United Utilities

helping life flow smoothly

UNITED UTILITIES GROUP PLC

Annual Report and Financial Statements
for the year ended 31 March 2013

United Utilities at a glance

United Utilities is the UK's largest listed water company.

Our company

United Utilities Group PLC owns and manages the regulated water and wastewater network in the North West of England, through its subsidiary United Utilities Water PLC (UUW). UUW constitutes the vast majority of the group's assets and profit and, as such, the group presents its results under a single segment for financial reporting purposes.

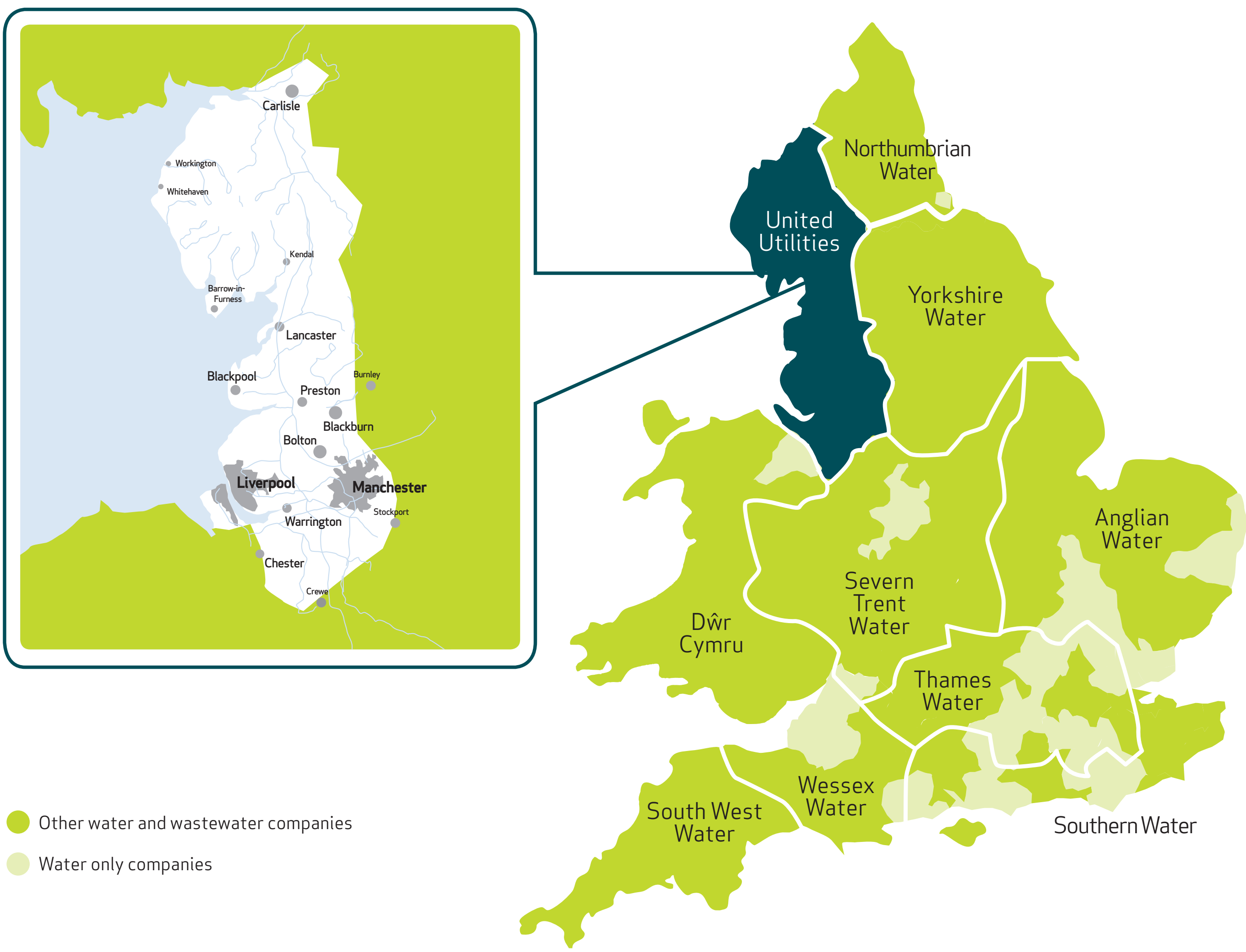
Our customers

UUW holds licences to provide water and wastewater services to a population of approximately seven million people and businesses in the North West of England.

Our assets

From Crewe to Carlisle, we keep the North West flowing through:

- **>56,000** hectares of catchment land
- **189** reservoirs
- **94** water treatment works
- **>42,000** km of water pipes
- **>77,000** km of sewer pipes
- **570** wastewater treatment works



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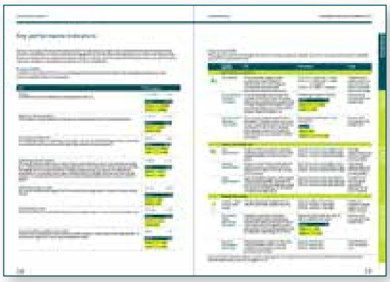

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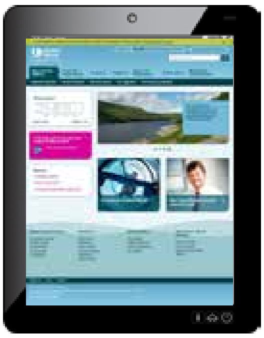


We use the following icons within this report to signpost to further areas of interest:

Cross reference to information within this report

Cross reference to information online

Important information

Cautionary statement:
The Annual Report and Financial Statements (the Annual 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 Annual Report and the company undertakes no obligation to update these forward-looking statements. Nothing in this Annual Report should be construed as a profit forecast. Certain regulatory performance data contained in this Annual Report is subject to regulatory audit.

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

Chairman's and Chief Executive Officer's statement

Dr John McAdam, Chairman

Steve Mogford, Chief Executive Officer

"We have delivered a third year-on-year improvement in customer satisfaction, underpinned by good operational and environmental performance and remain on course to deliver our regulatory outperformance targets"

Planning for the future
You can read more about our plans for the next 25 years by visiting our website **unitedutilities.com/future**

Strategy

We are pleased to report that we have made good progress during the year towards our vision of becoming a leading North West service provider and one of the best UK water and wastewater companies, as we aim to deliver the best service to customers, at the lowest sustainable cost and in a responsible manner. We have delivered a third year-on-year improvement in customer satisfaction, underpinned by good operational and environmental performance and remain on course to deliver our regulatory outperformance targets. We do, however, recognise that we have more to do to achieve our vision and we see considerable opportunities to deliver further improvements.

The UK Government's reform agenda for our sector is providing new opportunities for the company. The adoption of private sewers, which almost doubled the size of our wastewater network, went well. In anticipation of this change we revised our approach to management of our wastewater network and this has delivered higher levels of customer satisfaction at a slightly lower cost than originally estimated. We are also active in the expanding retail water market for business customers; we have won customers in Scotland and have a significant pipeline of further opportunities. Water and sludge trading are both opportunities that we are exploring with our regulators in discussions aimed at developing ideas tabled under the UK Government's reform agenda.

The North West presents a unique set of challenges for the company, containing areas of outstanding natural beauty, a long coastline supporting tourism and a significant proportion of the UK's remaining industrial base. Our plans must maintain a challenging balance between the needs of our customers and the natural environment. We recognise that we operate in a region characterised by high levels of socio-economic deprivation and that our future plans must take account of our customers' ability to pay a fair price for our services, particularly in these difficult economic times. Increasingly, our plans will be delivered through partnerships such as 'Turning Tides'; a partnership between the company, the Environment Agency, local authorities and other stakeholders to address improvements in North West bathing water quality to meet new European standards.

A fair deal for customers

We have continued to invest in our people, assets, systems and processes to improve the service our customers can expect of us. We expect to reinvest around £200 million of capital expenditure outperformance over the 2010–2015 period for the benefit of our customers and the environment.

We have implemented active pressure management in our water network to reduce bursts and leakage, helping us to meet or outperform our leakage target again. Should we have a burst, the additional investment completed during the year in strategic mains refurbishment and connectivity has improved the capability of our water network to maintain supply. We have again achieved a high level of water quality compliance throughout the year.

Whilst the North West did not experience the hosepipe bans seen elsewhere in the country last spring, rainfall across the region was much lower than expected. We were able to benefit from our investment in an integrated regional water network to keep customers supplied throughout the dry period. We are considering extending our integrated network to include the north west of Cumbria thereby improving security of supply to this area.

In contrast, the latter half of 2012 was characterised by a large number of exceptionally high rainfall events and this proved to be a testing time for our wastewater assets. We continued to invest heavily in schemes designed to mitigate the risk of flooding of our customers' homes and to improve river and bathing water quality, such as our £100 million+ project in Preston. Our operational and environmental focus is delivering results and we were pleased to achieve our best performance for

many years in the Environment Agency's operational performance metrics. Our wastewater network will continue to benefit from significant investment going forward as we adapt to weather patterns likely to result from climate change.

The North West contains over half of the one per cent most deprived areas in England and we recognise the financial difficulties many of our customers face. We are supporting customers in these tough economic times through a portfolio of measures to help those struggling to pay their water bills, including £5 million per year investment in our charitable trust. Our support measures and emphasis on helping customers back onto manageable payment plans has enabled us to contain levels of bad debt and so decrease the cost burden on all our customers.

We have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. We have delivered a number of improvements throughout the year and were pleased to see this reflected in a significant improvement in customer satisfaction for the third successive year.

Pictured:
Jane Hancock, graduate civil engineer. Our four-year scheme helps Jane gain valuable experience in the design and construction of our water and wastewater assets.

We were also pleased to see the results of our brand tracker survey which rated us highly against 10 leading service providers operating in the North West. Notwithstanding good progress, we could have done more to prevent the need for unnecessary contacts from our customers and we will continue in our efforts to improve further our service and responsiveness.

Investing for performance

Capital investment in our assets was accelerated in 2012/13 to deliver a number of beneficial projects early and reduce the risk associated with projects due to be delivered in the last two years of the 2010–15 period. Investment of £787 million in the year is up on last year's spend of £680 million. We have now invested over £2 billion in the first three years of the 2010–15 period, and we remain on track to deliver our planned five-year investment programme.

Our investment programme represents a significant contribution to the North West economy. Our capital investment of around £3.5 billion over the 2010–15 period provides an estimated £7 billion boost to the region's economy, supporting 9,000 jobs, and securing a legacy for the future. As we look ahead to the next price review, we are actively engaging with our customers and stakeholders to help address their needs and to shape our plans for the period 2015 to 2020.

Attractive deal for shareholders

Good underlying operational performance, effective capital programme delivery and improving levels of customer satisfaction are delivering value for our shareholders. Revenue increased by 4.5 per cent to £1.64 billion and underlying operating profit was up 2.2 per cent to £607 million in the continuing difficult economic conditions. Underlying earnings per share increased by 11 per cent to 39.1 pence. We remain on track to deliver operating expenditure outperformance against the regulatory allowance.

We are committed to delivering our dividend policy of RPI+2 per cent per annum through to at least 2015 while delivering significant improvements for customers and the environment. In line with this policy, the board is proposing a final dividend of 22.88 pence per ordinary share making a total of 34.32 pence per share for the 2012/13 financial year. This represents an increase of 7.2 per cent compared with last year. The final dividend is expected to be paid to shareholders on 2 August 2013.

A changing regulatory landscape

The UK Government published a draft Water Bill in July 2012, proposing the expansion of retail competition and the introduction of wholesale, or upstream, competition. We, along with various interested parties, submitted our response to these proposals to the Environment, Food and Rural Affairs (Efra) Select Committee and we await publication of the UK Government's Water Bill with interest.

Following a period of constructive dialogue with Ofwat, we were pleased to accept the revised licence modification proposals which were published by the regulator on 21 December 2012. These revised licence proposals focus on the changes required to facilitate the forthcoming 2014 price review (PR14). Ofwat published its PR14 methodology consultation in January 2013 and we submitted our response to Ofwat in March.

Chairman's and Chief Executive Officer's statement continued

In preparation for this more competitive environment and to align with the separated price controls, with effect from April 2013 we have revised our structure and activities around three business areas: Wholesale; Domestic Retail; and Business Retail.

Our employees

The people in United Utilities are key to the delivery of the highest levels of service to our customers and we would like again to thank them for their dedication and continued hard work during the year.

We strive to continuously improve our safety culture and we have implemented a number of initiatives throughout the year. We launched our employee guide for health and safety responsibilities and introduced a set of behavioural standards at our main office sites, called the 'Safety Six'. Health and safety will remain a significant area of focus for us.

A committed, capable and motivated workforce is central to delivering our vision and we remain fully focused on maintaining high levels of employee development and engagement. We are always looking for the best and the brightest talent and we are pleased to say that we extended our apprentice programme during the last year. We currently employ over 80 apprentices and plan to recruit up to 40 apprentices each year through to at least 2015. Alongside this, we are continuing to expand our graduate recruitment scheme, with plans to add over 20 graduates in 2013/14 in addition to more than 35 we currently employ.

Our board

Our plc structure and governance standards ensure that our board and non-executive directors continue to provide sound and prudent oversight in full compliance with the principles of the UK Corporate Governance Code. In addition, we are the only UK water company to have achieved and retained 'World Class' status in the Dow Jones Sustainability Index over the last five years, reflecting our high standards of governance. Indeed, we are one of only two water companies globally to reach this high standard.

On behalf of the board, we say thank you and farewell to Paul Heiden who will stand down at this year's annual general meeting after over seven years as a non-executive director. We wish Paul all the best for the future.

We are pleased to welcome Brian May to the board as a non-executive director following his appointment last September. Brian is also finance director at Bunzl plc. His expertise will be an asset to the board and he will replace Paul as chair of both the audit and risk committee and the treasury committee.

Outlook

We believe that our sustained focus on customer satisfaction and operational performance is delivering results for customers, shareholders and our other stakeholders. We continue to be on track to meet our regulatory outperformance targets, with substantial financing and operating outperformance already secured. Our capital structure remains robust and we have a sustainable dividend policy that targets real growth through to at least 2015.

Looking ahead, our focus remains centred on driving further customer satisfaction, alongside operational and environmental improvements and we believe there is still plenty of scope to achieve this. We are now preparing our business plan for the next Price Review, as we aim to address the needs of our stakeholders, support the environment and our regional economy, while recognising the need to keep bills affordable for our customers.

Dr John McAdam
Chairman

Steve Mogford
Chief Executive Officer

Responsible business

As a board we are responsible to our shareholders, customers and other stakeholders for the performance and long-term success of our company. The way in which we operate, we believe, reflects the highest standards of corporate governance.

We continue to listen to the views of all our stakeholders and endeavour to develop, manage and operate in an environmentally sustainable, economically beneficial and socially responsible manner. In recognition of the company's continued focus on responsible business, we retained our 'World Class' rating, as measured by the Dow Jones Sustainability Index for 2012, attaining our highest ever score. We also retained our 'Platinum Big Tick' ranking in Business in the Community Corporate Responsibility Index and were awarded membership of the FTSE 350 Carbon Disclosure Leadership Index. We are proud that we are one of only four FTSE 100 companies to hold all three awards.

The communities in which we operate are of great importance to our business and we have continued our investment in these communities of the North West both financially and in terms of employee time through volunteering. For example, our 'Pathways' volunteering scheme, delivered by our employees, provides practical help and support to people who have struggled to find work.

FACT

Our 2010-2015 investment programme supports 9,000 jobs across the region

Operational and financial highlights

Operational highlights

- Further customer service improvements: year-on-year progress on Ofwat's SIM measures
- Met water and wastewater asset serviceability standards
- Outperformed regulatory leakage target
- Effective delivery of capital investment programme: investment up 16 per cent at £787 million
- On track to meet outperformance targets, benefiting customers and shareholders

For more information on our **operational KPIs** go to page 19

Financial highlights

Revenue

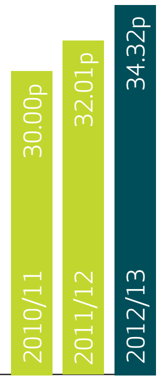
£1,636m
(2011/12: £1,565m)

Underlying operating profit

£607m
(2011/12: £594m)

Total dividend per share

34.32p
(2011/12: 32.01p)



For more information on our **financial KPIs** go to page 18

Why invest?

- Clear vision to be a leading North West service provider and one of the best UK water and wastewater companies
- Management team with extensive regulatory and operational experience
- Significant improvements in customer service and operational performance, with more to come
- Delivering customer and environmental benefits through substantial capital investment, which drives long-term growth in the regulatory capital value
- Transparency on regulatory outperformance and on track to deliver our targets
- Robust capital structure: stable A3 rating
- Dividend policy of targeting a real growth rate of RPI inflation +2 per cent per annum to at least 2015

	Total dividend	Yield*
2012/2013	34.32p	4.8%

* Based on closing share price on 28.03.13 of 708.5p.

Business review

Our business model and strategy

Performance

Principal risks and uncertainties

Pictured: John Butcher, regional water supplies manager. John's job helps to ensure that our customers receive a reliable supply of water through their taps every day.

Our business model and strategy

Overview

Our vision

To become a leading North West service provider and one of the best UK water and wastewater companies

Our objectives

Our aim is to deliver long-term shareholder value by providing:

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

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

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

Our operational key performance indicators

The best service to customers
- Serviceability
- SIM – quantitative
- SIM – qualitative

At the lowest sustainable cost
- Opex outperformance
- Financing outperformance
- Capex outperformance

In a responsible manner
- Leakage
- EA performance assessment
- Dow Jones Sustainability Index

For more information on our performance against our **operational KPIs** go to page 19

Our values

Underpinning everything we do, we operate under the core values of:
- **Customer focus** – providing services that our customers can rely on;
- **Innovation** – encouraging new ideas to make our services better, faster or cheaper; and
- **Integrity** – applying the highest standards of responsible business practice.

We outline the key value drivers for the business later in this section to help explain the dynamics of the industry and how customer service links to shareholder value. For more information on our **key value drivers** go to pages 16–17.

We have in place a range of financial and operational KPIs to provide a comprehensive view of how we are performing and these are outlined in the tables on pages 18–19.

Our business performance section provides more detail on how we have performed in the last year and how this has contributed to achieving our vision. For more information on our **business performance** go to pages 20–31.

Our business

Our industry
Every day, over 50 million household and non-household consumers in England and Wales receive water and wastewater services. There are currently 10 licensed companies which provide both water and wastewater services to consumers in their respective regions. Additionally, there are licensed companies which provide water only services and tend to be smaller in size. As each company in the water sector operates as a regional monopoly for the majority of its services, they are subject to regulation in terms of both price and performance.

The privatisation of the industry over two decades ago has been widely perceived as a success. It has led to improvements in the quality of services provided to customers, higher environmental standards and superior quality drinking water at lower estimated costs to customers than if the water sector was still owned by the UK Government. The water sector economic regulator, Ofwat, estimates that water bills are on average more than £100 lower per annum than they otherwise would have been. The water industry currently invests around £80 million a week in maintaining and improving assets and services.

Our customers
We provide services to approximately three million households in our region and this generates around two-thirds of our total revenues. We also serve approximately 200,000 businesses, ranging in size from large manufacturing companies down to small shops.

Our households pay just over £1 per day on average for the combined water and wastewater services we provide. Over the 2010–15 period, our customers' average annual bill will fall by £9 before the impact of inflation. Our objective is to continue to provide our customers with high quality drinking water to meet all their daily needs and environmentally responsible wastewater collection and treatment at a price to customers that represents good value for money.

We are continuing to invest in our assets and systems for the benefit of our customers. During the five-year period to 2015, we have a capital investment programme of approximately £3.5 billion. We would again expect a substantial investment programme for the 2015–20 period as we strive to further improve service and meet stringent environmental obligations. Capital investment in the 2015–20 period will help us deliver our five promises to our customers:

- to provide great water;
- to remove wastewater;
- to protect and enhance the environment;
- to provide customer service they can rely on; and
- to deliver value for money.

Water and wastewater operations
Almost 2,000 million litres of water is supplied every day to approximately 3.2 million homes and businesses. Water is collected from catchment land and other sources and stored in reservoirs before being treated and then delivered via a network of pipes to homes and industry. A large proportion of the water supplied flows freely by gravity and does not need to be pumped, reducing energy consumption and the carbon impact on the environment.

Wastewater is collected using a network of sewers and treated before being returned safely to the environment. A by-product of the treatment of wastewater is sewage sludge, which is treated further to produce an end product suitable for safe disposal while providing renewable energy generation.

Pictured:
Karen Bartley, customer advisor. Our operational contact centre in Warrington deals with customer calls in relation to all aspects of our water and wastewater services.

Our business model and strategy continued

Regulatory environment

As services in England and Wales are not provided in competitive markets, with only large business customers currently able to choose their supplier, the industry is subject to regulation.

Economic regulation

Economic regulation is the responsibility of an independent body, Ofwat, whose primary duties are:

- to protect the interests of consumers, wherever appropriate by promoting effective competition;
- to ensure that companies properly carry out their functions; and
- to ensure that companies can finance their functions.

As part of its periodic review Ofwat sets limits on the average annual increase in charges that a water company can impose across each price control period (usually five years).

The regulatory capital value (RCV) of a water company is a measure of its capital base which is used when Ofwat sets price limits. Capital expenditure to enhance and maintain the network as well as inflation is added to the RCV, while depreciation is deducted.

An allowed return on the RCV is set by Ofwat to ensure water companies can secure a reasonable return on their capital in order to finance their functions. Operating costs (subject to an efficiency target) as well as depreciation and tax are added to this allowed return. In addition, adjustments depending on each company's relative performance are added or deducted to derive the allowed revenue for each water company.

Based on each company's calculated allowed revenue across the regulatory period, Ofwat publishes annual price limits in its final price determination. The price limits for each company are set by reference to inflation as measured by the retail prices index (RPI), plus an adjustment factor known as 'K'.

Ofwat's approach to setting price limits for the 2010 - 2015 regulatory period.

1 Regulatory capital value (RCV)

×

2 Allowed return

+

3 Operating expenditure plus depreciation for an efficient company

+/−

4 Performance-related adjustments

+

5 Taxation

=

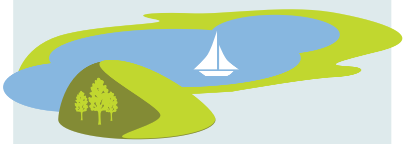
6 Ofwat allowed revenues

7 Overall price limit, K

Technology and nature work together in the water cycle

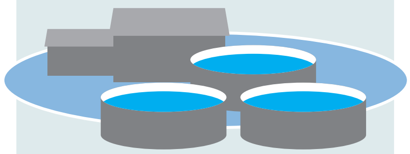
1

Water is collected and stored in reservoirs or taken from boreholes.



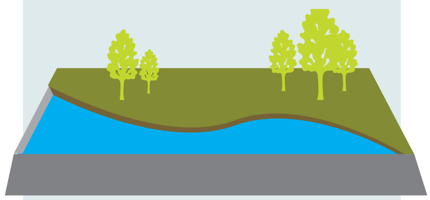
2

Water is purified at water treatment works.



3

Clean water is stored in covered reservoirs.



A company's annual 'K' factor therefore shows the amount by which it is allowed each year to change its price above or below inflation.

Price cap regulation in the UK is performance-based and companies are incentivised to be efficient in terms of their operating costs, capital programmes and financing. The benefit of any efficiency savings achieved through effective management is retained by the companies for a period of up to five years, after which time the benefit is passed to the customers via the subsequent price setting process. The cost of any under-performance, or failure to deliver specified output requirements, due to poor management is borne by the company. Companies are also incentivised to provide high standards of service and can be penalised if these standards are not achieved, primarily by means of an adjustment to the 'K' factor at the subsequent price review.

Our current price limits (published in November 2009)

UUW's profile of price limits for the five-year period 1 April 2010 to 31 March 2015 is set out below:

Year	2010/11	2011/12	2012/13	2013/14	2014/15
K factor	-4.3%	-0.2%	+0.6%	+1.0%	+1.2%

Ofwat's final determination of price limits for UUW was based on:

- a capital investment programme of approximately £3.5 billion;
- 12 per cent, or approximately £900 million, real growth in the RCV over the five years;
- an average annual underlying operating efficiency improvement of 1.2 per cent for the water service and 2.4 per cent for the wastewater service; and
- a return on capital of 4.5 per cent (post-tax, real).

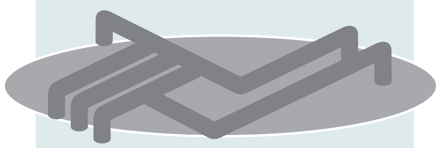
Every year, all water companies are required to publish details of their annual financial and operational performance. Ofwat uses this information and other data to monitor and compare companies' performance both individually and relative to the other water companies across a wide range of measures. This includes key performance indicators such as Service Incentive Mechanism (SIM), Serviceability and Leakage (see page 19).

4

Clean water is delivered to homes and factories through our network of pipes.

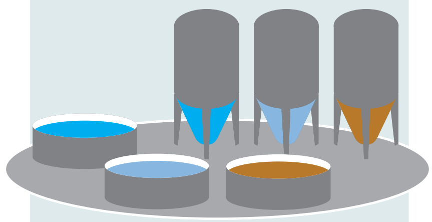
5

Wastewater is taken away for treatment through our sewer system.



6

Wastewater is cleaned at wastewater treatment works and cleaned water is put back into the rivers and sea.



Our business model and strategy continued

Environmental and quality regulation

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

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

- the Environment Agency (EA), which is responsible for conserving and redistributing water resources and securing their proper use, including the licensing of water abstraction. The EA also regulates discharges to controlled waters. The EA produces a composite assessment measuring the relative annual environmental performance of the 10 water and wastewater companies. This is included as one of our key performance indicators, see page 19;
- the Drinking Water Inspectorate, which enforces drinking water quality standards; and
- Natural England, which is responsible for the protection of designated sites for nature conservation, e.g. Sites of Special Scientific Interest. There is a statutory requirement to manage these sites to protect and enhance biodiversity.

Future regulation

In January, Ofwat published its methodology statement which provides a roadmap for the 2015–20 price review period. This statement confirmed that there will be separate price controls for water companies' wholesale water, wholesale wastewater, retail household and retail business operations, whereas currently there is only one overall price control.

Separate retail price controls aim to provide retail businesses with greater incentives and focus on delivering efficient service to business customers as competition expands and also to household customers under a new average cost to serve approach. This proposed retail household model allows water companies to only charge its customers an amount based on the average costs of the industry, although the details of how this will be implemented are still being discussed. Ofwat is safeguarding investment in the sector by protecting the existing asset base of companies, allocating all RCV to the wholesale business. It is also refining the way companies' operating and capital costs are assessed to encourage companies to utilise the most efficient, sustainable solutions under a new 'totex' model.

Greater emphasis is being placed on customer views and we are already embracing this approach, actively engaging with our customers to shape our business plan to meet their needs. Ofwat is also encouraging more flexible and sustainable use of water by increasing the incentives to trade water between regions as there has been little water trading between companies to date.

We, along with other stakeholders, submitted a response to Ofwat's methodology consultation in March. A final methodology statement is expected to be published by Ofwat this summer. We are already in the process of preparing our draft business plan for the 2015–20 period and we are scheduled to present this to Ofwat in December 2013. Ofwat is planning to publish its final determination for the 2015–20 period by the end of 2014.

Further developments in the environmental and quality regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive and the revised Drinking Water Directive). The Water Bill, announced in the Queen's speech on 8 May 2013, will also affect the regulatory environment in which we operate.

Regulatory risks

Given the complex legal and regulatory environment within which we operate, there are 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 2010–15 regulatory contract. We also face risks in relation to potential future changes in legislation or regulation, particularly with regard to the 2015–20 price review period. See pages 32–37 for more details in respect of these risks.

Customer views help shape the future

Customers and wider stakeholders across the North West are helping shape our plans for the future. We have sought the views of almost 13,000 customers to understand their needs and priorities and this has generated a set of customer promises which will drive the benefits our business can deliver for them, the environment and the regional economy over the next 25 years.

Those views and opinions are also influencing and shaping what we need to do now, over the next five-year business plan period, from 2015–2020, as part of the water sector's price review process. This is focusing what we invest in for the customers we serve and making sure that is balanced with the cost of that service, so our customers think their bills are reasonable. The quality of our customer engagement and how well we develop a plan based on those priorities and needs is being independently verified by a Customer Challenge Group.

Competitive environment

Competitors

One of our fundamental medium to long-term goals is to become one of the best UK water and wastewater (or sewerage) companies (WaSC). Our main competitors are the other nine WaSCs which operate across England and Wales. As the diagram to the right shows, we are the second largest WaSC based on regulatory capital value and we, along with these other nine companies, comprise the vast majority of the total water and wastewater sector.

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

In line with our aspiration to be one of the leading service providers in the North West, we benchmark our customer service performance against other large service providers in the region. In addition, as a publicly listed FTSE 100 company, the other UK and European listed utilities are competitors from an investment perspective.

Direct competition

Aside from comparative competition, there are two main forms of direct competition in the water and wastewater industry: new appointments or variations and water supply licensing.

New appointments or variations

A new appointment or variation is made when an existing undertaker is replaced by a new undertaker as the supplier of water and/or wastewater services for a defined area. Instances of new appointments or variations have been relatively rare, with less than 50 granted across the industry since privatisation in 1989.

Water supply licensing

Water supply competition was opened up in December 2005, when very large non-household customers (those with an annual consumption of at least 50 megalitres of water a year at each site) were allowed to choose their water supplier. A water undertaker is obliged to allow a licensed water supplier to use its network for this purpose, subject to payment of charges and certain conditions and rights of refusal.

In December 2011, this market was opened up further, with the threshold being reduced to five megalitres a year. To date very few customers have switched supplier in England and Wales.

Future competition

Looking ahead, the UK Government's Draft Water Bill, published in July 2012, proposed that the water supply threshold will be reduced further to zero for non-household customers and also be expanded to include sewerage as well as water services, with a target date of 2017 at the earliest. This will effectively open up retail competition for all business customers. The UK Government has not expressed any intention to expand competition to include household customers.

We are exploiting the opportunity presented by the expansion of retail competition for business customers and have already assembled a strong team. We have applied for and secured a licence to operate in Scotland and we have won our first customers there. We have a strong pipeline of further opportunities and look forward to developing our position outside of our region as the market opens in England.

For more details on our **performance** go to page 20.

The Draft Water Bill also proposed the future introduction of wholesale, or upstream, competition (for example the input of raw or treated water into a water company's network or the removal of wastewater for treatment). Scrutiny of the draft bill by the Efra Select Committee provided the opportunity for all interested parties to comment on the draft bill's provisions. The Select Committee published its report on the draft bill in February 2013 and we now await the Government's Water Bill with interest.

Water sector RCV

"Retail competition is opening up for all business customers"

Our business model and strategy continued

"Debt management continues to be a significant area of focus for us"

Pictured:
Construction of the West-East link main, which can transport 100 million litres of water per day between Merseyside and Manchester in either direction.

Economic environment

UK gross domestic product has continued to stagnate during 2012/13 and the equity markets experienced another volatile year, albeit boosted as concerns over the European debt crisis have abated somewhat recently. Bond yields have remained at relatively low levels throughout 2012/13. This has been beneficial to our future cost of debt as in March 2013 UUW raised a new £100 million, 10-year index-linked bank loan and as we continued with our 10-year rolling interest rate hedge strategy.

While RPI inflation has come down from the very high levels seen over the previous two financial years (peaking at 5.6 per cent in September 2011), it has remained higher than the long-term trend. Our revenues and asset base are linked to inflation (as explained in the economic regulation section on page 10), so the high recent levels of inflation have increased our reported revenue and RCV. We also have a large quantity of index-linked debt which means our finance costs increase as inflation rises, providing a partial economic offset to revenue, although it should be noted that both revenues and financing costs are based on differing lagged measures of inflation and so do not provide a perfect hedge. Higher RPI inflation can also lead to operating cost pressures as a number of our costs have either direct or indirect links to inflation.

The North West of England continues to face a particularly tough economic environment. The North West unemployment rate, having increased by more than any other UK region in 2011/12, remained above the national average, at 8.0 per cent for the quarter ending March 2013, compared to 7.8 per cent nationally. A report 'Department for Communities and Local Government, Indices of Deprivation 2010', published in March 2011, highlighted that the North West had more of the most deprived areas in England than any other region.

Commercial volumes have shown a downward trend in recent years, impacted by the persisting tough economic climate. Bad debt also remains a risk to which we are exposed, although Ofwat currently recognises this through a special factor allowance. Debt management continues to be a significant area of focus for us as we seek to use best practice in the recovery of debt and in helping customers back into making regular payment through use of manageable payment plans.

Our approach to doing business

We believe that responsible business should be embedded within everything we do and this should be evident across all of our activities.

We are committed to delivering our services in a responsible way and our approach to responsible business practice is set out in our Business Principles document. This states that for United Utilities, being a responsible business means:

- Providing a great service to our customers
- Working to protect and enhance our environment
- Actively supporting our local communities
- Supporting our employees to achieve their full potential in a safe workplace
- Delivering good value to our stakeholders and managing our supply chain fairly

We've explained these in more detail below:

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

Environment: Whether it's treating and delivering drinking water for our customers or returning treated wastewater to rivers and the sea, we're acutely aware of our responsibility to the environment. We continue to invest to protect and, where appropriate, enhance the natural environment of the North West. We continue to consider the impacts of climate change on the services we deliver and adapt accordingly.

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

Employees: Health and safety is paramount and we strongly focus on our health and safety performance. High employee engagement is a key contributor to our performance and we place significant emphasis on maintaining and strengthening levels of engagement. Our policies on maternity, paternity, adoption, personal and special leave go beyond the minimum required by law. For disabled applicants and existing employees, we are committed to fulfilling our obligations in accordance with the relevant legislation. Applicants with disabilities are given equal consideration in the application process. Disabled colleagues have equipment and working practices modified for them as far as possible and wherever it is safe and practicable to do so.

Delivering good value: We are committed to honouring our responsibility to our shareholders, credit investors and those who provide us with goods and services. We aim to operate as effectively as possible at the lowest sustainable cost and to retain a robust and sustainable financial profile to provide enduring shareholder value. We work with suppliers whose business principles, conduct, and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, supporting us in the delivery of wider social, economic and environmental benefits. More detail on the regulatory environment in which we operate is provided on pages 10–12. This annual report provides a comprehensive financial and operational review to help inform our investors of our performance.

Running our business with integrity

Given the long life of our infrastructure, we take a long-term view of our operations and our aim is to deliver our strategic objectives in a responsible, sustainable way. Acting responsibly is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility (CR) factors as a strategic consideration in its decision making. Our board-level CR committee (see page 44) develops and oversees our CR strategy and this continuing focus helped the group retain our Dow Jones Sustainability Index 'World Class' rating and our 'Platinum Big Tick' ranking in the Business in the Community CR Index. Details of our responsible business performance for the year can be found on pages 24–25, with further detailed information in our Business Principles document and in our CR report on our website at: **corporate.unitedutilities.com**

Our business model and strategy continued

Key value drivers

We create value principally by delivering our regulatory contract. This means meeting Ofwat's allowances on operating, financing and capital expenditure and achieving our required customer outcomes while avoiding penalties. In the current 2010–15 period, we are delivering a substantial capital investment programme of approximately £3.5 billion, providing benefits for our customers and the environment. This, along with RPI inflation, grows the RCV or asset base of our business.

Outperforming the regulatory contract, by delivering the requirements for less than Ofwat has allowed, creates further value. Conversely, poor performance, such as not delivering the requirements on time to specification or in an inefficient manner, can reduce the value creation.

Growth in shareholder value is a combination of share price appreciation and dividends paid. Share price appreciation relates to growth in the RCV. Our disciplined investment approach in growing the RCV helps support the retention of a robust capital structure and sustainable real growth in the dividend.

Operating in the North West region, the number of customers we serve is relatively stable. The main driver to revenue is the allowed change in price we charge our customers, which is determined by Ofwat's price control model (as explained in the economic regulation section on pages 10–11). There will also be some impact due to changes in consumption from our metered customers and over recent years, in the persisting tough economic conditions, consumption has shown a downward trend, particularly for our business customers.

We aim to deliver customer benefits and long-term shareholder value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

Best service to customers

It is important for our business to perform well operationally and customer focus is one of our core values. Providing the best service to our customers will help us to strengthen our reputation and help us improve our efficiency. It will also ensure we are in a strong position to compete as the business market for retail customers evolves. Ofwat can also apply financial incentives or penalties depending on our performance, both absolute and relative to our peers, such as its customer service measure, SIM.

The regulator can also require us to incur additional unfunded expenditure if, for example, we are not adequately sustaining our assets through its serviceability assessment.

Ofwat's SIM measure – key value driver

Our customer experience programme, first established in 2010/11, has helped us to better understand the needs and issues of our customers and we have introduced a range of initiatives to drive performance improvements in this area and we have many more in the pipeline. Having been in last place of the water companies under Ofwat's SIM measure at the start of the regulatory period, we are targeting a top quartile position in the medium-term. 2013/14 is the final year of three over which companies' SIM scores will be measured for the purpose of penalties or rewards at the next price review and we are committed to achieving the best position we can by the end of this final measurement year.

Innovative ideas to reduce costs and customer disruption

As part of our 'Future Concept of Design and Assembly' we have moved the construction of some of the key parts of our capital projects away from a traditional construction site. Instead, these assets are manufactured in a controlled environment in one of our factories or workshops before being transported to site. As well as being less disruptive for our customers, this is also saving on production time as well as time on site, reducing our overall costs. It also allows us to maintain a consistently high quality of asset and reduces the risk of employee accidents.

Lowest sustainable cost

As the price control mechanism restricts revenues, not profits, this encourages us to control or reduce our costs to the lowest possible sustainable levels with the aim of outperforming efficiency targets set by Ofwat.

Operating costs are the largest expense to our company and minimising our costs across areas such as employee costs, power, materials, property rates and service costs is important in order to add value to our company. However, minimising costs needs to be done on a sustainable basis and not to the detriment of customer service or long-term value. We have a strong focus on innovation to help optimise the management of our assets and networks, which helps us identify and resolve operational issues before they impact the customer, thereby also improving our efficiency.

In terms of financing costs, Ofwat allows all water companies an industry-wide fixed return on debt over the regulatory period in order to efficiently finance their businesses. For the 2010–15 period, this was set at 3.6 per cent plus inflation (pre tax). We can generate financing outperformance by locking-in a lower cost of borrowing than this assumed rate. At each price review, Ofwat takes account of the rates at which companies have raised debt, along with other factors. At the last price review in 2009, Ofwat reduced allowed returns, which is providing a beneficial impact on customer bills during the current regulatory period.

Outperformance of regulatory contract – key value driver

Through an efficient capital structure, supporting a solid A3 credit rating from rating agency Moody's, we aim to secure debt at a lower average rate than Ofwat's cost of debt allowance for the 2010–15 period.

Through the effective implementation of our cost control measures, we are targeting operating expenditure outperformance over the 2010–15 period on top of a tough £150 million efficiency challenge from Ofwat.

Through our disciplined investment approach, we aim to achieve capital expenditure outperformance compared to the 2010–2015 regulatory allowance.

Responsible manner

We are acutely aware of our responsibility to the environment and we are committed to delivering our services in a responsible and sustainable manner. This approach not only provides environmental benefits, but is important for our reputation and helps the delivery of sustainable profits. Our regulators can require us to incur additional unfunded expenditure if, for example, we fail to meet our leakage targets or can issue fines if we fail to meet certain environmental targets.

We know that the success of our business is driven by the talent, engagement and commitment of our employees. We respect the rights of our people and enable everyone to make their best contribution. We provide competitive rewards to attract and retain employees and recognise high achievement alongside investing in our employees' learning and development.

Leakage performance – key value driver

Our strong, year round operational focus on leakage has enabled us again to meet our annual leakage target, as set by Ofwat, making us one of the best performers in the industry. As well as the water resource and customer supply benefits, this has ensured we have avoided any unfunded expenditure requirements from our regulators and we are targeting to continue to meet this leakage target every year going forward.

Key performance indicators

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

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.

KPI	Performance
Revenue A definition of revenue is included in accounting policies note (c) on page 83	£1,636m +4.5% 2012/13 £1,636m 2011/12 £1,565m 2010/11 £1,513m
Regulatory capital expenditure Total regulatory capital expenditure during the year (including infrastructure renewals expenditure)	£787m +15.7% 2012/13 £787m 2011/12 £680m 2010/11 £608m
Underlying operating profit This underlying measure of operating profit excludes from the reported operating profit any restructuring costs and other significant non-recurring items. Reconciliation is shown on page 30	£607m +2.2% 2012/13 £607m 2011/12 £594m 2010/11 £596m
Underlying profit after taxation This measure deducts underlying net finance expense and underlying taxation from underlying operating profit. Underlying net finance expense makes adjustments to the reported net finance expense, including the stripping out of fair value movements. Underlying taxation strips out any prior year adjustments, exceptional tax or any deferred tax credits or debits arising from changes in the tax rate from reported taxation. A reconciliation between profit after taxation and underlying profit after taxation is shown on page 30	£266m +10.5% 2012/13 £266m 2011/12 £241m 2010/11 £239m
Underlying earnings per share This measure divides underlying profit after taxation by the average number of shares in issuance during the year	39.1p +10.8% 2012/13 39.1p 2011/12 35.3p 2010/11 35.1p
Total dividend per share As explained in the dividend per share section on page 27	34.32p +7.2% 2012/13 34.32p 2011/12 32.01p 2010/11 30.00p
Gearing: net debt to regulatory capital value Group net debt (including derivatives) divided by UUW's regulatory capital value (Ofwat's published RCV in outturn prices adjusted for actual capital expenditure to date)	60% +1% 2012/13 60% 2011/12 59% 2010/11 59%

Operational KPIs

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

Company objective	KPI	Performance	Target
Best service to customers			
Serviceability	Ofwat rates each company's assets as 'improving', 'stable', 'marginal' or 'deteriorating' across four categories covering water and wastewater infrastructure and non-infrastructure	**2012/13: 1 x improving, 3 x stable** 2011/12: 1 x improving, 2 x stable 1 x marginal 2010/11: 3 x stable, 1 x marginal	To hold at least a stable rating for all four asset classes, which is consistent with Ofwat's target
Service incentive mechanism – qualitative	Ofwat derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 21 water companies. Each company receives a score in the range of zero to five, with five being the highest attainable score	Further improvement in 2012/13 2012/13 14th 2011/12 16th 2010/11 21st	To move to the first quartile in the medium-term
Service incentive mechanism – quantitative	Ofwat derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 21 water companies. Each company receives a SIM point total, where the lowest score represents the best performance	34% further improvement in score for 2012/13 2012/13 179 2011/12 273 2010/11 539	To move to the first quartile in the medium-term
Lowest sustainable cost			
Opex outperformance	Progress to date on cumulative operating expenditure outperformance versus Ofwat's allowed operating costs over the 2010–15 period	**2012/13: On track to meet £50m target** 2011/12: On track to meet £50m target 2010/11: On track to meet £50m target	Total opex outperformance over the 2010–15 period of at least £50m
Financing outperformance	Progress to date on financing expenditure outperformance secured versus Ofwat's allowed cost of debt of 3.6% real over the 2010–15 period	**2012/13: On track to meet £300m+ target** 2011/12: On track to meet £300m+ target 2010/11: On track to meet £300m+ target	Total financing outperformance over the 2010–15 period of at least £300m
Capex outperformance	Capital expenditure progress to date against Ofwat's capital expenditure allowance for the 2010–15 period, after adjusting, through the regulatory methodology, for the impact of construction output prices	**2012/13: On track to meet capex allowance** 2011/12: On track to meet capex allowance 2010/11: On track to meet capex allowance	To meet Ofwat's revised capital expenditure allowance for the 2010–15 period
Responsible manner			
Leakage – rolling average annual leakage	Average annual water leakage from our network quantified in megalitres per day	**2012/13: 457Ml/d – Met target** 2011/12: 453Ml/d – Met target 2010/11: 464Ml/d – Met target	To meet our regulatory leakage target, as set by Ofwat, each year
Environment Agency performance assessment	Composite assessment produced by the Environment Agency, measuring the absolute and relative performance of the 10 water and wastewater companies across a broad range of areas, including pollution. The EA adjusted its methodology for 2011/12	Improved to third under new 2011/12 (latest available) assessment 2011/12 3rd 2010/11 7th 2009/10 6th	To move to the first quartile in the medium-term
Dow Jones Sustainability Index rating	Rating awarded to company by Dow Jones using sustainability metrics covering economic, environmental, social and governance performance	**2012/13: 'World Class'** 2011/12: 'World Class' 2010/11: 'World Class'	To retain 'World Class' rating each year

Our performance and the progress we have made against our objectives and their associated KPIs are included within the business performance section on pages 20–31.

Performance

Full year results for the year ended 31 March 2013

£m *Continuing operations*	Year ended 31 March 2013	Year ended 31 March 2012
Underlying operating profit[1]	607.1	594.1
Underlying profit before taxation[1]	354.3	327.0
Underlying profit after taxation[1]	266.3	240.9
Underlying earnings per share[1,2] (pence)	39.1	35.3
Revenue	1,636.0	1,564.9
Operating profit	604.5	591.5
Profit before taxation	304.7	280.4
Profit after taxation	282.3	311.4
Basic earnings per share[2] (pence)	41.4	45.7
Total dividends per ordinary share (pence)	34.32	32.01

Notes:
(1) Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables on page 30
(2) Earnings per share and underlying earnings per share are explained in the earnings per share section on page 27

- Operational improvement delivers benefits for customers
  - further customer service improvements: Ofwat's quantitative SIM score improved by 34 per cent
  - met water and wastewater asset serviceability standards
  - outperformed regulatory leakage target

- Effective delivery of capital investment programme
  - accelerated the programme with investment up 16 per cent at £787 million for the year
  - much improved capex delivery – internal Time: Cost: Quality index up from c50 per cent to c90 per cent
  - delivered all capital investment Environment Agency commitments this year

- On track to meet outperformance targets, benefiting customers and shareholders
  - reinvesting c£200 million of capex outperformance for the benefit of customers and the environment
  - customers will benefit from opex outperformance in 2015–20 regulatory period
  - reinvesting c£40 million of financing outperformance on unfunded private sewers costs for customers

- Strong financials
  - underlying operating profit up £13 million to £607 million
  - RCV gearing of 60 per cent in the middle of Ofwat's range
  - final dividend of 22.88 pence per share (total for the year of 34.32 pence), in line with policy

Operational performance

Supporting our drive to improve operational performance, last year we put in place a revised management structure with a strong focus on accountability and delivery. We moved from our previous functional structure, to an organisational structure where managers are responsible for end-to-end delivery of capital projects and operational performance within their respective regions, providing a more integrated approach. We have refined our organisational structure further in preparation for a more competitive environment and to align with the separated price controls that will apply at the 2014 price review. With effect from April 2013, we have revised our structure and activities around three business areas: Wholesale; Domestic Retail; and Business Retail.

We continue to make good progress towards our objective of becoming a leading North West service provider and one of the best UK water and wastewater companies. We are pleased to have been consistently ranked third out of 10 leading organisations in the North West, through an independent brand tracker survey which is undertaken quarterly. We are behind Marks & Spencer and John Lewis, but ahead of seven other major organisations covering utilities, telecoms, media and banking services. We have made further operational improvements during the year and have improved our performance relative to our water sector peers.

United Utilities aims to deliver long-term shareholder value by providing:

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

Best service to customers

We believe in delivering a fair deal for our customers and have continued to invest in our people, assets, systems and processes to improve the service our customers can expect of us. In addition, we expect to reinvest around £200 million of capex outperformance over the 2010-15 period for the benefit of our customers and the environment.

Robust water supply and reliability – We have implemented active pressure management in our water network to reduce bursts and leakage, helping us to meet or outperform our leakage target. Should we have a burst, the additional investment completed during the year in strategic mains refurbishment and connectivity has improved the capability of our water network to maintain supply.

Whilst the North West did not experience the hosepipe bans seen elsewhere in the country last spring, rainfall across our region was much lower than expected. We were able to benefit from our investment in an integrated regional water network to keep customers supplied throughout the dry period.

Overall, our customers continue to benefit from our robust water supply and demand balance and high levels of water supply reliability. We have again achieved a high level of water quality, with mean zonal compliance continuing to be over 99.9 per cent.

Major scheme in Preston to improve river and bathing waters

We are undertaking a £100 million+ project in Preston, which is designed to improve both river water and bathing water quality. The project involves building a 3.5 kilometre storm water storage tunnel and the construction of shafts to divert storm water flows, helping to retain large volumes of water during heavy rainfall. It will reduce the number of spills to the River Ribble from combined sewers and should deliver significant improvements to North West bathing waters and the Ribble Estuary in the Blackpool area. This is one of our largest projects in the 2010-15 period and is now nearing completion.

Performance continued

Investing to mitigate sewer flooding – The latter half of 2012 was characterised by a large number of exceptionally high rainfall events and this proved to be a testing time for our wastewater assets. We were disappointed to miss our Ofwat target in respect of the number of sewer flooding incidents, but have continued to invest heavily in schemes designed to mitigate the risk of flooding of our customers' homes. Our wastewater network will continue to benefit from significant investment going forward as we adapt to weather patterns likely to result from climate change.

Improving customer service performance – We have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. This has helped us deliver further improvements in our performance on Ofwat's service incentive mechanism (SIM), reflecting our continuing strong focus on dealing with customer enquiries. The number of customer complaints made to the Consumer Council for Water (CCW) in 2012/13 has reduced by a further 11 per cent, compared with 2011/12. We are pleased to report that the total number of escalated complaints assessed by the CCW was zero in the 2012/13 financial year, which is the first time we have achieved this. This has helped us improve our SIM performance further, as detailed in the KPIs section to the right, although our qualitative SIM score for the last quarter of 2012/13 saw us slip back against the trend achieved in the first three quarters. We ended the year in 14th place in the sector on this measure, up two places on the previous year. Encouragingly, we have recently received our qualitative SIM score for the first quarter of 2013/14 and we achieved 10th position out of the 21 water companies.

Asset serviceability – We have a range of actions to help support the serviceability of our assets. We are improving the robustness of our water treatment processes, refurbishing service reservoir assets, continuing with our comprehensive mains cleaning programme and are optimising water treatment to reduce discoloured water events. To help reduce sewer flooding, the actions include incident based targeting to focus on areas more likely to experience flooding, effective intervention in cleaning and rehabilitation or refurbishment of sewers and advising customers about items not suitable for sewer disposal.

Our programme also includes defect identification through CCTV sewer surveys, along with continual improvement of wastewater reporting systems to enable real time operational information to be made visible at all management levels and promote early intervention. Our comprehensive range of actions has helped us meet our water and wastewater serviceability standards, as detailed in the KPIs section opposite.

Retail competition for business customers – We have been building our capability to help ensure we are in a strong position to compete as the business market for retail customers evolves. We secured a water supply licence in 2012 to compete in Scotland and have built a team with a deep retail background in the utility and commercial sectors. Although the financial benefits from retail activities are relatively small at this stage, the market will evolve and business customers are looking for services over and above meter reading and billing. We are delivering a range of value-added services, such as on-site engineering solutions and water efficiency advice. We are pleased to have extended our presence and have now won several business customers outside of our region. We also have a significant pipeline of opportunities, a number of which are multi-site customers.

Improving customer service remains a significant area of continued management focus and we see plenty of opportunity to deliver further benefits for our customers.

Key performance indicators:

- **Serviceability –** Long-term stewardship of assets is critical and Ofwat measures this through its serviceability assessment (Ofwat defines serviceability as the capability of a system of assets to deliver a reference level of service to customers and to the environment now and in the future). Our range of actions has helped us return our wastewater infrastructure assets to a 'stable' rating, from a 'marginal' rating, and we are now meeting our serviceability standards. We are currently assessed as 'improving' for our wastewater non-infrastructure assets and 'stable' for our water infrastructure, water non-infrastructure and wastewater infrastructure assets. The aim is to continue to hold at least a 'stable' rating for all four asset classes, which is aligned with Ofwat's target.

- **Service incentive mechanism (SIM) –** UU made significant progress on Ofwat's combined SIM assessment for 2011/12, moving up five places to 16th of the 21 water companies, compared with 2010/11. This represented the largest overall SIM score improvement in the industry. Further progress has been made in 2012/13, with a quantitative score of 179 points, representing a further 34 per cent improvement compared with 2011/12. On the qualitative measure, UU has improved its 2012/13 average score by 0.25 points to 4.43 points, moving up two further places to 14th position, which represents sixth place among the 10 water and sewerage companies. Our continued progress is encouraging, as we aim to move to the first quartile in the medium-term.

Lowest sustainable cost

We are continuing to implement a wide range of initiatives to help optimise our performance and deliver sustainable efficiencies.

Materials – Our asset optimisation programme continues to provide the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power assets to generate renewable energy.

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

Energy costs – We have substantially locked in the cost of our power requirements through to 2014/15, via hedging, securing outperformance. Although power unit costs for 2013-15 have been secured at higher levels than those for 2011/12, this still delivers additional outperformance versus the regulatory contract.

Debt collection – We are continuing to enhance our proactive approach to debt collection and are implementing a detailed action plan. The North West faces a particularly tough economic environment, with unemployment having increased at a faster rate than any other UK region in 2011/12, particularly in the second half, resulting in an adverse impact on customers' ability to pay this year.

Although North West unemployment improved in 2012/13, it remains higher than the position at March 2011 and is still above the national average. We recognise the financial difficulties facing many of our customers and provide a range of options to help our customers who are struggling to pay their bills, including our charitable trust, and we have helped many customers back onto manageable payment plans. Despite the tough economic climate, our range of actions have helped us to again deliver a good performance and we have sustained bad debts at 2.2 per cent of regulated revenue for 2012/13, consistent with last year.

Pensions – UU placed its pension provision on a more sustainable footing in 2010 and has subsequently taken additional steps to de-risk the pension scheme further, with the group now benefiting from a small pension surplus. Further details on the group's pension provision are provided in the pensions section on page 29.

Capital delivery – The business is strongly focused on delivering its commitments efficiently and on time and has a robust commercial capital delivery framework in place for the 2010-15 period. We have improved our internal Time: Cost: Quality index (TCQi) score from around 50 per cent in 2010/11 to approximately 90 per cent in 2012/13. This means we have met our target two years ahead of schedule and we are firmly focused on sustaining this substantial improvement. This helped us accelerate our capital programme to help optimise capital delivery and reduce risk towards the end of the regulatory period. Regulatory capital investment in 2012/13, including £161 million of infrastructure renewals expenditure, was £787 million, an increase of 16 per cent compared with last year. This increase of over £100 million means that our cumulative investment across the first three years of the 2010-15 period is now just over £2 billion, reflecting a smoother and more effective investment profile than the previous five-year cycle. We remain on track to deliver the five-year programme within the regulatory allowance of around £3.5 billion and we are reinvesting any capex outperformance to deliver further customer benefits. We expect to deliver around £800 million of capital investment in 2013/14.

Regulatory commitments – Delivering our regulatory commitments is key, not only in terms of service to customers and the environmental impact, but also in respect of shareholder value. UU received a shortfalling revenue penalty of over £80 million at the last price review in 2009. Shortfalling is effectively where a company fails to deliver agreed requirements on time or to specification. We are strongly focused on meeting our regulatory commitments, as we aim to avoid, or at least minimise, any shortfalling revenue penalties at the 2014 price review. We are making good progress and we have delivered all of our capital investment Environment Agency commitments this year. This represents a much improved performance, so far, compared with the 2005-10 regulatory period, and we will continue to treat this as a priority area.

Private sewers – The transfer of private sewers around 18 months ago has gone well and is now embedded within our 'business as usual' activities. The volume of work and the level of expenditure continues to be a little below our expectations. The mix of work continues to relate more to enhancement capex than opex, compared with what we initially expected at the onset.

Our operating model has evolved to reflect the revised work scope and volumes. In addition to routine maintenance activity, we are enhancing the quality of the assets where appropriate. This will bring the private sewer infrastructure more in line with our asset standards and will reduce the risk of future problems for our customers. In 2012/13, we spent £8 million on opex, £11 million on infrastructure renewals expenditure and £14 million in relation to enhancement capex. Although spend rates remain a little lower than we anticipated, we are still only 18 months into the transfer so we are not changing our 2011-15 total cost estimate of £160 million (£40 million opex, £60 million infrastructure renewals expenditure and £60 million enhancement capex) at this stage. This lower rate of spend and the mix of work continues to be positive for both our customers and our investors.

Performance continued

Key performance indicators:

- **Financing outperformance –** UU has secured over £300 million of financing outperformance across the 2010-15 period, when compared with Ofwat's allowed cost of debt of 3.6 per cent real, based on an average RPI inflation rate of 2.5 per cent per annum. We expect to reinvest around £40 million of our financing outperformance in unfunded private sewers costs.

- **Operating expenditure outperformance –** The business is targeting total operating expenditure outperformance over the 2010-15 period of at least £50 million, or approximately two per cent, compared with the regulatory allowance. This is in addition to the base operating expenditure efficiency targets set by Ofwat, which equate to a total of approximately £150 million over the five years. We have now delivered cumulative operating expenditure outperformance of around £50 million in the first three years of the regulatory period and are ahead of schedule.

- **Capital expenditure outperformance –** UU is continuing to deliver significant efficiencies in the area of capital expenditure and expects to meet Ofwat's allowance after adjusting, through the regulatory methodology, for the impact of lower construction output prices. We expect to reinvest around £200 million of capital expenditure outperformance for the benefit of our customers and the environment.

Responsible manner

Acting responsibly is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility factors as a strategic decision in its decision making.

Leakage – We were pleased to beat our regulatory leakage target in 2012/13. This reflects our year round operational focus and the implementation of a range of initiatives, such as active pressure management. Our leakage performance, alongside the network resilience improvements we are making, are helping us to maintain a robust water supply and demand balance and deliver high levels of reliability for our customers.

Improving rivers and bathing water quality – We have a range of capital projects which are delivering significant customer and environmental benefits. Our Liverpool wastewater treatment works expansion project, at around £200 million, is our largest capital programme in this regulatory cycle. The project will enhance the capacity of the works so it can treat up to 11,000 litres of wastewater per second. The project is progressing well and the higher standards of treatment will continue the rejuvenation of the River Mersey and improve bathing waters across the river on the Wirral. It also provides a significant contribution to the local economy. The extended works are expected to come online in early 2016.

Reducing our carbon footprint – We are committed to reducing our carbon footprint and increasing our generation of renewable energy. Our carbon footprint for 2012/13 was 524,264 tonnes of carbon dioxide equivalent, a minor increase of 0.4 per cent compared with last year. This was as a result of an increase in the amount of electricity purchased as we undertook additional pumping activity. Not only did we experience one of the wettest years on record, resulting in significantly more wastewater in our sewers and treatment works, the year began and ended with a prolonged dry spell, so we needed to pump additional volumes of water around our integrated network. We were pleased to retain the Certified Emissions Measurement and Reduction Scheme certification for our carbon accounting methodology. We remain on track to meet our target of a 21 per cent reduction in carbon emissions by 2015 (measured from a 2005/06 baseline). UU has consistently generated around 100 GWh of renewable electricity annually for the past four years, principally from sludge processing. By 2014, we expect to have finished commissioning an innovative £100 million+ recycling and energy plant at one our largest wastewater treatment works at Davyhulme, near Manchester. By treating sludge that is left over at the end of the wastewater treatment process, we can generate enough electricity from biogas to power the Davyhulme site. Sludge is also converted into a valuable agricultural fertiliser.

Environmental performance – This is a high priority for UU and we were pleased to report the lowest number of major pollution incidents of the 10 water and wastewater companies, per kilometre of pipe, for 2011/12 (the latest available assessment). Our operational and environmental focus is delivering results and we were pleased to achieve our best performance for many years in the Environment Agency's performance metrics, where we have been rated as an 'above average performer', as detailed in the KPIs section on the next page.

Employees – A committed, capable and motivated workforce is central to delivering our vision and we remain strongly focused on high levels of employee development and engagement. We continue to be successful in attracting and retaining people and we were pleased to also extend our apprentice programme during the last year. We currently employ over 80 apprentices and plan to recruit up to a further 40 apprentices each year through to 2015. Alongside this, we are continuing to expand our graduate recruitment scheme, with plans to add more than 20 graduates in 2013/14. This

Sustainable abstraction scheme restores Lancashire rivers

We have recently launched a pioneering scheme in conjunction with the Environment Agency (EA), which is restoring two rivers in the Trough of Bowland in Lancashire. This joint EA and UU project – one of the first of its kind in the country – will help the rivers prosper by only taking water from the rivers when it is plentiful, using two new abstraction plants. By restoring a more natural flow, there is a greater opportunity to enhance and protect fish and other habitats. To make up for any shortfall of water for homes in the Blackburn area, we are building a new £12 million pipeline to connect the local water treatment works to a nearby service reservoir.

is in addition to over 35 graduates we currently employ. As part of our health and safety improvement programme, we implemented a number of initiatives throughout the year and launched a set of behavioural standards at our main office sites, called the 'Safety Six'. Health and safety will continue to be a significant area of focus for the company, as we strive for continuous improvement.

Communities – We continue to support community partnerships, which help in meeting our company objectives. For example, our partnership with UTV Media takes an online programme into schools to enable them to create a radio advert (part of the national curriculum) linked to one of our key campaigns, such as water efficiency or reservoir safety. With an emphasis on promoting the adverts through social media, this provides an innovative way for our key messages to reach our customers. Education is an integral part of our community approach and our new outreach education partnership started this year and has already reached 139 schools and 4,754 children.

Where we cause disruption as part of our major capital works, we invite local community groups to apply for small scale grants to support their work. Last year we contributed to 116 groups in 10 locations across the North West. We also contributed approximately £2 million supporting local communities providing debt advisory services and undertook over 26,000 hours of employee volunteering.

Leading credentials – Our environmental and sustainability performance across a broad front has received external recognition. UU continues to be rated 'World Class' in the Dow Jones Sustainability Index and has retained the highest ranking, 'Platinum Big Tick', in Business in the Community's Corporate Responsibility Index. In addition, UU holds membership of the FTSE 350 Carbon Disclosure Leadership Index. UU is one of only four FTSE 100 companies to hold all three awards.

Key performance indicators:

- **Leakage –** UU met its economic level of leakage rolling target for the seventh consecutive year in 2012/13, with a performance of 457 megalitres per day versus the regulatory target of 464 megalitres per day. The aim is to meet our regulatory leakage target each year.
- **Environmental performance –** On the Environment Agency's latest assessment, which covers a broad range of operational metrics, UU has been rated as an 'above average performer'. UU has three areas highlighted as 'Green', four as 'Amber', and, importantly, no areas highlighted as 'Red' on the traffic light reporting matrix. This would indicate third position among the 10 water and sewerage companies. Although the EA has revised its performance measure, UU was in seventh position on the EA's composite assessment for the previous year, so this represents good progress against the medium-term goal of being a first quartile company on a consistent basis.
- **Corporate responsibility –** UU has a strong focus on corporate responsibility and is the only UK water company to have a 'World Class' rating as measured by the Dow Jones Sustainability Index. The group aims to retain this 'World Class' rating each year.

Performance continued

Financial performance

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

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

Investment income and finance expense
The underlying net finance expense of £253 million was £14 million lower than last year, principally reflecting lower RPI inflation in respect of the group's index-linked debt with an eight-month lag. The indexation of the principal on index-linked debt amounted to a net charge in the income statement of £86 million, compared with a net charge of £100 million last year. The group had approximately £2.9 billion of index-linked debt as at 31 March 2013. The lower RPI indexation charge contributed to the group's average underlying interest rate of 4.9 per cent being lower than the rate in 2011/12 of 5.5 per cent.

Reported investment income and finance expense of £300 million was £11 million lower than in 2011/12, principally reflecting a reduction in the underlying net finance expense. The £42 million net fair value loss in the year is largely due to losses on the regulatory swap portfolio, resulting from a further decrease in sterling interest rates during the period. The group uses these swaps to fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by the regulator at each price review. The group fixed the majority of its non index-linked debt for the 2010-15 financial period, providing a net effective nominal interest rate of approximately five per cent.

Profit before taxation
Underlying profit before taxation was £354 million, £27 million higher than last year due to the £13 million increase in underlying operating profit and the £14 million reduction in underlying finance expense. This underlying measure adjusts for the impact of one-off items, principally from restructuring and reorganisation within the business, and fair value movements in respect of debt and derivative instruments. Reported profit before taxation increased by £24 million to £305 million.

Taxation
The current taxation charge was £74 million in the year and the current taxation effective rate was 24 per cent. This compares with 16 per cent in the previous year which included a £16 million credit following agreement with the UK taxation authorities of prior years' taxation matters.

The group has recognised a net deferred taxation credit of £52 million for the year, which primarily relates to a £53 million credit in respect of the change substantively enacted by the UK Government on 3 July 2012 to reduce the mainstream rate of corporation taxation from 24 per cent to 23 per cent with effect from 1 April 2013. A net deferred taxation credit of £77 million was recognised in the previous year, which included a £105 million credit reflecting a two per cent staged reduction in the rate of corporation taxation.

An overall taxation charge of £22 million has been recognised for the year ended 31 March 2013. Excluding the deferred taxation impact relating to the future reduction in the corporation taxation rate, the total taxation charge would have been £75 million or 25 per cent compared with a £74 million charge or 26 per cent in the previous year. This reduction is principally due to the decrease in the mainstream rate of corporation taxation from 26 per cent for 2011/12 to 24 per cent for 2012/13.

The taxation benefit of £16 million relating to pension contributions for deficit funding has been recorded in the statement of comprehensive income, rather than the income statement, as the actuarial movements giving rise to the deficit were previously recorded there. Deferred taxation movements of £26 million are also included in the statement of comprehensive income. The comparative prior year figures were a current taxation benefit of £33 million and a £29 million deferred taxation charge.

The group made cash taxation payments during the year of £55 million. This was higher than the group's net taxation payment of £5 million in 2011/12 primarily reflecting a £35 million cash taxation inflow last year relating to prior years' taxation matters and also reflecting the higher levels of pension contributions made last year.

Profit after taxation
Underlying profit after taxation of £266 million was £25 million higher than the previous year, principally reflecting the increase in underlying profit before taxation. Reported profit after taxation was £282 million, compared with £311 million last year, as the increase in underlying profit was more than offset by a decrease in deferred taxation credits associated with the enactment of the reductions in corporation taxation rates between the two years.

Earnings per share

Underlying earnings per share increased from 35.3 pence to 39.1 pence. This underlying measure is derived from underlying profit after taxation. This includes the adjustments for the deferred taxation credits in both 2012/13 and 2011/12, associated with the reductions in the corporation taxation rate. Basic earnings per share decreased from 45.7 pence to 41.4 pence, mainly due to the higher deferred taxation credit in 2011/12.

Dividend per share

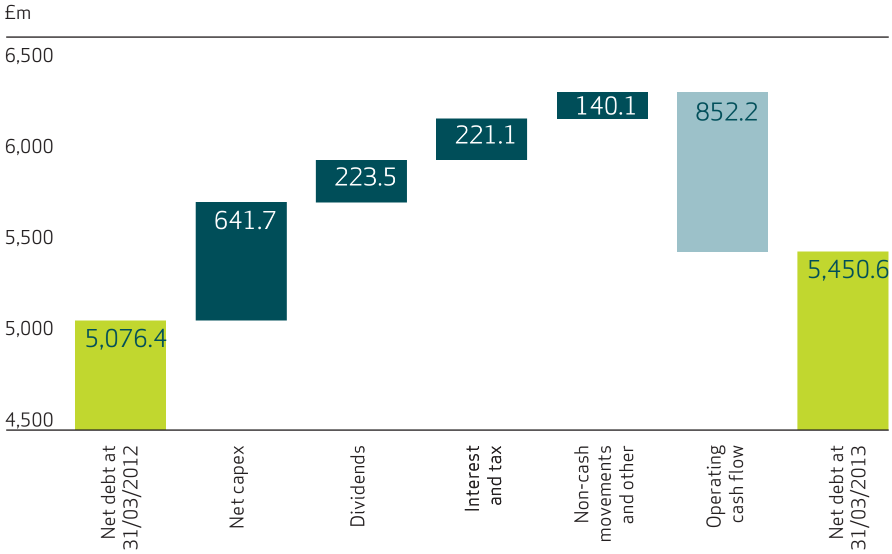
The board has proposed a final dividend of 22.88 pence per ordinary share in respect of the year ended 31 March 2013. Taken together with the interim dividend of 11.44 pence per ordinary share, paid in February, this produces a total dividend per ordinary share for 2012/13 of 34.32 pence. This is an increase of 7.2 per cent, compared with the dividend relating to the previous year, in line with group's dividend policy of targeting a growth rate of RPI+2 per cent per annum through to at least 2015. The inflationary increase of 5.2 per cent is based on the RPI element included within the allowed regulated price increase for the 2012/13 financial year (i.e. the movement in RPI between November 2010 and November 2011).

The final dividend is expected to be paid on 2 August 2013 to shareholders on the register at the close of business on 21 June 2013. The ex-dividend date is 19 June 2013.

Cash flow

Net cash generated from continuing operating activities for year ended 31 March 2013 was £631 million, compared with £560 million last year. This mainly reflected a reduction in the total pension contribution payments between the two years. The group's net capital expenditure was £642 million, principally in the regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under International Financial Reporting Standards.

Summary of net debt movement



Net debt including derivatives at 31 March 2013 was £5,451 million, compared with £5,076 million at 31 March 2012. This expected increase reflects expenditure on the regulatory capital expenditure programmes and payments of dividends, interest and taxation, alongside the accelerated pension deficit repair payments and an increase in the principal of our index-linked debt, partly offset by operating cash flows.

Debt financing and interest rate management

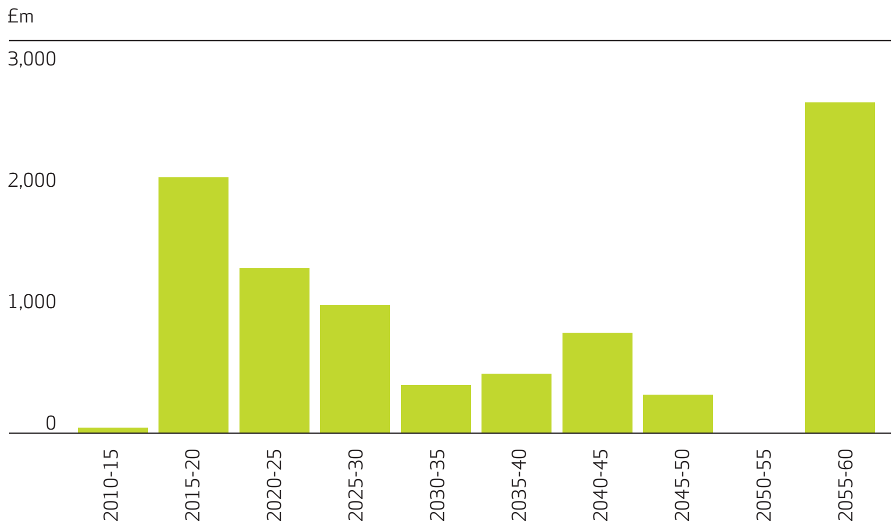
Gearing (measured as group net debt divided by UUW's regulatory capital value adjusted for actual capital expenditure) marginally increased to 60 per cent at 31 March 2013, compared with 59 per cent at 31 March 2012, and is in the middle of Ofwat's 55 per cent to 65 per cent assumed gearing range. The group now has a small pension surplus of £15 million, on an IFRS basis, compared with a deficit of £92 million as at 31 March 2012.

Gross debt

£770.0m Yankee bonds (USD)
£495.0m Euro bonds (EUR)
£1,698.9m GBP bonds
£1,634.4m GBP ind -
IB and other
ind -

Performance continued

Term debt maturity per regulatory period



At 31 March 2013, UUW had long-term credit ratings of A3/BBB+ and United Utilities PLC had long-term credit ratings of Baa1/BBB- from Moody's Investors Service and Standard & Poor's Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. In December 2012, Standard & Poor's put both the group's ratings on positive outlook, citing improving financial metrics and operational performance.

Cash and short-term deposits at 31 March 2013 amounted to £202 million. In March 2013, UUW arranged a new £100 million, 10-year index-linked loan with an existing relationship bank. The group also renewed £150 million of existing bank facilities in the period. The group has headroom to cover its projected financing needs into 2015.

The group has access to the international debt capital markets through its €7 billion euro medium-term note programme which provides for the periodic issuance by United Utilities PLC and UUW of debt instruments on terms and conditions determined at the time the instruments are issued. The programme does not represent a funding commitment, with funding dependent on the successful issue of the debt securities.

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

Long-term sterling inflation index-linked debt is the group's preferred form of funding as this provides a natural hedge to assets and earnings. At 31 March 2013, approximately 52 per cent of the group's net debt was in index-linked form, representing around 31 per cent of UUW's regulatory capital value, with an average real interest rate of 1.7 per cent. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets and is a key contributor to the group's average term debt maturity profile which is approximately 25 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, to manage exposure to long-term interest rates, the debt is generally swapped to create a floating rate sterling liability for the term of the liability. To manage exposure to medium-term interest rates, the group fixed interest costs for a substantial proportion of the group's debt for the duration of the 2010-15 period at around the time of the price review.

Following the 2009 price review, the group reassessed its interest rate hedging policy with a view to further reducing regulatory risk. To help address the uncertainty as to how Ofwat may approach the setting of the cost of debt allowance at the next price review in 2014, UU revised its interest rate management strategy to extend its fixed interest rate hedge out to a 10-year maturity on a reducing balance basis. The intention is that the effective interest rate, on the group's nominal debt, in any given year will, over time, be a 10-year rolling average interest rate. UU believes that this revised interest rate hedging policy, which provides for a longer fixing of interest rates, will put the company in a more flexible position to respond to whatever approach Ofwat adopts to the industry cost of debt in future.

Liquidity

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits and supported by committed but undrawn credit facilities. In addition to its €7 billion euro medium-term note programme, the group has a €2 billion euro-commercial paper programme, both of which do not represent funding commitments.

In line with the board's treasury policy, UU aims to maintain a robust headroom position. Available headroom at 31 March 2013 was £336 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover the group's projected financing needs into 2015.

UU believes that it operates a prudent approach to managing banking counterparty risk. Counterparty risk, in relation to both cash deposits and derivatives, is controlled through the use of counterparty credit limits. UU's cash is held in the form of short-term (generally no longer than three months) money market deposits with either prime commercial banks or with triple A rated money market funds.

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

Pensions

As at 31 March 2013, the group had an IAS 19 net retirement benefit, or pension, surplus of £15 million, compared with a net pension deficit of £92 million at 31 March 2012. This £107 million positive movement principally reflects payments of £65 million in respect of accelerated, previously agreed, deficit repair contributions, payments under the inflation funding mechanism and investment returns exceeding expectation. Following the accelerated deficit repair contributions paid in the first half of 2012/13, the group completed early all scheduled deficit repair payments through to March 2015.

The group has sought to adopt a more sustainable approach to the delivery of pension provision and prior to the start of the 2010-15 period amended the terms of its defined benefit pension schemes. UU stated previously that it would continue to evaluate its pensions investment strategy to de-risk further its pension provision and introduced an inflation funding mechanism, which facilitates a move to a lower risk investment strategy.

This allowed UU to reduce the allocation of its pension assets to approximately 25 per cent in equities and other high risk assets, down from 48 per cent at 31 March 2010. In addition, UU has adopted the use of more prudent longevity assumptions. Over the last two financial years, the group also progressively increased its interest rate hedge and this has now been extended to around 90 per cent of the pension scheme liabilities. Although any additional payments under the inflation funding mechanism would reduce financing outperformance, there would be a positive benefit to the pensions surplus or deficit position.

From an accounting perspective, IAS 19 treats the inflation funding mechanism as a schedule of contributions rather than a pension scheme asset. This means that the liabilities position can change to reflect a change in market expectations of long-term inflation, without a commensurate movement in assets. This accounting treatment means that there is likely to be a degree of volatility in future IAS 19 pension valuations.

The last actuarial valuations of the United Utilities Pension Scheme and the United Utilities PLC Group of the Electricity Supply Pension Scheme were carried out as at 31 March 2010. The valuations are performed on a triennial basis and, therefore discussions will take place over the coming months between the group and the trustees regarding the basis of the 31 March 2013 valuations. The actuarial valuations are based on scheme specific factors which may result in a different assessment of the pension schemes' position to the IAS 19 numbers reported in the group's financial statements.

Further detail is provided in note 20 ('Retirement benefit surplus/ (obligations)') of these consolidated financial statements.

Performance continued

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 taxation from continuing operations are reconciled to underlying operating profit, underlying profit before taxation and underlying profit after taxation (non-GAAP measures) as follows:

Continuing operations Operating profit	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Operating profit per published results	**604.5**	591.5
One-off items[1]	**2.6**	2.6
Underlying operating profit	**607.1**	594.1
Net finance expense	**£m**	£m
Finance expense	**(302.1)**	(315.5)
Investment income	**2.3**	4.4
Net finance expense per published results	**(299.8)**	(311.1)
Net fair value losses on debt and derivative instruments	**41.5**	43.2
Adjustment for interest on swaps and debt under fair value option	**8.3**	7.2
Adjustment for net pension interest expense	**11.5**	3.3
Adjustment for capitalised borrowing costs	**(14.3)**	(9.7)
Underlying net finance expense	**(252.8)**	(267.1)
Profit before taxation	**£m**	£m
Profit before taxation per published results	**304.7**	280.4
One-off items[1]	**2.6**	2.6
Net fair value losses on debt and derivative instruments	**41.5**	43.2
Adjustment for interest on swaps and debt under fair value option	**8.3**	7.2
Adjustment for net pension interest expense	**11.5**	3.3
Adjustment for capitalised borrowing costs	**(14.3)**	(9.7)
Underlying profit before taxation	**354.3**	327.0
Profit after taxation	**£m**	£m
Underlying profit before taxation	**354.3**	327.0
Reported taxation	**(22.4)**	31.0
Deferred taxation credit – change in taxation rate	**(53.0)**	(104.6)
Agreement of prior years' UK taxation matters	**(0.7)**	(0.4)
Taxation in respect of adjustments to underlying profit before taxation	**(11.9)**	(12.1)
Underlying profit after taxation	**266.3**	240.9

Note:
[1] Principally relates to restructuring costs within the business

Underlying operating profit reconciliation

The table below provides a reconciliation between group underlying operating profit and United Utilities Water PLC historical cost regulatory underlying operating profit (non-GAAP measures) as follows:

Continuing operations Underlying operating profit	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Group underlying operating profit	**607.1**	594.1
Underlying operating profit not relating to United Utilities Water	**(1.8)**	(10.9)
Infrastructure renewals accounting	**32.6**	40.2
Other differences	**–**	(3.9)
United Utilities Water statutory underlying operating profit	**637.9**	619.5
Revenue recognition	**1.7**	2.6
Infrastructure renewals accounting	**5.1**	(2.5)
Non-appointed business	**(6.2)**	(7.0)
United Utilities Water regulatory underlying operating profit	**638.5**	612.6

Principal risks and uncertainties

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

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

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

Corporate risk management framework

Key developments during the year

Regulatory related risks have featured prominently in our risk profile over the last 12 months with key areas of focus typically being the Government's market reform agenda and Ofwat's proposals for future price limits.

In addition, the risk of potential change in RPI methodology with the potential impact to RCV and income continues to exist but is a reduced risk for the group. This risk was highlighted in our half year accounts but the Office of National Statistics has now recommended no change to the methodology.

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

Strategic	
Government market reform agenda	Control/mitigation
The Government's White Paper (Water for Life) highlighted key policy priorities for the water industry. A draft Water Bill was published on 10 July 2012 and incorporates changes to legislation that would be required to enable many of the changes set out in the White Paper. These include measures to introduce competition and the removal of barriers to entry (see 'Competitive environment' on page 13). The scale and impact of retail and upstream competition will depend on the mechanisms set out in an expected new draft bill and what ultimately becomes legislation. As a result and until this publication, there is significant uncertainty about the potential impacts; however, these could include: increased costs, reduced income and reduced confidence in the RCV mechanism leading to a rise in future costs of borrowing.	We have been fully engaged, as has the whole industry, in all Government and Ofwat consultations in relation to competition and industry reform. We are also making determined efforts to retain customers in area, win out of area customers and prepare for a more competitive environment and the potential opportunities that this may bring.
Future price limits and the price control review 2014	Control/mitigation
In May 2012, Ofwat published a document setting out the key principles it expects to follow in future price reviews. Ofwat then undertook a lengthy and ongoing consultation over its proposals for reform of the methodology and approach for setting prices from 2015, the most recent of which was the draft methodology issued on 28 January 2013. The principal decision to date is that Ofwat will set two binding retail price controls (one for household and one for non-household) and two binding wholesale controls (one for water and one for wastewater). Other proposals include: household/non-contestable retail cost recovery based on an average cost to serve; the introduction of a new 'Totex' menu approach to assessing cost assumptions; the setting of a lower cost of capital and the potential for different approaches to sharing the benefits of outperformance between shareholders and customers (see 'Future regulation' on page 12). These areas contribute to a wider risk of failing to achieve a successful Final Determination following Ofwat's price control review which could result in loss of income and profit, significant cost recovery shortfall, a reduction in allowed expenditure (both capital and operating expenditure) and the ability to outperform. There will also be additional costs for preparing for and administrating separate price controls for retail and wholesale.	We have raised and explained our concerns with Ofwat and, where appropriate, made alternative proposals as part of the consultation process. We continue to make strong representation to Ofwat on these issues, particularly in relation to the 'cost to serve' proposals. More generally, a successful price control review (meeting the needs of customers and stakeholders) is being targeted through a dedicated PR14 programme team whose activities are focused on appropriate deliverables and stakeholder engagement. The final price review methodology proposals are due to be issued later this summer.

Principal risks and uncertainties continued

Compliance	
Failure to comply with applicable law or regulations	**Control/mitigation**
We are subject to various UK and international laws and regulations associated with water and wastewater service, health and safety, the environment, property/land management and the general running of a company. If we fail to comply, or become involved in third party proceedings including civil actions by third parties for infringement of rights or nuisance, we could face a range of outcomes. These include financial penalties (of up to 10 per cent of relevant regulated turnover), the imposition of an enforcement order requiring additional capital/operating expenditure, or compensation following litigation. In more extreme circumstances, impacts could ultimately include the revocation of our licence to operate or the appointment of a special administrator.	We have robust processes in place to identify risks to our compliance with legal and regulatory obligations. This includes the continual monitoring of legislative and regulatory developments, the training of employees in new developments and the participation in consultations to influence their outcome, either directly or through industry trade associations for wider issues. Funding for any additional compliance costs in our regulated business is sought as part of the price determination process. We also robustly defend litigation where appropriate and seek to minimise our exposure by establishing a provision and seeking recovery wherever appropriate.
The UK Government has lost a case in the Court of Justice of the European Union relating to the Government's approach to enforcement of the Urban Waste Water Treatment Directive (the 'Whitburn' case). The Directive relates to wastewater discharges and, if this case leads to a change in the law or enforcement of it, our capital investment programme and associated funding requirements could change.	No decision has been made on potential change to the law or its enforcement following 'Whitburn' but we are engaged with the industry and industry trade associations on this issue.
Material litigation	**Control/mitigation**
In February 2009, United Utilities International Limited (UUIL) was served with notice of a multiparty 'class action' in Argentina related to the issuance and payment default of a US$230 million bond by Inversora Eléctrica de Buenos Aires S.A. (IEBA), an Argentine project company set up to purchase one of the Argentine electricity distribution networks which was privatised in 1997. UUIL had a 45 per cent shareholding in IEBA which it sold in 2005. The claim is for a non-quantified amount of unspecified damages and purports to be pursued on behalf of unidentified consumer bondholders in IEBA. UUIL has filed a defence to the action and will vigorously resist the proceedings given the robust defences that UUIL has been advised that it has on procedural and substantive grounds. In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water PLC (UUW) in respect of UUW's discharges of water and treated effluent into the canal. UUW filed a Defence and Counterclaim in support of its believed entitlement to make discharges into the canal without charge and await MSCC's response. Although UUW won a 'summary judgment' application against MSCC in January on a significant element of the claim, MSCC subsequently appealed to the Court of Appeal who dismissed UUW's summary judgment. UUW was then granted permission to appeal to the Supreme Court, the hearing to be in the next 6 to 12 months.	The group faces the general risk of litigation in connection with its businesses. In most cases, liability for litigation is difficult to assess or quantify; recovery may be sought for very large and/or indeterminate amounts and the existence and magnitude of liability may remain unknown for substantial periods of time. The group robustly defends litigation, where appropriate, and seeks to minimise its exposure to such claims by early identification of risks and compliance with its legal and other obligations. Based on the facts and matters currently known and the provisions carried in the group's statement of financial position, the directors are of the opinion that the possibility of the disputes referred to in this risk section having a material adverse effect on the group's financial position is remote.

Financial

Pension deficit risk	Control/mitigation
The group participates in a number of pension arrangements (see note 20 in our financial statements). Estimates of the amount and timing of future funding for these schemes are based on various actuarial assumptions and other factors including, among other things, the actual and projected market performance of the scheme assets, future long-term bond yields, average life expectancies and relevant legal requirements. The impact of these assumptions and other factors may require the group to make additional contributions to these pension schemes which, to the extent they are not recoverable under the regulatory price determination process, could materially adversely affect the group's financial position.	In the 2009 water price review, Ofwat took account of broadly 50 per cent of the pension deficit shown in UUW's final business plan over a 10-year period (subject to reaffirmation at the next price review) and allowed for half of this deficit when setting its overall price controls for the 2010–15 period. In response to the size of our ongoing pension risks and pension costs we introduced a series of changes for employees in defined benefit (DB) schemes. These changes, which came into force on 31 March 2010, should result in reduced costs and risks, including deficit, associated with DB liabilities in the future. In conjunction with the trustees we continue to monitor and to look to reduce the investment strategy risks for the pension schemes, including our exposure to investment risks. We are also engaged with Ofwat on the appropriate allowance for pension deficits for the next price review period.

Counterparty risk	Control/mitigation
The group participates in treasury activities including the depositing of cash and holding of derivatives and foreign exchange instruments. Although we do not consider there to be an imminent exposure, a potential loss of deposits, financial assets or hedge due to bank failure, error or delay in receiving funds from a bank or sequestration could impact cash flow, the ability to meet debt obligations, credit rating and cost of borrowing.	Risks from treasury activities are covered by policies set by our treasury committee with operational management the responsibility of our treasury department. These include establishing a total credit limit for each counterparty which comprises a counterparty credit limit and an additional settlement limit to cover intra day gross settlement cash flows. In addition, potential derivative exposure limits are also established to take account of potential future exposures. These limits are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty. In respect of cash, short-term deposits and derivative financial instruments, the group does not have a material exposure to any financial instruments based within the Eurozone with the exception of Germany and has not experienced any credit issues in the financial year.

Operational

Customer service risk	Control/mitigation
Failure to deliver good customer service can be caused by failures in supply and quality requirements (see page 37) and also the effectiveness of communication and response. The Service Incentive Mechanism (SIM), introduced by Ofwat for the 2010–15 period, replacing the Overall Performance Assessment (OPA), compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well a company then deals with those contacts. Depending on UUW's relative performance under SIM it could receive a revenue penalty (up to 1 per cent of turnover in 2010–15) or reward (up to 0.5 per cent of turnover in 2010–15) when price limits are next reset in 2014.	The group has been monitoring and measuring customer satisfaction for a number of years and results have been improving consistently. We have already improved our SIM score as detailed in our KPIs (see 'Key performance indicators' on page 19). We have an overall customer experience programme covering a range of initiatives to improve customer service, responding to our customers' requirements and focusing on people, processes and systems. The company's focus is on ensuring right first time service delivery to our customers, thus avoiding the need for 'unwanted' contacts and reducing associated operating costs. Where 'unwanted' contacts do arise, there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score. These actions are intended to ensure that the company's performance under SIM is optimised thereby mitigating the risk of a penalty at the next price review.

Principal risks and uncertainties continued

Operational (continued)	
Bad debt risk	**Control/mitigation**
The service we provide is predominantly in the North West of England where the level of socio-economic deprivation is much higher than in any other region, leading to, amongst other things, an increased risk of bad debt. The law prohibits the disconnection of a water supply from certain premises including domestic dwellings as a method of enforcing payment.	Bad debt risk is managed in-house by the customer collections department whose approach includes the adoption of best practice collection techniques and segmentation of customers based on their credit risk profile.
Operational service risk	**Control/mitigation**
The group controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. Physical, environmental, technological or human factors, either within or outside the company's control, could result in impacts ranging from a decline in performance to interruptions and environmental impact. Ofwat could make financial adjustments at the next price review if corrective actions do not restore service to the required reference levels for each of their serviceability measures and could go on to force additional operating or capital expenditure if performance were to continue to decline. Additionally, depending on the nature and extent of an operational service incident, we could be fined for breaches of statutory obligations, be held liable to third parties or be required to provide an alternative water supply of equivalent quality, at additional cost.	Operational processes combined with the capital investment programme are targeted to maintain stable serviceability of our water and wastewater assets and to minimise the risk of significant operational events occurring. The various indicators of performance are closely and routinely monitored by management. There are also governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Where adverse trends in performance or asset integrity develop, corrective action is identified and taken. The sustainability and resilience of our water supply is also managed through regional aqueduct networks allowing flexibility and we operate emergency plans, incident management and disaster recovery processes for the response and/or recovery of operational service failures. Insurance cover is also in place against loss and liabilities associated with significant risks.
Capital delivery risk	**Control/mitigation**
Our core business requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities. Delivery of our capital investment programmes could be affected by a number of factors including adverse legacy effects of earlier capital investments (such as increased maintenance, repair, reinstatement or renewal costs) or amounts budgeted in prior capital investment programmes proving insufficient to meet the actual amount required. This may affect our ability to meet regulatory and other environmental performance standards.	Capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for outperformance and any necessary corrective actions. Executive directors are incentivised, as part of their bonusable measures, on time, cost and quality of delivery of our capital investment programme.

Operational (continued)

Secure supply of safe clean drinking water risk	Control/mitigation
A secure and reliable supply of safe, clean drinking water is critical for our way of life. There are several events, either within or outside our control, that could put at risk this key requirement. These include inadequate supply and demand prediction, leakage performance issues, operational or asset failures, changes to abstraction licences, low rainfall or malicious acts. Depending on the nature and extent of these circumstances, the impact to the group may include: failure to meet the security of supply index or quality standards with associated regulatory penalties, increased frequency of hosepipe bans and drought permits and additional operational activity and cost. In extreme and remote circumstances, impacts may include unavoidable water resource shortfalls or an impact on public health.	Our management of water catchments is designed to ensure reliable yields of good quality raw water. In addition, our water resources management plan compares future demand with availability, analyses historic droughts and climate change data and seeks to inform the delivery of supply enhancements and demand reductions. It covers leakage reduction programmes, enhanced water efficiency and network enhancements. We also maintain a drought management plan which includes processes, supporting communication plans and options for reserve supplies. Our treatment of water is based on quality assurance procedures and water supply is through an increasingly integrated network. Security measures are in place to protect these assets and our capital investment programme targets improvements to water quality and supply. This is all supported by testing regimes through our scientific services department and drinking water safety plans to ensure that risks to drinking water quality are identified and managed across our entire network. We also operate emergency and incident management processes should there ever be a need for alternative water supply of equivalent quality.

Hazard

Significant and catastrophic events	Control/mitigation
Our core activity involves the building, control and operation of water and wastewater networks and the maintenance of the associated assets with the objective of providing a continuous service. This includes major construction work and operations above and below ground and includes the use of vehicles, equipment and chemicals subject to a variety of physical and environmental factors/conditions. In exceptional and remote circumstances, such as the failure of an asset, an element of a network or supporting systems, plant or equipment, the impact could be significantly greater than operational service failures set out in other risks in this section. These could range from environmental impact, economic and social disruption to loss of life. Such consequences may arise due to a number of circumstances either within or outside our control e.g. human error, an individual's malicious intervention or unavoidable resource shortfalls. Whilst we seek to ensure that we have appropriate processes and preventative controls in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of our customers, regulators, Government and the wider stakeholder community. We could be fined for breaches of statutory obligations or be held liable to third parties or be required to provide an alternative water supply of equivalent quality, which could increase our costs.	We have developed and continue to focus on a strong safety and health culture throughout the organisation and seek to achieve the highest safety standards not simply to comply with legislation but to contribute to our overall business performance while protecting employees, contractors and the public from harm. In support of this, the business operates a Health and Safety Management System (HSMS) which sets out minimum expectations and requirements including monitoring the occupational health of individuals when appropriate. We operate long-standing, well tested and appropriately resourced incident response and escalation procedures. Our processes continue to be refined alongside related risk management and business continuity procedures which complement the governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Disaster recovery processes also exist for the recovery of IT applications, all recognising that possible events can have varying causes, impacts and likelihoods. The sustainability and resilience of our water supply is also managed through regional aqueduct networks which are enhanced by the West East Link pipeline. We also maintain insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost-effectively. The licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers (by way of interim determination) in the event of a catastrophic incident.

Governance

Pictured: Rebecca Brooks, scientist. Rebecca works in our laboratory in Warrington, which every year carries out more than 2.5 million tests to ensure we comply with Drinking Water Inspectorate and Environment Agency regulations.

Corporate governance report

Dr John McAdam, Chairman

Dear shareholder

We have continued our strategic journey during the year towards becoming a leading North West service provider and one of the best UK water and wastewater companies through the concentration of our efforts on improving the service we provide to our customers.

Licence changes

It has been an eventful year. As a board we have been fully engaged in the discussions relating to Ofwat's proposals to make some fundamental changes to the licence under which UUW provides water and wastewater services to our customers in the North West of England. Decisions such as these have a long-term impact on our group affecting our 2015–2020 regulatory period and beyond. In particular, a number of additional meetings of the UUW board were arranged beyond its normal schedule of meetings, where the board spent a considerable amount of time considering these changes for our group, our customers, our investors and our wider stakeholders.

The UUW board also met with Regina Finn, chief executive officer of Ofwat, in November 2012 to discuss the licence proposals with her. This reflected the constructive approach adopted by all parties to resolve the issue, and we believe the outcome delivered a positive result for our customers, our group and our stakeholders.

Board composition

In my role as Chairman of the board, I am responsible for ensuring that the directors are people with a diverse range of backgrounds and skills and that they all contribute to our decision making. I believe the composition of the board reflects this and that, both individually and collectively, we act with integrity and bring our individual viewpoints to board discussions so that we attain the highest standards of governance. Thereafter, I believe these standards are cascaded throughout the business. This year's board evaluation exercise again reconfirmed the positive outcome observed by last year's external evaluator and further demonstrated that the board functions effectively, although there were some suggestions where improvements could be made, details of which are given on page 49.

Our view of the business

A major part of our role as a board is to be responsible for providing constructive challenges to the executive team and its approach to implementing our strategic objectives and, in holding them to account for their actions. We have had a number of opportunities during the year to meet with members of the executive team and other senior managers which enables board members to develop a better understanding of the challenges they face in implementing the business's strategic objectives. Such meetings also enable board members to get to know senior managers considered to be potential successors for key roles and to form an opinion of these candidates for themselves.

Board changes

Paul Heiden will retire at the forthcoming AGM after over seven years' service, for many of which Paul has chaired the audit and risk committee. Our succession plan resulted in the recruitment of Brian May to the board as an independent non-executive director with effect from 1 September 2012. Consequently, Brian will replace Paul as chair of the audit and risk committee (and as our financial expert on the committee as required by the Code). I would like to thank Paul for his extensive contribution to the board and for his leadership of the committee, and we wish him well for the future.

Sara Weller, who joined the board on 1 March 2012, presents her first remuneration report on pages 54–68. Under Sara's guidance, the committee has reviewed the remuneration policy, and in particular, the long term share plans we have in place to incentivise our executive team and senior managers. As a consequence, the board is recommending that a new long term executive share plan should be approved by shareholders, and a resolution is contained in the notice of annual general meeting along with explanatory notes.

If you are able to attend, I look forward to seeing you at the AGM in July along with my fellow directors. In the meantime, we are keen to engage with our shareholders and stakeholders and we would welcome your thoughts and feedback on this annual report. Please email secretariat@uuplc.co.uk and let us know what you think.

John McAdam

Dr John McAdam
Chairman

During the year, we have fully complied with the 'Principles of the UK Corporate Governance Code 2010' ('principles' and 'code' respectively) and have measured ourselves and reported against these principles and the requirements of the code in this annual report. On the following pages, 41–68, you will find information on what the board has been doing during the year in terms of these code principles.

Code principle: Leadership

Overview of the board

Given the wide-ranging nature of the business activities which are needed in a water and wastewater service provider and the complex regulated environment in which it operates the skills and experience of the board of directors need to be similarly diverse and varied. Nearly all our directors have experience of working in a regulated environment, either as part of the regulatory body or the regulated organisation, spanning government departments, financial services, water, electricity and telecoms. The directors have also spent their careers in a diverse range of commercial environments including chemicals, defence, engineering, telecoms and retail and many individuals have worked both in the UK and internationally.

With the exception of the Chairman, for whom under the code the test is not appropriate, all of our non-executive directors are determined to be independent in accordance with the code and free from any business or other relationship which could compromise their independent judgement. Should they need it, the non-executive directors are supported in their role by the ability to seek independent specialist advice.

With the exception of Paul Heiden, all directors will be offering themselves for reappointment or election at the forthcoming AGM in July 2013 in accordance with the code. As confirmed by the board evaluation exercise, the board fully endorses the reappointment of the board members at the AGM, all of whom are considered to be making a valuable and effective contribution to the board. The board also supports the election of Brian May who was appointed as a director during the year. The board recommends that shareholders vote all the directors back into office at the forthcoming AGM.

Our board is responsible for setting the strategy of the group and has responsibility for the internal control systems operated across the group, allowing assessment and management of the key issues and risks impacting the business. The formal schedule of matters reserved for the board (available on our website) sets out its responsibilities including approving the company's overall strategic direction, values and standards, reviewing management performance and assessing whether the company has the necessary financial and human resources in place to meet its objectives. It also reviews the company's business planning, its approach to risk management and the development of policies. Decisions are taken with a view to promoting the long-term success of the company and to ensure that the principal goal of the company is to create shareholder value, whilst having regard to our other stakeholders represented by our employees, customers, regulators, suppliers, the environment and the community in which we operate and serve.

Conflicts of interest

The company's articles of association contain provisions which permit unconflicted directors to authorise conflict situations. Each director is required to notify the Chairman and/or company secretary of any potential conflict, and the board reviews the position of each director annually.

Pictured: Dr John McAdam (far left) and Steve Mogford on a board visit to Liverpool wastewater treatment works. The site is undergoing a £200 million expansion to handle up to 11,000 litres of wastewater every second, serving a population of more than 600,000 people and industry. The project is set to create 350 jobs and is scheduled for completion in 2016.

Corporate governance report continued

Board of directors

Dr John McAdam (65)

Chairman

Responsibilities:
Is responsible for the leadership of the board, setting its agenda and ensuring its effectiveness on all aspects of its role.

Qualifications:
BSc (Hons) Chemical Physics, Diploma Advanced Studies in Science, PhD.

Appointment to the board:
Appointed as a non-executive director in February 2008 and as Chairman in July 2008.

Committee membership:
Nomination (chair).

Current directorships/business interests:
Chairman of Rentokil Initial plc, senior independent director of J Sainsbury plc and a non-executive director of Rolls-Royce Holdings plc.

Career experience:
Appointed to the board of ICI plc in 1999 and became chief executive in 2003, a position held until ICI's takeover by Akzo Nobel. The only significant change for John's interests during the year ended 31 March 2013 was that he stepped down from Sara Lee Corporation as a non-executive director in June 2012.

Skills and experience:
With over 14 years' service as a board director in a wide range of companies, and as a current non-executive director serving on a number of other boards, John has a wealth of experience on which to draw in his role as Chairman and leader of the board.

Independence:
John is not deemed to be independent under the code in view of his unique role in corporate governance, although John was deemed to be independent at the time of his initial appointment to the board.

Steve Mogford (56)

Chief Executive Officer

Responsibilities:
To manage the group's business and to implement the strategy and policy approved by the board.

Qualifications:
BSc (Hons) Astrophysics/Maths/Physics.

Appointment to the board:
January 2011.

Committee membership:
Nomination, corporate responsibility.

Current directorships/business interests:
Non-executive director of Carillion PLC, vice-president of Liverpool School of Tropical Medicine.

Career experience:
Previously chief executive of SELEX Galileo, the defence electronics company owned by Italian aerospace and defence organisation Finmeccanica. Previously chief operating officer at BAE Systems PLC, and a member of its PLC board, he spent his earlier career with British Aerospace PLC.

Skills and experience:
Steve's experience of the highly competitive defence market and complex design, manufacturing and support programmes has brought renewed focus to customer service and operational performance at United Utilities, and his perspective of the construction and infrastructure sector provides valuable experience relating to United Utilities' capital investment programme.

Russ Houlden (54)

Chief Financial Officer

Responsibilities:
To manage the group's financial affairs and to contribute to the management of the group's business.

Qualifications:
BSc (Hons) Management Sciences, Fellow of the Chartered Institute of Management Accountants, Chartered Global Management Accountant and a Fellow of the Association of Corporate Treasurers.

Appointment to the board:
October 2010.

Committee membership:
Treasury.

Current directorships/business interests:
During the year, Russ was a member of the Ecosystem Markets Task Force reporting to the UK Government.

Career experience:
Chief financial officer at Telecom New Zealand. Previously finance director of Lovells and various divisions of BT and ICI.

Skills and experience:
Russ's experience in accounting, finance and treasury management in other competitive and regulated companies, along with his extensive experience of driving performance improvement and managing large capital expenditure programmes, provides the group with valuable expertise with regard to its drive for improvements in customer service, operations, capital expenditure and financing.

Dr Catherine Bell CB (62)

Independent non-executive director

Qualifications:
MA Geography, PhD Economic History.

Appointment to the board:
March 2007.

Committee membership:
Nomination, audit and risk, remuneration and corporate responsibility (chair).

Current directorships/business interests:
Non-executive director of the Civil Aviation Authority and the Department of Health.

Career experience:
A former civil servant and acting permanent secretary at the Department for Trade and Industry. Previously a non-executive director of Ensus Limited and Swiss Re GB Plc.

Skills and experience:
Catherine's civil service background and understanding of the operation of government departments and utility regulation is particularly valued given the regulated framework within which the business operates.

Paul Heiden (56)

Independent non-executive director

Qualifications:
BSc (Hons) Biology, Chartered Accountant ACA.

Appointment to the board:
October 2005.

Committee membership:
Audit and risk (chair), nomination and treasury (chair).

Current directorships/business interests:
Non-executive chairman of Intelligent Energy Holdings PLC, a non-executive director of Meggitt plc and London Stock Exchange Group plc.

Career experience:
Formerly non-executive chairman of Talaris Topco Limited and formerly chief executive of FKI plc and prior to that group finance director of Rolls-Royce plc. Previous senior finance roles at Hanson PLC and Mercury Communications and has been a non-executive director of Bunzl plc and Filtrona plc.

Skills and experience:
Paul utilises his extensive operational and financial experience and knowledge, having spent his career in senior finance roles across a range of companies and sectors, on behalf of the board as chair of the group's audit and risk committee and the treasury committee.

Nick Salmon (60)

Senior independent non-executive director

Qualifications:
BSc (Hons) Mechanical Engineering.

Appointment to the board:
April 2005.

Committee membership:
Nomination, remuneration and corporate responsibility.

Current directorships/business interests:
None.

Career experience:
Chief executive of Cookson Group plc until December 2012 when Cookson demerged to create two new listed companies, Vesuvius plc and Alent plc. Formerly executive vice-president of Alstom S.A. and of ABB Alstom Power and chief executive of Babcock International Group plc. Previous senior management positions held at GEC and GEC Alsthom in the UK and France and the China Light and Power Company, Hong Kong.

Skills and experience:
As an experienced CEO of two FTSE listed companies, Nick brings extensive executive experience to the board table. In addition, his considerable experience in the management of large capital construction projects supports the board's oversight of the capital investment programme.

Sara Weller (51)

Independent non-executive director

Qualifications:
MA Chemistry.

Appointment to the board:
March 2012.

Committee membership:
Nomination and remuneration (chair).

Current directorships/business interests:
Non-executive director of Lloyds Banking Group plc and lead non-executive director for the Department for Communities and Local Government. Sara is also a board member at the Higher Education Funding Council for England (HEFCE).

Career experience:
Sara has wide-ranging business experience having worked for Mars, Abbey National and Sainsbury's and most recently as managing director of Argos from 2004 to 2011. She served as the senior independent director at Mitchells and Butlers from 2003 to 2006 and also chaired its remuneration committee from 2003 to 2010.

Skills and experience:
Sara's experience of customer facing businesses, together with her knowledge of operating within a regulated environment, will be major assets to the board as the water industry prepares for the opening up of the sector to more competition and in improving customer service.

Brian May (49)

Independent non-executive director

Qualifications:
BSc (Hons) Actuarial Science, Chartered Accountant ACA.

Appointment to the board:
September 2012.

Committee membership:
Nomination and audit and risk.

Current directorships/business interests:
Finance director at Bunzl plc.

Career experience:
Brian has been finance director at Bunzl plc since 2006 and prior to that held a number of senior finance roles within the company. Prior to joining Bunzl, Brian qualified as a chartered accountant with KPMG.

Skills and experience:
Brian joined Bunzl in 1993 as head of internal audit before becoming group treasurer, then finance director, Europe and Australasia, and is currently group finance director. Brian's background and the various finance roles that he has held will serve him well in chairing both the audit and risk committee and the treasury committee on the retirement of Paul Heiden.

David Jones CBE, retired from the board on 27 July 2012.

Corporate governance report continued

Code principle: Leadership (continued)

Board of directors' attendance at meetings

Eight scheduled board meetings were planned and held during the year (2012: eight). A number of other board meetings and telephone conferences were also held during the year, as the need arose. The table below shows the actual number of meetings attended and the figures in brackets are the maximum number of scheduled meetings which the directors could have attended.

	Board	Audit and risk committee	Remuneration committee	Nomination committee	Corporate responsibility committee	Treasury committee
Steve Mogford	8(8)	n/a	n/a	2(2)	2(2)	n/a
Russ Houlden	8(8)	n/a	n/a	n/a	n/a	4(4)
Catherine Bell	8(8)	4(4)	7(7)	2(2)	2(2)	n/a
Paul Heiden	8(8)	4(4)	n/a	2(2)	n/a	4(4)
David Jones	4(4)	1(1)	3(3)	0(0)	n/a	n/a
Brian May	4(4)	3(3)	n/a	1(1)	n/a	n/a
John McAdam	8(8)	n/a	n/a	2(2)	n/a	n/a
Nick Salmon	8(8)	0(0)	7(7)	2(2)	n/a	n/a
Sara Weller	8(8)	n/a	7(7)	1(2)	n/a	n/a

Notes:
David Jones retired from the board at the 2012 AGM on 27 July 2012.
Brian May was appointed to the board on 1 September 2012.
Nick Salmon was appointed to the corporate responsibility committee on 1 April 2013 and as a temporary member of the audit and risk committee from 28 July 2012 to 1 September 2012.

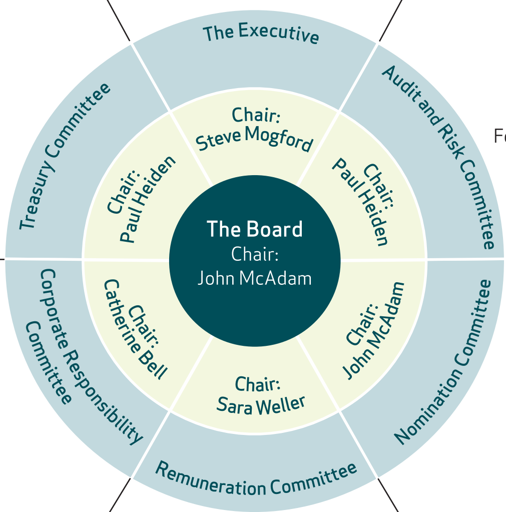
Governance structure

The board is responsible for setting the overall direction, values and standards of the company. It also reviews managerial performance and assesses whether the company has the necessary financial and human resources in place to meet its objectives. The board formally delegates specific responsibilities to a number of committees, as shown in the diagram below.

The executive
The executive team is responsible for implementing the board's strategy and the day-to-day operation of running the business. Formal monthly meetings are scheduled, although it meets more frequently if required.

Treasury committee
Considers and approves borrowing, leasing, bonding and other banking facilities within limits set by the board. Chaired by Paul Heiden, other members are the CFO and the head of treasury. The treasury committee has delegated some of its powers, subject to certain limits, to the CFO and the head of treasury.

Audit and risk committee
Responsible for maintaining risk management and internal control systems, for considering the application of the financial reporting policies and for maintaining an appropriate relationship with the external auditor.
For further information please go to page 50.



Corporate responsibility committee
Develops and oversees the company's corporate responsibility strategy. The committee members are Catherine Bell (as chair), Nick Salmon and Steve Mogford. Two employee representatives attend meetings and other management representatives may be invited to meetings from time to time.

Nomination committee
Reviews succession plans for the board and senior management and ensures that the skills and experience at board and senior level continue to be appropriate.
For further information please go to page 46.

Remuneration committee
Makes recommendations to the board on executive remuneration framework, approves the employment and remuneration terms of the executive directors and senior executives.
For further information please go to page 54.

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Topics discussed by our board during the year

In addition to the regular business of the board on financial and operational performance, our board also discussed:

Regulation

- Debated the implications of the Water Bill and the changes for retail competition for business customers;
- Assessed the implications of the modifications of the regulatory licence to supply water and wastewater services and the impact on the company and the water industry; and
- Strategy session focusing on the 2014 price review submission and updates on progress.

Customer

- Reviewed the improvements made to customer service;
- Reviewed the implications of retail competition and the group's readiness and strategy to respond to the changes; and
- Considered the approach, issues and initiatives to reduce customer debt.

Governance

- Reviewing and challenging the risk profile of the business and the risk management policy;
- Revising the group's 'Business principles' to reflect our values of customer focus, integrity and innovation; and
- Debating and discussing the proposal to adopt a new long-term plan as part of the executive incentive review.

People

- Focusing on succession within the business and developing a pipeline of talented individuals;
- Reviewing the results of the annual employee opinion survey to gain an insight into what employees think about management and about working for United Utilities; and
- Updates on health and safety performance within the business.

Sustainable Catchment Management Programme
In July 2012 prior to the board meeting, our board visited Dove Stone reservoir where they had the opportunity to look at our Sustainable Catchment Management Programme (SCaMP) in action. They also met with Mike Clarke, the chief executive of the RSPB with whom we have a number of partnerships around our catchments.

Corporate governance report continued

Code principle: Effectiveness

Nomination committee

Dr John McAdam

Current committee members

- John McAdam (chair)
- Catherine Bell
- Paul Heiden
- Brian May
- Steve Mogford
- Nick Salmon
- Sara Weller

Dear shareholder

Through the nomination committee, of which I am chair, our board and senior manager succession plans are kept continually under review as the needs of our company change over time. The skills and experience of our current board of directors we believe match the needs of our business. As shown in the biographical details of our directors (see pages 42–43), their careers have been spent in a wide range of industries and companies and, as a result, boards such as ours are considered to be more likely to make better decisions and be less at risk of suffering from group think (where their similar skills and experiences result in them thinking in the same way).

With the recent natural turnover of our directors we feel that the resulting refreshing of our board members has meant that our board discussions have also been kept alive with our new board members providing fresh perspective in their questions and challenge to board discussions.

Dr John McAdam
Chair of the nomination committee

Nomination committee: board succession

As referred to in the Chairman's introduction on page 40, our board succession plan identified that the replacement candidate for Paul Heiden should be a financial expert. All our non-executive directors, along with the CEO, are members of the nomination committee (whose role is to make recommendations to the board on the composition, balance and membership of our board and refreshing the membership of the board's principal committees). During the year, the committee met twice, and at these meetings it agreed on the skills and experience a successful candidate would need to replace Paul Heiden, as referred to above. In accordance with its board diversity policy (see page 47) the committee engaged Spencer Stuart, an executive search consultant, to help identify a suitable candidate. They were briefed with a description of the skills and experience that were needed, and resulted in the appointment of Brian May as an independent non-executive director on 1 September 2012. (Spencer Stuart is a signatory to the voluntary code of conduct on gender diversity for executive search firms, it has no other relationship with the group other than being used on a previous occasion for executive search purposes.)

Getting to know United Utilities: induction programme for Brian May

An initial two-day programme was arranged enabling Brian to meet with members of the executive team and other senior managers who provided an introduction to their areas of the business. An informal dinner was also held allowing Brian to meet members of the executive team. There will also be the opportunity for visits to key operational sites, including the Whitehaven customer services centre and major water and wastewater treatment sites.

Brian May said: "With regards to the induction, I found the two-day visit to the Warrington head office in November to be especially useful. I was able to spend time with key executives and their teams to better understand various strategic, operational and financial aspects of the business."

Wider succession plans and talent management

In the succession plans for our CEO and CFO roles, our first pool of talent is our executive team who have been working during the year on a strategic development programme in association with Manchester Business School. Female members of the executive team also have additional support with targeted development plans and executive coaching. Members of the executive team are also actively involved in coaching and mentoring some of our younger employees in our 'emerging talent group'; 56 per cent of this group are female.

Throughout 2012/2013, in our second talent pool, senior leaders have attended business education workshops and master classes at Manchester Business School, and have been involved with behavioural leadership development and 360 feedback exercises. Women in this group have additional development such as networking inside and outside of United Utilities, participating in a 'women in the workplace' module and have targeted development plans. The success of this programme is demonstrated by the promotion during the year of two internal female employees to two of our key business roles, namely the head of engineering and head of wastewater strategy, both of which have historically been held by men (see page 48 for details).

In 2013, we are sponsoring a North West Young Business Woman of the Year Award which will provide some of our female employees with an insight into other women's careers and the organisations they work for.

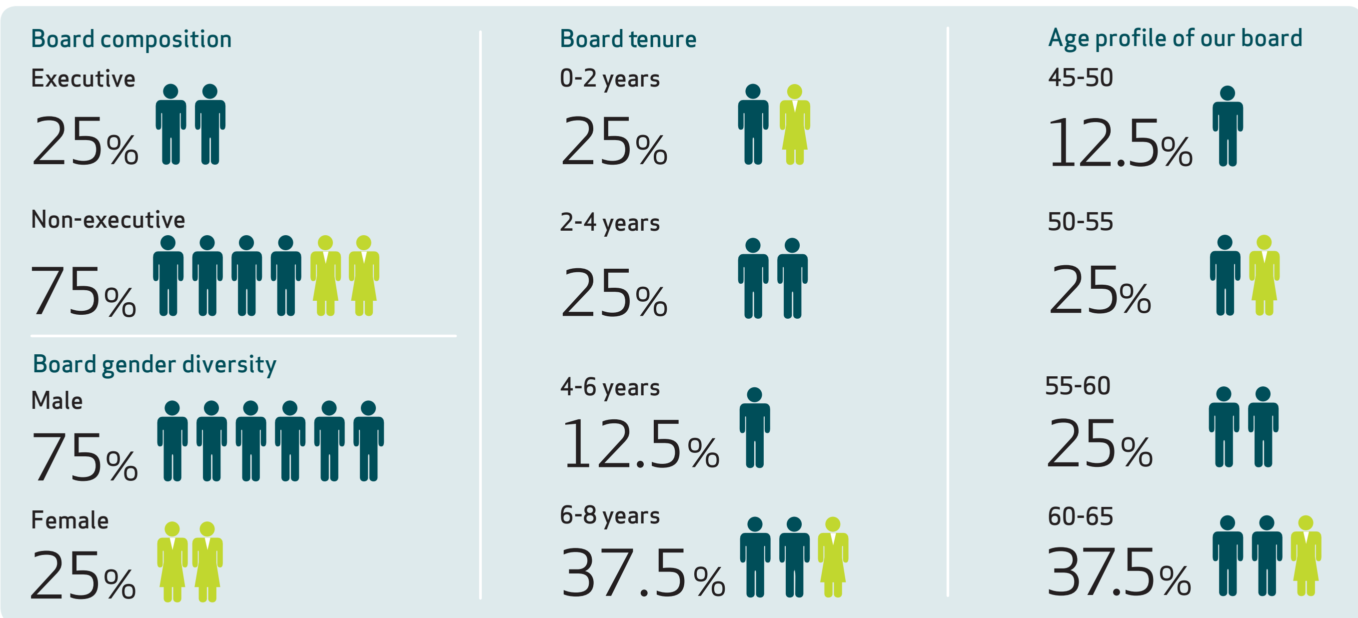
We continue to recruit graduates and apprentices to feed our future resourcing needs. Analysis of our attraction rate for female graduates and apprentices has enabled us to proactively target key schools and universities in our attraction campaign. This year we have seen an increase in the number of female graduates joining United Utilities to 23 per cent and for apprentices an increase to 10 per cent, compared with the national average of five to seven per cent.

Diversity

At the end of the financial year, in line with our board diversity policy and the recommendations of Lord Davies, 25 per cent of our directors were female. With the retirement of Paul Heiden at the annual general meeting, this will rise to 28 per cent. In the executive team, 38 per cent are female (five out of thirteen), (2012: 36 per cent (five out of fourteen)). In respect of our wider employees at the year end, 63 per cent were male and 37 per cent were female (2012: 64 per cent male and 36 per cent female). As is the case in many UK companies certain activities remain more widely populated by males (e.g. operational and engineering roles) or females (e.g. customer contact centre roles and support services). As previously described, we will continue our actions to try and address gender imbalances at all levels and in all areas of our business.

Board diversity policy: summary

- Ensure the selection process for board candidates provides access to a diverse range of candidates, although any appointments will be made on the basis of equal merit, but with due regard for the benefits of diversity on the board, including gender.
- Ensure that the policies adopted by the group will, over time, promote gender diversity among senior managers who will in turn aspire to a board position.
- In selecting candidates for board positions, only use the services of executive search firms who have signed up to the voluntary code of conduct for executive search firms as recommended by Lord Davies.
- Adopt measurable objectives from time to time for achieving gender diversity at board level – which shall currently be to maintain at least 25 per cent female representation.



Corporate governance report continued

Jo Harrison
Head of Wastewater Strategy

I started working for United Utilities in 1998 on the Graduate Recruitment scheme following a number of years in environmental consultancy. I am a chartered member of the Institute of Water and Environmental Management, with a BSc in Ecology and Geography and an MSc in Pollution Control from Manchester University.

I was identified by succession planning as a 'future talent' and in the last 12 months I have taken on a senior leadership role as head of wastewater strategy. This role involves defining the 25-year strategy for the wastewater business, setting our approach to planning our investment and managing the relationship with our regulator, the Environment Agency. Previously I have held the roles of area planning manager and wastewater strategy manager, as well as a number of management roles leading operational teams.

My development has been supported by attending a 12-month senior leadership programme; this has involved 360 feedback, a transformational leadership programme and a number of workshops and master classes at Manchester Business School.

Board evaluation

During the year, as facilitated by our company secretary, we undertook an internal evaluation of our board's performance, its committees and of each of the individual directors including the Chairman. Our questionnaires were designed to gain some insight into the directors' perceptions and views of what the relationship between the board members was like and whether the board processes and support, and interactions with its committees, were appropriate. Views were also sought on the administrative support for the board, and whether there was sufficient information and time devoted to: strategic planning and reviewing; financial and operating issues and management's performance of these issues; and on the visibility and processes around risk management and internal controls.

Our questionnaires followed the approach that Lintstock took last year when they facilitated our board evaluation and which was reported on in the 2012 annual report. In addition to board members, questionnaires were completed by senior managers responsible for reporting to the various committees and third party advisors to the committees. Thereafter, the individual responses were kept confidential; after analysis by the company secretary the results were discussed with the chairman, the chair of each committee as appropriate and thereafter by the board.

In summary, progress has been made in enhancing the board's effectiveness. The responses indicate that the atmosphere around our board table is a positive one and discussions are open and frank with all board directors sharing their knowledge and experience for the benefit of the company and actively participating in board discussions and decisions. The collective motivation as a board of directors is to 'do the right thing' to look after our company in the long-term for our shareholders and other stakeholders.

Actions arising from last year's evaluation (conducted by Lintstock in February 2012)	What we have done in response
Increase the customer-centric skills on the board.	Strengthened by the appointment of Sara Weller.
Improving the board's knowledge and understanding of water regulation and the different regulators' agendas.	Our board has spent considerable time at board meetings understanding the impact of the licence changes proposed by Ofwat; additionally, the director of economic regulation gives a presentation on regulation issues at most board meetings. Our board also met with Regina Finn, Ofwat's chief executive in November 2012.
Improving the timeliness of the distribution of papers prior to board meetings.	A timetable for the approval and distribution of board papers has been set and every effort is made to adhere to it although, on some occasions, papers have followed the scheduled despatch time.
Improving the presentations made by junior executives to the board.	Senior managers of the relevant business areas are encouraged to work more closely with their team members to improve the content of presentations relating to their business area to focus on the key issues requiring board input rather than providing too much operational detail.
Improving succession plans for key management positions beneath the board.	There has been further focus on the talent pipeline from the senior management population: see page 47.

2012/13 board evaluation

In this year's evaluation, our directors confirmed that they felt the action points coming out of last year's evaluation had been satisfactorily addressed.

The following actions came out of the 2012/13 board evaluation and we will report on the actions taken in the 2014 annual report:

- Build further on the improvement in the standard of presentations given to the board by ensuring that those presenting to the board infrequently provided information to board members at the appropriate level and focus.
- Maintain the opportunities for the board to meet with members of the executive and the wider senior management team, which were felt to be very beneficial.
- Further develop the focus of executive succession planning.
- Given the evolving regulatory agenda, ensure that the board continues to have opportunities to broaden its understanding and knowledge, with particular emphasis on market reform.

Code principle: Accountability

The board is satisfied that in these accounts for the year ended 31 March 2013, they have presented a fair, balanced and understandable assessment of our company in line with our statutory requirements.

Internal controls and risk management

The board is responsible for ensuring that the company has sound risk management and internal control systems in place, and for reviewing its effectiveness. It is supported in this role by the audit and risk committee, 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 risk as a result of these changes which might prevent us from achieving our objectives, and identify actions to mitigate those risks as far as is reasonably practicable and cost-effective to do so. These internal control and risk management systems, which are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss, have been in place continually for the year under review. On behalf of the board, the audit and risk committee completed its annual review of the effectiveness of the risk management and internal control processes up to the date of the annual report in accordance with the revised Turnbull Guidance on Internal Control. There were no significant failings or weaknesses identified in this review.

Risks impacting our business due to regulatory changes have dominated our risk review agenda at board meetings; the principal risks and uncertainties to the business are explained on pages 32–37. 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.

Corporate governance report continued

Audit and risk committee

Paul Heiden

Current committee members

- Paul Heiden (chair)
- Catherine Bell
- Brian May

The terms of reference of the committee are available on our website at **corporate.unitedutilities.com**

Dear shareholder

Following the annual cycle of work of the audit and risk committee, we concluded that sound risk management and internal control systems have been maintained during the year. In terms of our risk management processes, we were satisfied that there is a high level of awareness of risk management across the business. From the information and assurance provided by the day-to-day work of our internal audit team and the external audit review conducted by our auditor KPMG Audit Plc (KPMG) undertaken both at the half-year and full year; our understanding of the business; and information provided by our senior executive management team, the committee was satisfied that the report and accounts, taken as a whole, provide a fair, balanced and understandable assessment of the company's position at 31 March 2013.

Paul Heiden
Chair of the audit and risk committee

Directors' responsibilities

The statement of directors' responsibilities in the preparation of this report and accounts is given on page 73, has been reviewed by the committee and was recommended to the board for approval.

Going concern reporting

As part of its review of the financial report and accounts, the committee considered whether the group had adequate financial resources to continue trading as a going concern. FRC guidance requires that in order to be considered to be a going concern the group should have adequate financial resources for at least 12 months from the date of approval of the financial statements.

The directors have a reasonable expectation that the company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern policy in preparing the financial statements.

This conclusion is based upon, amongst other matters, a review of the group's financial projections together with a review of the cash and committed borrowing facilities available to the group as well as consideration of the group's capital adequacy. In addition, the directors considered, amongst other matters, the regulator's legal duty to ensure that United Utilities Water PLC is able to finance its activities. The directors also took into account potential contingent liabilities and other risk factors as interpreted by the guidance given in 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009'.

Audit tender

A full audit tender process was concluded in March 2011, resulting in the appointment of KPMG as the group's auditor to replace Deloitte LLP. Following its appointment, KPMG undertook its first audit of the company and its subsidiaries for the year ended 31 March 2012. The auditor's role is considered annually by the board for reappointment for the year end audit process on the recommendation of the audit and risk committee.

Appointment of auditor

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

Members of the audit and risk committee and their attendance at meetings

The biographical details of our directors can be found on pages 42–43, all members of the committee are independent within the meaning of the code. The board is content that Paul Heiden, chair of the committee, has recent and relevant financial experience and is independent within the meaning of the code and when Paul retires Brian May, as his successor, will also fulfil that requirement. Following the retirement of David Jones in July 2012, Nick Salmon was appointed as a member of the committee on a temporary basis to ensure that the membership of the committee was aligned with the Code; however, there was no requirement for the committee to meet and so, on the appointment of Brian May as a non-executive director and member of the committee on 1 September 2012, Nick stepped down from the committee.

What happens at meetings of the audit and risk committee

Although not members of the committee, the Chairman, the CEO and CFO also have a standing invitation to attend to help provide information to the committee as it requires. At each scheduled meeting the external auditor meets with the committee members to enable them to have a frank and open debate without the executives being present, as does the head of corporate audit and risk. Similarly, part of the meeting is also held without the external auditor being present, to enable the committee to discuss their performance openly.

What was on the audit and risk committee's agenda during the year

During the year, in addition to its standard items of business in conjunction with the requirements of the half-year and full year reporting cycle, internal controls and risk management systems, the committee reviewed the following topics:

- IT security and the implementation of the new IT system across the group which would both improve internal controls and minimise the potential opportunity for fraud;
- Operational debt write off practices were amended to align accounting and operational processes;
- In-depth review of risk management systems in:
  - asset performance in the group's wastewater part of the business;
  - asset planning and engineering;
  - information control and technology; and
  - within the retail domestic activities of the business including customer activities, water and wastewater connections, meter reading, billing and debt collection;
- Updates on anti-fraud, whistleblowing and bribery issues and compliance and readiness for the changes to be brought about as a result of the 2012 version of the UK Corporate Governance Code.

Significant issues considered by the audit and risk committee in relation to the 2013 financial statements

The committee considered the ongoing appropriateness of the company's accounting policies and the requirement to adopt any new financial reporting standards applicable for first time adoption in the current accounting period. In addition, the committee discussed the critical accounting judgements and key sources of estimation uncertainty, as noted in Section P of the accounting policies, and concluded that the estimates, judgements and assumptions used were reasonable based on the information available and that these had been used appropriately in applying the group's accounting policies.

In relation to the company's existing accounting policies, the committee discussed the following principal areas of judgement:

- The policy for providing against doubtful receivables was reviewed and it was concluded that the historical approach taken remained appropriate, while the approach to the assessment of the credit note provision was improved by a more detailed analysis of outstanding receivables.
- The methodologies and assumptions used in calculating the closing defined benefit pension position were reviewed and the reasons for the improvement in the net position discussed.
- The provision and disclosure for uncertain taxation matters were considered to remain appropriate.
- The ongoing contractual and legal claims against the company were discussed and it was concluded that the related accounting was appropriate.
- The operational policies for reviewing ongoing long-term capital projects were discussed along with the appropriateness of reviewing the allocation of costs on such projects, between classifications of type of expenditure, on an annual basis as well as at project completion.
- The committee discussed how cost attribution improvements have been made following the introduction of a new operating model focused on the company's first time resolution of issues together with a more granular analysis of the nature of the activity being undertaken.
- The committee was provided with an update on expenditure on private sewers and its allocation between operating and capital expenditure.

Corporate governance report continued

Table of fees paid to KPMG

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

Notes:
Included in the above statutory audit fee for the period ended 31 March 2013 is £25,000, in relation to the company (period ended 31 March 2012: £25,000).

Safeguarding auditor independence and non-audit services

Assurance is provided by KPMG twice a year confirming that their staff have no relationships with the company that could adversely affect their independence and objectivity. The committee monitors the use of KPMG's services across the business at every scheduled meeting of the committee. In line with the Financial Reporting Council's Guidance on Audit Committees published in September 2012, the committee amended its policy on the use of the external auditor, KPMG, to perform non-audit work. In accordance with the FRC's guidance, fees for permitted non-audit services such as tax advisory services are pre-approved by the committee (but require approval by the CFO) and do not require further approval so long as the cumulative value of these services is less than 30 per cent of the group annual audit and regulatory reporting fee (£320,000 for 31 March 2013); fees for permitted non-audit services in excess of this 30 per cent level will need to be specifically approved by the committee. There are a range of business services which KPMG are prohibited from providing to the company such as: business process improvement advisory services; employee benefit plan advisory services; operational consulting; internal audit services; cash management and treasury services; and strategic planning support.

What the audit and risk committee is planning to do, in addition to its usual items of business, during 2013/14

- The committee will be addressing the need to comply fully with the 2012 version of the Code in the 2014 annual report and accounts.

Outcome of audit and risk committee evaluation

The conclusions of the internal evaluation of the performance and operation of the committee were that the committee was functioning well. The main action identified was the need to ensure papers to the committee were succinct.

Code principle: Relations with shareholders

We are keen to engage with our shareholders and investors and to understand their views on our business, and our CEO and CFO have a regular programme of one-to-one meetings with representatives from major shareholders and investors and group presentations, both on an ad hoc basis and linked to our results announcements. Board members receive regular updates in the area of investor relations and reports from sector analysts to ensure that the board maintains an understanding of our investors' priorities. Additionally, we ask Makinson Cowell to produce an annual survey of shareholders, the results of which are reviewed by the board. Our non-executive directors also have the opportunity to attend meetings with major shareholders at either party's request. Copies of our results presentations are available on our website along with a range of other information. All directors welcome further engagement from our institutional investors as the Financial Reporting Council's Stewardship Code becomes adopted more widely. Sara Weller and the reward team have met with representatives from a number of major shareholders to discuss the new long-term plans.

Investor relations programme

We undertake a comprehensive investor relations programme and our CEO and CFO met with around 100 institutional investors in the year. This covers a wide range of geographies comprising the UK, Europe, North America and the Asia/Pacific region. The meetings represent a mix of existing shareholders and prospective investors and are supplemented by additional meetings hosted by our investor relations team. We also maintain very close contact with the range of City analysts that research United Utilities. In total, we met or offered to meet with 38 per cent by value of the overall shareholder base, which represents 74 per cent of the targetable institutional shareholder base (when adjusting for shareholders who typically do not take meetings, such as indexed funds).

In the meetings we have with investors, frequent areas of common interest include operational and environmental performance, customer service, capital investment, efficiency initiatives and regulatory outperformance. Financial stability is a key area and investors are interested in the level of gearing versus regulatory assumptions, cost of finance, debt portfolio and maturity profile, future financing requirements and dividends. Looking ahead, investors are keen to understand how the economy may impact the water sector, the implications of political and regulatory developments and the forthcoming price review in 2014.

Retail shareholders

We are very aware that many of our customers are also shareholders so their interest in us is from both an operational and a financial perspective. In fact, over 51 per cent of our shareholders are registered in the North West of England, reflecting the privatisation process over twenty years ago and we have a regular attendance of our more local shareholders at our AGM held in our region in Manchester.

We produce an online report for our shareholders and other interested parties, which provides information on our key social and environmental impacts and performance during the year. Together with the annual and the half-yearly financial reports, and interim management statements, these form the principal means of our communications with our shareholders. A substantial amount of company information is available via our website: corporate.unitedutilities.com.

Code principle: Remuneration

The way in which we remunerate our directors has been a key topic for our board's remuneration committee during the year. Sara Weller, having taken over as chair of the committee (since David Jones's retirement at the AGM last year), has been meeting with key shareholders to obtain a fuller understanding of their views of the content the remuneration package provided to our executive directors. It is our intention to ensure that our future remuneration policy reflects their expectations and current market practice in order that we can attract, motivate and retain the right individuals with the right skills and experience to contribute to, and ensure, our strategic objectives are implemented efficiently and effectively.

The remuneration report (pages 54–68) provides details of the proposed long term plan, which is subject to shareholder approval at the annual general meeting in July 2013.

What the remuneration committee is planning to do during 2013/14

In consideration of the Department for Business, Innovation and Skills draft regulations relating to remuneration reporting, the committee will be reviewing the future remuneration policy to ensure that it reflects the new requirements.

Outcome of the remuneration committee evaluation

The conclusions of the internal evaluation of the performance and operation of the committee were that the committee is functioning well and the tone is very positive, particularly given the challenges around the new long term plan in a rapidly changing external remuneration and regulatory environment.

The committee evaluation identified that there was a lack of visibility of the forthcoming items for discussion on the committee's agenda. This is being addressed by circulating the committee's rolling calendar to committee members on a regular basis.

The report of the remuneration committee can be found on the following pages.

Relations with other providers of capital

Running a water and wastewater business, by its very nature, requires a long-term outlook. Our regulatory cycle is based on five-year periods, and we raise associated funding in order to build and improve our water and wastewater treatment works and associated network of pipes for each five-year cycle. We are, as a group, heavily reliant on successfully acquiring long-term funding from banks and debt capital markets to fund our capital investment programme. This requires a long-term commitment and involvement from our credit investors who lend us the funds with the company paying them a return for doing so. The group currently has gross borrowings of £6,173m and we arrange term debt finance in the bond markets (with maturities typically ranging from seven years to up to 50 years at issue), with access to the sterling and euro public bond markets via the group's London listed multi-issuer Euro Medium Term Note programme. We also arrange committed credit facilities with various relationship banks on a bi-lateral basis. Additionally, the European Investment Bank (EIB), which is the financing arm of the European Union, is United Utilities' single biggest lender currently providing circa £1 billion of term funding used to support the financing of various projects undertaken in the current and prior regulatory periods, aimed at delivering environmental and quality improvements, climate change adaptation and eco-efficiency. In deciding which construction projects we need to undertake in each five-year cycle (which are approved by our regulators) we need to look into the future to help us prepare our facilities and network to match supply and demand for our services in areas of predicted population growth, as best we can.

Given the importance of debt funding to our group, we have an active credit investor programme, co-ordinated by group treasury, who provide a contact point for credit investors' queries. We engage with credit investors through one to one meetings, targeting coverage of the major European fund managers known to invest in corporate bonds, that may be current holders of the group's debt or be potential holders. We also arrange for regular mailings across the year as a commitment to keep credit investors informed of significant events and to encourage enquiries they may have regarding the industry or company. Additionally group treasury is in regular dialogue with its relationship banks and the EIB.

Corporate governance report continued

Sara Weller

Current committee members

- Sara Weller (chair)
- Catherine Bell
- Nick Salmon

Remuneration committee

Dear shareholder

As new chair of the remuneration committee, I am pleased to introduce the Directors' Remuneration Report for the year ending 31 March 2013.

Over the past year the company has worked hard to improve its service to customers and to continue to invest efficiently in strengthening our infrastructure to provide a strong and stable base for the future, and its progress has been reflected in a strong share price performance through the year. We know that these are difficult economic times, bringing challenges for many of our customers and therefore our approach to remuneration remains restrained. However, it is important that we reward employees at all levels for a strong operational performance during the year.

Maintaining a responsible approach to executive pay

Last year's remuneration report received a vote of 98.4 per cent in favour from shareholders, indicating that our prudent approach to executive remuneration is considered to be appropriate.

Whilst there has been good business performance this year (as already outlined in this annual report), base salary increases were limited to 2.4 per cent for both of the executive directors, which is below inflation and less than the average base salary increase applied at other levels in the company. Our good results this year have instead been rewarded through our annual bonus payments, which we believe is a more appropriate approach.

Remuneration for the year reflects performance

A key objective of our remuneration policy is to align executive pay to the company's strategy of delivering long-term shareholder value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner. Many of the corporate KPIs (see pages 18–19) are embedded as performance measures in the annual bonus plan.

This year, despite the continuing challenging economic conditions, we have delivered strong operational performance improvement, and in particular have significantly improved our customer service performance. This was reflected in a total shareholder return over the year of 24 per cent.

In this context, the committee is satisfied that bonus payments of around 84 per cent of maximum for the executive directors are reflective of performance. As the same bonus measures are used throughout the company, employees at all levels have benefited from this success.

Review of executive incentives

This year we have reviewed, and are proposing changes to our executive incentive schemes. We are putting forward a new long term plan (LTP) for approval by shareholders at the AGM on 26 July 2013. Details of the plan, which will be used instead of our two existing long term plans, are given in the notice of AGM 2013.

This review was necessitated by the challenge of setting long-term targets for the operational measures under our existing plans, where the three-year performance period starting in April 2013 extends in to a new regulatory period. As the regulatory contract for the five-year period 1 April 2015 to 31 March 2020 has not yet been agreed, it would be very difficult to set targets for these operational measures for the final year of the performance period. We also took the opportunity to ensure that our executive incentives are firmly aligned to our business priorities and those of our major stakeholders, including shareholders and customers.

In considering these changes, we have been mindful of the public debate on executive reward and we have consulted extensively with several leading shareholders and representative groups in developing our proposals. We have also taken the latest shareholder guidelines into account.

Our proposals place strong emphasis on the importance of delivering long-term value to shareholders, by not only continuing to focus on total shareholder return over each respective three-year period, but also on creating strong earnings that ensure the sustainability of dividends. They also recognise the importance of continuing to drive for ever higher standards of service and good value for our customers, which are key issues both for our shareholders and our economic regulator, Ofwat. They are also fundamental to delivering our vision of becoming a leading North West service provider and one of the UK's best water and wastewater companies.

We are mindful of our responsibilities as stewards of assets and operational efficiency in a sector where long-term planning is critical, and this is reflected in our move to a longer-term approach on executive incentives. The introduction of compulsory deferral of half of the annual bonus for executive directors into shares, and the requirement for awards under the new LTP to be held by executive directors for a further two years beyond the three-year performance period demonstrates this approach, and will further strengthen the alignment between executive and shareholder interests over the long term. At the same time, we are taking the opportunity to simplify the arrangements through the removal of the matching share award plan.

Under these new proposals the maximum face value of long-term incentives for executive directors will reduce from 140 per cent to 130 per cent of base salary, although the expected value of the executive package will not change. We believe this is appropriate given the relatively stable and long-term nature of the water business.

We are confident that the new proposals will allow for a more direct focus on delivering value for our shareholders and our customers in the long-term, which I very much hope you will support.

Structure of report

Throughout the year we have taken the opportunity to respond to the Department for Business, Innovation and Skills' consultations on remuneration reporting. In this report we have adopted elements of the draft regulations on reporting of directors' pay. This includes the splitting of our report into a distinct remuneration policy report followed by further details about how our policies have been implemented in the year ended 31 March 2013.

We will be seeking your support for this remuneration report, and the new LTP, at the 2013 AGM.

Sara Weller
Chair of the remuneration committee

Customer experience is central to incentives

Over half of the annual bonus opportunity for executive directors is based on customer service measures, either directly (though the use of our regulator's customer service measure) or indirectly (through making sure our assets are of good quality and work reliably, thereby delivering a stable and reliable level of service to our customers without any unintended consequences for the environment). In addition, under the proposed long term plan (LTP), one-third of the performance measures are based on delivering excellent customer service.

We believe that improving customer service will lead to the creation of long-term shareholder value as it results in increased efficiency and improves our reputation. Importantly, our regulator, Ofwat, can also apply financial incentives or penalties depending on our customer service performance and can require us to incur additional unfunded expenditure to ensure key customer targets (such as those for leakage or serviceability) are met.

Corporate governance report continued

The remuneration committee

Summary terms of reference

The committee's terms of reference were last updated in November 2012 and are available on our website: corporate.unitedutilities.com.

The committee's main responsibilities include:

- making recommendations to the board on the company's framework of executive remuneration and its cost;
- approving the individual employment and remuneration terms for executive directors and other senior executives, including: recruitment and severance terms, bonus plans and targets, and the achievement of performance against targets;
- approving the general employment and remuneration terms for selected senior employees;
- approving the remuneration of the Chairman;
- proposing all new long-term incentive schemes for approval of the board, and for recommendation by the board to shareholders; and
- assisting the board in reporting to shareholders and undertaking appropriate discussions as necessary with institutional investors on aspects of executive remuneration.

Composition of the remuneration committee

Member	Committee member since	To
Sara Weller (chair since 27.7.12)	1.3.12	To date
Catherine Bell	1.3.11	To date
Nick Salmon	4.4.05	To date
David Jones (chair until 27.7.12)	24.1.05	27.7.12

The committee's members have no personal financial interest in the company other than as shareholders and the fees paid to them as non-executive directors.

Advisors to the remuneration committee

By invitation of the committee, meetings are also attended by the Chairman of the company (John McAdam), the CEO (Steve Mogford), the company secretary (Simon Gardiner, who acts as a secretary to the committee), the business services director (Sally Cabrini) and the head of reward (Ruth Henshaw) who are consulted on matters discussed by the committee, unless those matters relate to their own remuneration. Advice or information is also sought directly from other employees where the committee feels that such additional contributions will assist the decision making process.

The committee is authorised to take such internal and external advice as it considers appropriate in connection with carrying out its duties, including the appointment of its own external remuneration advisors.

During the year, the committee was assisted in its work by the external advisors shown in the following table:

Advisor	Appointed by	Services provided to the committee	Other services provided to the company
New Bridge Street	Committee	General advice on remuneration matters	Benchmarking of roles not under the committee's remit
Deloitte LLP	Committee	Executive incentive review	Financial Reporting support VAT and corporate tax advisory services
Eversheds	Company	Advice on share schemes	Advice on employment law General legal advice
Addleshaw Goddard	Company	Drafting of share scheme rules	Advice on employment law General legal advice

The independent consultants New Bridge Street (a trading name of Aon Hewitt Limited, an Aon PLC company) and Deloitte LLP are members of the Remuneration Consultants Group, and as such, voluntarily operate under the Code of Conduct in relation to executive remuneration consulting in the UK. The committee is satisfied that the advice they received from external advisors is objective and independent.

Key activities of the remuneration committee during the year

The committee met seven times in the year ended 31 March 2013.

Regular activities

- Approved the 2012 directors' remuneration report.
- Reviewed the base salaries of executive directors and other members of the executive team.
- Assessed the achievement of targets for the 2011/12 annual bonus scheme, reviewed progress against the targets for the 2012/13 annual bonus scheme, and set the targets for the 2013/14 annual bonus scheme.
- Assessed the measurement of performance conditions for the long-term incentive awards vesting in 2012 including both performance share plan (PSP) awards and matching shares vesting under the matching share award plan (MSAP) and set the targets for awards made in 2012.
- Reviewed and approved awards made under the annual bonus scheme, MSAP and PSP.
- Monitored progress against shareholding guidelines for executive directors and other members of the executive team.
- Reviewed the committee's performance during the period.
- Reviewed the committee's terms of reference.

Other activities

- Conducted a review of the executive incentive arrangements (see pages 57–63).
- Consulted with shareholders on proposed changes to the executive incentive arrangements.
- Set the terms of appointment for new members of the executive team.
- Approved amendments to the performance conditions applying to the 2010 and 2011 long-term incentive awards (see page 66).

Remuneration policy report

Overview of remuneration policy

The company's remuneration arrangements are designed so that the overall level of remuneration (including salary and benefits together with the short and long-term incentive opportunities) is sufficient to attract, retain and motivate executives of the quality required to run the company successfully. The company does not pay more than is necessary for this purpose. The committee recognises that the company operates in the North West of England in a regulated environment and therefore needs to ensure that the structure of executive remuneration reflects both the practices of the markets in which its executives operate, and stakeholder expectations of how the company should be run.

A significant proportion of senior executives' remuneration is linked to company and individual performance. Senior executives are incentivised to achieve stretching results which are delivered with an acceptable level of risk. There is a strong direct link between incentives and the company's strategy and if the strategy is delivered, senior executives will be rewarded through the annual bonus and long-term incentives. If it is not delivered, then a significant part of their potential remuneration will not be paid.

Executive incentive review

As described in the chair's letter, during the year the committee carried out a full review of the executive incentive schemes. As part of this process the chair of the committee consulted with several leading shareholders and representative groups from December 2012 through to May 2013 on behalf of the committee.

Changes to incentives will apply from the year 2013/14, including the deferral of the 2012/13 bonus and the long-term incentive awards to be granted in summer 2013.

The key changes to the current structure are as follows:

- **Reduced maximum opportunity** whilst maintaining the expected value of the package
- **Introduction of compulsory deferral** of 50 per cent of annual bonus for executive directors
- **Introduction of new Long Term Plan (LTP)** to be used instead of the existing matching share award plan (MSAP) and performance share plan (PSP), featuring revised long-term measures aligned with strategy and shareholder objectives
- **Longer time horizon** on LTP for executive directors of five years (three-year performance period plus two-year holding period)
- **Complexity is reduced** by the removal of the matching element of the existing package
- **Clawback and malus provisions** have been strengthened

Further details regarding the incentives proposed for 2013/14 are set out in this report. The long-term awards to be granted in 2013 will be made under the LTP which is being put forward for shareholder approval at the 2013 AGM. The key terms of the LTP are set out in the notice of AGM.

How the views of shareholders are taken into account

The committee understands that listening to the views of the company's key stakeholders plays a vital role in formulating and implementing a successful remuneration policy over the long term. The committee thus actively seeks the views of shareholders and other key stakeholders to inform the development of the remuneration policy, particularly where any changes to policy are envisaged.

Corporate governance report continued

Remuneration policy table – executive directors

The table below summarises our policy for 2013/14, subject to the approval of the new long term plan (LTP) by shareholders at the 2013 AGM:

Element of remuneration	Purpose and link to strategy	Policy and approach	Opportunity 2013/14	Change of policy vs 2012/13?*
Base salary	Takes into account experience and personal contribution to the company's strategy. Attracts and retains executives of the quality required to deliver the company's strategy.	◗ Reviewed annually with changes effective from 1 September if applicable. ◗ Consideration is given to individual and company performance. ◗ General pay increases across the wider workforce are also taken into consideration. ◗ Aim is to pay within a mid-market range, but may pay higher salaries and total remuneration for outperforming individuals (or to attract and retain executives of the right calibre) and where the company itself outperforms. ◗ Referenced against companies of a similar size (particularly market cap and turnover), sector, level of capital investment, and nature, scope and complexity of operations. The committee uses this data with caution given the limited number of direct comparators and to avoid remuneration being ratcheted up as a result of benchmarking exercises with no corresponding improvement in performance.	Base salary increases are applied in line with the outcome of the annual review.	No.
Annual bonus	Drives and rewards performance against personal objectives and selected financial and operational KPIs which are directly linked to business strategy.	◗ The performance measures underlying the annual bonus are selected to ensure the company is focused on its strategic objectives. This is achieved by incorporating a number of the KPIs shown on pages 18–19 into the company scorecard element for bonus. ◗ The balance of financial, operational and personal measures is reviewed annually and may be adjusted by the committee if deemed appropriate. ◗ The threshold, intermediate and stretch targets are established annually by the committee, making sure that they are sufficiently stretching whilst also recognising the nature and risk profile of the company. ◗ 25% of the maximum bonus is payable for reaching threshold targets, 50% for reaching intermediate targets and 100% for reaching stretch targets (with straight-line payouts in between these points). ◗ Bonuses are subject to clawback provisions in the event of a material overstatement in the financial statements of the company because of fraud or error.	Maximum of 130% of base salary.	Yes: additional performance measure related to bad debt recovery.
Deferred bonus plan (DBP)	Aligns the interests of executives and shareholders through the delivery of an award in shares.	◗ Compulsory deferral of 50% of gross bonus into company shares for three years. ◗ Shares accrue dividend equivalents. ◗ Awards will normally not vest until the normal vesting date, except in the event of death, where awards would vest earlier. ◗ If the participant is dismissed for gross misconduct at any point prior to vesting, the award will lapse. ◗ On a date of a change of control, typically the awards will vest or roll-over into equivalent shares in acquirer. ◗ The committee will have the discretion to reduce the number of unvested shares, cancel an award or impose further conditions on an award, in such negative circumstances it considers such action is appropriate. For example: material misstatement of audited financial results, serious failure of risk management, or serious reputational damage. ◗ This is in addition to the current clawback arrangements in place in executive directors' service contracts (see table on page 60).	Compulsory deferral of 50% of gross bonus.	Yes: previously bonus was deferred voluntarily under MSAP. Main changes are: – compulsory deferral of bonus into shares for three years; – no matching award; and – wider malus provisions.

* Further details on the policy for 2012/13 are given in the implementation report section (see page 64).

Element of remuneration	Purpose and link to strategy	Policy and approach	Opportunity 2013/14	Change of policy vs 2012/13?*
Long term plan (LTP)	Incentivises long-term value creation and alignment with shareholders' interests through use of relative TSR, sustainable dividends and customer service performance measures.	◗ Three-year performance period starting at the beginning of the financial year in which awards are granted. ◗ One-third of awards vest based on a relative total shareholder return (TSR) performance condition, one-third based on a sustainable dividends performance condition, and one-third based on customer service excellence. Further details of the performance conditions are given on page 61. ◗ Additional two-year holding period applies after the end of the three-year performance period. ◗ Subject to continuing employment over the three-year performance period. The committee may enable vesting of awards to 'good' leavers and as appropriate subject to performance and time pro-rating. ◗ If the participant resigns during the three-year performance period the award will lapse. ◗ If the participant is dismissed for gross misconduct at any point prior to vesting (i.e. before completion of holding period), the award will lapse. ◗ Shares accrue dividend equivalents. ◗ On a date of change of control typically the awards will vest (taking in to account time pro-rating and performance) or roll-over into equivalent shares in acquirer. ◗ Clawback and malus arrangements are as for deferred shares (see above). ◗ Rules provide for a maximum award of 200% of base salary.	Maximum of 130% of base salary.	Yes: previously ongoing share awards were granted under the matching share award plan (MSAP) and performance share plan (PSP) (see pages 65–66). Main changes are: – use of one long-term plan through removal of MSAP; – reduced maximum opportunity whilst retaining expected value; – change to a wider TSR comparator group; – new sustainable dividend and customer service performance measures added aligned to business strategy; – longer time horizon through additional two-year holding period; and – wider malus provisions.
Pension	Defined contribution approach minimises the risk to the company associated with defined benefit pension plans.	◗ A company contribution into a defined contribution pension scheme; or ◗ A cash allowance in lieu of pension; or ◗ A combination of a company contribution into a defined contribution pension scheme and a cash allowance.	Choice of company contribution of up to 25% of base salary into a defined contribution pension scheme; or cash allowance of up to 22% of base salary; or a combination of both approaches.	Yes: additional flexibility introduced to be consistent with policy for other executives.
Other benefits	Provides market competitive benefits.	◗ Car allowance payable in monthly instalments alongside base salary (not bonusable). ◗ Private medical insurance, life assurance and group income protection (for ill health).	Based on individual circumstances.	No.
Share ownership guidelines	Provides alignment with shareholders' interests.	◗ Executive directors are encouraged to build up and retain a targeted level of shareholding. ◗ Normally to be built up within five years of appointment.	100% of base salary.	No.

* Further details on the policy for 2012/13 are given in the implementation report section (see page 64).

Corporate governance report continued

Main points of service contracts for executive directors and letters of appointment for non-executive directors

Executive directors	
Notice periods	◗ One year by the company and six months by the executive director. ◗ A company notice period longer than one year may be provided if necessary for recruitment, but reducing to a rolling one-year notice period after the initial period has expired.
Termination	◗ No termination payment if notice is worked. ◗ Otherwise, payment of a maximum of 12 months' basic salary, plus pension and car allowance. ◗ Half of the termination payment will be paid within 14 days of date of termination with the other half paid in monthly instalments between the 7th and 12th month anniversary from date of termination of employment. The payment will be reduced by the value of any salary, pension contribution and car allowance earned in new paid employment in that period. ◗ No automatic entitlement to payments under the annual bonus or long-term incentives. Any annual bonus payment is at the discretion of the company. ◗ Fair and reasonable mitigation to any contractual obligations may be applied, taking account of the UK Corporate Governance Code (the code) and legal advice on the company's liability to pay compensation. ◗ A robust line on reducing compensation is applied and payments to a departing employee may be phased in order to mitigate loss.
Clawback	◗ Clawback of bonus scheme payments, MSAP and PSP awards is possible in the case of a material overstatement in the financial statements of the company because of fraud or error. ◗ Actions include: requiring the executive to repay amounts received in respect of a bonus payment; reducing the number of shares awarded but not yet transferred to the executive in respect of a PSP or MSAP award; and requiring the executive to repay amounts related to the value of shares already transferred as a result of PSP or MSAP awards vesting. ◗ Note that this is in addition to the proposed wider malus provisions for the DBP and LTP described in the policy table above (effective for the new LTP if it is approved by shareholders at the AGM).
Service contract dates	◗ Steve Mogford – 5.1.11 ◗ Russ Houlden – 1.10.10
Non-executive directors	
Letters of appointment	◗ All non-executive directors should stand for reappointment on an annual basis at every AGM. ◗ No compensation will be paid for loss of office in the event of early termination. ◗ Letters of appointment can be viewed at the company's registered office and on the website: corporate.unitedutilities.com.
Fees	◗ Annual fees reflecting the responsibilities placed on the non-executive directors are paid. ◗ Additional fees are paid to the chairs of the audit and risk, corporate responsibility, remuneration and treasury committees, and to the senior independent non-executive director. ◗ The remuneration committee approves the remuneration for the Chairman, which is reviewed annually with any changes effective from 1 September. ◗ A separate committee of the board decides the remuneration of all of the other non-executive directors on an annual basis with any changes effective from 1 September. That committee is responsible for setting the base fee and also the fees received for chairing sub-committees and for the senior independent non-executive. ◗ Fee reviews take account of the level of fees paid by companies of similar size and complexity. ◗ Non-executive directors do not participate in any annual bonus or incentive plans, pension schemes, healthcare arrangements, the company's long-term incentive plans or employee share schemes. ◗ The company repays the reasonable expenses that non-executive directors incur in carrying out their duties as directors.
Date first appointed to the board	◗ John McAdam – 4.2.08 ◗ Catherine Bell – 19.3.07 ◗ Paul Heiden – 5.10.05 ◗ Brian May – 1.9.12 ◗ Nick Salmon – 4.4.05 ◗ Sara Weller – 1.3.12

Further detail on proposed LTP performance measures and targets for grants in 2013/14

The performance conditions for the 2013 LTP awards were selected following an extensive review and shareholder consultation process. The committee is of the view that the performance targets are aligned with the company's key strategic goals, and aligned with shareholders' interests over the coming years. Summary details about the LTP performance measures are shown in the following table. The LTP is subject to shareholder approval at the 2013 AGM.

Shareholder returns	Weighting: one-third of award
Key features	Comments
◗ TSR measured over a three-year performance period ◗ Relative to the FTSE 100 excluding financial services, oil & gas and mining companies (a comparator group of approximately 64 companies) ◗ No payment for below median performance ◗ Threshold vesting (25%) at median performance ◗ Stretch vesting (100%) at 1.15x median (or greater) ◗ 'Straight-line' vesting between threshold and stretch ◗ For the purpose of calculating TSR, the TSR index is averaged over the three months prior to the start and end of the performance period	Given the small size of the current comparator group (five companies) and the consequent challenges in measuring performance on a robust basis we believe that extending the group in the new LTP to comprise constituents of the FTSE 100 (excluding financial services, oil & gas and mining companies) provides a better basis for comparison. We believe the stretch target of 1.15x median is appropriate given our volatility relative to the comparator companies. If we do outperform the median over the three-year performance period this could generate significant returns for shareholders. For example, if the median TSR of the comparator group is 10% over the three-year performance period and stretch performance is achieved, then this could generate shareholder returns of around £275m per year more than would be delivered by achieving median TSR performance.
Sustainable dividends	**Weighting: one-third of award**
Key features	Comments
◗ Comprises two elements – dividend growth and dividend cover ◗ For 2013 where the performance period straddles two regulatory periods, dividend cover will operate as an underpin, with dividend growth (over the three-year period) providing the payout range based on threshold (25% vesting) to stretch (100% vesting) targets ◗ The remuneration committee will set challenging targets at the start of the performance period	Given the commercial sensitivity of attempting to publicly predict the outcome of a regulatory price review process, the committee believes that disclosing precise targets for this measure in advance would not be in shareholder interests. Actual targets, performance achieved and awards made will be published at the end of the performance period so shareholders can fully assess the basis for any pay-outs.
Customer service excellence	**Weighting: one-third of award**
Key features	Comments
◗ Based on Ofwat's customer service measure (currently the Service Incentive Mechanism) ◗ Vesting based on ranking position in final year compared to the other water and wastewater companies (currently 21 companies including United Utilities) ◗ No payment for below median performance ◗ Threshold vesting (25%) for median position (11 out of 21) ◗ Intermediate vesting (80%) for upper quartile position (6 out of 21) ◗ Stretch vesting (100%) for upper decile position or above (1 or 2 out of 21) ◗ 'Straight-line' vesting between these points	Customer service has a direct financial impact on the company as our regulator can apply financial incentives or penalties depending on our customer service performance. Threshold payments under this performance condition require achievement of median performance (11 out of 21). For 2011/12 the company was ranked 16 out of 21. Intermediate vesting has been set in line with our medium-term target of moving to the upper quartile. In line with our vision to be one of the UK's best water and wastewater companies we believe that achieving the position of 1st or 2nd in the rankings is an appropriately demanding stretch target.

The committee will have the flexibility to make appropriate adjustments to the performance targets in exceptional circumstances, to ensure that the award achieves its original purpose. The basis for any adjustments to the level of vesting will be fully disclosed retrospectively in the remuneration report.

Any vesting is also subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance.

Corporate governance report continued

How the new executive remuneration structure aligns to business strategy

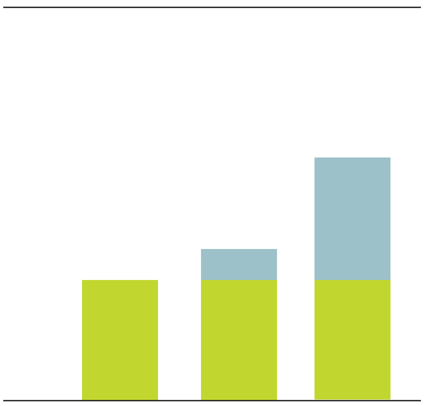
Element/measure	Our aim is to deliver long-term shareholder value	The best service to customers	At the lowest sustainable cost	In a responsible manner
Long term plan (weighting for 2013/14 if applicable):				
– Relative TSR (33.3%)	✓			
– Sustainable dividends (33.3%)	✓			✓
– Customer service excellence (33.3%)	✓	✓		✓
– Additional two-year holding period	✓			✓
Annual bonus (weighting for 2013/14 if applicable):				
– Operating profit (30%)	✓		✓	
– Customer service in year (20%)[1]	✓	✓		
– Maintaining and enhancing services for customers (16%)[2]	✓	✓	✓	✓
– Sustainability of service and corporate responsibility (20%)[3]	✓	✓		✓
– Bad debt recovery (4%)	✓		✓	
– Personal (10%)	✓	✓	✓	✓
– Compulsory deferral of bonus	✓			✓
Shareholding obligation	✓			

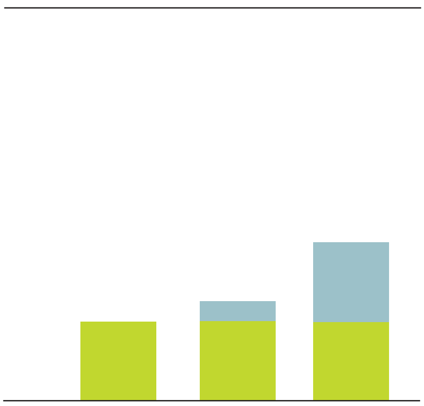
Focusing on customer service and corporate responsibility

1 **Customer service in year**
This measures our customer service performance over the bonus year, as reported by Ofwat through the SIM score.

2 **Maintaining and enhancing services for customers**
This measures how effectively and efficiently we deliver projects to improve our region's water and wastewater network. Our capital programme ensures we can provide a reliable service for our customers now and in the future and helps to provide a cleaner environment.

3 **Sustainability of service and corporate responsibility**
This measure is made up of two components: serviceability and the Dow Jones Sustainability Index. Serviceability relates to the overall reliability for our assets, such as treatment works, water pipes and pumping stations – ensuring that they deliver a stable and dependable level of service to our customers. The Dow Jones Sustainability Index is an assessment of our responsible business practice, measuring economic environmental, social and governance performance.





Based on what a director would receive if the threshold level of performance was achieved:
Annual variable element pays out at 25% of maximum
Long-term incentive element pays out at 25% of maximum

Based on what a director would receive if the maximum level of performance was achieved:
Annual variable element pays out at 100% of maximum
Long-term incentive element pays out at 100% of maximum

Corporate governance report continued

Implementation report

Aggregate remuneration
Table: Directors' emoluments and long-term incentive payments (audited information)

	Gross salary/ fees for the year ended 31 March £'000		Bonus earned for the year ended 31 March £'000		Other benefits in the year ended 31 March £'000(2)		Total emoluments for the year ended 31 March £'000		Long-term incentives with performance period ending during the year ended 31 March £'000		Allowances paid in lieu of pension contributions in the year ended 31 March £'000		Total remuneration for the year ended 31 March(1) £'000	
	2013	2012	2013	2012	2013	2012	2013	2012	2013(4)	2012(3)	2013	2012	2013	2012
Executive directors														
Steve Mogford	659.0	650.0	723.3	606.8	20.5	20.8	1,402.8	1,277.6	n/a	n/a	145.0	143.0	1,547.8	1,420.6
Russ Houlden	415.8	405.8	456.4	374.1	26.2	24.4	898.4	804.3	154.1	n/a	91.5	89.3	1,144.0	893.6
Non-executive directors														
John McAdam	267.3	260.9	n/a	n/a	0.9	0.5	268.2	261.4	n/a	n/a	n/a	n/a	268.2	261.4
Catherine Bell	62.8	61.4	n/a	n/a	0.7	0.4	63.5	61.8	n/a	n/a	n/a	n/a	63.5	61.8
Paul Heiden	72.8	71.4	n/a	n/a	0.0	0.6	72.8	72.0	n/a	n/a	n/a	n/a	72.8	72.0
David Jones(5)	22.0	66.4	n/a	n/a	3.2	0.0	25.2	66.4	n/a	n/a	n/a	n/a	25.2	66.4
Brian May	34.1	n/a	n/a	n/a	0.7	n/a	34.8	n/a	n/a	n/a	n/a	n/a	34.8	n/a
Nick Salmon	67.8	66.4	n/a	n/a	0.7	0.4	68.5	66.8	n/a	n/a	n/a	n/a	68.5	66.8
Sara Weller	64.6	4.8	n/a	n/a	0.0	0.0	64.6	4.8	n/a	n/a	n/a	n/a	64.6	4.8

Notes:
(1) Total remuneration includes total emoluments for the year, long-term incentives with performance periods ending during the year and allowances paid in lieu of pension contributions.
(2) For executive directors this includes car allowance, and health, life and income protection insurance. For non-executive directors this includes spouse's attendance at a company event in the UK, and where applicable, retirement gifts.
(3) The outcome of the 2009 awards was not known at the time of last year's report. The final vesting in respect of those awards was 37.5 per cent. The relative TSR performance condition (relating to 50 per cent of the awards) failed to reach the threshold vesting level. The remaining 50 per cent of awards were based on a scorecard of operational measures, of which 75 per cent were met. Neither of the current executive directors were participants in the 2009 awards, but the former executive directors Philip Green and Charlie Cornish received 43,170 and 12,007 shares respectively, related to the pro-rated awards they retained as good leavers.
(4) The performance period for the 2010 awards ended on 31 March 2013 and the awards vested on 21 May 2013. The final vesting of those awards was 35.3 per cent. Details of the performance measures are shown on pages 65-66. Former executive director Philip Green received 13,795 shares relating to the vested pro-rated awards he retained as a good leaver. Russ Houlden received 19,581 vested shares and the value of these shares shown in the table above has been calculated using the closing share price on the date of vesting, which was 787 pence per share.
(5) David Jones retired from the board at the 2012 AGM on 27 July 2012.

Executive director salaries
Steve Mogford received an increase of 2.4 per cent effective from 1 September 2012, increasing his base salary from £650,000 to £665,500. Russ Houlden also received an increase of 2.4 per cent effective from 1 September 2012, increasing his base salary from £410,000 to £420,000. The committee was satisfied that both executive directors had made good progress in delivering the business strategy during the year, and also considered the approach taken in respect of the wider workforce, along with external benchmark data when deciding to provide these increases.

Annual bonus
The following table summarises the performance measures and bonus outcome for 2012/13 for each of the executive directors:

Table: Annual bonus plan outcome for 2012/13 (as percentage of maximum bonus opportunity)

		Steve Mogford		Russ Houlden	
Measure	KPI	Max.	Actual	Max.	Actual
Operating profit	Underlying operating profit	30.0%	17.4%	30.0%	17.4%
Customer service in year	Service incentive mechanism (qualitative and quantitative)	20.0%	18.0%	20.0%	18.0%
Maintaining and enhancing services for customers	Regulatory capital expenditure (spend and outputs)	20.0%	20.0%	20.0%	20.0%
Sustainability of service and corporate responsibility	Serviceability and Dow Jones Sustainability Index rating	20.0%	20.0%	20.0%	20.0%
Personal	n/a	10.0%	9.0%	10.0%	9.0%
Total as % bonus maximum		**100.0%**	**84.4%**	**100.0%**	**84.4%**
Total as % base salary		**130.0%**	**109.7%**	**130.0%**	**109.7%**
Total £'000			**723.3**		**456.4**

Long-term incentives

Matching share award plan (MSAP)

The committee does not intend to make ongoing awards under the MSAP in 2013/14 or future years. The following provides a summary of the operation of the plan for awards in previous years.

Summary of policy for 2012/13

Voluntary deferral of up to 54 per cent of gross bonus into MSAP.

- Matched by award of company shares on 1:1 basis.
- Matching structure results in an overall maximum matching award equal to 70 per cent of base salary, assuming the maximum bonus applies.
- Three-year performance period applies to the matching shares starting at the beginning of the financial year in which awards are granted with 50 per cent based on the achievement of operational measures and 50 per cent based on TSR relative to an index (see below for further details).
- Any vesting is subject to the committee being satisfied that the company's performance is consistent with underlying business performance.
- Matching shares accrue dividend equivalents.
- Awards are subject to clawback provisions in the event of a material overstatement in the financial statements of the company because of fraud or error.
- Subject to continuing employment. In the case of leavers, the vesting of awards is at the discretion of the trustee based on a recommendation from the committee and an award will not normally vest unless the termination is for a 'good leaver' reason (as determined by the committee) such as retirement or because of ill health, or there are other special circumstances. Payments are then time pro-rated and subject to the performance conditions on which awards were granted (or modified, if appropriate) being satisfied.

Both executive directors elected to defer the maximum 54 per cent of gross bonus into the MSAP relating to their bonus for 2011/12. This award will be based on performance from 1 April 2012 to 31 March 2015.

Performance share plan (PSP)

The committee does not intend to make ongoing awards under the PSP in 2013/14 or future years. The following provides a summary of the operation of the plan for awards in previous years.

Summary of policy for 2012/13

- The same performance conditions and continuing employment conditions which apply to the MSAP also apply to the PSP.
- PSP shares accrue dividend equivalents.
- Awards are subject to clawback provisions in the event of a material overstatement in the financial statements of the company because of fraud or error.

PSP awards during 2012/13 were 70 per cent of salary for executive directors and will be based on performance from 1 April 2012 to 31 March 2015.

Alongside the awards granted to executives, awards were also granted to a small number of key employees under the PSP, with the same performance conditions as apply to the executive directors (albeit with different weightings between the TSR and operational performance conditions).

Vesting of 2010 long-term incentives

The same performance period and performance conditions applied to the 2010 MSAP and PSP awards. The performance period for the awards ended on 31 March 2013 and the final vesting in respect of those awards was 35.3 per cent. Of the 50 per cent based on relative TSR, 33.1 per cent vested. Of the 37.5 per cent based on relative efficiency and operating expenditure outperformance, 50 per cent vested. The employee engagement measure (12.5 per cent of the award) failed to meet the threshold vesting level. Neither of the current executive directors were participants in the 2010 MSAP, but Russ Houlden was a participant in the 2010 PSP, and received 19,581 vested shares.

Details on the performance measures applying to the 2012/13 MSAP and PSP

Total shareholder return (TSR)

50 per cent of the PSP and MSAP awards made in 2012/13 have a performance condition which measures the company's comparative TSR performance against a TSR index over a period of three financial years, starting on 1 April 2012. The index is constructed by assessing the TSR performance of the companies in the index, with their influence on the index being weighted according to relevance and size.

None of the TSR element of an award will vest if United Utilities' performance falls below the index; 25 per cent of the award will vest for performance equal to the index; and 100 per cent of the award will vest for outperforming the index by an additional 6.3 per cent (on a multiplicative basis) over the three-year performance period. Vesting is on a sliding scale for performance between these points.

The composition and weighting of the index for awards made during 2012/13 is shown below.

Company	Weighting
Severn Trent	100
Pennon Group	75
National Grid	25
Scottish & Southern Energy	25
Centrica	25

For the purpose of calculating TSR, the TSR index is averaged over the three months prior to the start and end of the performance period. TSR is independently calculated by New Bridge Street.

Corporate governance report continued

Operational performance measures

The operational measures applying to the remaining 50 per cent of the 2012/13 grants focused on:

- outperforming the operational expenditure regulatory targets over the three-year performance period from 1 April 2012 to 31 March 2015; and
- delivering the capital expenditure regulatory targets over the five-year regulatory period from 1 April 2010 to 31 March 2015 (although this is measured over the whole five-year regulatory period, the first two years of performance was known at grant and taken into account by the committee when assessing the difficulties of achieving the targets over the remaining three years).

These operational measures are important to business performance during a regulatory period as they measure success against key elements of our business strategy: outperformance and delivery of the regulatory contract, and delivering long-term shareholder value at the lowest sustainable cost. More detail on these measures is given in the table below:

Operational measure	Weighting	Measure	Vesting scale[1]
Opex outperformance (see page 19)	75%	Cumulative operating expenditure outperformance versus Ofwat's allowed operating costs over the 2012–15 period	100% vesting if stretch outperformance over the performance period is achieved; 50% vesting if intermediate outperformance over the performance period is achieved; 25% vesting if Ofwat's allowed operating costs over the performance period ('threshold') are achieved; and 0% vesting if threshold is not achieved.
Capex (see page 19)	25%	Cumulative capital expenditure versus Ofwat's capital expenditure allowance over the 2010–15 period	100% vesting if capital expenditure over the performance period matches Ofwat's capital expenditure allowance ('stretch'); 50% vesting for intermediate underperformance or outperformance; 25% vesting for threshold underperformance or outperformance; and 0% vesting if threshold is not achieved.

Note:
(1) Vesting is on a straight-line basis between threshold and intermediate, and intermediate and stretch performance.

Changes to existing performance measures

During the year it was necessary to make the following changes to the performance conditions applying to the 2010/11 and 2011/12 MSAP and PSP awards:

- Relative efficiency measure for the 2010/11 awards – 37.5 per cent of the awards related to a relative efficiency measure. However, as notified in last year's report, due to changes in Ofwat's reporting not all of the information necessary to produce annual relative efficiency assessments is now available in the public domain. The committee therefore replaced the original relative efficiency measure with a measure it considered to be no easier or harder to achieve than the original performance condition. The replacement measure was based on relative efficiency performance in the first year of the three year performance period and operating expenditure outperformance (relative to Ofwat's allowed operating costs) over the remaining two years of the performance period.
- Treatment of International Power for the 2010/11 and 2011/12 awards – following the delisting of Northumbrian Water Group (NWG) in 2011, the committee decided to replace NWG in the comparator group for the 2010/11 and 2011/12 LTIPs with Centrica and International Power. However, International Power was subsequently taken over by GDF Suez and it delisted in July 2012. Due to the relatively short period of time International Power had been in the comparator group, the committee agreed to remove International Power retrospectively from the comparator group.

Pension

During the year the company paid £236,500 (2012: £232,300) in respect of cash allowances in lieu of pension contributions to the executive directors.

Executive directors' interests in ShareBuy

During the year, both the executive directors participated in ShareBuy.

Table: Executive directors' interests in the company's share schemes (audited information)

				Awards granted during the year		Awards granted during the year from notional dividends[1]			Awards vested and exercised during the year ended 31 March 2013		
	Award date	End of performance period[2]	Number of shares at 1 April 2012	Number of shares	Market price of a share at award (p)	Number of shares	Value £'000s	Number of shares lapsed during the year	Number of shares	Value £'000s	Number of shares as at 31 March 2013
Steve Mogford											
PSP[3]	8.7.11	31.3.14	78,945	–	n/a	3,727	26.2	–	–	–	82,672
PSP[4]	15.6.12	31.3.15	–	66,862	680.5	3,156	25.3	–	–	–	70,018
MSAP[3]	8.7.11	31.3.14	17,166	–	n/a	809	5.7	–	–	–	17,975
MSAP[4]	15.6.12	31.3.15	–	48,151	680.5	2,272	16.0	–	–	–	50,423
MSIS[5]	27.5.11	5.1.16	91,281	–	n/a	4,308	30.2	–	–	–	95,589
Russ Houlden											
PSP[6]	28.3.11	31.3.13	52,973	–	n/a	2,500	17.6	–	–	–	55,473
PSP[3]	8.7.11	31.3.14	48,581	–	n/a	2,293	16.1	–	–	–	50,874
PSP[4]	15.6.12	31.3.15	–	42,174	680.5	1,990	14.0	–	–	–	44,164
MSAP[3]	8.7.11	31.3.14	22,246	–	n/a	1,049	7.4	–	–	–	23,295
MSAP[4]	15.6.12	31.3.15	–	29,684	680.5	1,400	9.8	–	–	–	31,084
MSIS[7]	1.10.10	1.10.15	39,332	–	n/a	1,856	13.0	–	–	–	41,188

Notes:

(1) All awards are increased by the notional reinvestment of dividends paid over the course of the retention or performance period.

(2) For the matched share investment schemes, there are no performance conditions and the dates in this column are the vesting dates.

(3) The performance period for this award started on 1 April 2011 and will end on 31 March 2014. Half of the performance measures are based on relative TSR and half are based on operational measures. Further details are given in last year's report.

(4) The performance period for this award started on 1 April 2012 and will end on 31 March 2015. Half of the performance measures are based on relative TSR and half are based on operational measures. Further details are given on pages 65-66.

(5) Full details of the one-off matched share investment award for Steve Mogford, introduced as a necessary part of his terms of appointment, were disclosed in the 2010/11 report. He invested in shares to the value of £500,000 and so a conditional matched award of shares to the value of £500,000 was made to him on 27 May 2011. Shares under this scheme will be transferred to him on 5 January 2016, subject to him still being employed by the group at that date.

(6) The performance period for this award started on 1 April 2010 and ended on 31 March 2013. Half of the performance measures were based on relative TSR and half were based on operational measures . On 21 May 2013, 35.3 per cent of the awards vested and 64.7 per cent lapsed. See page 65 for details.

(7) Full details of the one-off matched share investment award for Russ Houlden, introduced as a necessary part of his terms of appointment, were disclosed in the 2010/11 report. He invested in shares to the value of £210,000 and so a conditional matched award of shares to the value of £210,000 was made to him on 1 October 2010. Shares under this scheme will be transferred to him on 1 October 2015, subject to him still being employed by the group at that date.

Non-executive director fees

The Chairman's fee was increased by 2.5 per cent to £270,000 (from £263,400) with effect from 1 September 2012.

The remuneration of all of the other non-executive directors was reviewed by the committee referred to in the remuneration policy section. The base annual fee increased by 2.5 per cent to £58,400 per year (from £57,000). There were no changes to any of the other fees paid to the non-executive directors. The chairmanship of the audit and risk committee and the treasury committee are held by the same non-executive director (Paul Heiden) and he received an additional annual fee of £15,000. The chair of the remuneration committee (Sara Weller) and the senior independent non-executive director (Nick Salmon) each received an additional annual fee of £10,000. The chair of the corporate responsibility committee (Catherine Bell) received an additional annual fee of £5,000.

Directors' share interests

Details of beneficial interests in the company's ordinary shares as at 31 March 2013 held by each of the directors and their connected persons are set out in the table below along with the targeted shareholding guideline level. The table shows that both executive directors have already met this target shareholding. There is an expectation that executive directors will continue to build a shareholding throughout their period of employment with the company after the target shareholding is reached.

Corporate governance report continued

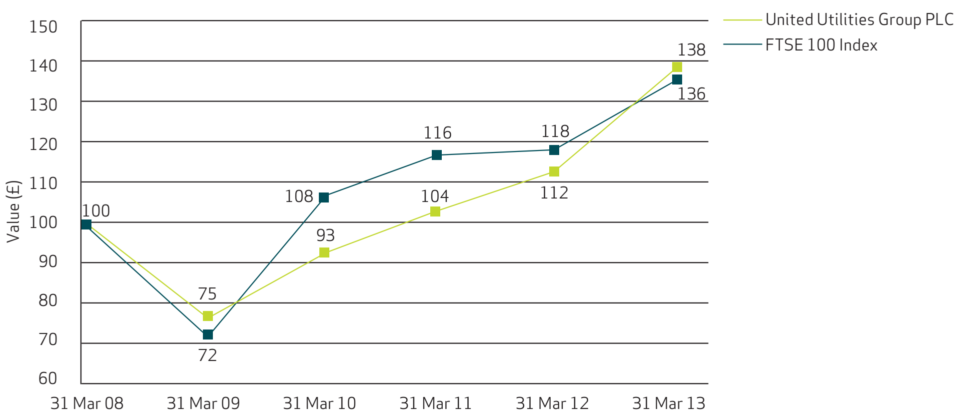
Table: Details of interests in shares held by directors

	At 31 March 2013	At 1 April 2012	Other shares counting towards shareholding target[1]	Target shareholding as % of base salary	Actual shareholding as % of base salary as at 31 March 2013	Date shareholding target should be achieved
Executive directors						
Steve Mogford[2]	118,554	95,145	45,883	100%	177%	5.1.16
Russ Houlden[2]	61,986	47,441	19,770	100%	140%	1.10.15
Non-executive directors						
John McAdam	1,837	1,837	n/a	n/a	n/a	n/a
Catherine Bell	7,000	7,000	n/a	n/a	n/a	n/a
Paul Heiden	2,421	2,421	n/a	n/a	n/a	n/a
David Jones	n/a	3,000	n/a	n/a	n/a	n/a
Brian May	3,000	n/a	n/a	n/a	n/a	n/a
Nick Salmon	1,004	1,004	n/a	n/a	n/a	n/a
Sara Weller	10,531	5,531	n/a	n/a	n/a	n/a

Notes:
(1) Excludes unvested shares with performance conditions under the company's share plans, but includes matching shares under the matched share incentive schemes (on a net of tax and national insurance basis). Share price used is the average share price over the three months from 1 January 2013 to 31 March 2013 (717.4 pence per share).
(2) In the period 1 April 2013 to 22 May 2013, additional shares were acquired by Steve Mogford (40 ordinary shares) and Russ Houlden (39 ordinary shares) in respect of their regular monthly contributions to the company's approved share incentive plan 'ShareBuy'.

Outside appointments
Steve Mogford remains a non-executive director of Carillion PLC for which he receives and retains an annual fee of £50,000.

Total shareholder return



The performance chart compares the group's annual TSR performance (reflecting B shares issued to shareholders and the share consolidation) for the past five years against the FTSE 100 index. The company is a member of the FTSE 100 and it is considered to be the most suitable widely published benchmark for this purpose.

The TSR indices used in the chart have been calculated relative to a base date of 31 March 2008.

The directors' remuneration report was approved by the board of directors on 22 May 2013 and signed on its behalf by:

Sara Weller
Chair of the remuneration committee

Status of this report
This report sets out the information required by the Companies Act 2006, Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the Listing Rules of the Financial Conduct Authority. The report is unaudited except where stated. An ordinary resolution to approve this report will be put to the annual general meeting on 26 July 2013.

Directors' report

Our directors present their management report and the audited financial statements of United Utilities Group PLC (the company) and its subsidiaries (together referred to as the group) for the year ended 31 March 2013.

Principal activities and business review

The company is a public limited company registered in England and Wales. Our registered office address is at Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP.

The company is the holding company of a group which owns and operates water and wastewater assets in the North West of England.

The business review on pages 2–37, which includes our Chairman's and Chief Executive Officer's statement and the financial performance section (pages 20–31), provides a balanced analysis of the development and performance of our business during the financial year, and the position of our business at the year end, and forms part of this directors' report. A summary of our key performance indicators can be found on pages 18–19. A further description of these key performance indicators and others can be found in the performance section of the business review on pages 20–31. A summary of our principal risks and uncertainties can be found on pages 32–37. An indication of likely future developments of the group can be found on pages 2–14. The company's principal subsidiary undertakings, and the associated companies and joint ventures in which the group participates, are listed in note 14 in our consolidated financial statements.

Dividends

Our directors are recommending a final dividend of 22.88 pence per ordinary share for the year ended 31 March 2013, which, together with the interim dividend of 11.44 pence, gives a total dividend for the year of 34.32 pence per ordinary share (the interim and final dividends we paid in respect of the 2011/12 financial year were 10.67 pence and 21.34 pence per ordinary share respectively). Subject to approval by our shareholders at our AGM, our final dividend will be paid on 2 August 2013 to shareholders on the register at the close of business on 21 June 2013. United Utilities Employee Share Trust Limited (UUESTL) has waived its rights to dividends, including dividends paid in respect of the year ended 31 March 2013. However, the shareholding of the UUESTL at 31 March 2013, and at the date of this report, was nil.

Directors

The summary biographical details, together with the skills and experience of our directors who served during the financial year ended 31 March 2013, can be found on pages 42–43. During the year, David Jones retired from the board at our AGM on 27 July 2012 and we appointed Brian May to the board on 1 September 2012.

Our articles of association provide that our directors must retire at the third annual general meeting following their last election or reappointment by our shareholders. However, our board, being mindful of the recommendation contained within the revised UK Corporate Governance Code published in June 2010 that all directors should be subject to annual election by shareholders, has decided that all of our directors will retire at the 2013 AGM and offer themselves for election/reappointment, as happened at the AGMs in 2011 and 2012.

Information regarding the appointment of our directors is included in our corporate governance report on pages 46–49. Details of the interests in the company's shares held by our directors and persons connected with them are set out in our directors' remuneration report on pages 54–68.

Corporate governance statement

Further details of our compliance with the code as published by the Financial Reporting Council in June 2010 are given on pages 40–68. Our statement includes a description of the main features of our internal control and risk management systems in relation to the financial reporting process and forms part of this directors' report. A copy of the code published in June 2010, as applicable to the company for the year ended 31 March 2013, can be found at the Financial Reporting Council's website frc.org.uk. Copies of the matters reserved to the board and the terms of reference for each of the main board committees can be found on our website: corporate.unitedutilities.com. Our corporate governance statement also includes the consideration given by our directors to the factors relevant to the adoption of the going concern basis.

Directors' report continued

Our annual general meeting (AGM)

Our 2013 AGM of the company will be held on 26 July 2013 at The Midland Hotel, Peter Street, Manchester, M2 3NQ.

Full details of the resolutions to be proposed to our shareholders, and explanatory notes in respect of these resolutions, can be found in our notice of AGM. A copy can be found on our website.

At our 2013 AGM, resolutions will be proposed, amongst other matters: to receive the annual report and financial statements; to approve the directors' remuneration report; to declare a final dividend; and to appoint KPMG LLP as auditor.

In addition, resolutions will be proposed: to approve our directors' general authority to allot shares; to grant the authority to issue shares without first applying statutory rights of pre-emption; to authorise the company to make market purchases of its own shares; to authorise the making of limited political donations by the company and its subsidiaries; and to enable the company to continue to hold general meetings on not less than 14 clear days' notice. A resolution to approve the new long-term share plan will also be proposed.

Share capital, transfers of shares and voting rights

At 31 March 2013, the issued share capital of the company was £499,819,926 divided into 681,888,418 ordinary shares of five pence each and 273,956,180 deferred shares of 170 pence each. Details of our share capital and movements in our issued share capital are shown in note 24 to the financial statements on page 122. The ordinary shares represented 71.3 per cent and the deferred shares represented 28.7per cent respectively of the shares in issue as at 31 March 2013.

All our ordinary shares have the same rights, including the rights to one vote at any of our general meetings, to an equal proportion of any dividends we declare and pay, and to an equal amount of any surplus assets which are distributed in the event of a winding-up.

Our deferred shares convey no right to income, no right to vote and no appreciable right to participate in any surplus capital in the event of a winding-up. The rights attaching to our shares in the company are provided by our articles of association, which may be amended or replaced by means of a special resolution of the company in general meeting. The company renews annually its power to issue and buy back shares at our AGM and such resolutions will be proposed at our 2013 AGM. Our directors' powers are conferred on them by UK legislation and by the company's articles. At the AGM of the company on 27 July 2012, the directors were authorised to issue relevant securities up to an aggregate nominal amount of £11,363,479 and were empowered to allot equity securities for cash on a non pre-emptive basis to an aggregate nominal amount of £1,704,521.

Electronic and paper proxy appointment and voting instructions must be received by our registrars (Equiniti) not less than 48 hours before a general meeting and when calculating this period, the directors can decide not to take account of any part of a day that is not a working day. There are no restrictions on the transfer of our ordinary shares in the company, nor any limitations on the holding of our shares in the company, save (i) where the company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the company with information requested by it in accordance with Part 22 of the Companies Act 2006; or (ii) where their holder is precluded from exercising voting rights by the Financial Conduct Authority's Listing Rules or the City Code on Takeovers and Mergers.

There are no arrangements known to us by which financial rights carried by any shares in the company are held by a person other than the holder of the shares, nor are there known to us any arrangements between holders of securities that may result in restrictions on the transfer of securities or on voting rights. All our issued shares are fully paid.

Major shareholdings

At 22 May 2013, our directors had been notified of the following interests in the company's issued ordinary share capital in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority:

	Per cent of issued share capital	Direct or indirect nature of holding
AXA S.A.	4.933	direct and indirect
BlackRock Inc	5.13	indirect
Legal & General Group PLC	3.94	direct
Pictet Asset Management S.A.	4.995	indirect
Norges Bank	3.01	direct

Purchase of own shares

At our last AGM held on 27 July 2012, our shareholders authorised the company to purchase, in the market, up to 68,180,879 of our ordinary shares of 5 pence each. We did not purchase any shares under this authority during the year. We normally seek such an authority from our shareholders annually. At our 2013 AGM, we will seek authority from our shareholders to purchase up to 68,188,841 of our ordinary shares of 5 pence each with such authority expiring at the end of our AGM held in 2014.

Change of control

As at 31 March 2013, United Utilities Employee Share Trust Limited (UUESTL) was the trustee that administered our executive share plans and had the ability to exercise voting rights at its discretion which related to shares that it held under the trust deed constituting the trust. In the event of a takeover offer which could lead to a change of control of the company, the trustee must consult with the company before accepting the offer or voting in favour of the offer. Subject to that requirement, the trustee may take into account a prescribed list of interests and considerations prior to making a decision in relation to the offer, including the interests of the beneficiaries under the trust. As detailed on page 69, at 31 March 2013 the trustee's holding of ordinary shares in the company was nil. With effect from 22 April 2013, Equiniti Trust (Jersey) Limited replaced UUESTL as trustee to the executive share plans.

In the event of a change of control, the participants in our share incentive plan would be able to direct the trustee of the share incentive plan, Equiniti Share Plan Trustees Limited, how to act on their behalf.

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. 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.

Political and charitable donations

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

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

Charitable donations by the group in the year amounted to £5,273,253 (2012: £5,345,093). Of this, £5,000,000 went to the United Utilities Trust Fund, an independent grant-making trust helping people facing severe financial challenges, whilst the remainder was in support of local charitable causes and those of interest to employees. Our other community investments, including volunteering time contributions, are described on page 25.

Employees

Our policies on employee consultation and on equal opportunities for our disabled employees can be found in the 'Our approach to doing business' section on page 15. 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 by taking action to improve how they feel about the company and understand its direction.

Our board encourages employees to own shares in the company and we offer an all employee share incentive plan called 'ShareBuy'.

For further information on our average number of employees during the year, go to page 92.

Directors' report continued

Environmental, social and community matters

Details of our approach to corporate responsibility, relating to the environment and social and community issues, can be found in the 'Our approach to doing business' section on page 15.

Essential contractual relationships

Certain suppliers we use contribute key goods or services, the loss of which could cause disruption to our services. However, none are so vital that their loss would affect our viability as a group as a whole nor are we overly dependent on any one individual customer.

Policy on payment of creditors

Our policy is in line with the BIS Prompt Payment Code (a copy can be found online at promptpaymentcode.org.uk). Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with our suppliers in advance.

We make every effort to comply with the payment terms that we agree with our suppliers, subject to there being no dispute with the invoices we receive. As at 31 March 2013, our average credit period taken for trade purchases was 36 days for the group (2012: 29 days). The company has no trade payables.

Approach to technology development

We are committed to using innovative, cost-effective and practical solutions for providing high quality services and we recognise the importance of ensuring that we focus properly our investment in the development of technology and that we have the right skills to apply technology to achieve sustainable competitive advantage and also that we continue to be alert to emerging technological opportunities.

Financial instruments

Our risk management objectives and policies in relation to the use of financial instruments can be found in note 19 to the financial statements.

Property, plant and equipment

The group holds significant land assets; however, the vast majority of these are water catchment assets which are an integral and essential part of the operation of the group's regulated business. The nature of these assets, which are primarily moorland areas and which could not be sold by the group, means that it is impracticable to obtain meaningful market values for the land. Other land owned by the group, the majority of which relates to operational sites, does not have a market value materially different from historic cost.

Events occurring after the reporting period

Details of events after the reporting period are included in note 31 to the consolidated financial statements on page 126.

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 or she is aware, there is no relevant audit information of which the company's auditor is unaware; and

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

Appointment of the auditor

Our board is proposing that our shareholders appoint KPMG LLP as our auditor at the forthcoming AGM and authorise our directors to fix the auditor's remuneration.

Approved by the board on 22 May 2013 and signed on its behalf by:

Simon Gardiner
Company Secretary

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 laws and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) and applicable law and have elected to prepare the parent company financial statements on the same basis.

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.

Under applicable law and regulations, the directors are also responsible for preparing a directors' report, directors' remuneration report and corporate governance statement that complies with that law and those regulations.

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

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

We confirm that to the best of our knowledge:

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

Approved by the board on 22 May 2013 and signed on its behalf by:

Dr John McAdam
Chairman

Russ Houlden
Chief Financial Officer


United
Utilities

Financial statements

Pictured: Lee Donnellan, production manager at Davyhulme wastewater treatment works in Manchester. Davyhulme serves the equivalent of 1.2 million people, with the capacity to clean up to 714 million litres of wastewater every day.

Independent auditor's report

Independent auditor's report to the members of United Utilities Group PLC

We have audited the financial statements of United Utilities Group PLC for the year ended 31 March 2013, which comprise: the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and company statements of financial position, the consolidated and company statements of changes in equity, the consolidated and company statements of cash flows, the accounting policies and the related notes 1 to 31. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union (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, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2013 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the corporate governance statement, with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the directors' remuneration report to be audited 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; or
- a corporate governance statement has not been prepared by the company.

Under the Listing Rules we are required to review:

- the directors' statement in relation to going concern;
- the part of the corporate governance statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the board on directors' remuneration.

John Luke (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc
Statutory Auditor
Chartered Accountants
St James' Square, Manchester, M2 6DS
United Kingdom
22 May 2013

Consolidated income statement
for the year ended 31 March

	Note	2013 £m	2012 £m
Continuing operations			
Revenue	1, 2	1,636.0	1,564.9
Employee benefits expense:			
excluding restructuring costs	3	(127.5)	(135.4)
restructuring costs	3	(2.6)	(2.6)
Total employee benefits expense	3	(130.1)	(138.0)
Other operating costs	4	(414.1)	(388.0)
Other income	4	3.1	4.8
Depreciation and amortisation expense	4	(329.2)	(297.8)
Infrastructure renewals expenditure		(161.2)	(154.4)
Total operating expenses		(1,031.5)	(973.4)
Operating profit	4	604.5	591.5
Investment income	5	2.3	4.4
Finance expense	6	(302.1)	(315.5)
Investment income and finance expense		(299.8)	(311.1)
Profit before taxation		304.7	280.4
Current taxation charge		(74.2)	(45.5)
Deferred taxation charge		(1.2)	(28.1)
Deferred taxation credit – change in taxation rate		53.0	104.6
Taxation	7	(22.4)	31.0
Profit after taxation from continuing operations		282.3	311.4
Discontinued operations			
Profit after taxation from discontinued operations	8	14.6	5.1
Profit after taxation		296.9	316.5
Earnings per share			
from continuing and discontinued operations			
Basic	9	43.5p	46.4p
Diluted	9	43.5p	46.4p
Earnings per share			
from continuing operations			
Basic	9	41.4p	45.7p
Diluted	9	41.3p	45.6p
Dividend per ordinary share	10	34.32p	32.01p

Consolidated statement of comprehensive income

for the year ended 31 March

	Note	2013 £m	2012 £m
Profit after taxation		296.9	316.5
Other comprehensive income			
Actuarial gains/(losses) on defined benefit pension schemes	20	42.1	(24.3)
Taxation on items taken directly to equity	7	(10.0)	4.4
Foreign exchange adjustments		0.6	(1.9)
Total comprehensive income		329.6	294.7

Consolidated and company statements of financial position

at 31 March

	Note	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
ASSETS					
Non-current assets					
Property, plant and equipment	11	**8,990.7**	8,644.5	**–**	–
Goodwill	12	**5.0**	5.0	**–**	–
Other intangible assets	13	**99.9**	89.5	**–**	–
Investments	14	**5.7**	3.3	**5,600.0**	5,600.0
Trade and other receivables	16	**2.2**	1.1	**–**	–
Retirement benefit surplus	20	**15.1**	–	**–**	–
Derivative financial instruments	19	**659.2**	567.5	**–**	–
		9,777.8	9,310.9	**5,600.0**	5,600.0
Current assets					
Inventories	15	**39.6**	47.4	**–**	–
Trade and other receivables	16	**326.9**	301.4	**41.4**	42.9
Cash and short-term deposits	17	**201.7**	321.2	**0.6**	–
Derivative financial instruments	19	**62.0**	49.9	**–**	–
		630.2	719.9	**42.0**	42.9
Total assets		**10,408.0**	10,030.8	**5,642.0**	5,642.9
LIABILITIES					
Non-current liabilities					
Trade and other payables	23	**(419.8)**	(378.0)	**–**	–
Borrowings	18	**(6,007.4)**	(5,728.1)	**–**	–
Retirement benefit obligations	20	**–**	(92.0)	**–**	–
Deferred tax liabilities	21	**(1,219.0)**	(1,245.2)	**–**	–
Provisions	22	**(3.4)**	(4.0)	**–**	–
Derivative financial instruments	19	**(196.2)**	(159.7)	**–**	–
		(7,845.8)	(7,607.0)	**–**	–
Current liabilities					
Trade and other payables	23	**(440.1)**	(447.6)	**(10.9)**	(14.8)
Borrowings	18	**(166.1)**	(127.1)	**(1,558.2)**	(1,732.1)
Current tax liabilities		**(71.5)**	(78.1)	**–**	–
Provisions	22	**(8.8)**	(6.3)	**–**	–
Derivative financial instruments	19	**(3.8)**	(0.1)	**–**	–
		(690.3)	(659.2)	**(1,569.1)**	(1,746.9)
Total liabilities		**(8,536.1)**	(8,266.2)	**(1,569.1)**	(1,746.9)
Total net assets		**1,871.9**	1,764.6	**4,072.9**	3,896.0
EQUITY					
Capital and reserves attributable to equity holders of the company					
Share capital	24, 25	**499.8**	499.8	**499.8**	499.8
Share premium account	24	**2.9**	2.4	**2.9**	2.4
Revaluation reserve	24	**158.8**	158.8	**–**	–
Cumulative exchange reserve	24	**(4.4)**	(5.0)	**–**	–
Capital redemption reserve	24	**–**	–	**1,033.3**	1,033.3
Merger reserve	24	**329.7**	329.7	**–**	–
Retained earnings	24	**885.1**	778.9	**2,536.9**	2,360.5
Shareholders' equity		**1,871.9**	1,764.6	**4,072.9**	3,896.0

These financial statements for the group and United Utilities Group PLC (company number: 6559020) were approved by the board of directors on 22 May 2013 and signed on its behalf by:

Steve Mogford
Chief Executive Officer

Russ Houlden
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 March

Group	Share capital £m	Share premium account £m	Revaluation reserve £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2012	499.8	2.4	158.8	(5.0)	329.7	778.9	1,764.6
Profit after taxation	–	–	–	–	–	296.9	296.9
Other comprehensive income							
Actuarial gains on defined benefit pension schemes (see note 20)	–	–	–	–	–	42.1	42.1
Taxation on items taken directly to equity (see note 7)	–	–	–	–	–	(10.0)	(10.0)
Foreign exchange adjustments	–	–	–	0.6	–	–	0.6
Total comprehensive income	–	–	–	0.6	–	329.0	329.6
Transactions with owners							
Dividends (see note 10)	–	–	–	–	–	(223.5)	(223.5)
New share capital issued	–	0.5	–	–	–	–	0.5
Equity-settled share-based payments (see note 27)	–	–	–	–	–	1.7	1.7
Exercise of share options – purchase of shares	–	–	–	–	–	(1.0)	(1.0)
At 31 March 2013	499.8	2.9	158.8	(4.4)	329.7	885.1	1,871.9

Group	Share capital £m	Share premium account £m	Revaluation reserve £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2011	499.8	1.3	158.8	(3.1)	329.7	691.0	1,677.5
Profit after taxation	–	–	–	–	–	316.5	316.5
Other comprehensive income							
Actuarial losses on defined benefit pension schemes (see note 20)	–	–	–	–	–	(24.3)	(24.3)
Taxation on items taken directly to equity (see note 7)	–	–	–	–	–	4.4	4.4
Foreign exchange adjustments	–	–	–	(1.9)	–	–	(1.9)
Total comprehensive (expense)/income	–	–	–	(1.9)	–	296.6	294.7
Transactions with owners							
Dividends (see note 10)	–	–	–	–	–	(209.0)	(209.0)
New share capital issued	–	1.1	–	–	–	–	1.1
Equity-settled share-based payments (see note 27)	–	–	–	–	–	1.2	1.2
Exercise of share options – purchase of shares	–	–	–	–	–	(0.9)	(0.9)
At 31 March 2012	499.8	2.4	158.8	(5.0)	329.7	778.9	1,764.6

Company statement of changes in equity

for the year ended 31 March

Company	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2012	499.8	2.4	1,033.3	2,360.5	3,896.0
Profit after taxation (see note 24)	–	–	–	399.2	399.2
Total comprehensive income	–	–	–	399.2	399.2
Transactions with owners					
Dividends (see note 10)	–	–	–	(223.5)	(223.5)
New share capital issued	–	0.5	–	–	0.5
Equity-settled share-based payments (see note 27)	–	–	–	1.7	1.7
Exercise of share options – purchase of shares	–	–	–	(1.0)	(1.0)
At 31 March 2013	499.8	2.9	1,033.3	2,536.9	4,072.9

Company	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2011	499.8	1.3	1,033.3	2,595.0	4,129.4
Loss after taxation (see note 24)	–	–	–	(25.8)	(25.8)
Total comprehensive expense	–	–	–	(25.8)	(25.8)
Transactions with owners					
Dividends (see note 10)	–	–	–	(209.0)	(209.0)
New share capital issued	–	1.1	–	–	1.1
Equity-settled share-based payments (see note 27)	–	–	–	1.2	1.2
Exercise of share options – purchase of shares	–	–	–	(0.9)	(0.9)
At 31 March 2012	499.8	2.4	1,033.3	2,360.5	3,896.0

Consolidated and company statements of cash flows

for the year ended 31 March

		Group		Company	
	Note	2013 £m	2012 £m	2013 £m	2012 £m
Operating activities					
Cash generated from continuing operations	29	852.2	727.4	433.8	2.5
Interest paid		(168.3)	(167.2)	(36.3)	(24.0)
Interest received and similar income		2.4	4.4	–	–
Tax paid		(55.2)	(39.8)	–	–
Tax received		–	35.0	–	–
Net cash generated from/(used in) operating activities (continuing operations)		631.1	559.8	397.5	(21.5)
Net cash used in operating activities (discontinued operations)		(1.4)	–	–	–
Investing activities					
Proceeds from disposal of discontinued operations	8	–	3.5	–	–
Transaction costs, deferred consideration and cash disposed		–	2.0	–	–
Proceeds from disposal of discontinued operations net of transaction costs, deferred consideration and cash disposed		–	5.5	–	–
Purchase of property, plant and equipment		(625.6)	(502.2)	–	–
Purchase of other intangible assets		(35.3)	(17.3)	–	–
Proceeds from sale of property, plant and equipment		2.9	4.8	–	–
Grants and contributions received	23	16.3	13.0	–	–
Purchase of investments		(3.0)	(2.2)	–	–
Proceeds from sale of investments		0.9	–	–	–
Net cash used in investing activities (continuing operations)		(643.8)	(498.4)	–	–
Financing activities					
Proceeds from issue of ordinary shares		0.5	1.1	0.5	1.1
Proceeds from borrowings		147.9	446.3	36.7	232.2
Repayment of borrowings		(39.4)	(231.7)	(209.1)	–
Dividends paid to equity holders of the company	10	(223.5)	(209.0)	(223.5)	(209.0)
Exercise of share options – purchase of shares		(1.0)	(0.9)	(1.0)	(0.9)
Net cash (used in)/generated from financing activities (continuing operations)		(115.5)	5.8	(396.4)	23.4
Effects of exchange rate changes (continuing operations)		–	0.5	–	–
Net (decrease)/increase in cash and cash equivalents (continuing operations)		(128.2)	67.7	1.1	1.9
Net decrease in cash and cash equivalents (discontinued operations)		(1.4)	–	–	–
Cash and cash equivalents at beginning of the year	17	312.1	244.4	(0.5)	(2.4)
Cash and cash equivalents at end of the year	17	182.5	312.1	0.6	(0.5)

Accounting policies

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

a) Basis of preparation
The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU), including International Accounting Standards (IAS) and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments, 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 generally accepted accounting principles (GAAP) under IFRS, requires management to make estimates and assumptions that affect the amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting periods presented. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from these estimates.

The adoption of the following standards and interpretations, at 1 April 2012, has had no material impact on the group's financial statements:

Amendments to IFRS 7 'Financial Instruments'
This amendment introduces new disclosure requirements about transfers of financial assets which will impact the group only if it enters into any relevant transactions in the future.

Going concern
The financial statements have been prepared on the going concern basis. The directors have set out factors considered in concluding the appropriateness of this presentation in the financial reporting and going concern section of the corporate governance report.

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

b) Basis of consolidation
The group financial statements consolidate the financial statements of the company and entities controlled by the company (its subsidiaries), and incorporate the results of its share of joint ventures using proportionate consolidation.

The results of subsidiaries and joint ventures acquired or disposed of during the year are included in the consolidated income statement from the date control is obtained or until the date that control ceases, as appropriate.

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

Subsidiaries
Control is achieved where the company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one-half of the voting rights of an investee entity so as to obtain benefits from its activities. In the parent company accounts, investments are held at cost less provision for impairment.

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

Joint ventures
Joint ventures are entities in which the group holds an interest on a long-term basis and which are jointly controlled with one or more parties under a contractual arrangement. The group's share of joint venture income, expenses, assets, liabilities and cash flows is included in the consolidated financial statements on a proportionate consolidation basis using the same accounting methods as adopted for subsidiaries.

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

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

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

Transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are included in the initial fair value of that instrument.

Accounting policies continued

Where borrowing costs are attributable to the acquisition, construction or production of a qualifying asset, such costs are capitalised as part of the specific asset.

e) Taxation

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

Current taxation

Current taxation, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at each reporting date.

Taxable profit differs from the net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Current taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the corporation taxation is also dealt with in equity.

Deferred taxation

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

Deferred taxation liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred taxation is measured at the average tax rates that are expected to apply in the periods in which the temporary timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted at each reporting date.

The carrying amount of deferred taxation assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the deferred taxation is also dealt with in equity.

f) Property, plant and equipment

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

The useful economic lives of these assets are as follows:

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

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

Water and wastewater infrastructure assets

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

Other assets

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

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

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

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

Transfer of assets from customers

Where the group receives from a customer an item of property, plant and equipment (or cash to construct or acquire an item of property, plant and equipment) that the group must then use, either to connect the customer to the network, or to provide the customer with ongoing access to a supply of goods or services, or to do both, such items are capitalised at their fair value and included within property, plant and equipment, with a credit of the same amount to deferred grants and contributions. The assets are depreciated over their useful economic lives and the deferred contributions released to revenue over the same period (or where the receipt of property, plant and equipment is solely to connect the customer to the network, the deferred contribution is released immediately to revenue). This interpretation has been applied to transfers of assets from customers received on or after 1 July 2009.

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

g) Intangible assets

Goodwill

Goodwill arising on consolidation is recognised as an asset. Following initial recognition, goodwill is subject to impairment reviews, at least annually, and measured at initial value less accumulated impairment losses. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, or jointly controlled entity, the attributable amount of goodwill is included in the determination of the gain or loss on disposal.

Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Other intangible assets

Other intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful economic lives. The carrying amount is reduced by any provision for impairment where necessary.

On a business combination, as well as recording separable intangible assets already recognised in the statement of financial position of the acquired entity at their fair value, identifiable intangible assets that arise from contractual or other legal rights are also included in the acquisition statement of financial position at fair value.

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

Amortisation periods for categories of intangible assets are:

- Computer software 3 to 10 years; and
- Other intangible assets 2 to 20 years.

h) Impairment of tangible and intangible assets excluding goodwill

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

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

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

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

i) Financial instruments

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

Cash and short-term deposits

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

Accounting policies continued

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

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

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

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

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

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

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

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

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

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

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

Derivative financial instruments
Derivative financial instruments are measured at fair value at each reporting date with changes in fair value being charged or credited to finance expense in the income statement. The group enters into financial derivatives contracts to manage its financial exposure to changes in market rates (see note 19).

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

The valuation of debt designated in a fair value hedge relationship is calculated based 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.

j) 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.

k) 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 difference between the expected return on scheme assets and interest cost on scheme liabilities is included in the income statement within investment income or finance expense.

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

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

Share-based compensation arrangements

The group operates equity-settled, share-based compensation plans. In accordance with the transitional provisions, IFRS 2 'Share-based Payments' has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2004.

The group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on estimates of the number of options that are expected to vest. Fair value is based on both simulation and binomial models, according to the relevant measures of performance. The group has the option to settle some of these equity-settled share-based payments on a net basis in cash.

At each reporting date, the group revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

l) Provisions

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

m) Foreign currency translation

Transactions and balances

Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange applicable on that date. Gains and losses arising on retranslation are included in net profit or loss for the period. Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity.

In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note 19).

Accounting policies continued

Group companies

On consolidation, the statements of financial position of overseas subsidiaries and joint ventures (none of which has the currency of a hyperinflationary economy) are translated into sterling at exchange rates applicable at each reporting date. The income statements are translated into sterling using the average rate unless exchange rates fluctuate significantly in which case the exchange rate at the date the transaction occurred is used. Exchange differences resulting from the translation of such statements of financial position at rates ruling at the beginning and end of the period, together with the differences between income statements translated at average rates and rates ruling at the period end, are dealt with as movements on the group's cumulative exchange reserve, a separate component of equity. Such translation differences are recognised as income or expense in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. The group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of implementation of IFRS 3 'Business Combinations' (1 April 1999) as sterling denominated assets and liabilities.

n) Grants and contributions

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

o) Leases

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

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

p) Critical accounting judgements and key sources of estimation uncertainty

In the process of applying its accounting policies, the group is required to make certain estimates, judgements and assumptions that it believes are reasonable based 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.

Carrying value of property, plant and equipment

The estimated useful economic lives of property, plant and equipment (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

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

United Utilities Water PLC raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and wastewater customers with water meters, the receivable billed is dependent 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 is dependent on the rateable value of the property, as assessed by an independent rating officer.

Allowance for doubtful receivables

At each reporting date, the company and each of its subsidiaries evaluate the recoverability of trade receivables and record allowances for doubtful receivables based 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.

Accounting for provisions and contingencies

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

Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 30, unless the possibility of transferring economic benefits is remote.

Retirement benefits

The group operates two defined benefit schemes which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 20. Profit before taxation and net assets are affected by the actuarial assumptions used. These assumptions include investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

Taxation

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the application of tax law and the result of negotiations with, and enquiries from, tax authorities in a number of jurisdictions.

q) Recently issued accounting pronouncements

International Financial Reporting Standards

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

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

- IFRS 9 'Financial Instruments – amendment' is effective for periods commencing on or after 1 January 2015 but will not be considered for endorsement by the EU until the remaining elements of the project have been completed. Under the provisions of this standard, where the group has chosen to measure borrowings at fair value through the profit or loss, the portion of the change in fair value due to changes in the group's own credit risk will be recognised in the statement of other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year, £1.5 million of losses would have been recognised in the statement of other comprehensive income rather than within the income statement.

- IAS 19 'Employee Benefits' was amended in June 2011 and is effective for periods commencing on or after 1 January 2013. The impact on the group will be to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit surplus/(obligations). The group has assessed the impact of the revised standard, the impact on the results for the year ended 31 March 2013 would be to recognise a net interest cost of £1.5 million in the income statement as opposed to the net pension interest cost of £11.5 million (the interest cost of £108.3 million net of the expected return on plan assets of £96.8 million). There would be no impact on either the net retirement benefit surplus/(obligations) or related deferred tax balance within the statement of financial position.

Accounting policies continued

- IFRS 11 'Joint Arrangements' is effective for periods commencing on or after 1 January 2014 and replaces IAS 31 'Interests in Joint Ventures'. IFRS 11 removes the option currently taken by the group to proportionately consolidate its joint ventures and requires equity accounting. The impact on the income statement and statement of financial position for the year ended 31 March 2013 would be that the group's interests in its joint ventures' assets, liabilities, income and expenses, as summarised in note 14, would be presented separately in the statement of financial position and income statement. There would be no impact on net assets.

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

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

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

Notes to the financial statements

1 TOTAL REVENUE

Total revenue, disclosed as required by IAS 18 'Revenue', recognised in the consolidated income statement is analysed as follows:

	2013 £m	2012 £m
Provision of goods and services (see note 2)	**1,636.0**	1,564.9
Revenue	**1,636.0**	1,564.9
Investment income (see note 5)	**2.3**	4.4
Total revenue	**1,638.3**	1,569.3

During the year ended 31 March 2013, £1.8 million of revenue was derived from exchanges of goods or services in relation to IFRIC 18 'Transfers of Assets from Customers' (2012: £0.9 million) (see note 23).

2 SEGMENT REPORTING

The board of directors of United Utilities Group PLC (the board) is provided with information on a single segment basis for the purposes of assessing performance and allocating resources. The board reviews revenue, underlying operating profit, operating profit, assets and liabilities at a consolidated level. In light of this, the group has a single segment for financial reporting purposes and therefore no further detailed segmental information is provided in this note.

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

2013	**UK £m**	**Rest of world £m**	**Total £m**
External revenue	**1,620.5**	**15.5**	**1,636.0**
Non-current assets*	**9,047.0**	**56.5**	**9,103.5**

2012	UK £m	Rest of world £m	Total £m
External revenue	1,548.9	16.0	1,564.9
Non-current assets*	8,686.3	57.1	8,743.4

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

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

3 DIRECTORS AND EMPLOYEES

Directors' remuneration

	2013 £m	2012 £m
Fees to non-executive directors	**0.6**	0.5
Salaries	**1.1**	1.1
Benefits	**0.3**	0.3
Bonus	**1.2**	1.0
Share-based payment charge	**0.8**	0.3
	4.0	3.2

Further information about the remuneration of individual directors and details of their pension arrangements are provided in the directors' remuneration report on pages 54 to 68.

Notes to the financial statements continued

3 DIRECTORS AND EMPLOYEES continued

Remuneration of key management personnel

	2013 £m	2012 £m
Salaries and short-term employee benefits	6.6	6.0
Post-employment benefits	0.2	0.2
Share-based payment charge	1.5	0.7
	8.3	6.9

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

Employee benefits expense (including directors)

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

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

	2013 £m	2012 £m
Defined benefit pension expense (see note 20)	16.5	13.3
Defined contribution pension costs (see note 20)	5.5	4.2
	22.0	17.5

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

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

Company

The company has no employees.

4 OPERATING PROFIT

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

	2013 £m	2012 £m
Other operating costs		
Hired and contracted services	112.8	130.6
Materials	54.9	55.4
Power	62.1	50.3
Property rates	81.3	79.4
Charge for bad and doubtful receivables (see note 16)	35.5	34.5
Legal and professional expenses	5.8	4.1
Accommodation costs	7.6	5.5
Movement in other provisions (see note 22)	4.9	(3.9)
Cost of properties disposed	10.7	3.4
Operating leases payable:		
Property	2.9	3.3
Plant and equipment	0.9	0.8
Amortisation of deferred grants and contributions (see note 23)	(7.1)	(6.9)
Research and development expenses	1.3	1.6
Loss on disposal of property, plant and equipment	6.6	5.5
Loss on disposal of other intangible assets	3.2	2.6
Other	30.7	21.8
	414.1	388.0
Other income		
Other income	(3.1)	(4.8)
	(3.1)	(4.8)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment: owned assets	305.9	278.0
Amortisation of other intangible assets	23.3	19.8
	329.2	297.8

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

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

Notes to the financial statements continued

5 INVESTMENT INCOME

	2013 £m	2012 £m
Interest receivable on short-term bank deposits held at amortised cost	2.3	4.4

6 FINANCE EXPENSE

	2013 £m	2012 £m
Interest payable		
Interest payable on borrowings held at amortised cost	249.1	269.0
	249.1	269.0
Fair value losses/(gains) on debt and derivative instruments[1]		
Fair value hedge relationships:		
Borrowings	99.0	210.0
Designated swaps	(93.5)	(205.0)
	5.5	5.0
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss[2]	17.6	19.1
Held for trading derivatives – economic hedge	(13.5)	(47.9)
	4.1	(28.8)
Held for trading derivatives – 2010–15 regulatory hedges	(16.1)	54.4
Held for trading derivatives – regulatory hedges >2015	52.6	18.2
Held for trading derivatives – electricity hedges	1.5	4.6
Net receipts on swaps and debt under fair value option	(7.6)	(7.7)
Held for trading derivatives – other[3]	4.0	(1.6)
Other	(2.5)	(0.9)
	31.9	67.0
Net fair value losses on debt and derivative instruments[4]	41.5	43.2
Expected return on pension schemes' assets (see note 20)	(96.8)	(100.5)
Interest cost on pension schemes' obligations (see note 20)	108.3	103.8
Net pension interest expense	11.5	3.3
	302.1	315.5

Notes:
(1) Fair value losses/(gains) on debt and derivative instruments includes foreign exchange losses of £14.6 million (2012: £22.3 million gains), excluding those on instruments measured at fair value through profit or loss. These losses are largely offset by fair value gains on derivatives.
(2) Includes £1.5 million losses (2012: £21.3 million gains) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.
(3) Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.
(4) Includes £8.3 million income (2012: £7.2 million) due to interest on swaps and debt under fair value option.

Interest payable for the year ended 31 March 2013 is stated net of £14.3 million (2012: £9.7 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and other intangible assets during the year. This has been calculated by applying a capitalisation rate of 4.3 per cent (2012: 4.8 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

7 TAXATION

	2013 £m	2012 £m
Continuing operations		
Current taxation		
UK corporation tax	79.4	60.1
Foreign tax	1.3	1.3
Adjustments in respect of prior years	(6.5)	(15.9)
Total current taxation charge for the year	74.2	45.5
Deferred taxation		
Current year	(4.6)	12.6
Adjustments in respect of prior years	5.8	15.5
	1.2	28.1
Change in taxation rate	(53.0)	(104.6)
Total deferred taxation credit for the year	(51.8)	(76.5)
Total taxation charge/(credit) for the year	22.4	(31.0)

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

	2013 £m	2013 %
Profit before taxation	304.7	
Taxation at the UK corporation tax rate of 24 per cent	73.1	24.0
Adjustments in respect of prior years	(0.7)	(0.2)
Change in taxation rate	(53.0)	(17.4)
Net expenses not deductible/other	3.0	1.0
Total taxation charge and effective tax rate for the year	22.4	7.4

	2012 £m	2012 %
Profit before taxation	280.4	
Taxation at the UK corporation tax rate of 26 per cent	72.9	26.0
Adjustments in respect of prior years	(0.4)	(0.1)
Change in taxation rate	(104.6)	(37.3)
Net expenses not deductible/other	1.1	0.4
Total taxation credit and effective tax rate for the year	(31.0)	(11.0)

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

Notes to the financial statements continued

7 TAXATION continued

The deferred taxation credit for the year ended 31 March 2012 includes a credit of £104.6 million to reflect the change enacted on 5 July 2011 to reduce the mainstream rate of corporation tax from 26 per cent to 25 per cent and the subsequent change enacted on 26 March 2012 to reduce the mainstream rate of corporation tax further to 24 per cent effective from 1 April 2012. A related deferred taxation charge of £3.9 million is included within items taken directly to equity.

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

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

Taxation on items taken directly to equity

Continuing operations	2013 £m	2012 £m
Current taxation		
Relating to other pension movements	(15.6)	(33.1)
Deferred taxation (see note 21)		
On actuarial gains/(losses) on defined benefit pension schemes	9.7	(5.8)
Relating to other pension movements	15.0	30.6
Change in taxation rate	0.9	3.9
	25.6	28.7
Total taxation charge/(credit) on items taken directly to equity	10.0	(4.4)

8 DISCONTINUED OPERATIONS

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

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

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

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

9 EARNINGS PER SHARE

	2013 £m	2012 £m
Profit after taxation attributable to equity holders of the company – continuing and discontinued operations	296.9	316.5
Adjustment for profit after taxation from discontinued operations (see note 8)	(14.6)	(5.1)
Profit after taxation attributable to equity holders of the company – continuing operations	282.3	311.4

9 EARNINGS PER SHARE continued

	2013 pence	2012 pence
Earnings per share from continuing and discontinued operations		
Basic	**43.5**	46.4
Diluted	**43.5**	46.4
Earnings per share from continuing operations		
Basic	**41.4**	45.7
Diluted	**41.3**	45.6
Earnings per share from discontinued operations		
Basic	**2.1**	0.7
Diluted	**2.2**	0.8

Basic earnings per share is calculated by dividing profit for the financial year attributable to equity holders of the company by 681.9 million, being the weighted average number of shares in issue during the year (2012: 681.8 million). Diluted earnings per share is calculated by dividing profit for the financial year attributable to equity holders of the company by 682.8 million, being the weighted average number of shares in issue during the year including dilutive shares (2012: 682.2 million).

The difference between the weighted average number of shares used in the basic and the diluted earnings per share calculations represents those ordinary shares deemed to have been issued for no consideration on the conversion of all potential dilutive ordinary shares in accordance with IAS 33 'Earnings per Share'.

The weighted average number of shares can be reconciled to the weighted average number of shares including dilutive shares as follows:

	2013 million	2012 million
Average number of ordinary shares – basic	**681.9**	681.8
Effect of potential dilutive ordinary shares – share options	**0.9**	0.4
Average number of ordinary shares – diluted	**682.8**	682.2

10 DIVIDENDS

	2013 £m	2012 £m
Amounts recognised as distributions to equity holders of the company in the year comprise:		
Ordinary shares		
Final dividend for the year ended 31 March 2012 at 21.34 pence per share (2011: 20.00 pence)	**145.5**	136.3
Interim dividend for the year ended 31 March 2013 at 11.44 pence per share (2012: 10.67 pence)	**78.0**	72.7
	223.5	209.0
Proposed final dividend for the year ended 31 March 2013 at 22.88 pence per share (2012: 21.34 pence)	**156.0**	145.5

The proposed final dividends for the years ended 31 March 2013 and 31 March 2012 were subject to approval by equity holders of United Utilities Group PLC and hence have not been included as liabilities in the consolidated financial statements at 31 March 2013 and 31 March 2012 respectively.

Notes to the financial statements continued

11 PROPERTY, PLANT AND EQUIPMENT

Group	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
Cost						
At 1 April 2011	248.2	3,874.1	5,163.5	427.9	745.9	10,459.6
Additions	1.9	169.4	64.3	37.3	387.5	660.4
Transfers	3.5	106.7	127.2	9.8	(247.2)	–
Disposals	(17.1)	(0.8)	(59.0)	(25.9)	(2.8)	(105.6)
Currency translation differences	(0.4)	(3.0)	–	(0.2)	–	(3.6)
At 31 March 2012	**236.1**	**4,146.4**	**5,296.0**	**448.9**	**883.4**	**11,010.8**
Additions	**6.5**	**75.8**	**67.0**	**27.9**	**484.0**	**661.2**
Transfers	**11.9**	**164.4**	**172.3**	**8.2**	**(356.8)**	**–**
Disposals	**(4.6)**	**(0.6)**	**(38.2)**	**(33.2)**	**(1.3)**	**(77.9)**
Currency translation differences	**0.1**	**0.3**	**–**	**–**	**–**	**0.4**
At 31 March 2013	**250.0**	**4,386.3**	**5,497.1**	**451.8**	**1,009.3**	**11,594.5**
Accumulated depreciation						
At 1 April 2011	80.0	170.7	1,686.5	247.5	–	2,184.7
Charge for the year	8.3	27.3	202.5	39.9	–	278.0
Disposals	(17.0)	–	(54.3)	(24.0)	–	(95.3)
Currency translation differences	(0.1)	(1.0)	–	–	–	(1.1)
At 31 March 2012	**71.2**	**197.0**	**1,834.7**	**263.4**	**–**	**2,366.3**
Charge for the year	**9.9**	**28.9**	**226.6**	**40.5**	**–**	**305.9**
Disposals	**(4.6)**	**(0.1)**	**(31.9)**	**(31.8)**	**–**	**(68.4)**
At 31 March 2013	**76.5**	**225.8**	**2,029.4**	**272.1**	**–**	**2,603.8**
Net book value at 31 March 2013	**173.5**	**4,160.5**	**3,467.7**	**179.7**	**1,009.3**	**8,990.7**
Net book value at 31 March 2012	164.9	3,949.4	3,461.3	185.5	883.4	8,644.5

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

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

Company

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

12 GOODWILL

Group	£m
Cost	
At 1 April 2011, 31 March 2012 and 31 March 2013	**5.0**

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

Company

The company has no goodwill.

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13 OTHER INTANGIBLE ASSETS

Group	Computer software £m	Other £m	Total £m
Cost			
At 1 April 2011	233.1	10.2	243.3
Additions	18.3	–	18.3
Disposals	(39.3)	–	(39.3)
Currency translation differences	–	(0.6)	(0.6)
At 31 March 2012	**212.1**	**9.6**	**221.7**
Additions	**36.1**	**0.8**	**36.9**
Disposals	**(41.9)**	**–**	**(41.9)**
Currency translation differences	**–**	**0.1**	**0.1**
At 31 March 2013	**206.3**	**10.5**	**216.8**
Amortisation			
At 1 April 2011	146.1	3.3	149.4
Charge for the year	19.6	0.2	19.8
Disposals	(36.7)	–	(36.7)
Currency translation differences	–	(0.3)	(0.3)
At 31 March 2012	**129.0**	**3.2**	**132.2**
Charge for the year	**22.5**	**0.8**	**23.3**
Disposals	**(38.6)**	**–**	**(38.6)**
At 31 March 2013	**112.9**	**4.0**	**116.9**
Net book value at 31 March 2013	**93.4**	**6.5**	**99.9**
Net book value at 31 March 2012	83.1	6.4	89.5

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

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

Company

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

14 INVESTMENTS

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

Notes to the financial statements continued

14 INVESTMENTS continued

During the year, the group increased its investment in Muharraq Holding Company 1 Limited by £3.0 million and disposed of its investment in Philwater Holdings Company Inc for consideration of £0.9 million.

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

Details of principal operating subsidiary undertakings and joint ventures are set out below. These undertakings are included within the consolidated financial statements. A full list of the group's subsidiary undertakings is included in the company's annual return.

	Class of share capital held	Proportion of share capital owned/voting rights %*	Nature of business
Subsidiary undertakings			
Great Britain			
United Utilities Water PLC	Ordinary	100.0	Water and wastewater services and network management
United Utilities Property Services Limited	Ordinary	100.0	Property management
Joint ventures			
Estonia			
AS Tallinna Vesi	Ordinary	35.3	Contract operations and maintenance services

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

Joint management of AS Tallinna Vesi (Tallinn Water) is based on a shareholders' agreement. Tallinn Water's financial year end is not coterminous with that of the group. The most recent financial year ended on 31 December 2012.

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

Group share of joint ventures	2013 £m	2012 £m
Non-current assets	46.8	49.1
Current assets	17.5	16.6
Non-current liabilities	(28.2)	(27.9)
Current liabilities	(8.0)	(6.7)
	28.1	31.1

Group share of joint ventures	2013 £m	2012 £m
Gross income	15.1	15.7
Expenses	(7.4)	(8.1)
Taxation	(1.3)	(1.3)
Profit after taxation	6.4	6.3

The joint ventures have no significant contingent liabilities to which the group is exposed. The group has issued guarantees of £5.2 million in support of its joint ventures (2012: £5.4 million) which are included in the contingent liabilities total disclosed in note 30.

14 INVESTMENTS continued

Company	Shares in subsidiary undertakings £m
Cost	
At 1 April 2011, 31 March 2012 and 31 March 2013	6,326.8
Impairment	
At 1 April 2011, 31 March 2012 and 31 March 2013	(726.8)
Net book value at 31 March 2012 and 31 March 2013	**5,600.0**

During the year ended 31 March 2013, a review has been performed supporting the carrying value of the investment of £5,600.0 million in United Utilities PLC. As in the prior year, the review considered a 'fair value less costs to sell' valuation and whether there were any indications that the value of the underlying business may have changed. No indications of impairment or impairment reversal were identified.

15 INVENTORIES

Group	2013 £m	2012 £m
Properties held for resale	**33.8**	42.3
Other inventories	**5.8**	5.1
	39.6	47.4

The company has no inventories.

16 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
Trade receivables	**190.1**	182.1	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**41.4**	42.9
Amounts owed by related parties (see note 28)	**1.0**	1.0	**–**	–
Other debtors	**19.5**	15.8	**–**	–
Prepayments and accrued income	**118.5**	103.6	**–**	–
	329.1	302.5	**41.4**	42.9

Amounts owed by subsidiary undertakings are a sum of all subsidiary balances where the total of debt and interest is in a net receivable position. No allowance has been made for doubtful receivables in respect of amounts owed by subsidiary undertakings (2012: £nil).

Notes to the financial statements continued

16 TRADE AND OTHER RECEIVABLES continued

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

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
Non-current	2.2	1.1	–	–
Current	326.9	301.4	41.4	42.9
	329.1	302.5	41.4	42.9

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

Group	2013 £m	2012 £m
At the start of the year	78.4	55.2
Amounts charged to operating expenses	35.5	34.5
Trade receivables written off	(26.4)	(11.3)
At the end of the year	87.5	78.4

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

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

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

Group At 31 March 2013	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	114.3	37.9	32.6	184.8

At 31 March 2012	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	110.4	29.8	35.0	175.2

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

Company

At 31 March 2013 and 31 March 2012, 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 2013 and 31 March 2012.

17 CASH AND CASH EQUIVALENTS

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
Cash at bank and in hand	14.6	12.4	0.6	–
Short-term bank deposits	187.1	308.8	–	–
Cash and short-term deposits	201.7	321.2	0.6	–
Bank overdrafts (included in borrowings, see note 18)	(19.2)	(9.1)	–	(0.5)
Cash and cash equivalents in the statement of cash flows	182.5	312.1	0.6	(0.5)

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

18 BORROWINGS

Group

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

Group	2013 £m	2012 £m
Non-current liabilities		
Bonds	4,633.7	4,491.1
Bank and other term borrowings	1,373.7	1,237.0
	6,007.4	5,728.1
Current liabilities		
Bonds	21.0	7.0
Bank and other term borrowings	125.9	111.0
Bank overdrafts (see note 17)	19.2	9.1
	166.1	127.1
	6,173.5	5,855.2

Notes to the financial statements continued

18 BORROWINGS continued

Terms and debt repayment schedule

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

Group	Currency	Year of final repayment	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Borrowings in fair value hedge relationships						
5.375% 150m bond	GBP	2018	179.9	178.6	177.1	176.1
4.55% 250m bond	USD	2018	178.1	189.7	163.6	179.2
5.375% 350m bond	USD	2019	256.4	277.8	235.0	262.8
4.25% 500m bond	EUR	2020	485.3	495.0	460.1	471.7
5.75% 375m bond	GBP	2022	451.5	441.0	430.4	421.6
5.625% 300m bond	GBP	2027	362.4	394.6	340.9	377.8
5.02% JPY 10bn dual currency loan	JPY/USD	2029	80.1	96.6	76.7	95.6
5% 200m bond	GBP	2035	215.6	256.0	202.1	244.6
Borrowings designated at fair value through profit or loss						
1.135% 3bn bond	JPY	2013	21.0	21.0	22.6	22.6
6.875% 400m bond	USD	2028	302.4	302.4	283.3	283.3
Borrowings measured at amortised cost						
Short-term bank borrowings - fixed	GBP	2013	125.6	125.6	110.8	110.8
0.24%+LIBOR 6.5m (floating) bond	GBP	2013	–	–	6.5	7.0
6.125% 425m bond	GBP	2015	483.7	428.6	489.7	429.7
1.97%+RPI 200m IL loan	GBP	2016	270.2	248.7	255.4	240.5
1.30%+LIBOR 5bn (floating) bond	JPY	2017	37.3	35.4	40.9	38.3
2.46%+RPI 50m IL loan	GBP	2020	72.4	56.3	65.4	54.5
2.10%+RPI 50m IL loan	GBP	2020	70.6	56.3	63.6	54.5
1.93%+RPI 50m IL loan	GBP	2020	70.0	56.4	62.9	54.6
1.90%+RPI 50m IL loan	GBP	2020	69.9	56.5	62.9	54.7
1.88%+RPI 50m IL loan	GBP	2020	69.7	56.3	62.6	54.6
1.84%RPI 50m IL loan	GBP	2020	69.7	56.6	62.6	54.8
1.73%+RPI 50m IL loan	GBP	2020	69.2	56.6	62.2	54.8
1.61%+RPI 50m IL loan	GBP	2020	68.7	56.7	61.7	54.9
0.47%+RPI 100m IL loan	GBP	2023	97.5	99.9	–	–
1.29%+RPI 50m IL loan	GBP	2029	58.3	53.4	49.8	51.6
1.23%+RPI 50m IL loan	GBP	2029	57.9	53.7	49.4	52.0
1.12%+RPI 50m IL loan	GBP	2029	56.4	52.9	48.0	51.3
1.10%+RPI 50m IL loan	GBP	2029	56.1	52.9	47.8	51.2
0.75%+RPI 50m IL loan	GBP	2029	52.1	51.7	43.9	50.1
1.15%+RPI 50m IL loan	GBP	2030	54.9	51.4	46.5	49.7
1.11%+RPI 50m IL loan	GBP	2030	54.2	51.5	45.2	49.9
0.76%+RPI 50m IL loan	GBP	2030	51.9	51.5	43.7	49.9
3.375%+RPI 50m IL bond	GBP	2032	95.9	68.0	86.3	65.8
1.9799%+RPI 100m IL bond	GBP	2035	148.4	127.7	128.3	123.8
1.66%+RPI 35m IL bond	GBP	2037	45.3	41.4	39.3	40.1
2.40%+RPI 70m IL bond	GBP	2039	102.4	80.6	89.1	78.1
1.7829%+RPI 100m IL bond	GBP	2040	143.9	126.4	123.6	122.5
1.3258%+RPI 50m IL bond	GBP	2041	64.7	63.0	55.1	61.1
1.5802%+RPI 100m IL bond	GBP	2042	137.0	126.0	116.7	122.1
1.5366%+RPI 50m IL bond	GBP	2043	68.4	62.9	58.1	60.9
1.397%+RPI 50m IL bond	GBP	2046	66.1	63.0	55.4	61.1
1.7937%+RPI 50m IL bond	GBP	2049	69.9	62.7	61.3	60.8
Commission for New Towns loan - fixed	GBP	2053	55.9	29.9	53.1	30.1
1.847%+RPI 100m IL bond	GBP	2056	142.3	125.0	123.0	121.0
1.815%+RPI 100m IL bond	GBP	2056	140.3	124.4	121.1	120.5
1.662%+RPI 100m IL bond	GBP	2056	133.8	124.2	115.2	120.3

18 BORROWINGS continued

Group	Currency	Year of final repayment	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Borrowings measured at amortised cost continued						
1.591%+RPI 25m IL bond	GBP	2056	32.6	31.0	28.0	30.0
1.5865%+RPI 50m IL bond	GBP	2056	65.3	62.1	56.2	60.1
1.556%+RPI 50m IL bond	GBP	2056	64.7	61.8	55.6	59.8
1.435%+RPI 50m IL bond	GBP	2056	62.0	61.5	53.1	59.6
1.3805%+RPI 35m IL bond	GBP	2056	42.6	43.1	36.5	41.7
1.702%+RPI 50m IL bond	GBP	2057	66.1	60.3	56.8	58.4
1.585%+RPI 100m IL bond	GBP	2057	126.0	119.5	108.2	115.7
Other debt issued by joint ventures	Various	Various	28.2	28.2	27.9	27.9
Other borrowings						
Bank overdrafts	GBP	2013	19.2	19.2	9.1	9.1
			6,470.0	6,173.5	5,830.3	5,855.2

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

Abbreviations used in the previous table are defined below:

Currency:

GBP	pound sterling
EUR	euro
USD	United States dollar
JPY	Japanese yen

Index-linked debt:

IL	Index-linked debt – this debt is adjusted for movements in the Retail 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)

Company

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

Company	2013 £m	2012 £m
Current liabilities		
Bank overdrafts (see note 17)	–	0.5
Amounts owed to subsidiary undertakings	1,558.2	1,731.6
	1,558.2	1,732.1

Borrowings are unsecured.

Notes to the financial statements continued

19 FINANCIAL INSTRUMENTS

Risk management

The board is responsible for treasury strategy and governance, which is reviewed on an annual basis. The annual treasury strategy review covers the group's funding, liquidity, capital management and interest rate management strategies, along with the delegation of specific funding and hedging authorities to the treasury committee.

The treasury committee, a sub-committee of the 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 board approved duration range. Liquidity is actively monitored by the group's treasury function and is reported monthly to the treasury committee through the operational compliance report.

At 31 March 2013, the group had £721.7 million (2012: £991.2 million) of available liquidity, which comprised £201.7 million (2012: £321.2 million) cash and short-term deposits and £520.0 million (2012: £670.0 million) of undrawn committed borrowing facilities. Short-term deposits mature within three months and bank overdrafts are repayable on demand.

The group had available committed borrowing facilities as follows:

Group	2013 £m	2012 £m
Expiring within one year	220.0	250.0
Expiring after one year but in less than two years	50.0	220.0
Expiring after more than two years	250.0	200.0
Total borrowing facilities	520.0	670.0
Offsetting bank guarantees	–	–
Undrawn borrowing facilities	520.0	670.0

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

At 31 March 2012, the group had an additional committed borrowing facility of £50.0 million expiring after more than two years that was available to be drawn from September 2013.

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.

The company does not have any committed facilities available.

19 FINANCIAL INSTRUMENTS continued

Maturity analysis

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

Group At 31 March 2013	Total[(1)] £m	Adjustment[(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
Bonds	9,873.4		190.1	169.9	595.6	145.4	182.7	8,589.7
Bank and other term borrowings	2,056.1		170.6	26.9	49.4	331.6	56.5	1,421.1
Adjustment to carrying value[(2)]	(5,756.0)	(5,756.0)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	6,173.5	(5,756.0)	360.7	196.8	645.0	477.0	239.2	10,010.8
Derivatives:								
Payable	1,064.9		97.7	80.8	52.3	46.3	77.0	710.8
Receivable	(1,643.9)		(152.3)	(174.6)	(86.9)	(85.3)	(143.9)	(1,000.9)
Adjustment to carrying value[(2)]	57.8	57.8						
Derivatives – net assets	(521.2)	57.8	(54.6)	(93.8)	(34.6)	(39.0)	(66.9)	(290.1)

At 31 March 2012	Total[(1)] £m	Adjustment[(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
Bonds	10,049.4		214.0	190.2	168.0	594.0	144.0	8,739.2
Bank and other term borrowings	1,886.4		103.9	36.5	26.4	48.6	329.4	1,341.6
Adjustment to carrying value[(2)]	(6,080.6)	(6,080.6)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	5,855.2	(6,080.6)	317.9	226.7	194.4	642.6	473.4	10,080.8
Derivatives:								
Payable	962.4		87.5	75.1	70.2	40.1	35.4	654.1
Receivable	(1,481.6)		(158.2)	(184.1)	(127.6)	(59.1)	(58.6)	(894.0)
Adjustment to carrying value[(2)]	61.6	61.6						
Derivatives – net assets	(457.6)	61.6	(70.7)	(109.0)	(57.4)	(19.0)	(23.2)	(239.9)

Notes:

(1) Forecast future cash flows are calculated, where applicable, utilising 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 2.65 per cent over the life of each bond.

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

The company has total borrowings of £1,558.2 million (2012: £1,732.1 million), which are payable within one year.

Notes to the financial statements continued

19 FINANCIAL INSTRUMENTS 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 does not believe it is exposed to any material concentrations of credit risk.

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the group's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. Considering the above, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 16).

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

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
Cash and short-term deposits (see note 17)	201.7	321.2	0.6	–
Trade and other receivables (see note 16)	329.1	302.5	41.4	42.9
Investments (see note 14)	5.7	3.3	–	–
Derivative financial instruments	721.2	617.4	–	–
	1,257.7	1,244.4	42.0	42.9

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2013, the group held £125.6 million (2012: £110.8 million) as collateral in relation to derivative financial instruments (included within borrowings in note 18). In respect of cash and short-term deposits and derivative financial instruments, the group does not have a material exposure to any financial institutions based within the eurozone, with the exception of Germany, and has not experienced any significant credit issues during the financial year.

Market risk

The group's exposure to market 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.

19 FINANCIAL INSTRUMENTS 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 scheme funding mechanism ensures that future contributions will be flexed for movements in RPI and smoothed over a rolling five-year period, providing a natural hedge against any inflationary uplift on the RCV.

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

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

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

Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Disclosure', the sensitivity analysis has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2013 and 31 March 2012, respectively. As a result, this analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI on the group's index-linked borrowings:

Increase/(decrease) in profit before taxation and equity	2013 £m	2012 £m
1 per cent increase in RPI	**(29.1)**	(27.2)
1 per cent decrease in RPI	**29.1**	27.2

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

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

The company has no material exposure to inflation risk.

Notes to the financial statements continued

19 FINANCIAL INSTRUMENTS 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 has fixed interest costs for a substantial proportion of the group's net debt for the duration of the current five-year regulatory pricing period. The group's interest risk management strategy is to fix interest rates out to a 10-year maturity on a reducing balance basis, seeking to lock in a 10-year rolling average interest rate on the group's nominal liabilities.

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

Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Disclosures', the sensitivity analysis has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place at the reporting date. As a result, this analysis is not indicative of the years then ended, as these factors would have varied throughout the year.

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

- fair value hedge relationships are fully effective;
- borrowings designated at fair value through profit or loss are effectively hedged by associated swaps;
- the main fair value sensitivity to interest rates in the statement of financial position (excluding the effect of accrued interest) is in relation to the fixed interest rate swaps which manage the exposure to medium-term interest rates;
- cash flow sensitivity in the statement of financial position to interest rates is calculated on floating interest rate net debt;
- the sensitivity excludes the impact of interest rates on post-retirement obligations;
- management has assessed one per cent as a reasonably possible movement in UK interest rates; and
- all other factors are held constant.

	Group		Company	
Increase/(decrease) in profit before taxation and equity	2013 £m	2012 £m	2013 £m	2012 £m
1 per cent increase in interest rate	**95.2**	83.2	**(15.6)**	(17.3)
1 per cent decrease in interest rate	**(97.2)**	(87.7)	**15.6**	17.3

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

19 FINANCIAL INSTRUMENTS continued

Repricing analysis

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

Group At 31 March 2013	Total £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,329.3	–	–	–	–	–	2,329.3
Effect of swaps	–	2,329.3	–	–	–	–	(2,329.3)
	2,329.3	2,329.3	–	–	–	–	–
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	323.4	21.0	–	–	–	–	302.4
Effect of swaps	–	302.4	–	–	–	–	(302.4)
	323.4	323.4	–	–	–	–	–
Borrowings measured at amortised cost							
Fixed rate instruments	584.1	125.9	0.3	429.0	0.4	0.5	28.0
Floating rate instruments	82.8	82.8	–	–	–	–	–
Index-linked instruments	2,853.9	2,853.9	–	–	–	–	–
	3,520.8	3,062.6	0.3	429.0	0.4	0.5	28.0
Effect of a fixed interest rate hedge	–	(1,831.3)	200.0	–	325.0	252.1	1,054.2
Total borrowings	6,173.5	3,884.0	200.3	429.0	325.4	252.6	1,082.2
Cash and short-term deposits	(201.7)	(201.7)	–	–	–	–	–
Net borrowings	5,971.8	3,682.3	200.3	429.0	325.4	252.6	1,082.2

Group At 31 March 2012	Total £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,229.4	–	–	–	–	–	2,229.4
Effect of swaps	–	2,229.4	–	–	–	–	(2,229.4)
	2,229.4	2,229.4	–	–	–	–	–
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	305.9	–	22.6	–	–	–	283.3
Effect of swaps	–	305.9	(22.6)	–	–	–	(283.3)
	305.9	305.9	–	–	–	–	–
Borrowings measured at amortised cost							
Fixed rate instruments	570.6	111.1	0.3	0.3	430.1	0.4	28.4
Floating rate instruments	82.3	82.3	–	–	–	–	–
Index-linked instruments	2,667.0	2,667.0	–	–	–	–	–
	3,319.9	2,860.4	0.3	0.3	430.1	0.4	28.4
Effect of a fixed interest rate hedge	–	(1,831.3)	–	454.2	300.0	325.0	752.1
Total borrowings	5,855.2	3,564.4	0.3	454.5	730.1	325.4	780.5
Cash and short-term deposits	(321.2)	(321.2)	–	–	–	–	–
Net borrowings	5,534.0	3,243.2	0.3	454.5	730.1	325.4	780.5

Notes to the financial statements continued

19 FINANCIAL INSTRUMENTS continued

Company	2013 Total £m	2013 1 year or less £m	2012 Total £m	2012 1 year or less £m
Borrowings measured at amortised cost				
Floating rate instruments	1,558.2	1,558.2	1,732.1	1,732.1
Total borrowings	1,558.2	1,558.2	1,732.1	1,732.1

Electricity price risk

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

The group has used electricity swap contracts to fix the price of a substantial proportion of its anticipated electricity usage out to the end of the AMP in 2015.

Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Dislosures', the sensitivity analysis has been prepared on the basis of the amount of the group's electricity swaps in place at the reporting date and, as a result, this analysis is not indicative of the years then ended, as this factor would have varied throughout the year.

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

Currency risk

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

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

The group seeks to manage its risk by maintaining currency exposure within 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.

19 FINANCIAL INSTRUMENTS continued

Capital risk management

The group's objective when managing capital is to maintain a capital structure that enables its primary subsidiary, United Utilities Water PLC, to retain a credit rating of A3 from Moody's Investors Services (Moody's), which the group believes best mirrors the Water Services Regulation Authority's (Ofwat) assumptions in relation to capital structure. The strategy of targeting a credit rating of A3 has been consistently maintained since 2007.

One of Ofwat's primary duties is to ensure that water companies are able to finance their functions, in particular by securing a reasonable return on their capital. Therefore, mirroring Ofwat's assumptions for credit ratings (and hence capital structure) should help safeguard the group's ability to earn a reasonable return on its capital, securing access to finance at a reasonable cost and enabling the group to continue as a going concern in order to provide returns for shareholders and credit investors, and benefits for other stakeholders.

In order to maintain a credit rating of A3 the group needs to manage its capital structure with reference to the ratings methodology and measures used by Moody's. The ratings methodology is normally based on a number of key ratios (such as RCV gearing and adjusted interest cover) and threshold levels as updated and published from time to time by Moody's.

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

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

Notes to the financial statements continued

19 FINANCIAL INSTRUMENTS continued

Fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

Group	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Financial assets				
Non-current assets				
Available for sale investments	5.7	5.7	2.5	2.5
Loans and receivables:				
Investments	–	–	0.8	0.8
Trade and other receivables	2.2	2.2	1.1	1.1
Derivative financial instruments:				
Fair value hedge derivatives – swaps	514.2	514.2	434.3	434.3
Held for trading derivatives – swaps[2]	145.0	145.0	133.2	133.2
Current assets				
Loans and receivables:				
Trade and other receivables	326.9	326.9	301.4	301.4
Cash and short-term deposits	201.7	201.7	321.2	321.2
Derivative financial instruments:				
Fair value hedge derivatives – swaps	62.0	62.0	48.4	48.4
Held for trading derivatives – swaps[2]	–	–	1.5	1.5
Financial liabilities				
Non-current liabilities				
Trade and other payables at amortised cost	(419.8)	(419.8)	(378.0)	(378.0)
Borrowings:				
Financial liabilities in hedge relationships:				
Fair value hedge	(2,209.3)	(2,329.3)	(2,085.9)	(2,229.4)
Financial liabilities designated at fair value through profit or loss	(302.4)	(302.4)	(305.9)	(305.9)
Other financial liabilities	(3,792.2)	(3,375.7)	(3,311.4)	(3,192.8)
	(6,303.9)	(6,007.4)	(5,703.2)	(5,728.1)
Derivative financial instruments:				
Fair value hedge derivatives – swaps	–	–	–	–
Held for trading derivatives – swaps[2]	(196.2)	(196.2)	(159.7)	(159.7)
Current liabilities				
Trade and other payables at amortised cost	(440.1)	(440.1)	(447.6)	(447.6)
Borrowings:				
Financial liabilities designated at fair value through profit or loss	(21.0)	(21.0)	–	–
Other financial liabilities	(145.1)	(145.1)	(127.1)	(127.1)
	166.1	166.1	(127.1)	(127.1)
Derivative financial instruments:				
Held for trading derivatives – swaps[2]	(3.8)	(3.8)	(0.1)	(0.1)
Adjustment for accrued interest[1]	40.4	–	40.0	–
	(6,231.8)	(5,975.7)	(5,531.3)	(5,596.2)

Notes:

[1] Fair values quoted include accrued interest of £40.4 million (2012: £40.0 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other payables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.

[2] Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £143.5 million (2012: £134.5 million).

19 FINANCIAL INSTRUMENTS continued

In order to determine the fair values in the table above, all borrowings and derivatives are valued using a discounted cash flow valuation model as described within the accounting policies on pages 83 to 90. In determining fair values, assumptions are made with regard to credit spreads based on indicative pricing data.

In respect of the total change during the year in the fair value of financial liabilities designated at fair value through profit or loss for continuing operations of a £17.5 million loss (2012: £19.1 million loss), a £1.5 million loss (2012: £21.3 million gain) is attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £74.7 million profit (2012: £76.2 million profit). The carrying amount is £99.2 million (2012: £81.7 million) higher than the amount contracted to settle on maturity.

Company	Fair value 2013 £m	Carrying value 2013 £m	Fair value 2012 £m	Carrying value 2012 £m
Financial assets				
Current assets				
Loans and receivables:				
Trade and other receivables	41.4	41.4	42.9	42.9
Cash and short-term deposits	0.6	0.6	–	–
Financial liabilities				
Current liabilities				
Trade and other payables at amortised cost	(10.9)	(10.9)	(14.8)	(14.8)
Borrowings:				
Other financial liabilities	(1,558.2)	(1,558.2)	(1,732.1)	(1,732.1)
	(1,527.7)	(1,527.7)	(1,704.0)	(1,704.0)

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

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

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

Notes to the financial statements continued

19 FINANCIAL INSTRUMENTS continued

Group 2012	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	–	2.5	–	2.5
Financial assets at fair value through profit or loss				
Derivative financial assets	–	617.4	–	617.4
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	–	(159.8)	–	(159.8)
Financial liabilities designated as fair value through profit or loss	–	(305.9)	–	(305.9)
	–	154.2	–	154.2

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

The company does not hold any financial instruments that are measured subsequent to initial recognition at fair value.

20 RETIREMENT BENEFIT SURPLUS/(OBLIGATIONS)

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 last actuarial valuations of UUPS and ESPS were carried out as at 31 March 2010. These valuations have been updated to take account of the requirements of IAS 19 'Employee Benefits' in order to assess the position at 31 March 2013 by projecting forward from the valuation date and have been performed by an independent actuary, AON Hewitt Limited.

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

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

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

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

Group	2013 % pa	2012 % pa
Discount rate	4.60	5.00
Expected return on assets*	4.60	4.50
Pensionable salary growth and pension increases	3.30	3.25
Price inflation	3.30	3.25

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

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

20 RETIREMENT BENEFIT SURPLUS/(OBLIGATIONS) continued

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

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

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

Group	Schemes' assets %	2013 £m	Schemes' assets %	2012 £m
Equities	14.9	363.9	14.9	315.4
Other non-equity growth assets	10.6	259.0	9.6	203.5
Gilts	2.1	50.7	2.0	41.6
Bonds	60.5	1,477.4	58.4	1,233.0
Other	11.9	291.0	15.1	319.5
Total fair value of schemes' assets	100.0	2,442.0	100.0	2,113.0
Present value of defined benefit obligations		(2,426.9)		(2,205.0)
Net retirement benefit surplus/(obligations)		15.1		(92.0)

To develop the expected long-term rate of return on asset assumptions, the group considered the current level of expected returns on risk-free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The group's actual return on the schemes' assets was a gain of £309.5 million (2012: £319.3 million).

The assets as at 31 March 2013, in respect of the UUPS, included in the table above, have been allocated to each asset class based on the return the assets are expected to achieve and not based on the physical assets held. The reason for this being that the UUPS has entered into a variety of derivative transactions in order to change the return characteristics of the physical assets held and in order to reduce undesirable market and liability risks.

The 'Other' element of the portfolio is set aside for collateral purposes linked to the derivative contracts entered into, as described above. The collateral portfolio, in addition to providing sufficient liquidity to maintain the derivative transactions, is expected to achieve a return in excess of LIBOR.

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

Group	2013 £m	2012 £m
At the start of the year	(2,205.0)	(1,912.9)
Interest cost on schemes' obligations	(108.3)	(103.8)
Actuarial losses	(170.6)	(243.1)
Curtailments/settlements arising on reorganisation	(0.6)	(1.2)
Member contributions	(6.8)	(6.8)
Benefits paid	80.3	76.1
Current service cost	(15.9)	(13.3)
At the end of the year	(2,426.9)	(2,205.0)

Notes to the financial statements continued

20 RETIREMENT BENEFIT SURPLUS/(OBLIGATIONS) continued

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

Group	2013 £m	2012 £m
At the start of the year	2,113.0	1,717.9
Expected return on schemes' assets	96.8	100.5
Actuarial gains	212.7	218.8
Member contributions	6.8	6.8
Benefits paid	(80.3)	(76.1)
Curtailments/settlements arising on reorganisation	–	(4.6)
Company contributions	93.0	149.7
At the end of the year	**2,442.0**	2,113.0

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

Continuing operations	2013 £m	2012 £m
Current service cost	(15.9)	(13.3)
Curtailments/settlements arising on reorganisation	(0.6)	(5.4)
Pension expense charged to operating profit	**(16.5)**	(18.7)
Expected return on pension schemes' assets	96.8	100.5
Interest cost on pension schemes' obligations	(108.3)	(103.8)
Net pension interest expense charged to finance expense (see note 6)	**(11.5)**	(3.3)
Net pension expense charged before taxation	**(28.0)**	(22.0)

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

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

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

Group	2013 £m	2012 £m
At the start of the year	(92.0)	(195.0)
Expense recognised in the income statement – continuing operations	(28.0)	(22.0)
Expense recognised in the income statement – discontinued operations	–	(0.4)
Contributions paid	93.0	149.7
Actuarial gains/(losses) gross of taxation	42.1	(24.3)
At the end of the year	**15.1**	(92.0)

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

20 RETIREMENT BENEFIT SURPLUS/(OBLIGATIONS) continued

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

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

Group	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Present value of defined benefit obligations	(2,426.9)	(2,205.0)	(1,912.9)	(2,182.2)	(1,696.9)
Fair value of schemes' assets	2,442.0	2,113.0	1,717.9	1,910.9	1,483.8
Net retirement benefit surplus/(obligations)	15.1	(92.0)	(195.0)	(271.3)	(213.1)
Experience adjustments on schemes' liabilities	6.3	(33.0)	25.2	1.8	(8.9)
Experience adjustments on schemes' assets	212.7	218.8	25.8	365.2	(496.4)

Defined contribution pension costs

The schemes also include a defined contribution section which constitutes around two per cent of the total asset value.

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

The company does not participate in any of the group's pension schemes.

21 DEFERRED TAX LIABILITIES

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

Group	Accelerated taxation depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2011	1,368.0	(50.7)	(24.2)	1,293.1
(Credited)/charged to the income statement	(78.1)	(0.1)	1.6	(76.6)
Charged to equity (see note 7)	–	28.7	–	28.7
At 31 March 2012	1,289.9	(22.1)	(22.6)	1,245.2
Credited to the income statement	(47.9)	(0.1)	(3.8)	(51.8)
Charged to equity (see note 7)	–	25.6	–	25.6
At 31 March 2013	1,242.0	3.4	(26.4)	1,219.0

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

The company had no deferred tax assets or liabilities at 31 March 2013 or 31 March 2012.

Notes to the financial statements continued

22 PROVISIONS

Group	Restructuring £m	Other £m	Total £m
At 1 April 2011	4.0	19.8	23.8
Charged/(credited) to the income statement	2.6	(3.9)	(1.3)
Utilised in the year	(6.0)	(6.2)	(12.2)
At 31 March 2012	0.6	9.7	10.3
Charged to the income statement	2.6	4.9	7.5
Utilised in the year	(1.6)	(4.0)	(5.6)
At 31 March 2013	1.6	10.6	12.2

The restructuring provision as at 31 March 2013 and 31 March 2012 relates to severance costs as a result of group reorganisation.

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

Provisions have been analysed between non-current and current as follows:

Group	Restructuring £m	Other £m	Total £m
At 31 March 2013			
Non-current	–	3.4	3.4
Current	1.6	7.2	8.8
	1.6	10.6	12.2
At 31 March 2012			
Non-current	–	4.0	4.0
Current	0.6	5.7	6.3
	0.6	9.7	10.3

Company

The company had no provisions at 31 March 2013 or 31 March 2012.

23 TRADE AND OTHER PAYABLES

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

Current	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Trade payables	52.7	40.2	–	–
Amounts owed to subsidiary undertakings	–	–	8.8	12.7
Other taxation and social security	4.7	4.4	–	–
Deferred grants and contributions	9.0	6.9	–	–
Other creditors	4.8	4.8	2.1	2.1
Accruals and deferred income	368.9	391.3	–	–
	440.1	447.6	10.9	14.8

The average credit period taken for trade purchases is 36 days (2012: 29 days).

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

Deferred grants and contributions

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

Notes to the financial statements continued

24 SHAREHOLDERS' EQUITY

Group	2013 £m	2012 £m
Share capital	499.8	499.8
Share premium account	2.9	2.4
Revaluation reserve	158.8	158.8
Cumulative exchange reserve	(4.4)	(5.0)
Merger reserve	329.7	329.7
Retained earnings	885.1	778.9
	1,871.9	1,764.6

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

The merger reserve arose in 2008/09 on consolidation and represents the capital adjustment to reserves required to effect the reverse acquisition of United Utilities PLC by United Utilities Group PLC.

Company	2013 £m	2012 £m
Share capital	499.8	499.8
Share premium account	2.9	2.4
Capital redemption reserve	1,033.3	1,033.3
Retained earnings	2,536.9	2,360.5
	4,072.9	3,896.0

79,619 ordinary shares were allotted during the year ended 31 March 2013 (2012: 196,755 ordinary shares) for the exercise of options in accordance with the rules of the employee ShareSave scheme and the executive share option scheme for a total consideration of £0.5 million (2012: £1.1 million).

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The results of the company for the financial year was a profit of £399.2 million (2012: £25.8 million loss) after accounting for dividends received from subsidiary undertakings of £432.6 million (2012: £nil).

25 SHARE CAPITAL

Company	2013 million	2013 £m	2012 million	2012 £m
Issued, called up and fully paid				
Ordinary shares of 5.0 pence each	681.8	34.1	681.8	34.1
Deferred shares of 170.0 pence each	274.0	465.7	274.0	465.7
	955.8	499.8	955.8	499.8

Refer to the directors' report for details of the voting rights of each category of shares.

26 OPERATING LEASE COMMITMENTS

Group	Property 2013 £m	Plant and equipment 2013 £m	Property 2012 £m	Plant and equipment 2012 £m
Commitments under non-cancellable operating leases due				
Within one year	**2.9**	**0.8**	3.3	0.8
In the second to fifth years inclusive	**9.2**	**0.6**	8.8	0.6
After five years	**255.6**	**–**	252.5	–
	267.7	**1.4**	264.6	1.4

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.

The company had no operating lease commitments at 31 March 2013 or 31 March 2012.

27 SHARE-BASED PAYMENTS

The company operates several share option schemes.

Company share option scheme 1999

The company share option scheme 1999 is for senior executives (excluding, with effect from the introduction of the group's long-term incentive plan, executive directors and other executives participating in that plan and its successor, the performance share plan).

Options under the company share option scheme 1999 are exercisable in a period beginning no earlier than three years and ending no later than 10 years from the date of grant. The number of options outstanding at 31 March 2013 was nil (2012: 16,136) and the weighted average exercise price of options exercised during the year was £5.44 (2012: £6.22).

Performance share plan, matching share award plan and matched share investment scheme

Details of these schemes are given on pages 54 to 68 in the Directors' Remuneration Report.

Deferred share plan

The deferred share plan (DSP) is used as a retention mechanism for certain key employees below board level on a discretionary basis. Shares are released after a three-year holding period and are conditional on continued employment with the group during this time. These options may, at the group's discretion, be settled in cash. DSP awards grant employees nil-cost options with no performance conditions which are entitled to dividend equivalents; therefore, the fair value of the award is equal to the market price of the share at the grant date (2013: 19,532 options granted; 2012: no grants). The number of options outstanding at 31 March 2013 was 70,589 (2012: 87,395). Options issued post 1 April 2012 include an element of operational conditions relating to satisfactory job performance.

The total expense included within employee benefits expense from continuing operations in respect of equity-settled share-based payments was £1.7 million (2012: £1.2 million expense) and £0.2 million (2012: £nil) in respect of cash-settled share-based payments, plus £0.3 million accrual of national insurance contributions (2012: £0.2 million).

Notes to the financial statements continued

27 SHARE-BASED PAYMENTS continued

The following tables show the inputs to the model used to calculate the fair value of equity-settled share options granted during the years ended 31 March 2013 and 31 March 2012 respectively.

Year ended 31 March 2013	Matching share award plan[1] TSR 50%	Matching share award plan[1] Operational 50%	Performance share plan[1] TSR 20%-50%	Performance share plan[1] Operational 50%-80%	Performance share plan[2] TSR 40%	Performance share plan[2] Operational 60%
Weighted average exercise price (£ per share)	–	–	–	–	–	–
Vesting period (years)	2.8	2.8	2.8	2.8	2.6	2.6
Expected volatility (%)	17.5	17.5	17.5	17.5	17.2	17.2
Risk-free rate (%)	0.3	–	0.3	–	0.2	–
Expected dividend yield (%)	–	–	–	–	–	–
Fair value (£ per share)	3.30	6.63	3.30	6.63	4.33	7.19

Notes:
[1] Awarded in June 2012.
[2] Awarded in August 2012.

Year ended 31 March 2012	Matched share investment scheme[1]	Matching share award plan[2] TSR 50%	Matching share award plan[2] Operational 50%	Performance share plan[2] TSR 50%	Performance share plan[2] Operational 50%	Performance share plan[3] TSR 20%-50%	Performance share plan[3] Operational 50%-80%
Weighted average exercise price (£ per share)	–	–	–	–	–	–	–
Vesting period (years)	5.0	2.8	2.8	2.8	2.5	2.3	2.3
Expected volatility (%)	–	25.2	25.2	25.2	25.2	18.6	18.6
Risk-free rate (%)	–	1.2	–	1.2	–	0.5	–
Expected dividend yield (%)	–	–	–	–	–	–	–
Fair value (£ per share)	6.24	2.46	6.06	2.46	6.06	2.33	5.90

Notes:
[1] Awarded in May 2011.
[2] Awarded in July 2011.
[3] Awarded in December 2011.

The expected volatility is based on the historical volatility of the company's share price over the expected life of the option.

The weighted average share price at date of exercise and the contractual remaining life of total outstanding options is provided below:

	Company share option scheme 1999	Matching share award plan	Performance share plan	Deferred share plan	Matched share investment scheme
Weighted average share price at date of exercise					
31 March 2013	**6.63**	**6.91**	**6.91**	**6.48**	**n/a**
31 March 2012	6.22	5.67	5.71	5.74	n/a
Contractual remaining life					
31 March 2013	**n/a**	**1.6 years**	**1.2 years**	**0.9 years**	**2.7 years**
31 March 2012	0.9 years	1.3 years	1.3 years	0.9 years	3.7 years

None of the share options identified above as outstanding at 31 March 2013 had vested at that date.

27 SHARE-BASED PAYMENTS continued

For the purpose of IFRS 2 'Share-based Payments', expiry of performance share plan awards is measured with reference to the achievement of the performance conditions at the reporting date, not the end of the notional vesting period of three years from grant date. Therefore, options with performance conditions measured at the end of a reporting period are treated as expired if their performance conditions are not achieved at the reporting date.

28 RELATED PARTY TRANSACTIONS

Group

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Trading transactions

The following transactions were carried out with the group's joint ventures:

	Sales of services		Purchases of goods and services	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Joint ventures	**1.3**	1.1	**0.7**	0.3

	Amounts owed by related parties		Amounts owed to related parties	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Joint ventures (see notes 16)	**1.0**	1.0	**–**	–

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

The amounts outstanding are unsecured and will be settled in accordance with normal credit terms. The group has issued guarantees of £5.2 million (2012: £5.4 million) in support of its joint ventures (see note 14).

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

Details of transactions with key management are disclosed in note 3.

Company

The parent company receives dividend income and pays and receives interest to and from subsidiary undertakings in the normal course of business. Total dividend income received during the year amounted to £432.6 million (2012: £nil) and total net interest payable during the year was £32.4 million (2012: £34.9 million). Amounts outstanding at 31 March 2013 and 31 March 2012 between the parent company and subsidiary undertakings are provided in notes 16, 18 and 23.

At 31 March 2013 and 31 March 2012, no related party receivables and payables were secured and no guarantees were issued in respect thereof. Balances will be settled in accordance with normal credit terms. No allowance for doubtful receivables has been made for amounts owed by subsidiary undertakings as at 31 March 2013 and 31 March 2012.

Notes to the financial statements continued

29 CASH GENERATED FROM OPERATIONS

	Group		Company	
Continuing operations	2013 £m	2012 £m	2013 £m	2012 £m
Profit/(loss) before taxation	304.7	280.4	400.0	(34.9)
Adjustment for investment income and finance expense	299.8	311.1	32.4	34.9
Operating profit	604.5	591.5	432.4	–
Adjustments for:				
Depreciation of property, plant and equipment	305.9	278.0	–	–
Amortisation of other intangible assets	23.3	19.8	–	–
Loss on disposal of property, plant and equipment	6.6	5.5	–	–
Loss on disposal of other intangible assets	3.2	2.6	–	–
Amortisation of deferred grants and contributions (see note 23)	(7.1)	(6.9)	–	–
Equity-settled share-based payments charge (see note 27)	1.7	1.2	–	–
Other non-cash movements	(1.9)	(0.1)	–	–
Changes in working capital:				
Decrease/(increase) in inventories	7.8	(0.1)	–	–
(Increase)/decrease in trade and other receivables	(26.5)	(8.2)	1.3	0.5
Increase/(decrease) in trade and other payables	9.3	(11.9)	0.1	2.0
Decrease in provisions and retirement benefit obligations	(74.6)	(144.0)	–	–
Cash generated from continuing operations	852.2	727.4	433.8	2.5

The group has received property, plant and equipment of £38.2 million (2012: £120.4 million) in exchange for the provision of future goods and services (see accounting policies notes 1 and 23).

30 CONTINGENT LIABILITIES

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

The company has not entered into performance guarantees as at 31 March 2013 or 31 March 2012.

31 EVENTS AFTER THE REPORTING PERIOD

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

Shareholder information

Key Dates

We plan to:

- **2 August 2013**
  Pay the 2012/13 final dividend
- **27 November 2013**
  Announce the half year results for the 2013/14 financial year (provisional)
- **3 February 2014**
  Pay the 2013/14 interim dividend (provisional)
- **May 2014**
  Announce the final results for the 2013/14 financial year
- **June 2014**
  Publish the Annual Report and Financial Statements for the 2013/14 financial year

Keeping you in the picture

You can find information about United Utilities quickly and easily on our website: **corporate.unitedutilities.com**. Here the Annual Report and Financial Statements, corporate responsibility report, other reports, company announcements, the half year and final announcements and associated presentations are published.

View or download the full Annual Report and Financial Statements from **unitedutilities.com/annualreport2013**

United Utilities is proud to have retained Platinum Big Tick ranking in the Business in the Community Corporate Responsibility Index, world class status in the Dow Jones Sustainability Index and to be in the FTSE 350 Carbon Disclosure Leadership Index.

Dividends paid direct to your bank account

Why not make life easy and have your dividends paid straight into your bank account?

- the dividend goes directly into your bank account and is available straight away
- no need to pay dividend cheques into your bank account
- no risk of losing cheques in the post
- no risk of having to replace spoiled or out-of-date cheques
- it's cost-effective for your company

To take advantage of this, please contact Equiniti via shareview.co.uk or complete the dividend mandate form that you receive with your next dividend cheque.

If you choose to have your dividend paid directly into your bank account you'll receive one tax voucher each year. This will be issued with the interim dividend normally paid in February and will contain details of all the dividends paid in that tax year. If you'd like to receive a tax voucher with each dividend payment, please contact Equiniti.

Electronic Communications

We're encouraging our shareholders to receive their shareholder information by email and via our website. Not only is this a quicker way for you to receive information, it helps us to be more sustainable by reducing paper and printing materials and lowering postage costs.

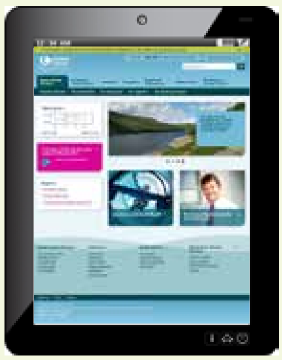
Registering for electronic shareholder communications is very straightforward, and is done online via shareview.co.uk which is a website provided by our registrar, Equiniti.

Log on to **shareview.co.uk** and you can:

- set up electronic shareholder communication
- view your shareholdings
- update your address details if you change your address
- get your dividends paid directly into your bank account

Please do not use any electronic address provided in this notice or in any related document to communicate with the company for any purposes other than those expressly stated.

To go straight to the investor page on our website scan the QR code on your smartphone



See further information online:
corporate.unitedutilities.com

Registrar

The group's registrar, Equiniti, can be contacted on **0871 384 2041** or textphone for those with hearing difficulties: **0871 384 2255**. Calls to these numbers will be charged at 8p per minute plus network extras. Lines are open 8.30 am to 5.30 pm, Monday to Friday excluding bank holidays.

The address is:
Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.

Overseas shareholders may contact them on: **+44 (0)121 415 7048**.
Equiniti offers a share dealing service by telephone: **0845 603 7037** and online: **shareview.co.uk/dealing**.
Equiniti also offers a stocks and shares ISA for United Utilities shares.
For more information, call **0845 300 0430** or go to: **shareview.co.uk/dealing**.

American Depositary Receipts (ADRs)

United Utilities shares are traded in the USA in the form of American Depositary Receipts (ADRs), and trade under the symbol 'UUGRY' on the OTC market. Each ADR represents two shares. Deutsche Bank is the depositary and its address for enquiries to Deutsche Bank's Shareholder Services is American Stock Transfer & Trust Company, Operations Center, 6201 15th Avenue, Brooklyn, NY 11219. Further information can be obtained through www.amstock.com.
Telephone: **(800) 937-5449** or outside the US, **+1 (718) 921-8124** or by email: **FUNDRM@AMSTOCK.com.**

Donating shares to ShareGift

ShareGift is a charity that accepts donations of small numbers of shares which are uneconomical to sell on their own. Shares donated to ShareGift are aggregated and sold with the proceeds passed on to a wide range of UK charities. For further details go to **ShareGift.org** or write to ShareGift at 17 Carlton House Terrace, London, SW1Y 5AH.
Telephone: **+44 (0)20 7930 3737**.

Warning to shareholders

Please be very wary of any unsolicited contact about your investments or offers of free company reports. It may be from an overseas 'broker' who could sell you worthless or high risk shares. If you deal with an unauthorised firm, you would not be eligible to receive payment under the Financial Services Compensation Scheme. Further information and a list of unauthorised firms that have targeted UK investors is available from the Financial Conduct Authority at **fca.org.uk/consumers/protect-yourself/unauthorised-firms**

REMEMBER: if it sounds too good to be true, it probably is!

Avoiding unsolicited mail

United Utilities is legally obliged to make its register of members available for inspection. In some circumstances, this may lead to you receiving unsolicited mail.

If you have a UK registered address and want to limit the amount of personally addressed unsolicited mail you receive, please write to the Mailing Preference Service, Freepost 29, LON20771, London, W1E 0ZT, or register by telephoning **+44 (0) 845 703 4599** or online at **mpsonline.org.uk**.

United Utilities Group PLC
Registered Office:
Haweswater House
Lingley Mere Business Park
Lingley Green Avenue
Great Sankey
Warrington
WA5 3LP
Telephone: +44 (0)1925 237000

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United Utilities Group PLC

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

Registered in England and Wales
Registered number 6559020

Stock Code: UU.

unitedutilities.com

Telephone +44 (0)1925 237000

Cover picture:
Ian Allwood, headworks controller, looking after the operation and maintenance of our six reservoirs in the Longdendale valley, which together supplies up to 750,000 people with their daily water needs.