Registered No: 2366616

United Utilities PLC

Annual Report and Financial Statements

31 March 2016

Contents

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', 'the group' or 'the UUG group' means United Utilities Group PLC and its subsidiary undertakings. 'UU' 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 vision

Our vision is to be the best UK water and wastewater company, providing great service to our customers.

How we create value

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

Our key performance indicators for 2015-20 measure our progress against some of the most important value drivers for the business, feeding through from our strategic themes: the best service to customers; at the lowest sustainable cost; and in a responsible manner.

For more information in relation to the industry and market within which we operate and progress towards realising our vision, please see pages 10 to 12 of the 2016 UUG annual report and financial statements.

Our business model

Key resources

Natural Resources

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

We own over 55,000 hectares of land around our reservoirs. Our sustainable catchment management programme (SCAMP) has shown that we can effectively manage these catchments to protect and enhance water quality and to provide other benefits such as an improved natural environment. Our new Catchment Wise project is looking at working with others to improve the lakes, rivers and coastal waters where we return wastewater to benefit the natural environment of the North West.

As well as water and our catchment land, another key resource is waste. Sludge from wastewater can be processed to generate renewable energy, helping to save power costs and protect the environment. Our advanced digestion facility at Davyhulme is one of the largest works of its type in the world and in 2016 we began injection of biogas from Davyhulme's wastewater treatment into the national gas network. We also recycle waste by supplying treated biosolids to agriculture, which provides a valuable resource to farmers.

In order to utilise these key natural resources to create value for our business, our 'Instrument of Appointment' or Licence is integral. This was granted to us as part of the privatisation of the water industry in 1989.

People

Our employees play a critical role in increasing long-term value generation. Fundamental to the decisions we take and operational performance we deliver is a skilled, engaged and motivated team.

We place a strong emphasis on providing comprehensive training and development opportunities to develop our existing employees, improving our internal skill-base as well as providing a more engaged workforce. By enhancing our understanding of best business practices in other companies and sectors around the world and bringing this learning back to our business we have increased our organisational knowledge and capability, which has been integral to developing our 'systems thinking' approach to operating our business. Our award-winning apprentice scheme, coupled with our graduate recruitment programme, is helping to ensure we can continue to attract and train up a high calibre of engineers, in a profession which has seen declining numbers in the UK in recent years.

All of our employees are paid at least the Living Wage as defined by Living Wage Foundation and independent studies have shown that this enhances the quality of work of staff, increases staff retention, reduces absenteeism as well as providing societal benefits. Management has a range of incentives that

Strategic report

focus on performance over a number of years, rather than just the current year, to encourage the delivery of benefits over the longer term.

Our policies on maternity, paternity, adoption, personal and special leave go beyond the minimum required by law. For disabled applicants and existing employees, we are committed to fulfilling our obligations in accordance with the relevant legislation. Applicants with disabilities are given equal consideration in the application process. Disabled colleagues have equipment and working practices modified for them as far as possible and wherever it is safe and practical to do so. We also have procedures and policies in place to ensure we act in accordance with the Universal Declaration of Human Rights.

We value diversity, providing equality of opportunity and recruiting and promoting on merit, which we believe provides the benefits of a more comprehensive and balanced skills-set. Despite being a highly engineering-based organisation, women are represented at all levels of our company, with one-third of our combined UUG board and executive team being female.

The health and safety of our employees is fundamental, most importantly to the welfare of our employees but also to the reputation and performance of our company. This continues to be a significant area of focus as we strive for continuous improvement. We have implemented a number of initiatives over recent years which have helped to reduce the employee accident frequency rate.

Our suppliers and contractors provide us with essential services which we rely on to deliver our strategy and we work with those whose business principles, conduct and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, further supporting the delivery of these benefits. It is fair to say that our suppliers are contributing significantly towards our c£9 billion forecast contribution to the regional economy over the 2015-20 period.

Maintaining a good relationship with our key stakeholders such as our suppliers, investors, regulators and customers is vital for the success of our business. For example, on large capital projects we work closely with our suppliers and by maintaining a good relationship and working towards the same goals we can help ensure the delivery of projects on time, to budget and with minimum customer impact. Maintaining regular contact and positive relations with investors may help encourage them to buy or retain our shares or finance our future capital programmes. Engagement with regulators may help positively influence future policy. Our stakeholder relationships are influenced by our reputation and so we try to ensure our strong values and performance are accurately portrayed externally.

Assets

Our fixed assets (including all our reservoirs, treatment works and pipes) have a gross replacement cost of around £90 billion which is the estimated amount it would cost for another company to build similar assets and networks. However, it is not the replacement cost of our assets upon which we are allowed to earn a return through our revenues. We earn a return on our regulatory capital value (RCV), a regulatory measure of the value of our capital base, which is currently just over £10 billion, so it is this asset value which is more important economically.

Many of our assets are long-term in nature – for example, our impounding reservoirs have a useful economic life of around 200 years. By carefully reviewing our potential capital projects, considering the most efficient long-term solutions, we can save future operating costs, also helping to reduce future customer bills and contributing to being able to operate in a more sustainable manner. It is also important that we have the right systems and procedures in place in order to monitor and control the assets efficiently and effectively within our network. Embracing innovation in our asset configuration and work processes can help to make our future service better, faster or cheaper.

Since privatisation in 1989, total capital investment of over £15 billion has provided substantial benefits to our customers and our region's environment as well as contributing to the North West economy through job creation, both within our company and in our supply chain. Disciplined investment, along with RPI inflation, also grows our RCV, increasing future revenues.

We expect to invest around £3.5 billion across 2015-20 and to continue with a substantial investment programme for the foreseeable future in order to meet more stringent environmental standards from the European Union and to maintain and improve the current standards of our assets and services. When deciding on our investment strategy we have to be mindful of the impact on our customers' bills and this is

Strategic report

why, for example, we are spreading some of the environmental spend required by European legislation over the next 15 years.

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

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

External environment

Natural
Whether it's treating and delivering drinking water for our customers, or returning treated wastewater to rivers and the sea, the natural environment is fundamental to our business. We continue to invest to protect and, where appropriate, enhance the natural environment of the North West, which in turn brings economic benefits such as underpinning the region's tourist industry.

We plan far into the future to ensure we are prepared for the changing natural environment, most notably the effects of climate change. With severe dry periods becoming increasingly common, we must ensure we continue to have resilient water resources and an infrastructure capable of moving water efficiently around the region. The potential effect of climate change on our future water resources is included in our 25-year Water Resource Management Plan.

We must tackle flooding incidents caused by the intensive bursts of rainfall that are becoming more frequent due to changing weather patterns. This was evident in December 2015, when Honister in Cumbria broke existing UK records for the most rainfall over a 24-hour period, with the consequential devastating flooding across the region.

Additionally, we must ensure we are able to meet increased demand on our sewerage network as the regional population is expected to increase. A phased, long-term approach ensures that the necessary work can be delivered whilst not placing too much pressure on customer bills.

We have a responsibility to return water to the environment safely. Spills from our network can lead to pollution which can damage the natural environment and could lead to loss of reputation and financial penalties, depending on their severity. Our number of serious pollution incidents has decreased over recent years and it is an important area of focus within our 25-year Strategic Direction Statement. The Environment Agency assesses water companies' performance across a basket of measures including pollution and its overall assessment is included as one of our KPIs (*see page 29 of the 2016 UUG annual report and financial statements*) with all of the pollution sub-measures also reported within our Corporate Responsibility pages on our website at: *corporate.unitedutilities.com/cr-environment*

We can make an important contribution to protecting and enhancing the natural environment by using fewer natural resources. We have been driving down our carbon footprint over the last decade (22 per cent fall in CO_2 emissions since 2005/06) and have plans to reduce further going forward. Less than 10 per cent of our waste goes to landfill and our use of recycled products is increasing. We are increasing our renewable energy production with plans to almost double our renewable energy production from 2015 to 2020, the main contributor being solar opportunities. This will provide environmental benefits and add value to shareholders through energy cost savings.

Strategic report

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

In recent years, unemployment in the North West has generally been higher than the national average. However, over the last year the North West unemployment rate has improved faster then the national average and is now broadly in line. A report from the Department for Communities and Local Government, published during 2015/16, reaffirmed that the North West continues to have more of the most deprived areas in England than any other region. Even as the North West economy recovers it is unlikely to have a significant impact on deprivation, which is the principal driver of our higher than average costs to serve our household customers. This is currently recognised by Ofwat through a special allowance for deprivation of £20 million per annum over the 2015-20 period.

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

Interest rates have remained below the long-term trend and we have benefitted from this as we drew down or raised over £600 million of new debt in 2015/16. Comparatively low interest rates have also been beneficial to our future cost of debt as we continue with our interest rate hedging strategy.

Despite picking up recently to 1.6 per cent at March 2016, RPI inflation has been relatively low over the last couple of years, impacted by the falls in oil and commodity prices. The prices we charge our customers (and therefore revenues), as well as our asset base, are linked to RPI inflation, so lower RPI has meant slightly lower growth on these measures.

However, we also have a large quantity of index-linked debt, which means our finance costs decrease as inflation falls, providing a partial economic offset to revenue (although this is not a perfect hedge as changes to revenue and index-linked finance costs are based on differing lagged measures of inflation). Our pension liabilities are also linked to inflation, which provides an additional economic offset against our asset base. Overall, we are currently more inflation-hedged than the other listed water and wastewater companies so we are better protected in a low inflation environment.

United Utilities' total forecast contribution to the regional economy over 2015-20 is estimated at £9 billion. Direct economic contributions from our activities include the purchase of goods and services and providing extensive employment. There is also an indirect economic contribution, for example when our suppliers, in turn, make purchases from their suppliers and when people whose jobs are supported by United Utilities spend their personal incomes.

Technological
Advances in technology can be used to help deliver improvements in the quality or cost of our service. Embracing innovation, using modern technology or techniques, is at the heart of how we do business. Our 'systems thinking' approach across the wholesale business is a key example of this.

We have also been utilising technology within our energy self-generation. For example, our Davyhulme sludge recycling centre employs a ground-breaking configuration of thermal hydrolysis to maximise energy generation from sludge and won an Annual Institute of Chemical Engineers award for innovation in 2013/14.

We also have to be mindful of our customers' ever increasing use of technology. We have recognised the increasing power of social media as communication channels for customers in doing business with us and we recently completed investment in a new digital external communications capability and a number of website improvements. This proved invaluable in handling the unprecedented increase in communication necessary with customers during the Lancashire water quality incident in summer 2015.

Technological advances give rise to greater risks as well as presenting 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.

Strategic report

Political and regulatory
Over a long time frame the political and regulatory environment can change significantly. In the 27 years since the water industry was privatised by the UK Government, we have seen substantial tightening of laws and regulations. Whilst to some extent changes to the regulatory environment are outside of our direct control, maintaining a good reputation is important to enable positive participation in regulatory discussions. By positively engaging and using our industry knowledge, we can help influence future policy with the aim of achieving the best outcome for our customers, shareholders and other stakeholders.

Economic regulation
The water industry currently operates within five-year planning cycles known as Asset Management Plan (AMP) periods. Prior to the start of each five-year period, companies submit their business plans which include their projected expenditure in order to enhance and maintain their assets. Following review of these plans, Ofwat sets the prices each company can charge their customers across the period. We have just finished the first year of the 2015-20 (AMP6) period.

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

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

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

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

The way companies' operating and capital costs are assessed has been modified to encourage companies to utilise the most efficient, sustainable solutions under a new 'totex' model. Where companies outperform their totex allowance, this gain would be shared between investors and customers, ensuring both receive the benefit.

There was also a move to a more outcomes-based approach, with greater emphasis being placed on customer engagement to agree the outcomes. Companies' performance will be measured through a range of outcome delivery incentives (ODIs) covering a wide range of measures assessing operational and environmental performance, with associated rewards or penalties.

Ofwat's SIM assessment is continuing, which will reward companies who perform well on customer service, or penalise companies who perform badly, relative to other water companies.

Each year all water companies are required to publish an annual performance report, the first of which is due in July 2016 and our report will be made available on our website at: *corporate.unitedutilities.com*.

Ofwat (the Water Services Regulation Authority) is the economic regulator of the water and sewerage sectors in England and Wales, responsible for ensuring the companies provide customers with good-quality, efficient service at a fair price.

Read more online at: *www.ofwat.gov.uk*

Changes in regulation opening up the competitive arena
Currently only very large business customers are allowed to choose their water supplier. Under this arrangement, the new water supplier would buy water directly from the regional water company and be allowed to use its network for this water supply. Although very few users have switched supplier in England, the 2014 Water Act aims to open up future retail competition to all business customers, including sewerage as well as water services from 2017. We are well positioned for this expansion of competition following our experiences in the Scottish market and our recently announced joint venture with Severn Trent, combining our business retail businesses *(see page 31 of the 2016 UUG annual report and financial statements for more details on this joint venture*).

Strategic report

Following a request from government, Ofwat is currently assessing the potential costs and benefits of extending retail competition to household customers, with a paper scheduled to be published in the next few months. Ofwat expects to factor in the UK Government's conclusions and decisions in this area at its next price review in 2019.

The Water Act also paves the way for the future introduction of competition for certain parts of the wholesale, or upstream, business. Following this, Ofwat proposed in its Water 2020 consultation document in December 2015, to open up competition in the areas of water resources and sludge treatment from 2020. We are fully engaged with regards to market reform, being always mindful of the potential impact on our customers and the value implications for our shareholders.

Environmental and quality regulation

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

Social

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

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

Internal environment

Governance

Good governance lies at the heart of all successful organisations and leads to better management decisions as well as helping to avoid exposure to potential risks. We strive to operate in a manner that reflects the highest standards of corporate governance. Our UUG company structure and governance standards are designed to ensure that our UUG board continues to provide sound and prudent governance in compliance with the principles of the UK Corporate Governance Code.

As you would expect of the provider of an essential service, we adopt a prudent approach to managing risks to our business. That being said, accepting some level of risk is a normal consequence for a commercial organisation. Also, given the complex legal and regulatory environment within which we operate, there is a range of risks to which we are exposed. Risks can be in the form of possible non-compliance with existing laws or regulations or failure to meet the terms of our current 2015-20 regulatory contract. We also face risks in relation to potential future changes in legislation or regulation.

An important risk to our business is ensuring that we get the constituent elements of our five-yearly business plans correct to ensure our financeability, and that they are agreed by Ofwat in its final determination, as we are bound by these plans for the following five-year period with limited opportunity to change them. See pages 17 to 22 for more details on what we consider to be our top risks.

Identifying and then being able to act upon potential opportunities can be a key determinant for adding value. Each quarter, senior management across each main area of the group routinely undertakes business reviews, including the identification and evaluation of potential opportunities.

The governance section on pages 50 to 109 of the 2016 UUG annual report and financial statements presents information on the board of United Utilities and its activities and those of the various UUG board

Strategic report

committees. It also sets out how the UUG board demonstrates leadership, effectiveness and its accountability to the group's stakeholders.

Culture
We operate under the three core values of integrity, innovation and customer focus. Acting with integrity, both at UUG board level and as a group, underpins our approach to responsible business and building trust. Our employees are integral to value creation and we actively encourage our people to express their opinions and views, through for example, our annual 'Your Opinion Survey'.

Innovation is a critical enabler in creating value, helping to keep us ahead of our competitors. Our employees are given the opportunity to develop and present their ideas to senior management, facilitating an innovative environment. Utilising innovation from our suppliers is part of our supply chain approach, which also provides another avenue to benefit from new ideas and technologies.

Over recent years, we have instilled a more customer-centric approach right across our organisation and this evolving culture has been a key driver to the major improvements in customer service we have been able to deliver. Putting customers right at the heart of what we do has also helped deliver benefits for shareholders and wider stakeholders.

Our business model

In line with Ofwat's evolution from one single price control to four (see political and regulatory environment on page 7), we have structured our business into four distinct areas: Wholesale water; Wholesale wastewater; Domestic retail; and Business retail.

Each business area undertakes both long-term and shorter-term planning to identify how it can best deliver its outcomes. We adopt an integrated approach which considers a whole range of stakeholders including customers, investors, the environment, our employees and local communities. These plans also take into account the internal and external factors described on pages 5 to 9. Underpinning our approach to planning, we undertake a cycle of continuous assessment using KPIs and other performance measures which helps formulate future plans, with a view to delivering further improvements for our various stakeholders.

All the group's RCV of just over £10 billion sits within the wholesale water and wholesale wastewater business areas and we are allowed to earn an annual return on this asset base based on an industry-allowed cost of debt and equity, set by Ofwat. Allowed costs for both wholesale price controls are determined by Ofwat using its totex cost assessment models. Our cost performance against our allowed cost of debt and totex will determine how much outperformance or underperformance we generate.

Allowed costs within the domestic retail price control are determined using a water industry average cost to serve approach, rewarding companies who are able to achieve costs below industry average costs. The business price control is being increasingly opened up, with full competition expected from 2017, providing a strong incentive for water companies to deliver efficiencies and service improvements in this area.

Planning

Planning – 25 years+
In order to maintain a reliable, high quality water service for our customers in the future, we have to look a long way ahead and anticipate those changes and core issues that are likely to impact on our activities. Our long-term strategy helps us to define what we need to deliver over the shorter term, which in turn helps to create value.

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

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

By anticipating these changes we can ensure that we continue to deliver what customers want at a fair price and in a responsible way.

Strategic report

Our Strategic Direction Statement, 'Playing our part to support the North West' (which can be downloaded at: *corporate.unitedutilities.com/future*), sets out our long-term strategy for the next quarter of a century. It examines the challenges ahead and explains how we will focus our resources and talents in order to meet them. We consulted with thousands of customers and stakeholders to ensure their expectations are reflected in our plans.

Some of the key ways we create value over this longer time frame are by:

- investing in our people to ensure a committed, capable and motivated workforce which delivers high performance;
- close collaboration with suppliers;
- efficiently implementing a robust and appropriate mix of debt and equity financing;
- disciplined investment, based on a sustainable whole-life cost modelling;
- embracing innovation to make our future services better, faster or cheaper;
- long-term planning and management of water resources – 25-year Water Resource Management Plan;
- responding to climate change; and
- sustainable catchment management.

Planning – 5 years
Each five-year investment period is designed to help us achieve our longer term vision.

By submitting a robust, balanced plan to Ofwat prior to the start of each five-year regulatory period, we can help ensure we receive a regulatory contract that allows for the best overall outcomes for our customers, shareholders and the environment.

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

Our five-year plan for 2010-15 was focused on improving customer satisfaction, meeting our statutory obligations and delivering shareholder value and we delivered on all fronts. We were the most improved water company as measured in Ofwat's SIM assessment, with customer complaints down approximately 75 per cent over 2010-15. We achieved upper quartile performance on Ofwat's and the Environment Agency's respective KPIs in both 2013/14 and 2014/15, met our annual leakage target each year and retained our 'World Class' status in the Dow Jones Sustainability Index. Our outperformance was generated mainly through efficiency savings on operating and capital expenditure and, in particular, by securing debt costs at below Ofwat's allowed industry cost of debt. For our shareholders, we delivered a strong total shareholder return of 115 per cent, outperforming the market. Our good performance over 2010-15 has provided a strong platform to deliver further value over the 2015-20 period.

For the 2015-20 regulatory period, some of the key ways in which we are aiming to create value are summarised below:

- improving customer service, which will improve efficiency, reduce costs and reduce potential penalties/increase rewards from Ofwat, under its service incentive mechanism (SIM);
- enhancing our debt collection activities, which will reduce our retail costs. Alongside this, we continue to provide comprehensive support for customers struggling to pay;
- raising low-cost finance, which helps us outperform the finance costs allowed in our regulatory contract. This is our main area of outperformance potential in the 2015-20 period;
- implementing our hedging strategies, such as fixing medium-term interest rates and power costs, to reduce the volatility of these costs, helping us meet our regulatory contract;
- minimising total costs on a sustainable basis, such as on power, materials and property rates, which helps us meet or outperform totex costs allowed in our regulatory contract;
- delivering our operational and regulatory commitments, which helps ensure we achieve high levels of customer service and meet environmental standards. Our performance can also result in potential financial rewards or penalties such as those linked to our outcome delivery incentives (ODIs), which include reliably delivered high-quality water and reducing pollution and sewer flooding incidents;

Strategic report

- maintaining a robust supply and demand balance, which provides water resource and customer supply benefits and avoids any penalties or unfunded expenditure requirements from our regulators; and
- increasing our production of renewable energy from waste, which helps protect us from rising energy costs and reduces our carbon footprint.

Supporting this value generation, each of our four business areas has plans over 2015-20 to deliver as follows:

Wholesale water

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

Wholesale wastewater

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

Domestic retail

- continue to improve the customer experience by being more proactive with customers, anticipating problems before they materialise and improving our communication channels so that we are easier to do business with;
- reduce further the number of customer complaints and to resolve them whenever we can, avoiding the need for complaints to be referred to the Consumer Council for Water;
- reduce the debt burden on the company and its customers by engaging with those who are struggling to pay, helping them to return to sustained payment behaviour. We are extending our options for assistance to hard-pressed customers, developing a new social tariff from 2015, and we remain committed to contribute annually to the United Utilities Trust Fund, which has proven effective in helping customers in difficulty return to regular payment; and
- reduce the cost to serve our customers through systems and process improvement. This is particularly important under the new price control methodology which uses an industry average retail cost to serve to determine part of customer bills.

Strategic report

Business retail

- build stronger relationships with customers to develop tailored plans to meet their needs;
- give customers greater choice in how they contact and transact with us;
- increase first point resolution and case ownership, reducing cost to serve and improving customer satisfaction;
- install meters in all business customer premises that give automated meter reads (AMR) to facilitate billing for actual consumption; and
- offering value-add additional services such as leakage detection and repair and ways in which to reduce water use.

We are already starting to plan for the next price review which will cover the 2020-25 period in order to achieve the optimal plan for our stakeholders. In light of the 2014 price review, a key area of focus is to compile more robust evidence to support our cost requirements reflecting our significant regional differences. For example, we have a higher proportion of industrial customers whose potent wastewater is more expensive to treat. We also have many designated sites of environmental importance, such as the Lake District, which requires us to treat wastewater to higher standards.

Planning – 1 year

Each financial year we develop a business plan, approved by the UUG board, which sets our annual targets to help deliver further improvements and move us towards achievement of our five-year goals. This business plan covers a broad range of measures across the three strategic areas of best service to customers, lowest sustainable cost and responsible manner. Senior management has quarterly business review meetings with the executive directors to monitor and assess performance to help ensure we are on track to deliver our targets.

At the end of every financial year, our performance is assessed against this basket of measures and this determines employees' annual bonuses right through the organisation. As well as annual targets, our directors are assessed against three-year performance covering total shareholder return, sustainable dividends and customer service through long-term incentive plans. Details of the 2015/16 annual bonus and vested long-term incentive plans for the UUG executive directors are shown in the remuneration report reported within the 2016 UUG annual report and financial statements.

Strategic report

Outcomes

By delivering our strategy in both the long and shorter term we aim to deliver the following key outcomes for our stakeholders:

The best service to customers:

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

At the lowest sustainable cost:

- We support those customers who are struggling to pay
- The North West’s economy is supported by our activities and investment
- Our services are provided in an increasingly efficient way
- Efficiencies are delivered in a sustainable way taking a long-term view

In a responsible manner:

- The natural environment is protected and improved in the way we deliver our services
- The North West’s bathing and shellfish waters are cleaner through our work
- Our services and assets are fit for a changing climate
- We invest in community partnerships for mutual benefit
- Our employees make a positive contribution to local communities
- Provide safe, secure working conditions
- Provide competitive rewards to attract and retain employees
- We invest in the learning and development of our employees

We aim to provide an appropriate risk and return for investors

Give value for money – customer bills are fair

Our households currently pay just over £1 per day on average for the combined water and wastewater services we provide. Our price determination for 2015-20 means customers will benefit from below inflation increases to average household bills for the decade to 2020.

For more information in relation to how we create value within our operating environment, please see pages 10 to 26 of the 2016 UUG annual report and financial statements.

Strategic report

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 2016	Year ended 31 March 2015
Financial KPIs		
Revenue	£1,730m	£1,720m
Underlying operating profit (1)	£604m	£664m
Underlying profit before tax (1)	£441m	£474m
Underlying profit after tax (1)	£353m	£375m
Regulatory capital expenditure (2)	£799m	£869m
Gearing: net debt to regulatory capital value (3)	61%	59%
Performance summary		
Operating profit	£568m	£653m
Profit before tax	£381m	£368m
Profit after tax	£420m	£292m

Notes:
(1) Underlying profit measures have been provided to give a more representative view of business performance.
(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 RCV (out-turn prices).

Financial performance

Revenue

United Utilities has delivered a good set of financial results for the year ended 31 March 2016. Revenue was up £10 million at £1,730 million despite the new regulated price controls, as we benefitted from higher than expected volumes, non-regulated sales were up and because last year was impacted by the £21 million special discount we applied to customer bills.

Operating profit

Underlying operating profit at £604 million was £60 million lower than last year, as expected. This reflects the new regulated price controls, an expected increase in depreciation and other costs, partly offset by a reduction in bad debts, power and regulatory fees. In line with our planned acceleration, there was also a £21 million increase in infrastructure renewals expenditure this year. Reported operating profit decreased by £85 million, to £568 million.

Investment income and finance expense

The underlying net finance expense of £173 million was £23 million lower than last year, mainly due to a lower cost of debt locked-in on the group’s nominal debt and the impact of lower RPI inflation on the portion of the group’s index-linked debt with an eight month lag. Interest on non index-linked debt of £112 million was £13 million lower than last year, due to the lower rates locked in on our interest rate swaps from 2015, compared with our 2010-15 swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £38 million, compared with a net charge of £47 million last year. As at 31 March 2016, the group had approximately £3.4 billion of index-linked debt at an average real rate of 1.5 per cent. Reported net finance expense of £192 million was significantly lower than the £291 million expense in 2014/15.

Profit before tax

Underlying profit before tax was £441 million, £33 million lower than last year, due to the £60 million decrease in underlying operating profit, partly offset by the £23 million decrease in underlying net finance expense. This underlying measure adjusts for the impact of the costs associated with the flooding and water quality incidents and retail business market reform and other items such as fair value movements in respect of debt and derivative instruments. Reported profit before tax increased by £13 million to £381 million.

Strategic report

Tax

In 2015/16, we paid corporation tax of £53 million, which represents an effective cash tax rate on underlying profits of 12 per cent, 8 per cent lower than the headline rate of corporation tax of 20 per cent. Consistent with prior years, the key reconciling item to the headline rate was allowable tax deductions on net capital investment.

The current tax charge was £59 million in 2015/16, compared with £62 million in the previous year. In addition, there were current tax credits of £9 million in 2015/16 and £10 million in 2014/15, both following agreement with the UK tax authorities of prior years’ tax matters.

For 2015/16, the group recognised a deferred tax charge of £19 million, compared with a charge of £14 million for 2014/15. In addition, in 2015/16 the group recognised a deferred tax charge of £6 million relating to prior years’ tax matters, compared with a charge of £9 million in 2014/15. In 2015/16, the group also recognised a deferred tax credit of £112 million relating to the enacted reduction in the headline rate of corporation tax to 18 per cent from 1 April 2020.

The total tax credit for 2015/16 was £39 million as compared to a total tax charge of £76 million for 2014/15, the main difference being the current year deferred tax credit of £112 million relating to changes in tax rates. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 20 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium term.

Profit after tax

Underlying profit after tax of £353 million was £22 million lower than last year, principally reflecting the £38 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits. Reported profit after tax was higher at £420 million, compared with £292 million in the previous year.

The group also has a number of operational KPI’s and the performance in respect of these can be found on page 29 and associated commentary on pages 31 to 38, of the 2016 UUG annual report and financial statements.

Strategic report

Underlying profit

In considering the underlying results for the period, the directors have adjusted for the items outlined in the table below to provide a more representative view of business performance. Reported operating profit and profit before tax are reconciled to underlying operating profit, underlying profit before tax and underlying profit after tax (non-GAAP measures) as follows:

	Year ended 31 March 2016	Year ended 31 March 2015
Operating profit	£m	£m
Operating profit per published results	567.9	653.3
Water quality incident	24.8	-
Flooding incidents (net of insurance proceeds recognised)	(0.6)	-
Business retail market reform (1)	11.1	-
Restructuring costs	0.9	11.0
Underlying operating profit	604.1	664.3
Net finance expense		
Finance expense	(224.4)	(317.8)
Investment income	32.9	27.3
Net finance expense per published results	(191.5)	(290.5)
Adjustments:		
Net fair value losses on debt and derivative instruments	26.3	104.7
Interest on swaps and debt under fair value options	16.5	4.0
Net pension interest (income)/expense	(3.1)	7.0
Capitalised borrowing costs	(21.3)	(20.9)
Underlying net finance expense	(173.1)	(195.7)
Profit before tax		
Share of profits of joint ventures	5.0	5.1
Profit before tax per published results	381.4	367.9
Adjustments:		
Water quality incident	24.8	-
Flooding incidents (net of insurance proceeds recognised)	(0.6)	-
Business retail market reform (1)	11.1	-
Restructuring costs	0.9	11.0
Net fair value losses on debt and derivative instruments	26.3	104.7
Interest on swaps and debt under fair value option	16.5	4.0
Net pension interest (income)/expense	(3.1)	7.0
Capitalised borrowing costs	(21.3)	(20.9)
Underlying profit before tax	441.0	473.7
Profit after tax		
Underlying profit before tax	441.0	473.7
Reported tax credit/(charge)	38.5	(76.0)
Deferred tax credit – change in tax rate	(112.5)	-
Agreement of prior years' UK tax matters	(3.4)	(0.7)
Tax in respect of adjustments to underlying profit before tax	(10.9)	(22.2)
Underlying profit after tax	352.7	374.8

(1) Relates to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

Strategic report

Principal risks and uncertainties

We identify and manage risks using our risk management framework
As a business our strategy is to deliver value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner. In doing so the group is exposed to a range of internal and external risks of varying types which can impact upon these objectives. We therefore maintain a risk management framework to continually identify, assess and manage risks.

All parts of the group use the same risk management framework ensuring consistency of approach and supporting risk management and monitoring. The framework includes: an embedded governance and reporting process; an assessment and management process which is aligned to ISO 31000: 2009; and a central database, tools and guidance to further support consistency, embedment and continuous improvement.

For more information in relation to our risk management framework, please see pages 46 to 47 of the 2016 UUG annual report and financial statements.

Key features and developments
Regulatory, operational, compliance and delivery risks remain key features of the group's risk profile. The introduction of outcome delivery incentives by Ofwat after PR14 creates a regime of potential penalties and rewards based on meeting targets for the delivery of operational and capital programmes. In the context of customer service and operational performance, the Lancashire water quality incident in the summer of 2015 reinforced the requirement to consistently deliver clean, safe drinking water and to further mitigate risks to a continuous service through implementing greater resilience in the asset base.

Market Reform and the introduction of non-household retail competition in April 2017 requires significant preparation so that the group's retail and wholesale functions are in a position to compete successfully while continuing to operate compliantly and in accordance with the 'level playing field'.

Looking further ahead, the expected introduction of competition in sludge and water resource activities and the further promotion of the existing inset regime and the UK Government's consideration (announced November 2015) of legislation to enable household retail activities to become competitive at some future date, all place risk on the group.

Climate change is also recognised as one of the sector's biggest challenges with significant and permanent implications on the water cycle and the long-term sustainability of the water and wastewater service including: water abstraction; supply and treatment capability; drainage and sewer capacity; and wastewater treatment and discharge efficiency and effectiveness.

Principal risks
The principal risks (aggregated clusters of event-based risks), which have been set out in the section below, reflect the categories of risks that define business activity or contributing factors where value can be lost or gained and could have a material impact on the business model, future performance, solvency or liquidity of the group. In each case the magnitude of the potential effect is highlighted together with the extent of management/mitigation. To ensure relevance with the current environment, issues or areas of uncertainty are also illustrated.

There continue to be two ongoing pieces of material litigation worthy of note, as outlined below. However, based on the facts currently known to us and the provisions in our statement of financial position, our directors remain of the opinion that the likelihood of these having a material adverse impact on the group's financial position is remote.

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

Strategic report

- In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water Limited (UUW) in respect of UUW's discharges of water and treated effluent into the canal. Whilst the matter has not reached a final conclusion, the Supreme Court has found substantively in UUW's favour on a significant element of the claim and the High Court has upheld UU's position on the remainder of the proceedings. We await to see whether MSCC pursue a further claim to introduce additional matters for determination.

Principal risks and uncertainties

1. The regulatory environment and framework
The potential change in the regulatory environment and/or frameworks.

Current key risks, issues or areas of uncertainty include:
- Market reform including non-household and upstream competition and, further ahead, the potential for the introduction of household competition
- A possible change from using the retail prices index to the consumer prices index for regulatory indexation

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

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

2. Corporate governance and legal compliance
The failure to meet all legal and regulatory obligations and responsibilities

Current key risks, issues or areas of uncertainty include:
- Competition law and regulatory compliance whilst preparing for and operating within a changing competitive market
- Current material litigation
- New higher fine levels for environmental offences

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

Control mitigation
Legislative and regulatory developments are continually monitored. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Funding for any 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.

Strategic report

3. Water and wastewater service
The inability to provide a secure and resilient supply of clean, safe drinking water and the inability to remove, treat and return wastewater to the environment in an effective, resilient and compliant manner.

Current key risks, issues or areas of uncertainty include:

- Population growth and climate change
- Meeting infrastructure investment requirements
- Expected change to the abstraction licensing regime
- Catchment management
- Raw water quality
- Drinking water safety and security

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

Control mitigation
Mitigation is provided through core business processes, including forecasting, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Ongoing system and network integration improves service provision and measures of success have been developed to monitor performance. Following the Lancashire water quality incident in 2015 we are further enhancing our approach to operational risk and resilience.

4. Security, assets and operational resilience
The inability to protect people, information and assets from malicious or accidental activity.

Current key risks, issues or areas of uncertainty include:

- Cybercrime, terrorism and other criminality relating to assets or operations

Potential impacts
Our resources, assets and infrastructure are exposed to various threats (malicious or accidental) which could impact the provision of vital services and/or harm people or commercial business.

Control mitigation
Physical and technological security measures combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Recent initiatives include awareness training across the business relating to seven key areas of security and the implementation of a security governance model to oversee all aspects of security and security strategy. 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.

5. Human, technological and physical resource
The inability to support/deliver effective and efficient business activity.

Current key risks, issues or areas of uncertainty include:

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

Strategic report

Potential impacts

The capacity or capability associated with human, technological and physical resource (including information, operational technology, skill sets, systems and telephony) can impact the efficiency and effectiveness of business activity, the ability to make appropriate decisions and ultimately meet targets. This can also affect the ability to recruit and retain knowledge/expertise or to recover effectively following an incident. In remote but extreme circumstances there is also the potential for higher levels of regulatory scrutiny, financial penalties, reputational damage and missed commercial opportunities.

Control mitigation

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

6. Financial risk

The inability to appropriately finance the business due to capital, credit, market, funding, liquidity or tax-related risk.

Current key risks, issues or areas of uncertainty include:

- Stability of financial institutions and the world economy
- Economic uncertainty
- Inflation/deflation
- Financial market conditions, interest rates and funding costs
- Brexit

Potential impacts

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

Control mitigation

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

Strategic report

7. Programme delivery
The ineffective or inefficient delivery of capital, operational and change programmes.

Current key risks, issues or areas of uncertainty include:
- Security of supply
- Delivery of solutions
- Quality and innovation
- New contract delivery partnerships for the 2015-20 period with a new approach to construction and design
- Price volatility

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

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

8. Revenues
The inability to maintain revenues and margin due to customer service provision.

Current key risks, issues or areas of uncertainty include:
- Socio-economic deprivation in the North West
- Welfare reform and the impact on domestic bad debt
- Competition in the water and wastewater market and competitor positioning
- Brexit
- Market Reform and the ability to treat other participants equally

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

Control mitigation
For Domestic Retail there is a transformation plan in place covering a wide range of initiatives and activities to improve customer service, with a number of controls in place to monitor achievement against the plan. Similarly, within Business Retail we look to retain existing and acquire new commercial customers by striving to meet their needs more effectively. We monitor competitor activity and target a reduction in operating costs. Within our wholesale department processes, systems, data and organisational

Strategic report

capacity and capability to deal with market participants and the central market operator are being prepared. The new market requirements will require all market participants to treat other participants equally ('on a level playing field') whilst maintaining compliance with existing regulations.

9. Health, safety and environmental
The potential harm to employees, contractors, the public or the environment.

Current key risks, issues or areas of uncertainty include:

- Excavation, tunnelling and construction work
- Working with water and wastewater
- Chemicals
- All weather conditions
- Driving, vehicle movement

Potential impacts
Working with and around water, sewage, construction and excavation sites, plant and equipment exposes people and the environment to various man-made and naturally occurring hazards. The nature and extent of exposure could result in harm to people, wildlife and natural habitats. Depending on the circumstances, the group could be fined for breaches of statutory obligations, be held liable to third parties and sustain reputational damage.

Control mitigation
We have developed a strong health, safety and environmental culture where 'nothing we do at United Utilities is worth getting hurt for'. This is supported by strong governance and management systems which include policies and procedures which are certified to OHSAS 18001 and ISO 14001.

The Strategic report was approved by the board on 10 June 2016 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 2016.

Profit and dividends
The results for the year, set out in the consolidated income statement on page 28 show that profit for the year after tax was £419.9 million (2015: £291.9 million).

The directors have not recommended a final ordinary dividend (2015: £nil). Interim ordinary dividends of £258.7 million (2015: £249.5 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 £5,360 (2015: £21,600) as part of this process. At the 2015 AGM, an authority was taken to cover such expenditure. A similar resolution will be put to our shareholders at the 2016 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.

The group is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The group also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the group was £2.3 million in the year ended 31 March 2016 (2015: £2.1 million).

Carbon footprint
The group is committed to reducing its carbon footprint and increasing its generation of renewable energy. In 2015/16, the group's carbon footprint totalled 454,857 tonnes of carbon dioxide equivalent, which is a 22 per cent reduction over the last 10 years. For further information please visit *corporate.unitedutilities.com/cr-environment*

Events after the reporting period
On 3 May 2016, the Competition and Markets Authority approved the joint venture arrangement with Severn Trent PLC detailed in note 14. The transaction was completed on 1 June 2016.

There were no further events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2016.

Directors' report

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 34.

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 employee consultation and on equal opportunities for its disabled employees can be found on pages 3 to 4. The company's business principles make clear how it and all 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, then taking action to improve how they feel about the company and understand its direction. Employees are provided with regular information to enable them to understand the financial and economic factors affecting the company's performance. The board encourages employees to own shares in the company through the all employee share incentive plan (ShareBuy). For further information on our average number of employees during the year, see note 2 on page 38.

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 2016, 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 21 to the financial statements on page 53.

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, and identifying any associated risks as a result of these changes which might prevent us from achieving our objectives and identify actions to mitigate those risks as far as is reasonably practicable and cost-effective to do so. These internal control and risk management systems, which are designed to manage rather than eliminate the risk of failure to achieve business

Directors’ report

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 17 to 22. We continue to work with all key parties to represent the best interests of our stakeholders, and where we can identify actions to mitigate the adverse consequences of these potential regulatory changes we are working hard to address these changes to our business in a proactive manner.

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 75 of the 2016 UUG 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
10 June 2016

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

The directors are responsible for preparing the annual 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 the parent company financial statements in accordance with IFRSs as adopted by the EU and applicable law.

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

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

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

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

We consider the report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

Independent auditor's report

to the members of United Utilities PLC

We have audited the financial statements of United Utilities PLC for the year ended 31 March 2016 set out on pages 28 to 85. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditor
As explained more fully in the Directors' Responsibilities Statement set out on page 26, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Opinion on financial statements
In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

John Luke (Senior Statutory Auditor) for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
St Peter's Square, Manchester, M2 3AE.
10 June 2016

Consolidated income statement

for the year ended 31 March

	Note	2016 £m	2015 £m
Revenue	1	1,730.0	1,720.2
Employee benefits expense	2	(146.9)	(145.1)
Other operating costs	3	(485.8)	(424.3)
Other income	3	3.6	3.3
Depreciation and amortisation expense	3	(363.7)	(352.6)
Infrastructure renewals expenditure		(169.3)	(148.2)
Total operating expenses		(1,162.1)	(1,066.9)
Operating profit		567.9	653.3
Investment income	4	32.9	27.3
Finance expense	5	(224.4)	(317.8)
Investment income and finance expense		(191.5)	(290.5)
Share of profits of joint ventures		5.0	5.1
Profit before tax		381.4	367.9
Current tax charge	6	(49.8)	(52.7)
Deferred tax charge	6	(24.2)	(23.3)
Deferred tax credit – change in tax rate	6	112.5	-
Tax	6	38.5	(76.0)
Profit after tax		419.9	291.9

Consolidated statement of comprehensive income

for the year ended 31 March

	Note	2016 £m	2015 £m
Profit after tax		419.9	291.9
Other comprehensive income			
Remeasurement gains on defined benefit pension schemes	17	160.1	250.5
Tax on items taken directly to equity	6	(26.5)	(50.1)
Foreign exchange adjustments		3.0	(3.1)
Total comprehensive income		556.5	489.2

With the exception of foreign exchange adjustments, none of the items in the table above will be prospectively reclassified to profit or loss.

Consolidated and company statements of financial position

at 31 March

			Group		**Company**
		2016	2015	2016	2015
	Note	£m	£m	£m	£m
ASSETS					
Non-current assets					
Property, plant and equipment	8	10,031.4	9,716.3	-	-
Intangible assets	9	162.4	144.9	-	-
Interests in joint ventures	10	35.1	31.7	-	-
Investments	11	8.7	8.6	4,209.6	4,940.1
Trade and other receivables	13	1,639.4	2.5	1,636.9	-
Retirement benefit surplus	17	275.2	79.2	48.3	4.4
Derivative financial instruments	A4	765.5	681.6	141.4	136.8
		12,917.7	10,664.8	6,036.2	5,081.3
Current assets					
Inventories	12	29.3	40.5	-	-
Trade and other receivables	13	376.9	1,971.8	1,560.0	3,177.0
Cash and short-term deposits	15	213.6	244.0	7.3	61.6
Derivative financial instruments	A4	0.1	1.0	-	1.7
Assets classified as held for sale	14	15.6	0.0	-	-
		635.5	2,257.3	1,567.3	3,240.3
Total assets		13,553.2	12,922.1	7,603.5	8,321.6
LIABILITIES					
Non-current liabilities					
Trade and other payables	20	(530.5)	(480.0)	-	-
Borrowings	16	(6,508.8)	(6,067.3)	(730.5)	(715.4)
Deferred tax liabilities	18	(1,062.0)	(1,123.8)	(8.0)	(1.2)
Derivative financial instruments	A4	(255.8)	(196.6)	-	-
		(8,357.1)	(7,867.7)	(738.5)	(716.6)
Current liabilities					
Trade and other payables	20	(346.8)	(386.6)	(161.8)	(942.7)
Borrowings	16	(524.5)	(631.9)	(815.5)	(823.7)
Current tax liabilities		(12.3)	(21.1)	-	-
Provisions	19	(15.1)	(12.5)	-	-
Derivative financial instruments	A4	(5.9)	(8.6)	(0.7)	(0.7)
		(904.6)	(1,060.7)	(978.0)	(1,767.1)
Total liabilities		(9,261.7)	(8,928.4)	(1,716.5)	(2,483.7)
Total net assets		4,291.5	3,993.7	5,887.0	5,837.9
EQUITY					
Capital and reserves attributable to equity holders of the company					
Share capital	21	881.8	881.8	881.8	881.8
Share premium account		1,430.0	1,430.0	1,430.0	1,430.0
Cumulative exchange reserve		(5.7)	(8.7)	-	-
Retained earnings		1,985.4	1,690.6	3,575.2	3,526.1
Shareholders' equity		4,291.5	3,993.7	5,887.0	5,837.9

These financial statements for the group and United Utilities PLC (company number: 2366616) were approved by the board of directors on 10 June 2016 and signed on its behalf by:

JR Houlden
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
Group					
At 1 April 2015	881.8	1,430.0	(8.7)	1,690.6	3,993.7
Profit after tax	-	-	-	419.9	419.9
Other comprehensive income					
Remeasurement gains on defined benefit pension schemes (see note 17)	-	-	-	160.1	160.1
Tax on items taken directly to equity (see note 6)	-	-	-	(26.5)	(26.5)
Foreign exchange adjustments	-	-	3.0	-	3.0
Total comprehensive income	-	-	3.0	553.5	556.5
Dividends (see note 7)	-	-	-	(258.7)	(258.7)
At 31 March 2016	881.8	1,430.0	(5.7)	1,985.4	4,291.5

	Share capital £m	Share premium account £m	Other reserve £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
Group						
At 1 April 2014	881.8	1,430.0	158.8	(5.6)	1,289.0	3,754.0
Profit after tax	-	-	-	-	291.9	291.9
Other comprehensive (expense)/income						
Remeasurement losses on defined benefit pension schemes (see note 17)	-	-	-	-	250.5	250.5
Tax on items taken directly to equity (see note 6)	-	-	-	-	(50.1)	(50.1)
Foreign exchange adjustments	-	-	-	(3.1)	-	(3.1)
Total comprehensive (expense)/income	-	-	-	(3.1)	492.3	489.2
Dividends (see note 7)	-	-	-	-	(249.5)	(249.5)
Transfer of other reserve	-	-	(158.8)	-	158.8	-
At 31 March 2015	881.8	1,430.0	-	(8.7)	1,690.6	3,993.7

On the group's transition to IFRS in the year ended 31 March 2006, the other reserve arose from the uplift to fair value of the infrastructure assets. This reserve is a component of retained earnings and, as such, has been transferred and presented within retained earnings during the year ended 31 March 2015.

Company statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2015	881.8	1,430.0	3,526.1	5,837.9
Profit after tax	-	-	278.4	278.4
Other comprehensive income				
Remeasurement gains on defined benefit pension schemes (see note 17)	-	-	35.5	35.5
Tax on items taken directly to equity (see note 6)	-	-	(6.1)	(6.1)
Total comprehensive income	-	-	307.8	307.8
Dividends (see note 7)	-	-	(258.7)	(258.7)
At 31 March 2016	881.8	1,430.0	3,575.2	5,887.0

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2014	881.8	1,430.0	2,883.2	5,195.0
Profit after tax	-	-	863.8	863.8
Other comprehensive income				
Remeasurement losses on defined benefit pension schemes (see note 17)	-	-	35.8	35.8
Tax on items taken directly to equity (see note 6)	-	-	(7.2)	(7.2)
Total comprehensive income	-	-	892.4	892.4
Dividends (see note 7)	-	-	(249.5)	(249.5)
At 31 March 2015	881.8	1,430.0	3,526.1	5,837.9

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 £278.4 million (2015: £863.8 million) after accounting for dividends received from subsidiary undertakings of £264.3 million (2015: £976.6 million), impairment of investments of £1.2 million (2015: £791.2 million) and a reversal of an investment impairment of £nil million (2015: £694.1 million) (see note 11).

Consolidated and company statements of cash flows

for the year ended 31 March

		Group		Company	
		2016	2015	2016	2015
	Note	£m	£m	£m	£m
Operating activities					
Cash generated from operations	A1	869.8	902.3	276.8	256.8
Interest paid		(168.7)	(175.6)	(22.5)	(20.3)
Interest received and similar income		29.5	26.7	0.2	0.6
Tax paid		(53.1)	(61.9)	(53.1)	(59.7)
Tax received		-	1.3	-	-
Net cash generated from operating activities		677.5	692.8	201.4	177.4
Investing activities					
Purchase of property, plant and equipment		(634.2)	(665.7)	-	-
Purchase of intangible assets		(66.1)	(63.4)	-	-
Proceeds from sale of property, plant and equipment		1.4	2.0	-	-
Grants and contributions received	20	17.3	18.1	-	-
Purchase of investments	11	-	(0.8)	-	-
Proceeds from investments	11	0.2	-	-	-
Dividends received from joint ventures		4.6	4.9	-	-
Net cash used in investing activities		(676.8)	(704.9)	-	-
Financing activities					
Proceeds from borrowings		694.6	421.3	29.2	38.9
Repayment of borrowings		(474.1)	(19.1)	(26.2)	(14.7)
Dividends paid to equity holders of the company	7	(258.7)	(249.5)	(258.7)	(249.5)
Net cash generated (used in)/from financing activities		(38.2)	152.7	(255.7)	(225.3)
Net (decrease)/increase in cash and cash equivalents		(37.5)	140.6	(54.3)	(47.9)
Cash and cash equivalents at beginning of the year		220.1	79.5	61.6	109.5
Cash and cash equivalents at end of the year	15	182.6	220.1	7.3	61.6

Accounting policies

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

Basis of preparation

The financial statements have been prepared 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 available cash and committed borrowing facilities as well as consideration of the group's capital adequacy, consideration of the primary legal duty of UUW's economic regulator to ensure that water and wastewater companies can finance their functions, and any material uncertainties. 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 2016, have had no material impact on the group's financial statements.

- Amendments to IAS 19 'Employee Benefits', in respect of employee contributions to defined benefit plans; and
- Improvements to IFRS (2012) and IFRS (2013), comprising a collection of narrow-scope amendments across a number of standards.

Critical accounting judgements and key sources of estimation uncertainty

In the process of applying its accounting policies set out in note A7, the group is required to make certain estimates, judgements and assumptions that it believes are reasonable based on the information available. These judgements, estimates and assumptions affect the amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses recognised during the reporting periods presented.

On an 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.

Property, plant and equipment

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

Accounting policies

In addition, management capitalise time and resources incurred by the group's support functions on capital programmes.

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

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

Revenue recognition and allowance for doubtful receivables

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

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

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

Provisions and contingencies

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

Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 23, unless the possibility of transferring economic benefits is remote.

Retirement benefits

The group operates two defined benefit schemes which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a

Accounting policies

firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note A5. Profit before tax and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions. 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.

Derivative financial instruments

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

Tax

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.

New and revised standards not yet effective

At the date of authorisation of these financial statements, the following relevant standards were in issue but not yet effective. The directors anticipate that these standards may have a material impact on the group's financial statements and that the group will adopt these standards on their effective dates.

IFRS 9 'Financial Instruments'

The standard is effective for periods commencing on or after 1 January 2018 but has not yet been endorsed by the EU. Under the provisions of this standard, where the group has chosen to measure borrowings at fair value through profit or loss, the portion of the change in fair value due to changes in the group's own credit risk will be recognised in other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year, a £15.1 million gain would have been recognised in other comprehensive income rather than within the income statement.

The standard also broadens the scope of what can be included within a hedge relationship, which may enable the group's regulatory swaps to be designated within cash flow hedge relationships. If the standard had been adopted in the current year, with all such swaps being designated and all hedges being fully effective, £46.2 million of fair value losses would have been recognised in other comprehensive income rather than within the income statement.

IFRS 16 'Leases'

The standard is effective for periods commencing on or after 1 January 2019 but has not yet been endorsed by the EU. Under the provisions of the standard most leases, including the majority of those previously classified as operating leases, will be brought onto the statement of financial position, as both a right-of-use asset and a largely offsetting lease liability. 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 and reduced by lease payments.

The impact of IFRS 16 has yet to be quantified, but if the standard had been adopted in the current year a depreciation charge in relation to the right-of-use asset and a lease interest charge would be recognised in the income statement in place of the operating lease charge of £5.0 million.

All other standards, interpretations and amendments, which are in issue but not yet effective, are not expected to have a material impact on the group's financial statements.

Notes to financial statements

1. Revenue and segment reporting

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.

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

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. Directors and employees

Directors' remuneration

	2016 £m	2015 £m
Salaries	1.7	1.6
Benefits	0.4	0.5
Bonus	0.6	0.7
Share-based payment charge	1.1	1.6
	3.8	4.4

Included within the above are aggregate emoluments of £1.8 million (2015: £2.2 million) in respect of the highest paid director. The highest paid director exercised share options during the current year.

No directors accrued benefits under defined benefit schemes during the current year (2015: no directors). All directors opted for a cash allowance in lieu of their company pension scheme entitlement (2015: all directors).

Four directors (2015: four directors) received shares in United Utilities Group PLC in respect of qualifying services, and three directors (2015: four directors) exercised nil-cost share options in United Utilities Group PLC during the year. Four directors (2015: four directors) had long-term incentive plans which vested during the year. Aggregate amounts receivable relating to long-term incentive plans of £2.4 million (2015: £2.5 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 annual report and financial statements.

Remuneration of key management personnel

	2016 £m	2015 £m
Salaries and short-term employee benefits	5.2	6.2
Post-employment benefits	0.1	0.2
Share-based payment charge	1.8	2.4
	7.1	8.8

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

Notes to financial statements

2. Directors and employees (continued)

Employee benefits expense (including directors)

Group	2016 £m	2015 £m
Wages and salaries	212.7	206.5
Social security	19.1	18.1
Severance	(0.2)	6.6
Post-employment benefits:		
Defined benefit pension expense (see note 17)	26.1	26.2
Defined contribution pension costs (see note 17)	9.9	8.8
	36.0	35.0
Charged to regulatory capital schemes	(120.7)	(121.1)
Employee benefits expense	146.9	145.1

Within employee benefits expense were £0.9 million (2015: £11.0 million) of restructuring cost.

Options over shares of the ultimate parent undertaking, United Utilities Group PLC have been granted to employees of the group under various schemes. Details of the terms and conditions of each share option scheme are given in the 2016 UUG annual report and financial statements. Included within wages and salaries is an expense of £2.3 million (2015: £2.9 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)

	2016 number	2015 number
Group		
Average number of employees during the year	5,265	5,278

Company

The average number of employees during the year was 211 (2015: 221). These employees were engaged in the provision of services to United Utilities Water Limited, and as such, employee costs of £15.4 million (2015: £15.7 million) in relation to these employees have been incurred directly by that company during the year.

Notes to financial statements

3. Operating profit

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

	2016 £m	Re-presented* 2015 £m
Other operating costs		
Hired and contracted services	107.5	93.4
Property rates	86.3	80.5
Materials	67.2	58.5
Power	65.3	69.1
Charge for bad and doubtful receivables (see note 13)	39.2	52.9
Regulatory fees	27.9	29.2
Third party wholesale charges	15.1	10.8
Impairment of property, plant and equipment (see note 8)	11.4	-
Cost of properties disposed	10.5	0.6
Legal and professional expenses	5.8	4.8
Loss on disposal of property, plant and equipment	5.4	5.1
Operating leases payable:		
Property	4.2	3.7
Plant and equipment	0.8	0.7
Impairment of assets classified as held for sale (see note 14)	2.7	-
Loss on disposal of intangible assets	-	0.5
Amortisation of deferred grants and contributions (see note 20)	(6.9)	(7.7)
Compensation from insurers	(20.1)	-
Other expenses	63.5	22.2
	485.8	424.3
Other income		
Other income	(3.6)	(3.3)
	(3.6)	(3.3)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (see note 8)	332.5	323.6
Amortisation of intangible assets (see note 9)	31.2	29.0
	363.7	352.6

* The comparatives have been re-presented to allocate £7.0 million accommodation, £3.4 million movements in other provisions, and £2.1 million research and development, to categories which better reflect the underlying nature of these costs. In addition, a separate category for third party wholesale charges has been presented, which were previously within other expenses.

During the year, there were £19.5 million (2015: £nil) of expenses incurred as a result of two significant flooding incidents caused by storms Desmond and Eva comprising an £11.4 million impairment of property, plant and equipment, £7.0 million of operating costs and £1.1 million of infrastructure renewals expenditure. Insurance compensation of £20.1 million relating to the flooding incidents has been recognised to the extent that the group considers the recovery to be 'virtually certain' at 31 March 2016. The group expects there to be further substantial recovery of the flooding incident costs under its insurance cover in the year ending 31 March 2017, though at this stage it is not practicable to estimate the value of this.

Notes to financial statements

3. Operating profit (continued)

In addition, there were £24.8 million (2015: £nil) of costs, largely comprising customer compensation payments included within other expenses, incurred in relation to a large water quality incident and £11.1 million (2015: £1.1 million) in relation to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

Research and development expenditure for the year ended 31 March 2016 was £2.3 million (2015: £2.1 million).

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

	2016 £'000	2015 £'000
Audit services:		
Statutory audit - group and company	62	37
Statutory audit - subsidiaries	216	268
Regulatory reporting	45	30
	323	335
Audit related services	50	30
Other non-audit services	238	250
	611	615

Included in the above statutory audit fee is £23,000 in relation to the company for the year ended 31 March 2016 (2015: £23,000).

4. Investment income

	2016 £m	2015 £m
Interest receivable on short-term bank deposits held at amortised cost	1.9	1.0
Net pension interest income (see note 17)	3.1	-
Interest receivable from ultimate parent undertaking (see note A6)	27.9	26.3
	32.9	27.3

Notes to financial statements

5. Finance expense

	2016 £m	2015 £m
Interest payable		
Interest payable on borrowings held at amortised cost(1)	198.1	206.1
	198.1	206.1
Fair value losses/(gains) on debt and derivative instruments(2)		
Fair value hedge relationships:		
Borrowings	60.8	112.8
Designated swaps	(62.2)	(122.7)
	(1.4)	(9.9)
Financial instruments at fair value through profit or loss		
Borrowings designated at fair value through profit or loss(3)	4.3	65.0
Associated Swaps(4)	(23.5)	(73.5)
	(19.2)	(8.5)
Fixed interest rate swaps(4)	46.2	133.5
Electricity swaps(4)	14.2	(6.0)
Net receipts on swaps and debt under fair value option	(16.1)	(2.5)
Other swaps(4)(5)	(3.0)	1.1
Other	5.6	(3.0)
	46.9	123.1
Net fair value losses on debt and derivative instruments(6)	26.3	104.7
Net pension interest expense (see note 17)	-	7.0
	224.4	317.8

Notes:

(1) Includes a £37.9 million (2015: £46.6 million) non-cash inflation uplift expense in relation to the group’s index-linked debt.

(2) Includes foreign exchange losses of £62.1 million (2015: £10.5 million gains), excluding those on instruments measured at fair value through profit or loss. These losses/gains are largely offset by fair value gains/losses on derivatives.

(3) Includes a £15.1 million gain (2015: £4.6 million loss) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.

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

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

(6) Includes £16.5 million income (2015: £4.0 million) due to net interest on swaps and debt under fair value option.

Interest payable is stated net of £21.3 million (2015: £20.9 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 2.7 per cent (2015: 3.1 per cent) to expenditure on such assets as prescribed by IAS 23 ‘Borrowing Costs’.

Notes to financial statements

6. Tax

	2016 £m	2015 £m
Current tax		
UK corporation tax	58.8	62.4
Adjustments in respect of prior years	(9.0)	(9.7)
Total current tax charge for the year	49.8	52.7
Deferred tax		
Current year	18.6	14.3
Adjustments in respect of prior years	5.6	9.0
	24.2	23.3
Change in tax rate	(112.5)	-
Total deferred tax (credit)/charge for the year	(88.3)	23.3
Total tax (credit)/charge for the year	(38.5)	76.0

The deferred tax credit of £112.5 million (2015: £nil) reflects the enacted reduction in the headline rate of corporation tax to 18 per cent from 1 April 2020. An additional reduction to 17 per cent effective from 1 April 2020 was announced in the Chancellor's Budget on 16 March 2016. Subject to enactment, this will result in a future deferred tax credit currently estimated at around £56.0 million.

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

	2016 £m	2016 %	2015 £m	2015 %
Profit before tax	381.4		367.9	
Tax at the UK corporation tax rate	76.2	20.0	77.3	21.0
Adjustments in respect of prior years	(3.4)	(0.9)	(0.7)	(0.2)
Change in tax rate	(112.5)	(29.5)	-	-
Net income/(expenses) not taxable/other	1.2	0.3	(0.6)	(0.2)
Total tax (credit)/charge and effective tax rate for the year	(38.5)	(10.1)	76.0	20.6

Tax on items taken directly to equity

Group	2016 £m	2015 £m
Deferred tax (see note 18)		
On remeasurement gains on defined benefit pension schemes	32.0	50.1
Change in tax rate	(5.5)	-
Total tax charge on items taken directly to equity	26.5	50.1

The deferred tax credit of £5.5 million (2015: £nil) reflects the enacted reduction in the headline rate of corporation tax to 18 per cent from 1 April 2020.

Notes to financial statements

6. Tax (continued)

	2016 £m	2015 £m
Company		
Deferred tax (see note 18)		
On remeasurement gains on defined benefit pension schemes	7.1	7.2
Change in tax rate	(1.0)	-
Total tax charge on items taken directly to equity	6.1	7.2

7. Dividends

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

	2016 £m	2015 £m
Ordinary shares		
Final interim dividend for the year ended 31 March 2015 at 19.44 pence per share (2014: 18.59 pence per share)	171.4	163.9
Interim dividend for the year ended 31 March 2016 at 9.90 pence per share (2015: 9.71 pence per share)	87.3	85.6
	258.7	249.5

Notes to financial statements

8. Property, plant and equipment

	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
Group						
Cost						
At 1 April 2014	272.1	4,555.7	5,927.2	482.6	926.4	12,164.0
Additions	8.4	112.8	91.0	19.9	496.4	728.5
Transfers	27.2	219.9	273.0	18.3	(538.4)	-
Disposals	(4.1)	(0.4)	(27.2)	(33.6)	-	(65.3)
At 31 March 2015	303.6	4,888.0	6,264.0	487.2	884.4	12,827.2
Additions	4.5	98.0	106.3	7.4	449.6	665.8
Transfers	19.1	134.8	156.5	11.1	(321.5)	-
Disposals	(0.3)	(0.1)	(47.2)	(7.6)	-	(55.2)
At 31 March 2016	326.9	5,120.7	6,479.6	498.1	1,012.5	13,437.8
Accumulated depreciation						
At 1 April 2014	83.4	239.8	2,230.8	291.5	-	2,845.5
Charge for the year	15.9	35.4	233.2	39.1	-	323.6
Disposals	(3.8)	-	(22.6)	(31.8)	-	(58.2)
At 31 March 2015	95.5	275.2	2,441.4	298.8	-	3,110.9
Charge for the year	9.0	34.6	249.6	39.3	-	332.5
Impairment	-	-	11.4	-	-	11.4
Disposals	(0.3)	(0.1)	(42.2)	(5.8)	-	(48.4)
At 31 March 2016	104.2	309.7	2,660.2	332.3	-	3,406.4
Net book value at 31 March 2015	208.1	4,612.8	3,822.6	188.4	884.4	9,716.3
Net book value at 31 March 2016	222.7	4,811.0	3,819.4	165.8	1,012.5	10,031.4

At 31 March 2016, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £439.0 million (2015: £394.5 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 2016 or 31 March 2015.

Notes to financial statements

9. Intangible assets

	Total £m
Group	
Cost	
At 1 April 2014	229.8
Additions	64.2
Disposals	(29.5)
At 31 March 2015	264.5
Additions	67.0
Disposals	-
Transfer to assets classified as held for sale (see note 14)	(20.6)
At 31 March 2016	310.9
Accumulated amortisation	
At 1 April 2014	119.6
Charge for the year	29.0
Disposals	(29.0)
At 31 March 2015	119.6
Charge for the year	31.2
Transfer to assets classified as held for sale (see note 14)	(2.3)
At 31 March 2016	148.5
Net book value at 31 March 2015	144.9
Net book value at 31 March 2016	162.4

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

At 31 March 2016, the group had entered into contractual commitments for the acquisition of intangible assets amounting to £8.3 million (2015: £2.3 million).

Company
The company had no intangible assets or contractual commitments for the acquisition of intangible assets at 31 March 2016 or 31 March 2015.

10. Joint ventures

At 31 March 2016, the group's interests in joint ventures mainly comprised its interest in AS Tallinna Vesi (Tallinn Water). Joint management of Tallinn Water is based on a shareholders' agreement.

The joint ventures have no significant contingent liabilities to which the group is exposed. The group has issued guarantees of £4.7 million in support of its joint ventures (2015: £4.7 million) which are included in the contingent liabilities total disclosed in note 23.

Notes to financial statements

11. Investments

	£m
Group	
At 1 April 2014	6.9
Additions	0.8
Currency translation differences	0.9
At 31 March 2015	8.6
Disposals	(0.2)
Currency translation differences	0.3
At 31 March 2016	8.7

During the year, the group reduced its investment in Muharraq Holding Company 1 Limited through a £0.2 million repayment of a shareholder loan.

During the year ended 31 March 2015, the group increased its investment in Muharraq Holding Company 1 Limited by £0.8 million.

At 31 March 2016, the group's investments mainly comprised its investment in Muharraq Holding Company 1 Limited. These investments are held at fair value.

	Shares in subsidiary undertakings £m
Company	
At 1 April 2014	4,731.4
Additions	305.8
Impairment charge	(791.2)
Reversal of impairment	694.1
At 31 March 2015	4,940.1
Disposals	(729.3)
Impairment	(1.2)
Net book value at 31 March 2016	4,209.6

During the year ended 31 March 2016, the Company disposed of a £562.2 million investment in the ordinary shares of United Utilities (Investments) BV, which resulted in a realisation of value of £562.2 million through a repayment of capital. This company was subsequently liquidated.

The Company also disposed of £167.1 million of its investment in the ordinary shares of United Utilities BV, which resulted in a realisation of value of £167.1 million through a repayment of capital.

In addition to this an impairment of £1.2 million was made to the investment in United Utilities International Limited due to a decrease in the underlying net assets of this company.

Additions of £305.8 million during the prior year comprised a £71.3 million investment in the ordinary shares of United Utilities (Tallinn) BV and a £234.5 million investment in the ordinary shares of Birchpoint No.1. The investment in United Utilities (Tallinn) BV resulted from the acquisition of shares from United Utilities Europe Holdings BV and United Utilities BV. The investment in Birchpoint No.1 resulted from the acquisition of shares from United Utilities BV.

An impairment of £556.7 million was made in the prior year to the investment in United Utilities (Jersey) Limited following a £556.7 million realisation of value through receipt of dividends. In addition, the investment in Birchpoint No.1 was impaired by £234.5 million following a £234.6 million realisation of value through receipt of dividends.

In the prior year, a review was performed of the carrying value of the company’s investment in United Utilities North West Limited which resulted in the reversal of the impairment made during the year ended 31 March 2010. The review was based on a ‘fair value less costs of disposal’ valuation. The reversal of the £694.1 million impairment increased the company’s investment in United Utilities North West Limited to £3,907.1 million at 31 March 2015.

Notes to financial statements

12. Inventories

	2016 £m	2015 £m
Group		
Properties held for resale	19.7	31.2
Other inventories	9.6	9.3
	29.3	40.5

Company
The company had no inventories at 31 March 2016 or 31 March 2015.

13. Trade and other receivables

	Group		Company	
	2016 £m	2015 £m	2016 £m	2015 £m
Trade receivables	175.1	176.6	0.1	-
Amounts owed by subsidiary undertakings	-	-	1,550.4	1,558.4
Amounts owed by ultimate parent undertaking (see note A6)	1,646.4	1,618.5	1,646.4	1,618.5
Amounts owed by related parties (see note A6)	2.9	2.8	-	-
Other debtors	54.4	22.6	-	0.1
Prepayments and accrued income	137.5	153.8	-	-
	2,016.3	1,974.3	3,196.9	3,177.0

At 31 March 2016 the group had £1,639.4 million (2015: £2.5 million) and the company had £1,636.9 million (2015:£nil) of trade and other receivables classified as non-current, which included £1,636.9 million (2015:£nil) relating to amounts owed by the ultimate parent undertaking.

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

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

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

	2016 £m	2015 £m
Group		
At the start of the year	100.5	97.9
Amounts charged to operating expenses (see note 3)	39.2	52.9
Trade receivables written off	(45.3)	(50.3)
At the end of the year	94.4	100.5

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

At 31 March 2016 and 31 March 2015, the group had no trade receivables that were past due and not individually impaired.

Notes to financial statements

13. 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:

	2016 £m	2015 £m
Company		
At the start of the year	91.7	90.5
Amounts (credited)/charged to operating expenses	(2.0)	1.2
At the end of the year	89.7	91.7

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 2016	127.0	37.5	5.1	169.6
At 31 March 2015	125.8	43.6	3.2	172.6

At 31 March 2016, the group had £5.5 million (2015: £4.0 million) of trade receivables that were not past due.

Company

At 31 March 2016 and 31 March 2015, the company had no trade receivables that were past due.

The directors consider that the carrying amount of trade and other receivables approximates to their fair value at 31 March 2016 and 31 March 2015.

14. Assets classified as held for sale

During the year, the group entered into an agreement which will involve the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, into a new joint venture with Severn Trent PLC. As at 31 March 2016, completion of the disposal was expected within 12 months, subject to clearance from the Competition and Markets Authority, and so £18.3 million of intangible assets have been classified as held for sale. These assets have subsequently been impaired by £2.7 million during the year to give a carrying value of £15.6 million, which ensures that the assets are valued at fair value less cost to sell in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'. See note 24 for events occurring after 31 March 2016.

Notes to financial statements

15. Cash and cash equivalents

	Group 2016 £m	Group 2015 £m	Company 2016 £m	Company 2015 £m
Cash at bank and in hand	4.8	4.5	0.3	0.1
Short-term bank deposits	208.8	239.5	7.0	61.5
Cash and short-term deposits	213.6	244.0	7.3	61.6
Book overdrafts (included in borrowings, see note 16)	(31.0)	(23.9)	-	-
Cash and cash equivalents in the statement of cash flows	182.6	220.1	7.3	61.6

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 that had not cleared as at the balance sheet date.

16. Borrowings

Group	2016 £m	2015 £m
Non-current liabilities		
Bonds	4,439.2	4,239.6
Book and other term borrowings	2,069.6	1,827.7
	6,508.8	6,067.3
Current liabilities		
Bonds	-	425.9
Bank and other term borrowings	437.7	127.9
Book overdrafts (see note 15)	31.0	23.9
Amounts owed to ultimate parent undertaking	55.8	54.2
	524.5	631.9
	7,033.3	6,699.2

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

Company	2016 £m	2015 £m
Non-current liabilities		
Bonds	730.5	715.4
Current liabilities		
Bank and other term borrowings	73.6	70.7
Amounts owed to subsidiary undertakings	686.1	698.8
Amounts owed to ultimate parent undertaking	55.8	54.2
	815.5	823.7
	1,546.0	1,539.1

Notes to financial statements

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	
	2016	2015	2016	2015
	£m	£m	£m	£m
Current service cost	22.3	18.1	1.6	1.4
Curtailments/settlements	1.1	5.5	0.2	0.7
Administrative expenses	2.7	2.6	1.0	1.0
Pension expense charged to operating profit	26.1	26.2	2.8	3.1
Net pension interest (income)/expense (credited)/charged to investment income and finance expense (see notes 4 and 5)	(3.1)	7.0	(0.4)	1.3
Net pension expense charged before tax	23.0	33.2	2.4	4.4

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £25.0 million (2015: £20.7 million) for the group and £2.6 million (2015: £2.4 million) for the company, comprising current service costs and administrative expenses.

Total post-employment benefits expense excluding curtailments/settlements charged to operating profit of £34.9 million (2015: £29.5 million) for the group and £2.6 million (2015: £2.4 million) for the company comprise the defined benefit costs described above of £25.0 million (2015: £20.7 million) for the group and £2.6 million (2015: £2.4 million) for the company and defined contribution pension costs of £9.9 million (2015: £8.8 million) for the group (see note 2). The company did not incur any defined contribution pension costs during the year (2015: £nil).

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

	Group		Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
At the start of the year	79.2	(177.4)	4.4	(31.8)
Expense recognised in the income statement	(23.0)	(33.2)	(2.4)	(4.4)
Contributions paid	58.9	39.3	10.8	4.8
Remeasurement gains gross of tax	160.1	250.5	35.5	35.8
At the end of the year	275.2	79.2	48.3	4.4

Included in the group contributions paid of £58.9 million (2015: £39.3 million) and company contributions paid of £10.8 million (2015: £4.8 million) were deficit repair contributions for the group of £33.3 million (2015: £9.7 million) and for the company of £8.5 million (2015: £1.7 million). No inflation funding mechanism payments were made during the year by either the group or the company (2015: £5.5 million paid by the group; £1.0 million paid by the company).

Notes to financial statements

17. Retirement benefit surplus (continued)

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

	Group		Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
The return on plan assets, excluding amounts included in interest	56.0	705.2	7.7	155.2
Actuarial gains/(losses) arising from changes in financial assumptions	98.1	(500.8)	26.7	(128.4)
Actuarial (losses)/gains arising from changes in demographic assumptions	(46.6)	10.2	(11.8)	2.2
Actuarial gains arising from experience	52.6	35.9	12.9	6.8
Remeasurement gains on defined benefit pension schemes	160.1	250.5	35.5	35.8

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

Defined contribution schemes

During the year, the group made £9.9 million (2015: £8.8 million) of contributions and the company made £nil (2015: £nil) of contributions to defined contribution schemes which are included in employee benefit expense (see note 2).

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:

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
Group				
At 1 April 2014	1,084.0	(35.5)	1.9	1,050.4
Charged/(credited) to the income statement	41.0	2.0	(19.7)	23.3
Charged to equity (see note 6)	-	50.1	-	50.1
At 31 March 2015	1,125.0	16.6	(17.8)	1,123.8
(Credited)/charged to the income statement	(88.2)	6.5	(6.6)	(88.3)
Charged to equity (see note 6)	-	26.5	-	26.5
At 31 March 2016	1,036.8	49.6	(24.4)	1,062.0
Company				
At 1 April 2014	(0.1)	(6.4)	0.8	(5.7)
Credited to the income statement	-	-	(0.3)	(0.3)
Charged to equity (see note 6)	-	7.2	-	7.2
At 31 March 2015	(0.1)	0.8	0.5	1.2
Charged/(credited) to the income statement	-	1.8	(1.1)	0.7
Charged to equity (see note 6)	-	6.1	-	6.1
At 31 March 2016	(0.1)	8.7	(0.6)	8.0

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

Notes to financial statements

19. Provisions

	Severance	Other	Group Total	Severance	Other	Company Total
	£m	£m	£m	£m	£m	£m
At 1 April 2014	2.4	13.9	16.3	0.1	-	0.1
Charged/(credited) to income statement	6.6	(3.4)	3.2	(0.1)	-	(0.1)
Utilised in the year	(4.2)	(2.8)	(7.0)	-	-	-
At 31 March 2015	4.8	7.7	12.5	-	-	-
(Credited)/charged to income statement	(0.2)	11.5	11.3	-	-	-
Utilised in the year	(3.7)	(5.0)	(8.7)	-	-	-
At 31 March 2016	0.9	14.2	15.1	-	-	-

The group and company had no provisions classed as non-current at 31 March 2016 or 31 March 2015.

The severance provision as at 31 March 2016 and 31 March 2015 relates to severance costs as a result of group reorganisation.

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

20. Trade and other payables

	Group 2016	Group 2015
	£m	£m
Non-current		
Deferred grants and contributions	517.4	476.7
Other creditors	13.1	3.3
	530.5	480.0

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

	Group 2016	Group 2015	Company 2016	Company 2015
	£m	£m	£m	£m
Current				
Trade payables	44.1	40.1	-	-
Amounts owed to ultimate parent undertaking	6.7	7.0	5.5	5.6
Amounts owed to subsidiary undertakings	-	-	144.6	925.4
Other tax and social security	4.9	4.7	-	-
Deferred grants and contributions	9.0	9.1	-	-
Other creditors	1.8	2.1	1.8	2.3
Accruals and deferred income	280.3	323.6	9.9	9.4
	346.8	386.6	161.8	942.7

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

	2016 £m	2015 £m
Group		
At the start of the year	485.8	450.7
Cash received during the year	17.3	18.1
Transfers of assets from customers	32.8	27.0
Credited to income statement – revenue	(2.6)	(2.3)
Credited to the income statement – other operating expenses (see note 3)	(6.9)	(7.7)
At the end of the year	526.4	485.8

21. Share capital

	2016 number	2016 £	2015 number	2015 £
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.

22. Operating lease commitments

	Property 2016 £m	Plant and equipment 2016 £m	Property 2015 £m	Plant and equipment 2015 £m
Group				
Commitments under non-cancellable operating leases due				
Within one year	3.0	0.7	3.5	0.7
In the second to fifth years inclusive	10.4	0.5	11.6	0.5
After five years	278.6	-	280.4	-
	292.0	1.2	295.5	1.2

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.

	Property 2016 £m	Property 2015 £m
Company		
Commitments under non-cancellable operating leases due		
In the second to fifth years inclusive	0.1	0.1
After five years	0.1	0.1
	0.2	0.2

Notes to financial statements

23. Contingent liabilities

The group has entered into performance guarantees as at 31 March 2016, where a financial limit has been specified of £9.8 million (2015: £9.7 million).

The company guaranteed loans of group undertakings up to a maximum of £1,945.5 million (2015: £1,616.3 million), including £1,849.0 million (2015: £1,519.8 million) relating to United Utilities Water Limited's loans from the European Investment Bank and £96.5 million (2015: £96.5 million) relating to intra-group loans made by subsidiary undertakings.

The company has entered into performance guarantees as at 31 March 2016, where a financial limit has been specified of £5.1 million (2015: £5.0 million).

24. Events after the reporting period

On 3 May 2016, the Competition and Markets Authority approved the joint venture arrangement with Severn Trent PLC detailed in note 14. The transaction was completed on 1 June 2016.

There were no further events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2016.

25. Ultimate parent undertaking

The company's immediate and ultimate parent undertaking and controlling party is United Utilities Group PLC, a company incorporated 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 statement – appendices

A1. Cash generated from operations

	Group		Company	
	2016 £m	2015 £m	2016 £m	2015 £m
Profit before tax	381.4	367.9	281.1	908.6
Adjustment for investment income (see note 4) and finance expense (see note 5)	191.5	290.5	(6.2)	(34.8)
Adjustment for share of profits of joint ventures	(5.0)	(5.1)	-	-
Operating profit	567.9	653.3	274.9	873.8
Adjustments for:				
Depreciation of property, plant and equipment (see note 8)	332.5	323.6	-	-
Amortisation of intangible assets (see note 9)	31.2	29.0	-	-
Impairment of property, plant and equipment (see note 8)	11.4	-	-	-
Impairment of assets classified as available for sale (see note 14)	2.7	-	-	-
Loss on disposal of property, plant and equipment (see note 3)	5.4	5.1	-	-
Loss on disposal of intangible assets (see note 3)	-	0.5	-	-
Amortisation of deferred grants and contributions (see note 20)	(6.9)	(7.7)	-	-
Other non-cash movements*	(3.8)	(1.2)	1.2	(694.3)
Changes in working capital:				
Decrease/(increase) in inventories	11.2	(0.7)	-	-
(Increase)/decrease in trade and other receivables	(41.7)	(48.7)	2.6	10.8
(Decrease)/increase in trade and other payables	(9.9)	(34.0)	6.1	68.3
Increase/(decrease) in provisions (see note 19)	2.6	(3.8)	-	(0.1)
Pension contributions paid less pension expense charged to operating profit	(32.8)	(13.1)	(8.0)	(1.7)
Cash generated from operations	869.8	902.3	276.8	256.8

* Material non-cash transactions during the prior year include, for the company, the reversal of a past impairment made against the company's investment in its subsidiary, United Utilities (Jersey) Limited (see note 11).

The group has received property, plant and equipment of £32.8 million (2015: £27.0 million) in exchange for the provision of future goods and services (see notes 20 and A7).

A2. Net Debt

Group	2016 £m	2015 £m
At the start of the year	5,977.8	5,559.4
Net capital expenditure	681.6	709.0
Dividends (see note 7)	258.7	249.5
Interest	139.2	148.9
Tax	53.1	60.6
Fair value movements*	42.4	107.2
Inflation uplift on index-linked debt (see note 5)	37.9	46.6
Other	(5.1)	(1.1)
Cash generated from operations (see note A1)	(869.8)	(902.3)
At the end of the year	6,315.8	5,977.8

* Fair value movements includes net fair value losses on debt and derivative instruments of £26.3 million (2015: £104.7 million), less £16.1 million (2015: £2.5 million) of net receipts on swaps and debt under fair value option (see note 5).

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

Notes to the financial statement – 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 2016 £m	Carrying value 2016 £m	Fair value 2015 £m	Carrying value 2015 £m
Borrowings in fair value hedge relationships			**2,293.0**	**2,373.0**	**2,218.0**	**2,252.1**
5.375% 150m bond	GBP	2018	169.6	162.5	175.1	167.0
4.55% 250m bond	USD	2018	183.9	185.6	181.3	183.0
5.375% 350m bond	USD	2019	263.2	269.3	259.1	265.8
4.25% 500m bond	EUR	2020	455.9	455.1	427.5	424.1
5.75% 375m bond	GBP	2022	449.5	434.5	457.9	432.4
1.129% 52m bond	EUR	2027	38.4	41.0	-	-
5.625% 300m bond	GBP	2027	382.7	411.1	391.2	408.1
5.02% JPY 10bn dual currency loan	JPY/USD	2029	81.4	96.1	75.4	86.3
2.058% 30m bond	EUR	2030	23.7	25.1	-	-
5.00% 200m bond	GBP	2035	244.7	292.7	250.5	285.4
Borrowings designated at fair value through profit or loss			**338.0**	**338.0**	**333.7**	**333.7**
6.875% 400m bond	USD	2028	338.0	338.0	333.7	333.7
Borrowings measured at amortised cost			**4,885.4**	**4,322.3**	**4,852.3**	**4,113.4**
6.125% 425m bond	GBP	2015	-	-	447.6	425.9
Short-term bank borrowings - fixed	GBP	2016	127.5	127.5	117.5	117.5
1.97%+RPI 200m IL loan	GBP	2016	269.9	267.4	271.9	264.1
1.30%+LIBOR 5bn bond	JPY	2017	31.7	32.0	29.2	28.8
2.46%+RPI 50m IL loan	GBP	2020	65.7	59.3	67.0	58.5
2.10%+RPI 50m IL loan	GBP	2020	64.7	59.3	65.8	58.5
1.93%+RPI 50m IL loan	GBP	2020	64.5	59.4	65.5	58.6
1.90%+RPI 50m IL loan	GBP	2020	64.5	59.5	65.5	58.7
1.88%+RPI 50m IL loan	GBP	2020	64.2	59.3	65.2	58.6
1.84%+RPI 50m IL loan	GBP	2020	64.4	59.6	65.3	58.8
1.73%+RPI 50m IL loan	GBP	2020	64.2	59.6	65.1	58.8
1.61%+RPI 50m IL loan	GBP	2020	63.9	59.7	64.8	58.9
0.80%+LIBOR 100m loan	GBP	2022	98.3	100.0	-	-
0.47%+RPI 100m IL loan	GBP	2023	105.0	105.2	105.0	103.8
0.49%+RPI 100m IL loan	GBP	2025	101.1	101.2	101.6	99.9
0.013%+RPI 25m IL bond	GBP	2025	24.2	25.2	-	-
0.1275%+RPI 100m IL loan	GBP	2026	96.4	100.0	-	-
1.29%+RPI 50m (amortising) IL loan	GBP	2029	58.6	54.2	59.3	55.4
1.23%+RPI 50m (amortising) IL loan	GBP	2029	54.6	52.5	59.1	55.8
1.12%+RPI 50m (amortising) IL loan	GBP	2029	57.6	53.7	58.2	55.0
1.10%+RPI 50m (amortising) IL loan	GBP	2029	57.4	53.7	58.0	54.9
0.75%+RPI 50m (amortising) IL loan	GBP	2029	55.2	54.4	55.6	53.7
1.15%+RPI 50m (amortising) IL loan	GBP	2030	56.2	54.1	56.8	53.4
1.11%+RPI 50m (amortising) IL loan	GBP	2030	56.2	54.2	56.8	53.5
0.76%+RPI 50m (amortising) IL loan	GBP	2030	55.0	54.3	55.4	53.6
0.178%+RPI 35m IL bond	GBP	2030	33.6	35.3	-	-
0.709%+LIBOR 100m (amortising) loan	GBP	2032	95.6	100.0	97.7	100.0
0.691%+LIBOR 150m (amortising) loan	GBP	2032	142.9	150.0	146.2	150.0
3.375%+RPI 50m IL bond	GBP	2032	107.6	72.8	110.9	72.0
0.573%+LIBOR 100m (amortising) loan	GBP	2033	93.7	100.0	96.1	100.0

Notes to the financial statement – appendices

A3. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2016 £m	Carrying value 2016 £m	Fair value 2015 £m	Carrying value 2015 £m
Borrowings measured at amortised cost (continued)						
0.511%+LIBOR 150m (amortising) loan	GBP	2033	140.0	150.0	-	-
0.01%+RPI 100m (amortising) IL loan	GBP	2033	94.7	99.7	-	-
0.01%+RPI 75m (amortising) IL loan	GBP	2034	71.1	74.7	-	-
1.9799%+RPI 100m IL bond	GBP	2035	171.4	136.4	174.9	135.0
1.66%+RPI 35m IL bond	GBP	2037	51.6	43.6	52.9	43.0
2.40%+RPI 70m IL bond	GBP	2039	113.5	85.0	117.2	83.8
1.7829%+RPI 100m IL bond	GBP	2040	172.8	135.0	177.4	133.6
1.3258%+RPI 50m IL bond	GBP	2041	78.9	67.3	80.7	66.7
1.5802%+RPI 100m IL bond	GBP	2042	166.6	134.5	171.7	133.2
1.5366%+RPI 50m IL bond	GBP	2043	82.5	67.1	85.0	66.5
1.397%+RPI 50m IL bond	GBP	2046	81.8	67.3	85.0	66.6
1.7937%+RPI 50m IL bond	GBP	2049	91.1	67.0	95.0	66.3
Commission for New Towns (amortising) loan - fixed	GBP	2053	52.5	28.7	55.6	29.3
1.847%+RPI 100m IL bond	GBP	2056	180.8	131.6	186.8	129.9
1.815%+RPI 100m IL bond	GBP	2056	179.4	131.0	185.5	129.3
1.662%+RPI 100m IL bond	GBP	2056	173.1	130.8	178.8	129.1
1.591%+RPI 25m IL bond	GBP	2056	42.4	32.6	43.6	32.2
1.5865%+RPI 50m IL bond	GBP	2056	85.6	65.3	86.9	64.5
1.556%+RPI 50m IL bond	GBP	2056	84.5	65.0	86.9	64.2
1.435%+RPI 50m IL bond	GBP	2056	82.0	64.8	84.2	63.9
1.3805%+RPI 35m IL bond	GBP	2056	56.7	45.3	58.2	44.7
1.702%+RPI 50m IL bond	GBP	2057	86.1	63.5	88.7	62.6
1.585%+RPI 100m IL bond	GBP	2057	165.1	125.9	172.1	124.2
Amounts owed to ultimate parent undertaking	GBP	2016	55.8	55.8	54.2	54.2
Book overdrafts (see note 15)	GBP	2016	31.0	31.0	23.9	23.9
			7,516.4	**7,033.3**	**7,404.0**	**6,699.2**

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

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

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 statement – appendices

A3. Borrowings (continued)

Terms and debt repayment schedule

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

	Currency	Year of final repayment	Fair value 2016 £m	Carrying value 2016 £m	Fair value 2015 £m	Carrying value 2015 £m
Company						
Borrowings in fair value hedge relationships			**447.1**	**454.9**	**440.4**	**448.8**
4.55% 250m bond	USD	2018	183.9	185.6	181.3	183.0
5.375% 350m bond	USD	2019	263.2	269.3	259.1	265.8
Borrowings measured at amortised cost			**1,153.5**	**1,091.1**	**1,157.4**	**1,090.3**
Short-term bank borrowings – fixed	GBP	2016	73.6	73.6	70.7	70.7
Amounts owed to subsidiary undertakings	GBP	2016	686.1	686.1	698.8	698.8
Amounts owed to ultimate parent undertaking	GBP	2016	55.8	55.8	54.2	54.2
6.875% 400m bond	USD	2028	338.0	275.6	333.7	266.6
			1,600.6	**1,546.0**	**1,597.8**	**1,539.1**

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 statement – 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 annual treasury strategy review covers (as applicable), the group's funding, liquidity, capital management and interest rate management strategies, along with the delegation of specific funding and hedging authorities to the treasury committee.

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 2016, the group had £888.6 million (2015: £1,244.0 million) of available liquidity, which comprised £213.6 million (2015: £244.0 million) cash and short-term deposits, £600.0 million (2015: £600.0 million) of undrawn committed borrowing facilities, and £75.0 million (2015: £400.0 million) of undrawn term loan facilities. Short-term deposits mature within three months.

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

		Group		**Company**
	2016	2015	2016	2015
	£m	£m	£m	£m
Expiring within one year	150.0	50.0	35.0	25.0
Expiring after one year but in less than two years	150.0	150.0	20.0	35.0
Expiring after more than two years	300.0	400.0	60.0	70.0
Undrawn borrowing facilities	600.0	600.0	115.0	130.0

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.

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

Notes to the financial statement – appendices

A4. Financial risk management (continued)

Maturity analysis (continued)

Group	Total(1) £m	Adjust-ment(2) £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2016								
Bonds	9,620.9		146.4	178.9	707.4	535.9	103.7	7,948.6
Bank and other term borrowings	3,148.3		505.3	89.8	107.4	109.7	656.9	1,679.2
Amounts owed to ultimate parent undertaking	55.8		55.8					
Adjustment to carrying value(2)	(5,791.7)	(5,791.7)						
Borrowings	7,033.3	(5,791.7)	707.5	268.7	814.8	645.6	760.6	9,627.8
Derivatives:								
Payable	1,154.6		94.7	117.1	393.2	411.1	26.4	112.1
Receivable	(1,671.3)		(128.1)	(196.2)	(700.0)	(485.4)	(8.0)	(153.6)
Adjustment to carrying value(2)	12.8	12.8						
Derivatives – net assets	(503.9)	12.8	(33.4)	(79.1)	(306.8)	(74.3)	18.4	(41.5)

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 2015								
Bonds	10,067.1		593.3	143.4	173.3	691.1	502.8	7,963.2
Bank and other term borrowings	2,536.5		184.1	348.9	84.2	85.8	86.9	1,746.6
Amounts owed to ultimate parent undertaking	54.2		54.2					
Adjustment to carrying value(2)	(5,958.6)	(5,958.6)						
Borrowings	6,699.2	(5,958.6)	831.6	492.3	257.5	776.9	589.7	9,709.8
Derivatives:								
Payable	1,039.6		89.3	70.7	101.3	369.9	383.0	25.4
Receivable	(1,534.2)		(124.2)	(101.4)	(176.9)	(626.9)	(502.3)	(2.5)
Adjustment to carrying value(2)	17.2	17.2						
Derivatives – net assets	(477.4)	17.2	(34.9)	(30.7)	(75.6)	(257.0)	(119.3)	22.9

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 over the life of each instrument.

(2) The carrying value of debt is calculated following various methods in accordance with IAS 39 ‘Financial Instruments: Recognition and Measurement’ and therefore this adjustment reconciles the undiscounted forecast future cash flows to the carrying value of debt in the statement of financial position.

Notes to the financial statement – appendices

A4. Financial risk management (continued)

Maturity analysis (continued)

Company	Total[(1)] £m	Adjust-ment[(2)] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2016								
Bonds	965.2		40.0	39.9	449.1	18.8	18.7	398.7
Bank and other term borrowings	73.6		73.6					
Amounts owed to ultimate parent undertaking	55.8		55.8					
Amounts owed to subsidiary undertakings	686.1		686.1					
Adjustment to carrying value[(2)]	(234.7)	(234.7)						
Borrowings	1,546.0	(234.7)	855.5	39.9	449.1	18.8	18.7	398.7
Derivatives:								
Payable	364.1		39.6	3.0	321.5			
Receivable	(507.3)		(56.3)	(20.9)	(430.1)			
Adjustment to carrying value[(2)]	2.5	2.5						
Derivatives – net assets	(140.7)	2.5	(16.7)	(17.9)	(108.6)	-	-	-

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 2015								
Bonds	964.7		38.9	38.9	38.7	434.6	18.2	395.4
Bank and other term borrowings	70.8		70.8					
Amounts owed to ultimate parent undertaking	54.2		54.2					
Amounts owed to subsidiary undertakings	698.8		698.8					
Adjustment to carrying value[(2)]	(249.4)	(249.4)						
Borrowings	1,539.1	(249.4)	862.7	38.9	38.7	434.6	18.2	395.4
Derivatives:								
Payable	368.9		37.2	3.5	4.7	323.5		
Receivable	(512.0)		(55.2)	(20.3)	(20.2)	(416.3)		
Adjustment to carrying value[(2)]	5.3	5.3						
Derivatives – net assets	(137.8)	5.3	(18.0)	(16.8)	(15.5)	(92.8)	-	-

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 over the life of each instrument.
(2) The carrying value of debt is calculated following various methods in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and therefore this adjustment reconciles the undiscounted forecast future cash flows to the carrying value of debt in the statement of financial position.

Notes to the financial statement – 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 and foreign exchange instruments). The group and company do not believe they are exposed to any material concentrations of credit risk.

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the group's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. In addition, 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 13).

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

At 31 March 2016 and 31 March 2015, 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**
	2016	2015	2016	2015
	£m	£m	£m	£m
Cash and short-term deposits (see note 15)	213.6	244.0	7.3	61.6
Trade and other receivables (see note 13)	2,016.3	1,974.3	3,196.9	3,177.0
Investments (see note 11)	8.7	8.6	-	-
Derivative financial instruments	765.6	682.6	141.4	138.5
	3,004.2	2,909.5	3,345.6	3,377.1

Included within trade and other receivables for the group are amounts owed by the ultimate parent undertaking of £1,646.4 million (2015: £1,618.5 million).

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2016 the group held £127.5 million (2015: £117.5 million) and the company held £73.6 million (2015: £70.7 million) as collateral in relation to derivative financial instruments (included within borrowings 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.

Notes to the financial statement – appendices

A4. Financial risk management (continued)

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

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

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

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

The carrying value of index-linked debt held by the group was £3,447.3 million at 31 March 2016 (2015: £3,083.8 million).

Sensitivity analysis
The following table details the sensitivity of profit before tax to changes in the RPI 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.

	2016	2015
Group	£m	£m
Increase/(decrease) in profit before tax and equity		
1 per cent increase in RPI	(35.0)	(31.4)
1 per cent decrease in RPI	35.0	31.4

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

Company
The company had no material exposure to inflation risk at 31 March 2016 or 31 March 2015.

Notes to the financial statement – appendices

A4. Financial risk management (continued)

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

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

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

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

The group seeks to manage its risk by maintaining its interest rate exposure within a board approved range. Interest rate risk is reported monthly 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.

		Group		**Company**
	2016	2015	2016	2015
	£m	£m	£m	£m
Increase/(decrease) in profit before tax and equity				
1 per cent increase in interest rate	175.1	173.6	(11.3)	(10.8)
1 per cent decrease in interest rate	(182.5)	(190.4)	11.3	11.2

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

Notes to the financial statement – 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 2016							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,373.0	-	-	617.4	455.1	-	1,300.5
Effect of swaps	-	2,373.0	-	(617.4)	(455.1)	-	(1,300.5)
	2,373.0	2,373.0	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	338.0	-	-	-	-	-	338.0
Effect of swaps	-	338.0	-	-	-	-	(338.0)
	338.0	338.0	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	156.2	127.7	0.5	0.5	0.6	0.6	26.3
Floating rate instruments	663.0	663.0	-	-	-	-	-
Index-linked instruments	3,447.3	3,447.3	-	-	-	-	-
	4,266.5	4,238.0	0.5	0.5	0.6	0.6	26.3
Effect of fixed interest rate swaps	-	(3,006.3)	(125.0)	(50.0)	1,127.1	325.0	1,729.2
Total external borrowings	6,977.5	3,942.7	(124.5)	(49.5)	1,127.7	325.6	1,755.5
Amounts owed to ultimate parent undertaking	55.8	55.8	-	-	-	-	-
Total borrowings	7,033.3	3,998.5	(124.5)	(49.5)	1,127.7	325.6	1,755.5
Cash and short-term deposits	(213.6)	(213.6)	-	-	-	-	-
Net borrowings	6,819.7	3,784.9	(124.5)	(49.5)	1,127.7	325.6	1,755.5

	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 2015							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,252.1	-	-	-	615.8	424.1	1,212.2
Effect of swaps	-	2,252.1	-	-	(615.8)	(424.1)	(1,212.2)
	2,252.1	2,252.1	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	333.7	-	-	-	-	-	333.7
Effect of swaps	-	333.7	-	-	-	-	(333.7)
	333.7	333.7	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	572.7	543.8	0.4	0.5	0.5	0.6	26.9
Floating rate instruments	402.7	402.7	-	-	-	-	-
Index-linked instruments	3,083.8	3,083.8	-	-	-	-	-
	4,059.2	4,030.3	0.4	0.5	0.5	0.6	26.9
Effect of fixed interest rate swaps	-	(2,656.3)	(250.0)	(125.0)	(50.0)	1,127.1	1,954.2
Total external borrowings	6,645.0	3,959.8	(249.6)	(124.5)	(49.5)	1,127.7	1,981.1
Amounts owed to ultimate parent undertaking	54.2	54.2	-	-	-	-	-
Total borrowings	6,699.2	4,014.0	(249.6)	(124.5)	(49.5)	1,127.7	1,981.1
Cash and short-term deposits	(244.0)	(244.0)	-	-	-	-	-
Net borrowings	6,455.2	3,770.0	(249.6)	(124.5)	(49.5)	1,127.7	1,981.1

Notes to the financial statement – 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 2016							
Borrowings in fair value hedge relationships							
Fixed rate instruments	454.9	-	-	454.9	-	-	-
Effect of swaps	-	454.9	-	(454.9)	-	-	-
	454.9	454.9	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	349.2	73.6	-	-	-	-	275.6
	349.2	73.6	-	-	-	-	275.6
Total external borrowings	804.1	528.5	-	-	-	-	275.6
Amounts owed to subsidiary undertakings	686.1	686.1	-	-	-	-	-
Amounts owed to ultimate parent undertaking	55.8	55.8	-	-	-	-	-
Total borrowings	1,546.0	1,270.4	-	-	-	-	275.6
Cash and short-term deposits	(7.3)	(7.3)	-	-	-	-	-
Net borrowings	1,538.7	1,263.1	-	-	-	-	275.6

	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 2015							
Borrowings in fair value hedge relationships							
Fixed rate instruments	448.8	-	-	-	448.8	-	-
Effect of swaps	-	448.8	-	-	(448.8)	-	-
	448.8	448.8	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	337.3	70.7	-	-	-	-	266.6
Total external borrowings	786.1	519.5	-	-	-	-	266.6
Amounts owed to subsidiary undertakings	698.8	698.8	-	-	-	-	-
Amounts owed to ultimate parent undertaking	54.2	54.2	-	-	-	-	-
Total borrowings	1,539.1	1,272.5	-	-	-	-	266.6
Cash and short-term deposits	(61.6)	(61.6)	-	-	-	-	-
Net borrowings	1,477.5	1,210.9	-	-	-	-	266.6

Notes to the financial statement – appendices

A4. Financial risk management (continued)

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

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

Sensitivity analysis
The following table details the sensitivity of the group's profit before tax and equity to changes in electricity prices. The sensitivity analysis has been based on the amounts of electricity swaps in place at the reporting date and, as such, is not indicative of the years then ended.

Group	2016 £m	2015 £m
Increase/(decrease) in profit before tax and equity		
20 per cent increase in electricity commodity prices	7.7	9.5
20 per cent decrease in electricity commodity prices	(7.7)	(9.5)

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.

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 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 2016, group consolidated gearing was 61 per cent (2015: 59 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, its existing 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 existing 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.

Notes to the financial statement – appendices

A4. Financial risk management (continued)

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
2016	£m	£m	£m	£m
Available for sale financial assets				
Investments	-	8.7	-	8.7
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	583.8	-	583.8
Derivative financial assets – held for trading[(1)]	-	181.8	-	181.8
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[(1)]	-	(261.7)	-	(261.7)
Financial liabilities designated as fair value through profit or loss	-	(338.0)	-	(338.0)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,149.5)	(143.5)	-	(2,293.0)
Other financial liabilities at amortised cost	(1,309.9)	(3,575.5)	-	(4,885.4)
	(3,459.4)	(3,544.4)	-	7,003.8

Group	Level 1	Level 2	Level 3	Total
2015	£m	£m	£m	£m
Available for sale financial assets				
Investments	-	8.6	-	8.6
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	521.6	-	521.6
Derivative financial assets – held for trading[(1)]	-	161.0	-	161.0
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[(1)]	-	(205.2)	-	(205.2)
Financial liabilities designated as fair value through profit or loss	-	(333.7)	-	(333.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,142.6)	(75.4)	-	(2,218.0)
Other financial liabilities at amortised cost	(2,530.3)	(2,322.0)	-	(4,852.3)
	(4,672.9)	(2,245.1)	-	(6,918.0)

(1) These derivatives form economic hedges and, as such, management intend to hold these through to maturity. Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £177.2 million (2015: £152.2 million).

Notes to the financial statement – appendices

A4. Financial risk management (continued)

Company **2016**	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	-	141.4	-	141.4
Derivative financial assets – held for trading(1) (2)	-	-	-	-
Financial liabilities at fair value through profit or loss				
Derivative financial assets – held for trading(1)	-	(0.7)	-	(0.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(447.1)	-	-	(447.1)
Other financial liabilities at amortised cost	-	(1,153.5)	-	(1,153.5)
	(447.1)	(1,012.8)	-	(1,459.9)

Company **2015**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	136.8	-	136.8
Derivative financial assets – held for trading(1) (2)	-	1.7	-	1.7
Financial liabilities at fair value through profit or loss				
Derivative financial assets – held for trading(1)	-	(0.7)	-	(0.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(440.4)	-	-	(440.4)
Other financial liabilities at amortised cost	-	(1,157.4)	-	(1,157.4)
	(440.4)	(1,019.6)	-	(1,460.0)

(1) These derivatives form economic hedges and, as such, management intend to hold these through to maturity.
(2) Includes amounts owed by subsidiary undertakings of £0.7 million (2015: £0.7 million).

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

The group and company have calculated fair values using quoted prices where an active market exists, which has resulted in £3,459.4 million (2015: £4,672.9 million) for group and £447.1 million (2015: £440.4 million) for 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. The £1,213.5 million reduction (2015: £1,493.9 million increase) in ‘level 1’ fair value measurements is largely due to the maturity of a £425.0 million bond during the year and a decrease in the number of observable quoted bond prices at 31 March 2016.

In respect of the total change during the year in the fair value of financial liabilities designated at fair value through profit or loss, of a £4.3 million loss (2015: £65.0 million), a £15.1 million gain (2015: £4.6 million loss) is attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £74.1 million profit (2015: £59.0 million). The carrying amount is £135.9 million (2015: £131.6 million) higher than the amount contracted to settle on maturity.

Notes to the financial statement – 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.

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

None of the executive directors accrue benefits under defined benefit schemes. See note 2 for further information about the pension arrangements for executive directors.

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**
	2016	2015	2016	2015
	£m	£m	£m	£m
Total value of current employees benefits	831.6	839.9	68.5	71.9
Deferred members benefits	624.1	666.5	285.4	299.7
Pensioner members benefits	1,514.7	1,548.1	432.8	440.4
Total defined benefit obligation	2,970.4	3,054.5	786.7	812.0

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

Funding requirements

The latest funding valuation of the schemes was carried out by an independent qualified actuary as at 31 March 2013 and reported a deficit. The basis on which liabilities are valued for funding purposes differs from the basis required under IAS 19. Under UK legislation there is a requirement that pension schemes are funded prudently.

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

The group and trustees have agreed long-term strategies for reducing investment risk in each scheme. For UUPS, this includes an asset-liability matching policy which aims to reduce the volatility of the funding level of the pension plan by investing in assets such as fixed income swaps and gilts which perform in line with the liabilities so as to hedge against changes in swap and gilt yields. For ESPS, a partial hedge is in place to protect against changes in swap and gilt yields.

Notes to the financial statement – appendices

A5. Retirement benefits (continued)

Funding requirements (continued)

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

The group expects to make contributions of £64.2 million in the year ending 31 March 2017, comprising £38.9 million to UUPS and £4.1 million to ESPS in respect of deficit repair contributions, £19.8 million and £0.8 million in respect of regular contributions to UUPS and ESPS respectively, and £0.6 million in respect of expenses to ESPS.

The company expects to make contributions of £11.9 million in the year ending 31 March 2017, comprising £6.8 million to UUPS and £3.4 million to ESPS in respect of deficit repair contributions, £1.0 million and £0.4 million in respect of regular contributions to UUPS and ESPS respectively, and £0.3 million in respect of expenses to ESPS.

Impact of scheme risk management on IAS 19 disclosures

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

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

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

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

In the year ended 31 March 2016, the discount rate has increased by 0.3 per cent, which includes a 0.7 per cent increase in credit spreads offset by a decrease in swap yields over the year. The IAS 19 remeasurement gain of £160.1 million for the group and £35.5 million for the company reported in note 17 has largely resulted from the impact of the increase in credit spreads during the year, partially offset by the impact of a 0.2 per cent increase in inflation.

Reporting and assumptions

The results of the latest funding valuations at 31 March 2013 have been adjusted to take account of the requirements of IAS 19 in order to assess the position at 31 March 2016, 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.

Notes to the financial statement – appendices

A5. Retirement benefits (continued)

The main financial and demographic assumptions used by the actuary to calculate the defined benefit surplus of UUPS and ESPS are outlined below:

Financial assumptions

	2016 % p.a.	2015 % p.a.
Group and Company		
Discount rate	3.4	3.1
Pensionable salary growth and pension increases	3.2	3.0
Price inflation	3.2	3.0

During the year, the group has undertaken a review of its pension assumptions and has made a number of amendments as a result. To align with market practice, the discount rate is now based on an AA ‘corporate bond’ curve rather than a broader AA ‘non-gilt’ curve that was previously used. This has resulted in a 0.2 per cent increase in the discount rate during the year and a 0.2 per cent increase in credit spreads. In addition, the allowance for inflation risk premium has been removed from the basis of the inflation rate assumption to better align with the risk management strategy, which has increased the inflation assumption by 0.3 per cent.

Demographic assumptions

Mortality in retirement is assumed to be in line with the Continuous Mortality Investigation’s (CMI) S1NA year of birth tables, with a one-year age rating for males in the UUPS only, reflecting actual mortality experience; and CMI 2014 (2015: CMI 2014) long-term improvement factors, with a long-term annual rate of improvement of 1.75 per cent (2015: 1.5 per cent). The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

	2016 years	2015 years
Group and Company		
Retired member - male	27.1	26.6
Non-retired member - male	29.2	28.3
Retired member - female	30.7	30.2
Non-retired member - female	32.9	32.0

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 £58.4 million (2015: £60.1 million) decrease/increase in the schemes’ liabilities for the group at 31 March 2016, although as long as credit spreads remain stable this will be largely offset by an increase in the value of the schemes’ bond holdings and other instruments designed to hedge this exposure. The discount rate is based on AA ‘corporate bond’ yields of a similar duration to the schemes’ liabilities.

Notes to the financial statement – 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 £55.3 million (2015: £56.6 million) increase/decrease in the schemes' liabilities for the group at 31 March 2016, as a significant proportion of the schemes' benefit obligations are linked to inflation. In some cases, caps on the level of inflationary increases are in place to protect against extreme inflation. The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit. Any change in inflation out-turn results in a change to the cash contributions provided under the IFM.

- ***Life expectancy***
  An increase/decrease in the mortality long-term annual rate of improvement of 0.25 per cent would have resulted in a £45.4 million (2015: £36.7 million) increase/decrease in the schemes' liabilities for the group at 31 March 2016. 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:

	Schemes' assets %	2016 £m	Schemes' assets %	2015 £m
Group				
Equities	9.8	318.3	9.9	308.7
Other non-equity growth assets	9.4	304.3	10.2	320.4
Gilts	36.9	1,196.2	14.7	461.8
Bonds	41.0	1,332.7	43.6	1,365.8
Other	2.9	94.1	21.6	677.0
Total fair value of schemes' assets	100.0	3,245.6	100.0	3,133.7
Present value of defined benefit obligations		(2,970.4)		(3,054.5)
Net retirement benefit surplus		275.2		79.2

	Schemes' assets %	2016 £m	Schemes' assets %	2015 £m
Company				
Equities	9.8	81.6	10.0	81.5
Other non-equity growth assets	9.4	78.1	10.1	82.3
Gilts	24.6	205.8	9.7	79.4
Bonds	42.7	356.8	44.7	365.0
Other	13.5	112.7	25.5	208.2
Total fair value of schemes' assets	100.0	835.0	100.0	816.4
Present value of defined benefit obligations		(786.7)		(812.0)
Net retirement benefit surplus		48.3		4.4

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

Notes to the financial statement – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

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

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

The defensive element of 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.

Notes to the financial statement – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)
Movements in the fair value of the schemes' assets were as follows:

		Group		Company
	2016	2015	2016	2015
	£m	£m	£m	£m
At the start of the year	3,133.7	2,377.0	816.4	652.0
Interest income on schemes' assets	96.3	101.0	25.2	27.6
The return on plan assets, excluding amounts included in interest	56.0	705.2	7.7	155.2
Member contributions	5.8	6.3	0.3	0.4
Benefits paid	(102.4)	(92.5)	(24.4)	(22.6)
Administrative expenses	(2.7)	(2.6)	(1.0)	(1.0)
Company contributions	58.9	39.3	10.8	4.8
At the end of the year	3,245.6	3,133.7	835.0	816.4

The actual return on the schemes' assets was a gain of £152.3 million (2015: £806.2 million) for the group and a gain of £32.9 million (2015: £182.8 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
	2016	2015	2016	2015
	£m	£m	£m	£m
At the start of the year	(3,054.5)	(2,554.4)	(812.0)	(683.8)
Interest cost on schemes' obligations	(93.2)	(108.0)	(24.8)	(28.9)
Actuarial gains/(losses) arising from changes in financial assumptions	98.1	(500.8)	26.7	(128.4)
Actuarial (losses)/gains arising from changes in demographic assumptions	(46.6)	10.2	(11.8)	2.2
Actuarial gains arising from experience	52.6	35.9	12.9	6.8
Curtailments/settlements	(1.1)	(5.5)	(0.2)	(0.7)
Member contributions	(5.8)	(6.3)	(0.3)	(0.4)
Benefits paid	102.4	92.5	24.4	22.6
Current service cost	(22.3)	(18.1)	(1.6)	(1.4)
At the end of the year	(2,970.4)	(3,054.5)	786.7	(812.0)

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

Notes to the financial statement – 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.

Trading transactions
There were sales of services of £1.2 million (2015: £1.0 million) and purchases of goods and services of £0.7 million (2015: £0.8 million) between the group and its joint ventures. Sales of services to related parties were on the group's normal trading terms.

At 31 March 2016, amounts owed by joint ventures were £2.9 million (2015: £2.8 million) and there were no amounts owed to joint ventures (2015: £nil). The amounts outstanding are unsecured and will be settled in accordance with normal credit terms. No expense or allowance has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (2015: £nil).

In addition, the group has issued guarantees of £4.7 million (2015: £4.7 million) in support of its joint ventures (see note 10).

Details of transactions with key management are disclosed in note 2.

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

	Interest receivable	
	2016	2015
	£m	£m
Ultimate parent undertaking	27.9	26.3

	Amounts owed by related parties		**Amounts owed to related parties**	
	2016	2015	2016	2015
	£m	£m	£m	£m
Ultimate parent undertaking	1,646.4	1,618.5	56.9	55.5

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

Total dividend income received during the year amounted to £264.3 million (2015: £976.6 million), total interest receivable during the year from subsidiary undertakings was £25.5 million (2015: £22.7 million), and total fair value gains during the year from subsidiary undertakings was £5.0 million (2015: £36.9 million gain). In addition, total interest receivable during the year from the ultimate parent company was £27.9 million (2015: £26.3 million). Amounts outstanding at 31 March 2016 between the parent company, subsidiary undertakings and ultimate parent undertaking are provided in notes 13, 20 and A3.

The company guaranteed intra-group loans made by subsidiary undertakings of £96.5 million (2015: £96.5 million). Balances will be settled in accordance with normal credit terms. An allowance for doubtful receivables of £89.7 million (2015: £91.7 million) has been made for amounts owed by subsidiary undertakings. In the year ended 31 March 2016, a credit of £2.0 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2015: £1.2 million debit) (see note 13).

The company had a £400 million intercompany interest rate swap with United Utilities Water Limited maturing in March 2015, as part of the 2010-2015 regulatory hedging programme. During the year the company received net interest of £nil (2015: £5.4 million) and £nil was debited through the income statement (2015: £3.7 million debit).

Notes to the financial statement – appendices

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 34 to 36.

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

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

Subsidiaries
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.

Revenue recognition
Revenue represents the fair value of the income 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.

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.

Notes to the financial statement – appendices

A7. Accounting policies (continued)

Tax
The tax expense represents the sum of current tax and deferred tax.

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.

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 of 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.

Notes to the financial statement – 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 the same period (or where the receipt of property, plant and equipment is solely to connect the customer to the network, the deferred contribution is released immediately to revenue). This interpretation has been applied to transfers of assets from customers received on or after 1 July 2009.

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

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

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

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

Notes to the financial statement – appendices

A7. Accounting policies (continued)

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

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

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

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

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 available for sale in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

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

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

Notes to the financial statement – appendices

A7. Accounting policies (continued)

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, whilst associated hedging derivatives are recognised at fair value, presents an accounting measurement mismatch that has the potential to introduce considerable volatility to both the income statement and the statement of financial position. Therefore, where feasible, the group takes advantage of the provisions under IAS 39 'Financial Instruments: Recognition and Measurement' to 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 the hedging derivative has been, and will continue to be, a highly effective hedge of the risk being hedged within the applicable borrowing instrument.

Borrowings designated within a fair value hedge relationship

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

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

Borrowings designated at fair value through profit or loss

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

Derivative financial instruments

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

Derivatives and borrowings – valuation

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

Notes to the financial statement – appendices

A7. Accounting policies (continued)

rate at each reporting date. Assumptions are made with regard to credit spreads based on indicative pricing data.

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

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

Inventories

Inventories are stated at the lower of cost and net realisable value. 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 of the schemes are carried out as determined by the pension scheme trustees using the projected unit credit method at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

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

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

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

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

Provisions

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

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

Notes to the financial statement – appendices

A7. Accounting policies (continued)

translated into sterling at the relevant rates of exchange applicable on that date. Gains and losses arising on retranslation are included in net profit or loss for the period.

Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity. In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note 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.

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 statement – 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 10 and 11.

	Class of share capital held	Proportion of share capital owned/voting rights %	Nature of business
Subsidiary undertakings			
England and Wales			
Halkyn District Mines Drainage Company Limited*	Ordinary	99.9	Dormant
North West Water International Limited	Ordinary	100.0	Holding company for international business
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	Energy generation
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 Operational Services Limited*	Ordinary	100.0	Operations and maintenance contract holder
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	Water and wastewater services
United Utilities Utility Solution (Industrial) Limited	Ordinary	100.0	Holding company
United Utilities Utility Solution Holdings 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
United Utilities Water Operations Holdings Limited*	Ordinary	100.0	Holding company
United Utilities Water Sales Limited	Ordinary	100.0	Water and wastewater retail 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
The Netherlands			
United Utilities (Tallinn) BV	Ordinary	100.0	Holding company
United Utilities BV	Ordinary	100.0	Holding company
United Utilities Europe Holdings BV*	Ordinary	100.0	Holding company
Thailand			
Manta Management Services Limited(1)*	Ordinary	49.0	Management company
Water Resources Limited(1)*	Ordinary	100.0	Non-trading

Notes to the financial statement – 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			
England and Wales			
Lingley Mere Business Park Development Company Limited*	Ordinary	50.0	Development company
Lingley Mere Management Company Limited*	Ordinary	50.0	Property management
Selectusonline Limited	Ordinary	16.7	Procurement portal
Estonia			
AS Tallinna Vesi(2)*	Ordinary	35.3	Water and wastewater services
Associated undertakings			
Bahrain			
Muharraq STP Company BSC(c)(3)*	Ordinary	20.0	Project company
Muharraq Wastewater Services Company WLL(3)*	Ordinary	35.0	Operations and maintenance company
Jebel Ali Free Zone, Dubai, UAE			
Muharraq Holding Company 1 Limited(4)*	Ordinary	20.0	Holding company
Muharraq Holding Company 2 Limited(4)*	Ordinary	20.0	Holding company

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

Notes:

(1) Registered address: 4th Floor, Iyara Building Room 405, 2/22 Chan Road, Thung Wat Don Sub-district, Sathon District , Bangkok, 10120, Thailand.

(2) Registered address: Adala 10, Tallinn 10614, Estonia.

(3) Registered address: Building 200, Road 13 Block 115, Hidd, Kingdom of Bahrain.

(4) Registered address: Al Tamimi & Company, 9th Floor, Dubai World Trade Centre, Sheikh Zayed Road, Dubai, United Arab Emirates.