United Utilities
helping life flow smoothly

UNITED UTILITIES GROUP PLC

Annual Report and Financial Statements for the year ended 31 March 2012

Welcome

United Utilities Group PLC provides water and wastewater services to around seven million people and businesses in the North West of England. The group has a strong focus on operational performance and customer service. Its capital investment programme of approximately £3.5 billion during the 2010–15 regulatory period will maintain and improve the asset base, providing further customer benefits and environmental improvements. High levels of capital investment are expected to continue beyond 2015, driving further growth in the value of the business. The group's policy is to deliver real growth in the dividend whilst retaining a robust and sustainable financial profile.

So why invest?

- Clear vision to be a leading North West service provider and one of the best UK water and wastewater companies
- Improving operational performance and customer service, with more to come
- Revenue and asset base linked to RPI inflation
- Substantial long-term growth expected in regulatory capital value
- Transparency on regulatory outperformance
- Robust capital structure – stable A3 rating
- Sustainable dividend policy with real growth of 2 per cent per annum above RPI inflation to at least 2015

For further information go to
corporate.unitedutilities.com/investors

Key performance indicators

We monitor a range of financial and operational key performance indicators (KPIs) to enhance the visibility of our performance and to help drive improvements. More detail on the KPIs listed below can be found on pages 12 to 13.

	2011/12	2010/11	Page reference
Financial KPIs			
Revenue	£1,564.9m	£1,513.3m	66
Underlying operating profit	£594.1m	£596.4m	24
Underlying profit after taxation	£240.9m	£239.2m	24
Underlying earnings per share	35.3p	35.1p	21
Total dividend per share	32.01p	30.00p	21
Regulatory capital expenditure	£680m	£608m	16
Gearing: net debt to regulatory capital value	59%	59%	22
Operational KPIs			
Best service to customers			
Serviceability(1)	1 x improving, 2 x stable, 1 x marginal	3 x stable, 1 x marginal	15
Service incentive mechanism – qualitative (relative)(2)	16	21	15
Service incentive mechanism – quantitative (absolute)(3)	273	539	15
Lowest sustainable cost			
Opex outperformance (2010–15 target of at least £50m)	On track	On track	17
Financing outperformance (2010–15 target of at least £300m)	On track	On track	17
Capex outperformance (2010–15 target to meet regulatory allowance)	On track	On track	17
Responsible manner			
Leakage – rolling average annual leakage	453Ml/d – Met target	464Ml/d – Met target	19
Environment Agency performance assessment(4)	7th	6th	19
Dow Jones Sustainability Index rating	'World Class'	'World Class'	19

(1) 2011/12 ratings subject to regulatory assessment. 2010/11 ratings have been restated from '4 x stable' following regulatory assessment.
(2) Performance relative to 21 water companies.
(3) Low number indicates good performance. 2011/12 number subject to regulatory audit.
(4) Performance relative to 10 water and wastewater companies and relating to 2010/11 and 2009/10, being the latest available assessments from the Environment Agency.

Financial highlights

Revenue
£1,564.9m
2011: £1,513.3m

Underlying operating profit
£594.1m
2011: £596.4m

Total dividends per share
32.01p
2011: 30.0p

Operational highlights

- Further customer service improvements delivered: significantly improved Ofwat SIM scores
- Met our regulatory leakage target for the sixth consecutive year
- On track to meet regulatory outperformance targets
- Continued good progress on capital investment programme

For information on our performance go to **page 14**

BUSINESS REVIEW
›page 01

GOVERNANCE
›page 33

FINANCIAL STATEMENTS
›page 64

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' 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 are confident that our strategy and renewed focus on operational performance will enable United Utilities to create value and deliver our commitments to our customers, shareholders and the environment.

Strategy

Following the completion of our non-regulated disposal programme, we set out our vision of becoming a leading North West service provider and one of the best UK water and wastewater companies. We said that our enhanced focus on the regulated business will enable us to deliver further customer service and operational efficiency improvements. We aim to outperform the regulatory contract and deliver long-term shareholder value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

During the last 12 months we have continued on our journey towards achieving our vision and we are pleased to report a good set of results in what is a tough economic climate. We have delivered improved customer satisfaction in our service and we remain on course to meet our regulatory outperformance targets, with significant financing outperformance already secured.

We have continued to make high levels of capital investment in our water and wastewater assets providing further benefits for our customers, shareholders and the environment.

Dividend

In line with our dividend policy, the board is proposing a final dividend for the year ended 31 March 2012 of 21.34 pence per ordinary share, an increase of 6.7 per cent compared with the final dividend relating to 2010/11. Together with the interim dividend of 10.67 pence, the total dividend relating to the year is 32.01 pence per ordinary share. The final dividend is expected to be paid to shareholders on 3 August 2012. We also confirm our intent to increase the dividend in line with our policy of targeting real growth of RPI+2 per cent per annum through to at least 2015.

Operational performance

Commensurate with our focus on customer service and operational performance we have continued to implement a wide range of business improvement initiatives. Our revised customer handling arrangements have led to a marked improvement in customer satisfaction, resulting in significant progress on Ofwat's service incentive mechanism. We have built on our progress last year, reducing customer complaints by over a quarter in the last 12 months and achieving our lowest ever level of referrals to the Consumer Council for Water. We are pleased with the recent progress we have made and believe there is plenty of opportunity to deliver further improvements.

We have in place key performance indicators (KPIs) to provide visibility of our operational performance in the areas of best service to customers, lowest sustainable cost and responsible manner. These measures are used across the company to focus our people on targets for improvement and to demonstrate the progress being made.

Delivering our regulatory contract

We have continued to make good progress throughout the first two years of this regulatory period and investment in our assets has remained at high levels, helping the business meet strict environmental standards and deliver an improved service for our customers. Capital expenditure in our water and wastewater business amounted to £680 million during the year, consistent with our planned investment programme over the 2010–15 period.

Customers

During 2011/12 our household customers have benefited from an average real reduction in their water bills of 0.2 per cent, following on from a 4.3 per cent real decrease in 2010/11. Despite this reduction in average customer bills, we have continued to invest heavily in our assets in order to ensure that we can continue to provide our customers with high quality drinking water to meet all their daily needs and environmentally responsible wastewater collection and treatment.

Our water and wastewater service currently costs households just over £1 per day on average. We believe this continues to represent excellent value for money for our customers. We recognise that we need to maintain the affordability of customer bills, in what continues to be a tough economic environment, and we continue to fund our Charitable Trust, providing £5 million per year to help customers who are struggling to pay their water bills.

Regulatory developments

The government published a Water White Paper 'Water for Life' in December 2011 which reaffirmed the success of the privatisation of the water industry, with companies having invested over £90 billion to maintain and improve assets, customer service and the environment. The paper highlights that the water industry needs to evolve in order to meet the challenges arising from factors such as climate change and a growing population to help ensure that high quality water is supplied reliably while remaining affordable.

We are pleased that the government recognised the need for evolutionary, rather than revolutionary, changes to the successful existing water model. We agree that a step-by-step approach to increasing competition for non-domestic customers, as outlined in the paper, is sensible provided sufficient time and effort goes into its preparation in what will represent a significant change for the industry.

We are in agreement with many of the long-term aims set out in the Water White Paper such as tackling over abstraction, water pollution, affordability and water efficiency as well as protecting water resources and the natural environment. We have been closely engaged in the dialogue with the government and its regulators on these matters and will continue to take an active part in shaping the response the sector can make to address the issues raised in the Water White Paper.

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, already reflects the highest standards of corporate governance. We continue to monitor closely new developments and requirements in this area and have updated our statement of responsible business practice, called our Business Principles, this year to ensure these standards underpin our business strategy.

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. We also retained our 'Platinum Plus' ranking in the Business in the Community Corporate Responsibility Index and are proud that we are one of only six FTSE 100 companies to hold both.

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.

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 believe that 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.

The safety and well-being of our employees is paramount and we believe that everybody in United Utilities, collectively and individually, has a part to play in maintaining a safe working environment. Although we have seen a reduction in employee accident rates in 2011/12, there is more to do and we will continue to give this area significant focus.

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

We are pleased to welcome Sara Weller to the board as a non-executive director following her appointment in March. Her understanding of customer facing businesses, together with her knowledge of operating within a regulated environment, will be major assets to the board. On David's departure, Sara will take over his position as chair of the Remuneration Committee.

Outlook

We believe that our sharp focus on customer service and operational efficiency is delivering results. The action plans being implemented are delivering efficiencies and we remain on track to meet our regulatory targets, with substantial financing outperformance already secured. The board is encouraged with our continuing progress over the first two years of the 2010–15 regulatory period and we are confident we can continue to build on this progress throughout the remainder of the period. Our capital structure remains robust and we have a sustainable dividend policy that targets real growth through to at least 2015. In the area of regulatory and political developments, we will continue to work with politicians, regulators and all key parties to represent the best interests of our stakeholders.

John McAdam

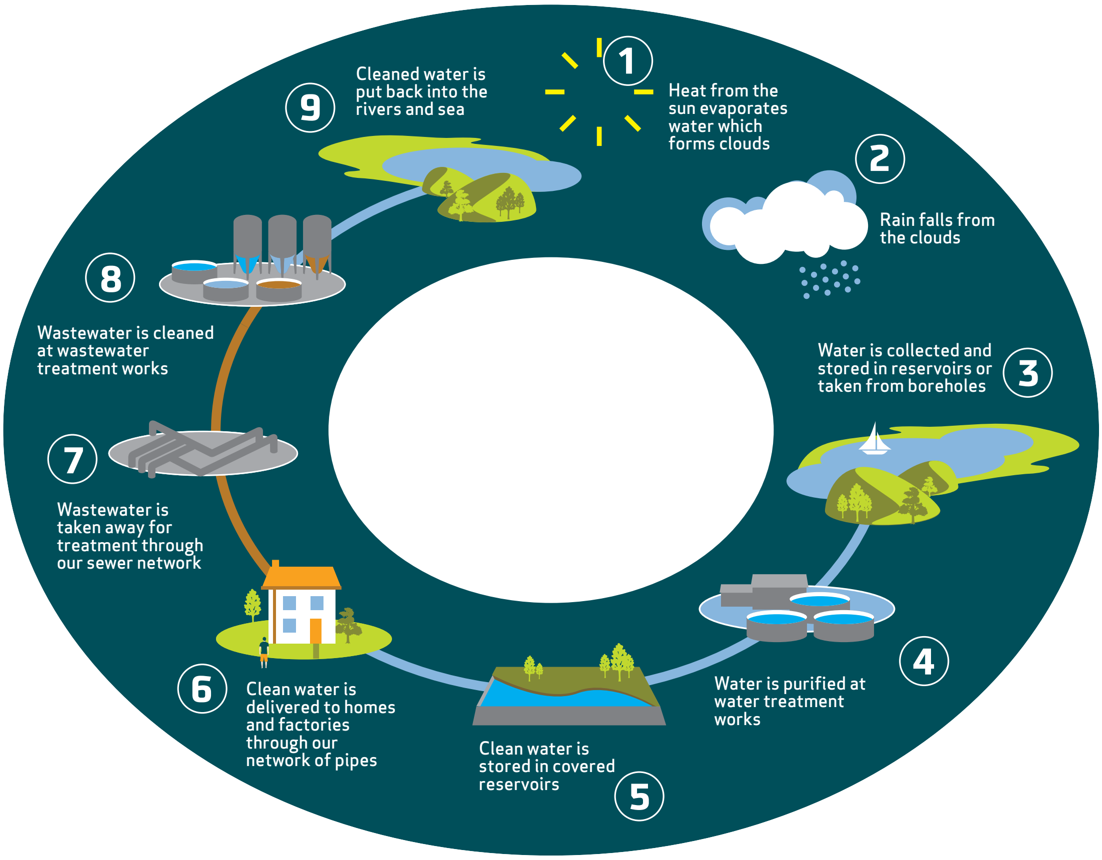
Dr John McAdam
Chairman

Steve Mogford
Chief Executive Officer

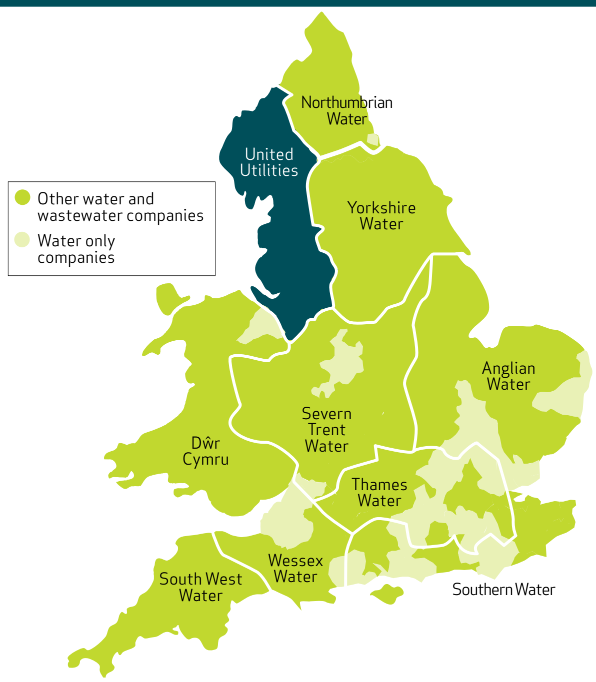
Business model and strategy

How the regulated business operates

Technology and nature work together in the United Utilities water cycle



Water suppliers



Our industry

Water and wastewater services are provided by 21 companies to more than 50 million customers across England and Wales. There are currently 10 licensed companies which provide both water and wastewater services to customers in their respective regions. Additionally, there are licensed regional companies which provide water only services and tend to be smaller in size. As each company in the water sector operates as a regional monopoly for its services, they are subject to regulation in terms of both price and performance.

The privatisation of the industry over two decades ago has been widely perceived as a success. 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 in public ownership. 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 company

United Utilities Group PLC is the UK's largest listed water company. The group owns and manages the regulated water and wastewater network in the North West of England, through its subsidiary United Utilities Water PLC (UUW), which constitutes the vast majority of the group's assets and profit. In light of this, United Utilities now has a single segment for financial reporting purposes.

Where we operate

UUW holds licences to provide water and wastewater services to a population of approximately seven million people in the North West of England. The area we cover includes the major cities of Manchester and Liverpool but also extends as far north as the Cumbrian–Scottish border and south beyond Crewe.

Our assets

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

>56,000 hectares of catchment land

180 reservoirs

94 water treatment works

>42,000 km of water pipes

>76,000 km of sewer pipes

569 wastewater treatment works

>5,000 employees

Our region

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 whilst providing renewable energy generation.

Our water and wastewater service currently costs households just over £1 per day on average. Over the 2010–15 regulatory period, the average annual bill will fall by £9 in real terms. We believe this represents excellent value for money, providing our customers with high quality drinking water to meet all their daily needs and for environmentally responsible wastewater collection and treatment.

Business model and strategy continued

Our vision

Our vision is to become:

- **A leading North West service provider**
- **One of the best UK water and wastewater companies**

Our values

To achieve our vision we will operate under the following key core values:

Customer focus	Providing services that our customers can rely on
Integrity	Applying the highest standards of responsible business practice
Innovation	Encouraging new ideas to make our services better, faster or cheaper

Our objectives

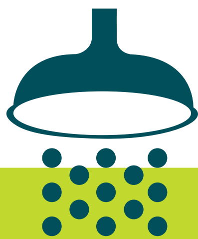
Our aim is to deliver long-term shareholder value:

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 services as effectively as possible at the lowest cost that can be sustained over the long-term
In a responsible manner	Managing responsibly our relationship with the environment, society, local communities and our employees

We expect continued growth in our business through our extensive capital investment programme, investing to improve our networks and service.

We are confident of delivering significant efficiencies across the current 2010–15 period in order to meet and outperform the regulatory contract.

We expect to provide sustainable real growth in the dividend whilst retaining a robust capital structure.



FACT:
We currently employ 80 apprentices, and plan to recruit up to 40 every year to 2015

Our approach to doing business

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; and delivering good value to our other stakeholders whilst managing our supply chain fairly.

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 practical to do so.

Other stakeholders: 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 8 –11. This annual report provides a comprehensive financial and operational review to help inform our investors of our performance.

Given the long life of our infrastructure, we take a long-term view of our operations and key to the group's strategic objectives is the goal to operate in a more sustainable manner. Sustainability is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility (CR) factors as a strategic consideration in its decision making. Our board-level CR committee 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 Plus' ranking in the Business in the Community CR Index. Details of our responsible business performance for the year can be found on pages 14 to 25, with further detailed information in our Business Principles document and in our CR Report on our website at **corporate.unitedutilities.com**.

Helping life flow smoothly

'Helping life flow smoothly' isn't just a new strapline under our logo; it's a way for us to capture the essence of the service we provide to our customers, as well as reflecting what our customers say they expect from us every day.

Improving our customers' experience of United Utilities is key if we are to become a leading North West service provider. And it's not just about including this wording on our vans and uniforms – it's also helping all our employees focus on delivering what our customers need and want from us.

Ultimately, delivering a great service not only leads to satisfied customers, but also helps to reduce complaints and avoids financial penalties from Ofwat, which are part of the new service incentive mechanism (SIM) measurement, which you can read about on page 13 under our operational KPIs.

Business model and strategy continued

COMPETITIVE ENVIRONMENT AND REGULATION

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

Economic regulation

Economic regulation is the responsibility of an independent body, Ofwat, whose primary duties are to protect the interests of consumers, 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).

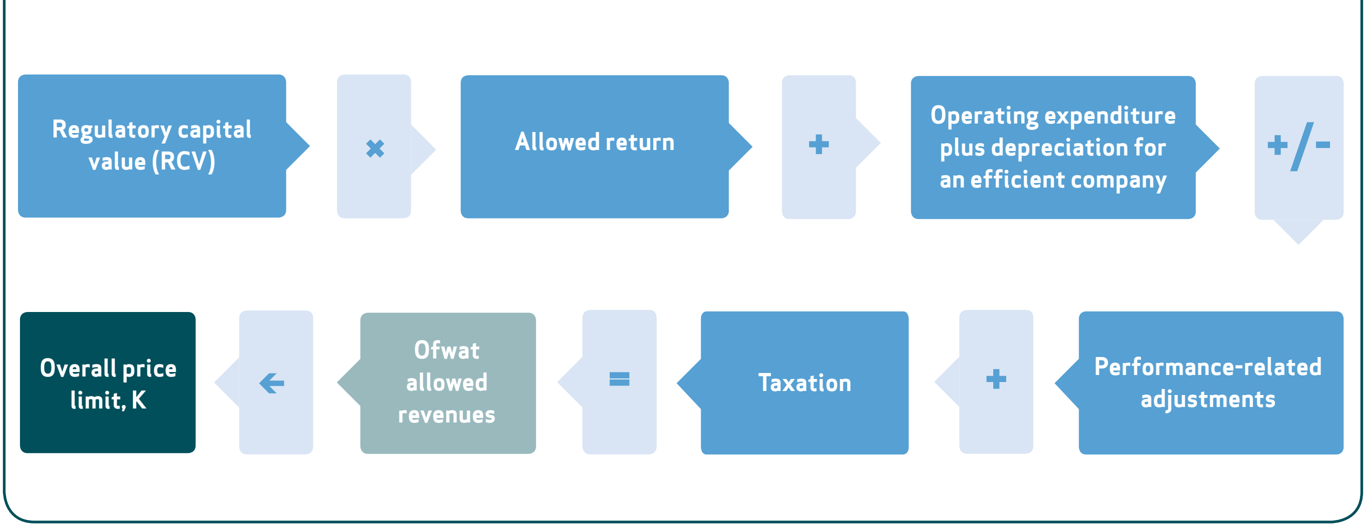
The regulatory capital value (RCV) of a water company is a measure of its capital base which is used when Ofwat sets price limits. Capital expenditure to enhance and maintain the network as well as inflation is added to the RCV, while depreciation is deducted.

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'. A company's annual 'K' factor, therefore, shows the amount above or below inflation that it is allowed by Ofwat to change its price by for that financial year.

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 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.

Ofwat's approach to setting price limits for the 2010–15 regulatory period



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 13).

Environmental and quality regulation

The water and wastewater industry in the UK is subject to substantial domestic and EC 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:

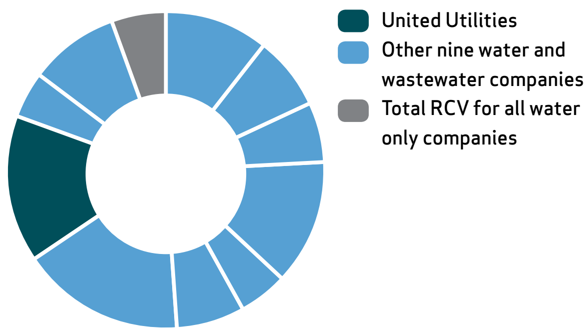
- the Environment Agency (EA), which is responsible for conserving and redistributing water resources and securing their proper use, including the licensing of water abstraction. The EA also regulates discharges to controlled waters. The EA produces a composite index, measuring the relative annual environmental performance of the 10 water and wastewater companies. This is included as one of our key performance indicators (see page 13);
- 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.

Further developments in the 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 impacts of the Natural Environment and Water White Papers, published in 2011, will also affect the regulatory environment in which we operate.

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 below 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.

Water sector RCV



FACT:
Since privatisation in 1989, we have halved leakage from our water network and have met our leakage target for the last six years

Business model and strategy continued

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 a leading North West service provider, other large service providers in the region are also important companies against which to benchmark performance. 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: inset appointments and water supply licensing.

An inset appointment is made when an existing undertaker is replaced by another as the supplier of water and/or wastewater services for one or more customers within its licensed area. In the last 22 years since privatisation, less than 20 inset appointments have been granted across the industry.

From 1 December 2005, water supply licensees have been able to provide both retail supply (i.e. the supply by a licensee of water purchased from a water undertaker's supply system to an eligible customer) and combined supply (i.e. the introduction of water into an incumbent water company's existing network for retail by the licensee to an eligible customer) to non-household users with an annual consumption of not less than 50 megalitres. This threshold was lowered to five megalitres a year in December 2011 following the publication of the UK Government's Water White Paper 'Water for life'. 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. Only one customer changed supplier in the six years since this was implemented.

Political and regulatory developments

The Water White Paper reaffirmed the success of the privatisation of the water industry, with companies having invested over £90 billion to maintain and improve assets, customer service and the environment. The paper highlights that the water industry needs to evolve in order to meet the challenges arising from factors such as climate change and a growing population to help ensure that high quality water is supplied reliably while remaining affordable. In line with expectations, a draft Water Bill was announced in the Queen's Speech on 9 May 2012 and is due to be published before Parliament's summer recess, which commences on 18 July 2012. In addition, Ofwat published its statement of principles for the 2014 price review on 15 May 2012.

We are pleased that the government recognised the need for evolutionary, rather than revolutionary, changes to the successful existing water model. We are in agreement with many of the aims set out in this paper, such as tackling water pollution, over abstraction, affordability and water efficiency, as well as protecting water and the natural environment. Indeed, much of what we already do supports many of the government's aspirations.

Our sustainable catchment management programme (SCAMP) is perhaps the most high profile example of how we address sustainable abstraction. This model has been adopted as best practice in the sector. We do benefit from having robust water resources in our region and continue to enhance our regional network to provide resilience to local water stress.

We have been undertaking water trading for many years, albeit on a fairly small scale, but certainly have the potential to do more within the right industry framework. In addition to our existing water trading arrangements, we are looking at further options to help other parts of the country deal with drought conditions and we have a number of connections which can be used for short periods when required. Looking ahead, there is potential to develop more cross-border export options and we are in a strong position to contribute in such a future market scenario, although we envisage the financial quantum of this to be fairly small relative to the size of the industry. However, water trading is not the sole answer to addressing drought conditions. The longer-term answer must be comprehensive and include more large capacity pipelines, enhanced storage capacity, flexible abstraction and water efficiency measures.

We believe that water companies are in a unique position to help facilitate the use of scarce water resources by customers. In the area of water efficiency, this is something we continue to focus on and United Utilities has one of the lowest per capita consumption levels in the industry. Recent measures adopted by the company include distributing shower regulators and devices to reduce flush volumes in toilets and rolling out education programmes. We believe that more can be done to promote water efficiency and the company supports the refinement of the regulatory framework to provide companies with incentives to encourage the wise use of water.

Underpinning all of this, and the plans to increase competition for non-domestic customers, is the need to retain investor confidence in the sector. This is of paramount importance and we are pleased that the strength of the current industry structure will be retained and that the historical regulatory capital value will be protected. Key issues that are currently undergoing industry consultation include possible modifications to water companies' licences and the replacement of the 'costs principle', which governs access pricing, along with Ofwat's proposed average cost to serve methodology for the retail price control. On the matter of licence modifications, we are supportive of the simple changes necessary to implement the government's decision for expanded non-domestic competition and those necessary to facilitate the 2014 review. With regard to the 'costs principle', it is important that, in order to ensure fair network access, that any parliamentary bill or act encourages only efficient entry and protects

FACT:
Our 2010–2015 investment programme supports 9,000 jobs across the region and injects an estimated £7 billion into the local economy

customers not eligible for competition from cross-subsidy. In respect of retail price controls, we believe it is essential that the regulator continues to take account of regional socio-economic conditions, addresses reporting inconsistencies between companies, retains the RPI inflation link and makes adjustments to reflect the number of customers that receive only water or wastewater services. We will continue with our active involvement on these issues.

Economic environment

Following on from a period of recovery since the 2008/09 global financial crisis, it has been a difficult year for the UK and the wider European economy, with economic news dominated by the ongoing European debt crisis. UK gross domestic product has stagnated during 2011/12 and the equity markets experienced a highly volatile year.

In the UK, RPI inflation has been relatively high over the last couple of years, reaching as high as 5.6 per cent in September 2011. Our revenues and asset base are linked to inflation (as explained in the economic regulation section on page 8), 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.

In the North West, the unemployment rate remained above the national average, reaching 9.6 per cent for the quarter ending March 2012, compared to 8.2 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. As such, particularly in the current difficult economic conditions, bad debt remains a risk to which we are exposed, although Ofwat recognises this through a special factor allowance, and this continues to be a significant area of focus for us.

Value drivers

Our business continues to grow through our extensive capital investment programme, investing to improve our networks and service. Capital expenditure helps to increase our RCV, thus generating growth in the asset base of the business, upon which Ofwat allows us an appropriate return.

Operating in the North West region, the number of customers we serve is relatively stable. Whilst there will be some impact on our revenue due to changes in consumption from our metered customers, the main driver will be from 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 page 8).

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.

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.

It is also important for our business to perform well operationally. Ofwat can apply financial incentives or penalties depending on our performance, both absolute and relative to our peers, such as on customer service through its SIM measures. The regulator can also require us to incur additional unfunded expenditure if, for example, we are not adequately sustaining our assets or fail to meet environmental standards or targets, such as leakage.

Capital investment

Our capital investment programme of approximately £3.5 billion for the 2010–2015 regulatory period continues to improve our asset base, delivering further benefits for customers. High levels of capital investment are expected to continue beyond 2015, driving further growth in the business.

Investment is focused on:

- **upgrading the region's water and wastewater network;**
- **maintaining ageing assets;**
- **delivering a cleaner environment;**
- **providing high quality water to our customers; and**
- **improving the customer experience.**

For further information go to
unitedutilities.com/lancashire

Pictured: Tunnelling work on a £160 million environmental improvement scheme in Preston.

Business model and strategy continued

Our key performance indicators (KPIs)

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 consideration of 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.

Company objective	KPI	Definition
Growth	Revenue	A definition of revenue is included in accounting policies note (c)
	Regulatory capital expenditure	Total regulatory capital expenditure during the year (including infrastructure renewals expenditure)
Delivering significant efficiencies	Underlying operating profit	A definition of operating profit is included in accounting policies note (a). This underlying measure excludes from the reported operating profit any restructuring costs and other significant non-recurring items. Reconciliation is shown on page 24
	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 24
	Underlying earnings per share	This measure divides underlying profit after taxation by the average number of shares in issuance during the year
Sustainable dividend policy with real growth	Total dividend per share	This measure divides total dividends declared by the average number of shares in issuance during the year
Robust capital structure	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)

BUSINESS REVIEW

Operational KPIs

Company objective	KPI	Definition	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	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	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	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	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	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	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 network quantified in megalitres per day	To meet our regulatory leakage target, as set by Ofwat, each year
	Environment Agency performance assessment	Composite index produced by the Environment Agency, measuring the absolute and relative performance, across a broad range of areas including pollution, of the 10 water and wastewater companies	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	To retain 'World Class' rating each year

A table showing our KPIs for the current year and their prior year comparators can be found on the inside cover. Our performance and the progress we have made against our objectives and their associated KPIs are included within the performance section on pages 14 to 25.

Performance

SUMMARY

Continuing operations £m	Year ended 31 March 2012	Year ended 31 March 2011
Underlying operating profit(1)	594.1	596.4
Underlying profit before taxation(1)	327.0	329.2
Underlying profit after taxation(1)	240.9	239.2
Underlying earnings per share(1,2) (pence)	35.3	35.1
Revenue	1,564.9	1,513.3
Operating profit	591.5	580.2
Profit before taxation	280.4	327.1
Profit after taxation	311.4	354.5
Basic earnings per share(2) (pence)	45.7	52.0
Total dividends per ordinary share (pence)	32.01	30.0

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 24.
(2) Earnings per share and underlying earnings per share are explained in the earnings per share section on page 21.

- Further customer service improvements delivered: significantly improved Ofwat SIM scores
- Met regulatory leakage target for sixth consecutive year
- On track to meet regulatory outperformance targets
- Continued progress on capex programme: invested £680 million, an increase of 12 per cent on prior year
- Underlying operating profit of £594 million down £2 million reflecting higher infrastructure renewals expenditure
- Robust financial position: substantially repaid all term debt due in 2010–15 period
- Final dividend of 21.34 pence per share, an increase of 6.7 per cent in line with policy

OPERATIONAL PERFORMANCE

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.

Operational performance and customer service are top priorities for United Utilities and the company aims to deliver significant improvements in these areas and outperform its regulatory contract. The business has a range of key performance indicators (KPIs) to enhance the visibility of its performance and help drive improvements.

Supporting our drive to improve operational performance, a revised management structure was put in place earlier in the year with a strong focus on accountability and delivery. The company has moved, from its previous functional structure, to an organisational structure and managers are now responsible for end to end delivery of capital projects and operational performance within their respective regions, providing a more integrated approach. This revised management structure is now well embedded in the business and is helping to deliver performance improvements. A 'whole company' scorecard has also been introduced and short-term incentives are now more directly aligned with operational performance. Long-term incentives are aligned with shareholders' and customers' interests, being linked to total shareholder return and regulatory outperformance.

Best service to customers

Actions:

Customer initiatives – We established a customer experience programme last year to help understand better the needs and issues of our customers and this is already delivering improvements in the levels of customer service we are providing. We offer additional contact options for customers, such as an online account management facility, to provide more choices as to when and how they can contact us. Staff availability has been extended, coupled with an online call back facility. A priority is to improve customer data management to ensure this provides a single view of the customer to help improve the efficiency and quality of service. We have focused on root cause analysis to help us understand better the reasons for customers contacting us. Supporting this customer experience programme, we increased staff training, better aligned staff incentive mechanisms, put new service level arrangements in place and we proactively contact customers to keep them informed of progress in respect of their enquiries. We have extended our focus to identifying potential customer queries in advance, through, for example, more proactive exception billing reporting and contacting the customer before the bill is sent to discuss the matter. Operationally, we are aiming for prompt completion of jobs and, where practicable, via a single visit, to improve the customer experience and reduce the need for unnecessary calls. We are also making ongoing improvements to our processes based on customer feedback.

We have made a significant improvement in our performance on Ofwat's service incentive mechanism (SIM), reflecting our increased focus on dealing with customer enquiries. The number of customer complaints made to the Consumer Council for Water (CCW) has reduced by 27 per cent in 2011/12, compared with last year, following a similar improvement in the previous year. This represents a reduction of close to a half in the number of complaints to the CCW over the last two years. We have also substantially reduced the number of escalated complaints assessed by the CCW in 2011/12, with zero assessments in several months of the year. This has helped United Utilities improve its quantitative SIM performance by 49 per cent in 2011/12, compared with 2010/11. This follows a similar significant improvement of more than 40 per cent in 2010/11, versus the indicative score for 2009/10. United Utilities has also moved up five places into the third quartile on qualitative SIM for 2011/12, representing the joint best improvement of the 21 water companies in the year. Encouragingly, we delivered continued improvement in the second half of the year on both SIM measures providing a strong platform from which to build in the forthcoming year. Improving customer service remains a significant area of continued management focus and we see plenty of opportunity to deliver further improvements.

Safe, clean drinking water – We have an action plan to maintain safe, clean drinking water through improving the robustness of our water treatment processes, refurbishing service reservoir assets, ongoing mains cleaning and optimising water treatment to reduce discoloured water events. United Utilities continues to supply a high quality of drinking water, with a mean zonal compliance water quality performance of 99.95 per cent.

Water supply and demand balance – To help ensure a continuous water supply to our customers, our action plan includes innovation and investment in remote monitoring to better manage and control the company's water supply system. We also have investment projects to optimise water pressures and improve network resilience. In addition, we are improving our response to burst mains to help keep the water flowing, supported by 'wet' repairs to water mains where the supply remains on through the repair process. United Utilities completed the West East Link in 2011/12, a significant capital project designed to improve further the water supply and demand balance in its region and enhance network resilience to climate change. In addition, our reservoir levels are robust and in line with typical levels for this time of year.

Wastewater – United Utilities has a range of actions to help support the serviceability of its wastewater assets. To help reduce sewer flooding, these 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. The plan also includes an improved approach to risk assessment to identify and reduce the risk profile of the company's wastewater treatment works.

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). Ofwat currently assesses one asset class (wastewater non-infrastructure) as 'improving' and two asset classes (water infrastructure and water non-infrastructure) continue to be rated 'stable'. United Utilities is currently assessed by the regulator as 'marginal' in respect of wastewater infrastructure and the company is implementing an action plan to return this asset class back to a 'stable' rating. The aim is to hold at least a 'stable' rating for all four asset classes, which is aligned with Ofwat's target.

Service incentive mechanism (SIM) – United Utilities improved its quantitative score for 2011/12 by 49 per cent, compared with 2010/11, to 273 points. This follows an improvement of over 40 per cent in the previous year. On the qualitative measure, United Utilities has improved its 2011/12 score by 0.39 points to 4.18 points and has moved up five places into 16th position (out of 21 water companies). This represents sixth position when compared with the 10 water and sewerage companies. This early progress is encouraging and the aim is to move to the first quartile in the medium-term.

Performance continued

Lowest sustainable cost

Actions:

Asset optimisation – Our asset optimisation programme continues to progress well, providing 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 (CHP) assets to improve energy efficiency. The implementation phase is well underway at over half of the 30 sites covered by the programme and a large number of schemes came on line in 2011, with further projects being scoped. The optimisation programme is targeting approximately £9 million of annual savings by 2013/14.

Proactive asset management – We are continuing to introduce 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 and customer service.

Power costs – United Utilities has substantially locked in the cost of its power requirements through to 2014/15, via hedging, securing outperformance. Power unit costs for 2011/12 were similar to the prior year and approximately 20 per cent lower compared with 2009/10. Although power unit costs beyond 2011/12 have been secured at higher levels than those for 2011/12, this still delivers additional outperformance versus the regulatory contract.

Debt collection – We are adopting a more proactive approach to debt collection and have delivered another good performance in the year. We are implementing a detailed action plan, which includes enhancing systems to improve customer segmentation analysis and to obtain better data on customers who have changed address, coupled with a more proactive debt follow up strategy. To support this, a proportion of our debt collection function which was previously off-shored has been brought back in-house and this has helped improve our debt collection performance. Bad debts as a proportion of regulated revenue improved from 2.5 per cent in 2009/10 to 2.1 per cent in 2010/11. 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 of the year. Despite this, we have again delivered a good performance with bad debts standing at 2.2 per cent of regulated revenue for 2011/12. Debt collection will remain a significant area of focus for the business.

Lean principles – Supporting the company's efficiency drive is its lean principles approach to doing business. Systems and processes continue to be streamlined and the business is rationalising its infrastructure and has in-sourced its IT provision to provide greater control of its IT assets and applications.

Pensions – The group placed its pension provision on a more sustainable footing in 2010 and has subsequently taken additional steps to de-risk the pension scheme further. An inflation funding mechanism has been introduced, which has facilitated a move to a lower risk investment strategy with the proportion of pension assets invested in equities or other high risk assets now reduced to around 25 per cent. More prudent longevity assumptions have also been recently introduced. Further details on the group's pension provision are provided in the pensions section on page 23.

Capital delivery – The business is strongly focused on delivering its commitments efficiently and on time. We utilised previous experience to improve the terms and conditions of our supplier contracts and have a robust commercial capital delivery framework in place for the 2010–15 period. Contractor performance is aligned with the company's business plan through appropriate incentive arrangements. In addition, the business has introduced a more disciplined approach to spend and outputs through a Time: Cost: Quality index (TCQi). This enhances the capital investment governance process and provides a sharper focus on the delivery of commitments, with a direct link to the executive remuneration scheme. The TCQi performance score has improved from around 50 per cent last year to over 80 per cent for 2011/12 and the company's long-term goal is to achieve over 90 per cent. Regulatory capital investment in 2011/12, including £154 million of infrastructure renewals expenditure, was £680 million, an increase of 12 per cent compared with last year. United Utilities has now delivered approximately £1.3 billion of capital investment in the first two years of the 2010–15 period. This spend is broadly in line with the regulatory allowance, after adjusting for the construction output price index (COPI) which is consistent with Ofwat's methodology. Good progress in the delivery of outputs has also been achieved in the early part of the new regulatory period, reflecting a smoother and more efficient investment profile than that experienced in the 2005–10 period. We expect regulatory capital expenditure to be around £700 million in the 2012/13 financial year, consistent with our five-year programme.

Sludge processing – A new £100 million sludge processing centre is being developed at the company's Davyhulme wastewater treatment works in Manchester. Sludge will arrive from seven feeder treatment works and will be processed using advanced thermal hydrolysis technology. The new facility will provide a range of benefits including energy self-sufficiency for the whole site, greater sludge disposal flexibility, with a wider choice of land disposal due to the advanced stage of the treated product, and improved sludge condition to enhance the efficiency of incineration. There will also be the option to pump the treated sludge to United Utilities' Shell Green sludge processing centre in Widnes.

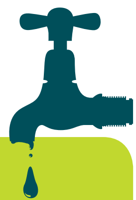
Private sewers – The ownership of, and responsibility for, private sewers was transferred to the wastewater companies in England and Wales from 1 October 2011. We have been preparing for this for some time resulting in a smooth transition. The number of customer contacts, the increase in work volumes and the level of expenditure, thus far, has been a little below initial expectations. In addition, the mix of work has been slightly different to that initially anticipated, with a greater proportion of expenditure relating to enhancement capex, as we undertake investigations and remedial work on these newly acquired assets. As we have evolved our operating model, we have seen an increasing proportion of work relating to enhancement expenditure as we have progressed through the period since 1 October. We are attaining better asset information and, in addition to jetting and cleaning activity, we are undertaking remedial work to improve and, where appropriate, enhance the quality of the infrastructure, to bring it more in line with United Utilities' asset standards and to reduce the risk of future problems for our customers. This is all consistent with our drive to deliver good customer service, where we aim to complete the job efficiently and effectively and in a single visit where practicable. We have also experienced lower levels of operating expenditure and infrastructure renewals expenditure (IRE) than anticipated. In the second half of 2011/12, operating expenditure was £6 million and capital expenditure was £15 million, of which £9 million was IRE. This has also resulted in a positive impact on operating profit in the second half of 2011/12. In light of this, we have outlined a revision to the level and mix of our cost estimates for the period October 2011 to March 2015. This reduces our total estimate for operating expenditure by £15 million to around £40 million, with a £5 million reduction in total capital expenditure to around £120 million. Importantly, the mix is now expected to be more evenly split between IRE and enhancement capital expenditure, reflecting experience over the last few months, with a revised estimate of £60 million for each of these expenditure categories. This lower rate of spend is positive for customers as it should be beneficial to bills at the next price review and, alongside this, we are raising asset standards. It is also beneficial for our investors, as costs are lower, a greater proportion of spend should be recoverable and we have the opportunity for additional growth in the regulatory capital value. We are still early into the transfer and will continue to review these cost estimates based on the levels and type of workload and activity experienced and will provide updated forecasts as appropriate.

Key performance indicators:

Financing outperformance – United Utilities 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. Should average RPI inflation outturn at 3.5 per cent per annum across the five-year period, this would increase financing outperformance to around £400 million, net of the impact of the pensions inflation funding mechanism. United Utilities agreed a £200 million index-linked loan with the European Investment Bank (EIB), drawn down between March and May 2011, at an average real interest rate of 1.2 per cent, which secures financing outperformance of around £20 million through to 2015. Subsequently, a further £200 million index-linked loan facility was agreed with the EIB and was drawn down in a number of tranches between November 2011 and March 2012 at an average interest rate of 0.9 per cent real. This is the best rate United Utilities has secured and generates further outperformance of over £15 million through to 2015.

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. United Utilities is on track to meet its five-year target and has now delivered cumulative operating expenditure outperformance of over £20 million in the first two years of the regulatory period.

Capital expenditure outperformance – United Utilities is delivering 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. Capital expenditure and the delivery of outputs remain on track.



FACT:
Since privatisation in 1989, bathing water standards across the North West have risen from just over 30 per cent to more than 90 per cent

Performance continued

Responsible manner

Actions:

Environment

Leakage management – The performance of the business in meeting its regulatory leakage target for 2010/11 was excellent, given the extreme winter weather, and United Utilities was one of only four water and sewerage companies to meet its regulatory leakage target in that year. This reflected strong year-round operational focus on leakage, an approach which we continued through 2011/12 and United Utilities has now met its leakage target for the sixth consecutive year. To help customers protect their homes in winter and prevent leakage from their own pipes, we undertook a customer awareness campaign and distributed over 100,000 advice packs.

Environmental performance – This is a high priority for the company and United Utilities has more than halved the number of major pollution incidents over the last few years. Wastewater treatment works compliance remains high at over 98 per cent, a slight improvement compared with the previous year. United Utilities is working more closely with the Environment Agency (EA), through its agreed protocol, to help minimise the occurrence and environmental impact of pollution incidents. This includes the sharing of resources, knowledge and expertise. The company is also enhancing its telemetry and flow monitoring equipment to provide early identification of incidents to enable prompt action to be taken to minimise the potential impact. Recognising that environmental performance is wide-ranging, the company is measuring itself against an EA composite measure as detailed in the key performance indicators below.

Sustainable catchment management programme – United Utilities owns over 56,000 hectares of land in the North West which it holds to protect the quality of water entering its reservoirs. The company has developed a sustainable catchment management programme which will help to protect and improve water quality and enhance biodiversity.

Renewable energy – United Utilities has a detailed carbon and renewable energy plan, which both contributes to sustainability and reduces costs. We are on track to meet our target of a 21 per cent reduction in carbon emissions by 2015 (measured from a 2005/06 baseline). Emissions in 2011/12 were 522,003 tonnes of carbon dioxide equivalent, a reduction of nine per cent on last year. We are now 13 per cent below our baseline position. United Utilities has consistently generated over 100 GWh of renewable electricity annually for the past three years, principally from sludge processing, with renewable energy equating to approximately 14 per cent of the group's total electricity consumption. United Utilities also reduced its energy purchases by over 20 GWh in 2011/12. The group has plans in place to increase renewable energy generation to 125 GWh per annum by 2015.

Liverpool wastewater treatment works enhancement

We have received planning permission for a £200 million plant expansion to our existing wastewater treatment works in Liverpool, which serves over half a million customers. This will enhance the capacity of the treatment works to handle up to 11,000 litres of wastewater per second and the treated water leaving the plant will be of a higher standard. The project will create up to 350 jobs during the construction period. The project will deliver both environmental benefits and growth in the company's regulatory capital value.

Pictured: An artist's impression of how the development will look when completed.

Employees

We continue to be successful in attracting and retaining people and in achieving UK high performing levels of employee engagement. We have, over a period of 12 months, delivered much more training of a higher standard and at the same time reduced the associated cost. This year we delivered 24,000 days of training to employees, of which more than 6,700 days were health and safety related. In addition, over 300 employees have been supported through a wide range of further education courses. We currently have 80 apprentices and plan to recruit up to a further 40 apprentices each year through to 2015. We have also re-energised our graduate recruitment programme and in 2012 expect to recruit up to 20 graduates. The past year has seen us strengthen our focus on improving health and safety, with a programme led by United Utilities' executive team. This has helped reduce our accident frequency rate for employees from 0.386 accidents per 100,000 hours worked in 2010/11, to 0.215 accidents per 100,000 hours worked in 2011/12. More detail is provided in our annual CR report. Health and safety performance will continue to be a significant area of focus for the company, as we strive to improve our performance further.

Communities

We actively support our local communities and we have a number of community partnerships to help us engage with the people in our region. This year we have increased the number of partnerships that address social issues in our region, such as education, water efficiency and employability skills. We understand the impact we can have on the communities where we operate and undertake capital projects so we seek to work with those communities to leave a positive legacy after our projects have been delivered. We have continued our award winning 'United Futures' programme with our partner, Groundwork, to help regenerate neighbourhoods after we have finished our work there. In addition, we have expanded our innovative 'Community Fund' where local community groups are invited to apply for small scale grants to support their work. During the year, we have contributed approximately £2 million supporting our local communities, providing debt advisory services and over 19,000 hours volunteered by our employees.

Key performance indicators:

Leakage – United Utilities met its economic level of leakage rolling target for the sixth consecutive year in 2011/12, with a performance of 453 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 – The EA computes a composite measure which incorporates a broad range of areas including pollution. United Utilities improved to a mid-ranking position for 2009/10 improving from its position in 2008/09, when it was ranked tenth out of ten water and sewerage companies. The company has reduced further the number of major pollution incidents and this has contributed to an improved performance score for 2010/11 (the latest assessment available) and United Utilities retains a mid-ranking position. United Utilities aims to move from this average relative position to the first quartile in the medium-term.

Corporate responsibility – United Utilities 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.

Community fund

We have implemented our new community fund scheme at our High Lane service reservoir project in Stockport. We assembled a selection panel of local councillors, the local residents' association and United Utilities' representatives to award grants to local good causes. Amongst the beneficiaries were Active at Windlehurst – a volunteer led activity group for adults with learning disabilities – who received a £500 grant through the programme. The group used their grant to buy outdoor furniture for their new wildlife garden, adjacent to Windlehurst Methodist Church. As work on the reservoir project will continue until 2014, it's important that we continue to work with the community, and get to know them, while we are delivering these vital improvements. Once complete, it will protect water supplies for 340,000 people in High Lane and the wider areas of Stockport.

Pictured: John and Mary Chriscoli, who created the wildlife garden for Active at Windlehurst.

BUSINESS REVIEW

Performance continued

FINANCIAL PERFORMANCE

Revenue

United Utilities has delivered a good set of financial results for the year ended 31 March 2012. Revenue increased by £52 million to £1,565 million, principally reflecting a 4.5 per cent nominal (0.2 per cent real price decrease plus 4.7 per cent RPI inflation) regulated price increase, partially offset by the ongoing impact of customers switching to meters and lower commercial volumes. The impact of meter switching was in line with our expectations, although commercial volumes were lower than expected, particularly in the second half of the year when the North West experienced an increase in unemployment. We would expect to recover the majority of this revenue shortfall through the regulatory methodology at the next price review.

Operating profit

Underlying operating profit decreased slightly by £2 million to £594 million, primarily as a result of increases in infrastructure renewals expenditure, depreciation and property rates, the impact of the transfer of private sewers and the new carbon reduction commitment charge, largely offset by the increase in revenue. Reported operating profit rose by two per cent to £592 million, as last year was impacted by one-off restructuring costs of £16 million which reduced operating profit in the prior period.

Investment income and finance expense

Investment income and finance expense of £311 million was £58 million higher than last year, principally reflecting £43 million of net fair value losses on debt and derivative instruments, compared with £19 million of net fair value gains in 2010/11. The £43 million net fair value loss in the period is largely due to losses on the regulatory swap portfolio resulting from a significant decrease in sterling interest rates during the period. The group uses these swaps to effectively 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 has continued to benefit from fixing the majority of its remaining debt for the 2010–15 financial period, providing a net effective nominal interest rate of approximately five per cent. Partially offsetting these losses, there has been a net fair value gain during the period due to widening credit spreads in the market, affecting the fair value of our fair value option debt.

FACT:

During the year we contributed approximately £2 million supporting our local communities

The indexation of the principal on index-linked debt amounted to a net charge in the income statement of £100 million, compared with a net charge of £103 million last year. This reflected lower RPI inflation in respect of the group's index-linked debt with a three month lag. This reduction was primarily offset by additional finance expense relating to the £400 million index-linked loan facilities provided by the European Investment Bank (EIB), which were drawn down in various tranches between March 2011 and March 2012. The first £200 million of facilities were drawn down at an average real interest rate of 1.2 per cent, with the second £200 million at 0.9 per cent, the lowest rate the company has achieved to date. The indexation charge does not represent a cash flow and is more than matched by an inflationary uplift to the regulatory capital value. The group had approximately £2.7 billion of index-linked debt as at 31 March 2012.

These offsetting factors resulted in the underlying net finance expense of £267 million being flat compared with the prior year, despite a slightly higher level of average net debt. The lower RPI indexation charge contributed to the group's average underlying interest rate of 5.5 per cent for 2011/12 being a little lower than the rate in 2010/11 of 5.7 per cent.

Profit before taxation

Underlying profit before taxation was £327 million, £2 million lower than last year in line with the reduction in underlying operating profit. 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 decreased by 14 per cent to £280 million, primarily as a result of net fair value losses on debt and derivative instruments.

Taxation

The current taxation charge was £46 million in the year and the current taxation effective rate was 16 per cent, compared with 11 per cent in the previous year. The current year charge includes a £16 million credit following agreement with the UK tax authorities of prior years' taxation matters, without which the effective rate would have been 22 per cent.

The group has recognised a net deferred taxation credit of £77 million for the year. This includes a £105 million credit, of which £50 million had already been recognised in first half of 2011/12, relating to the changes substantively enacted by the UK Government to reduce the mainstream rate of corporation taxation from 26 per cent to 24 per cent from 1 April 2012. A net deferred taxation credit of £99 million was also recognised in 2010/11, to reflect a similar two per cent staged reduction in the rate of corporation taxation.

An overall taxation credit of £31 million has been recognised for the year ended 31 March 2012. Excluding the impact of the reduction in the corporation taxation rate and the impact of the prior year taxation adjustments, the total taxation charge would be £74 million or 26 per cent compared with an £89 million charge or 27 per cent last year.

The taxation benefit of £33 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. Associated deferred taxation movements of £29 million are also included in the statement of comprehensive income.

The group made a net cash taxation payment during the year of £5 million, primarily reflecting the £35 million cash taxation inflow relating to prior years' taxation matters, which largely offset the cash taxation paid in the year. In the previous year, the group's net taxation payment was £47 million.

Profit after taxation

Underlying profit after taxation was £241 million. This is based on the underlying profit before taxation figure less an underlying taxation charge of £86 million, which includes an adjustment for the deferred taxation credit in relation to the change in the mainstream rate of corporation taxation and the credit relating to prior years' taxation matters. Reported profit after taxation was £311 million compared with £355 million last year.

Earnings per share

Underlying earnings per share increased slightly from 35.1 pence to 35.3 pence. This underlying measure is derived from underlying profit before taxation less underlying taxation. This includes the adjustments for the deferred taxation credits in 2011/12 and 2010/11, associated with the reductions in the corporation taxation rate, and the taxation credits in both years relating to prior years' taxation matters. Basic earnings per share decreased from 52.0 pence to 45.7 pence, principally reflecting net fair value losses on debt and derivative instruments.

Dividend per share

The board has proposed a final dividend of 21.34 pence per ordinary share in respect of the year ended 31 March 2012. Taken together with the interim dividend of 10.67 pence per ordinary share paid in February, this produces a total dividend per ordinary share for 2011/12 of 32.01 pence. This is an increase of 6.7 per cent, compared with the dividend relating to the previous year, in line with group's dividend policy of targeting a real growth rate of RPI+2 per cent per annum through to at least 2015. The inflationary increase of 4.7 per cent is based on the RPI element included within the allowed regulated price increase for the 2011/12 financial year (i.e. the movement in RPI between November 2009 and November 2010).

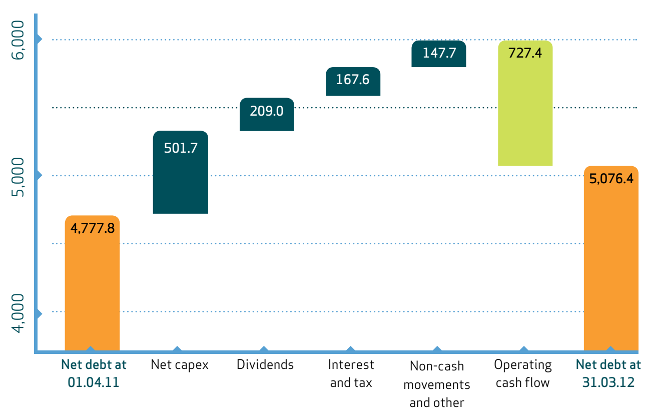
The final dividend is expected to be paid on 3 August 2012 to shareholders on the register at the close of business on 22 June 2012. The ex-dividend date is 20 June 2012.

Cash flow

Net cash generated from continuing operating activities for the year ended 31 March 2012 was £560 million, compared with £563 million last year. This small reduction reflected the accelerated pension deficit repair payment and an increase in operating costs, partly offset by a rise in revenue and the minimal amount of cash taxation paid in 2011/12 as the group benefited from a taxation rebate relating to prior years. The group's net capital expenditure was £502 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.

Net debt including derivatives at 31 March 2012 was £5,076 million, compared with £4,778 million at 31 March 2011. This expected increase reflects expenditure on the regulatory capital investment programmes and payments of dividends and interest, alongside the accelerated pension deficit repair payment, partly offset by operating cash flows.

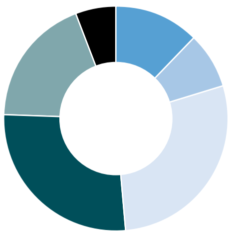
Summary of net debt movement (£ million)



Performance continued

Debt financing and interest rate management

Gross debt (£ million)



£725.3m	Yankee bonds
£471.7m	Euro bonds (EUR)
£1,656.8m	GBP bonds
£1,583.4m	GBP index-linked bonds
£1,083.6m	EIB index-linked loans
£334.4m	Other borrowings[1]

Total: £5,855.2 million

(1) Includes amounts relating to joint ventures of £27.9m

Gearing (measured as group net debt divided by United Utilities Water PLC's regulatory capital value adjusted for actual capital expenditure) remained flat at 59 per cent at 31 March 2012, compared with the position at 31 March 2011, and remains comfortably within Ofwat's 55 per cent to 65 per cent assumed gearing range. This is the net effect of three main factors: indexation of the principal of the group's index-linked debt, the accelerated pension deficit repair payment and growth in the regulatory capital value. The group's pensions deficit has reduced to £92 million, on an accounting basis, compared with a deficit of £195 million at 31 March 2011. Taking account of this small deficit, and treating it as debt, gearing increases slightly to 60 per cent.

At the year end, United Utilities Water PLC 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.

Cash and short-term deposits at 31 March 2012 amounted to £321 million. Between March and May 2011, United Utilities Water PLC drew down a £200 million index-linked loan facility with the EIB. The group also renewed £150 million of bank facilities during 2011/12. In addition, in November 2011, United Utilities Water PLC agreed a further £200 million index-linked loan facility with the EIB which was drawn down between then and March 2012. United Utilities has headroom to cover its projected financing needs into 2014.

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 United Utilities Water PLC 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.

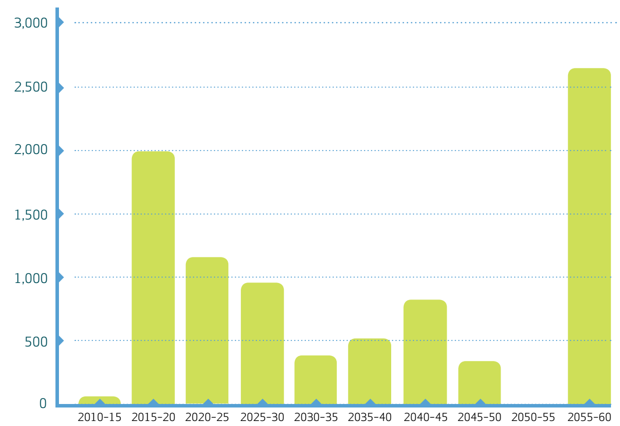
Long-term borrowings are structured or hedged to match assets and earnings, which are largely in sterling, indexed to UK retail price inflation and subject to regulatory price reviews every five years.

Very 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 2012, approximately 53 per cent of the group's net debt was in index-linked form, representing around 31 per cent of United Utilities Water PLC'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 regulatory period at around the time of the price review.

Following the 2009 price review, the group re-assessed 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, United Utilities has 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 to extend the interest rate hedge each year to eventually achieve a 10-year rolling average interest rate on the group's nominal debt. United Utilities 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.

Term debt maturity per regulatory period (£ million)



Liquidity

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits. The group has a €2 billion euro-commercial paper programme and further liquidity is provided by committed but undrawn credit facilities.

In line with the board's treasury policy, United Utilities aims to maintain a robust headroom position. Available headroom at 31 March 2012 was £614 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 2014.

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

United Utilities 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 2012, the group had a net retirement benefit, or pension, deficit of £92 million, compared with a net pension deficit of £195 million at 31 March 2011. This £103 million positive movement principally reflects payment of the £100 million accelerated deficit repair contribution.

The group has sought to adopt a more sustainable approach to the delivery of pension provision and in advance of the start of the 2010–15 regulatory period amended the terms of its defined benefit pension schemes, the details of which were included in the 2010 annual report and financial statements. United Utilities also reduced its future pension obligations as a result of the sale of non-regulated activities.

The group 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 (the details of which were included in the 2011 annual report and financial statements), which facilitates a move to a lower risk investment strategy. This has allowed United Utilities to reduce the allocation of its pension assets to 25 per cent in equities and other high risk assets, from 34 per cent at 31 March 2011. In addition, United Utilities has adopted the use of more prudent longevity assumptions. The group has also increased its interest rate hedge to around 65 per cent of pension scheme liabilities. Although any additional payments under this 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. The change in inflation has decreased the present value of the liabilities during the year to 31 March 2012. This accounting treatment means that there is likely to be a degree of volatility in future IAS 19 pension valuations.

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

Performance continued

Underlying profit

In considering the underlying results for the period, the directors have excluded fair value movements on debt and derivative instruments and one-off items. 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:

Operating profit	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Operating profit per published results	591.5	580.2
One-off items[1]	2.6	16.2
Underlying operating profit	594.1	596.4

Net finance expense	£m	£m
Finance expense	(315.5)	(255.9)
Investment income	4.4	2.8
Net finance expense per published results	(311.1)	(253.1)
Net fair value losses/(gains) on debt and derivative instruments	43.2	(19.2)
Adjustment for interest on swaps and debt under fair value option	7.2	5.7
Adjustment for net pension interest expense	3.3	3.8
Adjustment for capitalised borrowing costs	(9.7)	(4.4)
Underlying net finance expense	(267.1)	(267.2)

Profit before taxation	£m	£m
Profit before taxation per published results	280.4	327.1
One-off items[1]	2.6	16.2
Net fair value losses/(gains) on debt and derivative instruments	43.2	(19.2)
Adjustment for interest on swaps and debt under fair value option	7.2	5.7
Adjustment for net pension interest expense	3.3	3.8
Adjustment for capitalised borrowing costs	(9.7)	(4.4)
Underlying profit before taxation	327.0	329.2

Profit after taxation	£m	£m
Underlying profit before taxation	327.0	329.2
Reported taxation	31.0	27.4
Deferred taxation credit – change in taxation rate	(104.6)	(99.0)
Agreement of prior years' UK taxation matters	(0.4)	(17.8)
Taxation relating to underlying profit before taxation adjustments	(12.1)	(0.6)
Underlying profit after taxation	240.9	239.2

[1] Principally relates to restructuring and other reorganisation costs within the business.

Underlying operating profit reconciliation

2011/12 is the first year in which the group has presented the consolidated financial statements as a single segment and therefore 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 2012 £m**
Group underlying operating profit	**594.1**
Underlying operating profit not relating to United Utilities Water	(10.9)
Infrastructure renewals accounting	40.2
Other differences	(3.9)
United Utilities Water statutory underlying operating profit	**619.5**
Revenue recognition	2.6
Infrastructure renewals accounting	(2.5)
Non-appointed business	(7.0)
United Utilities Water regulatory underlying operating profit	**612.6**

Principal risks and uncertainties

Key developments during the year

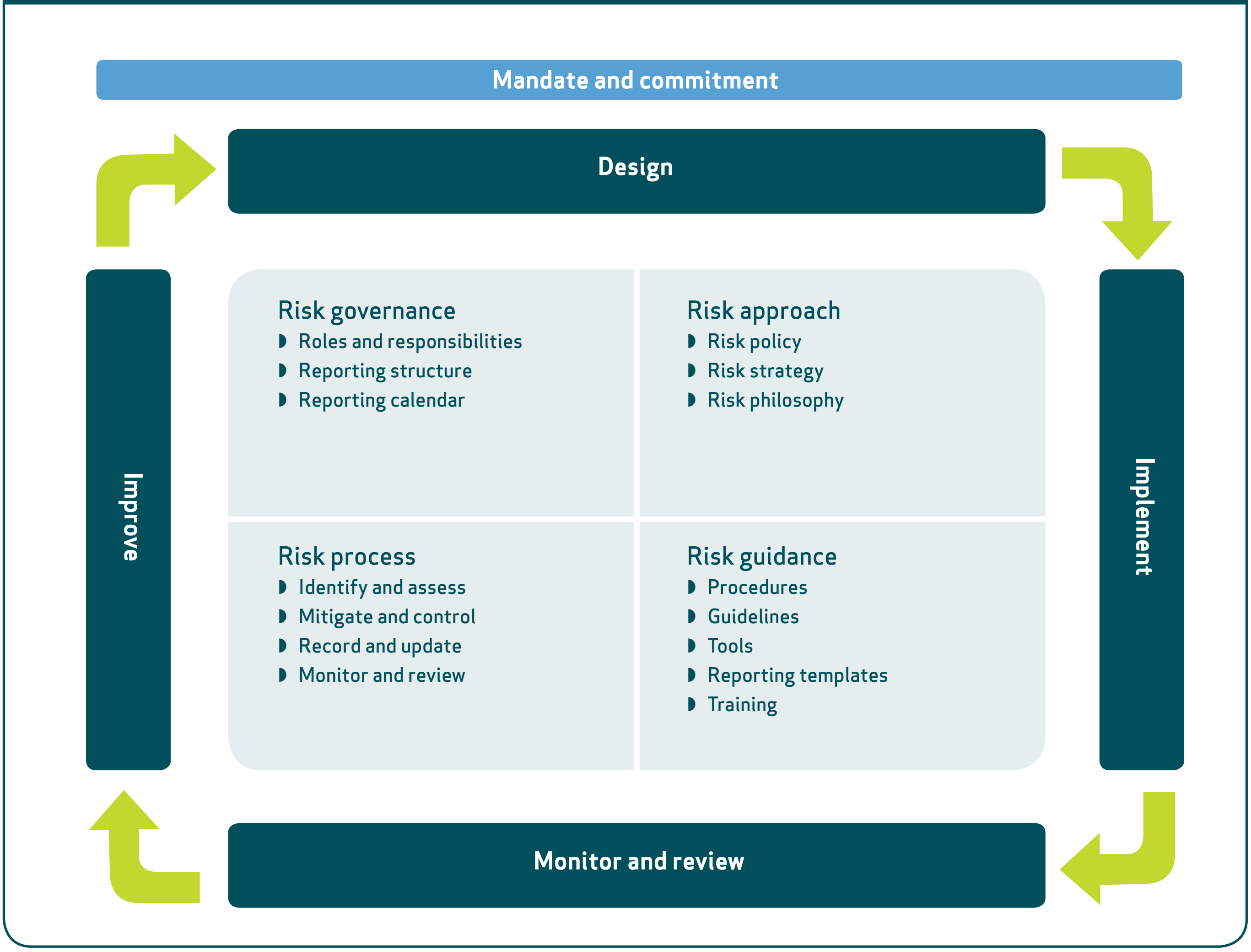
The risk profile of our group is now largely confined to the regulated water and wastewater business in the North West of England following the sale of the vast majority of our non-regulated businesses in 2010.

The legislative reform proposed by the government's recently published Water White Paper (Water for Life) is now one stage nearer. More information is set out in the 'Government Market Reform Agenda' entry opposite but the likely impact on the industry, positive or negative, will not be fully understood until the draft Water Bill is published and ultimately becomes legislation.

Ofwat has also started the process of preparing the ground for the 2014 price review process. This includes a consultation with stakeholders about 'Future Price Limits' which asks for consideration of a number of proposals for change that may be required to facilitate the aims of the Water White Paper.

We manage risk through our corporate risk management framework. As part of this, we maintain a process that regularly assesses the nature and magnitude of internal and external risks. Mitigation measures are used in a prioritised manner to reduce exposure and ensure resilience. The executive reviews significant risks so that the board can determine the nature and extent of those risks it is willing to take in achieving our strategic objectives. The audit and risk committee regularly reviews the framework's effectiveness and the group's compliance with it.

Corporate risk management framework



Government market reform agenda

Risk	Mitigation
The government's White Paper (Water for Life) highlights a number of areas which government will focus on to reform the water industry. These include: ◗ protecting water and the natural environment; ◗ tackling water pollution; ◗ tackling over abstraction; ◗ water and the green economy; ◗ reforming and extending competition; ◗ supporting growth and innovation; ◗ affordability and bad debt; and ◗ changing the way we use and value water. A draft Water Bill is expected to be published before Parliament's summer recess, which commences on 18 July 2012, and should deliver many of the aspects set out in the White Paper. Changes to the industry are expected to include extending competition to all non-household customers for both water and wastewater, the removal of barriers to the trading of abstraction licences and facilitating bulk supplies of water, reform of the special merger regime to allow more mergers of water companies and reform of the inset appointment regime. There is also a proposal (in the government's White Paper) to replace the 'costs principle' which underpins network access. Ofwat plans to consult on the methodology for the 2014 price review in the autumn of 2012.	The group has been fully engaged in all government and Ofwat consultations in relation to competition, industry reform and the price setting process. In respect of competition, a relatively small proportion of the group's profits derive from the retailing of water and wastewater services to non-household customers. If competition is expanded, there would be opportunities for the group to participate in a wider market in England and potentially Scotland. However, we recognise that reforms to the pricing rules that govern access to the group's water network and greater upstream competition could put at risk a greater proportion of the group's profits. We have raised our concerns with Ofwat and will be proposing an alternative to the 'costs principle', seeking to ensure that key underlying principles (on both cost of entry and efficiency of provision) are reflected in any replacement.

Future price limits – average cost to serve

Risk	Mitigation
It is expected that market reform will result in two price limits, one for retail and one for wholesale. Ofwat proposes to set an average cost to serve for non-contestable customers in the retail price limit. This proposal could result in us having a significant cost recovery shortfall over the next five-year price control period.	We have raised and explained our concerns with Ofwat and made alternative proposals as part of the consultation process and continue to make strong representation to Ofwat on this issue, citing the market evidence from investors and analysts to support our case.

Principal risks and uncertainties continued

Future price limits – licence modifications

Risk	Mitigation
Ofwat has made proposals to modify the licences of the water and wastewater industry to: ◗ allow it to remove reference to the use of the retail price index (RPI) in price setting; and ◗ allow flexibility in the number of price limits set and the duration of price controls.	All 21 water companies have rejected Ofwat's proposals and the regulator is now consulting with the wider water sector before making its decision on this later in 2012.

Capital investment programmes

Risk	Mitigation
The 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 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 the group's 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.

Service incentive mechanism

Risk	Mitigation
For the 2010–15 period, Ofwat has introduced a new comparative incentive mechanism to reward or penalise water companies' service performance, replacing the Overall Performance Assessment (OPA). The Service Incentive Mechanism (SIM) compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well they deal with those contacts. Depending on UUW's relative performance under SIM it could receive a revenue penalty (up to one per cent of turnover) or reward (up to 0.5 per cent of turnover) 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. To build on this success, we have a dedicated project team to ensure our processes, behaviours and systems provide consistent and excellent service to our customers. The company's focus is on ensuring right first time service delivery to its customers, thus avoiding the need for 'unwanted' contacts and reducing associated operating costs. Where 'unwanted' contacts do arise, then there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score. Capital costs of enhanced systems to improve performance are dealt with through the Capital Incentive Scheme. 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 setting.

Serviceability assessment

Risk	Mitigation
The group is required to maintain the serviceability of its water and wastewater assets, ensuring they continue to deliver a level of service and performance that is at least as good as in the past. Where serviceability falls below required reference levels of performance, Ofwat deploys a staged approach to regulatory action to secure corrective actions and could make financial adjustments at the next price setting if these actions did not restore service performance. If performance was to continue to decline, the group may incur additional operating or capital expenditure to restore performance.	The various indicators of performance are closely and routinely monitored by management. The company's capital investment programme is targeted to seek to maintain stable serviceability of the company's water and wastewater assets. Similarly, operational practice is intended to ensure stable serviceability. Where adverse trends develop and there is a risk of serviceability deviating from stable, then corrective action can be identified and taken.

Principal risks and uncertainties continued

Pension scheme obligations

Risk	Mitigation
The group participates in a number of pension arrangements. The principal schemes are defined benefit schemes, although these have been closed to new employees since October 2006. The assets of these schemes are held in trust funds independent of group finances, with the funds being well diversified and professionally managed. The group's current schemes had a combined IAS 19 deficit of £92 million as at 31 March 2012, compared with a deficit of £195 million as at 31 March 2011.	Increases to pension fund deficits may result in an increased liability for the group, the size of the liability depending on a number of factors, including levels of contributions and actuarial assumptions. 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) for the regulated business and allowed for half of this deficit when setting its overall price controls for the 2010–15 period. In response to the size of its ongoing pension risks and pension costs the group introduced a series of changes for employees in its 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 future. In conjunction with the trustees, the group continues to monitor and to look to reduce the investment strategy risks for the pension schemes, including the group's exposure to investment risks.

Failure to comply with applicable law or regulations

Risk	Mitigation
The group is subject to various laws and regulations in the UK and internationally. Regulatory authorities may, from time to time, make enquiries of companies within their jurisdiction regarding compliance with regulations governing their operations. In addition to regulatory compliance proceedings, the group could become involved in a range of third party proceedings relating to, for example: land use; environmental protection; health and safety and water quality. Amongst others, these may include civil actions by third parties for infringement of rights or nuisance claims relating to odour or other matters. Furthermore, the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business cannot always be predicted and, from time to time, interpretation of existing laws or regulations may also change or the approach to their enforcement may become more rigorous. If the group fails to comply with applicable law or regulations, in particular in relation to its water and wastewater licences, or has not successfully undertaken corrective action, regulatory action could be taken that could include the imposition of a financial penalty (of up to 10 per cent of relevant regulated turnover) or the imposition of an enforcement order requiring the group to incur additional capital or operating expenditure to remedy its non-compliance. In the most extreme cases, non-compliance may lead to revocation of a licence or the appointment of a special administrator.	The group endeavours to comply with all legal requirements in accordance with its business principles and robust processes are in place to seek to mitigate against non-compliance. The group continually monitors legislative and regulatory developments and, where appropriate, participates in consultations to seek to influence their outcome, either directly or through industry trade associations for wider issues. The group seeks appropriate funding for any additional compliance costs in the regulated business as part of the price determination process.

Events, service interruptions, systems failures, water shortages or contamination of water supplies

Risk	Mitigation
The group controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. The group is also dependent on the ability to access, utilise and communicate remotely via electronic software applications mounted on corporate information technology hardware and communicating through internal and external networks which are not wholly under its control. In exceptional circumstances, such as prolonged drought, system failure or catastrophic damage, a significant interruption of service provision could occur. Such consequences may arise due to a number of circumstances either within or outside the company's control. For example from water shortages, the failure of an asset or an element of a network or supporting plant and equipment, human error, an individual's malicious intervention or unavoidable resource shortfalls. Such instances have a low probability, but if materialised could result in significant loss of life, environmental damage and/or economic and social disruption. The group 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 costs.	The group operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The 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 applications, all recognising that possible events can have varying causes, impacts and likelihoods. Sustainability of our water supply is also managed through regional aqueduct networks which will be enhanced by the West East Link pipeline. While the group seeks to ensure that it has 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 customers, regulators, government and the wider stakeholder community. The group also maintains 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.

Principal risks and uncertainties continued

Material litigation

Risk	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 has served notice that it intends to appeal this decision.	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.

Governance

Corporate governance

Dr John McAdam
Chairman

Letter from the Chairman

We have now completed our first year operating under our simplified board structure with the same directors now taking responsibility for the leadership of both our primary listed company, United Utilities Group PLC (UUG) and United Utilities Water PLC (UUW) its principal operating subsidiary and the regulated water and wastewater licence holder. This move has reflected greater focus on the operation of our core water and wastewater business, and our vision to become a leading North West service provider and one of the best UK water and wastewater companies. The UK water industry has a number of regulators (see page 9 for further information on the business model) with whom, from time to time, the board engages and meets with, in order that both parties can gain an understanding of each other's priorities and challenges.

As Chairman and on behalf of my board colleagues we fully adopt the 'Principles of the UK Corporate Governance Code 2010' (the code) and have measured ourselves and reported against these 'Principles' and the requirements of the code in this annual report.

Leadership: As a board we are responsible to our shareholders, customers and other stakeholders for the performance of the company and in promoting its long-term success. The way in which we operate as a board, we believe, already reflects the highest standards of corporate governance, but we welcome the developments evolving in the many areas of corporate governance. Our view is that such changes can only enhance the performance of companies for the benefit of all their stakeholders and we will positively address the changes as required.

The board is fully supportive of the strategic aim that our Chief Executive Officer, Steve Mogford, and his executive team are implementing to improve the water and wastewater services that we provide to our customers in the North West of England. Our role is to ensure that we provide strategic oversight, constructive challenge and support to our executive team. As Chairman, I fully embrace my position as leader of the board and ensuring that, as individuals, we operate collectively in our decision-making to achieve our vision for the company and with the intention of furthering its long-term success, and that of the group.

Effectiveness: As individuals, and collectively, my fellow directors and I have many years' experience across a wide range of activities and industries relevant to United Utilities, as can be demonstrated in the biography section of this report (pages 36 and 37). During the year we commissioned an externally facilitated evaluation of the ways in which the board and the board committees operate and a review of each individual board member's performance (further details on pages 41 and 42). We have reviewed the succession plans for the board and, as a result, have undertaken an exercise to recruit a new independent non-executive director, which resulted in Sara Weller being appointed on 1 March 2012.

As Chairman of the board and nomination committee, part of my role is to ensure that United Utilities has the strongest possible leadership at board level. In response to the Davies Report, we have adopted a board diversity policy which was taken into consideration in our non-executive director (NED) selection process. The group has, almost continuously since the days of privatisation, over two decades ago, had female representation at board level, and so we are well versed in the benefits that gender diversity can bring to board discussions and the interactions of board members. A summary of our policy on board diversity is given on page 40, including maintaining at least 25 per cent female representation on our board. That said, as Chairman, ensuring that United Utilities has the strongest possible leadership at board level remains a key priority and appropriate candidates will always be appointed on merit, as was the case with the recent appointment of Sara Weller. We currently have two female board members out of eight (25 per cent) on the board and five out of fourteen (36 per cent) members of the executive team. In addition, 30 per cent of our full-time employees are female, which increases to 36 per cent if you include part-time employees.

The group has, almost continuously since the days of privatisation, over two decades ago, had female representation at board level.

Accountability: Our business model and strategy is given on pages 4 to 13, a statement of directors' responsibilities in the preparation of this annual report and financial statements is given on page 63, the auditor's report is on page 65, and the going concern statement is on page 45. Paul Heiden is chair of the audit and risk committee and the board is content that Paul has recent and relevant financial experience and is independent within the meaning of the code.

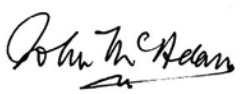
During the year, we have developed our processes around risk management and details are given on page 44 and this year the review of our internal control systems is reported on pages 43 to 45.

Remuneration: We need to attract, motivate and retain individuals with the appropriate skill sets and with the aptitude and interest to address the challenges of a regulated business such as ours, particularly with our drive to ensure that going forward as a business we focus on operational performance and customer service. The debate on executive remuneration and the way in which it is reported is evolving with recent consultations from the Department for Business, Innovation and Skills advocating the need for improved transparency from companies. The remuneration committee is fully appraised of these developments but is content that the current remuneration levels of its executive directors reflect the job they are doing and the performance that is being achieved.

Relations with shareholders: The CEO and CFO have a regular scheduled programme of investor meetings primarily in the UK but also in the USA and Europe to discuss the performance of the company. The company's investor relations team is always on hand to respond to investor queries in the first instance, and would escalate matters to the CEO and CFO as required. The board has an 'open door' policy when it comes to addressing investors' needs, which is part of my remit and Nick Salmon's role as the senior independent director.

We need to attract, motivate and retain individuals with the appropriate skill sets and with the aptitude and interest to address the challenges of a regulated business such as ours.

Some aspects of corporate governance are receiving much focus and attention. I am confident that our current stance, particularly relating to remuneration of our executive directors, is consistent with these developments and that their remuneration is directly linked to their performance. The board of United Utilities will embrace any changes which it believes are for the benefit of the company and all its stakeholders.



Dr John McAdam
Chairman

Board of directors

Overview of the board

The directors have a wide range of experience to draw upon. In the commercial field gained in defence, engineering and chemicals; and in the regulated utility sector experience gained in water, electricity and telecommunications. The recent appointment of Sara Weller with her understanding of customer facing businesses, together with her knowledge of regulated business, builds on the existing strengths and adds to the diversity of the board and its discussions. Many board members have worked both in the UK and internationally. As individuals, they are in different stages of their careers which facilitates discussion and views from different perspectives and provides challenge and support to the strategic decision making process. Given the relatively recent appointments of Steve Mogford and Russ Houlden to the group, in addition to their independent viewpoints, the non-executive directors also provide the necessary continuity at board level to ensure decisions are taken with the background knowledge of the recent history of the group. If needs be, the non-executive directors are supported in their ability to seek independent specialist advice. With the exception of the Chairman, all of our non-executive directors are determined by the board to be independent in accordance with the code and free from any business or other relationship which could compromise their independent judgement. With the exception of David Jones, all directors will be offering themselves for reappointment or election at the forthcoming annual general meeting in July 2012 in accordance with the code. As has been confirmed by the independent board evaluation conducted during the year, the board fully endorses the reappointment of the board members at the annual general meeting, who they consider to be making a valuable and effective contribution to the board, and the election of Sara Weller who has been recently appointed to the board.

Dr John McAdam (64)
Chairman

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

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, non-executive director of Rolls-Royce Holdings plc and Sara Lee Corporation.

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. There have not been any significant changes to John's interests during the year ended 31 March 2012.

Skills and experience: With over 12 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.

Independent: 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 (55)
Chief Executive Officer

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

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.

Career experience: 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 electronics market 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 (53)
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: None.

Career experience: Chief financial officer at Telecom New Zealand. Previously he was finance director of global law firm Lovells from 2002 to 2008 and prior to that was finance director at BT Wholesale, BT Networks and Information Services, ICI Polyurethanes and ICI Japan.

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

Dr Catherine Bell CB (61)
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.

Directors' length of service

Up to 1 year	1 director
1–3 years	2 directors
3–5 years	1 director
Over 5 years	4 directors

Paul Heiden (55)
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 Talaris Topco Limited, non-executive director of Meggitt plc and London Stock Exchange Group plc.

Career experience: 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.

David Jones CBE (70)
Independent non-executive director

Qualifications: MSc Control System Engineering, BSc Electrical Engineering.

Appointment to the board: January 2005.

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

Current directorships/business interests: None.

Career experience: Formerly chairman of UK Coal plc, group chief executive of The National Grid Company plc and chief executive of South Wales Electricity.

Skills and experience: David's experience of regulated utilities is particularly relevant to the group, and his knowledge and insight into the electricity sector was invaluable prior to the divestment of the electricity business.

Nick Salmon (59)
Senior independent non-executive director

Qualifications: BSc (Hons) Mechanical Engineering.

Appointment to the board: April 2005.

Committee membership: Nomination and remuneration.

Current directorships/business interests: Chief executive of Cookson Group plc.

Career experience: 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 the present CEO of a FTSE listed company Nick brings current executive board experience to the board table. In addition, his extensive prior experience in the management of large capital construction projects supports the board's oversight of the capital investment programme.

Sara Weller (50)
Independent non-executive director

Qualifications: MA Chemistry.

Appointment to the board: March 2012.

Committee membership: Nomination and remuneration.

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.

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 the 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.

Corporate governance continued

This corporate governance report describes how the board and its committees discharge their duties and how we apply the main principles of the UK Corporate Governance Code as published by the Financial Reporting Council in June 2010 (the code). This report (which incorporates the directors' biographies on pages 36 to 37 and the report from the audit and risk committee on pages 45 to 47), together with the remuneration report on pages 51 to 62, forms part of, and should be read in conjunction with, the directors' report set out on pages 48 to 50.

During the financial year ended 31 March 2012, the company complied fully with all the sections of the code. The table below provides a summary of our compliance with sections A (leadership), B (effectiveness) and E (relations with shareholders) which require a specific response or statement in accordance with the requirements of the code. Our compliance with section C of the code (accountability) and section D of the code (remuneration) can be found within the reports of the audit and risk committee and remuneration committee on pages 45 to 47 and pages 51 to 62 respectively.

Code provision	Comply (✓) or explain	Notes
A.1.1	✓	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. Our board has a formal schedule of matters reserved to it (available on our website), which ensures that it is responsible for approving the company's overall strategic direction, values and standards, reviews management performance and assesses whether the company has the necessary financial and human resources in place to meet its objectives. It also reviews the company's business planning, approach to risk management and development of policies. Decisions are taken with a view to promote 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, suppliers, the environment and the community in which we operate and serve.
A.1.2	✓	The names of our Chairman, Chief Executive Officer, senior independent director and members of our board committees and chairs thereof are set out on pages 36 to 37.
A.1.2	✓	The number of meetings of the board and its committees and the individual attendance at such meetings by directors is set out on page 39.
B.1.1	✓	Our board considers all of our non-executive directors to be independent and this is apparent from their range of other business interests and career experience which is set out on pages 36 to 37.
B.2.4	✓	Please see the section on the nomination committee on page 40.
B.6.1	✓	Please see the section on the externally facilitated board evaluation on pages 41 to 42.
E.1.2	✓	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. Our investor relations team undertakes a programme of regular investor meetings and presentations throughout the year, both in the UK and overseas. During the year, the investor relations team, and at certain meetings the CEO and/or the CFO, met or offered to meet with 147 different funds, representing 40 per cent of our issued share capital. Such briefings, together with regular announcements on current trading, are part of our dedicated investor relations programme undertaken to keep our equity and debt investors informed of developments affecting the group. We regard this programme as an important contribution to communicate with our investors and ensure that the board maintains an understanding of our investors' priorities. Board members receive regular updates in the area of investor relations and reports from sector analysts. 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. All directors normally attend annual general meetings and the board encourages shareholders to participate in the annual general meeting through the question and answer session with individual directors or, where appropriate, the chair of the relevant committee, who will always endeavour to answer questions relevant to the work of those committees.

The board of directors

The names of our current directors who served during the year, and their biographical details, are set out on pages 36 and 37. We scheduled and held eight board meetings during the year (2011: nine) and the board will meet more or less frequently as required. A number of telephone conferences were also held during the year. The table below shows the attendance of each of our directors at these scheduled meetings of the board and its principal committees. The figures in brackets show the maximum number of meetings which the directors could have attended.

	Board	Audit and risk committee	Nomination committee	Remuneration committee
Steve Mogford	8(8)	n/a	2(2)	n/a
Russ Houlden	8(8)	n/a	n/a	n/a
Dr Catherine Bell	8(8)	5(5)	2(2)	5(6)
Paul Heiden	8(8)	5(5)	2(2)	n/a
David Jones	8(8)	5(5)	2(2)	6(6)
Dr John McAdam	8(8)	n/a	2(2)	n/a
Nick Salmon	8(8)	n/a	2(2)	6(6)
Sara Weller	n/a*	n/a	n/a*	1(1)

Notes:
n/a in the above table denotes that the director is not a member of that committee.
* Sara Weller was appointed to the board on 1 March 2012. Between this date and 31 March 2012 only the remuneration committee met.

Principal committees of the board

The board has formally delegated specific responsibilities to certain committees as described in the diagram below. All of our board committees are provided with sufficient resources to undertake their duties, they have the authority to seek independent advice if they feel it is appropriate, and are supported by our company secretariat team.

In addition to the committees required by the code, the board has delegated certain powers and duties to the executive, the treasury committee and the corporate responsibility committee as described in the diagram below.

Governance structure

Board
(Chairman John McAdam)

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, it meets more frequently if required.

Audit and risk committee

(chair Paul Heiden)
(see pages 45 to 47)

Nomination committee

(chair John McAdam)
(see page 40)

Remuneration committee

(chair David Jones)
(see pages 51 to 62)

Treasury committee

Considers and approves borrowing, leasing, bond 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.

Corporate responsibility committee

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

Corporate governance continued

Nomination committee

The nomination committee meets at least once each year and otherwise as required and is chaired by the Chairman (except when succession issues surrounding that position are being considered). Its other members are our independent non-executive directors and our Chief Executive Officer. Its primary role is to make recommendations to the board on the composition, balance and membership of our board and refreshment of the board's principal committees. The committee evaluates the balance of skills, knowledge, experience and independence of board members and it prepares descriptions of the roles and capabilities required of any new director that it feels should be appointed and would then make a recommendation to the board. The nomination committee's terms of reference are available on our website.

During the financial year ended 31 March 2012, the nomination committee met twice. As a result of its discussions regarding board succession, it was decided that an additional independent non-executive director should be recruited. The committee also agreed the particular skills that the successful candidate would need, in order to address and support the strategic objectives of the group and the succession requirements of the board. These included, amongst other things, career experience in the field of regulation, marketing and customer service. As a result, executive search consultants JCA Group (who is a signatory to the voluntary code of conduct on gender diversity for executive search firms) was appointed to produce a shortlist of candidates for the role. It was proposed that the new non-executive director being sought would, in due course, become chair of the remuneration committee given David Jones's intention to retire at the 2012 AGM. A recommendation was made, and the board appointed Sara Weller with effect from 1 March 2012. The board felt Sara was an excellent candidate as her experience directly met the search criteria due to her understanding of customer facing businesses, together with her experience of regulated environments. Such experience would be vital to the board as the company prepares for the opening up of the water sector to more competition.

All the directors will retire at the 2012 annual general meeting and, with the exception of David Jones, offer themselves for election or reappointment as appropriate, as was the case in 2011. There is an explanation in the overview of the board on page 36 as to why the board believes that the relevant directors should be elected/reappointed.

The nomination committee also approved and recommended the board diversity policy to the board for adoption.

The committee also has responsibility for the succession planning arrangements of the senior executive management team. The letters of appointment of our non-executive directors are available on our website and these make it clear that no compensation is payable to non-executive directors for loss of office.

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.

Developing women in the workforce

At United Utilities, 36 per cent at the executive level are women. All members of our executive and business leadership group have a dedicated personal development plan and are participating in our strategic management development programme with Manchester Business School. The development plans for female executives and business leaders are tailored to each individual's needs and often include executive coaching to support their development as senior women both internally in the organisation and externally.

However, as well as supporting senior women in our organisation we need to be more proactive and are therefore putting a greater emphasis on our emerging female talent. We have identified our first cohort of emerging talent of which 56 per cent are women. This group participates in a fast track development programme which will include identifying senior male and female mentors to support their career development and a 'women in work' module which will cover impacting and influencing skills and effective networking.

As we start to be more proactive in developing women at work we are developing plans for further initiatives which include the introduction of focus groups to facilitate discussion on topics such as career paths taken by award winning directors and senior managers and analysis of our attraction rates for female applicants to our apprentice and graduate programmes. As we are predominantly recruiting talented engineers and potential engineers currently both programmes are male dominated and only 15 per cent of our apprentices and graduates are women. We are therefore reviewing our recruitment process to look at how we could target potential female applicants and continuing our work with schools to promote science, technology, engineering and maths (STEM) subjects at the earliest opportunity to young people.

Pictured: Graduate scheme employee Joanna Adamson.

Board and committee evaluation

During the year, as recommended by the code that the annual board evaluation should be externally facilitated every three years, the board instructed Lintstock Limited (Lintstock or the facilitator) to undertake an evaluation of the board's performance, its committees and of its individual directors. Lintstock is wholly independent from, and has no other relationship or connection with, United Utilities. The board and committee evaluation exercise took place from December 2011 to February 2012. Lintstock discussed the context of the evaluation with the Chairman and Company Secretary and then tailored questionnaires specifically for United Utilities, which were completed by all board members, committee members and by the senior managers directly responsible for supporting the various committees. Questionnaires were also completed by third party advisors to the various committees. The content of the questionnaires assessed the performance of:

- the composition of the board (including gender diversity), expertise and dynamics;
- board support, time management and board committees;
- strategic oversight;
- risk management and internal control;
- succession planning and human resource management; and
- priorities for change.

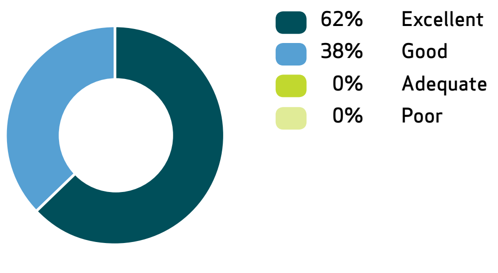
The questionnaires were confidential between the individual and the facilitator. The facilitator analysed the responses and thereafter presented their conclusions to the Chairman which were circulated and discussed by the board. The Chairman discussed with each individual director their own performance and Nick Salmon (as our senior independent director) discussed the Chairman's performance with the facilitator, and findings were discussed together as a board. The facilitator also provided written feedback to board committee chairs who in turn discussed the findings with their fellow committee members.

The findings of the board evaluation are summarised in the table on page 42.

Corporate governance continued

Observations arising from, and areas considered in, the board evaluation	Comments/actions
There was broad consensus as to the key strategic priorities of the group, the main risks being faced and the mitigating actions being taken to address them.	Common board membership between the UUW and UUG boards had led to an improvement in the board's oversight of strategy and risk under the new executive team.
Board succession planning was considered to be effective in relation to the current composition of the board.	Succession plans had been agreed with clear requirements and attributes, in order of priority, established for potential successors.
Relations between the non-executive directors and the executive directors were highly rated.	Efforts by executive and non-executive directors to improve communication and understanding had led to positive relationships.
Support by management for the information needs of the board.	The board felt that they were well supported with management providing them with appropriate information and assistance when required.
Performance of the Chairman and the operation of the board committees.	The performance of the Chairman and the performance and operation of the board committees were highly rated. All the board committees were working effectively in discharging their duties.
The migration to common board membership of the UUG and UUW boards.	There was unanimous support for the extension of board members' responsibilities to become directors of UUW as this better reflected the strategic direction of the group.
The role of the board in overseeing effective succession plans for the executive and senior management.	Steps were being taken for the board to meet more members of senior management and assess their abilities in surroundings other than formal board meetings.
The level of satisfaction with the content and format of management reports was high but some refinements could be made in the presentations made to the board.	Greater focus would be given on highlighting the key issues for the board to consider when preparing presentations.

Performance of the committees in discharging their duties (provided by Lintstock)



Having served on the board for more than six years, the individual evaluation process for Paul Heiden, David Jones and Nick Salmon demonstrated that they each remained committed to their roles and each allocated sufficient time to the company in their roles as effective independent non-executive directors.

Succession of senior management

As part of its role, the nomination committee is responsible for ensuring that there are plans in place for the orderly succession of the executive directors and the executive committee. During the year, there has been better alignment of the management team with the needs of the business resulting in significant change to the members of the executive team to better reflect roles and responsibilities.

Induction and training

On joining the company, directors receive a tailored induction programme, including an induction pack, time spent with the other directors, the Company Secretary and the executive team. For example, since joining the company, Steve Mogford has visited many of the key operational sites and major construction projects being undertaken as part of the capital investment programme. He has met employees at all levels and from all departments across the company to really understand what it is like to work for United Utilities and gain an insight of what is good and what is bad at the grass-roots level of the business. On joining, he spent time with each individual from the executive team and has received comprehensive training on the requirements of the various regulatory stakeholders.

An induction programme for Sara Weller has been devised and will be undertaken during the 2012/13 financial year. Our directors are provided with details of seminars and training courses relevant to their role and are encouraged to attend those that meet their development needs. The Chairman agrees and regularly reviews with each director their training and development needs. During 2011/12 guidance was provided to the whole board on topics such as the implementation of the Bribery Act and proposed new regulations on competition in the water industry. Given the complex nature of the regulated environment in which the business operates, the board receives regular presentations on regulation changes and the impact on the business. Given the potential changes to the regulatory landscape, this is an area which will be given further emphasis over the next 12 months. Our major regulators are also invited to meet with our board from time to time to ensure that the objectives of both the regulators and the company can both be explored and aligned as far as possible.

Major shareholders are also invited to meet with our new non-executive directors and shareholders have the opportunity to meet our directors at the annual general meeting held in July.

Conflicts of interest

Since 1 October 2008, all directors have been under a statutory duty to avoid any situation in which they have, or can have, a direct or indirect interest which conflicts or possibly may conflict with the interests of the company. As is permitted, our articles of association contain provisions which permit the unconflicted directors to authorise conflict situations and procedures have been put in place for the disclosure of any conflicts by the directors to the board and for the consideration and, if appropriate, authorisation of such conflicts. The procedures permit any authorisation to be subject to any terms and/or conditions that the unconflicted directors think fit. All directors are asked on an annual basis if their other commitments and interests have changed and a brief report to the board is prepared. In any case, all the directors are required to notify the Chairman and/or Company Secretary if they believe a conflict situation might arise. Any potential issue of conflict relating to prospective directors would be addressed by the nomination committee, with a recommendation to the board.

Information, support and advice

The Chairman is responsible for ensuring that directors receive comprehensive information on a regular basis to enable them to perform their duties properly, supported by our Company Secretary, Simon Gardiner. Board papers are generally distributed five days in advance of scheduled board meetings to enable directors to obtain a thorough understanding of the matters to be discussed and seek clarification if required. During the year, paper copies of board papers were replaced with electronic board packs for directors to use via electronic devices. As part of the preparation process for board meetings, the Chairman has implemented a programme of informal briefings with the non-executive directors and the CEO the evening before the scheduled board meetings.

Internal controls

The board has overall responsibility for the company's system of risk management and internal controls and for reviewing its effectiveness. The schedule of matters reserved to the board ensures that the directors are responsible for the control of, amongst other things, all significant strategic, financial and organisational risks.

An overview of the principal risks and uncertainties surrounding the company is contained in the business review section on pages 26 to 32. To manage these and other commercial and operational risks we have an established risk management programme that helps management identify, assess and mitigate business, financial, operational and compliance risks on a continual basis. We view the management of risk as integral to good business practice and our programme is designed to support management's decision-making, improve the reliability of business performance, and assist in the preparation of the company's consolidated accounts. The board is supported by our internal risk team who report to the head of audit and risk, who in turn reports directly to the audit and risk committee and our Chief Financial Officer.

The board delegates to the executive team the responsibility for designing, operating and monitoring both the system and the maintenance of effective internal control in the group. The system of internal control is based on an ongoing process of identifying, evaluating and managing key risks and includes the risk management processes referred to above. The system of internal control was in place throughout the year and up to the date of approval of the Annual Report and Financial Statements. The effectiveness of this system has been reviewed regularly throughout the year, and up to the date of the approval of the Annual Report and Financial Statements, by the company's management teams. The system of internal control was periodically reviewed by the audit and risk committee and the board and it is in line with the guidance in the Turnbull Report and the Internal Control Revised Guidance for Directors published by the Financial Reporting Council in October 2005. The system is also refined, as necessary, in response to changes in the company's business and the associated risks.

Control systems

The main components of the group's internal control framework are summarised on page 44. Their foundation is in the considerable value that we place throughout our activities on seeking to ensure that our employees are of the highest quality and integrity. Formal control is exercised through a management structure which includes clear lines of responsibility and documented delegations of authority from the board. Our internal control systems include a series of group policies, operating and procedural manuals and processes, with which all relevant employees are expected to comply. Processes underpinning the financial reporting systems are managed and monitored by management through regular reporting. Separately, the effectiveness of these internal controls is reviewed by the external auditor and the internal audit team, which in turn reports its results to members of the executive team and directly to the audit and risk committee. The work of the internal audit team is focused on the areas of perceived greatest risk as determined by our internal risk assessments, senior management and the audit and risk committee.

Corporate governance continued

Function of controls

The system of internal control (the control system) is designed to manage rather than eliminate the risk of failure to achieve business objectives. It can only provide reasonable and not absolute assurance against material errors, losses, fraud or breaches of laws and regulations. The key features of our control system include:

- a control environment with clearly defined organisation structures, operating within a framework of policies and procedures, covering every aspect of the business;
- comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the following year and projections for subsequent years;
- established procedures, set out in the group's internal control manual, for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews;
- review by the board of financial and non-financial performance to assess progress towards objectives;
- monthly meetings by the executive team, prior to the scheduled board meeting, where, amongst other matters, financial and non-financial performance is reviewed and strategic and operational issues which are of group-wide importance are explored;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements and internal audit reviews;
- regular monitoring of risks and control systems throughout the year by the operating business, supported by the use of risks and issues databases;
- conducting regularly throughout the year rolling reviews of group-wide risks and mitigating actions and controls by the senior management teams. Arising from such reviews, plans are developed to enhance internal control and risk management;
- an annual risk assessment exercise involving self-assessment by management of all major business risks in terms of impact, likelihood and control strength;
- an internal audit function which provides independent scrutiny of internal control systems and risk management procedures;
- a management self-assessment process whereby senior management are required to assess annually the compliance of their departments with the system of internal control; and
- data consolidated into the group's financial statements is reconciled to the underlying financial systems. A review of the consolidated data is undertaken by management to ensure that the true position and results of the group are reflected, through compliance with approved accounting policies and the appropriate accounting for non-routine transactions.

The group audit and risk board (GARB), on behalf of the executive team, monitors and reviews compliance with statutory requirements and internal processes. This includes the corporate risk management framework and the profile of most significant risks the organisation faces and the adequacy and effectiveness of the corresponding control/mitigation. The GARB is attended by the CEO and CFO and other senior managers as appropriate.

Annual review of risk management and internal control systems

In addition to the regular reports received by the audit and risk committee and the board, an annual review of the effectiveness of the risk management and internal control systems in operation during the year and up to the date of the approval of the Annual Report and Financial Statements is also undertaken. Through operational reports from management the board reviews the controls designed to mitigate risks. The board, through the audit and risk committee, also assesses the review that is conducted by internal audit. Management of all the parts of the group are required to complete and sign off control self-assessment questionnaires that assess annually the compliance of their departments with the system of internal control. Where weaknesses have been identified, plans and timetables for putting them right are also reported. Internal audit monitors and selectively checks the results of this exercise, ensuring that the representations made are consistent with the results of the internal audit function's work during the year. The results of this exercise are summarised for the audit and risk committee and the board.

In the event that any significant control failings occurred or losses were incurred during any year as a result of the failure of internal controls, an analysis would be reported to the audit and risk committee and the board. A plan would also be implemented to take the necessary action to remedy any significant weaknesses. In the year ended 31 March 2012, there were no such losses and the board was satisfied with:

- the changes since the last annual assessment in the nature and extent of significant risks identified by management;
- the company's ability to respond to changes in its business and the external environment to the extent that such changes are events that management can materially influence;
- the scope and quality of management's ongoing monitoring of risks and of the system of internal control and, where applicable, the work of its internal audit function and other providers of assurance;
- the extent and frequency of communication of the results of the monitoring to the board (or board committee(s)) which enables it to build up a cumulative assessment of the state of controls in the company and the effectiveness with which risk is being managed; and
- the company's external reporting processes.

Financial reporting and going concern

When releasing the annual and half-yearly financial reports and interim management statements the directors aim to present a balanced and understandable assessment of the group's position and prospects. These statements are posted on our website at the same time as they are released to the London Stock Exchange. To encourage effective communication, individuals with an email address can register free of charge to receive an email alert on the posting of each new release.

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 on, 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.

The board 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', published by the Financial Reporting Council in October 2009.

Report of the audit and risk committee

Paul Heiden
Chair of the audit and risk committee

Letter from the chair

As reported last year, we decided to tender the role of external auditor, particularly in the light of the strategic refocus of the group on its core business, and KPMG Audit Plc (KPMG) were appointed. During the year our risk management processes have been refocused to reflect best practice and the remit of the committee extended to incorporate this area.

Our internal audit function continues to operate on the co-sourced model introduced in 2010, through which the knowledge and skills of the in-house team are supplemented by external resource. This provides flexible access to subject matter resources and enables the internal audit function to provide greater coverage through their activities.

Paul Heiden
Chair of the audit and risk committee

Members

The audit and risk committee's members are Paul Heiden (chair), Dr Catherine Bell and David Jones. All members have extensive commercial experience and are independent within the meaning of the code. The qualifications of the members of our audit and risk committee are given on pages 36 and 37. Appointments to the committee are made by the board, on the recommendation of the nomination committee in consultation with the audit and risk committee chair. The terms of reference of our audit and risk committee are available to shareholders on request and are also available on our website.

Corporate governance continued

Attendees at meetings

Our Chairman, Chief Executive Officer, Chief Financial Officer, and head of audit and risk attend committee meetings by a standing invitation from the committee. Representatives of our external auditor KPMG also attend meetings by invitation. During the year ended 31 March 2012, representatives of the external auditor and internal audit and risk team attended and participated in all of the committee's meetings, and time was also set aside for them to have private discussions with the committee, in the absence of management.

Audit and risk committee activities

The audit and risk committee's terms of reference comply with the code.

During the year ended 31 March 2012, the matters considered by the committee included, amongst other matters, the code and disclosure and transparency rules requirements to:

- monitor the statutory audit of the annual and consolidated accounts;
- monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, including reviewing significant financial reporting judgements and any disclosures contained in them;
- review the company's internal financial controls and its internal control and risk management process and to make recommendations to the board;
- monitor and review the effectiveness of the company's internal audit function;
- make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, reappointment and if necessary removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements; and
- review the company's policy on the engagement of the external auditor to supply non-audit services. In doing so, account is taken of relevant ethical guidance regarding the provision of non-audit services by the external auditor and pre-approval practices. In this context, the committee will report to the board any matters in respect of which it considers that action or improvement is needed and makes recommendations as to the steps to be taken.

With effect from 27 April 2011, the audit committee was renamed as the audit and risk committee in order to reflect more accurately the powers delegated to the committee with regard to reviewing the company's internal financial controls and internal control and risk management systems. The committee's terms of reference were updated accordingly.

The audit and risk committee met five times during the financial year ended 31 March 2012. It has a formal policy, endorsed by the board, to keep under review the independence and objectivity of our external auditor. The audit and risk committee determined that it was satisfied that the independence of our external auditor had been maintained, having taken into account our external auditor's written representations and the committee's own enquiries. These were facilitated by a private meeting with our external auditor without executive management being present. The independence policy sets out certain disclosure requirements by our external auditor to the audit and risk committee, including restrictions on mutual hiring of personnel, rules for rotation of audit partners and procedures for the approval of non-audit services provided by the external auditor. The audit and risk committee has monitored the application of the policy both during the year ended 31 March 2012 and up to the date of this report.

The audit and risk committee reviewed our external auditor's audit scope, plans and materiality levels and the resources proposed to execute the plans. Having done so, the committee approved the terms of engagement and the audit fees. The committee also reviewed the findings of our external auditor and their management letters on internal financial controls. The audit and risk committee also assessed the qualifications, expertise and resources and independence of our external auditor and the effectiveness of the audit process. Through an embedded regular audit effectiveness review, the audit and risk committee has continued to keep the performance of our auditor and audit effectiveness under review. Mindful of the costs associated with our compliance requirements, the audit and risk committee continues to seek the most cost-effective approach to compliance and external audit generally.

The policy relating to the provision of non-audit services by our external auditor specifies the types of work from which our external auditor is excluded; for which our external auditor can be engaged without referral to the audit and risk committee; and for which a case-by-case decision is required. The ratio of non-audit fees to audit fees was monitored by the committee throughout the year ended 31 March 2012. The audit and risk committee is satisfied that this policy in respect of the provision of non-audit services was applied during the year ended 31 March 2012 and up to the date of this report.

Fees

As summarised above, the committee has established policies and procedures to pre-approve the engagement of our auditor to provide any audit or non-audit services and keep the nature and extent of non-audit services under review. All audit and audit related services proposed to be provided by our external auditor are pre-approved by the audit and risk committee and reviewed annually. The provision of audit related services is generally highly correlated with the role of independent auditor. Such services include assurance on non-statutory information, assurance work carried out in connection with reporting to a statutory regulator, analysis and interpretation of accounting principles, support for debt issues and similar transactions and other services that have a bearing on the group's financial statements on which the external auditor provides an opinion.

Non-audit services are allowed under the procurement of an audit and non-audit services policy, where they do not affect the independence of our external auditor, but do require the pre-approval of the audit and risk committee prior to the engagement. Specific approval may be delegated to a designated member of the audit and risk committee, with such approvals to be reported at the next audit and risk committee meeting. In granting such approval, the designated member of the audit and risk committee is required to consider the cumulative proportion of fees paid for such work compared with the statutory audit fees. In the financial year ended 31 March 2012, all such services were approved by the audit and risk committee.

The company also maintains a list of prohibited services that cannot be provided by our auditor as they are considered by statute or in the group's opinion to be incompatible with the role of the independent auditor.

The fees paid or payable to our auditor in the year ended 31 March 2012 and the preceding year were as follows:

Year ended 31 March	2012 £m	2011 £m
Statutory audit of the financial statements	0.1	0.3
Other fees to the auditor:		
Local statutory audits for subsidiaries	0.1	0.2
Other audit related	–	0.1
Regulatory reporting	0.1	0.1
Tax advisory services	0.1	–
Due diligence and transaction support	–	0.6
	0.4	1.3

Notes:

- Included in the above statutory audit fee for the period ended 31 March 2012 is £25,000 in relation to the company (period ended 31 March 2011: £35,000).
- Audit fees paid during the year ended 31 March 2011 were paid to the group's previous auditor, Deloitte LLP (see note 4 on page 83).

The committee is always mindful of the ratio of audit and non-audit fees and best practice in deciding any appointments for advisory work. For the year ended 31 March 2012, the non-audit related fees refer to ongoing services provided by KPMG in an advisory capacity. Being mindful of the need to ensure auditor independence the committee has agreed that, moving forward, KPMG will only be considered to undertake a piece of non-audit work where they demonstrably provide the most effective and efficient solution whilst at the same time not compromising their independence.

The audit and risk committee has satisfied itself that these advisory services undertaken by KPMG during the financial year ended 31 March 2012 did not prejudice the auditor's independence.

Evaluation of the external auditor

During the year, the audit and risk committee concluded that given the strategic refocus of the group an audit tender process was appropriate. As a result of the tender process, the committee therefore recommended to the board that KPMG be appointed auditor following the conclusion of Deloitte LLP's audit of the 2011 group financial statements. Shareholders approved the reappointment of KPMG at the 2011 annual general meeting.

To assess the effectiveness of the external auditor, KPMG, the audit and risk committee reviewed:

- the auditor's independence and objectivity;
- their fulfilment of the 2011/12 audit plan;
- the robustness and perceptiveness of the auditor in its handling of key accounting and audit judgements; and
- the content of the external auditor's reporting on internal controls;

and was content with its findings. As a result, a recommendation was made to the board that a resolution to reappoint KPMG should be proposed to shareholders at the 2012 annual general meeting which was duly agreed. There are no contractual obligations restricting the company's choice of external auditor.

Disclosure policy

The committee's objective is to ensure that arrangements are in place for the proportionate and independent investigation of matters raised in confidence and for appropriate follow-up action. Accordingly, the audit and risk committee periodically reviews the arrangements by which our employees may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. Our employees can report any concerns anonymously to an independent service provider, who can be contacted at any time.

The corporate governance statement and report of the audit and risk committee were approved by the board on 23 May 2012.

Directors' report

Our directors present their 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 2012.

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 (inside front cover to page 32), which includes our Chairman's and Chief Executive Officer's statement and the financial performance section (pages 14 to 25), provides a balanced analysis of the development and performance of the group's business during the financial year, and the position of the group's business at the year end, and forms part of this directors' report. A summary of key performance indicators can be found on the inside front cover. A further description of these key performance indicators and others can be found in the performance section of the business review on pages 14 to 25. A summary of the principal risks and uncertainties can be found on pages 26 to 32. An indication of likely future developments of the group can be found on pages 2 to 13. The company's principal subsidiary undertakings, and the associated companies and joint ventures in which the group participates, are listed in note 14 to the consolidated financial statements.

Dividends

Our directors are recommending a final dividend of 21.34 pence per ordinary share for the year ended 31 March 2012, which, together with the interim dividend of 10.67 pence, gives a total dividend for the year of 32.01 pence per ordinary share (the interim and final dividends paid in respect of the 2010/11 financial year were 10.0 pence and 20.0 pence per ordinary share respectively).

Subject to approval by our shareholders at the annual general meeting, the final dividend will be paid on 3 August 2012 to shareholders on the register at the close of business on 22 June 2012. United Utilities Employee Share Trust Limited (UUESTL) has waived its rights to dividends, including dividends paid in respect of the year ended 31 March 2012. However, the shareholding of the UUESTL at 31 March 2012, and at the date of this report, was nil.

Directors

Summary biographical details, together with the skills and experience of the directors who served during the financial year ended 31 March 2012, can be found on pages 36 to 37.

During the year, Sara Weller was appointed to the board on 1 March 2012.

Our articles of association provide that a director must retire at the third annual general meeting following his or her last election or reappointment by 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 our directors will retire at the 2012 annual general meeting and offer themselves for election/reappointment, as happened at the annual general meeting in 2011.

Information regarding the appointment of directors is included in the corporate governance report on pages 40 to 43. Details of the interests in the company's shares held by our directors and persons connected with them are set out in the directors' remuneration report on pages 51 to 62.

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 34 to 47. The 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 2012, 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 at corporate.unitedutilities.com. The corporate governance statement also includes the consideration given by the directors to the factors relevant to the adoption of the going concern basis.

The annual general meeting

Our annual general meeting of the company will be held on 27 July 2012 at The Midland Hotel, Peter Street, Manchester, M2 3NQ.

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

At our annual general meeting, 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 reappoint KPMG Audit Plc as auditor.

In addition, resolutions will be proposed: to approve the 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.

Share capital, transfers of shares and voting rights

At 31 March 2012, the issued share capital of the company was £499,815,945 divided into 681,808,799 ordinary shares of five pence each and 273,956,180 deferred shares of 170 pence each. Details of the share capital and movements in the issued share capital are shown in note 25 to the financial statements on page 111. The ordinary shares represented 71.3 per cent and the deferred shares represented 28.7 per cent respectively of the shares in issue as at 31 March 2012.

All ordinary shares have the same rights, including the rights to one vote at a general meeting, to an equal proportion of any dividend declared and payable, and to an equal amount of any surplus assets which are distributed in the event of a winding-up.

The 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 shares in the company are provided by the 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 its annual general meeting and such resolutions will be proposed at the 2012 annual general meeting. The directors' powers are conferred on them by UK legislation and by the company's articles. At the annual general meeting of the company on 22 July 2011, the directors were authorised to issue relevant securities up to an aggregate nominal amount of £11,361,356 and were empowered to allot equity securities for cash on a non pre-emptive basis to an aggregate nominal amount of £1,704,203.

Electronic and paper proxy appointment and voting instructions must be received by the company's registrars 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 ordinary shares in the company, nor any limitations on the holding of 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 Services Authority's Listing Rules or the City Code on Takeovers and Mergers.

There are no arrangements known to the company 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 the company any arrangements between holders of securities that may result in restrictions on the transfer of securities or on voting rights. All issued shares are fully paid.

Major shareholdings

At 23 May 2012, the 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 Services Authority:

Shareholder	% 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

Purchase of own shares

At the annual general meeting of the company held on 22 July 2011, shareholders authorised the company to purchase, in the market, up to 68,168,136 of its own ordinary shares of five pence each. No shares were purchased pursuant to that authority during the year. Such authority from shareholders is normally sought annually. Authorisation will be sought from shareholders of the company at the 2012 annual general meeting to grant authority to purchase up to 68,180,879 of its own ordinary shares of five pence each, such authority to expire at the conclusion of the company's annual general meeting in 2013.

Change of control

The UUESTL, which is the trustee that administers the performance share plans, matching share plans and deferred share award scheme, has the ability to exercise voting rights at its discretion which relate to shares that it holds 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 48, at 31 March 2012 the trustee's holding of ordinary shares in the company was nil.

In the event of a change of control, the participants in the 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

The company has in place contractual entitlements for 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.

Directors' report continued

Political and charitable donations

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

The period 2011/12 saw an increase in stakeholder engagement along a number of policy themes as the industry examined its future development. The group incurred expenditure of £12,328 (2011: £5,000) as part of this process. At the 2011 annual general meeting, an authority was taken to cover such expenditure. A similar resolution will be put to the shareholders at the 2012 annual general meeting to authorise the company and its subsidiaries to make such expenditure.

Charitable donations by the group in the year amounted to £5,345,093 (2011: £5,193,987). 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. The group's other community investments, including in-kind and volunteering time contributions, are described on page 19.

Employees

The company's policies on employee consultation and on equal opportunities for disabled employees can be found in the 'Our approach to doing business' section on page 7 and details of the company's disclosure policy can be found on page 47. The board encourages employees to own shares in the company; details of employee share schemes can be found in the remuneration report on page 62.

For further information on the average number of employees during the year, go to page 82.

Environmental, social and community matters

Details of the company's 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 7 .

Essential contractual relationships

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

Policy on payment of creditors

The group's policy is in line with the CBI Code of Prompt Payment (copies are available from the CBI, Centre Point, 103 New Oxford Street, London, WC1A 1DU). Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance.

The group makes every effort to comply with the payment terms as agreed with its suppliers subject to there being no dispute with the invoices received. As at 31 March 2012, the average credit period taken for trade purchases was 29 days for the group (2011: 31 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

The risk management objectives and policies of the company 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 impractical to obtain meaningful market values for the land. Other land owned by the group, the majority of which relates to operational sites, does not have a market value materially different from historic cost.

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 115.

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.

Reappointment of auditor

The board is proposing that shareholders reappoint KPMG Audit Plc as auditor at the forthcoming annual general meeting and authorise the directors to fix the auditor's remuneration.

Approved by the board on 23 May 2012 and signed on its behalf by:

Simon Gardiner
Company Secretary

Directors' remuneration report

David Jones
Chair of the remuneration committee

Letter from the chair

A responsible approach to executive pay

We are mindful of the financial pressures felt by many of our customers and the current spotlight on executive pay, and this is demonstrated in our restrained approach to executive remuneration. Our decision not to increase the base salary of the Chief Executive Officer (CEO) in 2011/12 and to award only a modest increase to the Chief Financial Officer (CFO) supports this approach, as does our decision not to increase the quantum of their incentive arrangements and our continued focus on setting stretching performance targets.

Furthermore, as disclosed in last year's report, the remuneration packages for the current CEO and CFO are now substantially lower than they were for the previous incumbents, reflecting the reduced scale and the change in focus of the company. We believe that the current remuneration arrangements are necessary and appropriate to recruit and retain executives working for a listed utility company operating in a regulated environment in the North West of England.

We responded to the recent Department for Business, Innovation and Skills' consultations on executive remuneration, and will continue to monitor the changes that are likely to arise as a result of that process. We understand and support the principle of rewarding executives only where there has been genuinely good performance.

Business strategy underpins our incentive arrangements

A key objective of our remuneration policy is to align executive pay to the company's strategy of outperforming the regulatory contract and delivering long-term shareholder value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

The business strategy underpins our incentive arrangements, not only at executive director level, but throughout the wider workforce. Many of the corporate KPIs (see pages 12 to 13) are performance measures for the annual bonus plan, including measures around customer service, efficiency and corporate responsibility. Our long-term incentive plans are strongly linked to the delivery of long-term shareholder value through the use of operational measures around regulatory outperformance as well as relative total shareholder return (TSR). Shareholding requirements for executives also provide further long-term alignment with shareholders.

Pay reflects what we do and how well we do it

You will be aware that the company has successfully implemented a range of changes over the past 18 months, in line with our enhanced focus on our core regulated water and wastewater business. Having completed the non-regulated disposal programme towards the end of 2010 we are a significantly leaner organisation, with clear financial and operational objectives.

Performance against those objectives during the year has been good, despite the continuing challenges of the external environment. There has been continued progress on the capital expenditure programme, and the company remains on course to outperform the regulatory targets. Improvements in the level of service provided to customers have resulted in a reduction in customer complaints, with a resultant significant improvement on Ofwat's service incentive mechanism. The achievement of the regulatory leakage targets for the sixth year in a row is further evidence of good performance. The committee is satisfied that overall bonus payments of around 70 per cent of maximum for the executive directors is reflective of this performance.

No significant changes

Overall, we think the current remuneration strategy is working well and we are not proposing to make any substantive changes during the year ending 31 March 2013. As a result of there being no significant proposed changes in 2012/13, there have been no formal consultations with shareholders during the year, although we continue to welcome feedback from shareholders and believe that this year's report positively reflects the feedback we received following last year's report.

David Jones
Chair of the remuneration committee

Directors' remuneration report continued

The remuneration committee

Summary terms of reference

The committee's terms of reference were last updated in November 2011 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

The committee's membership comprises solely of independent non-executive directors. During 2011/12, the following were members of the committee:

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

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.

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 HR director (Sally Cabrini) and the head of reward (Sean Duxbury until May 2011 and Ruth Henshaw from November 2011) who are consulted on matters discussed by the committee, subject to those matters not relating to their own remuneration. The committee can and does seek advice or information directly from other employees, where the committee feels that such additional contributions will assist the committee in its decision making.

Advisors to the remuneration committee

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 following external advisors:

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
Eversheds	Company	• Advice on share schemes	• Advice on employment law • General legal advice
Addleshaw Goddard	Company	• Review of executive contracts	• Advice on employment law • General legal advice

The independent consultants New Bridge Street (a trading name of Aon Plc) are signatories to the Remuneration Consultants Group Code of Conduct and any advice provided by them is governed by this code.

As referenced above, the committee also receives advice from the CEO, the Company Secretary, the HR director and the head of reward in relation to executive remuneration and governance matters (except in relation to their own pay).

Key activities of the remuneration committee over the past year

The committee met six times in the year ended 31 March 2012.

Regular activities

- Approved the 2011 directors' remuneration report.
- Reviewed the base salaries of executive directors and other members of the executive team.
- Assessed the achievement of targets for the 2010/11 annual bonus scheme and set the targets for 2011/12.
- Assessed the measurement of performance conditions for the long-term incentive awards vesting in 2011 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 2011.
- 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

- Agreed an appropriate replacement for Northumbrian Water Group in the TSR comparator group for the long-term incentive awards.
- Set the terms of appointment for new members of the executive team.
- Reviewed the executive shareholding guidelines.
- Reviewed the committee's approach to shareholder engagement.
- Had the outcome of the regular review of the committee's performance externally evaluated (see pages 41 to 42).

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.

In determining the total remuneration package and individual elements for executives, the committee looks at both the performance of the individual and the company. It also considers the range of pay in similar companies and continues to be mindful of remuneration issues across the wider workforce. For example, the performance measures for the corporate annual bonus scheme (in which most employees participate) are similar to those for the executive annual bonus scheme so that both employees and executives are rewarded if the business strategy is delivered.

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 remuneration will not be paid.

Executives are also encouraged to accumulate personal holdings in United Utilities Group PLC shares over time, thereby ensuring that their interests are fully aligned with those of shareholders.

Pay benchmarking group

The committee uses market data on salary levels and increases to inform, but not specifically to set, the level of base salary. The committee uses this data with caution given the lack of direct comparators and to avoid remuneration being ratcheted up as a result of benchmarking exercises with no corresponding improvement in performance. Pay is benchmarked against companies of a similar size, sector and UK presence taking into account the nature, scope and complexity of operations.

Directors' remuneration report continued

Remuneration for the year ended 31 March 2012
Summary of executive directors' remuneration

Element of remuneration	Purpose – link to strategy	Summary of how it operates 2011/12	Opportunity 2011/12	See page
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 increases 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. ◗ Benchmarked against pay benchmarking group.	CEO – £650,000 (no increase given in 2011/12). CFO – £410,000 from 1 September 2011 (an increase of 2.5%).	56
Annual bonus	Drives and rewards performance against personal objectives and selected financial and operational KPIs which are directly linked to business strategy.	◗ For the CEO, 50% of maximum bonus is based on financial measures, 40% on operational measures and 10% on personal measures. ◗ For the CFO, 40% of maximum bonus is based on financial measures, 40% on operational measures and 20% on personal measures. ◗ 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 fraud or a material error in the financial statements of the company.	Maximum of 130% of base salary.	56-57
Matching share award plan (MSAP)	Aligns the interests of executives and shareholders through the delivery of an award in shares and provides a mechanism for clawback of bonus. Performance conditions on matching shares are linked to the strategy of delivering long-term shareholder value through the use of key operational measures (outperformance of the regulatory contract) and relative TSR.	◗ Matching structure results in an overall maximum matching award equal to 70% of base salary, assuming the maximum bonus applies. ◗ Matching shares vest after three years, subject to continued employment and the achievement of certain performance conditions (the performance conditions are the same as for the PSP). ◗ Bonus deferred in shares is not subject to forfeiture provisions. ◗ Matching shares accrue dividend equivalents. ◗ Awards are subject to clawback provisions in the event of fraud or a material error in the financial statements of the company.	Voluntary deferral of up to 54% of overall gross bonus into MSAP. Matched on 1:1 basis, subject to continuing service and achievement of performance conditions. Both executive directors elected to defer the maximum allowed amount relating to the 2010/11 bonus into the MSAP in June 2011.	59

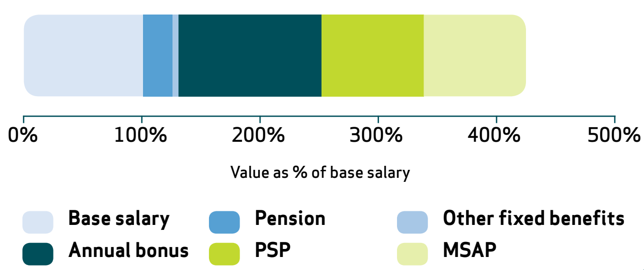
Element of remuneration	Purpose – link to strategy	Summary of how it operates 2011/12	Opportunity 2011/12	See page
Performance share plan (PSP)	Incentivises long-term value creation and alignment with shareholders' interests through use of key operational measures (outperformance of the regulatory contract) and relative TSR.	◗ Three-year performance period starting at the beginning of the financial year in which awards are granted. ◗ 50% is based on the achievement of operational measures (of which 75% is based on operational expenditure outperformance versus Ofwat's allowed operating costs and 25% on capital expenditure outperformance versus Ofwat's capital expenditure allowance). ◗ 50% is based on TSR relative to an index. Index TSR performance is a weighted average of the TSR of selected comparator companies. ◗ Maximum payout will only occur if operational measures meet stretch targets and if TSR exceeds that of the index by at least 6.3% (on a multiplicative basis) over the three-year performance period. ◗ Any vesting is subject to the committee being satisfied that the company's TSR performance is consistent with underlying business performance. ◗ PSP shares accrue dividend equivalents. ◗ Awards are subject to clawback provisions in the event of fraud or a material error in the financial statements of the company. ◗ Rules provide for a maximum award of 100% of base salary or more if the committee considers that exceptional circumstances apply.	Maximum of 70% of base salary.	58
Pension and benefits	Provides market competitive benefits. Defined contribution approach minimises the risk to the company associated with defined benefit pension plans.	Either: ◗ Company contribution of 25% of basic salary to a defined contribution pension arrangement; or ◗ A cash allowance in lieu of pension of 22% of base salary.	The CEO and CFO both elected to take a cash allowance of 22% of basic salary. Car allowance of £14,000 a year. Private medical insurance, life assurance and group income protection (for ill health).	60
Shareholding obligation	Aligns with interests of shareholders by requiring executive directors to hold wealth in company shares.	◗ Executive directors are required to build up and retain a shareholding equal in value to their base salary, normally within five years of appointment. ◗ Executive shareholdings are reviewed annually.	As at 31 March 2012: CEO – shareholding target exceeded. CFO – 98% of shareholding target achieved.	60

Directors' remuneration report continued

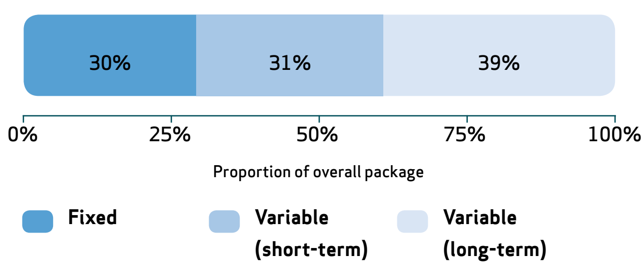
Composition of reward for executive directors

The charts below summarise the composition of reward at maximum performance:

Maximum value of package 2011/12



Relationship between fixed and variable pay for maximum package 2011/12



Notes:
Pension refers to the cash allowance paid in lieu of a pension contribution.
The maximum values apply only where maximum annual bonus is achieved and the PSP and MSAP have paid out fully.
The values for the PSP and MSAP assume a dividend reinvestment value of five per cent per year and exclude share price growth.

Aggregate remuneration

During the financial year, the aggregate remuneration paid to all directors was £2.61 million (2011: £5.21 million). This includes salaries, fees, benefits in kind (excluding pensions), and annual bonuses earned and accrued in the year ended 31 March 2012 but paid after the year end. The CEO (Steve Mogford) and CFO (Russ Houlden) were not participants in the 2009/10 LTIP and so neither had any long-term incentive plans due to vest during the year.

Executive directors' emoluments, the value of long-term incentives vested during 2011/12 and payments made by the employer in respect of pensions are set out in the table below. The figures for the year ended 31 March 2011 reflect part-year earnings, as both executive directors joined the company part-way through the year.

Table: Executive directors' emoluments and long-term incentive payments (audited information)

	Gross salary 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		Total emoluments for the year ended 31 March £'000		Long-term incentives vesting 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	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Steve Mogford	650.0	155.5	606.8	183.2	20.8	3.8	1,277.6	342.5	n/a	n/a	143.0	34.2	1,420.6	376.7
Russ Houlden	405.8	200.0	374.1	237.4	24.4	93.8	804.3	531.2	n/a	n/a	89.3	44.0	893.6	575.2

Note:
[1] Total remuneration includes total emoluments for the year, long-term incentives vesting during the year and allowances paid in lieu of pension contributions.

Base salaries

In consideration of the fact that Steve Mogford joined the company in January 2011 the committee decided not to provide a salary increase to him in 2011 and his base salary remained at £650,000. Russ Houlden received an increase of 2.5 per cent effective from 1 September 2011, increasing his base salary from £400,000 to £410,000. This was in recognition of his performance since joining the company, along with consideration of benchmark data and the approach taken in respect of the wider workforce.

The next review date for executive director salaries will be 1 September 2012.

Annual bonus

The performance measures underlying the annual bonus for 2011/12 were selected to ensure the company focused on its strategic objectives. This was done by incorporating a number of the KPIs shown on pages 12 to 13 into the company scorecard element for bonus. The following table summarises the performance measures and bonus outcome for 2011/12 for each of the executive directors:

Table: Annual bonus plan outcome for 2011/12 (as percentage of maximum bonus opportunity)

		Steve Mogford		Russ Houlden	
	Link to company objective	Max.	Actual	Max.	Actual
Financial measures					
Underlying operating profit	Delivering significant efficiencies	30%	18%	20%	12%
Regulatory capital expenditure (spend and outputs)	Growth	20%	19%	20%	19%
Operational measures					
Customer service:	Best service to customers	20%	16%	20%	16%
– Service incentive mechanism (qualitative)					
– Service incentive mechanism (quantitative)					
Sustainability:		20%	10%	20%	10%
– Serviceability	Best service to customers				
– Dow Jones Sustainability Index rating	Responsible manner				
Personal		10%	9%	20%	14%
Total as % bonus maximum		100%	72%	100%	71%
Total as % base salary		130%	93%	130%	92%
Total £'000			£606.8		£374.1

The maximum bonus opportunity for 2012/13 will remain at 130 per cent for executive directors and there will be no changes to the performance measures. The balance of financial, operational and personal measures will be aligned so that the weightings that applied to the CEO in 2011/12 will apply to both the CEO and the CFO in 2012/13. The threshold, intermediate and stretch targets will be established by the committee, making sure that they are sufficiently stretching whilst also recognising the nature and risk profile of the company.

Long-term incentives

Performance conditions

The company currently operates the PSP and MSAP to provide long-term incentives. The performance conditions for long-term incentive plans are focused on two key areas: total shareholder return (50 per cent) and operational performance (50 per cent).

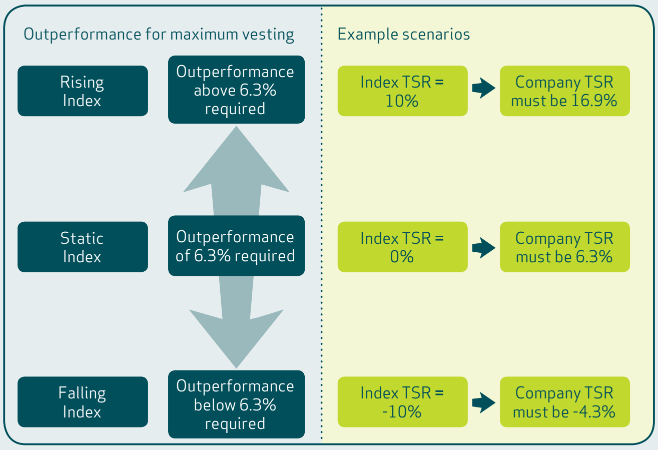
Total shareholder return (TSR)

TSR represents share price growth and reinvested dividends and is compared to returns achieved across a comparator group of companies. Grants are based on a performance condition which measures the company's comparative TSR performance against a TSR index over a period of three financial years, starting with the financial year in which the award is granted. Using an index allows for a meaningful comparison of performance to be made and a smoother sliding scale of vesting of awards. 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 vests if United Utilities' performance falls below the index; 25 per cent of the award vests for performance equal to the index; and 100 per cent of the award vests 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. Any vesting of awards is also subject to the committee being satisfied that the company's recorded TSR performance is consistent with underlying business performance.

Why use a multiplicative approach to TSR?

The multiplicative approach means that general conditions in the index are considered when assessing outperformance. So in a 'rising index', where the values of shares in the index are generally increasing, the outperformance required for maximum vesting on the TSR element will be greater than 6.3 per cent. Similarly, in a 'falling index', where the values of shares in the index are generally declining, the outperformance required for maximum vesting on the TSR element will be less than 6.3 per cent. Essentially, the multiplicative approach means the target isn't made easier or harder by general conditions in the index, as shown in the graphic below.



The composition and weighting of the index for awards made during 2011/12 is shown below. The companies and weightings shown are the same as for grants made since 2008.

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

Directors' remuneration report continued

During the year the committee decided to adjust the comparator group due to the acquisition of Northumbrian Water Group by UK Water (2011) Limited. Northumbrian Water Group (with a weighting of 75) was replaced in the comparator group by Centrica and International Power (each with a weighting of 25). Centrica and International Power were considered to be the closest listed comparators, the reduced weighting reflecting the size and nature of business relative to the company.

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.

Operational performance measures

As disclosed in last year's report, the operational measures applying to the 2011/12 grants focused on outperforming the capital expenditure and operational expenditure regulatory targets over the three-year performance period from 1 April 2011 to 31 March 2014. As stated in an earlier section of the report (page 13) these operational measures are critical to business performance as they measure success against two key elements of our business strategy: outperformance against 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 13)	75%	Cumulative operating expenditure outperformance versus Ofwat's allowed operating costs over the 2011–14 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 outperformance (see page 13)	25%	Cumulative capital expenditure outperformance versus Ofwat's capital expenditure allowance over the 2011–14 period.	100% vesting if stretch outperformance over the performance period is achieved; 50% vesting if Ofwat's capital expenditure allowance over the performance period is achieved; 25% vesting if an overspend of no more than a specified amount compared to Ofwat's capital expenditure allowance over the performance period ('threshold') is achieved; and 0% vesting if threshold is not achieved.

Note:
(1) For performance between the threshold and upper levels, vesting will be on a straight line basis.

Historic performance conditions

The PSP and MSAP matching share awards have a three year performance period. 50 per cent of performance measures for awards made in 2009/10 and 2010/11 are based on operational performance and 50 per cent are based on relative TSR. Further details of performance conditions are given in prior years' reports.

Outcome for 2009/10 long-term incentive awards

The final outcome for 2009/10 PSP and MSAP awards will not be known until the end of July 2012 due to the timing of the availability of the data for one of the operational measures. TSR performance was below that of the index over the three year performance period so the half relating to TSR performance will not vest. The final outcome of the operational performance measures will be disclosed in next year's remuneration report.

Neither of the current executive directors were participants in the 2009/10 long-term incentive plans.

Relative efficiency

Ofwat has now confirmed that not all of the information necessary to produce annual relative efficiency assessments will be available in the public domain. The committee is therefore reviewing the relative efficiency measure for the 2010 PSP and MSAP awards, with a view to incorporating a replacement which is no easier or harder to achieve than the original performance condition.

Performance share plan (PSP)

PSP awards during 2011/12 were 70 per cent of salary for executive directors. The performance conditions which apply to the awards are explained in the section above.

There will be no significant changes to the PSP awards for 2012/13. The same level of awards, and balance of TSR, Opex and Capex performance measures will apply. However, some necessary changes will be made to the Capex measure, which makes up 12.5 per cent of the award. The measure will continue to reward efficient use of Capex by incentivising the achievement of the company's objective of meeting Ofwat's capital expenditure allowance.

Matching share award plan (MSAP)

Both executive directors elected to defer the maximum 54 per cent of gross bonus into the MSAP relating to their bonus for 2010/11. The performance conditions are the same as those explained in the section above for the PSP.

There will be no significant changes to the MSAP awards for 2012/13. The same level of awards, and balance of TSR, Opex and Capex performance measures will apply. The performance conditions applying to MSAP awards will continue to match those applying to the PSP.

Matched share investment scheme (MSIS) for Steve Mogford

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 last year's 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. This will be transferred to him at the end of the five-year retention period on 5 January 2016, subject to him still being employed by the group at that date.

Matched share investment scheme (MSIS) for Russ Houlden

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 last year's report. He invested in shares to the value of £210,000 and a conditional matched award of shares to the value of £210,000 was made to him on 1 October 2010. This will be transferred to him at the end of the five-year retention period on 1 October 2015, subject to him still being employed by the group at that date.

Executive directors' interests in 'ShareBuy'

The company's HM Revenue & Customs (HMRC) approved share incentive plan, 'ShareBuy', is open to all employees. Further details are set out on page 62. 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 2012		
	Award date	End of performance period[2]	Number of shares as at 1 April 2011	Number of shares	Market price of a share at award (p)	Number of shares	Value £'000	Number of shares lapsed during the year	Number of shares	Value £'000	Number of shares as at 31 March 2012
Steve Mogford											
PSP[3]	8.7.11	31.3.14	–	75,020	606.5	3,925	23.3	–	–	–	78,945
MSAP[3]	8.7.11	31.3.14	–	16,313	606.5	853	5.1	–	–	–	17,166
MSIS[4]	27.5.11	5.1.16	–	86,742	622.0	4,539	26.9	–	–	–	91,281
Russ Houlden											
PSP[5]	28.3.11	31.3.13	50,339	–	n/a	2,634	15.6	–	–	–	52,973
PSP[3]	8.7.11	31.3.14	–	46,166	606.5	2,415	14.3	–	–	–	48,581
MSAP[3]	8.7.11	31.3.14	–	21,140	606.5	1,106	6.6	–	–	–	22,246
MSIS[6]	1.10.10	1.10.15	37,377	–	n/a	1,955	11.6	–	–	–	39,332

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 on pages 57 to 58.
(4) Shares under this scheme will be transferred to Steve Mogford on 5 January 2016, subject to him still being employed by the group at that date.
(5) The performance period for this award started on 1 April 2010 and will end on 31 March 2013. Half of the performance measures are based on relative TSR and half are based on operational measures.
(6) Shares under this scheme will be transferred to Russ Houlden on 1 October 2015, subject to him still being employed by the group at that date.

Directors' remuneration report continued

Pensions

During the year ended 31 March 2012, the company paid £232,300 (2011: £346,000) in respect of pensions to the executive directors. Both current executive directors have opted to receive a cash allowance of 22 per cent of base salary in lieu of their defined contribution pension entitlement. The comparative 2011 figure includes £267,400 in pension contributions paid on behalf of the other executive directors in post during that year.

Shareholding obligation

Executive directors are encouraged to build up and retain a target shareholding equal to the value of their base salary, normally within five years of appointment. The table below shows that Steve Mogford has already met this target and that Russ Houlden is on track to meeting the target shareholding within the required time frame.

Executive director	Target shareholding as % of base salary	Shareholding as % of base salary as at 31 March 2012[1]	Date shareholding target should be achieved
Steve Mogford	100%	130%	5.1.16
Russ Houlden	100%	98%	1.10.15

Note:
[1] Excludes unvested shares with performance conditions under the company's share plans, but includes deferred shares under the MSAP and 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 2012 to 31 March 2012 (608 pence per share).

Board appointments and contracts

Changes to the board during the year

Sara Weller was appointed to the board as a non-executive director on 1 March 2012.

Service contracts for executive directors

The company's policy is that the executive directors normally have one-year notice periods. The company may offer a longer notice period if it considers that necessary to recruit a new director. If it offers an initial notice period of more than one year, it will reduce that to a rolling one-year notice period after the initial period has expired. At 31 March 2012, both executive directors had rolling one-year notice periods.

The company retains the right to terminate any executive director's contract by making a payment of a sum equal to 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.

There is no automatic entitlement to payments under the annual bonus or long-term incentives. Any annual bonus payment is at the discretion of the company. The vesting of long-term incentives is at the discretion of the trustee based on a recommendation from the remuneration 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 pro-rated and subject to the performance conditions on which awards were granted (or modified, if appropriate) being satisfied.

The committee will apply such mitigation to any contractual obligations as it considers is fair and reasonable. It will take into account the best practice provisions of the UK Corporate Governance Code (the code) and will take legal advice on the company's liability to pay compensation. The company's policy is to take a robust line on reducing compensation, and it may phase payments for a departing employee in order to mitigate loss. Details of executive directors' contracts as at 31 March 2012 are set out below.

Table: Executive directors' service contracts as at 31 March 2012

Name	Date of contract	Notice period
Steve Mogford	5.1.11	12 months (rolling)
Russ Houlden	1.10.10	12 months (rolling)

Clawback

The service contracts for executive directors include clauses enabling the clawback of payments made under the bonus scheme and long-term incentive arrangements in certain circumstances including fraud or a material error in the financial statements of the company. Full details of the clawback provisions were contained in last year's report, but in summary the actions available to the committee 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.

Outside appointments

The company recognises that its executive directors may be invited to become non-executive directors of companies outside the company and exposure to such non-executive duties can broaden experience and knowledge, which will be to the benefit of the company. Subject to board approval (which will not be given if the proposed appointment is with a competing company, would otherwise lead to a material conflict of interest or could have a detrimental effect on a director's performance), executive directors are allowed to accept one non-executive directorship and to retain the fee. Steve Mogford remains a non-executive director of Carillion PLC for which he receives and retains an annual fee of £48,450.

Non-executive directors

Non-executive directors have letters of appointment, rather than service contracts. In the event of early termination, for any reason, they are not entitled to receive compensation for loss of office. In the company's articles of association the non-executive directors are subject to reappointment at the first AGM after their initial appointment and at an AGM at least every three years thereafter (if they are to be reappointed) although, in line with the code, the board has decided that all non-executive directors should stand for reappointment on an annual basis at every AGM, as was the case in 2011.

The non-executive directors' letters of appointment can be viewed at the company's registered office and on our website, corporate.unitedutilities.com. The letters set out the expected time commitment and non-executives agree to devote sufficient time to meet what is expected of them.

The company's policy is to pay annual fees that reflect the responsibilities placed on the non-executive directors. Fees are reviewed each year when account is taken of the level of fees paid by companies of similar size and complexity. 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. 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.

The remuneration committee approves the remuneration for the Chairman. The fees paid to the Chairman were reviewed during the year and, as a result, the Chairman's fee was increased to £263,400 (from £257,000) with effect from 1 September 2011.

A separate committee of the board decides the remuneration of all of the other non-executive directors. Its members are the Chairman (Dr John McAdam) and the executive directors (Steve Mogford and Russ Houlden). In 2011/12, the committee reviewed the fees paid to non-executive directors, effective 1 September 2011. The base annual fee increased to £57,000 per year (from £55,500). The chairmanship of the audit and risk committee and the treasury committee are held by the same non-executive director (Paul Heiden) and so he receives an additional annual fee of £15,000. The chair of the remuneration committee (David Jones) and the senior independent non-executive director (Nick Salmon) each receive an additional annual fee of £10,000. The chair of the corporate responsibility committee (Catherine Bell) receives an additional annual fee of £5,000. The next review of non-executive directors' fees will be in September 2012.

Non-executive directors' dates of appointment and fees for the year ended 31 March 2012 are set out in the table below.

Table: Non-executive directors' dates of appointment and total fees (audited information)

	Date first appointed to board	Year to 31 March 2012 £'000	Year to 31 March 2011 £'000
Dr John McAdam	4.2.08	260.9	254.4
Dr Catherine Bell	19.3.07	61.4	55.3
Paul Heiden	5.10.05	71.4	68.8
David Jones	3.1.05	66.4	64.9
Andrew Pinder(1)	1.9.01	n/a	16.8
Nick Salmon	4.4.05	66.4	64.9
Sara Weller	1.3.12	4.8	n/a
Total		531.3	525.1

Note:
(1) Andrew Pinder stepped down from the board at the July 2010 AGM.

Directors' share interests

Details of beneficial interests in the company's ordinary shares as at 31 March 2012 held by each of the directors and their connected persons are set out in the table below.

Table: Details of interests in shares held by directors

	At 31 March 2012	At 1 April 2011
Dr John McAdam	1,837	1,837
Dr Catherine Bell	7,000	5,000
Paul Heiden	2,421	2,421
David Jones	3,000	–
Nick Salmon	1,004	1,004
Sara Weller	5,531	n/a
Steve Mogford (1)	95,145	70,814
Russ Houlden(1)	47,441	36,736

Note:
(1) In the period 1 April 2012 to 23 May 2012, additional shares were acquired by Steve Mogford (49 ordinary shares) and Russ Houlden (49 ordinary shares) in respect of their regular monthly contributions to the company's approved share incentive plan 'ShareBuy'.

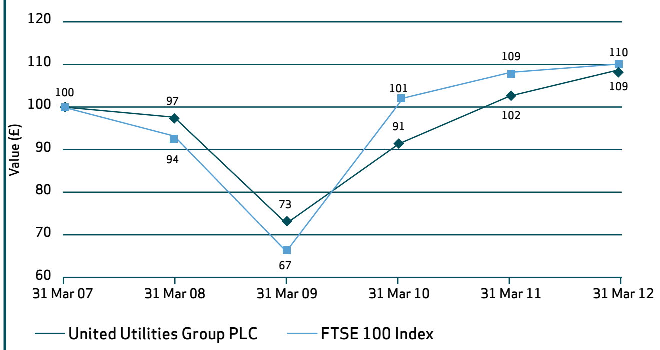
Directors' remuneration report continued

Total shareholder return (TSR) performance

The performance graph 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 was considered to be the most relevant benchmark for comparison purposes.

The TSR indices used in the chart have been calculated relative to a base date of 31 March 2007.

Total shareholder return
Source: Thomson Reuters



This graph shows the value, by 31 March 2012, of £100 invested in United Utilities on 31 March 2007 compared with the value of the FTSE 100 Index. The other points plotted are the values at intervening financial year ends.

Employee share schemes

The board believes that share ownership is an effective way of strengthening employees' involvement in the development of the business and bringing together their interests and those of shareholders. It offers employees the opportunity to build up a shareholding in the company.

The main all-employee scheme is the HMRC approved share incentive plan, 'ShareBuy'. This is a flexible way for employees to acquire shares in the company by buying 'partnership' shares up to the lower of £1,500 or 10 per cent of taxable pay each year. The funds are deducted from pre-taxable pay and passed to an independent trustee who makes a monthly purchase of shares at full market price. Employees can reinvest the dividends on partnership shares to buy more shares under the plan. The company gives one free share for every five partnership shares bought, which need to be held in trust for a five-year term in order to retain the maximum taxation advantages.

As disclosed in previous years, a limited number of senior managers have participated in a deferred share award scheme to facilitate the award of annual performance awards in the form of shares. Shares awarded were released after a waiting period of three years from the date the award was determined, provided that the individual remained employed within the company, with no additional performance conditions. In 2011, the committee decided that shareholder interests would be better represented by a scheme in which performance conditions applied, and so no awards were made under the deferred share award scheme in 2011/12. Instead, awards were granted to a small number of key employees under the PSP, with the same performance conditions as apply to the executive directors albeit with a lower weighing on the TSR element in recognition that they are less able to directly influence TSR performance than executive directors.

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 Services Authority. The report is unaudited except where stated. An ordinary resolution to approve this report will be put to the annual general meeting on 27 July 2012.

The directors' remuneration report was approved by the board of directors on 23 May 2012 and signed on its behalf by:

David Jones
Chair of the remuneration committee

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 23 May 2012 and signed on its behalf by:

Dr John McAdam
Chairman

Russ Houlden
Chief Financial Officer

Financial statements

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 2012, 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 (APB'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 APB's website at:
www.frc.org.uk/apb/scope/private.cfm

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 2012 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
23 May 2012

Consolidated income statement

for the year ended 31 March

	Note	2012 £m	Re-presented* 2011 £m
Continuing operations			
Revenue	1, 2	1,564.9	1,513.3
Employee benefits expense:			
excluding restructuring costs	3	(135.4)	(142.8)
restructuring costs	3	(2.6)	(3.1)
Total employee benefits expense	3	(138.0)	(145.9)
Other reorganisation costs		–	(13.1)
Other operating costs	4	(388.0)	(358.1)
Other income	4	4.8	4.9
Depreciation and amortisation expense	4	(297.8)	(290.5)
Infrastructure renewals expenditure		(154.4)	(130.4)
Total operating expenses		(973.4)	(933.1)
Operating profit	4	591.5	580.2
Investment income	5	4.4	2.8
Finance expense	6	(315.5)	(255.9)
Investment income and finance expense		(311.1)	(253.1)
Profit before taxation		280.4	327.1
Current taxation charge		(45.5)	(34.6)
Deferred taxation charge		(28.1)	(37.0)
Deferred taxation credit – change in taxation rate		104.6	99.0
Taxation	7	31.0	27.4
Profit after taxation from continuing operations		311.4	354.5
Discontinued operations			
Profit after taxation from discontinued operations	8	5.1	103.7
Profit after taxation		316.5	458.2
Earnings per share			
from continuing and discontinued operations			
Basic	9	46.4p	67.2p
Diluted	9	46.4p	67.2p
Earnings per share			
from continuing operations			
Basic	9	45.7p	52.0p
Diluted	9	45.6p	52.0p
Dividend per ordinary share	10	32.01p	30.00p

* The comparatives have been re-presented to include loss on disposal of property, plant and equipment of £2.7 million within other operating costs rather than other income, as previously presented, as this better reflects the nature of the expenditure.

Consolidated statement of comprehensive income

for the year ended 31 March

	Note	2012 £m	2011 £m
Profit after taxation		316.5	458.2
Other comprehensive income			
Actuarial losses on defined benefit pension schemes	20	(24.3)	(44.7)
Net fair value losses on cash flow hedges		–	(0.2)
Revaluation of investments	14	–	1.1
Reclassification from other reserves arising on disposal of financial asset investment	8	–	(6.6)
Reclassification from other reserves arising on disposal of subsidiaries	8	–	1.8
Reclassification from cumulative exchange reserve arising on disposal of subsidiaries	8	–	(26.1)
Taxation on items taken directly to equity	7	4.4	11.7
Foreign exchange adjustments		(1.9)	0.7
Total comprehensive income		294.7	395.9

Consolidated and company statements of financial position

at 31 March

	Note	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
ASSETS					
Non-current assets					
Property, plant and equipment	11	8,644.5	8,274.9	–	–
Goodwill	12	5.0	5.0	–	–
Other intangible assets	13	89.5	93.9	–	–
Investments	14	3.3	2.3	5,600.0	5,600.0
Trade and other receivables	16	1.1	–	–	–
Derivative financial instruments	19	567.5	363.3	–	–
		9,310.9	8,739.4	5,600.0	5,600.0
Current assets					
Inventories	15	47.4	47.6	–	–
Trade and other receivables	16	301.4	296.8	42.9	33.9
Cash and short-term deposits	17	321.2	255.2	–	–
Derivative financial instruments	19	49.9	2.0	–	–
		719.9	601.6	42.9	33.9
Total assets		10,030.8	9,341.0	5,642.9	5,633.9
LIABILITIES					
Non-current liabilities					
Trade and other payables	23	(378.0)	(249.8)	–	–
Borrowings	18	(5,728.1)	(5,203.6)	–	–
Retirement benefit obligations	20	(92.0)	(195.0)	–	–
Deferred tax liabilities	21	(1,245.2)	(1,293.1)	–	–
Provisions	22	(4.0)	(9.3)	–	–
Derivative financial instruments	19	(159.7)	(84.6)	–	–
		(7,607.0)	(7,035.4)	–	–
Current liabilities					
Trade and other payables	23	(447.6)	(433.0)	(14.8)	(2.3)
Borrowings	18	(127.1)	(109.7)	(1,732.1)	(1,502.2)
Current income tax liabilities		(78.1)	(70.5)	–	–
Provisions	22	(6.3)	(14.5)	–	–
Derivative financial instruments	19	(0.1)	(0.4)	–	–
		(659.2)	(628.1)	(1,746.9)	(1,504.5)
Total liabilities		(8,266.2)	(7,663.5)	(1,746.9)	(1,504.5)
Total net assets		1,764.6	1,677.5	3,896.0	4,129.4
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	2.4	1.3	2.4	1.3
Revaluation reserve	24	158.8	158.8	–	–
Cumulative exchange reserve	24	(5.0)	(3.1)	–	–
Capital redemption reserve	24	–	–	1,033.3	1,033.3
Merger reserve	24	329.7	329.7	–	–
Retained earnings	24	778.9	691.0	2,360.5	2,595.0
Shareholders' equity		1,764.6	1,677.5	3,896.0	4,129.4

These financial statements for the group and United Utilities Group PLC (company number: 6559020) were approved by the board of directors on 23 May 2012 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 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

Group	Share capital £m	Share premium account £m	Revaluation reserve £m	Treasury shares £m	Cumulative exchange reserve £m	Merger reserve £m	Other reserves £m	Retained earnings £m	Total £m
At 1 April 2010	499.8	0.9	158.8	(0.1)	22.3	329.7	3.8	492.7	1,507.9
Profit after taxation	–	–	–	–	–	–	–	458.2	458.2
Other comprehensive income									
Actuarial losses on defined benefit pension schemes (see note 20)	–	–	–	–	–	–	–	(44.7)	(44.7)
Net fair value losses on cash flow hedges	–	–	–	–	–	–	(0.2)	–	(0.2)
Revaluation of investments (see note 14)	–	–	–	–	–	–	1.1	–	1.1
Reclassification from other reserves arising on disposal of financial asset investment (see note 8)	–	–	–	–	–	–	(6.6)	–	(6.6)
Reclassification from other reserves arising on disposal of subsidiaries (see note 8)	–	–	–	–	–	–	1.8	–	1.8
Reclassification from cumulative exchange reserve arising on disposal of subsidiaries (see note 8)	–	–	–	–	(26.1)	–	–	–	(26.1)
Taxation on items taken directly to equity (see note 7)	–	–	–	–	–	–	0.1	11.6	11.7
Foreign exchange adjustments	–	–	–	–	0.7	–	–	–	0.7
Total comprehensive (expense)/income	–	–	–	–	(25.4)	–	(3.8)	425.1	395.9
Transactions with owners									
Dividends (see note 10)	–	–	–	–	–	–	–	(225.8)	(225.8)
New share capital issued	–	0.4	–	–	–	–	–	–	0.4
Shares disposed of from employee share trust	–	–	–	0.1	–	–	–	(0.1)	–
Equity-settled share-based payments (see note 27)	–	–	–	–	–	–	–	(0.1)	(0.1)
Exercise of share options	–	–	–	–	–	–	–	(0.8)	(0.8)
At 31 March 2011	499.8	1.3	158.8	–	(3.1)	329.7	–	691.0	1,677.5

FINANCIAL STATEMENTS

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 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

Company	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2010	499.8	0.9	1,033.3	2,609.9	4,143.9
Profit after taxation (see note 24)	–	–	–	211.8	211.8
Total comprehensive income	–	–	–	211.8	211.8
Transactions with owners					
Dividends (see note 10)	–	–	–	(225.8)	(225.8)
New share capital issued	–	0.4	–	–	0.4
Equity-settled share-based payments (see note 27)	–	–	–	(0.1)	(0.1)
Exercise of share options	–	–	–	(0.8)	(0.8)
At 31 March 2011	499.8	1.3	1,033.3	2,595.0	4,129.4

Consolidated and company statements of cash flows

for the year ended 31 March

		Group		Company	
			Re-presented*		
		2012	2011	2012	2011
	Note	£m	£m	£m	£m
Operating activities					
Cash generated from continuing operations	29	727.4	771.9	2.5	235.1
Interest paid		(167.2)	(165.8)	(24.0)	(37.1)
Interest received and similar income		4.4	3.1	–	–
Tax paid		(39.8)	(46.5)	–	–
Tax received		35.0	–	–	2.7
Net cash generated from/(used in) operating activities (continuing operations)		559.8	562.7	(21.5)	200.7
Net cash generated from operating activities (discontinued operations)		–	13.7	–	–
Investing activities					
Proceeds from disposal of discontinued operations	8	3.5	268.4	–	–
Transaction costs, deferred consideration and cash disposed		2.0	(97.9)	–	–
Proceeds from disposal of discontinued operations net of transaction costs, deferred consideration and cash disposed		5.5	170.5	–	–
Purchase of property, plant and equipment		(502.2)	(475.4)	–	–
Purchase of increased shareholding in joint venture		–	(5.0)	–	–
Purchase of other intangible assets		(17.3)	(20.2)	–	–
Proceeds from sale of property, plant and equipment		4.8	9.8	–	–
Grants and contributions received	23	13.0	12.7	–	–
Purchase of investments	14	(2.2)	–	–	–
Net cash used in investing activities (continuing operations)		(498.4)	(307.6)	–	–
Net cash used in investing activities (discontinued operations)		–	(52.7)	–	–
Financing activities					
Proceeds from issue of ordinary shares		1.1	0.4	1.1	0.4
Proceeds from borrowings		446.3	94.1	232.2	24.6
Repayment of borrowings		(231.7)	(88.0)	–	–
Dividends paid to equity holders of the company	10	(209.0)	(225.8)	(209.0)	(225.8)
Exercise of share options – purchase of shares		(0.9)	–	(0.9)	–
Net cash generated from/(used in) financing activities (continuing operations)		5.8	(219.3)	23.4	(200.8)
Net cash used in financing activities (discontinued operations)		–	(4.8)	–	–
Effects of exchange rate changes (continuing operations)		0.5	–	–	–
Effects of exchange rate changes (discontinued operations)		–	(1.3)	–	–
Net increase/(decrease) in cash and cash equivalents (continuing operations)		67.7	35.8	1.9	(0.1)
Net decrease in cash and cash equivalents (discontinued operations)		–	(45.1)	–	–
Cash and cash equivalents at beginning of the year	17	244.4	253.7	(2.4)	(2.3)
Cash and cash equivalents at end of the year	17	312.1	244.4	(0.5)	(2.4)

* The comparatives have been re-presented to show grants and contributions received of £12.7 million separately within investing activities (2011: previously included within decrease in provisions and payables as part of cash generated from continuing operations).

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 2011, has had no material impact on the group's financial statements:

'Improvements to IFRSs (2010)'
This is a collection of amendments to seven standards as part of the International Accounting Standards Board's (IASB) programme of annual improvements. The improvements were issued in May 2010, are effective for periods commencing on or after 1 January 2011 and were endorsed by the EU on 18 February 2011.

IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'
The interpretation addresses the interaction between a minimum funding requirement and the limit placed by IAS 19 on the measurement of the defined benefit asset or liability. The interpretation was issued in July 2007 and amended in November 2009. It is effective for periods commencing on or after 1 January 2011 and was endorsed by the EU on 19 July 2010.

Going concern

The financial statements have been prepared on the going concern basis. The directors have set out factors considered on 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), made up to 31 March each year, 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.

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.

Water and wastewater infrastructure assets

Infrastructure assets comprise a network of water and wastewater 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.

Employee costs incurred in implementing the capital schemes of the group are capitalised within infrastructure assets.

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.

Accounting policies
continued

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). The 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.

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, except where they are designated within a fair value hedge relationship or as fair value through profit or loss. 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.

Borrowings designated within a fair value hedge relationship

Designation is made where it can be demonstrated from inception that a highly effective fair value hedge exists. 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).

j) Inventories

Inventories are stated at cost less any allowance necessary to recognise damage and obsolescence.

Properties held for resale are included at the lower of cost and net realisable value. 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.

Accounting policies
continued

k) Employee benefits

Retirement benefit obligations

The group operates two defined benefit pension schemes, which are independent of the group's finances, for the majority of 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 within 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 in accordance with the advice of an expert. 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. Liabilities for environmental remediation are recognised and capitalised in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' as appropriate, when there is a legal or constructive obligation, environmental assessments indicate that clean-up is probable, and the associated costs can be reliably estimated.

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).

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. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

Operating leases

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 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, customer category and 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 policies
continued

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.

Derivatives and borrowings – hedging
The group's default treatment is that borrowings are carried at amortised cost, whilst associated hedging derivatives are recognised at fair value. This accounting measurement mismatch 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 are designated at fair value through profit or loss where the designation of such borrowings within a fair value hedge relationship is not feasible despite there being a significant fair value offset between the hedged item and the derivative, and where otherwise the inconsistent accounting treatment would result in a significant accounting measurement mismatch.

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.

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. 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', issued in October 2010, 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 other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year, £21.3 million of gains would have been recognised in other comprehensive income rather than within profit or loss.

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 IFRS 7 'Financial Instruments', issued in October 2010, is effective for periods commencing on or after 1 July 2011 and was endorsed by the EU on 22 November 2011. This will have a material impact on the group's financial statements only if it enters into any relevant transactions in the future.

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:

	2012 £m	2011 £m
Provision of goods and services (see note 2)	1,564.9	1,513.3
Revenue	1,564.9	1,513.3
Dividend income (see note 4)	–	0.1
Investment income (see note 5)	4.4	2.8
Total revenue	1,569.3	1,516.2

During the year ended 31 March 2012, £0.9 million of revenue was derived from exchanges of goods or services in relation to IFRIC 18 'Transfers of Assets from Customers' (2011: £0.4 million) (see note 23).

2 SEGMENT REPORTING

As previously reported, United Utilities has reshaped its portfolio over the last few years, from a group with a wide-ranging set of activities and interests, such as telecommunications, business process outsourcing, gas and electricity distribution and metering and international utility operations, into a focused regulated UK water and wastewater business. The group completed its non-regulated disposal programme in November 2010 and the residual non-regulated activities now represent less than two per cent of operating profit.

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 the segmental information presented in previous years is no longer required to be disclosed separately within this note.

Segmental information in respect of discontinued operations in the prior year is given in note 8.

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

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

			Continuing operations			*Discontinued operations*	*Total*
2011	UK £m	Rest of world £m	Total £m	UK £m	Rest of world £m	Total £m	Group £m
External revenue	1,496.2	17.1	1,513.3	296.3	57.1	353.4	1,866.7
Non-current assets*	8,321.1	55.0	8,376.1	–	–	–	8,376.1

* Non-current assets exclude financial instruments.

The group does not rely on any major customers.

3 DIRECTORS AND EMPLOYEES

Directors' remuneration

	2012 £m	Restated* 2011 £m
Fees to non-executive directors	0.5	0.5
Salaries	1.1	1.4
Benefits	0.3	0.2
Bonus	1.0	2.2
Post-employment benefits	–	0.3
Share-based payment charge	0.3	–
	3.2	4.6

* The comparatives have been restated to include post-employment benefits of £0.3 million and an increase in benefits of £0.1 million in respect of payments in lieu of pension contributions.

Further information about the remuneration of individual directors and details of their pension arrangements are provided in the directors' remuneration report on pages 51 to 62.

Remuneration of key management personnel

	2012 £m	Restated* 2011 £m
Salaries and short-term employee benefits	6.0	6.7
Post-employment benefits	0.2	0.5
Share-based payment charge	0.7	–
	6.9	7.2

* The comparatives have been restated to include an increase in benefits of £0.1 million in respect of payments in lieu of pension contributions.

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

Employee benefits expense (including directors)

Group	2012 £m	2011 £m
Continuing operations		
Wages and salaries	194.7	174.6
Social security costs	15.8	13.4
Post-employment benefits excluding restructuring costs	17.5	17.1
Charged to capital schemes*	(92.6)	(62.3)
Employee benefits expense excluding restructuring costs	135.4	142.8
Restructuring costs	2.6	3.1
Employee benefits expense attributable to continuing operations	138.0	145.9
Less: employee benefits expense attributable to joint ventures	(1.8)	(1.9)
Total employee benefits expense excluding joint ventures	136.2	144.0

* Central functional employee costs were recharged across the group in the prior year and capitalised indirectly, to the extent appropriate, from other operating costs. Following completion of the non-regulated disposal programme, such costs are now charged to capital schemes directly from employee costs. This has resulted in an increase in capitalisation associated with employee benefits expense, previously included within 'other' in other operating costs.

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

	2012 £m	2011 £m
Defined benefit pension expense – current service cost (see note 20)	13.3	11.9
Defined contribution pension costs (see note 20)	4.2	5.2
	17.5	17.1

Notes to the financial statements

continued

3 DIRECTORS AND EMPLOYEES CONTINUED

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

	2012 number	2011 number
Continuing operations	5,096	4,735

The average number of employees during the prior year for discontinued operations is analysed as follows:

	2011 number
Non-regulated activities	1,656

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:

	2012 £m	Re-presented* 2011 £m
Other operating costs		
Hired and contracted services	130.6	166.8
Materials	55.4	45.3
Power	50.3	49.1
Property rates	79.4	65.1
Charge for bad and doubtful receivables (see note 16)	34.5	30.6
Other operating leases payable:		
Property	3.3	4.9
Plant and equipment	0.8	0.8
Amortisation of deferred grants and contributions (see note 23)	(6.9)	(6.9)
Research and development expenses	1.6	0.9
Loss on disposal of property, plant and equipment	5.5	2.7
Loss on disposal of other intangible assets	2.6	2.8
Other	30.9	(4.0)
	388.0	358.1
Other income		
Dividend income	–	(0.1)
Other income	(4.8)	(4.8)
	(4.8)	(4.9)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment: owned assets	278.0	258.3
Amortisation of other intangible assets	19.8	32.2
	297.8	290.5

* The comparatives have been re-presented to include loss on disposal of property, plant and equipment of £2.7 million within other operating costs rather than within other income, as previously presented, as this better reflects the nature of the expenditure. In addition, loss on disposal of other intangible assets of £2.8 million in the prior year has been shown separately (2011: previously presented within other).

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

	2012 £m	2011 £m
Statutory audit of the financial statements	0.1	0.3
Other fees to the auditor:		
Local statutory audits for subsidiaries	0.1	0.2
Other audit related	–	0.1
Taxation advisory services	0.1	–
Regulatory reporting	0.1	0.1
Due diligence and transaction support	–	0.6
	0.4	1.3

The 2010/11 costs of £1.3 million relate to services provided by the group's previous auditor, Deloitte LLP. There have been no audit fees paid to Deloitte LLP during the year other than those relating to the 2011 settlement.

5 INVESTMENT INCOME

	2012 £m	2011 £m
Interest receivable on short-term bank deposits held at amortised cost	4.4	2.8

6 FINANCE EXPENSE

	2012 £m	2011 £m
Interest payable		
Interest payable on borrowings held at amortised cost	269.0	271.0
Intercompany interest – payable to discontinued operations	–	0.3
	269.0	271.3
Fair value losses/(gains) on debt and derivative instruments(1)		
Fair value hedge relationships:		
Borrowings	210.0	(20.2)
Designated swaps	(205.0)	11.1
	5.0	(9.1)
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss(2)	19.1	(0.8)
Held for trading derivatives – economic hedge	(47.9)	1.1
	(28.8)	0.3
Held for trading derivatives – 2005–10 regulatory hedges	–	(7.3)
Held for trading derivatives – 2010–15 regulatory hedges	54.4	1.4
Held for trading derivatives – regulatory hedges >2015	18.2	–
Held for trading derivatives – electricity hedges	4.6	–
Net receipts on swaps and debt under fair value option	(7.7)	(6.2)
Held for trading derivatives – other(3)	(1.6)	(3.1)
Other	(0.9)	4.8
	67.0	(10.4)
Net fair value losses/(gains) on debt and derivative instruments(4)	43.2	(19.2)
Expected return on pension schemes' assets (see note 20)	(100.5)	(102.2)
Interest cost on pension schemes' obligations (see note 20)	103.8	106.0
Net pension interest expense	3.3	3.8
	315.5	255.9

Notes:

(1) Fair value losses/(gains) on debt and derivative instruments includes foreign exchange gains of £22.3 million (2011: £15.2 million), excluding those on instruments measured at fair value through profit or loss. These gains are largely offset by fair value losses on derivatives.

(2) Includes £21.3 million gains (2011: £4.1 million losses) 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 £7.2 million income (2011: £5.7 million) due to interest swaps and debt under fair value option.

Interest payable for the year ended 31 March 2012 is stated net of £9.7 million (2011: £4.4 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 4.8 per cent (2011: 4.6 per cent) to expenditure on such assets as prescribed by IAS 23 (Revised 2007) 'Borrowing Costs'.

Notes to the financial statements
continued

7 TAXATION

	2012 £m	2011 £m
Continuing operations		
Current taxation		
UK corporation tax	60.1	61.8
Foreign tax	1.3	1.9
Adjustments in respect of prior years	(15.9)	(29.1)
Total current taxation charge for the year	45.5	34.6
Deferred taxation		
Current year	12.6	25.7
Adjustments in respect of prior years	15.5	11.3
	28.1	37.0
Change in taxation rate	(104.6)	(99.0)
Total deferred taxation credit for the year	(76.5)	(62.0)
Total taxation credit for the year	(31.0)	(27.4)

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

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

	Continuing operations		*Discontinued operations*		*Total*	
	2011 £m	2011 %	2011 £m	2011 %	2011 £m	2011 %
Profit before taxation	327.1		23.8		350.9	
Taxation at the UK corporation tax rate of 28 per cent	91.6	28.0	6.7	28.0	98.3	28.0
Adjustments in respect of prior years	(17.8)	(5.4)	1.8	7.6	(16.0)	(4.5)
Change in taxation rate	(99.0)	(30.3)	0.9	3.8	(98.1)	(28.0)
Net income not taxable/other	(2.2)	(0.7)	(0.2)	(0.8)	(2.4)	(0.7)
Total taxation (credit)/charge and effective tax rate for the year	(27.4)	(8.4)	9.2	38.6	(18.2)	(5.2)

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.

The deferred taxation credit for the year ended 31 March 2011 includes £99.0 million, which reflects both the change enacted on 27 July 2010 to reduce the mainstream rate of corporation tax from 28 per cent to 27 per cent and the subsequent change enacted on 29 March 2011 to reduce the mainstream rate of corporation tax from 27 per cent to 26 per cent effective from 1 April 2011.

There will be a further phased reduction in the mainstream rate of corporation tax to 22 per cent by 1 April 2014. The total deferred taxation credit in respect of this further reduction is expected to be in the region of £100.0 million.

The adjustments in respect of prior years of £0.4 million credit (2011: £17.8 million) relate to agreement of prior years' UK taxation matters.

Taxation on items taken directly to equity

Continuing operations	2012 £m	2011 £m
Current taxation		
Relating to other pension movements	(33.1)	–
Deferred taxation (see note 21)		
On actuarial losses on defined benefit pension schemes	(5.8)	(11.6)
Relating to other pension movements	30.6	–
Change in taxation rate	3.9	–
On net fair value losses on cash flow hedges	–	(0.1)
	28.7	(11.7)
Total taxation credit on items taken directly to equity	(4.4)	(11.7)

8 DISCONTINUED OPERATIONS

During the prior year, the group completed its non-regulated disposal programme which, including 2009/10 investment disposals, achieved a total enterprise value of £579.2 million. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', the relevant disposal groups were therefore classified as discontinued operations in the consolidated income statement and consolidated statement of cash flows.

	2012 £m	2011 £m
Revenue	–	353.4
Employee benefits expense:		
Excluding restructuring costs	–	(88.6)
Restructuring costs	–	(3.8)
Total employee benefits expense	–	(92.4)
Other reorganisation credits	–	7.0
Other operating costs	–	(225.9)
Depreciation and amortisation expense	–	(6.3)
Operating profit	–	35.8
Investment income and finance expense	–	(7.0)
Evaluation and disposal costs relating to discontinued operations	–	(5.0)
Profit before taxation	–	23.8
Current taxation charge	–	(1.8)
Deferred taxation charge	–	(7.4)
Taxation	–	(9.2)
Profit after taxation	–	14.6
Profit on disposal of discontinued operations after taxation	5.1	89.1
Total profit after taxation from discontinued operations	5.1	103.7

Notes to the financial statements
continued

8 DISCONTINUED OPERATIONS CONTINUED

The net assets and liabilities at disposal and the profit on disposal of discontinued operations after taxation is analysed as follows:

	2012 £m	2011 £m
Total proceeds*	3.5	268.4
Property, plant and equipment	–	(176.7)
Goodwill (see note 12)	–	(17.9)
Other intangible assets	–	(119.6)
Investments (see note 14)	–	(6.6)
Non-current trade and other receivables	–	(59.4)
Inventories	–	(11.7)
Current trade and other receivables	–	(203.1)
Cash and short-term deposits	–	(50.0)
Trade and other payables	–	230.8
Joint venture debt	–	228.7
Provisions (see note 22)	–	17.9
Retirement benefit obligations (see note 20)	(0.4)	7.3
Deferred taxation assets (see note 21)	–	(4.0)
Net assets disposed of	(0.4)	(164.3)
Transaction and other costs of disposal	2.0	(45.9)
Reclassification from other reserves arising on disposal of financial asset investment	–	6.6
Reclassification from other reserves arising on disposal of subsidiaries	–	(1.8)
Reclassification from cumulative exchange reserve arising on disposal of subsidiaries	–	26.1
Profit on disposal of discontinued operations after taxation	5.1	89.1

* Total fair value of the 2010/11 proceeds comprised cash of £268.4 million. The enterprise value of £447.1 million incorporates cash consideration received added to the market value of the net debt disposed of which, at the date of disposal, totalled £178.7 million. Combined with the cash consideration received from the disposal of investments in 2009/10 of £132.1 million, the non-regulated disposal programme achieved a total enterprise value of £579.2 million.

The profit on disposal of discontinued operations after taxation for the year ended 31 March 2012 relates primarily to the receipt of contingent consideration and the release of accrued costs of disposal in respect of certain elements of the group's prior year non-regulated disposal programme.

9 EARNINGS PER SHARE

	2012 £m	2011 £m
Profit after taxation attributable to equity holders of the company – continuing and discontinued operations	316.5	458.2
Adjustment for profit after taxation from discontinued operations (see note 8)	(5.1)	(103.7)
Profit after taxation attributable to equity holders of the company – continuing operations	311.4	354.5

	2012 pence	2011 pence
Earnings per share from continuing and discontinued operations		
Basic	46.4	67.2
Diluted	46.4	67.2
Earnings per share from continuing operations		
Basic	45.7	52.0
Diluted	45.6	52.0
Earnings per share from discontinued operations		
Basic	0.7	15.2
Diluted	0.8	15.2

Basic earnings per share is calculated by dividing profit for the financial year attributable to equity holders of the company by 681.8 million, being the weighted average number of shares in issue during the year (2011: 681.6 million). Diluted earnings per share is calculated by dividing profit for the financial year attributable to equity holders of the company by 682.2 million, being the weighted average number of shares in issue during the year including dilutive shares (2011: 681.9 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:

	2012 million	2011 million
Average number of ordinary shares – basic	681.8	681.6
Effect of potential dilutive ordinary shares – share options	0.4	0.3
Average number of ordinary shares – diluted	682.2	681.9

10 DIVIDENDS

	2012 £m	2011 £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 2011 at 20.00 pence per share (2010: 23.13 pence)	136.3	157.6
Interim dividend for the year ended 31 March 2012 at 10.67 pence per share (2011: 10.00 pence)	72.7	68.2
	209.0	225.8
Proposed final dividend for the year ended 31 March 2012 at 21.34 pence per share (2011: 20.00 pence)	145.5	136.3

The proposed final dividends for the years ended 31 March 2012 and 31 March 2011 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 2012 and 31 March 2011 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 2010	232.9	3,734.6	4,813.8	603.0	850.5	10,234.8
Additions	14.4	126.2	59.6	36.9	332.8	569.9
Transfers	4.2	84.0	323.1	12.4	(423.7)	–
Disposals	(3.3)	(67.7)	(33.0)	(224.7)	(13.6)	(342.3)
Currency translation differences	–	(3.0)	–	0.3	(0.1)	(2.8)
At 31 March 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
Accumulated depreciation						
At 1 April 2010	74.7	177.4	1,525.9	297.2	–	2,075.2
Charge for the year	8.1	26.6	187.4	41.6	–	263.7
Disposals	(2.8)	(31.8)	(26.8)	(91.5)	–	(152.9)
Currency translation differences	–	(1.5)	–	0.2	–	(1.3)
At 31 March 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
Net book value at 31 March 2012	164.9	3,949.4	3,461.3	185.5	883.4	8,644.5
Net book value at 31 March 2011	168.2	3,703.4	3,477.0	180.4	745.9	8,274.9

At 31 March 2012, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £331.8 million (2011: £241.7 million).

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

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 2012 or 31 March 2011.

On 1 October 2011, the ownership of, and responsibility for, private sewer assets was transferred to the group at £nil fair value.

12 GOODWILL

Group	£m
Cost	
At 1 April 2010	2.5
Additions	20.4
Disposals (see note 8)	(17.9)
At 31 March 2011 and 31 March 2012	5.0

Goodwill at 31 March 2012 and 31 March 2011 relates to the group's shareholding in AS Tallinna Vesi (Tallinn Water).

The company has no goodwill.

13 OTHER INTANGIBLE ASSETS

Group	Computer software £m	Service concessions £m	Other £m	Total £m
Cost				
At 1 April 2010	216.1	127.8	23.8	367.7
Additions – purchased	18.3	21.5	0.8	40.6
Disposals	(1.3)	(149.6)	(14.2)	(165.1)
Currency translation differences	–	0.3	(0.2)	0.1
At 31 March 2011	233.1	–	10.2	243.3
Additions – purchased	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
Amortisation				
At 1 April 2010	114.2	33.0	11.9	159.1
Charge for the year	32.0	0.7	0.4	33.1
Disposals	(0.1)	(33.7)	(8.9)	(42.7)
Currency translation differences	–	–	(0.1)	(0.1)
At 31 March 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
Net book value at 31 March 2012	83.1	–	6.4	89.5
Net book value at 31 March 2011	87.0	–	6.9	93.9

The 'other' intangible assets category relates mainly to customer contracts and customer lists. The service concession assets related to operations which were sold as part of the non-regulated activities disposal programme during the prior year (see note 8).

At 31 March 2012, the group had entered into contractual commitments for the acquisition of other intangible assets amounting to £63.6 million (2011: £43.9 million).

The company has no other intangible assets. The company had no contractual commitments for the acquisition of other intangible assets at 31 March 2012 or 31 March 2011.

14 INVESTMENTS

Group	Other investments £m
At 1 April 2010	7.7
Additions	0.1
Revaluations	1.1
Disposals (see note 8)	(6.6)
At 31 March 2011	2.3
Additions	2.2
Disposals	(1.1)
Currency translation differences	(0.1)
At 31 March 2012	3.3

At 31 March 2012, the group's other investments mainly comprised of its investment in Muharraq Holding Company 1 Limited and its preference shares in Philwater Holdings Company Inc.

Notes to the financial statements

continued

14 INVESTMENTS CONTINUED

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 2011.

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	2012 £m	2011 £m
Non-current assets	49.1	52.4
Current assets	16.6	15.2
Non-current liabilities	(27.9)	(30.0)
Current liabilities	(6.7)	(6.7)
	31.1	30.9

Group share of joint ventures	2012 £m	2011 £m
Gross income	15.7	121.1
Expenses	(8.1)	(94.8)
Taxation	(1.3)	(2.4)
Profit after taxation	6.3	23.9

Included within the prior year joint venture income statement measures disclosed in the table above are gross income of £108.3 million, expenses of £89.3 million and taxation of £0.5 million relating to entities that were disposed of during the year ended 31 March 2011 and hence were recorded within the results for discontinued operations (see note 8).

The joint ventures have no significant contingent liabilities to which the group is exposed and the group has issued guarantees of £5.4 million to its joint ventures (2011: £5.9 million) which are included in the contingent liabilities total disclosed in note 30.

Company	Shares in subsidiary undertakings £m
Cost	
At 1 April 2010, 31 March 2011 and 31 March 2012	6,326.8
Impairment	
At 1 April 2010, 31 March 2011 and 31 March 2012	(726.8)
Net book value at 31 March 2011 and 31 March 2012	5,600.0

During the year ended 31 March 2012, 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	2012 £m	2011 £m
Properties held for resale	42.3	42.9
Other inventories	5.1	4.7
	47.4	47.6

The company has no inventories.

16 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Trade receivables	260.5	243.5	–	–
Less: allowance for doubtful receivables	(78.4)	(55.2)	–	–
Trade receivables net	182.1	188.3	–	–
Amounts owed by subsidiary undertakings	–	–	42.9	33.9
Amounts owed by related parties (see note 28)	1.0	2.7	–	–
Other debtors	15.8	15.6	–	–
Prepayments and accrued income	103.6	90.2	–	–
	302.5	296.8	42.9	33.9

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Non-current	1.1	–	–	–
Current	301.4	296.8	42.9	33.9
	302.5	296.8	42.9	33.9

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

Group	2012 £m	2011 £m
At the start of the year	55.2	206.6
Amounts charged to operating expenses – continuing operations	34.5	30.6
Amounts charged to operating expenses – discontinued operations	–	2.0
Trade receivables written off	(11.3)	(170.1)
Disposed of during the year	–	(13.9)
At the end of the year	78.4	55.2

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.

During the year ended 31 March 2011, £131.1 million of debt was written off as a result of a detailed review of the group's trade receivables balance. This debt was significantly provided; therefore, the charge for bad and doubtful receivables in the prior year as a result of this exercise was a lower amount of £2.5 million.

Notes to the financial statements
continued

16 TRADE AND OTHER RECEIVABLES CONTINUED

Ageing of gross receivables

The following table provides information regarding the ageing of gross receivables:

Group 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 – gross	139.7	55.2	65.6	260.5
Amounts owed by related parties	1.0	–	–	1.0
Other debtors	15.4	–	0.4	15.8
Prepayments and accrued income	103.6	–	–	103.6

At 31 March 2011	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 – gross	147.2	43.4	52.9	243.5
Amounts owed by related parties	2.5	0.1	0.1	2.7
Other debtors	15.6	–	–	15.6
Prepayments and accrued income	90.2	–	–	90.2

The group manages its regulated bad debt risk by providing against gross trade receivables. This allowance is calculated by reference to customer categories rather than solely on the age profile of gross debtor balances. It is therefore not possible to age the allowance for doubtful receivables.

Company 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
Amounts owed by subsidiary undertakings – gross	42.9	–	–	42.9

At 31 March 2011	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
Amounts owed by subsidiary undertakings – gross	33.9	–	–	33.9

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 (2011: £nil).

The directors consider that the carrying amount of trade and other receivables approximates to their fair value at 31 March 2012 and 31 March 2011.

17 CASH AND CASH EQUIVALENTS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash at bank and in hand	12.4	17.3	–	–
Short-term bank deposits	308.8	237.9	–	–
Cash and short-term deposits	321.2	255.2	–	–
Bank overdrafts (included in borrowings, see note 18)	(9.1)	(10.8)	(0.5)	(2.4)
Cash and cash equivalents in the statement of cash flows	312.1	244.4	(0.5)	(2.4)

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	2012 £m	2011 £m
Non-current liabilities		
Bonds	4,491.1	4,208.5
Bank and other term borrowings	1,237.0	995.1
	5,728.1	5,203.6
Current liabilities		
Bonds	7.0	–
Bank and other term borrowings	111.0	98.9
Bank overdrafts (see note 17)	9.1	10.8
	127.1	109.7
	5,855.2	5,313.3

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 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
Borrowings in fair value hedge relationships						
5.625% 300m bond	GBP	2027	340.9	377.8	310.2	327.7
5.75% 375m bond	GBP	2022	430.4	421.6	390.7	371.6
5.375% 150m bond	GBP	2018	177.1	176.1	163.8	162.8
5.00% 200m bond	GBP	2035	202.1	244.6	186.3	208.2
4.25% 500m bond	EUR	2020	460.1	471.7	436.2	452.0
4.55% 250m bond	USD	2018	163.6	179.2	155.4	165.2
5.375% 350m bond	USD	2019	235.0	262.8	225.0	242.4
5.02% JPY 10bn dual currency loan	JPY/USD	2029	76.7	95.6	73.5	87.9
Borrowings designated at fair value through profit or loss						
6.875% 400m bond	USD	2028	283.3	283.3	264.3	264.3
1.135% 3bn bond	JPY	2013	22.6	22.6	22.5	22.5
Borrowings measured at amortised cost						
1.5802%+RPI 100m IL bond	GBP	2042	116.7	122.1	102.8	116.3
1.7829%+RPI 100m IL bond	GBP	2040	123.6	122.5	109.5	116.7
1.9799%+RPI 100m IL bond	GBP	2035	128.3	123.8	115.3	117.9
3.375%+RPI 50m IL bond	GBP	2032	86.3	65.8	79.1	62.6
1.3258%+RPI 50m IL bond	GBP	2041	55.1	61.1	48.5	58.2
1.397%+RPI 50m IL bond	GBP	2046	55.4	61.1	48.2	58.2
1.3805%+RPI 35m IL bond	GBP	2056	36.5	41.7	28.5	40.1
1.435%+RPI 50m IL bond	GBP	2056	53.1	59.6	41.6	57.3
1.556%+RPI 50m IL bond	GBP	2056	55.6	59.8	43.5	57.5
1.5865%+RPI 50m IL bond	GBP	2056	56.2	60.1	43.7	57.8
1.591%+RPI 25m IL bond	GBP	2056	28.0	30.0	21.8	28.8
1.662%+RPI 100m IL bond	GBP	2056	115.2	120.3	89.7	115.7
1.815%+RPI 100m IL bond	GBP	2056	121.1	120.5	94.3	115.9
1.847%+RPI 100m IL bond	GBP	2056	123.0	121.0	95.4	116.4
1.5366%+RPI 50m IL bond	GBP	2043	58.1	60.9	51.0	58.0
1.7937%+RPI 50m IL bond	GBP	2049	61.3	60.8	55.8	57.9
1.585%+RPI 100m IL bond	GBP	2057	108.2	115.7	87.3	111.3
1.702%+RPI 50m IL bond	GBP	2057	56.8	58.4	45.6	56.1
2.40%+RPI 70m IL bond	GBP	2039	89.1	78.1	73.8	75.1
1.66%+RPI 35m IL bond	GBP	2037	39.3	40.1	31.7	38.6
1.97%+RPI 200m IL loan	GBP	2016	255.4	240.5	207.0	228.5
1.61%+RPI 50m IL loan	GBP	2020	61.7	54.9	51.5	52.8
1.73%+RPI 50m IL loan	GBP	2020	62.2	54.8	52.0	52.7
1.84%+RPI 50m IL loan	GBP	2020	62.6	54.8	52.4	52.7
1.88%+RPI 50m IL loan	GBP	2020	62.6	54.6	52.7	52.5
1.90%+RPI 50m IL loan	GBP	2020	62.9	54.7	52.8	52.6
1.93%+RPI 50m IL loan	GBP	2020	62.9	54.6	52.9	52.6
2.10%+RPI 50m IL loan	GBP	2020	63.6	54.5	53.7	52.4
2.46%+RPI 50m IL loan	GBP	2020	65.4	54.5	55.3	52.5
1.23%+RPI 50m IL loan	GBP	2029	49.4	52.0	42.9	50.0
1.29%+RPI 50m IL loan	GBP	2029	49.8	51.6	–	–
1.12%+RPI 50m IL loan	GBP	2029	48.0	51.3	–	–
1.10%+RPI 50m IL loan	GBP	2029	47.8	51.2	–	–
0.75%+RPI 50m IL loan	GBP	2029	43.9	50.1	–	–
0.76%+RPI 50m IL loan	GBP	2030	43.7	49.9	–	–
1.15%+RPI 50m IL loan	GBP	2030	46.5	49.7	–	–
1.11%+RPI 50m IL loan	GBP	2030	45.2	49.9	–	–

Group	Currency	Year of final repayment	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
Borrowings measured at amortised cost continued						
6.125% 425m bond	GBP	2015	489.7	429.7	472.3	430.9
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	6.5	7.0	6.5	6.7
1.30%+LIBOR (floating) 5bn bond	JPY	2017	40.9	38.3	41.0	37.8
Long-term bank borrowings – floating	GBP	2011-2012	-	-	199.9	200.0
Commission for New Towns loan – fixed	GBP	2053	53.1	30.1	49.9	30.4
Joint venture borrowings	Various	Various	27.9	27.9	30.1	30.1
Short-term bank borrowings – fixed	GBP	2012	110.8	110.8	46.3	46.3
Other borrowings						
Bank overdrafts	GBP	2012	9.1	9.1	10.8	10.8
			5,830.3	5,855.2	5,065.0	5,313.3

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	2012 £m	2011 £m
Current liabilities		
Bank overdrafts (see note 17)	0.5	2.4
Amounts owed to subsidiary undertakings	1,731.6	1,499.8
	1,732.1	1,502.2

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.

The group's exposure to risk and its objectives, policies and processes for managing risk and the methods used for measuring risk have changed since the prior year in respect of inflation, interest rate and electricity price risk, which is discussed in the respective sections below.

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 2012, the group had £991.2 million (2011: £1,184.6 million) of available liquidity, which comprised £321.2 million (2011: £255.2 million) cash and short-term deposits and £670.0 million (2011: £929.4 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	2012 £m	2011 £m
Expiring within one year	250.0	375.0
Expiring after one year but in less than two years	220.0	250.0
Expiring after more than two years	200.0	320.0
Total borrowing facilities	670.0	945.0
Offsetting bank guarantees	–	(15.6)
Undrawn borrowing facilities	670.0	929.4

At 31 March 2012, the group had an additional committed borrowing facility of £50.0 million expiring after more than two years that was not available to be drawn until 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.

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 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)

At 31 March 2011	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	10,119.2		166.3	173.9	191.8	169.0	595.0	8,823.2
Bank and other term borrowings	1,564.5		133.6	174.4	35.7	24.6	29.7	1,166.5
Adjustment to carrying value[2]	(6,370.4)	(6,370.4)						
Financial liabilities excluding derivatives and trade and other payables at amortised cost	5,313.3	(6,370.4)	299.9	348.3	227.5	193.6	624.7	9,989.7
Derivatives:								
Payable	1,085.9		89.8	69.7	80.5	52.8	47.4	745.7
Receivable	(1,439.7)		(116.4)	(101.6)	(145.2)	(88.0)	(56.6)	(931.9)
Adjustment to carrying value[2]	73.5	73.5						
Derivatives – net assets	(280.3)	73.5	(26.6)	(31.9)	(64.7)	(35.2)	(9.2)	(186.2)

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 £1,732.1 million (2011: £1,502.2 million), which are payable within one year.

Credit risk

Credit risk arises principally from trade finance (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 trade finance 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).

Notes to the financial statements
continued

19 FINANCIAL INSTRUMENTS CONTINUED

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	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and short-term deposits (see note 17)	321.2	255.2	–	–
Trade and other receivables (see note 16)	302.5	296.8	42.9	33.9
Investments (see note 14)	3.3	2.3	–	–
Derivative financial instruments	617.4	365.3	–	–
	1,244.4	919.6	42.9	33.9

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2012, the group held £110.8 million (2011: £46.3 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 risks primarily result from its financing arrangements and the economic return which it is allowed on the regulatory capital value (RCV).

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

Inflation risk

The group earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. 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. During the prior year, a revised pension scheme funding mechanism was introduced so 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:

	2012 £m	2011 £m
Index-linked debt	2,667.0	2,215.7

Sensitivity analysis

As required by IFRS 7, the sensitivity analysis has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2012 and 31 March 2011, 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:

Impact on profit before taxation and equity	2012 £m	2011 £m
1 per cent increase in RPI	(27.2)	(22.6)
1 per cent decrease in RPI	27.2	22.6

Brackets denote a reduction in profit.

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 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.

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. During the year, the group revised its interest risk management strategy to now extend the fixing of 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.

Notes to the financial statements
continued

19 FINANCIAL INSTRUMENTS CONTINUED

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	
	2012	2011	2012	2011
Impact on profit before taxation and equity	£m	£m	£m	£m
1 per cent increase in interest rate	83.2	61.3	(17.3)	(15.0)
1 per cent decrease in interest rate	(87.7)	(64.0)	17.3	15.0

Brackets denote a reduction in profit.

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.

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 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

Group At 31 March 2011	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	2,017.8	–	–	–	–	–	2,017.8
Effect of swaps	–	2,017.8	–	–	–	–	(2,017.8)
	2,017.8	2,017.8	–	–	–	–	–
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	286.8	–	–	22.5	–	–	264.3
Effect of swaps	–	286.8	–	(22.5)	–	–	(264.3)
	286.8	286.8	–	–	–	–	–
Borrowings measured at amortised cost							
Fixed rate instruments	507.6	46.6	0.3	0.3	0.3	431.3	28.8
Floating rate instruments	285.4	285.4	–	–	–	–	–
Index-linked instruments	2,215.7	2,215.7	–	–	–	–	–
	3,008.7	2,547.7	0.3	0.3	0.3	431.3	28.8
Effect of a fixed interest rate hedge	–	(1,831.3)	–	–	1,381.3	450.0	–
Total borrowings	5,313.3	3,021.0	0.3	0.3	1,381.6	881.3	28.8
Cash and short-term deposits	(255.2)	(255.2)	–	–	–	–	–
Net borrowings	5,058.1	2,765.8	0.3	0.3	1,381.6	881.3	28.8

Company	2012 Total £m	2012 1 year or less £m	2011 Total £m	2011 1 year or less £m
Borrowings measured at amortised cost				
Floating rate instruments	1,732.1	1,732.1	1,502.2	1,502.2
Total borrowings	1,732.1	1,732.1	1,502.2	1,502.2

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.

During the year, the group extended its hedging policy, through the use of 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. Previously, the group had fixed electricity prices for up to two years directly with its energy supplier.

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.

Impact on profit before taxation and equity	2012 £m
10 per cent increase in commodity prices	4.3
10 per cent decrease in commodity prices	(4.3)

Brackets denote a reduction in profit.

Notes to the financial statements

continued

19 FINANCIAL INSTRUMENTS CONTINUED

Currency risk

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

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

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

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

Capital risk management

The group's objective when managing capital is to maintain 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.

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 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
Financial assets				
Non-current assets				
Available for sale investments	2.5	2.5	1.4	1.4
Loans and receivables:				
Investments	0.8	0.8	0.9	0.9
Trade and other receivables	1.1	1.1	–	–
Derivative financial instruments:				
Fair value hedge derivatives – swaps	434.3	434.3	280.0	280.0
Held for trading derivatives – swaps[2]	133.2	133.2	83.3	83.3
Current assets				
Loans and receivables:				
Trade and other receivables	301.4	301.4	296.8	296.8
Cash and short-term deposits	321.2	321.2	255.2	255.2
Derivative financial instruments:				
Fair value hedge derivatives – swaps	48.4	48.4	–	–
Held for trading derivatives – swaps[2]	1.5	1.5	2.0	2.0
Financial liabilities				
Non-current liabilities				
Trade and other payables at amortised cost	(378.0)	(378.0)	(249.8)	(249.8)
Borrowings:				
Financial liabilities in hedge relationships:				
Fair value hedge	(2,085.9)	(2,229.4)	(1,941.1)	(2,017.8)
Financial liabilities designated at fair value through profit or loss	(305.9)	(305.9)	(286.8)	(286.8)
Other financial liabilities	(3,311.4)	(3,192.8)	(2,727.4)	(2,899.0)
	(5,703.2)	(5,728.1)	(4,955.3)	(5,203.6)
Derivative financial instruments:				
Fair value hedge derivatives – swaps	–	–	(2.3)	(2.3)
Held for trading derivatives – swaps[2]	(159.7)	(159.7)	(82.3)	(82.3)
Current liabilities				
Trade and other payables at amortised cost	(447.6)	(447.6)	(433.0)	(433.0)
Borrowings:				
Other financial liabilities	(127.1)	(127.1)	(109.7)	(109.7)
Derivative financial instruments:				
Held for trading derivatives – swaps[2]	(0.1)	(0.1)	(0.4)	(0.4)
Adjustment for accrued interest[1]	40.0	–	38.7	–
	(5,531.3)	(5,596.2)	(4,874.5)	(5,161.5)

Notes:

[1] Fair values quoted include accrued interest of £40.0 million (2011: £38.7 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 £134.5 million (2011: £85.3 million).

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 72 to 79. In determining fair values, assumptions are made with regard to credit spreads based on indicative pricing data.

Notes to the financial statements
continued

19 FINANCIAL INSTRUMENTS CONTINUED

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 £19.1 million loss (2011: £0.8 million gain), £21.3 million gain (2011: £4.1 million loss) is attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £76.2 million profit (2011: £54.9 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £81.7 million (2011: £62.6 million).

Company	Fair value 2012 £m	Carrying value 2012 £m	Fair value 2011 £m	Carrying value 2011 £m
Financial assets				
Current assets				
Loans and receivables:				
Trade and other receivables	42.9	42.9	33.9	33.9
Financial liabilities				
Current liabilities				
Trade and other payables at amortised cost	(14.8)	(14.8)	(2.3)	(2.3)
Borrowings:				
Other financial liabilities	(1,732.1)	(1,732.1)	(1,502.2)	(1,502.2)
	(1,704.0)	(1,704.0)	(1,470.6)	(1,470.6)

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 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

2011	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	–	1.4	–	1.4
Financial assets at fair value through profit or loss				
Derivative financial assets	–	365.3	–	365.3
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	–	(85.0)	–	(85.0)
Financial liabilities designated as fair value through profit or loss	–	(286.8)	–	(286.8)
	–	(5.1)	–	(5.1)

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 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 Group PLC section 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 2012 by projecting forward from the valuation date and have been performed by an independent actuary, Mercer Limited.

The group made total contributions of £149.7 million (2011: £133.0 million) to its pension schemes for the year ended 31 March 2012. The group also continues to pay contributions in respect of the defined contribution members and insurance premiums. Overall, the group expects to contribute around £50.0 million to its defined benefit schemes in the year ending 31 March 2013.

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 obligations of UUPS and ESPS were as follows:

Group	2012 % pa	2011 % pa
Discount rate	5.00	5.50
Expected return on assets – UUPS	4.45	5.65
Expected return on assets – ESPS	5.00	6.10
Pensionable salary growth and pension increases	3.25	3.35
Price inflation	3.25	3.35

The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

Group	2012 years	2011 years
Retired member – male	26.5	25.1
Non-retired member – male	28.3	26.6
Retired member – female	29.8	28.9
Non-retired member – female	31.7	30.4

Current studies continue to show faster rates of life expectancy improvement than had previously been forecast. Studies have also illustrated that mortality rates vary significantly according to the demographics of the schemes' members. These factors have been considered in order to update the life expectancies disclosed above and the resulting calculation of the defined benefit pension obligations of the group during the year.

Notes to the financial statements
continued

20 RETIREMENT BENEFIT OBLIGATIONS CONTINUED

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 %	2012 £m	Schemes' assets %	2011 £m
Equities	14.9	315.4	34.1	585.1
Other non-equity growth assets	9.6	203.5	-	-
Gilts	2.0	41.6	2.5	43.7
Bonds	58.4	1,233.0	46.6	800.6
Other	15.1	319.5	16.8	288.5
Total fair value of schemes' assets	100.0	2,113.0	100.0	1,717.9
Present value of defined benefit obligations		(2,205.0)		(1,912.9)
Net retirement benefit obligations		(92.0)		(195.0)

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 £319.3 million (2011: £134.9 million).

The assets as at 31 March 2012, 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	2012 £m	2011 £m
At the start of the year	(1,912.9)	(2,182.2)
Interest cost on schemes' obligations	(103.8)	(112.6)
Actuarial losses	(243.1)	(70.5)
Curtailments/settlements arising on reorganisation	(1.2)	392.1
Member contributions	(6.8)	(7.1)
Benefits paid	76.1	82.8
Current service cost	(13.3)	(15.4)
At the end of the year	(2,205.0)	(1,912.9)

At 31 March 2012, £8.7 million (2011: £7.6 million) of the defined benefit obligations related to unfunded, unregistered benefit plans.

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

Group	2012 £m	2011 £m
At the start of the year	1,717.9	1,910.9
Expected return on schemes' assets	100.5	109.1
Actuarial gains	218.8	25.8
Member contributions	6.8	7.1
Benefits paid	(76.1)	(82.8)
Curtailments/settlements arising on reorganisation	(4.6)	(385.2)
Company contributions	149.7	133.0
At the end of the year	2,113.0	1,717.9

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

Continuing operations	2012 £m	2011 £m
Current service cost	(13.3)	(11.9)
Curtailments/settlements arising on reorganisation	(5.4)	(3.4)
Pension expense charged to operating profit	(18.7)	(15.3)
Expected return on pension schemes' assets	100.5	102.2
Interest cost on pension schemes' obligations	(103.8)	(106.0)
Net pension interest expense charged to finance expense (see note 6)	(3.3)	(3.8)
Net pension expense charged before taxation	(22.0)	(19.1)

Defined benefit pension costs excluding curtailments/settlements arising on reorganisation included within employee benefit expense were £13.3 million (2011: £11.9 million) comprising current service costs. Total post-employment benefits expense excluding curtailments/settlements arising on reorganisation charged to operating profit of £17.5 million (2011: £17.1 million) comprise the defined benefit costs described above of £13.3 million (2011: £11.9 million) and defined contribution pension costs of £4.2 million (2011: £5.2 million) (see note 3).

Discontinued operations	2012 £m	2011 £m
Current service cost	–	(3.5)
Curtailments/settlements arising on reorganisation	–	3.0
Pension expense charged to operating profit	–	(0.5)
Expected return on pension schemes' assets	–	6.9
Interest cost on pension schemes' obligations	–	(6.6)
Net pension interest income credited to investment income and finance expense	–	0.3
Curtailment/settlement arising on disposal and (charged)/credited to profit on disposal of discontinued operations (see note 8)	(0.4)	7.3
Net pension (expense)/income (charged)/credited before taxation	(0.4)	7.1

Notes to the financial statements
continued

20 RETIREMENT BENEFIT OBLIGATIONS CONTINUED

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

Group	2012 £m	2011 £m
At the start of the year	(195.0)	(271.3)
Expense recognised in the income statement – continuing operations	(22.0)	(19.1)
(Expense)/income recognised in the income statement – discontinued operations	(0.4)	7.1
Contributions paid	149.7	133.0
Actuarial losses gross of taxation	(24.3)	(44.7)
At the end of the year	(92.0)	(195.0)

Included in the 2012 contributions paid of £149.7 million was an accelerated deficit repair contribution of £100.0 million and an £8.8 million inflation funding mechanism payment to UUPS. Details of the inflation mechanism, entered into by UUPS with the company as part of a pension de-risking strategy, are included within the 2011 annual report. Included within the 2011 contributions paid of £133.0 million were lump sum payments of £31.8 million in relation to the disposal of the non-regulated activities and £16.8 million in relation to the bulk transfer from the schemes to Welsh Water Dŵr Cymru's pension arrangements, following the termination of the Welsh Water contract.

Actuarial gains and losses are recognised directly in the statement of comprehensive income. At 31 March 2012, a cumulative pre-tax loss of £289.5 million (2011: £265.2 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	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Present value of defined benefit obligations	(2,205.0)	(1,912.9)	(2,182.2)	(1,696.9)	(1,964.4)
Fair value of schemes' assets	2,113.0	1,717.9	1,910.9	1,483.8	1,863.2
Net retirement benefit obligations	(92.0)	(195.0)	(271.3)	(213.1)	(101.2)
Experience adjustments on schemes' liabilities	(33.0)	25.2	1.8	(8.9)	23.8
Experience adjustments on schemes' assets	218.8	25.8	365.2	(496.4)	(239.9)

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 £4.2 million (2011: £5.2 million) of contributions (see note 3) to defined contribution schemes relating to continuing operations and £nil (2011: £9.9 million) relating to discontinued operations, which are included in arriving at operating profit. Included within contributions in respect of discontinued operations in the prior year were £5.9 million in relation to the United Utilities Electricity Services Limited section of the Electricity North West Group of the ESPS. Further details of this scheme are included within note 20 of the 2011 annual report.

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 2010	1,461.7	(76.0)	(30.3)	1,355.4
(Credited)/charged to the income statement	(89.7)	34.3	0.8	(54.6)
Credited to equity	–	(11.6)	(0.1)	(11.7)
Disposals (see note 8)	(4.0)	2.6	5.4	4.0
At 31 March 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

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 2012 or 31 March 2011.

22 PROVISIONS

Group	Restructuring £m	Other £m	Total £m
At 1 April 2010	18.6	35.2	53.8
Charged to the income statement	9.8	23.9	33.7
Utilised in the year	(24.2)	(21.6)	(45.8)
Disposals (see note 8)	(0.2)	(17.7)	(17.9)
At 31 March 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

The restructuring provision as at 31 March 2012 and 31 March 2011 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 2012			
Non-current	–	4.0	4.0
Current	0.6	5.7	6.3
	0.6	9.7	10.3
At 31 March 2011			
Non-current	–	9.3	9.3
Current	4.0	10.5	14.5
	4.0	19.8	23.8

The company had no provisions at 31 March 2012 or 31 March 2011.

Notes to the financial statements

continued

23 TRADE AND OTHER PAYABLES

	Group		Company	
	2012	2011	2012	2011
Non-current	£m	£m	£m	£m
Deferred grants and contributions	366.5	241.1	–	–
Other creditors	11.5	8.7	–	–
	378.0	249.8	–	–

	Group		Company	
	2012	2011	2012	2011
Current	£m	£m	£m	£m
Trade payables	40.2	39.7	–	–
Amounts owed to subsidiary undertakings	–	–	12.7	2.3
Other taxation and social security	4.4	4.4	–	–
Deferred grants and contributions	6.9	6.7	–	–
Other creditors	4.8	2.9	2.1	–
Accruals and deferred income	391.3	379.3	–	–
	447.6	433.0	14.8	2.3

The average credit period taken for trade purchases is 29 days (2011: 31 days).

The directors consider that the carrying amount of trade payables approximates to their fair value at both 31 March 2012 and 31 March 2011.

Deferred grants and contributions

		Re-presented*
	2012	2011
Group	£m	£m
At the start of the year	247.8	182.6
Cash received during the year	13.0	12.7
Transfers of assets from customers	120.4	59.8
Credited to income statement – revenue (see note 1)	(0.9)	(0.4)
Credited to the income statement – other operating expenses (see note 4)	(6.9)	(6.9)
At the end of the year	373.4	247.8

* The comparatives have been re-presented to show transfers of assets from customers of £59.8 million separately (2011: previously included within received during the year).

24 SHAREHOLDERS' EQUITY

	2012	2011
Group	£m	£m
Share capital	499.8	499.8
Share premium account	2.4	1.3
Revaluation reserve	158.8	158.8
Cumulative exchange reserve	(5.0)	(3.1)
Merger reserve	329.7	329.7
Retained earnings	778.9	691.0
	1,764.6	1,677.5

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	2012 £m	2011 £m
Share capital	499.8	499.8
Share premium account	2.4	1.3
Capital redemption reserve	1,033.3	1,033.3
Retained earnings	2,360.5	2,595.0
	3,896.0	4,129.4

196,755 ordinary shares were allotted during the year ended 31 March 2012 (2011: 76,012 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 £1.1 million (2011: £0.4 million).

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The amount of group profit for the financial year dealt with in the company's income statement is £25.8 million loss (2011: £211.8 million profit) after accounting for dividends received from subsidiary undertakings of £nil (2011: £233.8 million).

25 SHARE CAPITAL

Company	2012 million	2012 £m	2011 million	2011 £m
Issued, called up and fully paid				
Ordinary shares of 5.0 pence each	681.8	34.1	681.6	34.1
Deferred shares of 170.0 pence each	274.0	465.7	274.0	465.7
	955.8	499.8	955.6	499.8

Refer to the directors' report for details of the voting rights of each category of shares.

26 OPERATING LEASE COMMITMENTS

Group	Property 2012 £m	Plant and equipment 2012 £m	Property 2011 £m	Plant and equipment 2011 £m
Commitments under non-cancellable operating leases due				
Within one year	3.3	0.8	3.6	0.7
In the second to fifth years inclusive	8.8	0.6	11.9	0.5
After five years	252.5	–	249.0	–
	264.6	1.4	264.5	1.2

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

The company had no operating lease commitments at 31 March 2012 or 31 March 2011.

Notes to the financial statements
continued

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 (five years for discounted options under the former executive share option scheme, which are no longer granted) and ending no later than 10 years from the date of grant. The number of options outstanding at 31 March 2012 was 16,136 (2011: 55,644) and the weighted average exercise price was £6.22 (2011: £6.01).

Performance share plan, matching share award plan, matched share investment scheme (MSIS) and main all employee share scheme
Details of these schemes are given on pages 51 to 62 in the Directors' Remuneration Report.

Deferred share plan
The deferred share plan (DSP) is for the employees at the level below senior executive. An annual award in deferred group shares is made on the basis of a maximum of 30 per cent of salary, apportioned according to the extent of the employee's achievement of the annual cash incentive plan maximum for the financial year. A limited number of employees at the next level below senior executive may also be nominated to receive a one-off award of a fixed number of deferred group shares in recognition of exceptional performance during the year. 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 free shares 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 (2012: no grants; 2011 weighted average fair value at date of award: £5.62). The number of options outstanding at 31 March 2012 was 87,395 (2011: 200,477). The company also operates a cash-settled share-based payment scheme. No cash-settled share options were granted during the year (2011: £0.5 million).

The total expense included within employee benefits expense from continuing operations in respect of equity-settled share-based payments was £1.2 million (2011: £0.1 million income) and £nil (2011: £0.2 million expense) in respect of cash-settled share-based payments, plus £0.2 million accrual of national insurance contributions (2011: £nil).

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 2012 and 31 March 2011 respectively.

Year ended 31 March 2012	Matched share investment scheme n/a[(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.

Year ended 31 March 2011	Matching share award plan[1] TSR 50%	Matching share award plan[1] Operational 50%	Performance share plan[1] TSR 50%	Performance share plan[1] Operational 50%	Performance share plan[2] TSR 50%	Performance share plan[2] Operational 50%
Weighted average exercise price (£ per share)	–	–	–	–	–	–
Vesting period (years)	2.7	2.7	2.7	2.7	2.0	2.0
Expected volatility (%)	27.8	-	27.8	-	25.9	-
Risk-free rate (%)	1.4	-	1.4	-	1.3	-
Expected dividend yield (%)	–	–	–	–	–	–
Fair value (£ per share)	2.71	5.60	2.71	5.60	2.36	5.89

Notes:
[1] Awarded in July 2010.
[2] Awarded in March 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 2012	6.22	5.67	5.71	5.74	n/a
31 March 2011	6.01	5.38	n/a	5.71	5.71
Contractual remaining life					
31 March 2012	0.9 years	1.3 years	1.3 years	0.9 years	3.7 years
31 March 2011	1.7 years	0.3 years	1.0 years	1.5 years	4.5 years

None of the share options identified above as outstanding at 31 March 2012 had vested at that date.

For the purpose of IFRS 2, expiry of performance share plan awards is measured with reference to the achievement of the performance conditions within the vesting 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.

Notes to the financial statements

continued

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	
	2012 £m	2011 £m	2012 £m	2011 £m
Joint ventures	1.1	44.2	0.3	9.5

	Amounts owed by related parties		Amounts owed to related parties	
	2012 £m	2011 £m	2012 £m	2011 £m
Joint ventures (see notes 16, 23)	1.0	2.7	–	–

Included within the comparatives in the table above are amounts relating to entities disposed of during the year ended 31 March 2011.

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 £5.4 million (2011: £5.9 million) to its joint ventures (see note 14).

No allowance has been made for doubtful receivables in respect of the amounts owed by related parties (2011: £0.3 million). No expense has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (2011: £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 £nil (2011: £233.8 million) and total net interest payable during the year was £34.9 million (2011: £29.6 million). Amounts outstanding at 31 March 2012 and 31 March 2011 between the parent company and subsidiary undertakings are provided in notes 16, 18 and 23.

At 31 March 2012 and 31 March 2011, 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 2012 and 31 March 2011.

29 CASH GENERATED FROM OPERATIONS

	Group		Company	
		Re-presented*		
	2012	2011	2012	2011
Continuing operations	£m	£m	£m	£m
Profit/(loss) before taxation	280.4	327.1	(34.9)	204.1
Adjustment for investment income and finance expense	311.1	253.1	34.9	29.7
Operating profit	591.5	580.2	–	233.8
Adjustments for:				
Depreciation of property, plant and equipment	278.0	258.3	–	–
Amortisation of other intangible assets	19.8	32.2	–	–
Loss on disposal of property, plant and equipment	5.5	2.7	–	–
Loss on disposal of other intangible assets	2.6	2.8	–	–
Amortisation of deferred grants and contributions (see note 23)	(6.9)	(6.9)	–	–
Equity-settled share-based payments charge/(credit) (see note 27)	1.2	(0.1)	–	–
Other non-cash movements	(0.1)	–	–	–
Changes in working capital:				
(Increase)/decrease in inventories	(0.1)	2.1	–	–
(Increase)/decrease in trade and other receivables	(8.2)	(20.1)	0.5	1.3
(Decrease)/increase in provisions and payables	(155.9)	(79.3)	2.0	–
Cash generated from continuing operations	727.4	771.9	2.5	235.1

* The comparatives have been re-presented to show amortisation of deferred grants and contributions separately (2011: previously included within decrease in provisions and payables) along with the reclassification of grants and contributions received which were previously included in decrease in provisions and payables, now shown separately on the consolidated statement of cash flows within investing activities.

The group has received property, plant and equipment of £120.4 million (2011: £59.8 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 2012 where a financial limit has been specified of £85.2 million (2011: £104.5 million).

The company has not entered into performance guarantees as at 31 March 2012 or 31 March 2011.

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 2012.

Shareholder information

Key dates

We plan to:

3 AUG 2012	Pay the 2011/12 final dividend.
28 NOV 2012	Announce the half year results (provisional).
1 FEB 2013	Pay the 2012/13 interim dividend (provisional).
MAY 2013	Announce the final results for the 2012/13 financial year.
JUNE 2013	Publish the Annual Report and Financial Statements for the 2012/13 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/annualreport2012**.

For further information go to corporate.unitedutilities.com

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.

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.

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 cost 8 pence per minute from a BT landline, other providers' costs may vary. 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.
JPMorgan Chase & Co. is the depositary and its address for enquiries is JPMorgan Chase & Co. P.O. Box 64504, St Paul, MN 55164-0504.
adr.com and click on the shareholders section.
Telephone: (800) 990-1135 or outside the US,
+1 (651) 453 2128
or by email: **jpmorgan.adr@wellsfargo.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)207 930 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 Services Authority at **fsa.gov.uk/pages/consumerinformation**.

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

United Utilities is proud to have retained platinum plus ranking in the Business in the Community Corporate Responsibility Index and to be leading the water sector for the third year running in the Dow Jones Sustainability Index.

CR INDEX 2012 PLATINUM PLUS BUSINESS IN THE COMMUNITY

Dow Jones Sustainability Indexes Member 2011/12

Designed and produced by Jones and Palmer Ltd.

Printed by Park Communications on FSC® certified paper.

Park is an EMAS certified CarbonNeutral® Company and its Environmental Management System is certified to ISO 14001.

100% of the inks used are vegetable oil based, 95% of press chemicals are recycled for further use and, on average 99% of any waste associated with this production will be recycled.

This document is printed on Challenger Offset and Claro Bulk: both papers contain Environmental Chlorine Free (ECF) virgin fibre sourced from well-managed, sustainable, FSC certified forests.

ecf

FSC MIX Paper from responsible sources FSC® C001785 www.fsc.org

unitedutilities.com
Telephone +44 (0)1925 237000

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

LSE Stock Code: UU.

Cover image:
Thirlmere in Cumbria which provides around 11% of the North West's water supply.