidiary undertakings	GBP	2019	540.5	540.5	721.5	721.5
Amounts owed to ultimate parent undertaking	GBP	2019	74.1	74.1	62.0	62.0
6.875% 400m bond	USD	2028	373.9	305.2	347.7	282.7
			1,088.5	**1,019.8**	**1,685.4**	**1,615.1**

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

Notes to the financial statements – appendices

A4. Financial risk management

Risk management

The UUG board is responsible for treasury strategy and governance, which is reviewed on an annual basis.

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

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

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

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

Liquidity risk

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

At 31 March 2019, the group had £1,039.3 million (2018: £1,205.0 million) of available liquidity, which comprised £339.3 million (2018: £510.0 million) of cash and short-term deposits and £700.0 million (2018: £695.0 million) of undrawn committed borrowing facilities. Short-term deposits mature within three months.

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

		Group		Company
	2019	2018	2019	2018
	£m	£m	£m	£m
Expiring within one year	100.0	100.0	20.0	20.0
Expiring after one year but in less than two years	50.0	150.0	10.0	30.0
Expiring after more than two years	650.0	500.0	215.0	185.0
Total borrowing facilities	800.0	750.0	245.0	235.0
Facilities drawn[1]	(100.0)	(55.0)	(100.0)	(55.0)
Undrawn borrowing facilities	700.0	695.0	145.0	180.0

Note:
[1] Facilities expiring after more than two years.

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 – appendices

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 group and company's financial liabilities 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	Total[(1)] £m	Adjust-ment[(2)] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2019								
Bonds	10,174.4	-	583.4	129.1	504.9	109.2	110.1	8,737.7
Bank and other term borrowings	3,007.5	-	292.8	680.4	125.1	356.1	125.4	1,427.7
Amounts owed to ultimate parent undertaking	74.1	-	74.1	-	-	-	-	-
Adjustment to carrying value[(2)]	(5,366.6)	(5,366.6)	-	-	-	-	-	-
Borrowings	7,889.4	(5,366.6)	950.3	809.5	630.0	465.3	235.5	10,165.4
Derivatives:								
Payable	1,389.0	-	510.2	43.7	36.6	32.6	30.1	735.8
Receivable	(1,825.0)	-	(607.0)	(71.5)	(70.2)	(93.8)	(64.7)	(917.8)
Adjustment to carrying value[(2)]	26.8	26.8	-	-	-	-	-	-
Derivatives – net assets	(409.2)	26.8	(96.8)	(27.8)	(33.6)	(61.2)	(34.6)	(182.0)

Group	Total[(1)] £m	Adjust-ment[(2)] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2018								
Bonds	10,343.8	-	733.9	585.7	116.7	492.5	96.7	8,318.3
Bank and other term borrowings	3,118.8	-	288.9	125.2	682.5	124.5	355.3	1,542.4
Amounts owed to ultimate parent undertaking	62.0	-	62.0	-	-	-	-	-
Adjustment to carrying value[(2)]	(5,550.8)	(5,550.8)	-	-	-	-	-	-
Borrowings	7,973.8	(5,550.8)	1,084.8	710.9	799.2	617.0	452.0	9,860.7
Derivatives:								
Payable	1,382.5	-	404.4	475.6	28.6	22.4	19.7	431.8
Receivable	(1,885.7)	-	(750.0)	(546.9)	(28.7)	(28.7)	(51.6)	(479.8)
Adjustment to carrying value[(2)]	(31.3)	(31.3)	-	-	-	-	-	-
Derivatives – net assets	(534.5)	(31.3)	(345.6)	(71.3)	(0.1)	(6.3)	(31.9)	(48.0)

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Maturity analysis (continued)

Notes:

(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 and CPI will be two per cent over the life of each instrument.

(2) The carrying value of debt is calculated following various methods in accordance with IFRS 9 'Financial Instruments' and therefore this adjustment reconciles the undiscounted forecast future cash flows to the carrying value of debt in the statement of financial position.

Company	Total[1] £m	Adjust-ment[2] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2019								
Bonds	465.7	-	20.9	20.6	20.4	20.2	20.0	363.6
Bank and other term borrowings	100.2	-	100.2	-	-	-	-	-
Amounts owed to ultimate parent undertaking	74.1	-	74.1	-	-	-	-	-
Amounts owed to subsidiary undertakings	540.5	-	540.5	-	-	-	-	-
Adjustment to carrying value[2]	(160.7)	(160.7)	-	-	-	-	-	-
Borrowings	1,019.8	(160.7)	735.7	20.6	20.4	20.2	20.0	363.6
Derivatives:								
Payable	33.7	-	33.7	-	-	-	-	-
Receivable	(34.3)	-	(34.3)	-	-	-	-	-
Adjustment to carrying value[2]	0.1	0.1	-	-	-	-	-	-
Derivatives – net assets	(0.5)	0.1	(0.6)	-	-	-	-	-

Company	Total[1] £m	Adjust-ment[2] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2018								
Bonds	883.3	-	461.1	19.1	18.8	18.6	18.4	347.3
Bank and other term borrowings	116.7	-	116.7	-	-	-	-	-
Amounts owed to ultimate parent undertaking	62.0	-	62.0	-	-	-	-	-
Amounts owed to subsidiary undertakings	721.5	-	721.5	-	-	-	-	-
Adjustment to carrying value[2]	(168.4)	(168.4)	-	-	-	-	-	-
Borrowings	1,615.1	(168.4)	1,361.3	19.1	18.8	18.6	18.4	347.3
Derivatives:								
Payable	359.8	-	359.8	-	-	-	-	-
Receivable	(480.3)	-	(480.3)	-	-	-	-	-
Adjustment to carrying value[2]	1.8	1.8	-	-	-	-	-	-
Derivatives – net assets	(118.7)	1.8	(120.5)	-	-	-	-	-

Notes:

(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.

(2) The carrying value of debt is calculated following various methods in accordance with IFRS 9 'Financial Instruments' 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 – appendices

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 of derivative instruments). While the opening of the non-household retail market to competition from 1 April 2017 has impacted on the profile of the group's concentration of credit risk, as discussed further below, the group does not believe it is exposed to any material concentrations that could have an impact on its ability to continue as a going concern or its longer-term viability.

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the majority of the group's customer base consisting of a large number of unrelated households. 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.

Following the non-household retail market opening to competition, credit risk in this area is now concentrated to a small number of retailers to whom the group provides wholesale water and wastewater services. Retailers are licensed and monitored by Ofwat and as part of the regulations they must demonstrate that they have adequate resources available to supply services. The group's retail customers are on 30 day credit terms in respect of trading transactions. As at 31 March 2019, Water Plus was the group's single largest debtor, with amounts outstanding in relation to wholesale services of £39.1 million (2018: £42.2 million). During the year, sales to Water Plus in relation to wholesale services were £454.8 million (2018: £495.4 million). Details of transactions with Water Plus can be found in note A6.

Under the group's revenue recognition policy, revenue is only recognised when collection of the resulting receivable is reasonably assured. Considering the above, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 14). An allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable.

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

At 31 March 2019 and 31 March 2018, the maximum exposure to credit risk for the group and company is represented by the carrying amount of each financial asset in the statement of financial position:

	Group		Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Cash and short-term deposits (see note 15)	339.3	510.0	12.1	9.6
Trade and other receivables (see note 14)	2,128.4	2,101.4	3,174.4	3,337.5
Investments (see note 12)	11.5	7.1	-	-
Derivative financial instruments	489.1	635.5	0.7	118.7
	2,968.3	3,254.0	3,187.2	3,465.8

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Credit risk (continued)

Included within trade and other receivables for the group are amounts owed by the ultimate parent undertaking of £1,730.8 million (2018: £1,699.4 million), and £143.5 million (2018: £137.2 million) of amounts owed by joint ventures in respect of borrowings, further details of which can be found in note A6.

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2019 the group held £52.0 million (2018: £106.7 million) and the company held £nil (2018: £61.5 million) as collateral in relation to derivative financial instruments (included within short-term bank borrowings - fixed in note A3).

Market risk

The group'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.

Inflation risk

The group earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. Currently the group's regulatory assets are linked to RPI inflation; however, following Ofwat's decision to transition to the use of CPIH for inflation indexation for the 2020–25 regulatory period, from 2020 the group's RCV will be 50 per cent linked to RPI inflation and 50 per cent linked to CPIH inflation, with any new additions being added to the CPIH portion of the RCV.

The group's inflation hedging policy aims to have around half of the group's net debt in index-linked form (where it is economic to do so), by issuing index-linked debt and/or swapping a portion of nominal debt. This is expected to remain mostly in RPI-linked form until CPI and/or CPIH debt and swaps become available in sufficient size at an economic cost.

The group believes this is an appropriate inflation hedging policy taking into account a balanced assessment of the following factors: economic hedge of United Utilities Water Limited's (UUW) RCV and revenues; cash flow timing mismatch between allowed cost of debt and the group's incurred cost of debt; the inflation risk premium that is generally incorporated into nominal debt costs; income statement volatility; hedging costs; debt maturity profile mismatch risk; and index-linked hedging positioning relative to the water sector.

As a result of the evaluation of the above factors, the group will continue to identify opportunities to maintain around 50 per cent of the group's net debt being hedged for inflation, which can be evidenced by issuing of CPI index-linked debt since 2017 and the swapping of RPI-linked debt to CPI after the reporting period as described in note 25. Inflation risk is reported monthly to the treasury committee in the operational compliance report.

The carrying value of index-linked debt held by the group was £3,775.8 million at 31 March 2019 (2018: £3,729.8 million).

Sensitivity analysis

The following table details the sensitivity of profit before tax to changes in the RPI and CPI on the group's index-linked borrowings. The sensitivity analysis has been based on the amount of index-linked debt held at the reporting date and, as such, is not indicative of the years then ended. In addition, it excludes the hedging aspect of the group's regulatory assets and post-retirement obligations described above.

Group	2019 £m	2018 £m
Increase/(decrease) in profit before tax and equity		
1 per cent increase in RPI/CPI	(38.2)	(37.7)
1 per cent decrease in RPI/CPI	38.2	37.7

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Inflation risk (continued)

The sensitivity analysis assumes a one per cent change in RPI and CPI 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 and CPI changes impact on the income statement, and the analysis does not incorporate this factor. The portfolio of index-linked debt is calculated on either a three or eight-month lag basis. Therefore, at the reporting date the index-linked interest and principal adjustments impacting the income statement are fixed and based on the annual RPI or CPI change either three or eight months earlier.

Company

The company had no material exposure to inflation risk at 31 March 2019 or 31 March 2018.

Interest rate risk

The group's policy is to structure debt in a way that best matches its underlying assets and cash flows. The group currently earns an economic return on its RCV, comprising a real return through revenues, determined by the real cost of capital fixed by the regulator for each five-year regulatory pricing period, and an inflation return as an uplift to its RCV (see inflation risk section for changes being introduced by Ofwat to inflation indexation from 2020).

In the next regulatory period, Ofwat intends to continue using materially the same methodology in setting a fixed real cost of debt in relation to embedded debt (currently assumed to be 70 per cent of net debt), but will introduce a debt indexation mechanism in relation to new debt (currently assumed to be 30 per cent of net debt).

Therefore, sterling index-linked debt is left unswapped at inception, in accordance with our inflation hedging policy goal to maintain around half of the group's net debt in index-linked form. Conventional nominal debt is hedged as set out below.

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 10 years in advance on a reducing balance basis, mirroring Ofwat's expected split of 70 per cent embedded and 30 per cent new debt. As such, at the start of each regulatory period, around 30 per cent of the projected nominal net debt for that regulatory period will remain floating until it is fixed via the above 10-year reducing balance basis, which should more closely mirror Ofwat's new debt indexation mechanism.

This interest rate hedging policy dovetails with our revised inflation hedging policy should we need to swap a portion of nominal debt to real rate form to maintain our desired mix of nominal and index-linked debt.

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

Sensitivity analysis

The following table details the sensitivity of the group's profit before tax and equity to changes in interest rates. The sensitivity analysis has been based on the amount of net debt and the interest rate hedge positions in place at the reporting date and, as such, is not indicative of the years then ended.

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Interest rate risk (continued)

	Group		Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Increase/(decrease) in profit before tax and equity				
1 per cent increase in interest rate	129.4	127.5	(7.3)	(12.1)
1 per cent decrease in interest rate	(140.5)	(137.7)	7.3	12.1

The sensitivity analysis assumes that both fair value hedges and borrowings designated at fair value through profit or loss are effectively hedged and it excludes the impact on post-retirement obligations.

The exposure largely relates to the fair value movements on the group's fixed interest rate swaps which manage the exposure to medium-term interest rates. Those swaps are not included in hedge relationships.

Repricing analysis

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

Our largest concentration of floating interest rate risk is with index-linked instruments. This has been classified as repricing in one year or less due to the refixing of the interest charge with changes in RPI and CPI.

Group	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
At 31 March 2019							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,765.8	441.9	-	406.2	-	-	1,917.7
Effect of swaps	-	2,323.9	-	(406.2)	-	-	(1,917.7)
	2,765.8	2,765.8	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	373.9	-	-	-	-	-	373.9
Effect of swaps	-	373.9	-	-	-	-	(373.9)
	373.9	373.9	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	179.4	152.6	0.6	0.7	0.7	0.7	24.1
Floating rate instruments	720.4	720.4	-	-	-	-	-
Index-linked instruments	3,775.8	3,775.8	-	-	-	-	-
	4,675.6	4,648.8	0.6	0.7	0.7	0.7	24.1
Effect of fixed interest rate swaps	-	(2,330.9)	148.5	50.0	164.5	575.0	1,392.9
Total external borrowings	7,815.3	5,457.6	149.1	50.7	165.2	575.7	1,417.0
Amounts owed to ultimate parent undertaking	74.1	74.1	-	-	-	-	-
Total borrowings	**7,889.4**	**5,531.7**	**149.1**	**50.7**	**165.2**	**575.7**	**1,417.0**
Cash and short-term deposits	(339.3)	(339.3)	-	-	-	-	-
Net borrowings	7,550.1	5,192.4	149.1	50.7	165.2	575.7	1,417.0

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Repricing analysis (continued)

Group	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
At 31 March 2018							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,895.3	583.2	466.4	-	411.5	-	1,434.2
Effect of swaps	-	2,312.1	(466.4)	-	(411.5)	-	(1,434.2)
	2,895.3	2,895.3	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	347.7	-	-	-	-	-	347.7
Effect of swaps	-	347.7	-	-	-	-	(347.7)
	347.7	347.7	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	189.4	162.0	0.6	0.6	0.7	0.8	24.7
Floating rate instruments	749.6	749.6	-	-	-	-	-
Index-linked instruments	3,729.8	3,729.8	-	-	-	-	-
	4,668.8	4,641.4	0.6	0.6	0.7	0.8	24.7
Effect of fixed interest rate swaps	-	(3,006.3)	925.4	252.1	50.0	164.5	1,614.3
Total external borrowings	7,911.8	4,878.1	926.0	252.7	50.7	165.3	1,639.0
Amounts owed to ultimate parent undertaking	62.0	62.0	-	-	-	-	-
Total borrowings	7,973.8	4,940.1	926.0	252.7	50.7	165.3	1,639.0
Cash and short-term deposits	(510.0)	(510.0)	-	-	-	-	-
Net borrowings	7,463.8	4,430.1	926.0	252.7	50.7	165.3	1,639.0

Company	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
At 31 March 2019							
Borrowings in fair value hedge relationships							
Fixed rate instruments	-	-	-	-	-	-	-
Effect of swaps	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	405.2	100.0	-	-	-	-	305.2
	405.2	100.0	-	-	-	-	305.2
Total external borrowings	-	-	-	-	-	-	-
Amounts owed to subsidiary undertakings	540.5	540.5	-	-	-	-	-
Amounts owed to ultimate parent undertaking	74.1	74.1	-	-	-	-	-
Total borrowings	1,019.8	714.6	-	-	-	-	305.2
Cash and short-term deposits	(12.1)	(12.1)	-	-	-	-	-
Net borrowings	1,007.7	702.5	-	-	-	-	305.2

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Repricing analysis (continued)

Company	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
At 31 March 2018							
Borrowings in fair value hedge relationships							
Fixed rate instruments	432.4	432.4	-	-	-	-	-
Effect of swaps	-	-	-	-	-	-	-
	432.4	432.4	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	399.2	116.5	-	-	-	-	282.7
	399.2	116.5	-	-	-	-	282.7
Total external borrowings	831.6	548.9	-	-	-	-	282.7
Amounts owed to subsidiary undertakings	721.5	721.5	-	-	-	-	-
Amounts owed to ultimate parent undertaking	62.0	62.0	-	-	-	-	-
Total borrowings	1,615.1	1,332.4	-	-	-	-	282.7
Cash and short-term deposits	(9.6)	(9.6)	-	-	-	-	-
Net borrowings	1,605.5	1,322.8	-	-	-	-	282.7

Electricity price risk

The group is allowed a fixed amount of revenue by the regulator, in real terms, to cover electricity costs for each five-year regulatory pricing period. To the extent that electricity prices remain floating over this period, this exposes the group to volatility in its operating cash flows. The group's policy, therefore, is to manage this risk by fixing a proportion of electricity 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 and has begun fixing prices for the subsequent AMP from 2020 to 2025, partially through entering into electricity swap contracts.

The adoption of IFRS 9 'Financial Instruments' has enabled the group to designate electricity swaps into cash flow hedge relationships. This means that only the impact of any hedging ineffectiveness is recognised through fair value in the income statement, with movements reflecting the effective portion of the swaps being recognised in other comprehensive income. As a result of this, changes in electricity prices are no longer significant sources of volatility in the income statement and therefore sensitivity analysis in this area will no longer be meaningful.

The company has no exposure to electricity price risk.

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 often designated within a fair value accounting hedge.

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Currency risk (continued)

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

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

Capital risk management

The group's objective when managing capital is to maintain efficient access to debt capital markets throughout the economic cycle. The UUG board therefore believes that it is appropriate to maintain gearing, measured as group consolidated net debt (including derivatives) to regulatory capital value (RCV) of United Utilities Water Limited (UUW), within a target range of 55 per cent to 65 per cent. As at 31 March 2019, group consolidated gearing was 61 per cent (2018: 61 per cent), which is comfortably within this range.

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

In order to maintain targeted minimum credit ratings, the group needs to manage its capital structure with reference to the 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, 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 UUG board. Capital risk is reported monthly to the treasury committee through the operational compliance report.

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

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.

Group	Level 1	Level 2	Level 3	Total
2019	£m	£m	£m	£m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	329.4	-	329.4
Derivative financial assets – held for trading[1]	-	158.5	-	158.5
Derivative financial assets – cash flow hedge[2]	-	1.2	-	1.2
Investments[3]	-	11.5	-	11.5
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – fair value hedge	-	(2.3)	-	(2.3)
Derivative financial liabilities – held for trading[1]	-	(75.9)	-	(75.9)
Derivative financial assets – cash flow hedge[2]	-	(1.7)	-	(1.7)
Financial liabilities designated as fair value through profit or loss	-	(373.9)	-	(373.9)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,316.9)	(432.4)	-	(2,749.3)
Other financial liabilities at amortised cost	(680.9)	(5,174.6)	-	(5,855.5)
	(2,997.8)	**(5,560.2)**	**-**	**(8,558.0)**

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Fair values (continued)

Group **2018**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	-	7.1	-	7.1
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	455.7	-	455.7
Derivative financial assets – held for trading(1)	-	179.8	-	179.8
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – fair value hedge	-	(24.2)	-	(24.2)
Derivative financial liabilities – held for trading(1)	-	(76.8)	-	(76.8)
Financial liabilities designated as fair value through profit or loss	-	(347.7)	-	(347.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,192.4)	(713.5)	-	(2,905.9)
Other financial liabilities at amortised cost	(2,425.6)	(3,372.8)	-	(5,798.4)
	(4,618.0)	**(3,892.4)**	**-**	**(8,510.4)**

Note:

(1) These derivatives form economic hedges and, as such, management intends to hold these through to maturity. Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £151.3 million (2018: £151.8 million).

(2) On adoption of IFRS 9 'Financial Instruments', electricity swaps, previously classified as held for trading under IAS 39 'Financial Instruments: Recognition and Measurement', have been designated in cash flow hedge relationships.

(3) Prior to the adoption of IFRS 9 'Financial Instruments' on 1 April 2018, investments were classified as available-for-sale financial assets in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'.

- 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).

Company **2019**	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	-	-	-	-
Derivative financial assets – held for trading(1) (2)	-	0.7	-	0.7
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading(1)	-	(0.2)	-	(0.2)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	-	-	-	-
Other financial liabilities at amortised cost	-	(1,088.5)	-	(1,088.5)
	-	**(1,088.0)**	**-**	**(1,088.0)**

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Fair values (continued)

Company **2018**	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	-	118.4	-	118.4
Derivative financial assets – held for trading(1) (2)	-	0.3	-	0.3
Financial liabilities at fair value through profit or loss				
Derivative financial assets – held for trading(1)	-	-	-	-
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(437.7)	-	-	(437.7)
Other financial liabilities at amortised cost	-	(1,247.7)	-	(1,247.7)
	(437.7)	**(1,129.0)**	**-**	**(1,566.7)**

Notes:

(1) These derivatives form economic hedges and, as such, management intends to hold these through to maturity.
(2) Includes amounts owed by subsidiary undertakings of £0.3 million (2018: £0.3 million).

The group and company have calculated fair values using quoted prices where an active market exists, which has resulted in £2,997.8 million (2018: £4,618.0 million) for the group and £nil (2018: £437.7 million) for the company of 'level 1' fair value measurements. In the absence of an appropriate quoted price, the group and company have applied discounted cash flow valuation models utilising market available data in line with prior years. In the group, the £1,620.2 million reduction (2018: £1,914.0 million reduction) in 'level 1' fair value measurements is largely due to an increase in the number of observable quoted bond prices in active markets at 31 March 2019.

During the year, changes in the fair value of financial liabilities designated at fair value through profit or loss resulted in a £26.2 million loss (2018: £27.8 million gain). Included within this was a £6.6 million gain (2018: £24.0 million loss) attributable to changes in own credit risk. Following adoption of IFRS 9 'Financial Instruments', this £6.6 million gain has been recognised in other comprehensive income rather than profit or loss. The cumulative amount due to changes in credit spread was £44.8 million profit (2018: £38.2 million profit). The carrying amount is £147.8 million (2018: £145.6 million) higher than the amount contracted to settle on maturity.

Notes to the financial statements – appendices

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 group of the Electricity Supply Pension Scheme (ESPS), both of which are closed to new employees. The assets of these schemes are held in trust funds independent of the group's finances.

The 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.

In the year ended 31 March 2019, the majority of active members in the defined benefit sections of the UUPS transitioned to a hybrid section comprising both defined benefit and defined contribution elements. Pension benefits relating to pensionable service before 1 April 2018 were unaffected by the changes. This transition is a consequence of an increase in future service costs and is intended to reduce the overall costs and risk to the group while balancing the interests of employees by maintaining an element of defined benefit pension provision.

The group also operates a series of historic unfunded, unregistered retirement benefit schemes. The costs of these schemes are included in the total pension cost, on a basis consistent with IAS 19 'Employee Benefits' 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 defined benefit obligation includes benefits for current employees, former employees and current pensioners as analysed in the table below:

		Group		**Company**
	2019	2018	2019	2018
	£m	£m	£m	£m
Total value of current employees benefits	754.3	913.8	55.3	66.0
Deferred members benefits	651.4	748.6	279.4	319.4
Pensioner members benefits	2,019.5	1,836.3	558.7	513.0
Total defined benefit obligation	3,425.2	3,498.7	893.4	898.4

The duration of the combined schemes is around 18 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.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Funding requirements

The latest finalised funding valuations of the schemes were carried out by independent qualified actuaries as at 31 March 2018, earlier than originally planned due to the aforementioned changes to the pension scheme, and determined that the schemes were both in a deficit position on a funding basis. The basis on which scheme liabilities are valued for funding purposes differs from the basis required under IAS 19, with liabilities on a funding basis being subject to assumptions at the valuation date that are not updated between revaluations. Funding deficits vary significantly from company to company, but neither the deficits, the assumptions on which they are based, the associated sensitivities, nor the risk exposures are disclosed by many companies and, therefore, meaningful cross-company comparisons are not possible. Conversely, scheme liabilities are valued on a consistent basis between companies under IAS 19 and are subject to assumptions and sensitivities that are required to be disclosed. Consequently, the relative economic positions of companies are comparable only on an IAS 19 basis, subject to normalisation of assumptions used between companies.

A retirement benefit surplus was recognised as an asset at both 31 March 2019 and 31 March 2018 as, under both the UUPS and ESPS scheme rules, the group has an unconditional right to a refund of the surplus assuming the full settlement of the plans' liabilities in a single event, such as a scheme wind-up.

Under UK legislation there is a requirement that pension schemes are funded prudently, and that funding plans are agreed by pension scheme trustees. The group had plans in place with the schemes' trustees to address the funding deficits by 31 December 2021 for the UUPS and 30 September 2024 for the ESPS, through a series of deficit recovery contributions. This timescale has been accelerated, with accelerated deficit repair contributions of £97.6 million and £5.4 million made to the UUPS and ESPS respectively in April 2019. These payments represent the final acceleration of deficit repair contributions set out in the schedules of contributions agreed with the schemes' trustees as part of the 31 March 2018 valuation process, and reduce the deficit repair contributions payable, due from the company, to nil.

As the 2018 valuation basis was consistent with a long-term target for self-sufficiency, the expectation is that there should be minimal ongoing reliance on the company by the pension schemes.

The group and trustees have agreed long-term strategies for reducing investment risk in each scheme. 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 corporate bonds and gilts, supplemented by swap and gilt long-term hedges of interest and inflation rates, which perform in line with the liabilities so as to hedge against changes in interest and inflation rates.

In addition, in the year ended 31 March 2019, the investment and risk management strategy continued to evolve with both UUPS and ESPS now fully hedging inflation exposure through external market swaps and gilts. As a consequence, the Inflation Funding Mechanism (IFM), which previously provided an element of inflation hedging directly with the company, has now ceased to apply and, therefore, no IFM payments were made during the year. Further details of the derivatives used in reducing investment risk are disclosed in the 'Further reporting analysis' section of this appendix.

The group expects to make further contributions of £8.4 million in the year ending 31 March 2020, £7.1 million and £0.9 million in respect of current service contributions to UUPS and ESPS respectively, and £0.4 million in respect of expenses to the ESPS.

The schemes' funding plans are reviewed regularly, and the next funding valuation for UUPS and ESPS is due no later than 31 March 2021.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

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 CPI and the current member mortality assumptions. These projected cash flows are then discounted by a high-quality 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 and CPI. Due to the IFM ceasing to exist, as mentioned above, both UUPS and ESPS are now fully hedging inflation exposure along with underlying interest rates through external market swaps and gilts, the value of which is included in the schemes' assets.

Consequently, the reported statement of financial position under IAS 19 remains volatile due to changes in credit spread which have not been hedged, primarily due to the difficulties in doing so over long durations, and changes in mortality as management has decided, at the current time, 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 bases, which formed the basis for regular deficit repair contributions, are unlikely to suffer from significant volatility due to credit spread, because a prudent, fixed credit spread assumption is applied.

Pension benefits under the defined benefit element of the new UUPS hybrid section, that became effective for pensionable service from 1 April 2018, are linked to CPI rather than RPI.

In the year ended 31 March 2019, the discount rate decreased by 0.2 per cent (2018: 0.05 per cent increase), which includes a 0.1 per cent decrease in credit spreads and a 0.1 per cent decrease in gilt yields over the year. The IAS 19 remeasurement gain of £73.0 million (2018: £50.2 million) reported in note 17 has largely resulted from the favourable impact of updated membership data due to the 2018 funding valuation, changes in mortality assumptions, and growth asset gains, partially offset by the reduction in credit spreads and gilt yields during the year.

Guaranteed Minimum Pensions (GMP) equalisation

On 26 October 2018, the High Court issued its ruling in a landmark case involving Lloyds Banking Group on GMP. The implication of the ruling is that GMP will be equalised for males and females. The impact of GMP equalisation under the chosen C2 method of calculation is £5.5 million (0.2 per cent of liability) for the UUPS and £1.1 million (0.3 per cent of liability) for the ESPS, resulting in an overall increase in the pension liability of £6.6 million as a result of additional benefits being recognised, with a corresponding amount recorded in past service costs in the income statement. Any future true-up costs will be accounted for in other comprehensive income as a change in management estimate.

Reporting and assumptions

The results of the latest funding valuations at 31 March 2018 have been adjusted for IAS 19 in order to assess the position at 31 March 2019, 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.

Member data used in arriving at the liability figure included within the overall IAS 19 surplus has been based on the finalised actuarial valuations as at 31 March 2018 for both UUPS and ESPS.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Financial assumptions

The main financial and demographic assumptions used by the actuary to calculate the defined benefit surplus of UUPS and ESPS are outlined below:

	2019	2018
Group and Company	% p.a.	% p.a.
Discount rate	2.40	2.60
Pensionable salary growth and pension increases	3.45	3.35
Price inflation - RPI	3.45	3.35
Price inflation - CPI	2.05	1.95

The discount rate is consistent with a high-quality corporate bond rate, with 2.40 per cent being equivalent to gilts plus 90 basis points (31 March 2019: 2.60 per cent being equivalent to gilts plus 100 basis points).

Demographic assumptions

At both 31 March 2019 and 31 March 2018, mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S2PA year of birth tables, with a scaling factor of 106 per cent and 109 per cent for male pensioners and non-pensioners respectively and 104 per cent and 105 per cent for female pensioners and non-pensioners respectively (2018: 108 per cent for males and 102 per cent for females), reflecting actual mortality experience. At 31 March 2019, mortality in retirement is based on CMI 2018 (2018: CMI 2016) long-term improvement factors, with a long-term annual rate of improvement of 1.50 per cent (2018: 1.75 per cent).

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

	2019	2018
Group and Company	years	years
Retired member - male	26.4	27.0
Non-retired member - male	27.5	28.7
Retired member - female	28.6	29.4
Non-retired member - female	30.0	31.1

Sensitivity of the key scheme assumptions

The measurement of the group's defined benefit surplus is sensitive to changes in key assumptions, which are described above. 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 £73.2 million (2018: £72.7 million) decrease/increase in the schemes' liabilities for the group, and a £18.3 million (2018: £17.7 million) decrease/increase in the schemes' liabilities for the company, at 31 March 2019, 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 high quality corporate bond yields of a similar duration to the schemes' liabilities.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Sensitivity of the key scheme assumptions (continued)

- ***Price inflation***

  An increase/decrease in the inflation assumption of 0.1 per cent would have resulted in a £68.4 million (2018: £68.1 million) increase/decrease in the schemes' liabilities for the group, and an £17.1 million (2018: £16.6 million) increase/decrease in the schemes' liabilities for the company, at 31 March 2019, as a significant proportion of the schemes' benefit obligations are linked to inflation. However, nearly all of the schemes' liabilities were hedged for RPI in the external market at 31 March 2019, meaning that this sensitivity is likely to be insignificant as a result. As assumptions for pensionable salary growth and pension increases are in line with those for price inflation, sensitivities are also in line.

- ***Mortality long-term improvement rate***

  An increase in the mortality long-term improvement rate to 1.75 per cent would have resulted in a £37.5 million decrease in the schemes' liabilities at 31 March 2019.

- ***Life expectancy***

  An increase/decrease in life expectancy of one year would have resulted in a £137.1 million (2018: £128.6 million) increase/decrease in the schemes' liabilities for the group, and a £35.6 million (2018: £33.0 million) increase/decrease in schemes' liabilities for the company, at 31 March 2019. 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.

Further reporting analysis

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

Group	Schemes' assets %	2019 £m	Schemes' assets %	2018 £m
Equities	-	0.8	9.5	363.9
Other non-equity growth assets	7.7	302.5	5.7	219.1
Gilts	33.5	1,310.2	47.2	1,813.3
Bonds	46.2	1,805.8	40.6	1,561.7
Other	12.6	489.8	(3.0)	(115.1)
Total fair value of schemes' assets	100.0	3,909.1	100.0	3,842.9
Present value of defined benefit obligations		(3,425.2)		(3,498.7)
Net retirement benefit surplus		483.9		344.2

The fair values in the table above are all based on quoted prices in an active market, with the exception of £203.8 million (2018: £150.1 million) of assets included in 'Other', which fall within the 'Level 3' fair value categorisation in accordance with IFRS 13 'Fair Value Measurement'.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

Company	Schemes' assets %	2019 £m	Schemes' assets %	2018 £m
Equities	-	0.1	6.4	62.6
Other non-equity growth assets	8.0	80.7	6.8	66.7
Gilts	34.2	342.9	44.2	433.0
Bonds	46.5	466.8	43.6	426.0
Other	11.3	113.0	(1.0)	(9.8)
Total fair value of schemes' assets	100.0	1,003.5	100.0	978.5
Present value of defined benefit obligations		(893.4)		(898.4)
Net retirement benefit surplus		110.1		80.1

The fair values in the table above are all based on quoted prices in an active market, with the exception of £35.1 million (2018: £25.8 million) of assets included in 'Other', which fall within the 'Level 3' fair value categorisation in accordance with IFRS 13 'Fair Value Measurement'.

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.

The portfolio contains a proportion of assets set aside for collateral purposes linked to the derivative contracts entered into, as described above. The collateral portfolio, comprising cash and eligible securities readily convertible to cash, provides sufficient liquidity to manage the derivative transactions and is expected to achieve a return in excess of LIBOR.

The fair value derivatives included within pension scheme asset classification are analysed as follows:

			Group			**Company**
At 31 March 2019	Underlying assets £m	Fair value of Derivatives £m	Combined £m	Underlying assets £m	Fair value of Derivatives £m	Combined £m
Equities	4.8	(4.0)	0.8	0.8	(0.7)	0.1
Other non-equity growth assets	302.5	-	302.5	80.7	-	80.7
Gilts	1,310.2	-	1,310.2	342.9	-	342.9
Bonds	1,821.0	(15.2)	1,805.8	468.1	(1.3)	466.8
Other	370.0	119.8	489.8	87.6	25.4	113.0
Total fair value of schemes' assets	**3,808.5**	**100.6**	**3,909.1**	**980.1**	**23.4**	**1,003.5**

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

At 31 March 2018	Group			Company		
	Underlying assets	Fair value of Derivatives	Combined	Underlying assets	Fair value of Derivatives	Combined
	£m	£m	£m	£m	£m	£m
Equities	357.3	6.6	363.9	61.5	1.1	62.6
Other non-equity growth assets	219.1	-	219.1	66.7	-	66.7
Gilts	1,813.3	-	1,813.3	433.0	-	433.0
Bonds	1,561.1	0.6	1,561.7	423.6	2.4	426.0
Other	170.1	(285.2)	(115.1)	38.8	(48.6)	(9.8)
Total fair value of schemes' assets	**4,120.9**	**(278.0)**	**3,842.9**	**1,023.6**	**(45.1)**	**978.5**

The derivative values in the tables above represent the net market value of derivatives held within each of these asset categories as follows:

- Derivatives are held within the UUPS equity portfolio to gain economic exposure equivalent to around 4.0 per cent of that scheme's assets, and comprises total return swaps on equity indices with a value of £nil (2018: £4.7 million) for the group and £nil (2018: £0.8 million) for the company and currency forwards with a value of £(4.0) million (2018: £1.9 million) for the group and £(0.7) million (2018: £0.3 million) for the company;

- Derivatives are used within both the UUPS and ESPS bond portfolio to hedge non-sterling exposure back to sterling:
  - the UUPS total value of £(17.1) million (2018: £nil) for the group and £(2.9) million (2018: £nil) for the company, comprises interest rate swaps with a value of £(15.0) million (2018: £(3.9) million) for the group and £(2.6) million (2018: (0.7) million) for the company and currency forwards with a value of £(2.1) million (2018: £1.1 million) for the group and £(0.3) million (2018: £0.2 million) for the company; and
  - the ESPS total value of £1.9 million (2018: £3.4 million) for the group and £1.6 million (2018: £2.9 million) for the company relates to interest rate swaps.

- Derivatives are used within both the UUPS and ESPS 'other' portfolios to manage liability risks. Both schemes use a range of derivatives to target a high level of interest rate and inflation hedging, comprising £112.7 million (2018: £(285.9) million) for the group and £19.4 million (2018: £(49.2) million) for the company in the UUPS and £7.1 million (2018: £0.7 million) for the group and £6.0 million (2018: 0.6 million) for the company in the ESPS. These are further broken down as follows:

  - the UUPS net value of £112.7 million (2018: £(285.9) million) for the group and £19.4 million (2018: £(49.2) million) for the company comprise asset swaps with a value of £(32.7) million (2018: £(27.3) million) for the group and £(5.6) million (2018: £(4.7) million) for the company, interest rate swaps with a value of £143.6 million (2018: £252.1 million) for the group and £24.7 million (2018: £43.4 million) for the company, gilt repurchase agreements with a value of £nil (2018: £(517.2) million) for the group and £nil (2018: £(89.0) million) for the company and RPI inflation swaps with a value of £1.8 million (2018: £6.5 million) for the group and £0.3 million (2018: £1.1 million) for the company; and
  - The ESPS net value of £7.1 million (2018: £0.7 million) for the group and £6.0 million (2018: £0.6 million) for the company represents gilt repurchase agreements with a value of £7.4 million (2018: £2.3 million) for the group and £6.2 million (2018: £1.9 million) for the company and RPI inflation swaps with a value of £(0.3) million (2018: £(1.6) million) for the group and £(0.2) million (2018: £(1.3) million) for the company.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

The derivatives shown in the tables only cover those expressly held for the purpose of reducing certain undesirable asset and liability risks. The schemes also invest in a number of other pooled funds that make use of derivatives. No allowance is made in the figures above for any derivatives held within these, as these are not held expressly for the purpose of managing risk. The total fair value of pooled funds held within the schemes' assets was £582.0 million (2018: £567.4 million) for the group and £128.8 million (2018: £126.5 million) for the company.

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

		Group		**Company**
	2019	2018	2019	2018
	£m	£m	£m	£m
At the start of the year	3,842.9	3,863.0	978.5	986.3
Interest income on schemes' assets	98.4	97.7	25.0	25.0
The return on plan assets, excluding amounts included in interest	58.5	(60.0)	11.4	(13.5)
Member contributions	2.9	4.9	0.4	0.3
Benefits paid	(166.0)	(131.7)	(37.2)	(31.3)
Administrative expenses	(2.8)	(2.6)	(1.0)	(0.8)
Company contributions	75.2	71.6	26.4	12.5
At the end of the year	3,909.1	3,842.9	1,003.5	978.5

The actual return on the schemes' assets was a gain of £156.9 million (2018: £37.7 million) for the group and a gain of £36.4 million (2018: £11.5 million) for the company, principally due to gains on derivatives hedging the schemes' liabilities.

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

		Group		**Company**
	2019	2018	2019	2018
	£m	£m	£m	£m
At the start of the year	(3,498.7)	(3,615.5)	(898.4)	(933.3)
Interest cost on schemes' obligations	(88.9)	(90.6)	(22.8)	(23.4)
Actuarial (losses)/gains arising from changes in financial assumptions	(160.6)	85.1	(39.0)	21.8
Actuarial gains arising from changes in demographic assumptions	70.9	43.2	20.7	11.6
Actuarial gains/(losses) arising from experience	104.2	(18.1)	11.5	(4.3)
Curtailments/settlements	(9.0)	(2.3)	(1.1)	(0.1)
Member contributions	(2.9)	(4.9)	(0.4)	(0.3)
Benefits paid	166.0	131.7	37.2	31.3
Current service cost	(6.2)	(27.3)	(1.1)	(1.7)
At the end of the year	(3,425.2)	(3,498.7)	(893.4)	(898.4)

Notes to the financial statements – appendices

A6. Related party transactions

Group

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

The related party transactions with the group's joint ventures during the period and amounts outstanding at the period end date were as follows:

	2019 £m	2018 £m
Sales of services	455.8	496.3
Charitable contributions advanced to related parties	0.5	-
Purchase of goods and services	0.1	0.7
Costs recharged at nil margin under transitional service agreements	0.2	1.4
Interest income and fees recognised on loans to joint ventures	4.3	3.4
Amounts owed by related parties	182.9	179.7
Amounts owed to related parties	0.6	1.4

Sales of services to related parties during the year mainly represent non-household wholesale charges to Water Plus Group Limited (Water Plus), a joint venture in which the group holds a 50 per cent stake alongside Severn Trent PLC, that were billed during the period. These transactions were on the group's normal trading terms in respect of non-household wholesale charges, which are governed by the wholesale charging rules issued by Ofwat.

Charitable contributions advanced to related parties during the year relate to amounts paid to Rivington Heritage Trust, a charitable company limited by guarantee for which United Utilities Water Limited is one of three guarantors.

At 31 March 2019, amounts owed by joint ventures, as recorded within trade and other receivables in the statement of financial position, were £182.9 million (2018: £179.7 million), comprising £39.4 million (2018: £42.5 million) of trade balances, which are unsecured and will be settled in accordance with normal credit terms, and £143.5 million (2018: £137.2 million) relating to loans. Included within these loans receivable were the following amounts owed by Water Plus:

- £100.0 million outstanding on a £100.0 million revolving credit facility provided by United Utilities Water Limited, which is guaranteed by United Utilities PLC, with a maturity date of 30 September 2020, bearing a floating interest rate of LIBOR plus a credit margin;

- £9.6 million receivable being the fair value of amounts owed in relation to a £12.5 million unsecured loan note held by United Utilities PLC, with a maturity date of 28 March 2027. This is an interest-free shareholder loan with a total amount outstanding at 31 March 2017 of £12.5 million, comprising the £9.6 million receivable held at fair value, and £2.9 million recorded as an equity contribution to Water Plus recognised within interests in joint ventures; and

- £32.5 million outstanding on a £32.5 million revolving credit facility provided by United Utilities PLC, with a maturity date of 30 September 2020, bearing a floating interest rate of LIBOR plus a credit margin.

A further £1.4 million of non-current receivables (2018: £1.4 million) was owed by other related parties at 31 March 2019.

£nil expense or allowance has been recognised for bad and doubtful receivables in respect of amounts owed by related parties (2018: £nil).

Notes to the financial statements – appendices

A6. Related party transactions (continued)

During the year, United Utilities PLC provided guarantees in support of Water Plus in respect of certain amounts owed to wholesalers. The aggregate limit of these guarantees was £58.1 million, of which £35.1 million related to guarantees to United Utilities Water Limited.

At 31 March 2019, amounts owed to joint ventures were £0.6 million (2018: £1.4 million). The amounts outstanding are unsecured and will be settled in accordance with normal credit terms (2018: same).

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

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

	Interest receivable	
	2019	2018
	£m	£m
Ultimate parent undertaking	30.5	25.4

	Intercompany group tax relief payable	
	2019	2018
	£m	£m
Ultimate parent undertaking	5.8	10.4

	Amounts owed by related parties		**Amounts owed to related parties**	
	2019	2018	2019	2018
	£m	£m	£m	£m
Ultimate parent undertaking	1,730.8	1,699.4	82.1	74.2

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

Company

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

Total dividend income received during the year from subsidiary undertakings amounted to £617.4 million (2018: £319.9 million), including dividends totalling £375.6 million (2018: £316.7 million) received from United Utilities North West, a dividend of £2.1 million (2018: £3.2 million) received from United Utilities (Tallinn) BV and a dividend of £239.7 million (2018: £nil) received from United Utilities Utility Solutions Holdings Limited prior to its dissolution.

Total interest receivable during the year from subsidiary undertakings was £30.6 million (2018: £25.8 million), and total fair value losses during the year relating to balances with subsidiary undertakings were £27.9 million (2018: £41.8 million gains). In addition, total net interest receivable during the year from the ultimate parent company was £30.5 million (2018: £25.4 million). Amounts outstanding at 31 March 2019 between the parent company, subsidiary undertakings and ultimate parent undertaking are provided in notes 13, 20 and A3.

An allowance for doubtful receivables of £95.9 million (2018: £95.2 million) has been made for amounts owed by subsidiary undertakings (see note 14). In the year ended 31 March 2019, a charge of £0.7 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2018: £5.8 million charge).

Notes to the financial statements – appendices

A6. Related party transactions (continued)

As at 31 March 2019, total guarantees given by the company to its related parties were £1,999.9 million (2018: £2,181.4 million). Included within these guarantees were the following amounts:

- £1,831.0 million (2018: £1,882.1 million) relating to United Utilities Water Limited's loans from the European Investment Bank;
- £nil (2018: £96.5 million) relating to intra-group loans made between United Utilities Utility Solutions Holdings Limited and United Utilities Water Operations Holdings Limited;
- £100.0 million (2018: £100.0 million) relating to Water Plus's revolving credit facility from United Utilities Water Limited;
- Guarantees with an aggregate limit of £58.1 million (2018: £42.5 million) relating to Water Plus in respect of certain amounts owed to wholesalers, of which £24.0 million (2018: £24.0 million) related to guarantees to United Utilities Water Limited; and
- Performance guarantees with an aggregate limit of £10.8 million (2018: £60.3 million) given to subsidiaries.

A7. Accounting policies

Of the accounting policies outlined below, those deemed to be the most significant for the group are those that align with the critical accounting judgements and key sources of estimation uncertainty set out on pages 66 to 68.

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.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used under the relevant local GAAP into line with those used by the group. Amounts attributable to non-controlling interests are presented separately in equity and total comprehensive income where material.

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.

Joint ventures

Joint ventures are entities in which the group holds an interest on a long-term basis and which are jointly controlled with one or more parties under a contractual arrangement. The group's share of joint venture results and assets and liabilities is incorporated using the equity method of accounting. Under the equity method, an investment in a joint venture is initially recognised at cost and adjusted thereafter to recognise the group's share of the profit or loss. In the parent company accounts, investments in joint ventures are held at cost less provision for impairment.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

Joint ventures (continued)

On losing control of a subsidiary disposed of to a joint venture, the group recognises the gain or loss attributable to measuring the investment retained in the former subsidiary at its fair value at the date when control is lost.

Revenue recognition

Revenue represents the fair value of the consideration receivable in the ordinary course of business for goods and services provided, exclusive of value added tax and foreign sales tax. 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.

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. This includes the revenue in respect of connection activities which has been impacted by the adoption of IFRS 15. The revenue in respect of these activities is released to the income statement over a period of 60 years, which is deemed to be the time over which the performance obligation for providing the connection is satisfied.

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 on an accruals basis.

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.

Tax

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Assessing the outcome of uncertain tax positions requires judgements to be made regarding the application of tax law and the result of negotiations with, and enquiries from, tax authorities in a number of jurisdictions. A current tax provision is only recognised when the group has a present obligation as a result of a past event and it is probable that the group will be required to settle that obligation to a taxing authority.

Current tax

Current tax is based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at each reporting date.

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

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

Notes to the financial statements – appendices

A7. Accounting policies (continued)

Tax (continued)

Deferred tax

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

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

Property, plant and equipment

Property, plant and equipment comprises water and wastewater infrastructure assets and overground assets.

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.

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

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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.

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 60 years, which is the estimated period over which an average connection through which the group provides water and wastewater services is expected to be in place (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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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 assets

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

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

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

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

Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as having been met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

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 book overdrafts.

Financial investments

Investments (other than interests in subsidiaries, joint ventures and fixed deposits) are initially measured at fair value, including transaction costs. Investments classified as financial assets measured at fair value through profit or loss (FVPL) in accordance with IFRS 9 'Financial Instruments' are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in the net profit or loss for the period. The business model employed in respect of financial assets is that of a hold-to-collect model.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

Trade receivables

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

Trade payables

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

Financial liabilities and equity

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

Equity instruments

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

Borrowings

The group's default treatment is that bonds and loans 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, whilse 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 IFRS 9 'Financial Instruments' to make fair value adjustments to 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 there is an economic relationship between the borrowing instrument and the hedging derivative and that the designated hedge ratio is consistent with the group's risk management strategy.

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.

Under the provisions of IFRS 9 'Financial Instruments', changes in the group's own credit risk are recognised in other comprehensive income.

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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

Derivative financial instruments

The group's default treatment is that 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 A5).

Derivative financial instruments designated within a cash flow hedge relationship

Gains or losses resulting from the effective portion of the hedging instrument are recognised in other comprehensive income and in the cash flow hedge reserve with any remaining gains or losses recognised immediately in the income statement. The cash flow hedge reserve is adjusted to the lower of the cumulative gain or loss on the hedging instrument and cumulative change in fair value of the hedged item. At the maturity date, amounts paid/received are recognised against operating expenses in the income statement.

Upon discontinuation of a cash flow hedge, the amount accumulated in other comprehensive income remains in the cash flow hedge reserve if the hedged future cash flows are still expected to occur. Otherwise the amount is immediately reclassified to the income statement.

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 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 IFRS 9 'Financial Instruments'. 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. For properties held for resale, cost includes the cost of acquiring and developing the sites, including borrowing costs where applicable.

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

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 to determine the funding of the schemes, along with future contribution rates, are carried out by the pension scheme actuary as directed by the trustees at intervals of not more than three years. In any intervening years, the trustees review the continuing appropriateness of the funding and contribution rates.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

From a financial reporting perspective and in accordance with IAS 19 'Employee Benefits', defined benefit assets are measured at fair value while liabilities are measured at present value, using the projected unit credit method. The difference between the two amounts is recognised as a surplus or obligation in the statement of financial position. Where this difference results in a defined benefit surplus this is recognised in accordance with IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction' on the basis that the group has an unconditional right to a refund of any surplus that may exist following the full settlement of plan liabilities in a single event.

The pension cost under IAS 19 is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary, which are used to estimate the present value of defined benefit obligations. 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.

The cost of providing pension benefits to employees relating to the current year's service (including curtailment gains and losses) is included within employee benefits expense, while the interest on the schemes' assets and liabilities is included within investment income and finance expense respectively. Remeasurement gains/losses on scheme assets and liabilities are presented in other 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.

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).

Group companies

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

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

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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.

Notes to the financial statements – appendices

A8. Subsidiaries and other group undertakings

Details of the group's subsidiary undertakings, joint ventures and associates are set out below. Unless otherwise specified, the registered address for each entity is Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington WA5 3LP, United Kingdom. For further details of joint ventures and associates please see notes 11 and 12.

	Class of share capital held	Proportion of share capital owned/voting rights %	Nature of business
Subsidiary undertakings			
Great Britain			
Halkyn District Mines Drainage Company Limited*	Ordinary	99.9	Dormant
Lingley Mere Management Company Limited*	Ordinary	90.7	Property management
North West Water International Limited	Ordinary	100.0	Holding company
North West Water Limited*	Ordinary	100.0	Dormant
United Utilities (Overseas Holdings) Limited*	Ordinary	100.0	Holding company
United Utilities Energy Limited	Ordinary	100.0	Non-trading
United Utilities Healthcare Trustee Limited	Ordinary	100.0	Corporate trustee
United Utilities International Limited	Ordinary	100.0	Consulting services and project management
United Utilities North West Limited	Ordinary	100.0	Holding company
United Utilities Pensions Trustees Limited	Ordinary	100.0	Corporate trustee
United Utilities Property Services Limited	Ordinary	100.0	Property management
United Utilities Renewable Energy Limited	Ordinary	100.0	Renewable energy generation
United Utilities Total Solutions Limited	Ordinary	100.0	Waste treatment
United Utilities Utility Solutions (Industrial) Limited	Ordinary	100.0	Holding company
United Utilities Water Finance PLC*	Ordinary	100.0	Financing company
United Utilities Water Limited*	Ordinary	100.0	Water and wastewater services
UU (ESPS) Pensions Trustee Limited	Ordinary	100.0	Corporate trustee
UU Group Limited	Ordinary	100.0	Dormant
UU Secretariat Limited	Ordinary	100.0	Dormant
YCL Transport Limited	Ordinary	100.0	Non-trading
United Utilities Bioresources Limited	Ordinary	100.0	Wastewater services
The Netherlands			
United Utilities (Tallinn) BV	Ordinary	100.0	Holding company
Thailand			
Manta Management Services Limited[(1)]*	Ordinary	49.0	Management company

Notes to the financial statements – appendices

A8. Subsidiaries and other group undertakings (continued)

	Class of share capital held	Proportion of share capital owned/voting rights %	Nature of business
Joint ventures			
Lingley Mere Business Park Development Company Limited*	Ordinary	50.0	Development company
Selectusonline Limited	Ordinary	16.7	Procurement portal
Water Plus Group Limited(2)	Ordinary	50.0	Water and wastewater non-household retail
Water Plus Limited	Ordinary	50.0	Water and wastewater non-household retail
Water Plus Select Limited	Ordinary	50.0	Water and wastewater non-household retail
Estonia			
AS Tallinna Vesi(3)*	Ordinary	35.3	Water and wastewater services
Associated undertakings			
Bahrain			
Muharraq STP Company BSC(c)(4)*	Ordinary	20.0	Project company
Muharraq Wastewater Services Company WLL(4)*	Ordinary	35.0	Operations and maintenance company
Jebel Ali Free Zone, Dubai, UAE			
Muharraq Holding Company 1 Limited(5)*	Ordinary	20.0	Holding company
Muharraq Holding Company 2 Limited(5)*	Ordinary	20.0	Holding company

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

Notes:

(1) Registered address: Unit 2201, No.1, Soi Chan 2, Yak 3 Chan Road, Thung Wat Don Sub District, Sathorn District, Bangkok, Thailand 10120

(2) Registered address: Two Smithfield, Leonard Coates Way, Stoke-on-Trent, United Kingdom, ST1 4FD.

(3) Registered address: Adala 10, Tallinn 10614, Estonia.

(4) Registered address: Building 200, Road 13 Block 115, Hidd, Kingdom of Bahrain.

(5) Registered address: Al Tamimi & Company, 9th Floor, Dubai World Trade Centre, Sheikh Zayed Road, Dubai, United Arab Emirates.